

## **HKE<sub>x</sub> LISTING DECISION**

**HKE<sub>x</sub>-LD36-2 (October 2003) (Updated in September 2009) (Withdrawn in October 2012; Superseded by GL43-12)**

<b>Summary</b>	
Name of Parties	Company A - a GEM new listing applicant Mr Z - a shareholder of Company A
Subject	Pre-IPO placing - whether shares subject to lock-up and counted as part of public float
Listing Rules	GEM Listing Rules 1.01, 11.23 <sup>1</sup> , 13.16(1) <sup>1</sup> and 13.17(2) <sup>1</sup>
Decision	Lock-up is determined on case-by-case basis – placee subject to lock-up not counted as public

### **Summary of Facts**

Mr Z had acquired some shares in Company A by way of transfer from an initial management shareholder shortly before Company A's listing application.

Mr Z was an investor with no managerial position in Company A. His shareholding in Company A would be less than 5 per cent on the listing date. The consideration paid by him represented a substantial discount to the IPO price.

Company A's sponsor asked the Exchange whether Mr Z's shares would be subject to a lock-up and whether it could be counted as part of the public float for the purpose of the minimum public float requirement.

### **Analysis**

Under the GEM Listing Rules, shares of initial management shareholders and significant shareholders are subject to lock-ups of varying periods.

#### ***Initial management shareholders***

Any person who is, or group of persons who together are, entitled to exercise 5 per cent or more of the voting power of an issuer and who is or are able to direct or influence the management is regarded as a management shareholder (GEM Listing Rule 1.01). "Initial management shareholder" means any management shareholders immediately prior to the listing document date, and also includes the following persons who are shareholders immediately prior to the listing date:

- (a) all members of senior management;
- (b) all executive and non-executive directors; and
- (c) all investors, including but not limited to investment funds, with board representation (GEM Listing Rule 13.15(2)).

An initial management shareholder must undertake not to dispose of (or enter into any agreement to dispose of) his interest in the issuer during the first year after listing (GEM Listing Rule 13.16(1)(a)<sup>1</sup>).

An initial management shareholder with no more than a 1 per cent shareholding in the issuer must undertake not to dispose of (or enter into any agreement to dispose of) his interest in the issuer during the first 6 months after listing (GEM Listing Rule 13.16(1)(b)<sup>1</sup>).

An initial management shareholder is not, at the time of listing and for the duration of the applicable lock-up period, regarded as a member of the public (Note 2 to GEM Listing Rule 11.23(5)<sup>1</sup>).

#### Significant shareholders

Any person who is entitled to exercise 5 per cent or more of the voting power of an issuer immediately prior to the listing document date and the listing date and who is not a management shareholder is regarded as a "significant shareholder" (GEM Listing Rule 1.01).

A significant shareholder must undertake not to dispose of (or enter into any agreement to dispose of) his interest in the issuer during the first 6 months after listing (GEM Listing Rule 13.17(2)<sup>1</sup>).

A significant shareholder is not, at the time of listing and for the duration of the 6-month lock-up period, regarded as a member of the public (Note 2 to GEM Listing Rule 11.23(5)<sup>1</sup>).

#### Further considerations on meaning of "public"

In addition to the above, note 2 to GEM Listing Rule 11.23(5)<sup>1</sup> also provides that the Exchange will not regard, at any time, a connected person of the issuer as a member of the "public" and note 3 to that Rule provides that the Exchange will also not recognise as a member of the "public": -

- any person whose acquisition of securities has been financed directly or indirectly by a connected person; or
- any person who is accustomed to taking instructions from a connected person in relation to the acquisition, disposal, voting or other disposition of securities of the issuer registered in his name or otherwise held by him.

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The Exchange was of the view that, as a general principle on GEM, placings of shares shortly before a listing application should be permitted subject to full disclosure in the prospectus. However, the placee may be subject to a lock-up of his shares. The question of whether the placee should be subject to a lock-up is determined on a case-by-case basis having regard to all the circumstances of the case.

The placing of shares to persons shortly before the proposed listing of a company tends to call into question the genuineness of the transaction and may lead one to query whether the placee will be holding the shares for his own benefit or for the benefit of an initial management shareholder or significant shareholder, with a view to circumventing the lock-up provisions of the GEM Listing Rules. In the absence of satisfactory evidence to the contrary, the placee should be subjected to the same lock-up as that to which the initial management shareholder or significant shareholder would himself have been subject. Furthermore, the Exchange would not regard any placee who is subject to a lock-up as a member of the public at the time of listing and for the duration of his lock-up period.

It was also noted that:

- “shortly before a listing application” tends to be measured in terms of months rather than weeks and with the date of the listing application as reference point;
- the greater the amount of any discount to the IPO price and/or the greater the proximity in time of the placing to the date of the listing application, the greater would be the doubt as to the genuine nature of the transaction such that a lock-up of the shares would be warranted;
- whether the placing is of existing shares or new shares is of limited relevance since both methods achieve the same end, namely the final shareholding structure of the company upon listing;
- where a placee is not subject to any lock-up, the prospectus should include a prominent statement in the prospectus that there are no lock-up arrangements for the placee concerned together with an explanation as to why there are no lock-up arrangements in place; and
- in all cases, the prospectus should include a prominent statement giving the reasons for the placing, including any contribution which the placee has made to the company, any benefits which the placing is expected to bring to the company and a justification of the placing price.

## **Decision**

Based on the facts of the present case, namely that Mr Z had acquired his shares shortly before the proposed listing and at a substantial discount to the IPO price, Mr Z's shares would be subject to a lock-up for the same period as the initial management shareholder who transferred the shares to him. Consequently, he would not be counted as a member of the "public" at the time of listing and for the duration of his lock-up period. As to whether he would be counted as a member of the "public" after the lock-up period had expired, one would still need to have regard to notes 2 and 3 to GEM Listing Rule 11.23(5)<sup>1</sup>.

### *Note:*

1. *GEM Rules 11.23(5), 13.16(1) and 13.17(2) were repealed on 1 July 2008. Under current GEM Rule 13.16A, only the controlling shareholders are subject to lock-up. (Added in September 2009)*