

HKE_x LISTING DECISION

Cite as HKE_x-LD62-4 (Published in November 2008) (Updated in July 2014, October 2019
(Rule amendments))

Summary	
Name of Party	Company A - a Main Board listed company Holding Company – the holding company of Company A
Subject	Whether the Exchange would disregard the calculation of revenue ratio in respect of the proposed Transaction as requested by Company A and accept the alternative size tests submitted by Company A under Main Board Listing Rules 14.20 and 14A.80
Listing Rule	Main Board Listing Rules 14.20, 14A.80
Decision	The Exchange determined that it was inappropriate to disregard the revenue ratio in respect of the Transaction under Main Board Listing Rules 14.20 and 14A.80.

SUMMARY OF FACTS

1. Company A was principally engaged in the provision of banking and financial services.
2. In addition to Company A, the Holding Company was also the holding company of a group of companies engaged in insurance businesses.
3. In year 2005, Company A had acquired from a third party vendor (the “**Vendor**”) the entire equity interest in Target X (which was principally engaged in the provision of banking and financial services) together with about 95% of the equity interest in Target Y (which was principally engaged in insurance businesses) (the “**Acquisition**”).
4. At the time of the Acquisition, Company A had stated its intention to transfer the interest in Target Y to the Holding Company following the completion of the Acquisition. Nevertheless, Company A and the Holding Company had not entered into any contractual or binding arrangements in respect of the transfer of interest in Target Y to the Holding Company.
5. In year 2006, Company A proposed to enter into an agreement with the Holding Company for the transfer of its 95% equity interest in Target Y to the Holding Company (the “**Transaction**”).

6. In respect of the proposed Transaction, the assets ratio and profits ratio were less than 1%. The consideration ratio was about 2.1% and the revenue ratio was about 10%.

7. Company A submitted the following information to support its request to disregard the revenue ratio in respect of the Transaction under Rules 14.20 and

14A.80:

- The calculation of the revenue ratio produced an anomalous result given that the revenue ratio was approximately 10% but the other percentage ratios were all below 2.5%.
- The revenue ratio was not appropriate to the sphere of activity of Company A because of the difference in what constituted “revenue” for a banking company and an insurance company. It was not meaningful to compare the interest income of a bank with the premium income of an insurance company.
- The Acquisition and the proposed Transaction formed part of a single transaction. Company A’s intention to transfer Target Y to the Holding

Company was supported by the following facts:

- the financial results of Target Y were not consolidated in Company A’s accounts for the year 2005 given Company A’s intention to transfer Target Y to the Holding Company; and
- under the proposed Transaction, Target Y would be transferred to the Holding Company at cost plus interest payment determined with reference to the one-month HIBOR for the period during which the interest in Target Y was held by Company A.

8. Company A submitted some alternative size tests to the Exchange which compared (i) the premium income of Target Y with the interest earning loans of Company A or new deposits collected by Company A; (ii) the number of employees; or (iii) the net asset values.

THE ISSUE RAISED FOR CONSIDERATION

9. Whether the Exchange would disregard the calculation of revenue ratio in respect of the proposed Transaction as requested by Company A and accept the alternative size tests submitted by Company A under Rules 14.20 and 14A.80.

APPLICABLE LISTING RULE OR PRINCIPLE

10. Main Board Listing Rule 14.07(3) provides that a “revenue ratio” refers to:

the revenue attributable to the assets which are the subject of the transaction divided by the revenue of the listed issuer
11. Main Board Listing Rule 14.20 provides that the Exchange may, where any of the calculations of the percentage ratios produces an anomalous result or is inappropriate to the sphere of activity of the listed issuer, disregard the calculation and substitute other relevant indicators of size, including industry specific tests. The listed issuer must provide alternative tests which it considers appropriate to the Exchange for consideration.:
12. Main Board Listing Rule 14A.80 provides that:

if any percentage ratio produces an anomalous result or is inappropriate to the activity of the listed issuer, the Exchange may disregard the ratio and consider alternative test(s) provided by the listed issuer. The listed issuer must seek prior consent of the Exchange if it wishes to apply this rule.

ANALYSIS

13. Rule 14.07 sets out five percentage ratios for assessing the impact of a transaction on the listed issuer from different perspectives. The revenue ratio serves to assess the impact of a transaction on the listed issuer by measuring the relative level of activity of the target being acquired or disposed of against that of the listed issuer.
14. The percentage ratio calculation forms the basis for classifying the transaction which determines whether the transaction is subject to any disclosure, reporting and/or shareholders’ approval requirements under Chapter 14 or 14A. A connected transaction on normal commercial term is exempt from shareholders’ approval requirements if each of the percentage ratios (other than the profits ratio) is less than 2.5%¹.
15. When considering Company A’s request to disregard the revenue ratio in respect of the proposed Transaction, the Exchange had taken into account the following factors:
 - The revenue ratio indicated that the Transaction was of a material size that required independent shareholders’ approval under Chapter 14A. This was not out of line with the results of other percentage ratios. In particular, the Exchange noted that the consideration ratio was close to the 2.5%¹ threshold requiring independent shareholders’ approval. The Exchange did not consider the result of the revenue ratio to be anomalous.
 - The revenue ratio measured the impact of the Transaction on Company A by comparing the revenue generated from the principal activity of each of Target Y and Company A. While Target Y was engaging in a line of business different from Company A’s principal activity, it did not mean that the calculation of the

revenue ratio would be inappropriate in the sphere of activity of Company A. It was not uncommon for listed issuers to acquire or dispose of businesses that were not in line with the issuers' principal activities. The Exchange did not consider that Company A had provided compelling grounds to substantiate its case and declined to exercise its power under Rules 14.20 and 14A.80 to modify the percentage ratio calculation.

- At the time of the Acquisition, Company A and the Holding Company had not entered into any contractual or binding arrangements in respect of the transfer of interest in Target Y to the Holding Company. Although Company A had stated its intention to effect the transfer following the Acquisition, the proposed Transaction could not be viewed as part of the Acquisition in which Company A had complied with the Rule requirements. Accordingly, when Company A entered into the Transaction, it was required to comply with the Rule requirements which were assessed based on the terms of that transaction. The Exchange did not consider the circumstances of this case be exceptional that warranted the Exchange to disregard any percentage ratios.
16. The Exchange was not satisfied with the alternative tests submitted by Company A as they could not provide a meaningful measure of the relative level of activity of Target Y against that of Company A.

DECISION

17. Based on the above analysis, the Exchange determined that it was inappropriate to disregard the revenue ratio in respect of the Transaction under Rules 14.20 and 14A.80.

Notes:

1. *Effective from 3 June 2010, the threshold for exempting a connected transaction from the independent shareholder approval requirement has been increased from 2.5% to 5%. (Added in July 2014)*
2. *On 1 October 2019, Rules 14.20 and 14A.80 were amended to clarify that if any calculation of the percentage ratio produces an anomalous results or is inappropriate to the sphere of activities of the issuer, the Exchange (or the issuer) may apply an alternative size test that it considers appropriate to assess the materiality of a transaction under Chapters 14 and 14A.*

The Rule amendments would not change the analysis and conclusion in this case.