HKEx LISTING DECISION
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Summary	
Parties	Company A – a Main Board listed company The Target Company – a statutory corporation whose operations were to be merged with Company A under the Merger
Subject	1. Whether the Exchange would grant a waiver to Company A from strict compliance with Rule 14.69(4)(a)(i) in respect of the accountants' report on the business being acquired under the proposed Merger 2. Whether Rules 14.71 and 14A.70(9)~~14A.59(17)~~ would apply to the proposed Merger
Listing Rules	Main Board Listing Rules 14.69(4)(a)(i), 14.71, 14A.70(9) ~~14A.59(17)~~
Decision	1. To grant a waiver to Company A from strict compliance with Rule 14.69(4)(a)(i) on condition that the Circular would contain the alternative disclosure proposed by Company A in its application 2. That Rules 14.71 and 14A.70(9)~~14A.59(17)~~ would not apply to the proposed Merger

SUMMARY OF FACTS

1. The principal activities of both Company A and the Target Company included operating railway systems.

2. Company A and the Target Company entered into agreements regarding the proposed merger of their operations and other related transactions (the **Merger**). Under the Merger, Company A would acquire substantially all business operations of the Target Company whose residual operations would predominantly be administrative only.

3. The Merger would constitute a very substantial acquisition for Company A under Chapter 14. As the Target Company was a connected person of Company A, the Merger would also constitute a connected transaction under Chapter 14A. The Merger would be subject to approval by Company A's independent shareholders.

<u>Issue 1</u>

4. Under Rule 14.69(4)(a)(i), Company A had to include an accountants' report in accordance with Chapter 4 on the business being acquired under the Merger in its circular for the Merger (the **Circular**).

5. Company A applied for a waiver from compliance with Rule 14.69(4)(a)(i) for the following reasons:

   - The Merger effectively involved an acquisition (whether by way of transfer of legal or beneficial title, service concession or licence) of those assets, or rights, and liabilities which were then required by the Target Company to operate and maintain its business.

   - The tangible assets that formed part of the Target Company's then railway network were not acquired by Company A but were subject to a service concession arrangement under which Company A would have the right to access, use and operate them for a specified term. Legal title to the assets would remain with the Target Company and they would continue to be recognised in the Target Company's balance sheet as fixed assets. However, the operating results generated from the assets over the concession period would effectively be acquired by Company A. Company A would recognise a service concession asset in respect of payments to acquire the rights to operate the Target Company's assets under the service concession arrangement.

   - To prepare an accountants' report on the business being acquired under the proposed Merger, it would be necessary to "carve-out" the assets, liabilities, income and expenses that were not subject to the Merger from the accounts of the Target Company and its subsidiaries (the **Target Group**). This would require significant judgements and assumptions and was not practical given the nature, complexity and detail of the arrangements under the Merger. Further, this financial information might not provide a meaningful picture on the assets employed by the Target Group for its business operations during the reporting period as the railway assets subject to the service concession arrangement would not be recognised in the balance sheets.

   - Company A was of the view that the audited financial statements of the Target Group would present meaningful and comprehensive information to shareholders of Company A in understanding the business operations subject to the Merger by presenting the revenue generated and expenses incurred, together with the assets employed and liabilities incurred during the period reported on.

6. Company A proposed that the Circular would contain an accountants' report on the Target Group which would include the following information:

   (i) the Target Group's financial statements for the latest three financial years and the stub period (the **Relevant Period**);

(ii) additional information including a reconciliation table and narrative descriptions by way of an explanatory note to explain the impact of the Merger on the Target Group's financial results and cashflows for the Relevant Period and its financial position as at the end of the period, the adjustments for items which would not be acquired by Company A, and how the figures would be translated to the pro-forma financial information of the enlarged group in the Circular (the **Additional Information**); and

(iii) the opinion of Company A's reporting accountants that the Target Group's financial information (including the Additional Information) gave a true and fair view of the results and cashflows for each of the financial years and period reported on and the state of affairs of the Target Group as at the end of each year and the period.

Issue 2

7. Company A noted that there were specific disclosure requirements in Rule 14.71 and 14A.70(9)~~14A.59(17)~~ for a very substantial acquisition and connected transaction which involved acquiring an interest in an infrastructure project or an infrastructure or project company. While "infrastructure project" was not defined in Chapters 14 and 14A, reference was made to Rule 8.05B(2) which provided that "infrastructure projects" are projects which create the basic physical structures or foundations for the delivery of essential public goods and services necessary for the economic development of a territory or country. According to Rule 8.05B(2), examples of infrastructure projects included the construction of railways and mass transit systems.

8. The Merger would involve Company A acquiring the rights to access, use and operate the assets which formed part of the then railway network of the Target Company under a service concession arrangement. Company A enquired whether Rules 14.71 and 14A.70(9)~~14A.59(17)~~ would apply to the Merger.

ISSUES

Issue 1

9. Whether the Exchange would grant a waiver to Company A from strict compliance with Rule 14.69(4)(a)(i) in respect of the accountants' report on the business being acquired under the Merger.

Issue 2

10. Whether Rules 14.71 and 14A.70(9)~~14A.59(17)~~ would apply to the Merger.

APPLICABLE LISTING RULE OR PRINCIPLE

11. Rule 14.69(4)(a)(i) provides that a circular issued in relation to a very substantial acquisition or a listing document issued in relation to a reverse takeover must contain:-

> ...
>
> (4)(a) on an acquisition of any business, company or companies:
>
> (i) an accountants' report on the business, company or companies being acquired in accordance with Chapter 4 of the Exchange Listing Rules... The financial information on the business, company or companies being acquired as contained in the accountants' report must be prepared using accounting policies which should be materially consistent with those of the listed issuer.

12. Rule 14.71 provides that:

> Where a major transaction, very substantial acquisition, … involves acquiring or disposing of an interest in an infrastructure project or an infrastructure or project company, the listed issuer shall incorporate in the circular or listing document a business valuation report on the business or company being acquired or disposed of and/or traffic study report in respect of the infrastructure project or infrastructure or project company. Such report(s) must clearly set out:
>
> (1) all fundamental underlying assumptions including discount rate or growth rate or growth rate used; and
>
> (2) a sensitivity analysis based on the various discount rates and growth rates.
>
> Where any business variation is based on a profit forecast, the accounting policies and calculations for the underlying forecasts must be examined and reported on by the auditors or reporting accountants. Any financial adviser mentioned in the circular or listing document must also report on the underlying forecasts.

13. Rule 14A.70(9) ~~14A.59(17)~~ provides that a circular in relation to a connected transaction that involves an acquisition or disposal of a company or business engaging in an infrastructure project must contain, among others,

> ~~(a) where appropriate,~~ a business valuation report on that company or business ~~a business or company being acquired or disposed of~~ and/or traffic study report on the ~~in respect of any infrastructure~~ project~~ or infrastructure or project company~~. ~~Such~~ The report(s) must set clearly out:

(a~~i~~) all significant ~~fundamental~~ underlying assumptions including discount rate or growth rate used; and

(b~~ii~~) a sensitivity analysis based on different ~~the various~~ discount rates and growth rates;

~~(b)~~ If the ~~where any~~ business valuation is based on a profit forecast, the accounting policies and calculations for the underlying forecasts must be examined and reported on by the auditors or reporting accountants. Any financial adviser mentioned in the circular must also report on the underlying forecasts; …

14. Rule 8.05B provides that:

> The Exchange may accept a shorter trading record period and/or may wary or waive the above profit or other financial standards requirement in rule 8.05 in the following cases:-
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> …
>
> (2) newly formed 'project' companies, for example a company formed to construct a major infrastructure project. The Exchange considers that "infrastructure projects" are projects which create the basic physical structures or foundations for the delivery of essential public goods and services that are necessary for the economic development of a territory or country. Examples of infrastructure projects include the construction of roads, bridges, tunnels, railways, mass transit systems, water and sewage systems, power plants, telecommunication systems, seaports and airports. A new applicant of such 'project' companies must be able to demonstrate that:
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> …
>
> (d) where it is involved in more than one project, the majority of its project(s) are in the pre-construction or construction stage.
>
> …

ANALYSIS

15. Under the Listing Rules, an issuer must ensure that the information contained in its circular for a notifiable and/or connected transaction is accurate and complete in all material respects and not misleading or deceptive. The circular must contain all information necessary to allow the issuer's shareholders to make a properly informed decision on how to vote on the transaction.

Issue 1

16. Rule 14.69(4)(a)(i) requires the circular for a very substantial acquisition to contain an accountants' report on the business or company to be acquired to enable shareholders to assess the performance and financial position of the business or company. Chapter 4 sets out the standards of preparation and assurance for the disclosure of information in the accountants' report.

17. Issuers are expected to exercise all reasonable care to ensure full compliance with the Listing Rules. The Exchange will not grant waivers, except where the Rules already contemplate the granting of waivers under certain circumstances or where it is satisfied that there are exceptional and justifiable circumstances to grant a waiver. The "Guide on Applications for Waivers and Modifications of the Listing Rules" available on the HKEx website sets out a non-exhaustive list of factors that the Exchange will generally consider when assessing a waiver application.

18. In deciding on a waiver, the Exchange will take into account the circumstances and reasons outlined in the application and all other information supplied by the issuer.

19. In this case, the Merger involved complex and detailed arrangements, and it would be impractical for Company A to prepare an accountants' report on the business being acquired under the proposed Merger. An accountants' report, even if prepared, would be "pro-forma" financial information and would not comply with Rule 4.29.

20. The Exchange also took into account that:

- The Merger would effectively involve an acquisition of substantially all the business operations of the Target Company. It would be acceptable for Company A to provide the Target Group's historical financial statements to facilitate shareholders' understanding of the Target Group's business operations during the Relevant Period. The Additional Information would explain the impact of the Merger on the results and financial position of the Target Group in the Relevant Period and the items that would be accounted for differently in Company A's accounts after the Merger.

- The accountants' report, including the Target Group's financial statements during the Relevant Period and the Additional Information, would be reported on by Company A's reporting accountants.

- This alternative disclosure was submitted by Company A after considering alternative approaches for preparing an accountants' report for the Circular. The Exchange accepted that Company A had taken reasonable steps to ensure sufficient information was provided to its shareholders to make a properly informed assessment of the business being acquired.

21. The Exchange was satisfied that the circumstances of this case were exceptional and the granting of the waiver would be unlikely to result in undue risks to the shareholders whose interests the Listing Rules were intended to protect.

<u>Issue 2</u>

22. Rule 14.71 or <u>14A.70(9)</u>~~14A.59(17)~~ applies to the circular for a notifiable transaction (being major or above) or a non-exempt connected transaction which involves acquiring or disposing of an interest in an infrastructure project or an infrastructure or project company. The Rules require the circular to contain a business valuation report on the business or company being acquired or disposed of and/or traffic study report in respect of the infrastructure project or infrastructure or project company.

23. When applying Rules 14.71 and <u>14A.70(9)</u>~~14A.59(17)~~, the Exchange will take a purposive approach to ensure that the intent of the Rules is adhered to. The purpose of the additional disclosure requirements under the Rules is to ensure shareholders have the necessary information to make an informed judgement of the acquisition or disposal of an infrastructure project. This is particularly the case where the infrastructure project is under construction or in the pre-construction stage or is recently completed. The lack of a reasonable trading record for the project calls for the need for a business valuation report and/or traffic study report in respect of the project to facilitate shareholders' assessment of the transaction. The approach is consistent with the requirements of Rule 8.05B(2).

24. The Rules are not intended to apply to an acquisition of a completed infrastructure project, or a company holding the completed project, with a reasonable trading record (which is ordinarily expected to cover at least three years). This is because an accountants' report on the business or company will be available for shareholders to properly assess its operations and financial position.

25. In this case, the Exchange accepted that Rule<u>s</u> 14.71 and <u>14A.70(9)</u>~~14A.59(17)~~ would not apply to the Merger having regard to the following factors:

- the Merger would involve Company A acquiring the rights to access, use and operate the assets which formed part of the then railway network of the Target Company under a service concession arrangement. The information and analysis provided by Company A indicated that a majority of the assets being acquired were related to completed infrastructure projects with a reasonable trading record.

- The Circular would contain the accountants' report which would provide Company A's shareholders with the necessary information to make a properly informed assessment of the business being acquired under the Merger.

DECISION

26. The Exchange decided to grant a waiver to Company A from strict compliance with Rule 14.69(4)(a)(i) on condition that the Circular would contain the alternative disclosure proposed by Company A in its waiver application.

27. The Exchange determined that Rules 14.71 and 14A.70(9)~~14A.59(17)~~ would not apply to the Merger.