Guidance on application of the reverse takeover Rules

I. Background and purpose

1. This guidance letter provides guidance on the application of the reverse takeover (**RTO**) Rules (**RTO Rules**) and related requirements, with an appendix setting out examples to illustrate how the Exchange applies the RTO Rules.

2. Under the RTO Rules, a reverse takeover is defined as an acquisition or series or acquisitions which, in the opinion of the Exchange, constitutes an attempt to achieve a listing of the assets acquired and a means to circumvent the new listing requirements (**principle based test**)[1].

3. The RTO Rules also contain two specific forms of RTOs involving a change in control of the listed issuer (as defined under the Takeovers Code) and an acquisition or a series of acquisitions of assets from the new controlling shareholder and/or its associates at the time of, or within 36 months of the change in control (**bright line tests**)[2].

4. In recent years, the prevalence of backdoor listings has resulted in a substantial increase in the value of a listing status, leading to extensive activities related to investors acquiring controls of listed issuers for their listing platforms (rather than the underlying business) with a view to eventual backdoor listings, and listed issuers undertaking corporate actions (such as disposals of businesses) to facilitate the sale of their listing platforms. Such activities also led to opportunities for market manipulation and undermine investors' confidence in our market. Where these "shell" companies subsequently enter into significant acquisitions, the Exchange would apply the RTO Rules to discourage "shell" activities.

5. In July 2019, the Exchange published its consultation conclusions on *Backdoor Listing, Continuing Listing Criteria and Other Rule Amendments*. The Rule amendments are intended to apply the RTO Rules to:

   - arrangements that circumvented the then RTO Rules, for example, structuring a RTO transaction as a series of smaller acquisitions, or re-sequencing transactions to acquire a new business before disposing of the original business, or through a series of acquisitions and disposals; and

   - arrangements involving an investor acquiring control of a listed issuer and using the listed issuer as a listing platform to achieve a listing of new businesses that may have no connection with the issuer's original business. These new businesses may be acquired by the listed issuer, or developed as greenfield operations and, following the disposal, cessation and/or curtailment of the original business operation, become the major operation of the listed issuer[3].

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[1] See Rule 14.06B.
[2] See Note 2 to Rule 14.06B.
[3] Acquisition of new business(es) may be subject to the RTO Rules. Rule 14.06D (see paragraph 38) may apply to greenfield operations and large scale issue of securities, and Rule 14.06E (see paragraphs 39 to 42) may impose restrictions on disposals.

6. In applying the RTO Rules, the Exchange has regard to the following:

- The RTO Rules are principle based, anti-avoidance provisions designed to prevent the circumvention of new listing requirements for the assets acquired and/or to be acquired. As such, the Exchange would apply the RTO Rules purposively and the six assessment factors described in the Listing Rules provide guidance to the market on factors that the Exchange would normally consider in a RTO assessment. The applications of these assessment factors would vary from case to case, depending on the specific circumstances of the issuer.

- As the RTO Rules are principle based, they should provide a framework for addressing backdoor listings and sufficient flexibility to address changing RTO structures, without imposing undue restrictions on legitimate business activities of issuers.

- The RTO Rules are not intended to restrict legitimate business activities of listed issuers, including business expansion or diversification that is part of the issuer's business strategies related to its existing business, or is consistent with the issuer's size and resources.

- When applying the RTO Rules, the Exchange's approach is targeted towards transactions that represent an attempt to circumvent the new listing requirements, particularly those involving companies engaging in "shell" activities, as indicated by the factors (a) change in control or de facto control of the listed issuer and (b) fundamental change in the issuer's principal business.

7. All Rule references in this letter are to the Main Board Listing Rules. As GEM RTO Rules are the same as Main Board RTO Rules, the guidance in this letter also applies to GEM issuers.

II. Further guidance on the assessment factors under the principle based test

A. Rule 14.06B (principle based test)

8. Rule 14.06B defines a RTO to be *an acquisition or a series of acquisitions of assets by a listed issuer which, in the opinion of the Exchange, constitutes, or is part of a transaction and/or arrangement or series of transactions and/or arrangements which constitute, an attempt to achieve a listing of the acquisition targets and a means to circumvent the requirements for new applicants set out in Chapter 8 of the Listing Rules.* Note 1 to this Rule sets out factors the Exchange will normally consider in assessing whether the acquisition or series of acquisitions is a RTO transaction:

   i) the size of the acquisition or series of acquisitions relative to the size of the issuer;

   ii) a fundamental change in the issuer's principal business;

   iii) the nature and scale of the issuer's business before the acquisition or series of acquisitions;

   iv) the quality of the acquisition targets;

   v) a change in control (as defined in the Takeovers Code) or de facto control of the listed issuer (other than at the level of its subsidiaries); and/or

vi) other transactions or arrangements which, together with the acquisition or series of acquisitions, form a series of transactions or arrangements to list the acquisition targets.

9. Rule 14.04(2A) defines acquisition targets to be the assets to be acquired, or in the context of a series of transactions and/or arrangements, the assets acquired and/or to be acquired. In other words, a series of transactions and/or arrangements may include completed acquisition(s).

10. In assessing the principle based test, the Exchange will consider the six assessment factors and whether, taken together, the proposed acquisition (or series of acquisitions) would be considered an attempt to circumvent the new listing requirements and a means to achieve the listing of the acquisition targets.

B. The six assessment factors

i) Size of acquisition relative to the issuer

11. Where an issuer undertakes an acquisition of significant size, its existing principal business may become immaterial after the transaction, supporting a concern that the transaction may represent a means to achieve a listing of the target business.

12. The Exchange does not prescribe an absolute threshold in determining whether the size of an acquisition is significant[4]. In assessing the impact of the acquisition on the issuer, the Exchange will take into account other assessment factors such as the nature and scale of the issuer's existing business after the acquisition, and whether the acquisition would result in a fundamental change in the issuer's business.

ii) Acquisition(s) resulting in a fundamental change in the issuer's principal business

13. Where an issuer acquires a target business that is completely different from its existing business and that target business is substantially larger than its existing business, it may be viewed as a fundamental change in the issuer's principal business. This is more likely the case where the issuer's existing business is so immaterial that after the acquisition, the issuer would be substantially carrying on the target business.

14. For the avoidance of doubt, a "fundamental change in the issuer's principal business" does not refer to acquisitions that are part of the issuer's business strategies related to its existing business, including business expansion or diversification, or are consistent with the issuers' size and resources. This may involve an issuer expanding upstream or downstream into new business segments, or an issuer acquiring businesses as part of the issuer's expansion strategy as illustrated in the following examples:

    - technology companies in the new economy sector making acquisitions of businesses in mature industries as part of their business strategies, where the acquisitions formed part of their expansion strategies.

    - a listed issuer engaging in financial advisory and other financial services proposing to acquire an app-based retail banking services business, where the acquisition is part of the issuer's strategy to expand its business into the fintech sector.

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[4] It should be noted that under the Listing Rules, an acquisition below the size of a very substantial acquisition may be a RTO. This would normally be the case if there are other factors resulting in specific concerns about circumvention of the RTO Rules.

15. Further, where an issuer operating a mature business seeks opportunities to diversify its operations (and income stream) and acquires a target business that is completely different from its existing business, absent other factors (for example, a change in control or de facto control in the issuer and/or an acquisition that is substantial in size), the RTO Rules would not normally apply to restrict an issuer from such business diversification.

iii) Nature and scale of the issuer's business before the acquisition

16. A significant acquisition is more likely to be considered a RTO if the scale of the issuer's existing business is small, as the existing business would likely be immaterial after the acquisition and the issuer would be in substance operating the target business.

17. The Exchange will consider the nature of the issuer's existing business and its financial position. The RTO Rules address concerns about shell activities; accordingly, significant acquisitions by listed issuers with "shell" like characteristics are more likely to be RTO transactions. For example, an issuer that has wound down/disposed of its original business and moved into new businesses that can be easily discontinued (e.g. trading business or money lending business[5]) may suggest that the issuer is engaged in shell activities to facilitate backdoor listing. A newly listed issuer that conducted a series of arrangements (such as change in controlling shareholder, acquisitions and/or disposals) shortly after the lock-up period may also suggest shell activities.

iv) Quality of the acquisition targets

18. The Exchange would consider whether the target business can meet the eligibility and suitability criteria for new listing. In general, a substantial acquisition of a target business that is not suitable for listing will likely be considered circumvention of the new listing requirements, as that target business could not otherwise obtain a new listing. Examples include early exploration companies or a business that operates illegally. Similarly, acquisitions of new businesses or assets that have no track record or have yet to commence operations are more likely to raise questions. This is more so the case where the target business is completely different from that of the issuer. Examples include an acquisition of a patent for new technology or new business proposals where the infrastructure (e.g. production facilities) is under construction.

v) Change in control (as defined in the Takeovers Code) or de facto control of the listed issuer

19. Where a proposal does not fall under the bright line test, it may nevertheless be treated as a RTO under the principle based test. In assessing whether there has been any change in control or de facto control, the Exchange would consider:

    i) a change in the controlling shareholder of the issuer; or

    ii) a change in the single largest substantial shareholder who is able to exercise effective control over the issuer as indicated by factors such as a substantial change to its board of directors and/or senior management. For the avoidance of doubt, these are non-exhaustive factors. There could be other factors that the Exchange may consider as indication of exercise of effective control by the single largest substantial shareholder.

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[5] See Guidance Letter GL96-18.

20. The Exchange will consider changes to the personnel and changes to the executive functions of the existing directors when making an assessment. Examples of substantial change of board and/or senior management include change in a majority of the issuer's executive directors and/or senior management carrying executive functions; change in a majority of the directors and/or their executive functions; or change of the chief executive officer.

21. The "change in control or de facto control" factor would not normally apply if (a) the new substantial (and not controlling) shareholder is a passive investor in the issuer; or (b) there are changes in the issuer's board of directors and/or senior management but not its controlling or single largest substantial shareholder. However, where the issuer does not have a controlling or single largest substantial shareholder, a substantial change in its board of directors and/or senior management may raise questions about whether there is a change in de facto control in the issuer.

22. The Exchange normally applies this factor in conjunction with the "series of transactions and/or arrangements" factor. For example, an investor may acquire material shareholding interests in an issuer, appoints new directors to the board which oversees the operations and direction of the listed issuer, and subsequently acquires new businesses. The new directors have no experience in the issuer's original business but have expertise in the new business acquired by the issuer. The Exchange may apply the RTO Rules if, taking into account other factors, it considers that such actions are a means to achieve a listing of the new business and to circumvent the new listing requirements.

23. As described in paragraph 5 above, in the Exchange's experience a change of control together with a series of corporate actions (such as disposals of the issuer's existing business and acquisitions of different lines of businesses)[6] are commonly associated with new investors attempting to achieve a listing of new businesses and circumventing the new listing requirements. In those circumstances the Exchange would more likely apply the RTO Rules.

24. We also clarify that this assessment factor is applied only in the RTO context to identify the circumstances where there may be a backdoor listing concern. It is not a determinant of whether an issuer has "changed control" under the Takeovers Code or for other Rules purposes.

25. ***Change in de facto control arising from issue of restricted convertible securities***[7] - in circumstances involving the issue of restricted convertible securities, the Exchange would consider whether in substance, the issuance serves to allow the vendor (who will hold the issuer's convertible securities) to effectively "control" the issuer. For example, the vendor would become a controlling shareholder of the issuer assuming the convertible securities were fully converted and where i) the issuer has no controlling shareholder when it proposes the acquisition; or ii) the existing controlling shareholder would cease to be a controlling shareholder after the conversion.

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[6] An example involves an issuer engaged in garment business conducting a very substantial acquisition to acquire a property development business from a third party vendor, and shortly after that the issuer's original controlling shareholder proposed to sell its entire interests in the issuer to the vendor, which would result in a change in control of the issuer. The close nexus between the change in control and the completed acquisition may raise concern about circumvention of the new listing requirement. The Exchange may consider these events as a series of arrangements in assessing whether the RTO Rules would apply to the completed acquisition.

[7] Restricted convertible securities are convertible securities with a conversion restriction mechanism to avoid triggering a change in control under the Takeovers Code.

vi) Events and transactions which together with the acquisition form a series of transactions and/or arrangements to circumvent the RTO Rules

26. As set out in paragraph 5 above, the amended RTO Rules address arrangements that are conducted as a series of transactions and/or arrangements over time to achieve a listing of new businesses and circumvention of the new listing requirements. Examples of such arrangements include a series of smaller acquisitions that result in the listing of a new business, or re-sequencing transactions to acquire a new business before disposing of the original business of the issuer, or a series of acquisitions and disposals. This is achieved by assessing a series of transactions and/or arrangements in totality when considering the application of the RTO Rules.

27. The "series of transactions and/or arrangements" factor is normally applied in conjunction with other assessment factors such as the relative size of the transactions to the issuer, and whether the series of transactions and/or arrangements would lead to a fundamental change in the issuer's principal business.

a) A series of transactions or arrangements within 36 months or are otherwise related

28. The Exchange may regard transactions and arrangements as a part of a series if they take place in reasonable proximity to each other (normally within a 36-month period) or are otherwise related. Transactions or arrangements may include change in control or de facto control, acquisitions or disposals of businesses.

29. The RTO Rules are not intended to unduly restrict business expansion or diversification by issuers that take place over a reasonable period where there would be more disclosure for shareholders and the public to assess the issuers' business operations and developments. The Exchange would not normally consider a transaction or arrangement outside the 36-month period as part of the series, unless there is clear nexus between the transactions and/or arrangements, or where there are specific concerns about circumvention of the RTO Rules. For example:

    - a transaction proposed shortly outside the 36-month period and which was likely under contemplation during the 36-month period;

    - where an issuer terminated a proposed acquisition of a target business (or downsized the acquisition) in response to the Exchange's RTO ruling, the Exchange may treat any further acquisition(s) of the target business made outside the 36-month period as part of a series;

    - where an issuer acquired a new business together with an option to acquire another target business and this option is exercised more than 3 years from the original acquisition, the Exchange may consider these acquisitions as a series.

30. Where an issuer acquires new business(es) over a period of time, the Exchange may aggregate the acquisitions when considering whether the acquired businesses together are substantial to the issuer and a means to achieve a listing of the acquired businesses. Acquisitions that are considered as part of a series would normally bear some relationship to each other, for example: (a) acquisitions that are part of a similar line of business, or (b) acquisitions of interests in the same company or group of companies in stages; or (c) acquisitions of businesses from the same or related party.

31. Absent indication of an attempt to achieve a listing of assets and a means to circumvent the new listing requirements, acquisitions of multiple businesses from different parties would not normally be aggregated in a RTO assessment. Circumstances indicating circumvention of the new listing requirements may include a change in control in the issuer followed by a disposal of its original business and acquisitions of multiple lines of new businesses from various parties.

32. When considering whether the size of the acquisitions in a series is substantial, the Exchange would normally aggregate the financial figures/consideration of the acquisition targets (at the time of the respective acquisitions), compared to the size of the issuer, being the lower of (i) the issuer's latest published financial figure (i.e. revenue/profits/assets) or market capitalization before the first transaction in the series; and (ii) its latest published financial figure or market capitalization at the time of the last transaction in the series.

33. When considering whether there is a fundamental change in business over the 36-month period, the Exchange will have regard to the size of the acquisition targets (at the time of their respective acquisitions), compared to the size of the original business (at the time of the last transaction in the series).

34. In addition, where an issuer disposes the business it operated at the commencement of the series of transactions (the original business), it has the effect of reducing the size of the issuer and consequently, may have a bearing on the Exchange's assessment of other assessment factors, including whether there is a fundamental change of business of the issuer, whether the size of the acquisitions are substantial, and whether the issuer is a "shell"[8].

35. Where an issuer conducts shell activities through a series of transactions and/or arrangements involving greenfield operations, equity fundraisings, and/or termination of all or some of its original businesses and such activities are not within the scope of the RTO Rules, the Exchange may exercise its rights under Rule 2.04 to impose additional conditions, for example, requiring the issuer to comply with the RTO requirements. The Exchange may also address shell maintenance concerns (e.g. an issuer operates multiple lines of new businesses or terminates its businesses) by applying Rule 6.01(4) (suitability for listing)[9] or Rule 13.24 (sufficiency of operations)[10].

b) Treating a series of transactions as one transaction

36. When applying the RTO Rules, a series of transactions would be treated as if they were one transaction. Consequently, while an acquisition of the new business may have been completed at an earlier time within the period, by viewing the series of arrangements as one transaction, the RTO Rules would also apply to that completed acquisition.

37. Where the proposed series of transactions and/or arrangements involve a disposal that is preceded by an acquisition (or acquisitions) of a target business, both the RTO Rules and the continuing listing requirements (Rule 13.24) may apply. The target business (i.e. the issuer's remaining business after the proposed disposal) must meet the continuing listing requirement under Rule 13.24[11], failing which the issuer may be subject to the delisting procedures under Rule 6.01(3). Additionally, the RTO Rules may apply to the target business (i.e. the acquisition(s)) that is part of the series of transactions and/or arrangements.

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[8] See footnote 5.

[9] See Guidance Letter GL96-18.

[10] See Guidance Letter GL106-19.

[11] Specifically, Rule 13.24 requires an issuer to carry on a sufficient level of operation and have sufficient asset to support its operations to warrant its continued listing.

III. Large scale issue of securities

38. Rule 14.06D describes circumstances involving an investor acquiring control or de facto control of a listed issuer through a large scale subscription of the issuer's securities, and the listed issuer using the proceeds to acquire or develop a new business unrelated to the original business of the listed issuer, achieving a listing of that new business and circumventing the new listing requirements. These arrangements involve a change in control or de facto control and acquisition of new business and/or greenfield operations as discussed in paragraph 5 above. Its application is set out in Guidance Letter GL105-19.

IV. Restriction on disposals

39. Rule 14.06E[12] imposes restriction on a disposal or distribution in specie (or a series of disposals or distributions) that involves all or a material part of the issuer's existing business at the time of, or within 36 months from a change in control (as defined in the Takeovers Code) of the issuer, unless the remaining business or the assets acquired by the issuer can meet the requirements under Rule 8.05 (or Rule 8.05A or 8.05B).

40. This Rule complements the RTO bright line tests in Note 2 to Rule 14.06B to discourage investors from re-sequencing a RTO transaction by acquiring a new business before disposing its original business, thereby circumventing the bright line test (which involves acquisitions that are classified as very substantial acquisitions). The Rule may also apply where an issuer develops a new business through greenfield operation after a change in control, with a view to operating the new business through the listed issuers and circumventing the new listing requirements. As these arrangements do not involve acquisitions, they are not caught by Rule 14.06B.

41. The Note to Rule 14.06E provides the Exchange discretion to apply the same restriction to disposal(s) or distribution(s) by a listed issuer of all or a material part of its existing business at the time of, or within 36 months from a change in de facto control of the listed issuer (by reference to the "change in control or de facto control" factor in the principle based test), where the Exchange considers that the disposal(s) and/or distribution(s) form part of a series of transactions/arrangements to circumvent the new listing requirements. In making this assessment the Exchange would make reference to the six assessment factors under the principle based test. The Exchange would apply this Rule to a series of arrangements that involve an issuer developing a new business through greenfield operation after a change in control or de facto control[13], with a view to operating the new business through the listed issuer and circumventing the new listing requirements (see paragraph 5).

42. Rule 14.06E is not intended to restrict issuers from disposing part of their businesses or assets for commercial reasons. For example, an investor may acquire control in the listed issuer and thereafter, conduct a series of business reorganizations to streamline the underlying business, including the disposal of certain non-performing segments of the issuer's business, provided that is not all or a material part of the issuer's business.

[12] This Rule incorporates former Rule 14.92.
[13] See paragraphs 19 to 25 for the factors set out in the "change in control or de facto control" factor.

V. Extreme transaction

43. The RTO Rules apply to acquisitions that constitute an attempt to achieve a listing of the assets to be acquired and a means to circumvent the new listing requirements under Chapter 8 of the Listing Rules. Where an acquisition or a series of acquisitions of assets, which individually or together with other transactions or arrangements, may, by reference to the factors under the principle based test have the effect of achieving a listing of the acquisition targets, but the issuer can demonstrate that it is not an attempt to circumvent the new listing requirements, the proposed acquisition (or series of acquisitions) may be classified as an "extreme transaction" under Rule 14.06C.

44. The extreme transaction classification would not be available where the listed issuer demonstrates "shell" like characteristics. This is because the RTO Rules discourage activities related to the trading of, or acquisitions of "listed shells" for backdoor listings. The Exchange will assess the application of the "extreme transaction" category case by case. For an acquisition (or series of acquisitions) to be qualified as an extreme transaction, the issuer has to satisfy the following additional requirements in addition to demonstrating that it is not an attempt to circumvent the new listing requirements:

    i) the issuer has been under the control or de facto control of the same person or group of persons for a long period (normally not less than 36 months) prior to the proposed transaction, and the transaction would not result in a change in control or de facto control of the issuer. The Exchange would make reference to the "change in control or de facto control" factor under the principle based test (see paragraphs 19 to 25) in making this assessment; or

    ii) the issuer has been operating a principal business of substantial size, which will continue after the transaction.

        As general guidance, this may include an issuer with annual revenue or total asset value of HK$1 billion or more based on the latest published financial statements. When assessing the size of the issuer, the Exchange will also take into account the issuer's financial position, the nature and operating model of the business and the issuer's future business plans. For example, an issuer that meets the HK$1 billion in revenue but has very small net asset value (or is in a net liability position) and operates an indent trading business may not meet this test.

Procedural and compliance requirements for extreme transactions

45. Rule 14.06C(2) requires that (i) the acquisition targets must meet the suitability for listing requirement (Rule 8.04) and the new listing track record requirements (Rule 8.05 or 8.05A or 8.05B); and (ii) the enlarged group must meet all the new listing requirements set out in Chapter 8 of the Listing Rules (except Rule 8.05).

46. The issuer would be required to provide sufficient information to the Exchange to demonstrate that the acquisition target meets Rule 8.04 and Rule 8.05 (or Rule 8.05A or 8.05B). This may be in the form of a draft circular with material information, including, for example, draft accountants' report of the acquisition target for the track record period, detailed description of its business and its management, risk factors, legal compliance and any other information as requested by the Exchange. Failure to provide sufficient information for the Exchange to make a determination may result in a RTO ruling.

47. Rule 14.53A requires the issuer to appoint a financial adviser to perform due diligence on the acquisition targets and to provide the declaration in the form set out in Appendix 29. The Listing Committee may, in principle, allow the issuer to classify its proposed acquisition as an extreme transaction based on the information provided in its written submission and/or draft circular and any additional information requested by the Department. However, this classification is subject to the completion of the financial adviser's due diligence work on the target business and its submission of a declaration to support that the acquisition target can meet Rule 8.04 and Rule 8.05 (or Rule 8.05A or 8.05B).

48. The Exchange will require the issuer to reclassify the acquisition as a RTO if the financial adviser cannot provide the declaration, or where there is additional information indicating that the acquisition target cannot meet Rule 8.04 and Rule 8.05 (or Rule 8.05A or 8.05B), or where there are any other concerns about circumvention of the new listing requirements.

VI. Compliance requirements applicable to RTO

Compliance with new listing requirements

49. Where a transaction is ruled as a RTO, the issuer will be treated as if it were a new listing applicant. Rule 14.54(1) requires that (i) the acquisition targets must meet the suitability for listing requirement (Rule 8.04) and the new listing track record requirements (Rule 8.05 or Rule 8.05A or 8.05B); and (ii) the enlarged group must meet all the new listing requirements under Chapter 8 of the Listing Rules (except Rule 8.05).

50. Under Rule 14.54(2), where the issuer has failed to comply with Rule 13.24(1), the acquisition targets must also meet Rule 8.07. The issuer and its sponsor must demonstrate that there is sufficient public interest in the business of the acquisition target and the enlarged group. This may be demonstrated by, for example, conducting a public offer or other analysis with evidence to demonstrate a sufficient level of public interest in the acquisition targets. For this purpose, it would not be sufficient to simply rely on the issuer's existing shareholder base to satisfy the requirements.

51. Note 1 to Rule 14.54 states that if the Exchange is aware of information suggesting that the RTO is to avoid any new listing requirements, the issuer will be required to demonstrate that the acquisition targets meet all the new listing requirements set out in Chapter 8 of the Listing Rules.

52. Where the RTO transaction involves a series of acquisitions (including completed acquisitions), all the acquisition targets in the series of acquisitions must as a whole comply with the requirements in Rule 14.54.

VII. Compliance requirements relating to RTOs or extreme transactions that involve a series of transactions

Track record and due diligence requirements

53. Where the Exchange considers a series of transactions and/or arrangements to constitute a RTO or an extreme transaction, the entire series of acquisitions should, as a whole, meet the new listing requirements of Rule 8.05.

54. The issuer is required to provide sufficient information to the Exchange to demonstrate that the acquisition targets can meet Rule 8.05, including financial information of the targets based on accountant's report or audited financial information[14]. For this purpose the track record period for the completed acquisition(s) and the proposed acquisition(s) in the series shall be referenced to the latest proposed transaction and covers the three financial years [15] immediately prior to the issue of circular for that transaction.

55. The due diligence requirements for RTOs or extreme transactions apply to the acquisition targets that form part of the series as mentioned above[16].

56. As the RTO or extreme transaction Rules apply to i) acquisitions from various independent parties and ii) a series of acquisitions, including completed acquisitions, it is possible that the issuer may not meet the management and/or ownership continuity requirements in the eligibility criteria. The Exchange would consider granting waivers on a case by case basis.

Shareholders' approval requirement

57. Rules 14.53A and 14.55 require shareholders to approve a RTO or an extreme transaction. Where a RTO or extreme transaction involves a series of transactions, this approval requirement applies to the proposed transaction only. In other words, a listed issuer is not required to seek shareholders' approval for the completed transaction(s) that form part of the series.

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14 Such approach is in line with our practice in requiring an issuer to provide to the Exchange financial results of its remaining group to demonstrate that the remaining group can meet Rule 8.05 in a spin-off under Practice Note 15.

15 For GEM issuers, the track record period covers the two financial years immediately prior to the issue of circular for that transaction (see GEM Rule 19.57A).

16 Where during the course of due diligence review the financial adviser identifies issues (e.g. legal non-compliance), the issuer is expected to take measures to resolve these issues.

Appendix

This appendix sets out the cases to illustrate how the Exchange applies the RTO Rules in circumstances described in the guidance letter.

	Case number	Description
I.	**Principle based test under the RTO Rules**	
	Case 1	Acquisition that was significant in size based on its financial forecast
	Cases 2 and 3	Acquisitions of target companies that were considered unsuitable for listing
	Cases 4 and 5	Acquisitions of minority interests in target companies
	Cases 6, 7 and 8	Acquisitions of mining companies
	Case 9	Acquisition that formed part of the issuer's expansion strategies related to its existing business
II.	**Bright line test under the RTO Rules**	
	Case 10~~9~~	Significant acquisition that would result in a change in the issuer's immediate holding company but not the ultimate controlling shareholder
	Case 11~~0~~	Waiver from the RTO Rules
	Case 12~~1~~	Proposed change to the terms of restricted convertible securities previously issued by the issuer in connection with a very substantial acquisition
III.	**Application of Rule 2.04 to require issuers to comply with the RTO requirements**	
	Case 13~~2~~	Shell activities through a series of arrangements involving continuing connected transactions with the new controlling shareholder
	Case 14~~3~~	Shell activities through a series of arrangements involving termination of part of the original business
IV.	**Extreme transactions**	
	Case 15~~4~~	Acquisition of a target company that met the new listing requirements
	Case 16~~5~~	Acquisition of a target company with a substantial change in its business model during the track record period

I. Principle based test under the RTO Rules

Case number / Listing Rule reference	Background and Decision
Case 1 Rule 14.06B	**Background** 1. Company A was principally engaged in hotel business. Its principal assets comprised one hotel property and cash. It has been loss making over the last five years. 2. Company A proposed to acquire a majority interest in a target company that was newly established to carry out a natural gas project involving the construction and operation of gas pipes and gas stations in the PRC. The target company had signed relevant contracts for the natural gas project and expected to commence the sales of natural gas upon completion of the construction work for the project. 3. The target company was expected to record substantial amounts of revenue and profits in the coming years. The proposed acquisition constituted a disclosable transaction for Company A based on the historical financials of the target company. However, based on the forecast financials of the target company, the acquisition was substantial with projected annual revenue at over 20 times of the revenue of Company A's hotel business. **Decision** 4. The Exchange considered the proposed acquisition would constitute a reverse takeover because: • Company A's existing business had a low level of operations. Based on the target company's business plan and financial forecast, its natural gas business would be significantly larger than the existing business of Company A in terms of revenue and profits. • The target company's natural gas business was different from, and unrelated to, Company A's existing business. The proposed acquisition would lead to a fundamental change in Company A's principal business. • The target company had not generated any revenue before the proposed acquisition. It did not have a track record and could not meet the new listing requirements.

Case number / Listing Rule reference	Background and Decision
Case 2* Rule 14.06B	**Background** 1. Company A was principally engaged in trading of food and beverage products. 2. It proposed to acquire a target company that was engaged in production and sale of organic fertilizers. The revenue, consideration and equity ratios of the proposed acquisition were between 110% and 150%, and the asset ratio was about 90%. 3. Company X (the vendor) was the target company's sole supplier of a major raw material critical for production of the target company's fertilizer products. 4. Company X produced such raw material using its proprietary technology. Company X intended to authorise the target company to use such technology to produce the raw materials and expected the target company could master the technology and achieve full scale production of the raw material within three years. **Decision** 5. The Exchange considered the proposed acquisition would constitute a reverse takeover because: • The target company's business was different from, and unrelated to, Company A's existing business. The proposed acquisition would lead to a fundamental change in Company A's principal business given the significant size of the target company's business. • The proposal involved Company A acquiring part, and not the whole, of an integrated business from Company X. While the target company had planned to manufacture the raw material itself, it was uncertain as to whether and when the target company would be able to do so, and the impact of any such change in its business model and on its financial results. Thus, the target company's historical track record could not reflect its performance after completion of the proposed acquisition. • The target company was unsuitable for listing. It relied on Company X as the sole supplier of the critical raw material that has no alternative suppliers or substitutes for its products. The target company did not have the technology or expertise to produce the critical raw material independently. Company A could not demonstrate that the target company was, or would upon completion of the proposed acquisition be, capable of carrying on its business independently from Company X.

<table>
<tr><th>Case number / Listing Rule reference</th><th>Background and Decision</th></tr>
<tr><td>Case 3*

Rule 14.06B</td><td>Background

1. Company A was principally engaged in manufacturing and sale of household products.

2. It proposed to acquire a target company which was newly set up by Mr. X (the vendor) to hold certain inventories, machinery and equipment for the production of beverage products (the Target Assets).

3. The asset ratio, the consideration ratio and equity ratio for the transaction were between 200% and 300%.

4. As the target company had not yet obtained a manufacturing licence, it would enter into supply and sales contracts with a PRC company for a term of three years upon completion of the proposed acquisition, such that:

• the PRC company would manufacture the beverage products for the target company using the Target Assets; and

• the target company would sell the beverage products back to the PRC company.

Decision

5. The Exchange considered that the proposed acquisition would constitute a reverse takeover because:

• The target company did not meet the new listing requirements as it had no trading record. Further, the target company would be unsuitable for listing as it would heavily rely on the PRC company for both the production and sale of its products and would be unable to carry on its business independently from the PRC company.

• The target company's business was different from, and unrelated to, Company A's existing business. The proposed acquisition would lead to a fundamental change in Company A's principal business given the significant size of the target company's business.

6. After the Exchange decided to treat the proposed acquisition as a reverse takeover, Company A submitted a revised proposal to acquire only a 30% interest in the target company.</td></tr>
</table>

Case number / Listing Rule reference	Background and Decision
	7. The Exchange noted that the revised proposal was made for the purpose of downsizing the acquisition to slightly below 100% (i.e. the threshold for very substantial acquisitions). Notwithstanding the change, the Exchange maintained its view that the revised proposal would still be a reverse takeover as the proposed acquisition was substantial based on the asset and consideration ratios and a means to circumvent the new listing requirements, and the target company was not suitable for listing.
Case 4* Rule 14.06B	**Background** 1. Company A was principally engaged in the businesses of property investment, fund management, and fund and securities investment. 2. Company A proposed to subscribe in the Fund as a limited partner with commitments of about HK$4.5 billion. Company A would have no control over or right to participate in the management of the Fund and the investments to be made by the Fund. 3. The proposed subscription represented about 80% of the asset value and over 900% of the market capitalisation of Company A. Company A intended to finance the subscription using a loan facility granted to it by its controlling shareholder and its internal resources. 4. The Fund was a newly established partnership. It did not have any investments, assets or liabilities, and had not recorded any income or expenses. Company A submitted that the Fund had a clear investment objective to invest in debt instruments of companies established to develop real estates in the PRC. Company A had considered the experience and track record of the directors of the Fund's general partners and was confident in the prospects of the Fund. The proposed subscription would allow Company A to leverage on the Fund's expertise, experience, relationship and resources to source and manage potential investments in the PRC real estate market. **Decision** 5. The Exchange considered that the proposed subscription in the Fund would constitute a reverse takeover because: • The subscription was of a significant size to Company A. Should Company A proceed with the subscription, the investment in the Fund would represent a significant part of Company A's assets.

Case number / Listing Rule reference	Background and Decision
	• The Fund was newly set up and did not have any track record, investments or assets. • Although Company A would invest a significant amount of money in the Fund, it would have no control over or right to participant in the management of the Fund or the investments to be made by the Fund. • The subscription was a means to circumvent the new listing requirements. This raised a concern about suitability of listing.
Case 5* Rules 14.06B and 14.54	**Background** 1. Company A proposed to acquire 50% interest in a target company. Upon completion, the investment in the target company would be accounted for as an interest in an associated company or an investment in Company A's financial statements. 2. Company A would pay for the acquisition in cash and by issuing consideration shares and restricted convertible securities to the vendor. 3. The target company was engaged in the manufacturing and trading of sanitary ware products, which was different from Company A's principal businesses. It was significantly larger than Company A based on the asset ratio of about 40 times and a revenue ratio of about 11 times. 4. Company A submitted that the target company could meet the profit requirement for new listing applicants under Rule 8.05(1). The acquisition should not be treated as a reverse takeover. **Decision** 5. The Exchange considered that the proposed acquisition would constitute a reverse takeover because: • Given the significant size of the target company, Company A's existing businesses and assets would be relatively immaterial to the enlarged group upon completion of the acquisition. The acquisition was a means to achieve the listing of the investment in the target company.

<table>
<tr><th>Case number / Listing Rule reference</th><th>Background and Decision</th></tr>
<tr><td></td><td>
Company A asserted that the target company could meet requirement under Rule 8.05(1). However, as Company A would account for the investment in the target company as an interest in an associated company or an investment, the Exchange considered that the target company's trading record should be excluded for the purpose of Rule 8.05(1).
</td></tr>
<tr><td>Cases 6, 7 and 8*

Rules 14.06B and 18.03(2)</td><td>
Background

1. Each of Companies A, B and C proposed to acquire a target company which was engaged in mining activities.

2. The size of the acquisitions was very significant to each of the Companies. When assessing whether the acquisitions would constitute reverse takeovers, one of the factors that the Exchange considered was whether the target companies could meet the new listing requirements for a mineral company.

3. In these cases, there was an issue whether the target company could meet Rule 18.03(2) which requires a new applicant mineral company to have at least a portfolio of Indicated Resources, and the portfolio must be meaningful and of sufficient substance:

In the case of Company A, the target company was engaged in oil and natural gas exploration, extraction and processing. It had exploration and extraction rights in two gas fields. One gas field was in a preliminary exploration stage and had resources classified as Prospective Resources under the Petroleum Resources Management System (PRMS). The target company had yet to commence any exploration work in the other gas field.
In the case of Company B, the target company was engaged in the exploration, exploitation and processing of mineral resources in some offshore areas. It was agreed that:

- Company B would pay 10% of the consideration to the vendor upon completion of the acquisition on the basis that the vendor produced a valuation report showing that the offshore areas had Indicated Resources of value not less than 10% of the consideration.

- Company B would deliver to an escrow agent convertible securities representing the remaining 90% of the consideration. After completion of the acquisition, the vendor could perform extra works in the offshore areas during a specified period, and the escrow agent would release an amount of convertible securities to the vendor according to the value of any additional Indicated Resources discovered. After

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</table>

Case number / Listing Rule reference	Background and Decision
	the specified period, Company B would cancel any convertible securities that had not been released to the vendor, and the consideration for the acquisition would be reduced accordingly. Company B submitted that it would only pay the consideration based on the value of the Indicated Resources identified under a reporting standard acceptable by the Listing Rules. The portfolio of mineral resources to be acquired was meaningful and of sufficient substance. • In the case of Company C, the target company held mining rights of certain iron mines in the PRC but had not yet commenced production. To address the issue, Company C provided the estimate of resources and reserves for the iron mines identifiable under the Chinese standard. It would appoint a competent person to report on the resources and reserves under the JORC Code when preparing the circular for the acquisition at a later stage. **Decision** 4. In these cases, the Exchange considered that none of the target companies could meet the new listing requirements and thus the proposed acquisitions would constitute reverse takeovers: • Company A failed to demonstrate that the target company had at least a portfolio of Contingent Resources as required under Rule 18.03(2). • In the case of Company B, at the time of the proposed acquisition, the parties could only prove the existence of Indicated Resources of value representing 10% of the consideration, and a substantial part of the target company's portfolio of minerals was not substantiated in the competent person's report. The vendor was given a long period after completion of the acquisition to ascertain whether there were any additional Indicated Resources in the offshore areas. The circumstances of the case indicated that the target company was an early exploration company at the time of the acquisition and did not meet the requirements of Rule 18.03(2). • Company C could only provide the estimate on resources and reserves under the Chinese standard when determining the transaction classification at the announcement stage. However, Chinese standards are not yet recognised as acceptable reporting standards for the purpose of the Chapter 18 requirements. As the basis for information presentation under Chinese standards and JORC-like codes are fundamentally different, resources and reserves presented under Chinese standards may not be recognised as such under JORC-like codes.

Case number / Listing Rule reference	Background and Decision
Case 9 Rules 14.06B and 14.06C	**Background** 1. Company A was principally engaged in the provision of drug discovery services since its initial listing. 2. It proposed to acquire a majority interest in a target company that was engaged in the provision of drug development and manufacturing services. The consideration would be settled by cash. 3. The revenue ratio of the proposed acquisition was about 380% while the asset, profit and consideration ratios were between 20% and 80%. 4. The target company had a trading record of more than three years and recorded profits of more than RMB130 million in aggregate in the last three financial years. Company A considered the proposed acquisition would allow it to expand its business vertically along the pharmaceutical outsourcing service value chain to the drug development and manufacturing business, which formed part of its business strategies disclosed in the IPO prospectus. **Decision** 5. The Exchange agreed that the proposed acquisition would be treated as a very substantial acquisition but not a reverse takeover nor an extreme transaction because: • The proposed acquisition would not lead to a fundamental change in Company A's business as it represented a vertical expansion of Company A's existing business which was in line with Company A's business strategies as disclosed in the IPO prospectus. • The size of the proposed acquisition was not extreme compared to Company A's existing business which had been sizable in scale since listing and would continue to be Company A's principal business after the proposed acquisition.

II. Bright line test under the RTO Rules

<table>
<tr><th>Case number / Listing Rule reference</th><th>Background and Decision</th></tr>
<tr><td>Case 910*

Rule 14.06B</td><td>

Background

1. Company A proposed to acquire from the vendor its interest in a target company. Company A and the target company were engaged in the same line of business.

2. Since Company A would settle part of the consideration by issuing new shares to the vendor, the acquisition would result in a change in its shareholding structure. The simplified group structures before and after the acquisition are:

<u>Before the proposed acquisition</u>

The Municipal Government
Entity X
Entity Y
100%
The vendor
100%
Holding company
>50%
The target company
>50%
Company A

<u>After the proposed acquisition</u>

The Municipal Government
Entity X
Entity Y
100%
The vendor
100%
Holding company
>50%
20%
Company A
>50%
The target company

3. The proposed acquisition was a connected transaction for Company A as the Exchange had deemed the vendor and its associates to be Company A's connected persons since the listing of Company A. Based on the percentage ratio calculation, the acquisition was also a very substantial acquisition.

4. Company A considered that the proposed acquisition was not a reverse takeover. Although the acquisition would result in the vendor acquiring a controlling interest in Company A, there would not be a change in control because:

- Both Entity X and Entity Y were subordinate departments of the Municipal Government and under its supervision. Through these entities, the Municipal Government had exercised control over each of the Company A's holding company, Company A, the vendor and the target company, including through the exercise of voting rights.

- The Municipal Government had, and would continue to have, ultimate control over Company A before and after the proposed acquisition.

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Case number / Listing Rule reference	Background and Decision
	Decision 5. The Exchange agreed that the proposed acquisition would not constitute a reverse takeover because: • Since the Municipal Government would remain as Company A's controlling shareholder following the proposed acquisition, there would not be a change in its ultimate control as a result of the proposed acquisition. • The Exchange also took into account the assessment of "control" under the Takeovers Code. In this case, the Takeovers Executive had granted a waiver to the vendor from its obligation to make a general offer under Note 6(a) (acquisition from another member) to Rule 26.1 of the Takeovers Code.
Case 1~~0~~1 Rule 14.06B	**Background** 1. Company A operated port terminals in the PRC. 2. Company X (controlling shareholder of Company A) was originally wholly owned by the Provincial Government. About a year ago, Company Y acquired 51% equity interest in Company X from the Provincial Government. This constituted a change in control of Company A under the Takeovers Code. *Proposed transaction* 3. Company A proposed to merge with a target company which was listed on a PRC stock exchange and controlled by Company X. The target company also operated port terminals in the PRC. 4. The proposed merger would constitute a reverse takeover under the bright line tests as it was a very substantial acquisition from Company X (being an associate of Company Y) within 36 months of Company Y gaining control of Company A through Company X. The profit ratio was about 120%. Other size tests were below 100%. 5. The proposed merger would allow Company A to expand its existing port terminal business by integrating its port-related resources with those held by the target company and bringing synergy amongst the port operators controlled by Company X. Company A submitted that the proposed merger was not an attempt to achieve a listing of new business and sought a waiver from applying the bright line tests of Rule 14.06B to the merger.

Case number / Listing Rule reference	Background and Decision
	Decision 6. The Exchange agreed that the proposed merger was not a backdoor listing of new business by the incoming controlling shareholder and granted the waiver to Company A for the following reasons: • The proposed merger was in line with Company A's strategies to expand its port terminal business and the size of the merger was not significant to Company A. It would not result in a fundamental change to Company A's principal business. • The proposed merger represented an internal restructuring of the port-related businesses held under Company X which controlled Company A and the target company before the proposed merger and would continue to do so after the merger. There was no injection of asset or business from Company Y.
Case 1~~1~~2* 14.06B and 28.05	**Background** 1. About a year ago, Company A acquired a target company from the vendor. The target company's principal business was different from that of Company A before the acquisition. 2. The consideration was paid in (i) cash, (ii) consideration shares and (iii) restricted convertible notes. The convertible notes were redeemable only upon maturity three years after issue. 3. The terms of the convertible notes included a conversion restriction which did not allow any conversion which would trigger a mandatory general offer under the Takeovers Code. The acquisition was classified as a very substantial acquisition based on percentage ratio calculations. *Proposal to change the terms of the restricted convertible notes* 4. Company A proposed an open offer, fully underwritten by the vendor, to raise funds for its business operations. If no shareholders took up their entitlements and the vendor took up all the offer shares, the vendor's interest in Company A would increase from 18% to approximately 40%.

Case number / Listing Rule reference	Background and Decision
	5. Under the underwriting agreement, the vendor would fulfil its underwriting obligation partly in cash and partly by offsetting the convertible notes. To facilitate this offsetting arrangement, the parties proposed to change the terms of the convertible notes to make them redeemable before maturity. This would require the Exchange's prior approval. **Decision** 6. At the time of the acquisition, the Exchange did not classify the acquisition as a reverse takeover given the terms of the acquisition and in particular, the conversion restriction was structured to avoid triggering the change in control test under the bright line tests of the RTO Rules. 7. In considering whether to approve the proposed change in the redemption clause of the convertible notes, the Exchange was concerned that its purpose was to circumvent the RTO Rules because: • The proposed change was to facilitate the offsetting arrangement which, together with the open offer, would allow Company A to redeem the convertible notes before its maturity and to issue new shares to the vendor resulting in the vendor taking control of Company A. This would effectively change the structure based on which the acquisition had not been treated as a reverse takeover. • Company A had no other reason to immediately redeem the convertible notes which would mature in two years. 8. In response to the Exchange's concern, Company A and the vendor agreed to revise the open offer structure. There would be no change in the terms of the convertible notes and the vendor would not take control (as defined under the Takeovers Code) of Company A under the revised structure of the open offer.

III. Application of Rule 2.04 to require issuers to comply with the RTO requirements

Case number / Listing Rule reference	Background and Decision
Case 1~~2~~3* Rules 2.04	**Background** 1. At the time of its initial listing, Company A was principally engaged in the original business of leasing and trading of construction machinery in Hong Kong. 2. Mr. X (the founder, the chairman and an executive director of Company A) disposed of his controlling interest in Company A to Mr. Y shortly after the 12 month lock-up period. 3. Mr. Y made a general offer for all the remaining shares in Company A under the Takeovers Code. Upon close of the offer, all the directors of Company A have resigned and new directors (including Mr. Y) were appointed to the board of Company A. The new directors did not have experience in the original business. A majority of the new directors were also directors of Company Z which was controlled by Mr. Y and engaged in property business in the PRC. 4. The first annual results released by Company A after its listing showed a 30% drop in revenue from the original business. Company A disclosed that the industry of the original business would slow down and it intended to diversify its business by leveraging on the experience of its directors in the PRC. *Proposed transactions with Company Z* 5. A few months after the close of the offer, Company A proposed to engage in a new business by entering into a framework agreement with Company Z for the provision of property management services to the properties controlled or being developed by Company Z. 6. The transaction with Company Z would constitute a continuing connected transaction (the Proposed CCT). Based on the highest annual cap proposed by Company A, the revenue contributed from the Proposed CCT would represent over 70% of Company A's revenue in the first year after listing. 7. Company A also intended to further expand the new business and was negotiating similar property management service agreements with independent third parties.

Case number / Listing Rule reference	Background and Decision
	Decision 8. The Exchange was concerned that Company A was engaging in shell activities as indicated by a change in control shortly after the lock-up period. The post-listing developments appeared to deviate significantly from the disclosures in Company A's IPO prospectus about its business plans and the rationale for its listing. This suggested that Mr. Y acquired Company A for its listing status rather than the developments of its underlying business. 9. The Exchange informed Company A of its intention, to exercise its right to impose additional conditions on the Proposed CCT under Rule 2.04, by treating Company A as if it were a new listing applicant and requiring it to comply with the requirements for a RTO. In arriving at such decision, the Exchange considered that the Proposed CCT would be an attempt to circumvent the new listing requirements because: • The new business was completely different from the original business and its size would be significant to Company A based on the annual cap for the Proposed CCT. The Proposed CCT would lead to a fundamental change in Company A's business and represent an attempt to achieve a listing of the new business through greenfield operations which had no track record and would not meet the new listing requirements. • While Company A submitted that the Proposed CCT would not be its major operation based on its projected revenues of the original business for the next three years, the Exchange noted that such projection was made on the assumption that the original business would grow at a compound growth rate which was contrary to the performance of the original business after listing, and Company A had not provided any information to support the assumption. The Exchange did not consider this sufficient to address its concern.
Case 143* Rules 2.04	**Background** 1. At the time of its initial listing, Company A was principally engaged in the original business of operating entertainment venues at separate locations under different brand names. 2. Mr. X (the founder, the chairman and an executive director of Company A) disposed of his 70% equity interest in Company A to Mr. Y shortly after the 12 month lock-up period.

Case number / Listing Rule reference	Background and Decision
	3. Mr. Y made a general offer for all the remaining shares in Company A under the Takeovers Code. Upon close of the offer, all the directors of Company A resigned and new directors (including Mr. Y) were appointed to the board of Company A. The new directors did not have experience in the original business. A few months later, Company A closed down two of its entertainment venues that were loss-making. 4. About two years after the offer, Company A acquired from Mr. Y a target company engaged in property management business, which constituted a major and connected transaction. At that time, Company A stated that the acquisition would enable it to diversify its income stream and it had no intention to dispose of or terminate the original business. *Proposal to terminate part of the original business* 5. A few months after the completion of the acquisition, Company A proposed to terminate the lease agreement for one of its two remaining entertainment venues (the Proposal). That entertainment venue contributed a material part of Company A's revenue from the original business but it was operated at a loss in the latest financial year. 6. Company A submitted that a new tenant had leased a venue in the same building to operate an entertainment business in competition with that of Company A. The Proposal was initiated by the landlord who offered Company A a rent-free period before the termination date in exchange for an early termination. **Decision** 7. The Exchange was concerned that Company A was engaging in shell activities as indicated by a change in control shortly after the lock-up period. The subsequent events, including the change in its board of directors, the injection of the new business into Company A and the series of actions to scale down the original business, suggested that Mr. Y acquired Company A for its listing status rather than the developments of its underlying business. 8. The Exchange made the decision to exercise its right to impose additional conditions on the Proposal under Rule 2.04, by treating Company A as if it were a new listing applicant and requiring it to comply with the requirements for a RTO. In arriving at such decision, the Exchange considered that the Proposal, together with the acquisition, would be an attempt to circumvent the new listing requirements because:

Case number / Listing Rule reference	Background and Decision
	• The Proposal would lead to the termination of a material part of the original business and the new business would become the major operation of Company A. The Proposal, which was made shortly after the acquisition, would be a means to "cleanse" the listed shell. It formed part of a series of arrangements to achieve a listing of the new business that would not have otherwise met the new listing requirements. • While Company A submitted that the Proposal was initiated by the landlord and was carried out for commercial reasons, the Exchange did not consider this sufficient to address the concerns.

IV. Extreme transactions

Case number / Listing Rule reference	Background and Decision
Case 154 Rules 14.06B and 14.06C	**Background** 1. Company A was principally engaged in leasing of properties, production and sale of education-related equipment and money lending. The leasing and education-related equipment businesses contributed over 95% of Company A's revenue in recent years. 2. Company A proposed to acquire a target company from Company X (controlling shareholder of Company A for more than three years). The proposed acquisition would not result in a change in control of Company A. 3. The target company was engaged in the provision of financial leasing and factoring services in the PRC. It was substantially larger than Company A, with percentage ratios between 10 and 35 times. **Decision** 4. The Exchange considered that the proposed acquisition would have the effect of achieving a listing of the target company's business because: • The size of proposed acquisition was extreme compared to Company A's existing businesses and the target company's business was different from Company A's core businesses. Given the significant size of the proposed acquisition, it would result in a fundamental change in Company A's principal business. • Company A argued that the proposed acquisition was not an extreme case as it represented an expansion of Company A's existing money lending business. However, the Exchange noted that the money lending business was small in scale. Further, the target company's business was substantially different from Company A's money lending business in terms of operating scale, business models and customers base. Company A would be substantially carrying on the target company's business after the proposed acquisition. 5. Nevertheless, the Exchange agreed that the proposed acquisition could be classified as an extreme transaction (and not a RTO) because: • The target company could meet the new listing requirements (Rule 8.05(1)) and the suitability for listing requirement (Rule 8.04) subject to the completion of the financial adviser's due diligence work on the target company. The proposed acquisition was not an attempt to circumvent the new listing requirements; and

Case number / Listing Rule reference	Background and Decision
	• Company A met the eligibility criterion set out in Rule 14.06C(1)(a) as it had been under control of Company X for more than 36 months and the proposed acquisition would not result in a change in control of Company A.
Case 1~~5~~6* Rule 14.06B	**Background** 1. Company A was principally engaged in trading business. It proposed to acquire a target company from Company X by issuing consideration shares. Upon completion of the acquisition, Company X would become a substantial shareholder of Company A (25% of the enlarged issued shares). 2. The target company was significantly larger than Company A given the asset ratio of about 8 times and revenue ratio of about 50 times. 3. The target company was principally engaged in coal mining. It owned two coal mines (Target Mines) which had been under commercial production for a few years. The information provided showed that there were changes in the business model of the target company: • During the track record period, the target company had been selling mixed coal by mixing the coal extracted from the Target Mines with different types of raw coal purchased from other coal mines owned by Company X (Other Mines). • The target company's coal products were mainly sold to Company X who then on-sell the products to customers for the purpose of centralised management and planning by Company X. Sales to Company X accounted for about 50% of the target company's revenue in the first year of the track record period, and over 90% in the last two financial years. • In light of the recent change in market conditions, the target company intended to sell coal produced from the Target Mines without mixing with raw coal from the Other Mines after completion of the proposed acquisition. • Further, the target company had set up its own sales and distribution team and started to sell its products directly to the customers. 4. Company A submitted that the target company could meet the profit requirement for new listing applicants under Rule 8.05(1) and the acquisition should be treated as an extreme transaction.

Case number / Listing Rule reference	Background and Decision
	Decision 5. The Exchange considered that the proposed acquisition would constitute a reverse takeover because: • Company A's existing business had a small scale of operations and the target company was significantly larger than Company A. • The proposed acquisition would result in a fundamental change in Company A's business. • Although Company A submitted that the target company would meet the profit requirement under Rule 8.05, the Exchange was concerned that the target company's historical financial information were not representative of its future performance due to the significant changes in its business model, including the type of coal sold and the sales and distribution arrangements. As these changes only took place recently, the target company's trading record could not provide sufficient information to allow investors to make an informed assessment of the management's ability to manage the target company's business and the likely performance of that business in the future. The Exchange was concerned that the target company could not satisfy the new listing requirements under Paragraph 2 of Practice Note 3.

*Note * While these cases happened before the amendments of the RTO Rules in October 2019, such amendments would not change the analysis and conclusion in these cases.*

Important note:
This letter does not override the Listing Rules and is not a substitute for advice from qualified professional advisers. If there is any conflict or inconsistency between this letter and the Listing Rules, the Listing Rules prevail. You may consult the Listing Division on a confidential basis for an interpretation of the Listing Rules, or this letter.