

HKE_x LISTING DECISION

HKE_x-LD57-2013 (Published in April 2013) (Updated in October 2019 (amendments to the reverse takeover Rules) and January 2022 (amendments to the minimum profit requirement Rules) **and withdrawn in January 2024**)

[Streamlined and incorporated into the guidance letter GL104-19 (Guidance on application of the reverse takeover Rules).]

Parties	Company A – a Main Board issuer Target – a company which Company A proposed to acquire
Issue	Whether Company A’s proposed acquisition of an interest in the Target was a reverse takeover
Listing Rules	Main Board Rule 8.05(1), 14.06B and 14.54
Decision	The acquisition was a reverse takeover

FACTS

1. Company A proposed to acquire some shares in the Target (the **Target Shares**) representing 50% of the Target’s issued share capital. Upon completion, the Target Shares 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 convertible bonds to the vendor. The consideration shares and the conversion shares would in aggregate represent over 1.8 times Company A’s existing issued share capital. However, the terms of the convertible bonds did not allow any conversion which would trigger a mandatory general offer under the Takeovers Code.
3. The Target’s principal business was principally engaged in the manufacturing and trading of sanitary ware products, which was different from Company A’s principal businesses. Company A submitted that the Target could meet the profit requirement for new listing applicants under Rule 8.05(1).
4. The acquisition would be a very substantial acquisition based on the size tests. With an asset ratio of about 40 times and a revenue ratio of about 11 times, the Target was significantly larger than Company A.
5. There was an issue whether the acquisition would be treated as a reverse takeover under Rule 14.06(6).

APPLICABLE LISTING RULES

6. Rule 8.05(1) states that:

“To meet the profit test, a new applicant must have an adequate trading record under substantially the same management and ownership. This means that the issuer, or its group (excluding any associated companies and other entities whose results are recorded in the issuer’s financial statements using the equity method of accounting), as the case may be, must satisfy each of the following:

- (a) *A trading record of not less than three financial years (see rule 4.04) during which the profit attributable to shareholders must, in respect of the most recent year, be not less than HK\$20,000,000 and in respect of the two preceding years, be in aggregate not less than HK\$30,000,000. ...”*

(Rule 8.05(1)(a) was amended on 1 January 2022. See Note 2 below.)

7. Rule 14.06(6) defines a “reverse takeover” as:

“an acquisition or a series of acquisitions of assets by an issuer which, in the opinion of the Exchange, constitutes, or is part of a transaction or arrangement or series of transactions or arrangements which constitute, an attempt to achieve a listing of the assets to be acquired and a means to circumvent the requirements for new applicants set out in Chapter 8 of the Exchange Listing Rules. A “reverse takeover” normally refers to:

- (a) *an acquisition or a series of acquisitions (aggregated under rules 14.22 and 14.23) of assets constituting a very substantial acquisition where there is or which will result in a change in control (as defined in the Takeovers Code) of the listed issuer (other than at the level of its subsidiaries); or*
- (b) *acquisition(s) of assets from a person or a group of persons or any of his/their associates pursuant to an agreement, arrangement or understanding entered into by the listed issuer within 24 months of such person or group of persons gaining control (as defined in the Takeovers Code) of the listed issuer (other than at the level of its subsidiaries), where such gaining of control had not been regarded as a reverse takeover, which individually or together constitute(s) a very substantial acquisition.”*

8. Rule 14.54 states that:

“The Exchange will treat a listed issuer proposing a reverse takeover as if it were a new listing applicant. The enlarged group or the assets to be acquired must be able to meet the requirements of Rule 8.05 and the enlarged group must be able to meet all the other basic conditions set out in Chapter 8 of the Exchange Listing Rules. ...”

(Rule 14.06(6) (now Rule 14.06B) and Rule 14.54 were amended on 1 October 2019. See Note 1 below.)

ANALYSIS

9. Rule 14.06(6) seeks to prevent circumvention of the new listing requirements. Its introductory paragraph defines “reverse takeover” as an acquisition or a series of acquisitions which represents, in the Exchange’s opinion, an attempt to list the assets to be acquired and circumvent the new listing requirements. Rules 14.06(6)(a) and (b) provide bright line tests which apply two specific forms of reverse takeovers. They are not meant to be exhaustive. Therefore, transactions which are in substance backdoor listings but fall outside sub-rules (a) and (b) could still be treated as reverse takeovers. This, in practice, has been applied only to extreme cases (see the Listing Committee Annual Report 2009).
10. Here Rules 14.06(6)(a) and (b) did not apply because (i) the acquisition would not trigger the change in control test under sub-rule (a); and (ii) the vendor did not gain control of Company A within 24 months before the acquisition would be completed.
11. When determining whether the acquisition should be classified as a reverse takeover under Rule 14.06(6), the Exchange noted that:
 - The acquisition would be a very substantial acquisition and, in terms of size, would be significant to Company A. Upon completion, Company A’s existing businesses and assets would be relatively immaterial to the enlarged group. The acquisition was a means to achieve the listing of the Target Shares.
 - Neither the assets to be acquired nor the enlarged group would be able to meet Rule 8.05:
 - It was Company A’s view that the Target could meet Rule 8.05(1). However, as Company A would account for the Target Shares as an interest in an associated company or an investment, the Exchange considered that the Target’s trading record should be excluded for the purpose of Rule 8.05(1).
 - Company A had recorded losses in recent years. The enlarged group (excluding the Target Shares) could not meet Rule 8.05.

CONCLUSION

12. The Exchange considered that the acquisition was a transaction intended to list the Target Shares and circumvent the new listing requirements. It was an extreme case and should be classified as a reverse takeover under Rule 14.06(6).

Notes

1. *The reverse takeover Rules were amended on 1 October 2019. Under the new Rule 14.06B (which incorporates former Rule 14.06(6) with certain modifications):*

- *A “reverse takeover” is defined as an acquisition or series of acquisitions 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 constitutes, an attempt to achieve a listing of the acquisition targets and a means to circumvent the requirements for new applicants as set out in Chapter 8 of the Listing Rules.*
- *Note 1 to Rule 14.06B sets out the factors that the Exchange will normally consider in assessing whether the acquisition or series of acquisitions is a reverse takeover, including:*
 - 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 the 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.*
- *Note 2 to Rule 14.06B contains two specific forms of reverse takeovers involving a change in control (as defined in the Takeovers Code) of the listed issuer (other than at the level of the subsidiaries) 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 from, the change in control.*

Rule 14.54 (as amended) requires that in the case of a reverse takeover, the acquisition targets must meet the requirements of Rule 8.04 and Rule 8.05 (or Rule 8.05A or 8.05B), and the enlarged group must meet all the new listing requirements in Chapter 8 of the Rules except Rule 8.05. Where the reverse takeover is proposed by an issuer that does not meet Rule 13.24, the acquisition targets must also meet the requirement of Rule 8.07.

2. *The financial requirement under Rule 8.05(1)(a) has been amended with effect from 1 January 2022. Under the revised Rule 8.05(1)(a), a new applicant must have an adequate trading record of not less than three financial years during which the profit attributable to shareholders must, in respect of the most recent year, be not less than HK\$35 million and, in respect of the two preceding years, be in aggregate not less than HK\$45 million. The profit mentioned above should exclude any income or loss of the issuer, or its group, generated by activities outside the ordinary and usual course of its business.*

- 3 *The Rule amendments would not change the analysis and conclusion in this case, but an assessment of whether the enlarged group could meet Rule 8.05 would not be required.*