

HKEx LISTING DECISION

HKEx-LD95-3 (July 2010) (updated in October 2019 (amendments to the reverse takeover Rules) and withdrawn in January 2024)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 The Target – a company acquired by Company A from the Vendor The Vendor – the vendor of the Target
Issue	Whether the Exchange would consent to Company A’s proposed change in the terms of its convertible notes issued to the Vendor
Listing Rules	Main Board Rules 14.06B, 28.05
Decision	The Exchange did not consent to the proposed change

FACTS

Background

- 1 About a year ago, Company A acquired the Target from the Vendor (the **Acquisition**). The Target’s principal business was different from that of Company A before the Acquisition. The Acquisition was a very substantial acquisition.
- 2 The consideration was paid in (i) cash, (ii) convertible notes and (iii) consideration shares.
- 3 The convertible notes were redeemable only upon maturity three years after issue. Their terms did not allow any conversion which would trigger a mandatory general offer under the Takeovers Code (the **Conversion Restriction**). The consideration shares and the new shares fully converted from the convertible notes would have represented 60% of Company A’s enlarged issued share capital.

The proposed open offer and related arrangements

- 4 Company A proposed an open offer, fully underwritten by the Vendor, to raise funds for its business operations. The subscription price represented about a 2% discount to the prevailing market price of Company A’s shares and a 6% premium to their net asset value. 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%.

- 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.

APPLICABLE LISTING RULES

- 6 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.".

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

- 7 Rule 28.05 states that:

any alterations in the terms of convertible debt securities after issue must be approved by the Exchange, except where the alterations take effect automatically under the existing terms of such convertible debt securities.

ANALYSIS

- 8 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 (i) list the assets to be acquired and (ii) circumvent the new listing requirements. Rules 14.06(6)(a) and (b) provide bright line tests which apply to two specific forms of reverse takeover. 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).
- 9 In this case, the Acquisition adopted a convertible note structure with a restriction on conversion so that the change in control test under Rule 14.06(6)(a) was not triggered. But for the Conversion Restriction, the Acquisition would have resulted in the Vendor taking control of Company A and constituted a reverse takeover under the rule.
- 10 At the time of the Acquisition, the Exchange did not exercise its discretion to classify the transaction as a reverse takeover under 14.06(6) given the structure and terms of the Acquisition.
- 11 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 reverse takeover Rule because:
 - a. The proposed change was to facilitate the offsetting arrangement which, together with the open offer, would allow Company A to repay the convertible notes by issuing new shares to the Vendor and result 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 under Rule 14.06(6)(a).
 - b. Company A had no other reason to immediately redeem the convertible notes which would mature in two years.
- 12 In response to the Exchange’s concern, Company A and the Vendor agreed to revise the open offer structure as follows:
 - a. They agreed not to change the terms of the convertible notes.
 - b. The Vendor would only underwrite offer shares that would not trigger a mandatory general offer and pay for the offer shares underwritten by it in cash.

- c. Another underwriter would underwrite the offer shares not underwritten by the Vendor.
- 13 Under the revised structure of the open offer, there would be no change in the terms of the convertible notes and the Vendor would not be in a position to take control (as defined under the Takeovers Code) of Company A.

CONCLUSION

- 14 The Exchange did not consent to the proposed change in the terms of the convertible notes. It allowed Company A to proceed with the open offer under the revised structure.

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