

HKEX LISTING DECISION

HKEX-LD113-2017 (published in October 2017) (updated in October 2019 (amendments to the reverse takeover Rules) and withdrawn in January 2024)

[This listing decision is withdrawn.]

Parties	Company A – a Main Board issuer Company B – the former controlling shareholder of Company A Mr. X – the owner of Company B and a former director of Company A
Issue	Whether the Exchange would impose additional requirements under Rule 2.04 on Company A's proposed disposal of its original business
Listing Rules	Main Board Rules 2.04, 14.06B and 14.54
Decision	Company A terminated the proposed disposal after being informed of the Exchange's intention to treat it as if it were a new listing applicant under Rule 2.04 should it proceed with the proposed disposal

FACTS

1. Company A listed its original business (**Original Business**) four years ago. According to its IPO prospectus, it planned to expand and use the IPO proceeds for the Original Business only.
2. At the time of its initial listing, Company A was owned as to 75% by Company B which was owned by Mr. X. Mr. X was the founder, the chairman and an executive director of Company A, and had some 20 years of experience in the Original Business.
3. Within two years after Company A's initial listing,
 - (a) Company B disposed of almost all of its equity interest in Company A.
 - (b) All the directors of Company A at the time of its initial listing (including Mr. X) resigned.
 - (c) New directors with experience in a business which was fundamentally different from and unrelated to the Original Business (**New Business**) were appointed. None had experience in the Original Business.

- (d) Company A started acquiring companies engaging in the New Business (**Acquisitions**). These companies had not generated revenue and had been loss making before the Acquisitions. One of the Acquisitions resulted in the vendor in question becoming Company A's single largest shareholder holding a 28% interest. In between these Acquisitions, Company A disposed of its 49% interest in the subsidiary operating the Original Business to Mr. X's private company (**49% Disposal**).

Proposed transaction

4. Company A proposed to dispose of its remaining 51% interest in the subsidiary operating the Original Business to Mr. X's private company (**Proposed Disposal**). This disposal was a major transaction. After completion, Company A's operations and revenue would be derived solely from the New Business.
5. The Exchange questioned whether the Proposed Disposal, together with the Acquisitions and the 49% Disposal, formed part of a series of transactions to achieve the listing of the New Business and a means to circumvent the new listing requirements under Chapter 8 of the Rules and the reverse takeover rule under Rule 14.06(6).
6. In response, Company A explained that there was a commercial reason for this proposal, with the Original Business facing keen competition and starting to record losses.

APPLICABLE LISTING RULES AND GUIDANCE MATERIALS

7. Rule 2.04 states that -

"... the Exchange Listing Rules are not exhaustive and that the Exchange may impose additional requirements or make listing subject to special conditions whenever it considers it appropriate..."

8. Rule 14.06(6) defines "reverse takeover" as *"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 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."* This is a principle based test.

9. 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..."

10. The Exchange Guidance Letter (GL78-14) on reverse takeovers (**RTO**) explains that Rule 14.06(6) is an anti-avoidance provision designed to prevent circumvention of the new listing requirements. Paragraphs 7 to 9 of the guidance letter states that:

“7. If a transaction falls outside the bright line tests, the Exchange will apply the principle based test to assess whether the acquisition constitutes an attempt to achieve a listing of the assets to be acquired and a means to circumvent the requirements for new listing. The transaction would be treated as a RTO under the principle based test if the Exchange considers it is an “extreme” case taking into account the following criteria:

- the size of transaction relative to the size of the issuer;*
- the quality of the business to be acquired – whether it can meet the trading record requirements for listings, or whether it is unsuitable for listing (e.g. an early stage exploration company);*
- the nature and scale of the issuer’s business before the acquisition (e.g. whether it is a listed shell);*
- any fundamental change in the issuer’s principal business (e.g. the existing business would be discontinued or very immaterial to the enlarged group’s operations after the acquisition);*
- other events and transactions (historical, proposed or intended) which, together with the acquisition, form a series of arrangements to circumvent the RTO Rules (e.g. a disposal of the issuer’s original business simultaneously with a very substantial acquisition); and*
- any issue of Restricted Convertible Securities¹ to the vendor which would provide it with de facto control of the issuer.*

*8. A transaction would be treated as an extreme very substantial acquisition (**extreme VSA**) where the Exchange considers it “extreme” by reference to the criteria set out in paragraph 7, but the assets to be acquired can meet the minimum profit requirement under Rule 8.05 (the positive cash flow requirement under GEM Rule 11.12A) and circumvention of new listing requirements would not be a material concern. Extreme VSAs are presented to the Listing Committee for its decision.*

9. Where the Committee resolves that the RTO Rules will apply, the issuer will be treated as if it were a new listing applicant and will be subject to all applicable listing requirements for new applicants (see paragraph 4). Where the Committee resolves that the RTO Rules will not apply to an extreme VSA, the issuer will be required to prepare a transaction circular under an enhanced disclosure and vetting approach, and to appoint a financial adviser to conduct due diligence on the acquisition. ...”

¹ **Restricted Convertible Securities** are highly dilutive convertible securities with a conversion restriction mechanism (e.g. restriction from conversion that would cause the securities holder to hold 30% interest or higher) avoid triggering a change of control under the Code on Takeovers and Mergers.

(The reverse takeover Rules were amended on 1 October 2019. See Note 1 below.)

ANALYSIS

11. In this case, within two years after its initial listing, Company A underwent a complete change in control and management and started undertaking a series of transactions (including the Proposed Disposal) leading to a fundamental change in its business, from the Original Business to the New Business. This gave rise to the Exchange's concern on the cause(s) of these actions and their rationale which was fundamentally different from the disclosures in the IPO prospectus about Company A's business plan and developments.
12. The Exchange applied the principle-based test to assess whether the Proposed Disposal, together with the previous transactions, would constitute a RTO. When applying the principle-based test, the Exchange would consider all the criteria set out in Guidance Letter 78-14 to assess whether a transaction or a series of transactions would constitute an attempt to achieve a listing of the assets acquired or to be acquired and a means to circumvent the Exchange's new listing requirements.
13. In its assessment, the Exchange noted that:
 - a. The Original Business was Company A's main business before the Acquisitions. Had Company A disposed of the Original Business before the Acquisitions, it would have been a listed shell at the time of the Acquisitions.
 - b. Company A would cease to operate the Original Business after the Proposed Disposal. The Proposed Disposal, together with the Acquisitions, would effect a complete change in Company A's principal business to the New Business, which was fundamentally different from and unrelated to the Original Business.
 - c. The New Business, before the Acquisitions taking place, had not generated revenue and had been loss making. It would not have met the initial listing requirements had it become the subject of a new listing application.
14. Based on the above, had Company A fully disposed of the Original Business before conducting the Acquisitions, the Acquisitions would have been an extreme case and treated as a RTO under Rule 14.06(6). In such event Company A would have been treated as if it were a new listing applicant and hence required to meet all the initial listing requirements of Chapter 8 of the Rules.

15. In light of the course of events described in paragraph 11, the Exchange considered that the Proposed Disposal, together with the Acquisitions and the 49% Disposal, was a blatant attempt to achieve the listing of the New Business and circumvent the new listing requirements. This was the same concern as set out in Rule 14.06(6) (which applies to acquisition(s) and not a disposal), that is, an attempt to achieve the listing of assets to be acquired and circumvention of the new listing requirements.
16. Company A submitted that the Proposed Disposal was carried out for commercial reasons. However, the Exchange did not consider this sufficient to address its concern.

CONCLUSION

17. Therefore, the Exchange considered it appropriate, and informed Company A of its intention, to exercise the right to impose additional conditions on the Proposed Disposal under Rule 2.04, by treating Company A as if it were a new listing applicant and requiring it to comply with the additional requirements for a RTO.
18. Before the Exchange making a decision, Company A announced its termination of the Proposed Disposal.

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.*
 - *The Exchange also added a new Rule 14.04(2A) to clarify that a reverse takeover may involve a series of acquisitions some or all of which may have been completed. Accordingly, Rule 14.06B may apply in circumstances where an issuer proposes to dispose of its existing business after the completion of an acquisition of a new business.*
2. *The Rule amendments would not change the analysis in this case, except that the Exchange would apply Rule 14.06B to treat the Acquisitions as a reverse takeover should Company A proceed with the Proposed Disposal.*