HKEX LISTING DECISION
HKEX-LD122-2019 (published in July 2019) (updated in October 2019 (amendments to the reverse takeover Rules) and withdrawn in January 2024)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 Mr. X – the former controlling shareholder of Company A Mr. Y – the existing controlling shareholder of Company A
Issue	Whether the Exchange would impose additional requirements under Rule 2.04 on Company A's proposed termination of a lease agreement relating to its original entertainment business
Listing Rules	Main Board Rules 2.04, 14.06B and 14.54
Decision	The Exchange informed Company A that should it proceed with the proposal, the Exchange would treat it as if it were a new listing applicant under Rule 2.04

FACTS

Background

1. At the time of its initial listing, Company A was principally engaged in the business of operating entertainment venues at separate locations under different brand names (the **Original Business**). Mr. X was the founder, the chairman and an executive director of Company A.

2. Shortly after the 12 month lock-up period, Mr. X disposed of his 70% equity interest in Company A to Mr. Y, which triggered a general offer for all the remaining shares in Company A under the Takeovers Code.

3. Upon close of the offer, all the directors of Company A at the time of its initial listing resigned. The new directors (including Mr. Y) appointed to the board of Company A 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.

The Acquisition

4. About two years after the offer, Company A acquired from Mr. Y a target company (the **Acquisition**) engaged in property management business (the **New Business**). The Acquisition was a major and connected transaction. Property management would become one of the principal activities of Company A upon completion of the Acquisition.

5. 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.

The Proposal

6. 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.

7. 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.

APPLICABLE LISTING RULES AND GUIDANCE MATERIALS

8. 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…".

9. Rule 14.06(6) defines a "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.

10. 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.)

11. The Exchange Guidance Letter (GL68-13A) provides guidance on the suitability for listing of new applicants to help prevent shell creation through IPO. The Guidance Letter states that:

"…

1.1 The Exchange notes that there have been a number of listed issuers where their controlling shareholders either changed or have gradually sold down their interests shortly after the regulatory lock-up period following listing. One explanation for this phenomenon is the perceived premium attached to the listing status of such issuers rather than the development of the underlying business or assets.

1.2 The Exchange believes that such companies (often referred to as "shell companies") will invite speculative trading activities when identified by potential buyers. This can lead to opportunities for market manipulation, insider trading and unnecessary volatility in the market post-listing, none of which is in the interest of the investing public. Furthermore, activities by such companies may be structured so that they are not subject to regulatory scrutiny under Rules 14.06B to 14.06E, our Guidance Letters HKEX-GL104-19 on reverse takeovers, and HKEX-GL105-19 on large scale issuers of securities.

…

4.4 Once listed, an issuer must ensure that it and its business continues to be suitable for listing. Failing to meet this requirement may lead to the Exchange canceling the issuer's listing under Main Board Rule 6.01(4) … The Exchange closely monitors the developments of listed issuers. It may have a concern about the suitability of an issuer or its business for continued listing if, for example, the issuer's activities are found to deviate significantly from its original business model or strategy or the commercial rationale for its listing set out in its listing application."

(Guidance Letter GL68-13A was updated to make reference to the reverse takeover Rules (as amended) and the new guidance letters on reverse takeovers and large scale issues of securities, which became effective on 1 October 2019. See Note 1 below.)

12. The Exchange Guidance Letter (GL96-18) on a listed issuer's suitability for continued listing cited examples of circumstances where the Exchange may raise concerns about the suitability for continued listing of a listed issuer or its business:

"…

9. In Guidance Letter GL68-13A, the Exchange noted a number of newly listed issuers whose controlling shareholders either changed or gradually sold down their interests shortly after the regulatory lock-up period following listing. It questioned whether these issuers' listing applications were driven by the perceived premium attached to the listing status rather than the development of their underlying business or assets. These issuers, when identified by potential buyers, would invite speculative trading and create opportunities for market misconduct (e.g. market manipulation or insider trading) and unnecessary volatility in the market post listing…"

ANALYSIS

13. The Exchange considered that the Proposal, together with the Acquisition, would be an attempt to circumvent the new listing requirements having regard to the following:

    (a) 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.

    (b) 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.

14. Company A submitted that the Proposal was initiated by the landlord and was carried out for commercial reasons. However, the Exchange did not consider this sufficient to address the concerns.

CONCLUSION

15. The Exchange considered it appropriate, and informed Company A of its intention, 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.

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.*

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