

HKE_x LISTING DECISION

Cite as HKE_x-LD62-1 (November 2008) (updated in October 2019 (Rule amendments))

Summary	
Name of Party	The Parent - a Main Board listed company The Subsidiary – a non wholly-owned subsidiary of the Parent
Subject	Whether the Exchange would disregard the calculation of consideration ratio in respect of the Capital Contribution as requested by the Parent and accept the alternative size test submitted by the Parent under Main Board Listing Rule 14.20
Listing Rules	Main Board Listing Rule 14.20
Decision	The Exchange decided to disregard the calculation of the consideration ratio in respect of the Capital Contribution as requested by the Parent and accept the alternative size test submitted by the Parent under Main Board Listing Rule 14.20.

SUMMARY OF FACTS

1. The Parent owned a 89.5% equity interest in the Subsidiary, and consolidated the results of the Subsidiary in its accounts.
2. The Parent proposed an increase in the Subsidiary's registered capital from RMB480 million to RMB1,350 million and for such purpose, the Parent would contribute RMB800 million to the registered capital of the Subsidiary (the "**Capital Contribution**"). The remaining balance would be contributed by one of the minority shareholders of the Subsidiary.
3. As a result of the proposed Capital Contribution, the Parent's equity interest in the Subsidiary would increase by approximately 1.6%, from 89.5% to 91.1%. The Subsidiary would remain a subsidiary of the Parent and its results would continue to be consolidated in the Parent's accounts.
4. For the purposes of classifying the Capital Contribution, the Parent calculated the assets, profits and revenue ratios, none of which exceeded 0.4%.
5. The Capital Contribution of RMB800 million was the value of consideration under Rule 14.15 used for the purpose of calculating the consideration ratio which was over 7%. Having regard to other percentage ratios, the Parent submitted that

the consideration ratio produced an anomalous result and requested the Exchange to disregard it under Rule 14.20.

6. The Parent submitted an alternative size test using, as the value of the consideration for the consideration ratio, the amount it contributed in excess of the contribution required to maintain its interest in the Subsidiary (i.e. RMB1,350 million x 1.6%). The result of the alternative size test was 0.2%.

THE ISSUE RAISED FOR CONSIDERATION

7. Whether the Exchange would disregard the calculation of consideration ratio in respect of the Capital Contribution as requested by the Parent and accept the alternative size test submitted by the Parent under Rule 14.20.

APPLICABLE LISTING RULE OR PRINCIPLE

8. Main Board Listing Rule 14.15(1) provides that when calculating the consideration ratio:

the value of the consideration shall be the fair value of the consideration determined at the date of the agreement of the transaction in accordance with applicable Hong Kong Financial Reporting Standards or International Financial Reporting Standards. Normally, the fair value of the consideration should be the same as the fair value of the asset which is the subject of the transaction. ...

9. Main Board Listing Rule 14.20 provides that:

the Exchange may, where any of the calculations of the percentage ratios produces an anomalous result or is inappropriate to the sphere of activity of the listed issuer, disregard the calculation and substitute other relevant indicators of size, including industry specific tests. The listed issuer must provide alternative tests which it considers appropriate to the Exchange for consideration.

10. Main Board Listing Rule 14.26 provides that:

in an acquisition or disposal of equity capital, the numerators for the purposes of the (a) assets ratio, (b) profits ratio and (c) revenue ratio are to be calculated by reference to the value of the total assets, the profits attributable to such capital and the revenue attributable to such capital respectively.

11. Main Board Listing Rule 14.28 provides that:

the value of the entity's total assets, profits and revenue, ... is to be multiplied by the percentage of the equity interest being acquired or disposed of by the listed issuer. However, 100% of the entity's total assets, profits and revenue will be taken as the value of the total assets, profits and revenue, irrespective of the size of the interest being acquired or disposed of, if:

- (1) the acquisition will result in consolidation of the assets of the entity in the accounts of the listed issuer; or
- (2) the disposal will result in the assets of the entity no longer being consolidated in the accounts of the listed issuer.

ANALYSIS

12. Rule 14.07 sets out five percentage ratios for assessing the impact of a transaction on the listed issuer. The percentage ratio calculation forms the basis for classifying the transaction which determines whether the transaction is subject to any disclosure, reporting and/or shareholders' approval requirements under Chapter 14.
13. In the present case, the proposed Capital Contribution would result in an increase in the Parent's equity interest in the Subsidiary by 1.6%. Pursuant to Rule 14.28, when calculating the assets ratio, profits ratio and revenue ratio, the numerators would be the values of the Subsidiary's total assets, profits and revenue (calculated in accordance with Rule 14.27) multiplied by the percentage of the equity interest being acquired by the Parent (i.e. 1.6%).
14. As to the consideration ratio, Rule 14.15 requires the use of the total consideration payable by the listed issuer as the numerator, which in this case, would be the amount of capital proposed to be contributed by the Parent (i.e. RMB800 million).
15. When considering the Parent's request to adopt the alternative size test in place of the consideration ratio under Rule 14.20, the Exchange accepted that the consideration ratio produced an anomalous result having regard to the following factors:
 - The consideration ratio was calculated based on the total amount of Capital Contribution which included not only the amount payable for the additional 1.6% equity interest in the Subsidiary but also the contribution required to maintain the Parent's interest in the Subsidiary. However, as the Subsidiary was consolidated in the accounts of the Parent, the amount to be contributed by the Parent for maintaining its interest in the Subsidiary would have no impact on the consolidated financial position of the Parent group.

- Unlike the consideration ratio, the other percentage ratios (i.e. the assets ratio, profits ratio and revenue ratio) measured the impact of the acquisition of 1.6% equity interest in the Subsidiary on the Parent and their results indicated that the impact of the transaction on the Parent was insignificant. The consideration ratio was substantially higher than the other percentage ratios.
16. In considering the appropriateness of the alternative size test submitted by the Parent, the Exchange noted that the test was calculated based on the value of the Capital Contribution which was in excess of the contribution required to maintain the Parent's interest in the Subsidiary. The alternative size test compared the consideration for acquiring the additional 1.6% equity interest in the Subsidiary and served to measure the impact of the acquisition on the Parent. This approach was in line with the principle for calculating the consideration ratio for a deemed disposal as a result of any issue of shares by a subsidiary of a listed issuer.

DECISION

17. The Exchange decided to disregard the calculation of the consideration ratio in respect of the Capital Contribution as requested by the Parent and accept the alternative size test submitted by the Parent under Rule 14.20.

Note: On 1 October 2019, Rule 14.20 was amended to clarify that if any calculation of the percentage ratio produces an anomalous results or is inappropriate to the sphere of activities of the issuer, the Exchange (or the issuer) may apply an alternative size test that it considers appropriate to assess the materiality of a transaction under Chapter 14.

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