

## HKEX LISTING DECISION

HKEX-LD94-2016 (published in March 2016) (updated in October 2019  
(amendments to the reverse takeover Rules))

<b>Party</b>	Company A – a Main Board issuer  The Fund – an investment fund
<b>Issue</b>	Whether Company A’s proposed subscription for an interest in the Fund would be a reverse takeover
<b>Listing Rules</b>	Main Board Rule <del>14.06(6)</del> <u>14.06B</u>
<b>Decision</b>	The proposed subscription was a reverse takeover

### FACTS

1. Company A was principally engaged in the businesses of property investment, fund management, and fund and securities investment. Its available-for-sale investments included a number of fund investments with a total value of about HK\$1.5 billion.
2. Company A proposed to subscribe for an interest as a limited partner in the Fund with commitments of about HK\$4.5 billion (which was about 80% of the size of the Fund). Company A would have no control over or right to participate in the management of the Fund and the investments to be made by the Fund. Its investment in the Fund would be accounted for as an available-for-sale investment in its financial statements.
3. The proposed subscription represented about 80% of the asset value and over 900% of the market capitalization of Company A. Company A intended to finance the subscription using a loan facility granted to it by its controlling shareholder and its internal resources.
4. The Fund was a newly established partnership. It did not have any investments, assets or liabilities, and had not recorded any income or expenses. Company A submitted that the Fund had a clear investment objective to invest in debt instruments of companies established to develop real estates in the PRC. Company A had considered the experience and track record of the directors of the Fund’s general partners and was confident in the prospects of the Fund. The proposed subscription would allow Company A to leverage on the Fund’s expertise, experience, relationship and resources to source and manage potential investments in the reviving PRC real estate market.

5. There was a question whether the proposed subscription would constitute a reverse takeover for Company A.

## **APPLICABLE LISTING RULES**

6. Rule 8.04 requires that both the issuer and its business “*must, in the opinion of the Exchange, be suitable for listing*”.
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...*”. This is a principle based test.
8. The Exchange Guidance Letter (GL78-14) on reverse takeovers (**RTOs**) explains that Rule 14.06(6) is an anti-avoidance provision designed to prevent circumvention of the new listing requirements. Paragraph 7 of the guidance letter states that:-

*“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 Securities<sup>1</sup> to the vendor which would provide it with de facto control of the issuer.”*

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

## **ANALYSIS**

9. While the proposed subscription fell outside the bright line tests, the Exchange applied the principle based test with reference to the criteria set out in Guidance Letter GL78-14 to assess whether, taking the criteria together, the acquisition would constitute an attempt to achieve a listing of the assets to be acquired and a means to circumvent the new listing requirements.
10. The Exchange considered that the proposed subscription in the Fund would be a reverse takeover under Rule 14.06(6) because:-
  - a. The subscription was of a significant size to Company A based on the asset ratio of 80% and the consideration ratio of 900%. Should Company A proceed with the subscription, the investment in the Fund would represent a significant part of Company A's assets.
  - b. The subscription was a means to circumvent the new listing requirements. The Fund was newly set up and did not have any investments or assets. It had no track record to meet the profit requirement under Rule 8.05.
  - c. Although Company A would invest a significant amount of money in the Fund, it would have no control over or right to participate in the management of the Fund or the investments to be made by the Fund. This raised a concern about suitability of listing.

## **CONCLUSION**

11. The subscription for an interest in the Fund constituted a reverse takeover for Company A under Rule 14.06(6).

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<sup>1</sup> **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.

## 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.

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