

HKEX LISTING DECISION

HKEX-LD96-2016 (published in March 2016) (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(amendments to the reverse takeover Rules) and withdrawn in January 2024)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).]

Party	Company A – a Main Board issuer Target – a company that Company A proposed to acquire from Company B Company B – the vendor of the Target
Issue	Whether Company A's proposed acquisition of the Target would be a reverse takeover
Listing Rules	Main Board Rule 14.06B
Decision	The acquisition was a reverse takeover

FACTS

1. Company A was principally engaged in trading of food and beverage products.
2. Company A proposed to acquire the Target from Company B. It would settle the consideration by issuing convertible bonds to Company B (with a conversion restriction that prevented Company B from holding a 30% interest or higher). Assuming full conversion of the convertible bonds, Company B would be holding over 50% of issued shares of Company A as enlarged by the conversion shares.
3. The Target was engaged in production and sale of certain types of organic fertilizers. It sold its products to end users through its own sale team and a number of distributors. It recorded profits of about HK\$15 million to HK\$20 million in the last three years.
4. Company B was the Target's sole supplier of a major raw material (**Material**) necessary for producing the Target's products. Company B produced the Material using a unique technology developed and owned by it (**Technology**).
5. The Target intended to produce the Material itself in the coming years. Company B would authorize the Target to use the Technology for producing the Material. It was expected that the Target could master the Technology and achieve full scale production of the Material within three years.

6. The revenue, consideration and equity ratios of the proposed transaction were between 110% and 150%. The asset ratio was about 90%.
7. Company A submitted that the Target was able to meet the minimum profit requirement under Rule 8.05 and the size of the acquisition was not extreme. It sought the Exchange's confirmation that the proposed acquisition would not constitute a reverse takeover.

APPLICABLE LISTING RULES

8. Rule 8.04 requires that both the issuer and its business "*must, in the opinion of the Exchange, be suitable for listing*".
9. 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.
10. The Exchange Guidance Letter (HKEX-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 Securities¹ 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

11. While the proposed acquisition 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.
12. The Exchange considered that the proposed acquisition would be a reverse takeover under Rule 14.06(6) because:-
 - a. The proposed acquisition was a means to circumvent the new listing requirements.
 - The Target was unsuitable for listing. It relied on Company B's supply of the Material which was critical to its business operations. There were no other suppliers or substitutes for the Material, and the Target did not have the Technology and expertise to produce the Material itself. Company A could not demonstrate that the Target was, or would upon completion of the proposed acquisition be, capable of carrying on its business independently from Company B.
 - The proposal involved Company A in acquiring part, and not the whole, of an integrated business from Company B. While the Target had planned to manufacture the Material itself, it was uncertain as to whether and when the Target would be

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.

able to do so, and the impact of any such change in business model on its financial results. The Target's track record could not reflect its performance under the new business model.

- b. As set out in the RTO guidance letter, the Exchange does not prescribe an absolute threshold in determining whether the size of a transaction is extreme. When assessing the impact of an acquisition on an issuer, the Exchange would take into account the nature and scale of the issuer's existing business after the acquisition, and whether the acquisition would result in a fundamental change in the issuer's business.
- In this case, Company A was loss making in recent years. It only operated a trading business that had a low level of activities and generated minimal gross profit. The Target's business would be significant to Company A after the acquisition.
 - The Target's business in manufacturing and sale of fertilizers was completely different from Company A's existing businesses. The acquisition would result in a fundamental change in Company A's principal business.
- c. The acquisition would be a means for Company B (who would acquire a de facto control of Company A using restricted convertible securities) to list the Target by injecting it into Company A.

CONCLUSION

13. The acquisition constituted a reverse takeover for Company A under Rule 14.06(6).

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.*