SLAUGHTER AND MAY

SUBMISSION BY SLAUGHTER AND MAY

REGARDING THE STOCK EXCHANGE OF HONG KONG LIMITED'S

CONSULTATION PAPER ON CAPITAL RAISINGS BY LISTED ISSUERS

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Consultation Questions

1. Do you agree with the proposal to disallow highly dilutive pre-emptive offers unless there are exceptional circumstances?

We support the concept of introducing a bright line test based on the dilutive effect of a pre-emptive offer or specific mandate placing to allow greater certainty on the feasibility of a proposed fund raising, whilst building in flexibility through giving the Exchange discretion to disapply the test in certain circumstances.

Highly dilutive offers may contravene the principle of fair and equal treatment of all shareholders, and the Exchange and the SFC may object to or raise enquiries on such offers. To date, there has been no prescribed threshold for an offer to be considered highly dilutive and/or detrimental to minority shareholders. We therefore support the introduction of a prescribed threshold, as it would give issuers greater transparency and certainty on how they should structure their capital raisings in a manner that is less likely to raise concerns with the Exchange and/or the SFC.

For our comments on certain aspects of the proposal please see below. A balance should be struck in allowing legitimate and good faith capital fundraising by listed companies in Hong Kong which is in the best interest of shareholders. Furthermore, the flexibility in which secondary fund raisings may be carried out on the Hong Kong Stock Exchage has contributed to its ability to attract listings in Hong Kong and its success as one of the leading stock markets in the world.

2. Do you agree with the proposed 25% threshold on value dilution? If not, what is the appropriate percentage threshold and the reasons for this threshold?

Although we would defer to the views of issuers and their financial advisers on whether the 25% threshold is appropriate to accommodate issuers' genuine capital raising needs, we note that (according to the consultation paper) 35% of pre-emptive offers (*i.e.*, rights issues and open offers) conducted during 2013-2016 would have exceeded the 25% threshold and would have been prohibited under the proposed rule amendments. . Looking only at 2016, the figure also stands at 35% of pre-emptive offers.

Given the proposed threshold captures over one-third of recent pre-emptive offers, we would submit the following comments for consideration by the Exchange:

1. we would like to understand further as to whether the proposed 25% threshold was based on previous pre-emptive offers that were considered unjustifiably detrimental to minority shareholders and lacking in commercial rationale;

2. the Exchange could consider introducing a less stringent dilution threshold for an initial period and monitor whether this threshold, combined with the additional safeguards that will be introduced to protect minority shareholders, are sufficient to address the concerns raised in the consultation paper. The level of threshold can be revised if appropriate after an initial period of monitoring; and

3. we would propose that more flexibility be given to the Exchange to permit exceptions in circumstances considered "justifiable" by the Exchange – rather than the proposed wording of "exceptional circumstances (for example…financial difficulty…)". Certain issuers will have genuine commercial reasons to conduct an offer above the proposed dilution threshold in circumstances that may not constitute financial distress. For example, capital raising for an acquisition that is itself compliant with Chapter 14 of the Listing Rules, especially where shareholders' approval therefor is required and has been obtained, should be considered to provide a good commercial rationale for the Exchange allowing an offer that would otherwise be prohibited as a highly dilutive pre-emptive offer. We therefore submit that a softer wording than "exceptional circumstances" may be more appropriate to allow the Exchange to take

into account the circumstances of each case (including by reference to commercial rationale being demonstrated), particularly in borderline cases that fall close to the threshold and which may be subject to safeguards such as compensatory arrangements and/or minority shareholder approval.

3. Do you agree that the proposed requirements should also apply to share issuance under a specific mandate?

We agree with the proposal in principle. Please see our response to Question 2 on the appropriate threshold.

4. Do you agree with the proposal to aggregate rights issues, open offers and specific mandate placings within a rolling 12-month period?

We agree with the proposal in principle. Please see our response to Question 2 on the appropriate threshold.

5. Do you agree with the proposed method of calculating cumulative value dilution? If not, what is the appropriate method?

While we do not object to the overall concept of how value dilution and cumulative value dilution are calculated, we have the following technical drafting queries:

1. we note the proposed rules calculate the value of the shares prior to the offer by reference to "the issuer's total market capitalization (as defined in rule 14.07(4)) immediately before the issue". On the other hand, the consultation paper (in Appendix III) contemplates that such value should be calculated by multiplying the number of issued shares before the offer with the "benchmarked price". It would appear the price is calculated slightly differently under the definitions of "total market capitalization" and "benchmarked price". We would welcome the Exchange's clarification on this aspect; and

2. where aggregation of a series of share issues is required, the proposed rule states the theoretical dilution effect should be calculated as if the issues were made "at the time of the first issue". For clarity, we would suggest amending this to "at the same time as the first issue". We would also request clarification on how to calculate the weighted average of the price discounts of the issues.

To assist the market with these technical and complex calculations, we would suggest an FAQ be issued alongside the revised Listing Rules, which sets out dummy calculations on theoretical dilution effect and cumulative theoretical dilution effect.

6. Do you agree with the proposal to extend the minority shareholder approval requirement to all open offers (unless the new securities are issued under the general mandate)?

We agree minority shareholder approval should be required on certain open offers outside the general mandate, but the Exchange could consider relaxing or dispensing with the requirement where the open offer in question is a pro-rata offer to all existing shareholders, has compensatory arrangements in place, is within the limits of the proposed dilution threshold and the existing 50% threshold (*i.e.*, does not increase issued shares or market capitalisation by more than 50%), and (assuming there is an underwriter) has an independent SFC-licensed underwriter. If the underwriter or sub-underwriter is a connected person, independent shareholder approval would be required under the revised rules in any event.

7. Do you agree with the proposal to remove the underwriting requirement for pre-emptive offers?

We agree with the proposal. The long underwriting period (hence prolonged risk exposure) has in the past made it unattractive for investment banks to take up underwriting for pre-emptive offers, which in turn makes this avenue of fund raising not easily available to issuers.

8. Do you agree with our proposal to require underwriters to be licensed persons independent from the issuers and their connected persons?

We agree issuers should be permitted to appoint independent SFC-licensed persons as underwriters.

9. In view of paragraphs 72 and 73 of the Consultation Paper:

   (a) do you agree that controlling shareholders should be allowed to act as underwriters?

We agree issuers should be given this option (subject to the additional safeguards proposed by the Exchange such as mandatory compensatory arrangements), as there may be a genuine commercial rationale for having a controlling shareholder act as an underwriter.

   (b) do you think that substantial (but not controlling) shareholders should be allowed to act as underwriters?

We agree issuers should be given this option (subject to the additional safeguards proposed by the Exchange), as there may be a genuine commercial rationale for appointing a substantial shareholder as an underwriter. We would in fact suggest giving issuers the flexibility to appoint other parties as an underwriter provided that, where the underwriter is not an independent SFC-licensed person, mandatory compensatory arrangements and connected transaction rules or shareholder approval (as applicable) apply. For example, there appears to be no real reason to distinguish between an underwriter who is a substantial shareholder and one who is a 9% shareholder.

10. Do you agree with compensatory arrangements should be mandatory when pre-emptive offers are underwritten by connected persons?

We agree with the proposal. In addition, we would like to seek clarification on whether it is also the intention to require compensatory arrangements where a sub-underwriter is a connected person.

11. Do you agree with the proposal to remove the connected transaction exemption for underwriting (including sub-underwriting) of pre-emptive offers by connected persons?

We agree with the proposal where the pre-emptive offers are highly dilutive. This is because in non-highly dilutive pre-emptive offers, there is less concern that the connected persons are taking advantage through the value transfer. Otherwise, a non-highly dilutive pre-emptive offer that would not otherwise require shareholders' approval would now require shareholders' approval only because a connected person has agreed to act as underwriter to assist the issuer in its fund raising exercise. This would be unduly burdensome for the issuer.

12. Do you agree with the proposal to make it mandatory for issuers to adopt either the excess application arrangement or the compensatory arrangement in rights issues and open offers?

We agree with the proposal.

13. Do you agree with the proposal to limit the excess applications by a controlling shareholder and his/her/its associates to a maximum number equivalent to the offer shares minus their pro rata entitlements?

We agree with the proposal.

14. Do you agree with our proposal to disallow the use of general mandate for placing of warrants and options for cash consideration?

We would suggest that the Exchange give more detailed guidance on the meaning of and process of determining “fair value” under Listing Decision LD90-2015 in order to allow issuers the option of using the general mandate for warrants issued at fair value.

15. Do you agree with the proposal to disallow any price discount of the initial conversion price of convertible securities to be placed under general mandate?

We agree with the proposal. The reference to “benchmark price” in draft Rule 17.42C(2) should be amended to “benchmarked price”.

16. Do you agree with the proposal to require disclosure of the use of proceeds from all equity fundraisings in interim and annual reports?

We agree with the proposal.

17. Do you agree with the proposal to impose a minimum price requirement on subdivision or bonus issue of shares?

We agree with the proposal. We note the proposed rule states the share price (as adjusted for the subdivision or bonus issue) must not be less than the prescribed minimum price based on the daily closing price of the shares during the 6-month period before the relevant announcement – we would like to seek clarification on whether this entails calculating adjusted share prices for each daily closing price for the last 6 months to see if any of them fall below the prescribed minimum (rather than an adjusted share price based on the average closing price for the last 6 months).

18. Do you agree with the proposed minimum adjusted price of HK$1? If not, what is the threshold you consider appropriate: (a) HK$0.5; or (b) other?

☐ HK$1

☑ HK$0.5

☐ Other (Please specify the appropriate threshold)

If your answer is "Other", please give reasons for your views.

19. Do you support a demonstration period of six months? If not, please specify the period you consider appropriate.

We agree with the proposal.

If the Exchange has any queries regarding this submission, please feel free to contact Benita Yu [redacted], John Moore [redacted] or Lydia Kungsen [redacted].

24 November 2017