

HKEX LISTING DECISION

HKEX-LD26-2012 (Published in February 2012) (Updated in April 2015 and July 2018)

Parties	Company A – a Main Board issuer Parent Company – a state-owned enterprise, and Company A’s controlling shareholder
Issue	Whether Company A could seek a prior mandate from its shareholders for conducting a rights issue under Rules 7.19A(1) and 7.27A
Listing Rules	Main Board Rules 7.19A(1) and 7.27A
Decision	The Exchange allowed Company A to proceed with the proposal after revising the mandate period

FACTS

1. Company A signed an agreement to acquire a target from the Parent Company for cash consideration. It was a very substantial and connected acquisition subject to independent shareholders’ approval.
2. Company A would conduct a rights issue to finance the acquisition and the target’s business. It had not yet entered into any underwriting agreement(s) for the rights issue, but it expected that the right issue would increase its share capital by more than 50% and therefore require independent shareholders’ approval under Rules 7.19A(1) and 7.27A. The Parent Company intended to take up its entitlement to the rights shares.
3. As the Parent Company was a state-owned enterprise, the acquisition and the Parent Company’s subscription of the rights shares were subject to the approval of Mainland regulatory authorities. Based on the legal advice, Company A should have obtained shareholders’ approval for the rights issue before the parties could make formal applications to the Mainland regulatory authorities.
4. Company A submitted that it would be difficult to secure an underwriter and agree the terms of the rights issue before the general meeting given the uncertainty as to the additional time required to obtain the regulatory approval and the then market conditions. It enquired whether it could seek a mandate for the rights issue from the independent shareholders at the same general meeting to consider the acquisition. The rights issue would be made under the following framework:

- The rights issue would be fully underwritten by independent licensed firm(s).
 - The number of rights shares and the issue price would be determined by the directors in consultation with the underwriter(s), taking into account the market conditions and the share trading price at the relevant time. In any event,
 - the basis of the rights issue would be up to one rights share for every existing share held; and
 - the amount to be raised would fall within a range specified in the circular.
 - The net proceeds would be used to settle the cash consideration for the acquisition. Any remaining balance would be assigned to finance the target's operations.
 - There would be arrangement for shareholders to apply for excess rights shares.
5. The mandate was intended to last 12 months from the date it was approved by the independent shareholders, which would be in line with the long-stop date of the acquisition agreement.

APPLICABLE LISTING RULES

6. Rule 7.19A(1) states that

“A proposed rights issue must be made conditional on minority shareholders’ approval in the manner set out in rule 7.27A if the proposed rights issue would increase either the number of issued shares or the market capitalization of the issuer by more than 50% (on its own or when aggregated with any other rights issue or open offers announced by the issuer ...):-

...”

7. Rule 7.27A states that

“Where minority shareholders’ approval is required for a rights issue ... under Rule 7.19A ...:

- (1) the rights issue ... must be conditional on approval by shareholders in general meeting by a resolution on which any controlling shareholders and their associates or ... shall abstain from voting in favour;

- (2) ...
- (3) the issuer must set out in the circular to shareholders:
 - (a) the purpose of the proposed rights issue ..., together with the total funds expected to be raised and a detailed breakdown and description of the proposed use of proceeds. ...; and
 - (b) ...”

ANALYSIS

- 8. The purpose of Rule 7.19A(1) is to protect minority shareholders’ interests when the potential dilution effect of a proposed rights issue (individually or together with any similar fund raising exercise(s) made in the previous 12 months) is material. In seeking the shareholders’ approval, the issuer must provide sufficient information to enable shareholders to make an informed assessment of the rights issue, which normally include the number of rights shares and the issue price, and the principal terms of the underwriting agreement.
- 9. In this case, when considering whether to accept a prior mandate in lieu of a shareholders’ approval on the terms of the rights issue, the Exchange noted that the rights issue was made with a specific purpose, i.e. to finance the acquisition and the target’s business. Company A had taken reasonable steps to provide sufficient information about the rights issue to the independent shareholders to decide how to vote, including the purpose of the rights issue, its maximum dilution effect on shareholding, the amount to be raised, and details of the intended use of proceeds. The circular would also contain an independent financial adviser’s opinion on the proposed right issue and its recommendation to the independent shareholders on how to vote.
- 10. However, the Exchange considered the proposed mandate period of 12 months was too long and unjustified. If the rights issue did not materialize within a reasonable period, independent shareholders should be given the opportunity to reconsider the proposal taking into account the company’s circumstances and the market conditions at that time.

CONCLUSION

- 11. To address the Exchange’s concern, Company A shortened the mandate period to 4 months having regard to the estimated timetable for obtaining the necessary

regulatory approval for the acquisition, and the forthcoming long holidays in the Mainland.