

**HKE<sub>x</sub> LISTING DECISION**  
**HKE<sub>x</sub>-LD90-2015 (published in May 2015)**

<b>Party</b>	Company A – a Main Board issuer
<b>Issue</b>	Whether Company A was allowed to use the general mandate for placing of warrants to third party investors
<b>Listing Rules</b>	Main Board Rules 13.36 and 15.02
<b>Decision</b>	The Exchange required Company A to seek shareholder’s approval in general meeting for the placing of warrants

**FACTS**

1. Company A signed an agreement for a placing of warrants to certain places who were not connected persons. It disclosed that the purpose of the placing was to raise additional funds for its business operations.
2. The warrants would be issued at the price of HK\$0.01 each. The warrant holders would have the right to subscribe new shares in Company A at the exercise price during a period of 2 years.
3. The exercise price represented a premium of about 10% to the closing price of Company A’s shares on the date of the placing agreement. It was higher than the benchmark price set out in the Rules for a placing of securities under general mandate.
4. There was an issue whether Company A would be allowed to issue the warrants under the general mandate.

**APPLICABLE LISTING RULES**

5. Rule 13.36 states that:

*“(1) (a) Except in the circumstances mentioned in rule 13.36(2), the directors of the issuer ... shall obtain the consent of shareholders in general meeting prior to allotting, issuing or granting: -*

*(i) shares;*

*(ii) ...*

*(iii) options, warrants or similar rights to subscribe for any shares or such convertible securities.*

...

(2) *No such consent as is referred to rule 13.36(1)(a) shall be required: -*

(a) ...

(b) *if, but only to the extent that, the existing shareholders of the issuer have by ordinary resolution in general meeting given a general mandate to the directors of the issuer, ... to allot or issue such securities ..., subject to a restriction that the aggregate number of securities allotted or agreed to be allotted must not exceed the aggregate of 20% of the existing issued shares of the issuer ...*

...

(5) *In the case of a placing of securities for cash consideration, the issuer may not issue any securities pursuant to a general mandate given under rule 13.36(2)(b) if the relevant price represents a discount of 20% or more to the benchmark price of the securities, ...”*

6. Rule 15.02 states that

*“All warrants must, prior to the issue or grant thereof, be approved by the Exchange and in addition, where they are warrants to subscribe equity securities, by the shareholders in general meeting (unless they are issued by the directors under the authority of a general mandate granted to them by shareholders in accordance with rule 13.36(2)...”*

## **ANALYSIS**

7. Under the Rules, an issuer may seek a general mandate from its shareholders for issuing securities up to 20% of its shares in issue at the date of the shareholders' approval of the mandate. Where the general mandate is used for placing of securities, the securities cannot be issued at a discount of 20% (or more) to the market price of securities. These requirements are meant to allow issuers flexibility in fund raising and at the same time, afford protection to shareholders ensuring that securities are issued at values not substantially different from their fair value.
8. In the case of a placing of warrants, there is a time gap between the setting of the exercise price of the warrants and when (and if) the warrants are eventually exercised. Even though the exercise price is set at or above the benchmark price at the time the warrants are issued, it may be at a substantial discount to the market price at the time of exercise, causing a significant dilution of the shareholders' interests. The issuer must ensure that the warrants are properly priced to compensate its shareholders for the fair value of the warrants.

9. Given the nature of warrants and applying a purposive approach to interpreting the general mandate requirements, the Exchange considers that a placing of warrants may be conducted under general mandate only if the issuer can demonstrate that the warrants are issued at, or approximate, their fair value.
10. The onus is on the issuer to demonstrate whether the issue price of the warrants represents the fair value. In general, the Exchange will, at a starting point, measure the fair value of warrants by reference to their valuation calculated using a common option pricing model.
11. In this case, the warrants were to be issued at a nominal price, representing a substantial discount to the value of warrants calculated using a common option pricing model. There was a concern about a significant transfer of value to the placees at the expense of existing shareholders. While Company A argued that the option pricing model was subject to a number of limitations and had over-estimated the value of warrants, it was unable to demonstrate that the issue price of the warrants represented the fair value. The Exchange considered that the placing could not meet the general mandate requirements.
12. The Exchange also questioned the rationale for Company A to raise fund through the placing of warrants as the proceeds from the initial warrant subscription was minimal and it had no control over the exercise of the warrants and whether it would collect further proceeds. There was a concern about possible abuse of this type of warrant issues to facilitate other activities that might be prejudicial to the shareholders' interests or affect the operation of a fair and orderly market. The Exchange required Company A to confirm in its documents i) whether there were any other arrangements between the placees and Company A and its connected persons; and ii) whether the placees were in possession of potential deals or information about Company A that might crystallize over the exercise period of the warrants.
13. The Exchange decided that shareholders should be given the opportunity to evaluate and vote on the placing of warrants based on the terms of the placing and the particular circumstances of Company A. The circular must contain sufficient information for shareholders to decide how to vote, including the directors' explanation as to the basis for determining the issue price of the warrants and why they consider the placing is in the interest of Company A and its shareholders as a whole.

## **CONCLUSION**

14. The Exchange required Company A to seek shareholders' approval for the placing of warrants, and to confirm i) whether there were any other arrangements between the placees and Company A and its connected persons; and ii) whether the placees were in possession of potential deals or information about Company A that might crystallize over the exercise period of the warrants.