HKEX LISTING DECISION
HKEX-LD95-2016 (published in March 2016) (updated in October 2019 (amendments to the reverse takeover Rules) and withdrawn in January 2024)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 holding inventories and production facilities Mr. B – the owner of the Target PRC Company – a company engaging in manufacturing and sale of beverage products in the PRC
Issue	Whether Company A's proposed acquisition of an interest in the Target from Mr. B 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 manufacturing and sale of household products. It proposed to acquire the Target to diversify its business into the beverage industry.

2. The Target was newly set up by Mr. B to hold certain inventories, machinery and equipment for the production of beverage products (together, **Target Assets**).

3. As the Target had not yet obtained a licence for manufacturing beverage products, it would enter into supply and sales contracts with the PRC Company for a term of three years upon completion of the proposed acquisition:

   - under the supply contract, the PRC Company (which had a manufacturing licence) would manufacture beverage products for the Target using the Target Assets; and

   - under the sales contract, the Target would sell the beverage products supplied under the supply contract to the PRC Company.

4. These supply and sales contracts would allow the Target to commence operations before it obtained a licence for manufacturing beverage products,

and to make use of the PRC Company's distribution channel to sell the products to customers.

5. The consideration for the proposed acquisition was determined with reference to a preliminary valuation of the Target Assets. The asset ratio and the consideration ratio for the transaction was about 300% and 200% respectively.

6. Company A would satisfy the consideration by issuing new shares (**Consideration Shares**) and convertible bonds (with a conversion restriction that prevented Mr. B from holding a 30% interest or higher) to Mr. B. As a result, Mr. B would become the single largest shareholder (28%) of Company A upon completion of the acquisition. Assuming full conversion of the convertible bonds, Mr. B would be holding about 78% of issued shares as enlarged by the issue of new shares and conversion shares.

7. There was a question whether the proposed acquisition would constitute a reverse takeover for Company A.

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:*
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> - *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[1] 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 did not meet the new listing requirements. It had no trading record to meet the profit requirement under Rule 8.05(1).

[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.

- The Target would be unsuitable for listing under Rule 8.04. It would heavily rely on the PRC Company for both the production and sale of its products and would be unable to carry on its business independent from the PRC Company.

b. The value of the Target Assets was significant to Company A, representing about 3 times of Company A's assets value. The Target's business in manufacturing and sale of beverage products was completely different from Company A's existing businesses. There would be a fundamental change in Company A's principal business following the completion.

c. The proposed acquisition would be a means for Mr. B (who would become the single largest shareholder of Company A) to list the Target by injecting it into Company A.

Revised proposal

13. After the Exchange decided to treat the proposed acquisition as a reverse takeover, Company A submitted a revised proposal to acquire only a 30% interest in the Target. The consideration would be reduced accordingly and satisfied by the issue of the Consideration Shares and promissory notes to Mr. B. The asset ratio and the consideration ratio for the revised proposal would be about 80% and 90% respectively. Company A sought the Exchange's confirmation that the revised proposal would not constitute a reverse takeover.

14. The Exchange noted that the revised proposal was made for the purpose of downsizing the acquisition to slightly below 100% (i.e. the threshold for very substantial acquisitions). Notwithstanding the change, the Exchange considered that the revised proposal would be a reverse takeover under Rule 14.06(6) because:-

    a. 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.

    b. The revised proposal would still be a significant acquisition for Company A based on the asset and consideration ratios, and a means to circumvent the new listing requirements as the Target's business was completely different from Company A's existing business and was not suitable for listing. The revised proposal was still an extreme case based on a combination of these criteria.

CONCLUSION

15. The proposed 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.*