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# Hong Kong Stock Exchanges Publishes Three Listing Decisions on Reverse Takeovers

The Hong Kong Exchanges and Clearing Limited (the **Exchange**) has released three listing decisions in relation to reverse takeovers. They are: [HKEx-LD57-2013](http://www.hkex.com.hk/eng/rulesreg/listrules/listdec/Documents/ld57-2013.pdf) [[archived copy](ld57-2013.pdf)], [HKEx-LD58-2013](http://www.hkex.com.hk/eng/rulesreg/listrules/listdec/Documents/ld58-2013.pdf) [[archived copy](ld58-2013.pdf)] and [HKEx-LD59-2013](http://www.hkex.com.hk/eng/rulesreg/listrules/listdec/Documents/ld59-2013.pdf) [[archived copy](ld59-2013.pdf)]. The Listing Rule (**Rule**) relevant to these decisions is Rule 14.06(6), which defines a reverse takeover as an acquisition or series of acquisitions which, in the opinion of the Exchange, is an attempt to list the assets being acquired while circumventing the listing application process. Essentially an attempt at a backdoor listing, a reverse takeover is normally (but not always):

* an acquisition or a series of acquisitions of assets constituting a very substantial acquisition where there is or which will result in a change in control (as defined in the Takeovers Code) of the listed issuer (other than at the level of its subsidiaries); or
* acquisition(s) of assets from a person or a group of persons or any of his/their associates pursuant to an agreement, arrangement or understanding entered into by the listed issuer within 24 months of such person or group of persons gaining control (as defined in the Takeovers Code) of the listed issuer (other than at the level of its subsidiaries), where such gaining of control had not been regarded as a reverse takeover, which individually or together constitute(s) a very substantial acquisition.

The two forms of reverse takeover under Rules 14.06(6)(a) and 14.06(6)(b) may be called bright line tests. They are common forms of reverse takeover but are not an exhaustive list of such. The three listing decisions below show that the key to determining whether a transaction is a reverse takeover is to assess whether or not it amounts to an attempt to achieve a new listing by circumventing the requirements of the application process for new listings.

## HKEx-LD57-2013

The Main Board listed issuer in this case (**Company A**) attempted to acquire half of the share capital of the target company in consideration of cash, consideration shares and convertible bonds. The consideration shares and convertible bonds issued would have comprised 180% of Company A’s existing share capital, but the terms of the convertible bonds would not allow a conversion which would trigger a mandatory general offer under the Takeovers Code. The acquisition would have constituted a very substantial acquisition according to size tests. The target’s principal business was entirely different from those of Company A and following completion, the target’s shares would be accounted for as an interest in an associated company or an investment in Company A’s financial statements.

The issue was whether the acquisition constituted a reverse takeover under Rule 14.06(6). Neither of the bright line tests applied; the transaction would not have resulted in a change in control under Rule 14.06(6)(a), nor would the target company have gained control of Company A within the 24 months prior to completion of the acquisition as required under Rule 14.06(6)(b). However, the Exchange concluded that the acquisition would be a reverse takeover in essence for the following reasons:

* Not only would the transaction be a very substantial acquisition, but on completion, Company A’s existing business and assets would be relatively immaterial to the enlarged group; and
* Neither the assets being acquired nor the enlarged group could meet the requirements of Rule 8.05(1), which requires new listing applicants to have a trading record of:
	+ three financial years;
	+ HK$20 million in profits for the most recent year; and
	+ HK$30 million in profits (in aggregate) for the preceding two years.

Company A argued that the enlarged group would satisfy the profits test under Rule 8.05(1), but the Exchange determined that the target company’s trading record should not be included for the purposes of the Rule since Company A would account for the assets being acquired as an interest in an associated company or an investment. Company A had recorded losses in the years before the proposed acquisition and the enlarged group (excluding the shares in the target company) could not meet Rule 8.05. The Exchange considered this to be an extreme case of a reverse takeover. The acquisition did not meet the bright line tests under Rule 14.06(6), but as a transaction intended to list the shares in the target while circumventing the listing requirements, it was nevertheless a reverse takeover in essence.

## HKEx-LD58-2013

In this case, the acquiring company (**Company B**) was a suspended Main Board company that had delisted and ceased operations because it did not maintain a sufficient level of assets or operations as required by Rule 13.24. Company B attempted to acquire the target company (as part of its proposal for the resumption of trading in its own securities) in exchange for the issue of consideration shares that would have comprised over 90% of its share capital. The vendor in the transaction would have become the controlling shareholder of Company B and it intended to place down its shares in Company B to meet the public float requirement before the resumption of trading.

The acquisition would be a very substantial acquisition that resulted in a change in control of Company B, a listed issuer, putting it within the bright line test under Rule 14.06(6)(a), thus making it a reverse takeover. However, Company B requested that the Exchange should not regard the transaction as a reverse takeover because the target company could meet the trading record requirements for a new listing applicant under Rule 8.05, citing a past listing decision, [HKEx-LD95-1](http://www.hkex.com.hk/eng/rulesreg/listrules/listdec/Documents/ld95-1.pdf) [[archived copy](ld95-1.pdf)].

In response, the Exchange decided that the acquisition would be a reverse takeover under Rule 14.06(6) since:

* The transaction clearly fell within the ambit of Rule 14.06(6)(a);
* Company B was a shell company and the vendor in the transaction was trying to use that shell to achieve a listing of the target’s business without going through the listing application process; and
* The circumstances of the case were unlike those of listing decision HKEx-LD95-1 because, in that case, the investor who gained control over the listed issuer did not inject assets into it as the vendor would have injected assets into Company B.

## HKEx-LD59-2013

An electronic gaming company (**Company C**) attempted to acquire patents in an overseas market from an individual (**Mr. X**), an executive director and substantial shareholder of Company C. The transaction was a very substantial acquisition and connected transaction for Company C, which would provide cash and consideration shares as consideration. Mr. X would hold more than 30% of Company C’s enlarged share capital after the transaction, and would apply for a whitewash waiver under the Takeovers Code to avoid the requirement to make a mandatory general offer. Since this transaction was a very substantial acquisition that would result in a change of control in the listed issuer, it would be a reverse takeover under Rule 14.06(6)(a).

Company C sought a waiver from that Rule because the purpose of acquiring the patents was to expand its gaming business overseas and its existing business was profitable and operating on a substantive scale. The acquisition was not significantly larger than Company C. Additionally, Company C argued that its disclosure of the acquisition in its circular would be of a standard comparable to that required in an IPO prospectus, and would include a valuation report and details of its due diligence on the patents being acquired.

The Exchange considered that the acquisition of the patents was a reverse takeover within the ambit of the bright line test under Rule 14.06(6)(a). However, it accepted Company C’s submission that the transaction was related to its principal business and was not an attempt to achieve a listing of the patents while circumventing the Listing Rule requirements. The Exchange therefore waived Rule 14.06(6)(a) and classified the acquisition as a very substantial acquisition and a connected transaction, but not a reverse takeover.

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