

HKE_x GUIDANCE LETTER
HKE_x-GL76-14 (May 2014)

Subject	Guidance on opinion letters prepared by independent financial advisers under the Listing Rules
Listing Rules	Main Board Rules 13.39(6) & (7), 13.80 to 13.84 and 14A.22 GEM Rules 17.47(6) & (7), 17.92 to 17.96 and 20.22

Important note: *This letter does not override the Listing Rules and is not a substitute for advice from qualified professional advisers. If there is any conflict or inconsistency between this letter and the Listing Rules, the Listing Rules prevail. You may consult the Listing Division on a confidential basis for an interpretation of the Listing Rules, or this letter.*

I. Purpose

1. This letter provides guidance on the disclosure in opinion letters prepared by independent financial advisers (**IFAs**) and certain recommended practices for IFAs, issuers and independent board committees (**IBCs**) in performing their duties under the Rules.

II. Applicable Listing Rules

2. Under the Rules, an issuer is required to appoint an IFA to advise its IBC and shareholders on:
 - (i) connected transactions;
 - (ii) equity fund raisings that would result in a material dilution of shareholders' interests, i.e. any rights issue or open offer that would increase the issuer's share capital or market capitalization by more than 50%, and refreshment of general mandate;
 - (iii) other corporate actions which would affect an issuer's listing status, i.e. withdrawal of listing, fundamental change in the issuer's business within 12 months after listing, and material spin-off that require shareholders' approval.

(A) IFA

Eligibility to act as IFA

3. Rules 13.82 to 13.84 (GEM Rules 17.94 and 17.96) require that an IFA must be appropriately licensed by the Securities and Futures Commission (**SFC**)¹

¹ Under the current regime, an IFA must be licensed by the SFC (i.e. Type 6 license and permitted to undertake work as a sponsor). A firm which holds a Type 6 license but does not have the capacity to act as a sponsor may be acceptable to act as an IFA if it has provided corporate finance advice on at least two significant corporate finance transactions. See also HEK_x news release issued on 24 October 2006 and Listing Decision (LD102-2) issued in August 2010.

and must discharge its responsibilities with due care and skill, and perform its duties with impartiality. Under the SFC's Corporate Finance Adviser Code of Conduct, an IFA should ensure that it has adequate competence, professional expertise and resources for the proper performance of its duties.

4. Under Rules 13.83 and 13.84 (GEM Rules 17.95 and 17.96), an IFA must perform its duties with impartiality and must be independent from the issuer for whom it acts.
5. Rule 13.84 (GEM Rule 17.96) also provides a set of bright-line tests to assess the IFA's independence. The IFA is required to submit a declaration to the Exchange that it is independent under the Rule.

Content of IFA letters

6. Rules 13.39 and 14A.22 (GEM Rules 17.47 and 20.22) require an IFA to disclose in its letter:
 - (i) whether the terms of the proposed transaction is fair and reasonable and in the interest of the issuer and its shareholders as a whole, and in the case of a connected transaction, whether it is on normal commercial terms and in the issuer's ordinary and usual course of business,
 - (ii) advice to the IBC on whether independent shareholders should vote in favour of the transaction;
 - (iii) the reasons for its opinion;
 - (iv) key assumptions made; and
 - (v) the factors taken into consideration in forming that opinion.

Standard of IFA works

7. Rule 13.80 (GEM Rule 17.92) requires an IFA to have a reasonable basis in formulating its opinion. Further, it should have no reason to believe that information it relied on is not true or omits a material fact.
8. The Rule also sets out reasonable steps that an IFA are typically expected to perform. They include:
 - (i) obtaining all information and documents of the issuer relevant to an assessment of the fairness and reasonableness of the transaction's terms;
 - (ii) researching the relevant market and economic conditions and trends relevant to the pricing of the transaction;
 - (iii) reviewing the fairness, reasonableness and completeness of any assumptions or projections relevant to the transactions;
 - (iv) reviewing and assessing the alternative offers and the reasons given by management for rejecting these offers.; and
 - (v) where third party expert opinion or valuation is involved,
 - interviewing the expert as to its expertise and independence;
 - reviewing the terms of engagement and assessing the appropriateness of the scope of work; and
 - assessing the reasonableness of any representations made by the issuer or the party to the transaction to the expert.

(B) IBC

9. Under Rule 13.39(6) (GEM Rule 17.47(6)), an issuer is required to establish an IBC (which shall consist only of independent non-executive directors) to advise shareholders as to whether the terms of the relevant transaction or arrangement are fair and reasonable and whether such a transaction or arrangement is in the interests of the issuer and its shareholders as a whole and to advise shareholders on how to vote, taking into account the recommendations of the IFA.

(C) Issuer

10. Under Rule 13.81 (GEM Rule 17.93), an issuer must afford any IFA it appoints under the Rules full access at all times to all persons, premises and documents relevant to the IFA's performance of duties. In particular, the terms of engagement with experts retained to perform services related to the transaction should contain clauses entitling the IFA to such expert, its report and information provided to or relied on by the expert.
11. Under Rules 2.13 and 14A.58 (GEM Rules 17.56 and 20.58), the information contained in an issuer's circular must be accurate and complete in all material respects and not be misleading or deceptive, and the circular must provide a clear and adequate explanation of the subject transaction and all information necessary to allow the shareholders to make an informed decision.

III. Guidance

12. An IFA advises the IBC and shareholders on material corporate actions of the issuer, and it is important that the IFA's advice is impartial and useful to assist shareholders to make informed voting decisions.
13. The Rules have specific requirements governing the provision of an IFA opinion on issuer's corporate actions. Issuers, IBCs and IFAs are expected to observe the following when performing their duties under the Rules:

(A) IFA's qualifications, experience and relationships

14. An IFA must ensure that it is independent from the issuer and other parties to the proposed transaction, and has sufficient expertise and resources to give an opinion on the transaction.
15. The opinion letter should include the following information that shareholders may consider relevant for assessing what weight to give to the opinion:
- (i) the qualifications and experience of the person signing off the IFA letter that are relevant to the proposed transaction; and
 - (ii) any relationships or interests with the issuer or any other parties that could reasonably be regarded as relevant to the independence of the IFA². In particular, where the IFA has in the last two years acted as an IFA to the issuer's other transactions and has assessed that such relationship

² An IFA is not independent if any of the circumstances set out in Rule 13.84 (GEM Rule 17.96) exist.

would not affect its independence, details of the services provided should be disclosed.

(B) Access to information

16. An IFA should determine what information it requires for giving its opinion on the proposed transaction.
17. The issuer is obliged to afford the IFA full access to all persons, premises and documents relevant to the IFA's performance of its duties. Examples include:
 - (i) any expert retained by the issuer to perform services for the transaction and the documents and information related to the expert's work; and
 - (ii) where an issuer has agreed on the consideration for an acquisition based on a valuation of the target, details of the valuation model, key assumptions and financial forecasts related to the target.

(C) Work done on information obtained

18. The IFA should take all reasonable steps to satisfy itself that there is no reason to believe that the information it relies on is untrue, or omits a material fact. While the IFA may not undertake due diligence work on the transaction, it should carefully consider the extent of work it requires to properly discharge its duties. It is expected to:
 - (i) critically review the information obtained. Where it involves valuation (including forecasts or projections) of the assets or businesses subject to the transaction, the IFA should assess whether the methodologies and assumptions used are reasonable, cross-check the valuation using other methodologies that it considers appropriate and comment on the results and any material differences; and
 - (ii) where it involves reports prepared or opinions given by an expert, take steps to assess the quality of the expert's work and its independence and qualification, including:
 - interviewing the expert as to its expertise and independence, reviewing its terms of engagement and assessing the appropriateness of its scope of work, and
 - making due inquiries to assess the accuracy and completeness of information relied on by the expert, and the reasonableness of any representations made by the issuer or the party to the expert.

(D) Analysis of the transaction

19. An IFA should form its opinion based on reasonable grounds and disclose them in its opinion letter. It is required to take all reasonable steps to satisfy itself that it has a reasonable basis for giving its advice and recommendation required by the Rules.

20. In practice, it is common for IFAs to refer to reports prepared or opinions given by experts retained by the issuers and/or use comparable analysis to assess the fairness of the transaction. To assist shareholders to better understand the transaction and the IFA's analysis and how it formed its opinion, the IFA should:
- (i) disclose its work done to assess the reasonableness of the valuation or opinion given by the expert (see also paragraph 18);
 - (ii) to the extent possible, use more than one valuation methodology to assess the value of the assets or businesses subject to the proposed transaction, and where only one methodology is used, state the reason why this is so;
 - (iii) describe the methodologies it used and the reasons for choosing them, and comment on the range of values derived from these methods;
 - (iv) explain all key assumptions that are specific and on which its opinion is based. It should also consider including a sensitivity analysis if changes in any key assumptions are likely to affect the valuation significantly;
 - (v) ensure that the comparables are a fair and representative sample. The bases for compiling such comparables should be clearly stated, including the parameters or criteria for selecting the comparables, the reasons for using these parameters or criteria, and any adjustments for the dissimilarities among the comparables or anomalous items; and
 - (vi) set out other relevant factors for assessing the fairness and reasonableness of the transaction. Examples include: its research on market conditions and trends relevant to the transaction, any alternative options or offers available to the issuer and the reasons given by its management for rejecting them, the issuer's financial situation and solvency, its bargaining position and the opportunity costs.
21. The IFA should not attempt to deal with any limitations or deficiencies it faces by disclaiming or limiting its scope of assessment.

(E) Presentation of information in IFA letter

22. An IFA letter must be clear and concise, and contain only information that is relevant and necessary to enable shareholders to arrive at an informed decision. It should set out:
- (i) a clear view of the IFA on the fairness and reasonableness of the subject transaction and the reasons for its view;
 - (ii) its analysis or comments on the key terms of the proposed transaction and other relevant factors (e.g. the reasons and benefits for entering into the transaction);
 - (iii) the valuation methodologies and key assumptions adopted by the IFA;

- (iv) the source of information which is material to the IFA's opinion, including sufficient detail to enable the significant of the information to be assessed (or where appropriate, a cross-reference to information contained in other parts of the circular or public document); and
 - (v) its work done and comments on any valuation or projection provided by the issuer or any expert's work that it relies on in forming its opinion; and
 - (vi) the IFA's and the expert's (if applicable) qualification and experience relevant to the transaction, and their relationship and interests in the issuer and other parties to the transaction (see paragraphs 15 and 18).
23. An IFA should prepare its opinion letter in plain language and ensure that the letter is easy to read and understand. It should also note that:
- (i) the information included in its letter should relate to its analysis and opinion;
 - (ii) its letter should avoid repeating the information contained in other parts of the transaction circular. Where appropriate, the letter may include reference to this information;
 - (iii) pictorial representations, charts, graphs and diagrams should be presented without distortion and, where relevant, should be to scale; and
 - (iv) quotations (for example, from newspapers or stockbroker circulars) should not be used unless the IFA has corroborated or substantiated them and details of the origin are stated.

(F) Role of the IBC

24. Under the Rules, the IBC (comprising independent non-executive directors) is required to advise shareholders on the fairness of the subject transaction and how they should vote. It is in turn advised by the IFA.
25. To discharge its duties and ensure that it is properly advised, the IBC should take an active role in selecting an IFA that is independent and qualified to opine on the subject transaction:
- (i) The IBC should be primarily responsible for selecting the IFA, and approving its terms of engagement and fees. They should consider all relevant factors in selecting the appropriate IFA, including:
 - (a) the nature, scale and complexity of the subject transaction;
 - (b) the qualifications and experience of the IFA. For example, the IFA's experience in advising similar transactions, its technical expertise relevant to the transaction or ability to assess other expert's work;

- (c) whether the IFA can meet the independence guidelines set out in Rules, and whether there are any other matters that may affect, or perceived to affect, the IFA's independence (including any previous engagement as an IFA to other transaction of the issuer); and
 - (d) whether the IFA has adequate resources to perform the work.
- (ii) The IBC should oversee the procedures adopted by the management in identifying potential IFAs and avoid any practice that would undermine the IFA's independence and objectivity (e.g. opinion shopping).
- 26. The IBC should ensure that its members and the IFA have sufficient time to evaluate the transaction. The parties should ensure that any discussions or communications in the early stage would not undermine the IFA's independence and objectivity. For example, the IFA should not be involved in the formulation of the proposed transaction or structuring of its terms.
- 27. It is the IBC's responsibility to give its own views and recommendation on the subject transaction, taking into account the IFA's opinion. Members of the IBC should exercise independent judgement on the transaction and critically review the IFA letter and use their knowledge and expertise to challenge the IFA's views and analysis.

(G) Issuer's responsibility

- 28. The issuer should support the IBC in performing its duties, including adopting procedures for selection of IFAs and providing all information and documents that are necessary for the IBC to assess the subject transaction.
- 29. The issuer should announce the appointment of the IFA in its announcement of the subject transaction, or where an IFA has not been appointed, as soon as possible after the appointment is made.
- 30. The issuer is required to provide the IFA with all information it reasonably requires for giving its opinion on the subject transaction. It should also respond on a timely basis to the issues raised by the IFA to enable it to properly discharge its duties.
- 31. The issuer should keep the IFA informed of any material changes to any information previously given to or accessed by the IFA.
- 32. The issuer must ensure that the circular contains all information that is necessary for its shareholders to make an informed assessment of the subject transaction. They include:
 - (i) details of the bases for determining the consideration, and where it is supported by a valuation of assets or businesses subject to the transaction, the valuation methods and assumptions adopted by the management;

- (ii) detailed explanations as to the reasons and benefits for entering into the transactions; and
- (iii) the management's discussion and analysis on any alternative options or offers available to the issuer and the reasons given for not accepting them.
