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GOING DARK IN THE USA

How to Exit the US Public Markets and Options for US-Listed Chinese Companies

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Presentation Overview

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2. US Holding Foreign Companies Accountable Act
3. Going Private and Share Repurchases
4. Delisting and Deregistration
5. Secondary Listings in Hong Kong

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BACKGROUND AND CONTEXT

Setting the Stage

- On May 20, 2020, the US Senate unanimously passed the S. 945 the Holding Foreign Companies Accountable Act (HFCAA).
- Prohibits foreign issuers from listing and trading their securities on any US securities exchange (e.g., NYSE or Nasdaq) if authorities in the foreign issuer's home jurisdictions prohibit the Public Company Accounting Oversight Board (the PCAOB) from inspecting the issuer's registered public accounting firm.
- Aimed at US-listed Chinese companies.

Setting the Stage (cont.)

- Puts US-listed Chinese companies in a difficult position.
- Compliance may be impossible
- Chinese regulations prohibit inspection of public accounting firms based in China by foreign regulators, including the PCAOB.

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THE HOLDING FOREIGN COMPANIES ACCOUNTABLE ACT

HFCAA: Disclosure and PCAOB Inspection

- HFCAA triggered if issuer retains a registered public accounting firm that has a branch or office that
  - (i) is located in a foreign jurisdiction and
  - (ii) the PCAOB is unable to inspect or investigate completely because of a position taken by an authority in the foreign jurisdiction.
- Also requires issuers to submit to the SEC documentation showing that the issuer is not owned or controlled by a governmental entity.

HFCAA: Disclosure and PCAOB Inspection (cont.)

- Issuers identified by the SEC must allow the PCAOB to inspect or investigate
- Failure to allow PCAOB inspection for three consecutive years, SEC prohibits trading on a US securities exchange
- Trading prohibition can be removed:
  - Issuer certifies it has retained a registered public accounting firm that the PCAOB has inspected to the satisfaction of the SEC.
- Failure to comply again = trading suspended for a minimum of 5 years.

HFCAA: Additional Disclosure Requirements

- In any year when an issuer uses a non-PCAOB-inspected accounting firm to prepare its audit report, the issuer must disclose in its annual report:
  - that a non-PCAOB inspected accounting firm prepared its audit report;
  - percentage of shares of the issuer owned by governmental entities;
  - whether governmental entities in the foreign jurisdiction of the accounting firm have a controlling financial interest in the issuer;
  - name of each official of the Chinese Communist Party who is a member of the board of directors of the issuer; and
  - whether the constitutive documents of the issuer contains any charter of the Chinese Communist Party, including the text of any such charter.

Timing of Potential Effective Legislation and SEC Rulemaking

- The Process
  - Bill must be passed by both US Senate and House of Representatives
  - signed into law by the President
  - SEC rulemaking (90 days to implement).
- Where are we now?
  - Act has only been passed by US Senate.
  - Bill with the same language (which could ultimately be amended) introduced in the House on May 20, 2020 – remains subject vote.
  - On June 4, 2020, President Trump convened a working group to prepare a report due by August 3, 2020.
- 2021 likely the earliest a version of HFCAA could be implemented.

Some Options for US-Listed Chinese Companies

- Current draft of the legislation = up to three years before non-compliance would compel a delisting.
- Options available to a US-listed Chinese issuer:
  - going private
  - voluntarily delisting and deregistering ("going dark")
  - secondary listing outside of the United States, such as Hong Kong

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GOING PRIVATE AND SHARE REPURCHASES

Going Private - Overview

- "going private" = controlling shareholder, significant shareholder or other affiliated persons reduces amount of public float, generally by cashing out its public shareholders.
- No public shareholders allows the issuer to "go dark", in other words, terminate its public company status and related reporting and compliance obligations under the US Exchange Act of 1934, as amended (the "Exchange Act") and the Sarbanes-Oxley Act.

Going Private Overview (cont.)

- Going private transactions commonly take the form of:
  - negotiated share acquisition by a controlling shareholder, significant shareholder or other affiliated persons; or
  - a repurchase or public tender offer for shares.

Negotiated Share Acquisition – Disclosure

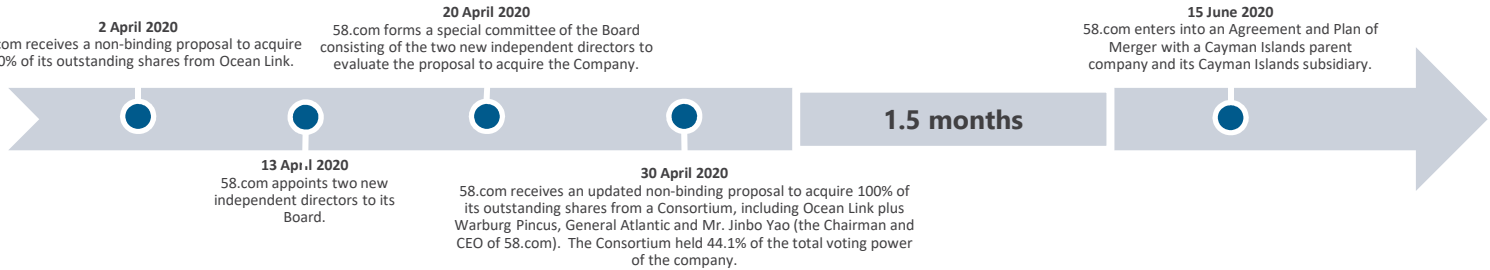
- Both US federal and state securities laws create disclosure obligations that apply to going private transactions.
- The timing and substantive of the disclosure will depend, in part, on the structure of the transaction.

Negotiated Share Acquisition – Disclosure (cont.)

- Additional disclosure obligations under Rule 13e-3 for going private transactions include:
  - purpose of the transaction (including alternatives considered and why they were rejected);
  - fairness of the transaction (both substantive and procedural); and
  - reports, opinions, appraisals and negotiations.
- Information "materially related" to the transaction must be filed with the SEC.
  - This includes investment banking valuation presentations made to the target's board.

Going Private in the United States – Examples

58.com Inc.



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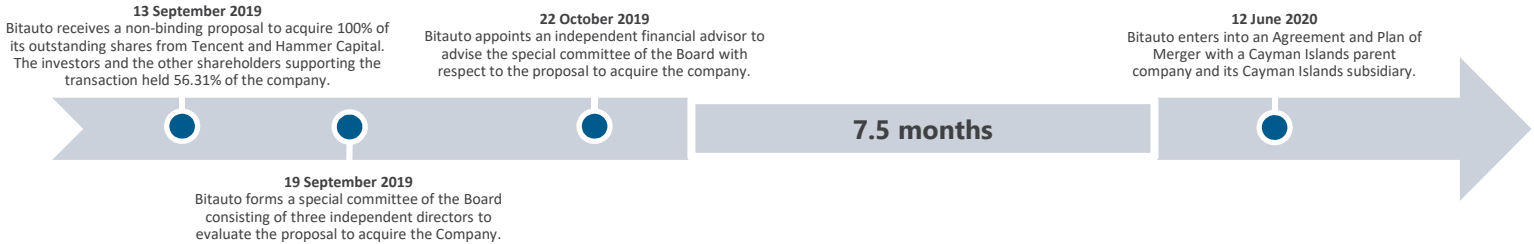

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Going Private in the United States – Examples

China Biologic

- China Biologic's Rule 13e-3 disclosure filings include:
  - copies of the SPAs pursuant to which the Consortium will acquire shares in the company;
  - a copy of a "Consortium Agreement" among the investors setting out various processes with respect to the transaction and terms among the investors;
  - summaries of events related to the transaction, including the dates and content of discussions among the various parties and their advisors; and
  - statements as to the purpose and fairness of the transaction and its various steps.

Open-Market Purchases

- A market-oriented repurchase of public equity.
  - financial intermediary to negotiate and effectuate open-market repurchases
  - agree with a financial intermediary to repurchase shares that the financial intermediary purchases on a principal basis.
- Only effective if the issuer is seeking to repurchase only a small percentage of shares or if the shares are not widely held.
- An issuer repurchasing any US-registered securities runs the risk of inadvertently triggering the US federal tender offer rules (e.g., a "creeping tender offer") so it is important that the trades are structured properly.

Public Tender Offer

- What is it?
  - TO is an offer to purchase from holders all or a portion of an issuer's shares for cash.
- Allows issuer to capture a large part of the outstanding US public equity.
- Straightforward documentation and a short timeframe for execution (usually within 30 days from kick-off).
- US federal tender offer rules apply.
- Tendering holders must be paid promptly (i.e., within 3 BD)

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DELISTING AND DEREGISTRATION

Overview

- Delisting and deregistration are related but separate processes -- both need to be undertaken in order for an issuer to suspend and terminate its reporting and compliance obligations as a US-listed issuer.
- Delisting
  - withdrawing listing on a US national securities exchange, such as the NYSE or Nasdaq.
- Deregistration
  - withdrawing from registration under the US Securities Act of 1933, as amended (the Securities Act) and terminating and/or suspending reporting obligations under the Exchange Act.

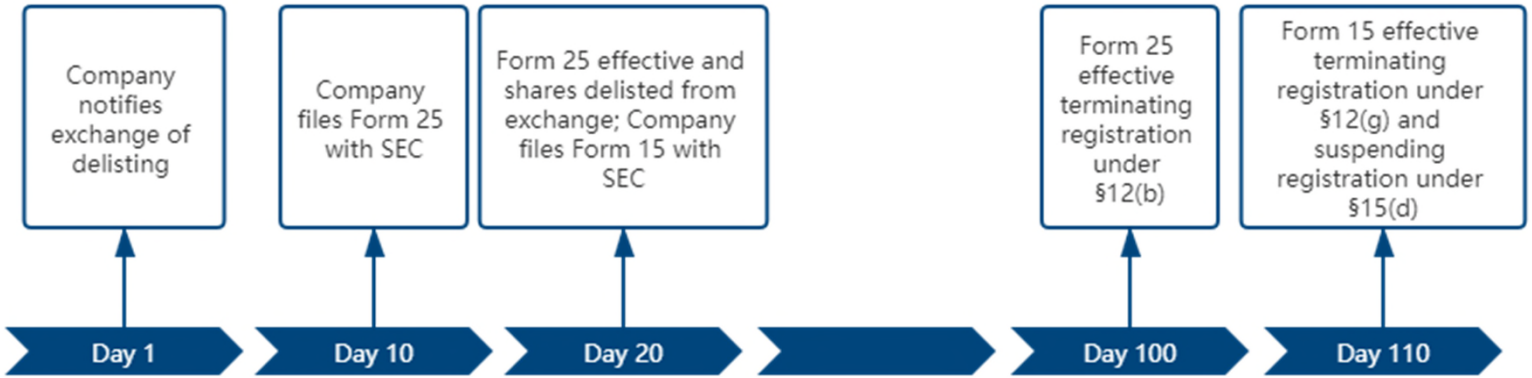
Exchange Act Reporting – Some Background

- An issuer becomes subject to Exchange Act reporting requirements if it has a class of securities registered under Section 12 or 15(d) of the Exchange Act.
- This can occur in several different ways, including:
  - Section 12(b) = by listing a class of securities on a national securities exchange (Section 12(b)) which captures companies that have conducted IPOs in the US on the NYSE or Nasdaq;
  - Section 12(g) = by meeting certain statutory thresholds with respect to total assets and the number of shareholders (Section 12(g)); or
  - Section 15(d) = by having an effective registration statement under the Securities Act (Section 15(d)).

Exchange Act Reporting – Some Background (cont.)

- An issuer is not subject to Exchange Act reporting obligations under more than one section at a time.
- Reporting obligations under Section 12(b) by virtue of being listed on the NYSE or Nasdaq suspend any other reporting obligations under another provision of the Exchange Act, such as Section 12(g) or Section 15(d).
- **However**, if the Section 12(b) registration is terminated, any other previously suspended reporting obligations under the Exchange Act (i.e., under Section 12(g) or Section 15(d)) **are revived**.
  - Need to terminate or suspends reporting obligations under ALL relevant Exchange Act provisions.

Delisting and Deregistration Timeline



Delisting and Deregistration – Section 12(b)

NYSE (Rule 806.2)

- Written notice to the NYSE of intent to withdraw a class of securities from listing and/or registration;
- Publication of a press release providing notice of the delisting and the intention and reasons for withdrawal.
  - The notice must also be posted on the company's website until the completion of the delisting process.
  - The press release with notification must be made at least 10 days before filing a Form 25 with the SEC;
- Provide the NYSE with board resolutions authorizing delisting;
- File a Form 8-K (or 6-K if the issuer is a foreign private issuer (FPI)) announcing the delisting; and
- File Form 25 with the SEC.

Nasdaq (Rule 5840(j))

- Written notice to Nasdaq of intent to withdraw a class of securities from listing and/or registration;
- Publication of a press release providing notice of the delisting and the intention and reasons for withdrawal.
  - The notice must also be posted on the company's website until the completion of the delisting process.
  - The press release with notification must be made at least 10 days before filing a Form 25 with the SEC;
- File a Form 8-K (or 6-K if the issuer is a foreign private issuer (FPI)) announcing the delisting; and
- File Form 25 with the SEC.

Delisting and Deregistration – Section 12(b) (cont.)

- Once the Form 25 is filed with the SEC, the delisting occurs automatically after 10 days.
- The Form 25 filing also serves to withdraw the class of securities from registration, which becomes effective 90 days after its filing.
- Once effective, the issuer's reporting obligations under Section 12(b) of the Exchange Act are terminated.

Deregistration – Section 12(g)

- The termination of an issuer's Exchange Act reporting obligations under Section 12(b) may revive the issuer's Section 12(g) reporting obligations if
  - the class of securities to be deregistered was listed on Nasdaq prior to August 2006 or
  - there are more than 300 shareholders of record of the class of securities to be deregistered.
- Fewer than 300 shareholders of record, Section 12(g) deregistration is effective by operation of law.
- Otherwise…..

Deregistration – Section 12(g) (cont.)

- ….to terminate any revived reporting obligations under Section 12(b), the issuer must file a Form 15 with the SEC.
- Form 15
  - Can only be filed after the Form 25 is effective, therefore the earliest the Form 15 can be filed is 10 days after the Form 25 is filed.
  - Effective 90 days after filing unless the SEC allows for earlier effectiveness.
  - Filing immediately suspends the issuer's periodic and other reporting obligations under Section 13(a) of the Exchange Act.

Deregistration – Section 15(d)

- The termination of an issuer's Exchange Act reporting obligations under Section 12(b) also may revive the issuer's Section 15(d)) reporting obligations if the issuer has an effective registration statement on file with the SEC.
- Note: Once an issuer is registered under Section 15(d), the issuer's reporting requirement can never be terminated but its obligations can be suspended.

Deregistration – Section 15(d) Automatic

- Section 15(d) reporting obligations are suspended automatically if
  - an issuer has a class of securities registered under Section 12 or
  - there are fewer than 300 shareholders of record of the class of securities subject to registration on the first day of any fiscal year (other than the year in which the subject registration statement became effective).
- If an issuer's Section 15(d) reporting obligations are suspended, but the issuer later does not meet the record holder and asset eligibility thresholds for suspension on the first day of a subsequent fiscal year, the issuer's reporting obligations under Section 15(d) will be revived.
- Issuers must monitor number of record holders to make sure it meets requirements otherwise reporting obligations may not be suspended.

Deregistration – Section 15(d) Voluntary

- Rule 12h-3 of the Exchange Act permits an issuer to suspend its Section 15(d) reporting obligations voluntarily if it files a Form 15 and meets the following conditions:
  - it is current in its Exchange Act reporting requirements for the last three fiscal years and the portion of the current prior to filing of the Form 15 and
  - the registered class has (a) fewer than 300 shareholders of record or (b) as of the end of the company's last fiscal year, fewer than 500 shareholders of record and assets less than US$10 million.
- Issuer only needs to count the number of registered holders on its shareholder list.

Deregistration – Section 15(d) Voluntary (cont.)

- Rule 12h-3 of the Exchange Act not available to an issuer if RS become effective in the fiscal year for which the issuer seeks to suspend reporting, or has had a RS updated by Section 10(a)(3) of the Securities Act (e.g., an annual report incorporated by reference) during the fiscal year for which the issuer seeks to suspend reporting.
- An issuer may not rely on the fewer than 500 record holders and US$10 million in assets rule if a Securities Act RS went effective or required a Section 10(a)(3) update during the two succeeding fiscal years.
  - Issuers with outstanding F-3s are considered to have had a RS "updated" during the year because the annual report filing is a Section 10(a)(3) update to the RS, because the annual report is automatically incorporated by reference.

Special Deregistration for FPIs

- Rule 12h-6, which allowed FPIs to suspend their reporting obligations under Section 15(d) or deregister a class of securities under Section 12(g) if they satisfy the following three conditions:
  - the FPI must have had reporting obligations under the Exchange Act for 12 months and filed or furnished all reports during this period including the filing of at least one annual report;
  - the class of securities of the FPI sought to be deregistered, must not have been sold, subject to certain exceptions, through a registered public offering in the 12 months leading up deregistration; and
  - the FPI must have maintained a listing on an exchange in the FPI's primary trading market for at least the 12 months preceding the deregistration filing.

Special Deregistration for FPIs (cont.)

- If the three conditions are met, there are two ways an FPI can terminate its reporting obligations under the Exchange Act:
  - the Average Daily Trading Volume Threshold Method
    - ADTV must be 5% or less of that class of securities ADTV on a worldwide basis.
  - the Record Holder Threshold Method
    - (i) less than 300 record holders on a worldwide basis, or (ii) less than 300 record holders who reside in the United States.

Special Deregistration for FPIs - Process

- File a Form 15F to deregister securities
- Once the Form 15F has been filed, the FPI's reporting obligations under the Exchange Act are immediately terminated.

Registration Rights, Shareholder Agreements and Debt Instruments – Special Considerations

- Review Agreements Early
  - Especially registration rights or shareholder agreements and terms of its debt instruments prior to undertaking a delisting and deregistration exercise.
- Following delisting and deregistration, a company may no longer be able to comply with any existing obligations to register privately-placed shares.
- Certain debt instruments may have covenants requiring maintenance of a listing -- failure to do so may cause an EOD.

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SECONDARY LISTINGS IN HONG KONG

Primary vs. Secondary Listing

- If an issuer chooses Hong Kong as its only listing venue, it is a primary listing. The HKEx, as opposed to any other overseas stock exchange, is its primary listing regulator.
- In a dual listing, the Hong Kong listing may be either primary or secondary.
- To qualify for a secondary listing in Hong Kong, the issuer must maintain a primary listing on a recognized overseas stock exchange which the HKEx recognizes as providing equivalent standards of shareholder protection.
- The Hong Kong Listing Rules (HKLR) give greater latitude in a secondary listing in respect of listing requirements and ongoing obligations.

Secondary Listing with an Offering vs Secondary Listing by Introduction

- An issuer may seek a secondary listing in Hong Kong with an offering of new shares, or its shareholders may sell existing shares, or a combination of both
- A secondary listing can also be achieved by way of introduction by migrating a certain number of shares traded on the primary listing venue to the secondary listing venue.
- Vetting process is the same in both cases but in a secondary listing by way of introduction, no offering or other marketing arrangements are required.

Concessionary Secondary Listing Route – Chapter 19C

- Chapter 19C route to a secondary listing for large emerging and innovative companies which are primarily listed on a major international exchange.
- Chapter 19C Issuer must meet the following requirements:
  - Be a "innovative company";
  - Primary listing on the NYSE, Nasdaq or the Main Market of the London Stock Exchange Premium Listing, with a good record of compliance for at least two full financial years; and
  - Market cap of at least HK$10 billion at the time of secondary listing in Hong Kong.

Chapter 19C Innovative Company

- Success attributable new technologies, innovations and/or a new business model - differentiate the company from existing players
- R&D is a significant contributor of its expected value and constitutes a major activity and expense;
- Success attributable to its unique features or IP; and/or
- Outsized market capitalisation / intangible asset value relative to its tangible asset value.
- A “facts and circumstances” test

Chapter 19C – Special Considerations

- A US-listed Chinese issuer and/or an issuer with a Weighted Voting Rights (WVR)
  - minimum revenue of HK$1 billion in its most recent audited financial year if its market capitalisation is less than HK$40 billion.
- Important to a US-listed Chinese issuer with a "centre of gravity" in Greater China as they were not eligible for a secondary listing adoption of Chapter 19C of the HKLR.

Chapter 19C – Special Considerations (cont.)

- Only those US-listed Chinese issuers listed before December 15, 2017, will enjoy the concessions in connection with the following:
  - Equivalence requirement
  - VIE structures
  - WVR safeguards
- US-listed Chinese issuers that listed on or after December 15, 2017 will have to comply with existing HKLR requirements in relation to key shareholder protection standards, VIE structures and WVR safeguards.
- Secondary listing under Chapter 19C entitled confidential filing treatment of its application.

Effects of US-delisting on Concessionary Secondary Listing in Hong Kong

- If a US-listed Chinese issuer fails to meet its obligations under the US regulations and listing rules (e.g., fails to meet the requirements of the Act, if passed), it would be a non-compliance event on its primary listing venue.
- HKEx would likely review this non-compliance event on a case-by-case basis as to whether it would affect the secondary listing status.
- If the primary listing status of the issuer is impacted the issuer may shift not less than 55% (or all) of its trading volume to Hong Kong whereby HKEx will regard the issuer as having a primary listing in Hong Kong and it will no longer enjoy the concessions granted under Chapter 19C.

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