

Listing Decisions on Calculations of Size Tests

Quick Read

Hong Kong Exchanges and Clearing Limited (“**HKEx**”) published two listing decisions “HKEx-LD20-2011” and “HKEx-LD21-2011” on 30 November 2011 in relation to calculations of size tests for the purpose of determining the classification of the subject transactions under the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (“**Listing Rules**”).

Relevant Listing Rules

Rule 14.07 of the Listing Rules sets out the following five percentage ratios (“**size tests**”):

- Assets ratio - the total assets which are the subject of the transaction divided by the total assets of the listed issuer.
- Profits ratio - the profits attributable to the assets which are the subject of the transaction divided by the profits of the listed issuer.
- Revenue ratio - the revenue attributable to the assets which are the subject of the transaction divided by the revenue of the listed issuer.
- Consideration ratio - the consideration divided by the total market capitalisation of the listed issuer.
- Equity capital ratio - the nominal value of the listed issuer’s equity capital issued as consideration divided by the nominal value of the listed issuer’s issued equity capital immediately before the transaction.

By applying the size tests, a listed issuer is able to classify the subject transaction and know whether it

is subject to any disclosure and/or shareholders’ approval requirements under Chapter 14 of the Listing Rules.

First Listing Decision (HKEx-LD20-2011)

BACKGROUND

The targeted company (“**Target A**”) was a company listed on an overseas stock exchange. Listco A (a Main Board listed issuer) was holding 15% of Target A’s interests as an investment at the time the offeror (“**Offeror**”) made a cash offer to purchase Target A’s shares from its existing shareholders.

Listco A was considering whether to accept the offer. The proposed disposal of the interests in Target A by Listco A (“**Disposal**”) would be classified as a very substantial disposal under the consideration ratio as this ratio exceeded 75%. However, based on calculations of the other percentage ratios, the Disposal would only amount to a major transaction.

ISSUES

Listco A submitted that the Disposal should be classified as a major transaction instead of a very substantial disposal based on the following rationale:

- When the offer was first made by the Offeror (around one month earlier), the percentage ratios (including the consideration ratio) calculated at that time indicated that the Disposal would only amount to a major transaction and not a very substantial disposal.

- After that time, there was no material change in Listco A's operations and financial position although its share price had decreased significantly due to the general market downturn. Accordingly, the consideration ratio became substantially larger than the other percentage ratios. Using the consideration ratio solely to classify the transaction was inappropriate.

HKEX DECISION

HKEx considered Listco A's submission and decided that the Disposal would be classified as a major transaction only. HKEx was of the view that:

- Listco A was only holding Target A's shares as an investment and it had other significant operations. The Disposal could not be considered "very substantial" to Listco A when compared to its financial position. This was supported by the other percentage ratios, which were substantially smaller than the consideration ratio.
- The Disposal would require shareholders' approval no matter whether it was categorised as a major transaction or a very substantial disposal.

You can download copies of the listing decision via the link below:

<http://www.hkex.com.hk/eng/rulesreg/listrules/listdec/Documents/ld20-2011.pdf>

Second Listing Decision (HKEx-LD21-2011)

BACKGROUND

The targeted company ("**Target B**") was a jointly controlled entity which was 40% owned by Listco B (a Main Board listed issuer) and 60% owned by certain third parties. According to Listco B Group's ("**Group**") latest accounts, the share of net assets and profits from Target B represented about 50% and 90% of the Group's total assets and net profits respectively.

Target B was required to restructure for the purpose

of complying with Mainland regulations and the restructuring would involve the following:

- *Reduction of Listco B's shareholding in Target B* - Listco B would sell a 7% interest in Target B to third party purchaser(s) ("**Reduction**"); and
- *Issue of new shares by Target B* - Target B would then issue new shares to third party investor(s) to enlarge its capital base ("**Issue of Shares**").

The Reduction and Issue of Shares were two separate transactions and collectively, they would result in the reduction of Listco B's shareholding in Target B to approximately 15%. The Issue of Shares would not be regarded as a deemed disposal by Listco B because Target B was not its subsidiary.

ISSUES

When applying the size tests to the Reduction, the profits and consideration ratios calculations were less than 25% and the assets and revenue ratios calculations were more than 75%. They indicated that the Reduction would be a very substantial disposal for Listco B and shareholders' approval was required.

Listco B submitted the following:

- The assets and revenue ratios should not be applicable. It was not reasonable to compare 7% of Target B's assets and revenue with those of the Group as shown in its accounts because Target B and the Group were engaging in different businesses and that Target B's assets and revenue were not consolidated in the Group's accounts.
- Listco B proposed that comparison should be made between 7% of Target B's assets/revenue and the Group's total assets/revenue after adjusting its proportionate interests in the assets/revenue of Target B and other jointly controlled entities. It also proposed to compare 7% of Target B's net assets with the Group's net assets. Based on these alternative size tests, the Reduction would only amount to a discloseable transaction.

HKEX DECISION

HKEx decided that the Reduction was a very substantial disposal for Listco B based on the following rationale:

- Target B was a material joint venture of Listco B in view of its contributions to the Group's net assets (50%) and net profits (90%). In Listco B's financial reports, Target B's business was disclosed as one of Listco B's principal businesses.
- The Reduction was part of a proposal to reduce Listco B's shareholding in Target B. When classifying the Reduction, it was necessary to consider the overall effect of Target B's restructuring on the Group.
- The Reduction and Issue of Shares would collectively result in Target B ceasing to be a joint venture of Listco B. As the transaction would have a material impact on the Group's business and financial position, it was appropriate to categorise the Reduction as a very substantial disposal for Listco B.
- Listco B's proposed alternative size tests were not acceptable as they did not take into account the overall effect of Target B's restructuring on the Group.

You can download copies of the listing decision via the link below:

<http://www.hkex.com.hk/eng/rulesreg/listrules/listdec/Documents/ld21-2011.pdf>

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