

GUIDE TO NOTIFIABLE TRANSACTIONS UNDER THE HONG KONG LISTING RULES

by Eden McMahon

What's Chapter 14 all about?

"Notifiable Transactions" are transactions which, as a result of their size, require specific disclosure to, or approval by, a listed issuer's shareholders. The more significant the transaction is for the company, the more onerous the requirements. Chapter 14 contains detailed and complex provisions regarding the types of transactions that trigger the rules. Transactions are classified according to their size on the basis of several percentage ratios, and each classification has a corresponding set of obligations for the listed issuer.

How does Chapter 14 work?

The transactions

Any type of transaction by a listed issuer, provided it is not of a revenue nature in the ordinary and usual course of their existing business, is potentially caught by Chapter 14. Several types of transactions are specifically referred to, including: acquisitions and disposals, options to acquire or dispose of assets or securities, finance leases, operating leases, the provision of financial assistance and the entering into of joint ventures. On top of the broad, inclusive definition, there are deeming provisions (for example, the allotment of shares by a subsidiary is deemed to be a disposal by the listed issuer), provisos and exceptions. It is important to note that the Stock Exchange of Hong Kong Limited (the "Exchange") may require a listed issuer to aggregate a series of transactions and treat them as though they are one transaction if the transactions are completed in a twelve month period or are otherwise related.

The math

Any "transaction" must then be categorized on the basis of certain calculations expressed as percentages, collectively referred to as "the percentage ratios". Listed issuers must consider all applicable percentage ratios, but may specifically request that the Exchange disregard a calculation that produces an anomalous result. Chapter 14 contains detailed notes regarding the figures to be used in the calculations. Briefly, the percentage ratios are:

- » **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 value of the consideration in the transaction divided by the total market capitalization of the listed issuer; and
- » **equity capital ratio:** the number of shares to be issued by the listed issuer as consideration in the transaction divided by the total number of the listed issuer's pre-transaction shares.

The verdict

Once the percentages for the transaction or series of transactions are calculated, the listed issuer can then determine whether they have a "notifiable transaction", and if this is the case, where such a transaction fits within the ambit of Chapter 14. In summary, the classifications of transactions, or series of transactions used in Chapter 14 are:

- » **share transaction:** acquisitions where the consideration includes listed securities and where all percentage ratios are less than 5%;
- » **discloseable transaction:** where any percentage ratio is more than 5% but less than 25%;
- » **major transaction:** where any percentage ratio is more than 25% but less than 100% for an acquisition or 75% for a disposal;
- » **very substantial disposal ("VSD"):** a disposal where any percentage ratio of more than 75%;
- » **very substantial acquisition ("VSA"):** an acquisition where any percentage ratio is more than 100%; and
- » **reverse takeover ("RTO"):** a VSA which is an attempt to achieve a backdoor listing of assets, normally involving a change in control of the listed issuer.

The consequences

The listed issuer must inform the Exchange and publish an announcement as soon as possible after the terms of any notifiable transaction have been finalised. Major transactions, VSDs, VSAs and RTOs must be made conditional on shareholders' approval. For major transactions, written

approval from shareholders holding more than 50% of securities will, in some cases, be accepted in lieu of a general meeting. However, in the case of VSDs, VSAs and RTOs, approval must always be given by a majority vote at a general meeting. A detailed circular must be despatched to shareholders at the same time as or before the listed issuer gives notice of the general meeting to approve the transaction (or in the case of a major transaction to be approved by way of written shareholders' approval, within 15 days after publication of the announcement). Circulars relating to the acquisition of businesses or companies will need to include an accountants' report. Listed issuers undertaking RTOs and some extreme VSAs will be treated as new listing applicants and will therefore need to meet the Exchange's conditions of listing and issue a circular similar to a prospectus.

Anything else to look out for?

Where do we start? These are just some of the other issues you may need to consider when you are contemplating a notifiable transaction:

- » **connected transaction:** if a notifiable transaction is also a connected transaction (sometimes known as a related party transaction in other jurisdictions) for the purposes of Chapter 14A of the Listing Rules, a listed issuer will need to comply with both sets of requirements.
- » **mineral or petroleum assets:** under Chapter 18 of the Listing Rules, if the company acquires mineral or petroleum assets following listing and the transaction is a major transaction, VSD, VSA or RTO, then the circular the company sends to shareholders must also include a competent persons report on the resources or reserves being acquired or disposed of as part of the transaction, a valuation report, and various specific disclosures about the assets and the Company's operations.
- » **cash company:** where for any reason, including after completing a notifiable transaction, the assets of a listed issuer will consist wholly or substantially of cash or short dated securities, the listed issuer will be designated as a "cash company" not suitable for listing and trading in its securities will be suspended.
- » **mandatory general offer:** if the transaction involves a change in control, the new controlling shareholder may trigger a mandatory offer under the Code on Takeovers and Mergers. Note, if the change in control will arise as a result of the issue of new shares as consideration for an acquisition, or a cash subscription, the mandatory offer requirement may in some cases be waived if there is an independent vote at a shareholders meeting, known as a "whitewash".

Got it?

Below is an even quicker guide to our quick guide:

Type of transaction (percentage ratio)	Notify the Exchange and publish an announcement	Circular, shareholders' approval and accountants report	Treated as a new listing applicant
Share transaction (<5%)	Yes	No, provided shares can be issued under general mandate	No
Discloseable transaction (5% to <25%)	Yes	No	No
Major transaction (25% to <100% for acquisition or <75% for disposal)	Yes	Yes	No
Very substantial disposal (VSD) (75% or more)	Yes	Yes to circular and approval, but accountants' report not required	No
Very substantial acquisition (VSA) (100% or more)	Yes	Yes	Extreme cases only
Reverse takeover (RTO)	Yes	Yes	Yes



Eden McMahon

Partner
 Hong Kong
 (852) 2105-0220
mcmahon.eden@dorsey.com

This guide has been prepared by Dorsey & Whitney and is for general information only. It is not a full analysis of the matters presented and should not be relied upon as legal or other professional advice. If you would like to discuss the matters contained in this guide, please contact Dorsey & Whitney. © Copyright 2016 Dorsey & Whitney LLP