Practice Note 6 (PN6) – Appropriate offers for convertibles or warrants under Rule 13 and calculation of "see-through" price

Rule 13.1 of the Takeovers Code provides that "[w]here an offer is made for equity share capital and the offeree company has convertible securities outstanding, the offeror must make an appropriate offer or proposal to the holders of the convertible securities to ensure that their interests are safeguarded. Equality of treatment is required".

The main rationale of Rule 13.1 is to ensure equal treatment of holders of convertible securities or warrants of the offeree company during an offer (see General Principle 1 of the Codes). Rule 13.1 also reflects General Principle 2 of the Codes which provides that "[i]f control of a company changes or is acquired or is consolidated, a general offer to all other shareholders is normally required".

<u>Appropriate offers to be made</u>

In an earlier consultation the Executive was asked whether it would waive the requirement to make an appropriate offer to the holder of a convertible note of the offeree company under Rule 13.1 in the event a possible offer is made. This request was made on the basis that, among other things, the conversion rights under the note are not exercisable within the offer period (the note would only be exercisable sometime after the end of the offer period).

The Executive wishes to clarify that regardless of whether the conversion rights under convertible securities or warrants are exercisable within the offer period, where there is an offer for shares of a company under the Takeovers Code, the Executive would normally require an appropriate offer to be made under Rule 13.

<u>Calculation of "see-through" price</u>

Normally the consideration under any offer or proposal in relation to convertible securities, warrants, options or subscription rights will be considered appropriate if it is based on the offer price for the relevant equity share capital and such "see-through" price should be regarded as the minimum offer price (see Note 1 to Rule 13). The market price of the relevant securities is not relevant to the calculation of the "see-through" price. The following example illustrates how the "see-through" price of convertible securities may be calculated:

Example:

An offeror is offering $2 for each ordinary share in the offeree company. Other than ordinary shares, the offeree company has in issue (i) options entitling holders to subscribe for ordinary shares at an exercise price of $1 per share and (ii) convertible notes with a face value of $100 which is convertible into ordinary shares at $4 per share.

The option offer – The see-through value of each option would be the difference between the offer price for each ordinary share and the exercise price of each option. In this case, the relevant see-through price is $1 for each option on the basis that the offer price for each ordinary share is $2 and the exercise price of each option is $1.

The convertible note offer – The see-through value of each convertible note would be the number of ordinary shares which each convertible note is convertible into multiplied by the offer price for each ordinary share. In this case, the relevant see-through price is $50 for each convertible note with face value of $100 on the basis that each convertible note is convertible into 25 ordinary shares (i.e. $100 face value divided by the conversion price of $4 per share) and the offer price for each ordinary share is $2.

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