

TAKEOVERS AND MERGERS PANEL

Far East Aluminium (Holdings) Limited

Panel decision in relation to the application of Rule 26.3 of the Takeovers Code

Introduction

1. The Panel met on 30 March 1999 to consider a referral by the Executive in connection with Far East Aluminium (Holdings) Limited ("FEAH"), a company listed on The Stock Exchange of Hong Kong Limited. The referral was made by the Executive to the Panel for a ruling pursuant to paragraph 10 of the Introduction to the Takeovers Code (the "Code") as it considered that an important and novel point was at issue. The key issue was whether the proposed offer price should take into account amounts paid by the offeror and a party acting in concert with it under pre-existing guarantees.

Facts

2. In January 1995, Panorama International Limited ("Panorama") borrowed HK\$280,000,000 (the "Loan") from CEF (Capital Markets) Limited (the "Lender") to finance its acquisition of control and the making of a general offer for FEAH. The term of the Loan was one year, and was secured by Panorama's entire interest in FEAH, 225,771,900 shares or 75% in February 1995 and currently 220,911,900 shares or 60.14%.
3. Far East Wagner (BVI) Limited ("FEW"), the immediate holding company of Panorama, provided a guarantee in favour of the Lender for the full amount of the Loan. FEW was held as to 65% indirectly by Mr. and Mrs. K. K. Wong, the founding shareholders of FEW, and 35% indirectly by Leading Point Investment Limited ("Leading Point"). The shareholding structure of FEAH in 1995 was set out in **Schedule 1**.

4. When the Loan was due in January 1996, Panorama failed to repay the Loan and the outstanding balance of the Loan was extended for another year.
5. In January 1997, Panorama failed to repay the outstanding balance again. After a series of negotiations, Panorama sold part of the pledged shares to repay part of the Loan. The balance of HK\$120,000,000 was rolled-over to January 1998 with the support of a guarantee provided by Leading Point in favour of the Lender in October 1997 for the full amount of the Loan. Leading Point, indirectly holding 35% of FEW, was in turn indirectly held by, inter alia, China National Aero-Technology Import & Export Corporation Limited ("CATIC"), Cheung Kong Holdings Limited ("CKH"), and CEF Holdings Limited ("CEF Holdings").
6. In January 1998, the Lender agreed to extend the Loan again to October 1998 as additional guarantees were obtained from CATIC International Finance Limited ("CATIC Finance") (on behalf of CATIC) and CKH. CATIC Finance is a subsidiary of CATIC which indirectly held 48.98% of Leading Point. CKH was an indirect shareholder of Leading Point with an attributable interest of 22.96%¹. **Schedule 2** sets out FEAH's shareholding structure at the time of the hearing.
7. The guarantees provided by CATIC Finance and CKH were on a several basis only and **not** for the full amount of the Loan. CATIC Finance's guarantee was limited to HK\$58,776,000 (or such lesser amount representing 48.98% of the Loan). The guarantee provided by CKH was limited to HK\$27,552,000 (or such lesser amount representing 22.96% of the Loan). CATIC Finance and CKH in total guaranteed an amount of HK\$86,328,000 (or such lesser amount representing 71.94% of the Loan) in favour of the Lender.

¹ CKH's attributable interest in Leading Point includes that of Longhin International Limited as Longhin's shares in Kash Rich Investments Limited were charged to CKH (via Beauty Queen Limited which had advanced a loan to Longhin) and Longhin was in default under the loan.

8. Before this hearing, the Lender informed Panorama that no further extension would be given and the Loan was overdue. The outstanding balance of the Loan at the time of the hearing was HK\$120,000,000 and was secured by a charge over the shares of FEAH held by Panorama. In summary, at the time of hearing, the Loan was secured by the following guarantees:
 - i. FEW for the full amount of the Loan;
 - ii. Leading Point for the full amount of the Loan;
 - iii. CATIC Finance for a maximum of HK\$58,776,000 or such lesser amount representing 48.98% of the Loan; and
 - iv. CKH for a maximum of HK\$27,552,000 or such lesser amount representing 22.96% of the Loan.

9. It was agreed that CATIC HK Limited ("CATIC HK"), a wholly owned subsidiary of CATIC, would acquire from Panorama approximately 51% of FEAH and Beauty Queen Limited ("Beauty Queen"), a wholly owned subsidiary of CKH, would acquire the remaining 9.14% of FEAH from Panorama (the "Acquisition") both at a price of HK\$0.23 per share (the "Acquisition Price"). The shareholding structure of FEAH after the Acquisition is set out in **Schedule 3**.

10. Panorama would use the total consideration of HK\$50,810,000 (220,911,900 shares at HK\$0.23 per share) to repay the Loan. The Lender would then release the pledged shares after CATIC and CKH injecting new funds in a total sum of HK\$69,190,000 into Leading Point to repay the Loan in full. The new funds would be injected in the same proportions as the respective guarantee obligations of CATIC Finance and CKH. Hence, CATIC and CKH would come up with additional sums of HK\$47,110,000 and HK\$22,080,000 respectively. In return, CATIC's interest in Leading Point would increase from 48.98% to 68.03% and CKH would become a direct shareholder of Leading Point holding 31.83%. The interest of Kash Rich Investment Limited ("Kash Rich", the other existing shareholder of Leading Point, see Schedule 2 regarding the existing relationship between Kash Rich and CKH) in Leading Point would be diluted from 51.02% to 0.14%. The proposed shareholding structure of Panorama after the Acquisition and the fund injection is shown in **Schedule 4**.

11. The Lender was a wholly owned subsidiary of CEF Holdings. CKH had a 50%

interest in CEF Holdings, the remaining 50% interest was held by the Canadian Imperial Bank of Commerce. CEF Holdings was also a shareholder of Panorama through its indirect interest in Leading Point.

12. CICC, on behalf of CATIC HK, applied for a ruling from the Executive that the price per share for the general offer resulting from the Acquisition will be equivalent to the Acquisition Price at HK\$0.23 per share. The Executive considered that an important and novel point was at issue and referred the matter to the Panel.
13. The shares of FEAH had been illiquid, and had only been traded on five days from the beginning of the year to 25 March 1999. The price was in the range of HK\$0.24 to HK\$0.25 per share in early January 1999. After FEAH issued an announcement on 25 January 1999 on the proposed change of shareholding and loss warning, the price fell further to HK\$0.19 per share. The closing price of the shares had been at HK\$0.17 from 3 February 1999 to 25 March 1999.
14. While FEW and Leading Point both guaranteed the full amount of the Loan, it was unlikely that they had the resources to repay the Loan in full. The two guarantors that were of substance were CATIC Finance and CKH, who had on a several basis, guaranteed HK\$58,776,000 and HK\$27,552,000 respectively (a total of HK\$86,328,000).
15. If the Lender decided to call on the guarantees provided by CATIC Finance and CKH, the balance of the Loan, i.e. a shortfall of HK\$33,672,000 (HK\$120,000,000 less HK\$86,328,000) would remain. Based on 220,911,900 shares of FEAH (or 60.14%), the Lender would need to exercise its power under the pledge to sell the shares at only HK\$0.152 per share for it to recover the Loan in full.
16. FEAH reported a HK\$10.31 million profit attributable to shareholders for the fiscal year ending 31 December 1997. For the six months ending 30 June 1998, it still reported a HK\$2.18 million profit attributable to shareholders. However, on 25 January 1999, it made a warning announcement stating that unaudited losses for the eleven months ending 30 November 1998 amounted to approximately HK\$145 million. Based on the information provided by CICC, after adjustment for the eleven months losses, the net asset value per share amounted to approximately HK\$0.294 per share.

17. The proposed offer price of HK\$0.23 per share was at a 21.8% discount from the adjusted net asset value of HK\$0.294 of FEAH as of November 1998. It was also at a 6% discount from the closing price of HK\$0.245 on 11 January 1999, two days before the filing of the application with the Executive. The market price on 24 March 1999 was HK\$0.17 per share.

The Issue

18. Rule 26.3(a) of the Code provides that –

"Offer made under this Rule must ... be in cash or be accompanied by a cash alternative at not less than the highest price paid by the offeror or any person acting in concert with it for voting rights of the offeree during the offer period and within 6 months prior to its commencement."

19. The fundamental issue is whether the payments under the guarantees by CATIC Finance and CKH² were to be regarded as part of the "price paid by the offeror or any person acting in concert with it".
20. Both the Applicant and the Executive submitted that the Loan was a normal commercial transaction, which, together with its supplemental agreements and guarantees, were all properly documented. They also believed that when Panorama was unable to repay the Loan in January 1998, it was normal commercial decision of the Lender to require additional guarantees from CATIC and CKH for it to agree to extend the term of the Loan. The Executive, after taking into consideration the internal procedures adopted by the Lender, also believed that the Lender had acted independently with respect to the Loan.

Panel Decision

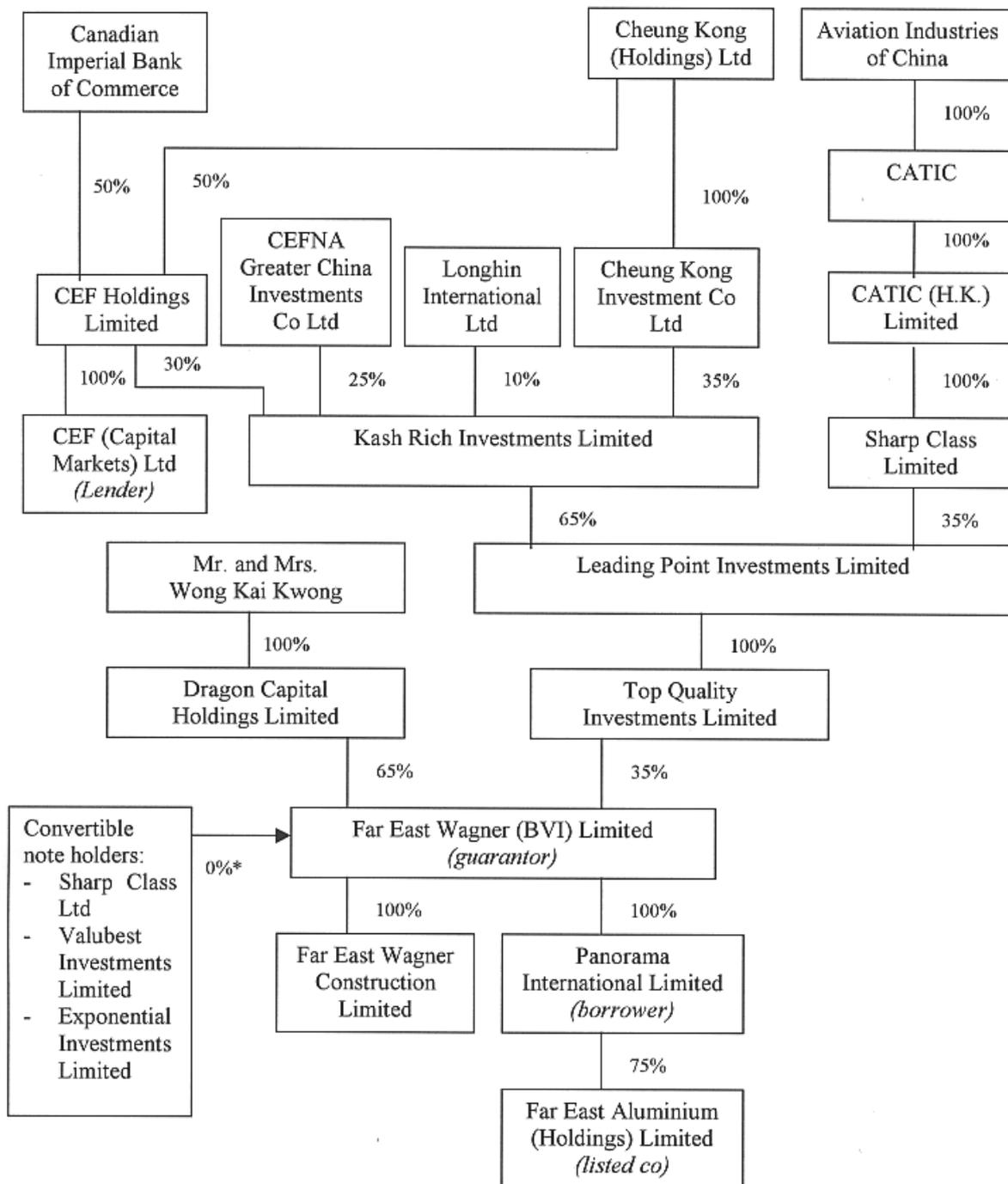
21. Based on the evidence provided and circumstances pertinent to the case, the Panel granted the application and allowed the offer to proceed at the Acquisition Price. The Panel was mindful of paragraph 1.8 of the Introduction to the Code which provides that the Code should not be concerned with the financial or commercial advantages or disadvantages of a takeover transaction. Accordingly, the Panel would emphasize that it was not ruling on the fairness and reasonableness of the proposed offer price.

²*The Applicant and CKH admitted that they were parties acting in concert.*

22. The Panel noted that CATIC had during the hearing undertaken that it would proceed with the mandatory general offer at HK\$0.23 per share if the application was agreed by the Panel.
23. Notwithstanding the above, if similar cases arise in the future, the Panel would be concerned, depending on the facts and pertinent circumstances, as to whether the acquisition price and the resultant offer price were arrived after genuine and arm's-length negotiation. In this connection, the relevant parties may need to consider at an early stage other possible steps to ensure a due process of negotiation, such as to involve independent directors of the offeree company, or to introduce an independent financial adviser to assess whether the proposed offer price is fair and reasonable.
24. Finally, as the Panel has placed heavy reliance on the evidence provided and circumstances pertaining to this particular case in making the decision, this Panel decision should not be treated as a precedent for similar cases in the future for each should be considered on its own merits. In particular, the Panel decision should not be treated as a precedent that amounts paid by an offeror and parties acting in concert with it under pre-existing guarantees would be disregarded in the determination of the price of an offer under Rule 26.3.

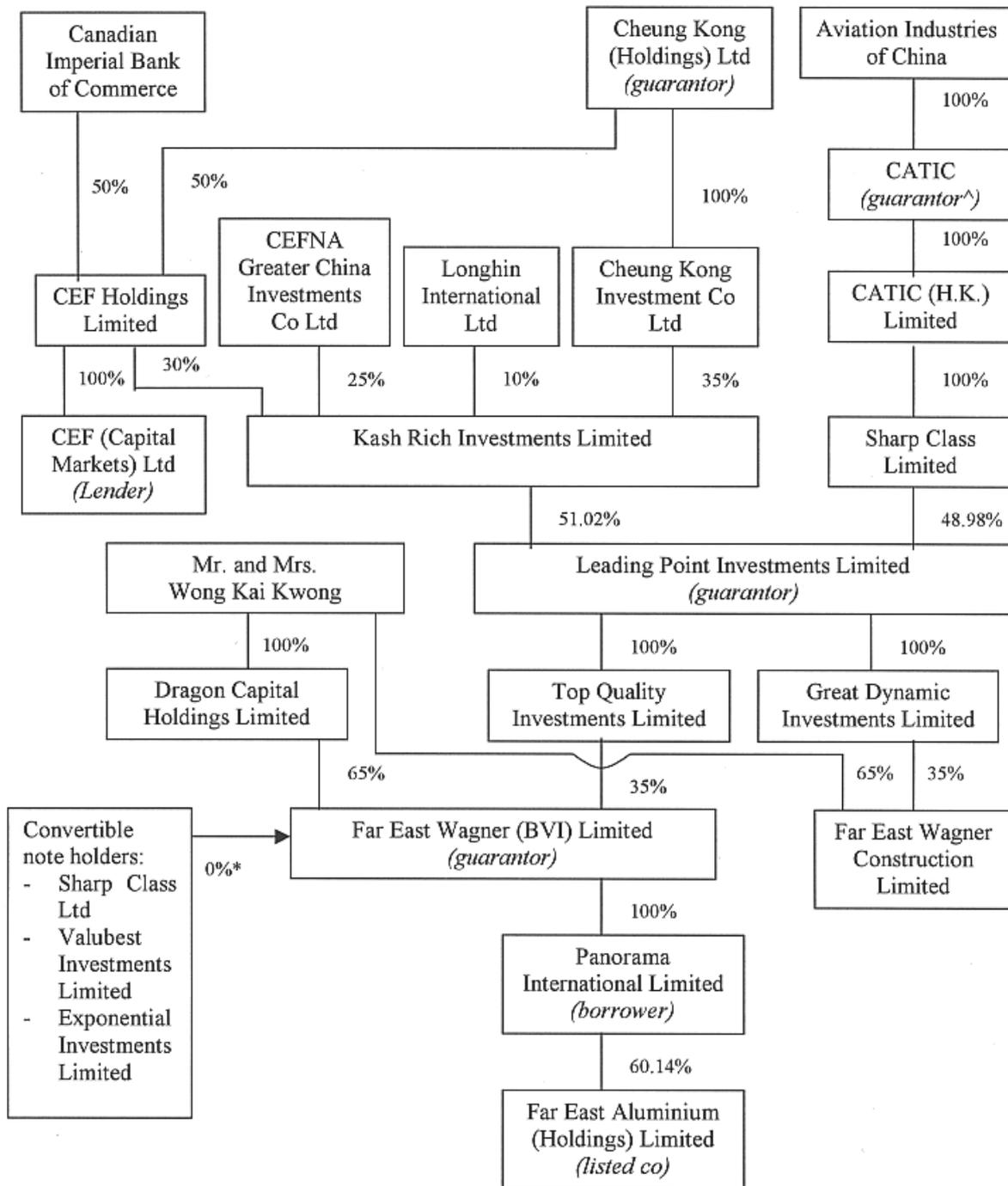
14 April 1999

Holding structure of Panorama International Limited immediately after the close of offer and the subsequent placing in February 1995



* The Convertible note holders are entitled to approximately 22.5% of the enlarged issued share capital of Far East Wagner (BVI) Limited upon exercise of their respective conversion rights.

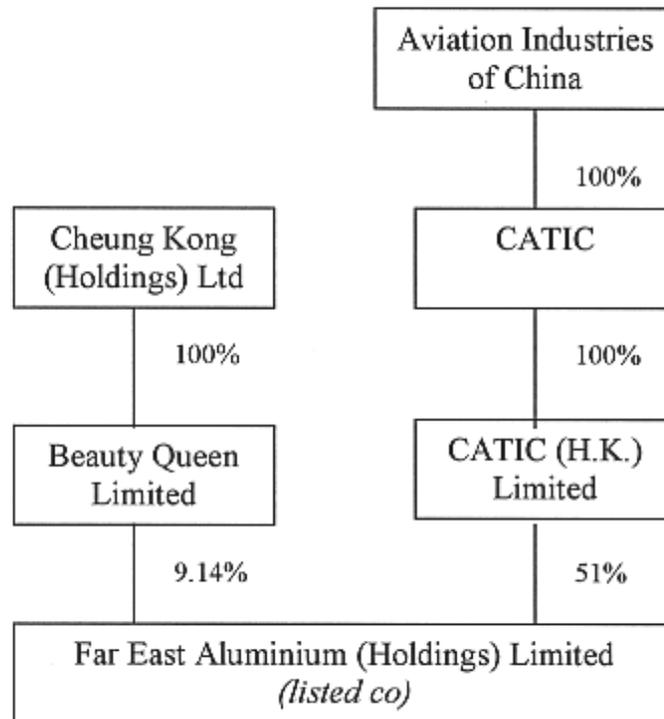
Current holding structure of Panorama International Limited



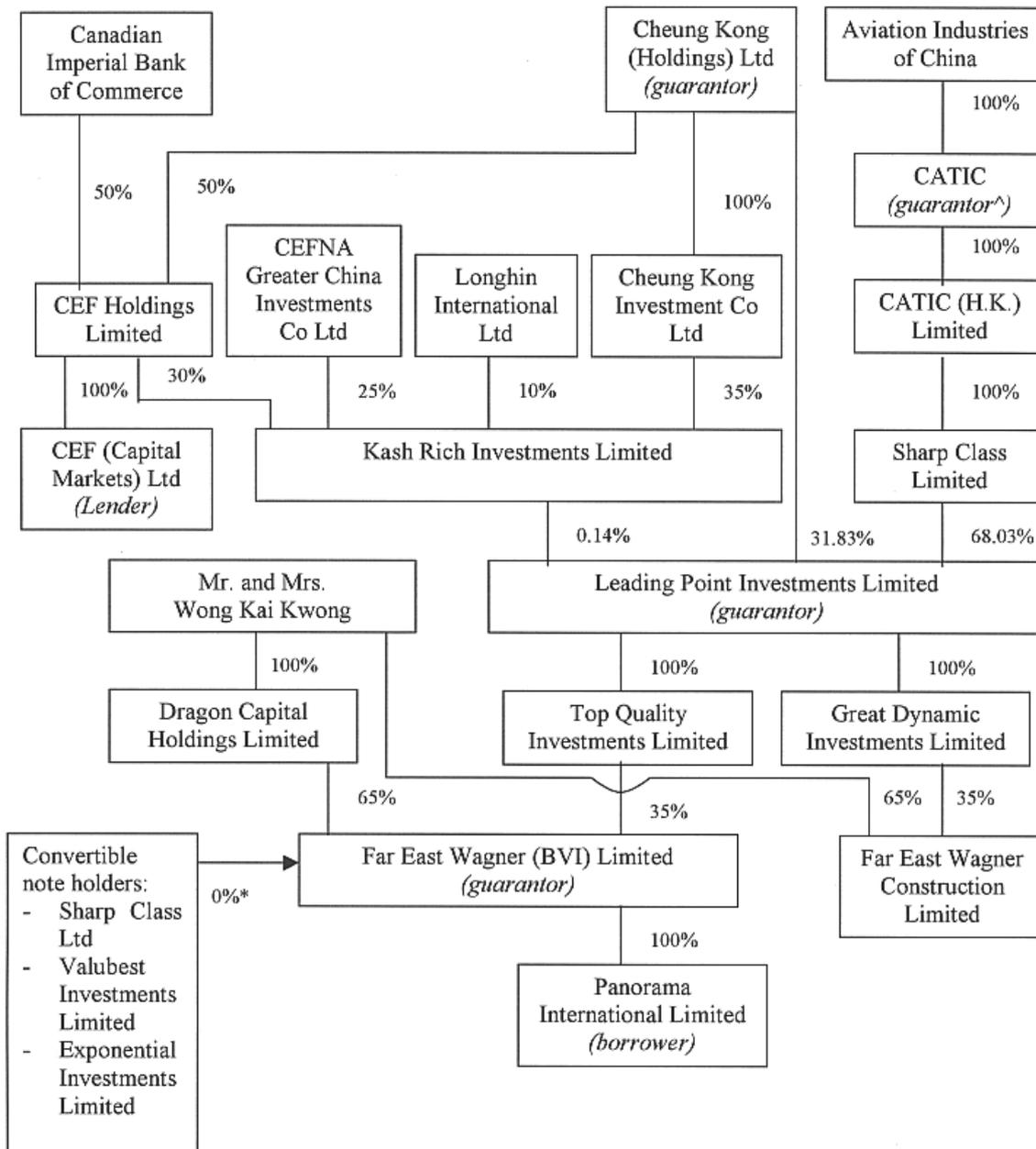
^ Through CATIC International Finance Limited.

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Holding structure of Far East Aluminium (Holdings) Limited after the Acquisition



Holding structure of Panorama International Limited after the Acquisition and the payments under the guarantee obligations



^ Through CATIC International Finance Limited.

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