

## TAKEOVERS AND MERGERS PANEL

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### Panel Decision

**In relation to a referral by the Takeovers Executive to the Takeovers and Mergers Panel (the "Panel") for a ruling as to whether certain parties were acting in concert in relation to Hung Hing Printing Group Limited ("Hung Hing") and related issues under the Codes on Takeovers and Mergers and Share Repurchases ("Codes")**

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#### Introduction

1. The Panel met on 12 April 2011 to consider a referral by the Takeovers Executive under section 10.1 of the Introduction to the Codes, which relates to referrals by the Takeovers Executive in respect of particularly novel, important or difficult points at issue.
2. The Panel was asked to consider:
  - (a) Whether the parties, namely, Rengo Co., Ltd ("Rengo") and the family ("Family") of the late Mr Yam Cheong Hung ("Mr Yam") are parties acting in concert in relation to Hung Hing?
  - (b) If so, whether a mandatory general offer obligation will be triggered as a result of the completion of the proposed acquisition of a 29.9% interest in Hung Hing ("Proposed Acquisition") from Asia Packaging Company Limited ("Asia Packaging")?
  - (c) Whether any arrangements exist between Rengo and Asia Packaging that would effectively allow Rengo to exercise control over Asia Packaging's remaining 7.6% interest in Hung Hing should the Proposed Acquisition complete?
3. Rengo and Asia Packaging agreed the terms of a sale and purchase agreement relating to the Proposed Acquisition ("SP Agreement") the entry into which was conditional, inter alia, upon clearance by the Takeovers Executive that no mandatory bid would be triggered by the Proposed Acquisition. Pursuant to the SP Agreement:
  - (a) Rengo proposes to acquire a 29.9% shareholding interest in Hung Hing from Asia Packaging.
  - (b) Rengo would pay HK\$5.25 per share, which represents a premium of approximately 52.2% compared to the closing share price of Hung Hing on 16 February 2011, the date of an exclusivity agreement between Rengo and Asia Packaging.
  - (c) Directors nominated by Asia Packaging shall propose the appointment of three nominees from Rengo to Hung Hing's board of directors and the directors nominated by Asia Packaging shall vote in favour of the appointment of the Rengo nominees conditional on completion of the SP Agreement taking place.

## Background and facts

4. Hung Hing is a company listed on the Main Board of The Stock Exchange of Hong Kong Limited ("Stock Exchange") engaging in book and packaging printing, consumer product packaging, corrugated box manufacturing and paper trading. Hung Hing was founded by Mr Yam in 1950. Mr Yam passed away in December 2010. Hung Hing has been run by the Family for more than 60 years. Mr Matthew Yum Chak Ming ("Mr Yum"), the son of Mr Yam, is the Chairman and an executive director of Hung Hing. The Family held an approximately 50.53% shareholding interest in Hung Hing immediately before Asia Packaging's subscription for new shares in 2008 (see paragraph 5 below). Its current shareholding interest in Hung Hing is approximately 33.39%. Hung Hing's board of directors comprises ten directors (two executive directors, five non-executive directors and three independent non-executive directors). Both executive directors and one non-executive director were nominated by the Family, and the remaining four non-executive directors were nominated by Asia Packaging.
5. Asia Packaging is a company controlled by funds advised by CVC Asia Pacific Limited ("CVC"). CVC is a private equity and investment advisory firm. In 2008 Asia Packaging subscribed 323,500,445 shares (representing approximately 35% of the then enlarged issued share capital) of Hung Hing for cash at HK\$2.70 each ("Asia Packaging Subscription"). At that time Asia Packaging applied for, and was granted, a waiver pursuant to Note 1 on dispensations from Rule 26 of the Codes as a result of its acquisition of 30% or more of the voting rights under the Asia Packaging Subscription. Upon the Asia Packaging Subscription, the Family's shareholding in Hung Hing was diluted from 50.53% to 32.85% resulting in it becoming the second-largest shareholder in Hung Hing. Prior to entering into the Proposed Acquisition Asia Packaging's shareholding interest in Hung Hing was approximately 37.5%.
6. Rengo is a packaging solutions company incorporated in Japan and publicly traded on the Tokyo Stock Exchange. On 16 March 1992, Rengo acquired 100,000 shares in Hung Hing representing approximately 0.01% shareholding interests in Hung Hing. Rengo held a 0.01% shareholding interest in Hung Hing prior to entering into the Proposed Acquisition.
7. Since 1995 Rengo and Hung Hing have had mutual ownership interests in two foreign-invested enterprises ("Paper Mill Joint Ventures") which carry out paper manufacturing in a plant in Zhongshan in the People's Republic of China, namely, Zhongshan Rengo Hung Hing Paper Manufacturing Limited and Zhongshan Ren Hing Paper Manufacturing Company Limited. The Paper Mill Joint Ventures were initially held as to 35% and 65% respectively by Rengo and Hung Hing. Following the Asia Packaging Subscription, Hung Hing did not want to expand the paper mill business and sold 30% of its interest to third parties (including a company wholly owned by Mr Spencer Sung ("Mr Sung"), a cousin of Mr Yum) in 2009. In 2010, Rengo injected US\$37.5 million of capital into the Paper Mill Joint Ventures. Upon such injection Rengo's shareholding interest in the Paper Mill Joint Ventures increased to 62.8% and Hung Hing's interest was diluted to 11.3%. Another 71% owned subsidiary of Hung Hing holds a 7.5% interest in the Paper Mill Joint Ventures and Homegrace Consultants Limited, a company wholly owned by Mr Sung, holds a further 3.1%. For many years there has been, and continues to be, regular contact between Rengo and Hung Hing through their participation in the board meetings of the Paper Mill Joint Ventures, which are held once or twice a year. Recently, due to the capital injection by Rengo and consolidation of the Paper Mill Joint Ventures, the parties have met more frequently (every two to three

months). Rengo's contact has been with Mr David Eitemiller, Chief Executive Officer of Hung Hing, Mr Eric Lui, Chief Financial Officer of Hung Hing and Mr Sung.

### **The relevant provisions of the Codes**

8. "Acting in concert" is defined in the Codes as follows:

*"Persons acting in concert comprise persons who, pursuant to an agreement or understanding (whether formal or informal), actively cooperate to obtain or consolidate "control" (as defined below) of a company through the acquisition by any of them of voting rights of the company."*

As a number of decisions of the Panel confirm, "acting in concert" requires three conditions to be met: it requires more than one person actively cooperating pursuant to an agreement or understanding; the purpose of the cooperation is to obtain or consolidate control of the company to which the provisions of the Codes apply; and at least one of the persons actively cooperating to acquire voting rights attaching to shares in that company.

9. Under Rule 26.1

*"Subject to the granting of a waiver by the Executive, when*

*(a) ...*

*(d) two or more persons are acting in concert, and they collectively hold not less than 30%, but not more than 50%, of the voting rights of a company, and any one or more of them acquires additional voting rights and such acquisition has the effect of increasing their collective holding of voting rights of the company by more than 2% from the lowest collective percentage holding of such persons in the 12 month period ending on and inclusive of the date of the relevant acquisition;*

*that person shall extend offers, on the basis set out in this Rule 26, to the holders of each class of equity capital of the company..."*

When a controlling shareholder, such as Asia Packaging, sells a part only of its shareholding, the Takeovers Executive under Note 7 to Rule 26.1 "will be concerned to see whether in such circumstances the arrangements between the purchaser and vendor effectively allow the purchaser to exercise a significant degree of control over the retained voting rights, in which case a general offer would normally be required." The Note then describes the criteria which would be applied to establish the degree of control over the retained voting rights in the following terms:

*"A judgement on whether such a significant degree of control exists will obviously depend on the circumstances of each individual case, but, by way of guidance, the Executive would regard the following points as having some significance:-*

- (a) there would be less likelihood of a significant degree of control over the retained voting rights if the vendor was not an "insider";*
- (b) the payment of a very high price for the voting rights would tend to suggest that control over the entire holding was being secured;*

- (c) *if the parties negotiate options over the retained voting rights it may be more difficult for them to satisfy the Executive that a significant degree of control is absent. On the other hand, where the retained voting rights are in themselves a significant part of the company's capital (or even in certain circumstances represent a significant sum of money in absolute terms) a correspondingly greater element of independence may be presumed; and*
- (d) *it would be natural for a vendor of part of a controlling holding to select a purchaser whose ideas as regards the way the company is to be directed are reasonably compatible with his own. It is also natural that a purchaser of a substantial holding in a company should press for board representation and perhaps make the vendor's support for this a condition of purchase. Accordingly, these factors, divorced from any other evidence of a significant degree of control over the retained voting rights, would not lead the Executive to conclude that a general offer should be made."*

### **The case of the Takeovers Executive in summary**

10. The Executive believed that the facts and circumstances of this case raised serious concerns that Rengo and the Family may be acting in concert in that it appeared likely that they had reached some sort of understanding or agreement, albeit informal, to actively cooperate to obtain or consolidate control through the acquisition of voting rights. In reaching this view, the Executive paid significant regard to the following:
  - (a) there was a long-standing pre-existing relationship between the Family and Rengo which dated back to a time before 1995, when Mr Yam and the former Chief Executive Officer of Rengo had first had contact. Rengo and Hung Hing have had joint interests in the Paper Mill Joint Ventures since 1995. The fact that CVC initiated the Proposed Acquisition did not alter this fact. When an acquisition becomes possible, and parties then meet and reach an understanding, it becomes irrelevant who actually initiated the possibility of making that acquisition;
  - (b) for many years there had been, and continued to be, regular contact between Rengo and Hung Hing through their participation in the board meetings of the Paper Mill Joint Ventures;
  - (c) at a dinner meeting on 19 January 2011 attended by the Family, Rengo and Asia Packaging, the Family indicated that they would prefer the buyer of Asia Packaging's stake to be someone known to them. The Family's wish that the buyer was known to it illustrates its intention to safeguard its continued dominance of Hung Hing. Furthermore, given the closeness (29.9% versus 33.39%) of the parties' respective shareholdings in Hung Hing following completion of the Proposed Acquisition, the submissions that neither party had given thought to the possibility of any hostility arising between them in future and what might be done to protect their respective interests in such eventuality lack credibility;
  - (d) guidelines prepared by Rengo's advisers for its meeting with the Family indicate, in the event that the Family did not intend to sell down its stake in Hung Hing, Rengo's willingness to work together with Family members as partners to develop the business of Hung Hing together in the future. This, in the Executive's view, not only indicated a close relationship and one of trust,

but also indicated a relationship that was expected to endure long after completion of the acquisition of shares by Rengo;

- (e) the Executive found the submissions from both the Family and Rengo that there was no discussion whatsoever between Rengo and the Family regarding board seat arrangements for Rengo also to lack credibility. The Executive's concern was further reinforced by the fact that during the dinner meeting the parties discussed a number of substantive issues including the Family's attitude towards disposing of its shares in Hung Hing and remaining as a shareholder in the event that Hung Hing were successfully privatised;
- (f) the Executive believed it to be significant that Rengo is prepared to pay a purchase price of an approximate 52.2% premium per share to the closing price of the shares on 16 February 2011 (this represents a premium of approximately 67.73% as compared with the closing price on 1 April 2011) for a 29.9% interest in Hung Hing which will result in it becoming the second largest shareholder. The Executive also noted that the proposed purchase price represents a premium of approximately 68.44% over the net asset value of Hung Hing based on its latest interim report and a price to earnings multiple of 25.86x based on its latest published annual report; and
- (g) the Executive believed that the facts and circumstances of this case tend to suggest that the concerns set out in Note 7 to Rule 26.1 do not apply to the current situation and accordingly the question set out in paragraph 2(c) above should be answered in the negative.

### **The case of Rengo in summary**

11. Rengo argued that, in a situation where an investor proposes to become a significant new shareholder and where there is an existing shareholder with a controlling stake, in order to support a finding of acting in concert there must be more than a temporary meeting of minds or a level of comfort with one another. In Rengo's view, the Executive had presented no evidence to support its preliminary finding that the three elements of acting in concert were present, other than circumstantial evidence that the parties knew one another and had met one another, and conjecture that they must have reached some understanding as to joint control because of the high price offered for the relevant shares.
12. According to Rengo:
  - (a) There was no active cooperation. At most, there was passive acquiescence by the Family towards Rengo's proposed acquisition.
  - (b) There was no evidence as to what possible benefits Rengo could obtain from an agreement or understanding with the Family, such as an agreement to increase dividends in the future, merge businesses, or vote in favour of some impending resolution. The Executive has asserted that the parties must have conspired to have Rengo nominees appointed to the board of directors of Hung Hing and generally to control the company in the future. However, Rengo maintained that no agreement was reached as to board seats.
  - (c) Rengo had very real and compelling reasons to invest at the price and on the terms proposed. It would acquire a strategic minority investment, within the discounted cash flow valuation range used by Rengo to determine value.

### **The case of the Family in the selling process by Asia Packaging**

13. The Family claimed a very passive role in the sales process and stressed its inability to influence the outcome of that process. In particular, the Family stated that it did not have any details as to individual bid structures, what percentage stake each bidder was seeking to acquire, or any board arrangements. In addition, the Family had also been distracted by the passing away of Mr. Yam at the end of 2010.
14. The Family stated that it felt no need to safeguard its dominance over Hung Hing, as it did not feel in danger of losing control of the company. The Family's 33.34% stake already allowed it to exercise a degree of control at shareholders' meetings, and the company could not be delisted and privatised without the Family's consent.
15. The Family said that it did not indicate a preference for any particular bidder and considered all the shortlisted bidders to be of a very good international or regional standard. The Family believed that each of these bidders would be a very good shareholder in terms of providing long-term shareholder support.
16. The Family conceded that it did have a long relationship with Rengo, but it believed that the relationship should not be automatically construed as a concerted relationship. For example, the Family stated that there had been past instances where the Family had been in disagreement with Rengo on business matters. As far as the Family was concerned, the relationship with Rengo was driven entirely by business considerations. The Family maintained that the mutual respect and the long-standing relationship would not always translate into collaboration or agreement.
17. Finally, although the Executive had focused on the relationship between Hung Hing and Rengo through the Paper Mill Joint Ventures, the Family pointed out that this represented a very small business, relative to Hung Hing or Rengo's overall businesses.

### **The case of Asia Packaging/CVC and selling process to Rengo**

18. CVC's submission was mainly limited to comments on the competitive process and valuation in respect of the stake sale, and in particular whether such valuation represented a payment for control or was justifiable for other good business and commercial reasons.
19. CVC identified its criteria for selecting the final bidders as price, certainty, and speed of closing of the deal. Its preference was to sell its entire stake, and it instructed JP Morgan to ask for a higher price if it could only sell a portion of its shares, because it would take the risk for disposing of the remaining shares at a potentially lower price.
20. The final shortlist for the proposed sale comprised bidders identified and brought into the process by JP Morgan through their own research, not by the Family or CVC. CVC represented the process as being conducted on an arm's length basis. CVC was free to transfer its stake in Hung Hing, with no obligation to the Family in terms of consent to sell or any first right of refusal.
21. CVC indicated that the Family was excluded totally from the selection of bidders and any negotiations during the process. It said that the Family was only informed of the deal structure and the identity of the buyer at a board meeting with all other directors of Hung Hing, including the independent directors after the relevant parties

had fully negotiated and agreed the terms of a share purchase agreement and signed an exclusivity agreement.

22. Regarding Asia Packaging's residual stake in Hung Hing, CVC believed that, after the sale, Hung Hing's share price should favourably reflect the true value of the business, first because the company would have a stronger shareholder with deep pockets and a deep knowledge of the industry, and also because of the possible synergies the new shareholder could bring to the company.

#### **Private Session for JP Morgan to present the sales process**

23. For reasons of commercial sensitivity regarding other potential buyers, and with the consent of Rengo and the Family, they and their respective advisers excused themselves while the Panel was given a presentation by JP Morgan regarding the sales process.
24. The Panel members gained a good understanding of the sales process conducted by JP Morgan.

#### **The decision and the reasons for it**

25. On balance, weighing the evidence presented, the Panel is unable to find sufficient evidence to establish that Rengo and the Family were acting in concert in relation to the Proposed Acquisition. Accordingly, no general offer obligation arises from it.
26. Whilst Rengo and the Family know each other, the Panel is not satisfied, on the evidence available, that they were "actively cooperating" to obtain or consolidate control.
27. The disposal process established by Asia Packaging appears to have been transparent, was managed by an independent party (namely JP Morgan), and involved other potential bidders. Although the price to be paid by Rengo for the 29.9% stake if the transaction completes will be at a substantial premium to the market price as stated in paragraph 10(f) above, and it is evident that Rengo wished to avoid triggering a general offer obligation by acquiring 30% or more of Hung Hing, there is no evidence of any proposed control or influence by Rengo over the residual stake to be held by Asia Packaging. Accordingly, even if the premium contains some compensation to Asia Packaging for the lower price it would likely receive in the market for its residual stake, the existence of a large premium in itself would not establish that an interest in voting rights of 30% or more will be acquired.
28. Asia Packaging has also assured the Executive that it will use all reasonable endeavours to dispose of its remaining stake of 7.6% as soon as possible. Based on the representations made by Asia Packaging, the Panel is satisfied that Rengo would not exercise control over this remaining stake.

24 May 2011

Parties present at the hearing:

The Takeovers Executive

Rengo Co., Ltd

Nomura International (Hong Kong) Limited and Nomura Securities Co., Ltd. – Financial advisers to Rengo Co., Ltd

Jackson Woo & Associates in association with Ashurst Hong Kong – Legal adviser to Rengo Co., Ltd

Asia Packaging Company Limited, controlled by funds advised by CVC Asia Pacific Limited

J.P. Morgan - Financial adviser to Asia Packaging Company Limited

Clifford Chance - Legal adviser to Asia Packaging Company Limited

The Family of the late Mr Yam Cheong Hung

Shearman & Sterling - Legal adviser to The Family of the late Mr Yam Cheong Hung