

TAKEOVERS AND MERGERS PANEL

PANEL DECISION

In relation to a referral to the Takeovers Panel by the Executive for a ruling on the comparable offer price to be made for the “H” Shares in Sanmenxia Tianyuan Aluminum Company Limited (“Sanmenxia”)

Purpose of the hearing

1. The Panel met on 1st August, 2007 to consider a referral by the Executive under section 10 of the Introduction to the Code on Takeovers and Mergers (the “Code”), which relates to a particularly novel, important or difficult point at issue, for a ruling to determine the comparable offer price for the “H” Shares in Sanmenxia. The Panel welcomes referrals of this kind if it can assist the market in understanding better the requirements and operation of the Code.

Background and facts

2. Sanmenxia is a company incorporated in the PRC, the “H” Shares of which are listed on the Growth Enterprise Market of the Stock Exchange of Hong Kong Ltd. Its issued share capital comprises 818,180,000 Domestic Shares and 350,020,000 “H” Shares. Before April, 2007 its controlling shareholder was Sanmenxia Tianyuan Aluminum Group Limited (“Tianyuan Group”), a state-owned enterprise, which held 782,882,280 Domestic Shares, representing 67.02% of Sanmenxia’s

issued share capital and voting rights attaching to its shares. The Domestic Shares are not freely transferable. Apart from the fact that the “H” Shares are listed and are freely transferable, and the payment of cash distributions to holders of the “H” Shares are in Hong Kong dollars, the two classes of shares in the capital of Sanmenxia are identical.

3. Tianrui Group Company Limited (“Tianrui Group”) entered into an agreement to acquire the entire 67.02% interest in Sanmenxia held by Tianyuan Group for a cash consideration equivalent to RMB 0.1577 per Domestic Share. The acquisition agreement was approved by the State-owned Assets Supervision and Administrative Commission of the State Council (“State SASAC”) on 11th September, 2006. Tianrui Group has made no purchases of “H” Shares in Sanmenxia since that date or in the six months preceding it.
4. Trading in the “H” Shares in Sanmenxia was suspended on 21st September, 2006 and remained suspended at the time of the Panel’s meeting. On 29th September, 2006 Sanmenxia issued an announcement giving details of the agreement between Tianrui Group and Tianyuan Group and the possibility of a mandatory unconditional cash offer.
5. On 25th December, 2006, the Ministry of Commerce approved the transfer of the Domestic Shares in Sanmenxia to Tianrui Group. Payment was made by Tianrui Group on 25th April, 2007 for the Domestic Shares and the registration of these shares was effected on 30th April, 2007. In all probability on 25th April, 2007 and 30th April, 2007 at the latest, Tianrui Group had incurred a mandatory offer obligation under Rule 26.1 of the Code for all the shares in Sanmenxia, both Domestic and “H” Shares, held by parties other than it or acting in concert with it.
6. Due to PRC capital controls, Tianrui Group is not permitted to satisfy an offer for shares in Hong Kong dollars so it was unable to discharge its mandatory offer obligation itself. It, therefore, entered into a consortium arrangement on 10th May,

2007 with Alpha Alliance Management Services Limited (“Alpha Alliance”), a Hong Kong company, under which Tianrui Group agreed to make the offer required by the Code to be made to holders of Domestic Shares and Alpha Alliance agreed to make the offer required to the holders of “H” Shares.

7. On 30th May, 2007 the lawyers to Tianrui Group informed the Executive of the consortium arrangements with Alpha Alliance. On 4th July, 2007 a submission was made by the financial adviser of Alpha Alliance to the Executive stating that the comparable offer to be made for the “H” Shares should be at the same price per “H” Shares as that paid for each Domestic Share, being RMB 0.1577, converted into Hong Kong dollars at the rate prevailing on 11th September, 2006 when the original acquisition was approved by the State SASAC.

The relevant provisions of the Code

8. The overriding requirement for offerors to treat holders of different classes of equity even-handedly is set out in General Principle 1 of the Code which states:

“All shareholders are to be treated even-handedly and all shareholders of the same class are to be treated similarly.”

9. The requirement of General Principle 1 to treat holders of different classes of equity even-handedly is then elaborated in Rule 14 which states:

“Where a company has more than one class of equity share capital, a comparable offer must be made for each class whether such capital carries voting rights or not. The Executive must be consulted in all cases.”

Rule 14 applies to all offers, whether mandatory or voluntary. Specific mention is also made in Rule 26, the Rule which covers mandatory offers, of the requirement to extend an offer on the basis of Rule 26 to the holders of each class of equity share capital of the company, whether the class carries voting rights or not.

10. Further guidance on comparable offers is given in Note 1 to Rule 14. This Note states the following:

“Comparable offers

In order to achieve comparability, this Rule 14 may involve an offeror paying a higher price for a particular class of shares than the highest price paid by him in the preceding 6 months for shares of that class. A comparable offer need not be an identical offer but the difference must be capable of being justified to the Executive, who will have regard to all relevant circumstances including the rights attaching to each class of shares and may also consider the historical record of their market prices.”

11. The decision also makes reference to Rule 3.5 of the Code which sets out the requirements of an announcement of a firm intention to make an offer. Under this Rule an announcement of a firm intention to make an offer should only be made if the offeror has every reason to believe it can and will continue to be able to implement the offer. The Rule also sets out the information to be contained in the announcement including the confirmation by the financial adviser that resources are available to satisfy full acceptance of the offer.

The Executive’s case in summary

12. The Executive’s starting point was to see if it could establish through an examination of information on similar or analogous transactions a basis to establish what differential value the “H” Shares in Sanmenxia may have had in comparison with its Domestic Shares. In essence the Executive sought to establish whether a specific value could be placed on the marketability and transferability of the “H” Shares and the fact that they trade in a freely exchangeable currency and cash distributions to its shareholders are made in such a currency. It also examined comparative takeover regulations in the PRC. Having failed to establish a consistent basis for valuing the special features of the “H” Shares, the Executive concluded that the offer for both classes of shares in the capital of Sanmenxia should be the same. In referring the matter to the Panel, the Executive sought the Panel’s endorsement of its conclusion on the basis that such a decision will not be

binding against subsequent cases where the differential between the Domestic Shares and “H” Shares can be determined. When asked when the exchange rate should be determined where an offer for a company to which the Code applied was triggered in a non-convertible currency, the Executive answered that it would be acceptable if it were to be determined at the time the Rule 3.5 announcement is made.

13. Alpha Alliance did not prepare a separate submission but relied on the submission made by the Executive. It did, however, advance the argument that in negotiating the price for the Domestic Shares Tianrui Group had agreed to pay a premium over the net asset value of Sanmenxia and that premium, in part, reflected a value for the listed status of the “H” Shares. Alpha Alliance made no representation as to the basis on which the exchange rate should be determined and indicated it would be guided on this matter by the Panel.

The decision and the reasons for it

14. In making its decision the Panel is of the view that Note 1 of Rule 14 sets out the approach to be adopted to ascertain whether offers for more than one class of equity are comparable and fulfil the requirements of General Principle 1 and Rule 14. In assessing the comparable price required to be made under Rule 14, the starting point is an offer that is identical for each class of equity. Then, depending on the context and circumstances of a particular offer and having regard to all relevant factors, prices for different classes of equity which are not identical may be capable of being justified to the Executive. Accordingly, in the absence of a justification for a different price for a particular class of equity which is accepted by the Executive, the comparable price is to be identical for each class of equity. When questioned the Executive also agreed with this approach.
15. In the present case, the Domestic Shares and the “H” Shares in Sanmenxia have equal voting rights and an equal participation in the profits of the company.

Statutory control of Sanmenxia has been obtained without the purchase of any “H” Shares. Control could only have been acquired by the purchase of at least some Domestic Shares as the “H” Shares constitute less than 30% of Sanmenxia’s issued voting share capital so could not by themselves confer control. In these circumstances, there appears no justification for a price for the “H” Shares which is different to that paid for the Domestic Shares. Further, no justification was advanced. Under Rule 14 the offer price for the “H” Shares is, therefore, RMB0.1577 per share. This price also accords fully with the requirement for even-handed treatment under General Principle 1.

16. As the RMB is not a freely exchangeable currency, the offer could not be made in RMB. Therefore, it was also necessary for the Panel to determine when the exchange rate should be fixed in order to calculate the comparable offer to be made for the “H” Shares in Hong Kong dollars. As stated above, the Executive was of the view that it is acceptable for the exchange rate to be determined at the time the Rule 3.5 announcement is made. In the present case, no Rule 3.5 offer has been made and, in the absence of such an announcement, the Panel decided that the exchange rate should be fixed on the date on which the mandatory offer obligation was triggered. This event would normally be expected to result in a Rule 3.5 announcement being made if no such announcement had been made previously. Accordingly, the comparable offer for the “H” Shares is the Hong Kong dollar equivalent of RMB 0.1577 calculated with reference to the Hong Kong dollar: RMB exchange rate prevailing on the date the mandatory offer was triggered.

Delay

17. The purpose of the Panel hearing was on the narrow point of the comparable offer required under the Code for the “H” Shares in Sanmenxia. However, the Panel wishes to place on record its concern about the time which has elapsed since the obligation arose to make a comparable offer to the holders of “H” Shares without such an offer being made, particularly given the length of time the possibility of

such an offer has been in prospect, and refers this matter to the Executive for such action, if any, as it may consider appropriate.

6 August 2007