

A periodic newsletter to help participants in Hong Kong's financial markets better understand the Codes on Takeovers and Mergers and Share Repurchases

Introduction

1. In this issue of the Takeovers Bulletin, the Executive informs readers that Practice Note 2 has been revised to clarify its application to profit forecasts and to reflect the Executive's approach regarding profit warning announcements.
2. The Executive revises Practice Note 6 to clarify the calculation of "see-through" prices in offers for convertible securities.
3. The Executive reminds market practitioners of the importance of early identification of Code implications and consultation with the Executive.
4. Finally, the Executive explains arrangements relating to offers affected by adverse weather conditions.

Highlights

- Revised Practice Note 2
- Revised Practice Note 6
- Reminder on early identification of Code implications
- Arrangements for closing of offers on days affected by adverse weather

Revisions to Practice Note 2 (PN2) regarding the treatment of profit forecasts

PN2 deals with the treatment of certain financial projections which may appear in Code-related documents. Such financial projections are normally regarded as profit forecasts under Rule 10 of the Takeovers Code and therefore need to be “reported on” by the related companies’ financial advisers and accountants or auditors before the publication of announcements containing forecasts (see Rule 10.4).

PN2 states that if the only reason for publishing a profit forecast is that it is required by the laws and regulations of an overseas jurisdiction but is not otherwise proposed to be published by the offeree company, the Executive will normally be prepared to relax the strict application of Rule 10 and permit publication of the forecast without its being reported on as stipulated by Rule 10.4 of the Takeovers Code. In this instance the profit forecast must be accompanied by an appropriate warning to shareholders to exercise caution in placing reliance on such forecast. In all such cases the Executive should be consulted at the earliest opportunity.

The Executive would like to clarify that such relaxation will not be permitted unless the Executive is satisfied that the parties have encountered genuine practical difficulties (time-wise or otherwise) in meeting the reporting requirements set out in Rule 10. In determining what constitutes “practical difficulties,” the Executive will take into account the specific facts and circumstances of each case. In any event the Executive will normally require the forecast to be reported on as soon as reasonably practicable and the relevant reports to be contained in the next document to be sent to shareholders. This may require the issue of a supplemental document to shareholders if an offer document or whitewash document has already been sent out.

The Executive would also like to take this opportunity to clarify the treatment of profit warning statements or positive profit alert announcements issued by listed issuers during an offer period. A listed issuer (being an offeree company or an offeror company in the case of a securities exchange offer, or a company undertaking a whitewash transaction) may see the need to issue a profit warning announcement or positive profit alert announcement pursuant to the requirements of Rule 13.09 of the Listing Rules (Rule 17.10 of the GEM Listing Rules) during an offer period. The Listing Rules require such announcements to be issued as soon as practicable. The Executive understands that as a matter of practice they are issued almost immediately after the directors of the company come into possession of the relevant price-sensitive information.

Such profit warning or positive profit alert announcements would normally be regarded as profit forecasts under Rule 10 of the Takeovers Code and would therefore need to be “reported on” in compliance with Rule 10.4 of the Takeovers Code. Given the time constraints faced by listed issuers when issuing such announcements, the Executive will normally be prepared to permit publication of the profit forecast information without full compliance with Rule 10 of the Takeovers Code. The Executive would give such permission so long as (i) the forecast is to be reported on as soon as practicable thereafter and the relevant reports are to be set out in a Code document or circular to be sent to shareholders; and (ii) the announcement containing the profit warning or positive profit alert contains an appropriate warning to shareholders to exercise caution in placing reliance on such forecast. This may require the issue of a supplemental document to shareholders in the event that an offer document or whitewash document has already been sent out.

In all cases involving this issue the Executive should be consulted at the earliest opportunity.

Consequential changes to PN2 can be found in the Practice Note page of the Takeovers & Mergers section of the SFC website.

Clarification on calculation of “see-through” price for convertible securities

Rule 13.1 of the Takeovers Code provides that where 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. The offeror is also required to make an appropriate offer or proposal to the holders of any warrants, options or subscription rights outstanding in respect of any class of equity share capital of the offeree company (see Rule 13.5). The purpose of Rule 13 is to safeguard the interests of holders of securities in their capacity as potential holders of shares with voting rights to which the share offer relates.

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 that 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.

Practice Note 6 will be expanded to reflect the above and can be found in the Practice Note page of the Takeovers & Mergers section of the SFC website.

Importance of early identification of Code implications and consultation with the Executive

The Executive has noted that in a number of recent cases companies and their advisers appear to have overlooked implications under the Codes in particular regarding the issue of Code-related announcements, such as the issuance of a profit warning announcement during an offer period as mentioned above.

Rule 12.1 of the Takeovers Code provides that “[a]ll documents must be filed with the Executive for comment prior to release or publication and must not be released or published until the Executive has confirmed that it has no further comments thereon.” In addition, all documents should include the directors’ responsibility statement as required under Rule 9.3 of the Takeovers Code.

In this regard, a “document” as defined under the Takeovers Code includes any announcement, advertisement or document issued or published by any party to an offer or possible offer in connection with such offer or possible offer. It also includes any announcement, advertisement or document issued or published by any person in connection with a transaction: (i) where a ruling is sought that no offer obligation arises; (ii) which is stated to be conditional on no such offer obligation arising; or (iii) which is stated to be conditional on a ruling being given that no such offer obligation arises.

Section 1.5 of the Introduction to the Codes states that the responsibilities provided for in the Codes apply to:-

- (a) directors of companies that are subject to the Codes;
- (b) persons or groups of persons who seek to gain or consolidate control of companies that are subject to the Codes;
- (c) their professional advisers;
- (d) persons who otherwise participate in, or are connected with, transactions to which the Codes apply; and
- (e) persons who are actively engaged in the securities market.

Section 1.7 of the Introduction of the Codes imposes additional responsibility on financial and other professional advisers and states that part of their responsibility is to use all reasonable efforts to ensure that their clients understand, and abide by, the requirements of the Codes.

The Executive wishes to advise companies and their advisers that they should check carefully from the outset of a Code-related transaction whether any Code implication arises to ensure that all relevant Code requirements are met. If a person is in doubt whether any provision of the Code is applicable, the Executive should be consulted at the earliest opportunity.

Arrangements for offers affected by adverse weather conditions

Where a period laid down by the Codes ends on a day that is not a business day, the period is extended until the next business day (see Note 3 to the Definitions section of the Codes).

A business day is defined under the Codes as “a day on which the Stock Exchange is open for the transaction of business.”

In the event a tropical cyclone warning signal No. 8 or above or a black rainstorm warning signal is in force on a relevant date and not cancelled in time for trading on the Stock Exchange to resume in the afternoon, the Executive will regard the Stock Exchange as closed for business on that day. In the circumstances, if a closing date for the purposes of Rules 15.1 and 19.1 of the Takeovers Code falls on such a day (with the cut-off point for counting valid acceptances set at 4:00p.m.), the closing date and publication of the relevant closing announcement as required by Rule 19.1 will be deferred to the next business day.

For ease of reference, the table below summarises the corresponding closing date arrangements depending on the suspension or resumption of trading on the Stock Exchange:

<i>Trading in the morning session</i>	<i>Trading in the afternoon session</i>	<i>Closing date and Rule 19.1 announcement</i>
Suspended	Suspended	Next business day
Normal	Suspended	Next business day
Suspended	Resumed	Same day

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