

HKEX LISTING DECISION
HKEX-LD102-2016 (published in December 2016)

Party	Company A – a Main Board issuer
Issue	Whether the Exchange would grant listing approval for the proposed rights issue of Company A
Listing Rules	Main Board Rules 2.03, 2A.03 and 7.19(6)
Decision	The Exchange refused to issue listing approval in the circumstances of this case noting that the proposed rights issue, followed on from a recent similar fundraising exercise, was highly dilutive and would be detrimental to shareholders who did not participate in the rights issue.

FACTS

1. Company A proposed to undertake the following corporate actions to raise net proceeds of HK\$300 million:
 - (a) a share consolidation of 20 existing shares into 1 consolidated share; and
 - (b) a rights issue on the basis of 20 rights shares for 1 consolidated share (**Proposed Rights Issue**). The subscription price for each right share is HK\$0.30, representing (i) a 90% discount to the then closing share price (taking into account the adjustment for the proposed share consolidation). The dilution impact of the rights issue was about 85%.¹
2. Regarding the Proposed Rights Issue, Company A submitted that:
 - (a) About 35% of the net proceeds were intended for acquiring a property for redevelopment, and the balance would be used to finance its investment in listed securities, loan financing business, and general working capital.

¹ The dilution impact of an offer is measured based on the offer ratio and the discount of the offer price to the share price prior to the announcement of the offer.

- (b) The substantial discount of the offer price to the market price of Company A's shares was made with a view to encouraging the shareholders to participate in the Proposed Rights Issue.
 - (c) Other alternative fundraisings were considered inappropriate. For example, a placing would dilute the shareholders' interests in the company. Debt financing would incur interest costs and increase gearings which would not be favorable to the company.
3. The Exchange noted that Company A had completed another rights issue (**Last Rights Issue**) a few months before the Proposed Rights Issue. The Exchange had the following observations:
- (a) The Last Rights Issue was also priced at a deep discount to the then market share price, with a dilution effect of over 80% on the interests of non-participating shareholders. This high dilution caused a significant transfer of value from these shareholders to the subscribing shareholders (including the controlling shareholder) and the underwriter.
 - (b) While the Last Rights Issue was approved by a large percentage of the voting shareholders, **the attendance rate of shareholders at the relevant general meeting was low (about 20%)**. In addition, excluding the controlling shareholder, **the Last Rights Issue was undersubscribed by 52%**. A majority of the public shareholders did not subscribe for their entitled rights shares or applied for excess rights shares and suffered significant dilution losses.
 - (c) The rights issue together with the related corporate actions (i.e. share consolidation and change in board lot size) created considerable odd lots.

LISTING RULES

4. Rule 2.03 states that:

"The Listing Rules reflect currently acceptable standards in the market place and are designed to ensure that investors have and can maintain confidence in the market and in particular that:—

(1) ...;

...

- (4) *all holders of listed securities are treated fairly and equally;*
- (5) *directors of a listed issuer act in the interests of its shareholders as a whole — particularly where the public represents only a minority of the shareholders; and*
- (6) *all new issues of equity securities by a listed issuer are first offered to the existing shareholders by way of rights unless they have agreed otherwise.*

In these last four respects, the rules seek to secure for holders of securities, other than controlling interests, certain assurances and equality of treatment which their legal position might not otherwise provide.”

5. Rule 2A.03 states that:

“In discharging their respective functions and powers the Listing Appeals Committee, the Listing Committee, the Listing Division and the Chief Executive of the Exchange are required to administer the Exchange Listing Rules, and otherwise to act, in the best interest of the market as a whole and in the public interest.”

6. Rule 7.19(6) states that:

“If the proposed rights issue would increase either the number of issued shares or the market capitalisation of the issuer by more than 50% (on its own or when aggregated with any other rights issues or open offers announced by the issuer (i) within the 12 month period immediately preceding the announcement of the proposed rights issue or (ii) prior to such 12 month period where dealing in respect of the shares issued pursuant thereto commenced within such 12 month period, together with any bonus securities, warrants or other convertible securities (assuming full conversion) granted or to be granted to shareholders as part of such rights issues or open offers):—

(a) the rights issue must be made conditional on approval by shareholders in general meeting by a resolution on which any controlling shareholders and their associates or, where there are no controlling shareholders, directors (excluding independent non-executive directors) and the chief executive of the issuer and their respective associates shall abstain from voting in favour. The issuer must disclose the information required under rule 2.17 in the circular to shareholders...”

ANALYSIS

7. Under Rule 2A.03, in considering a listed issuer's listing application for a new issue of shares, the Exchange has a duty to act in the best interest of the market as a whole and in the public interest. The Exchange may not grant a listing approval where it has concerns that the terms of the proposed offer might be detrimental to public shareholders and undermine investors' confidence in the market. There is no prescribed threshold for an offer to be considered highly dilutive and/or detrimental to minority shareholders. An assessment would be made case by case based on the specific circumstances of individual issuers.
8. Where a new share issue is made at a discount to the market price, this discount represents a cost to shareholders. In a pre-emptive offer, this cost to shareholders is avoided to the extent a shareholder exercises his rights to subscribe for his pro-rata entitlements to new shares. However, any shareholder who does not fully participate in the offer would suffer dilution to his investment, as the value of the discount would be transferred to underwriters and other shareholders taking up those rights to subscribe new shares. The larger the discount to market price and/or the higher the subscription ratio, the larger the value transfer and dilution to the non-participating shareholders' investment.
9. Where an issuer proposes a highly dilutive offer, the Exchange will consider the effect of the proposed offer on minority shareholders. The Exchange has concerns where an issuer proposes a highly dilutive offer with a recent history of similar dilutive pre-emptive offer that had a low level of subscriptions by minority shareholders and had significantly diluted the interests of non-participating shareholders.
10. In this case, the Exchange considered that Company A's proposal would be detrimental to shareholders who did not participate in the Proposed Rights Issue, and inconsistent with Rule 2.03(5) and the broader public interest in a fair and orderly market. Factors that the Exchange considered included:
 - (a) Under its proposal, Company A repeated a highly dilutive rights issue within a few months after completion of the Last Rights Issue. The Last Rights Issue had a dilution effect of over 80% on the interests of non-participating shareholders and was not subscribed by a majority of public shareholders. As a result, the non-participating shareholders had suffered a substantial loss in the value of their interests.

- (b) The Proposed Rights Issue had a dilution impact of 85% based on the large subscription ratio and the deep discount of the subscription price to the market price of the share. It would significantly dilute the interests of the non-participating shareholders if they did not subscribe for their entitlements.
- (c) The Company failed to demonstrate that this deeply discounted and highly dilutive fundraising was justified:
 - Company A said that the deep discount of the subscription price to the market price was to encourage shareholders to participate in the Proposed Rights Issue. However, it did not appear to be supported by the fact that the Last Rights Issue (also priced at a deep discount) was undersubscribed by 52% (excluding the controlling shareholder), and a majority of public shareholders did not participate in that rights issue.
 - The proposed use of proceeds (including possible acquisition of property, loans to third parties and general working capital) was unspecified. The Company did not have a pressing funding need to justify a substantial dilution to non-participating shareholders.
- (d) The Proposed Rights Issue and the related share consolidation would create considerable odd lots, which were usually saleable only at a discount to the market price and at additional costs². This would cause further losses to shareholders, particularly smaller shareholders who may only hold one or a few board lots.

Revised proposal

- 11. In response to the Exchange's view, the Company revised the terms of the Proposed Rights Issue by:
 - (a) changing the subscription ratio to 3 rights shares for 1 consolidated share and adjusting the subscription price to \$0.25 per rights share, representing a 72% discount to then market share price. As a result, the dilution impact of the rights issue was reduced to 55%, and the net proceeds was reduced to \$200 million; and
 - (b) revising the use of proceeds to: 62% would be used for a possible acquisition of a property and the rest for general working capital.

² As a result of the share consolidation, one board lot comprising 5,000 shares would become 250 shares (0.05 board lot).

12. However, this revised proposal did not address the Exchange's concerns. The Exchange remained of the view that the dilution impact was high and unjustified.

CONCLUSION

13. The Exchange considered it inappropriate to grant listing approval to the Proposed Rights Issue.