Summary: HKSE Guidance Letter on Cash Company Rules (HKEx-GL-84-15, Dec 15)

Recently, there has been an increase in "innovative forms" of takeovers. Some of these take the form of the proposed investors' injecting substantial cash in the subject companies. This Guidance Letter sets out guidance on SEHK's approach in applying cash company rules in these cases.

(Please refer to our November 15 legal update. Under the same theme, SEHK also updated Listing Decision LD75-4, providing guidance on circumstances where more stringent requirements will apply to quasi takeovers involving "very substantial disposals" by issuers).

I. Rule 14.82 and guidance

(1) Under Rule 14.82, a cash company is a company whose assets consist "wholly or substantially of cash or short-dated securities". Once a company is found to be a cash company, it will not be regarded as suitable for listing and trading in its securities will be suspended. The company must apply to SEHK to lift the suspension as if it were a new listing application. It has to comply with all new listing requirements and issue a full listing document.

(2) there is no prescribed quantitative threshold for assessing whether a company's assets consist "substantially "in cash. It is not simply a matter of assessing a company's cash to assets ratio. Consideration is to be given to the background facts and circumstances of the company's business, operation, and financial position.

(3) A number of common features in the "cash company cases" were given:

- Fundraising of a significant size; bears little or no co-relation with the needs of its existing principal business
- Funds used in largely greenfield operations of new projects with little or no relation to the company's existing business
- The investors would obtain control (or de facto control) of the company and will intend to manage the new businesses. A significant portion of the existing directors will be replaced by nominees of the investor
- The company would use the cash obtained from the fundraising to operate new businesses which are expected to be substantially larger than the original business

(4) Some cases have tried to address the "cash company concerns" by providing further details about the business plans and/or signing agreements to commit the use of the cash

proceeds. SEHK does not agree that these arrangements will allow the issuers to exclude the cash so utilized from their cash position upon completion. The cash company assessment should be made based on a company's cash balance as a result of the fundraisings and the situation as pertaining at the date of completion of the fundraising. The company cannot rely on the future use of proceeds. Once the company is considered to be a cash company, SEHK is required to evaluate its business plans as if it were a new listing application.

(5) Under Rule 14.82, the expression "wholly or substantially" is interpreted as meaning "in the main" or "as of the greater part". A company with less than half (50%) of its assets being cash as a result of the fundraising would not normally be caught. However, if SEHK considers that any fundraising, acquisition or other corporate action of the company in the future together with the current fundraising are a means to list new businesses that are not suitable for listing or otherwise circumvent the new listing requirements, it will impose additional requirements on the future transactions.

II. Early consultation of SEHK

Issuers are encouraged to early consult SEHK regarding relevant large scale fundraisings. Announcements relating to cash companies have to be pre-vetted by SEHK.

III. Examples given

The Guidance Letter also gave two examples where the cash company rule applies.