Sponsor-led take privates in Hong Kong – a partial alternative?

Introduction

Publicly listed companies which are trading at a discount to their true market value have proved a valuable source of transactions for private equity sponsors in a number of jurisdictions around the world, notably the US, UK, Singapore and Australia. However, in Hong Kong, otherwise an open and generally very "deal friendly" environment, this is definitely not the case. A combination of the shareholder dynamics in companies listed on the Hong Kong Stock Exchange (where the majority of companies have significant controlling shareholders) and a focus by the regulator and regulations on protecting minority shareholders (as evidenced by the 10% dissenting shareholder rule on schemes of arrangement not found in other jurisdictions[1]) has resulted in there not being a single successful sponsor-led take private of a Hong Kong listed company to date.

We published client briefings in March 2009 on takeovers by way of a scheme of arrangement (featuring the innovatively structured *Natural Beauty* transaction on which Clifford Chance advised the sponsor but which was ultimately voted down by shareholders) (click here) and in May 2012 on the Hong Kong Government's proposal to abolish the "headcount test" in Hong Kong (click here). Whilst it remains to be seen, when the proposal finally attains the force of law, whether this will help drive potential acquirors from making voluntary offers to launching schemes of arrangement and in turn stimulate privatisations and result in successful schemes, there is within the current regulatory and legal framework in Hong Kong a potential alternative route to gaining a substantial stake in a listed company (without some of the attendant risks of a voluntary offer), one which has been rarely tested to date – partial offers.

Partial Offers

Partial offers are offers to shareholders to buy a precise number (but not all) of shares which carry voting rights of a target company not already owned by the offeror and its concert parties. All partial offers are subject to the consent of the Executive Director of the Corporate Finance Division of the Hong Kong Securities and Futures Commission (*the Executive*). Historically, where a partial offer crossed into the "creeper" zone (a holding in the listed company between 30% and 50%), there was a general perception that the Executive would be hesitant to grant its consent, since a partial offer could be regarded as an exemption from the requirement to make a mandatory general offer, which would ordinarily apply. In recent years, we have observed gradual improvement in the sentiment of the Executive towards partial offers, evident from the number of successful partial offers launched in recent years (from three during the period between 2001 and 2006 to six during the period between 2007 and 2012). This is due in part to the recognition by the Executive that there may be compelling commercial reasons on the part of potential investors not to acquire more than the specified number of shares (e.g. the offeror may wish to consolidate the business of the target company with its own but may not have the sufficient resource (financial or otherwise) to undertake a mandatory general offer). Also, a partial offer presents an opportunity for shareholders of the target company to cash in on part of its investment (the offer price is typically at a premium to the market price), while at the same time allowing them to retain an ongoing interest in the target company, which may enable them to benefit from any future up-side of such investment.

> *"There have not been any successful sponsor-led take privates in Hong Kong."*

The key conditions precedent for completing a partial offer are:

- consent from the Executive (*consent requirement*)
- valid acceptances of the partial offer being received from shareholders in respect of not less than the number of shares intended to be acquired by the offeror (*acceptance requirement*)
- where a partial offer may result in the offeror holding 30% or more of the voting rights of a target company, approval of the partial offer by the shareholders holding over 50% of the voting rights not held by the offeror or parties

[1] If 10% of the disinterested shareholders of a Hong Kong listed company subject to a proposed scheme of arrangement vote against the scheme then the scheme will be blocked.

acting in concert with it (*approval requirement*)

"The number of successful partial offers has doubled in the last 5 years compared to the previous 5 years."

Consent requirement

Whilst the consent requirement has rarely been an issue for partial offers (a) which would not result in the offeror and persons acting in concert with it holding 30% or more of the voting rights of a target company or (b) where the offeror and persons acting in concert with it hold more than 50% of the voting rights of a target company and the partial offer is for up to such number of shares as would take the holding of voting rights to not more than 75% of the voting rights of the target company (or such high percentage as the Hong Kong Listing Rules may permit), it is not until recently that the Executive made it clear that it would also be prepared to grant its consent to partial offers crossing the "creeper" zone, provided that the approval requirement is satisfied. Based on our recent experience (including various informal conversations that we have had with the regulator), whilst we note that the Executive may now be more prepared to give its consent where a partial offer crosses the "creeper" zone, one of its key determining factors in granting such consent remains whether there will be a change of control following completion of a partial offer. It is likely that the Executive would be more prepared to grant its consent where there is no change of control in the target company, either because there is no single largest shareholder in the target company or the offeror was the single largest shareholder prior to completion of the partial offer. This is obviously very fact specific to the relevant proposed transaction in question.

Acceptance requirement

The offeror must receive sufficient valid acceptances of the partial offer, namely the number of shares tendered by shareholders must not be less than the specified number of shares that the offeror intends to buy. In practice, each shareholder of the target company would be asked to return an acceptance form indicating how many shares it is willing to tender under the partial offer. Where the number of shares tendered is more than the number of shares that the offeror intends to buy, the number of shares that would be sold by each accepting shareholder would be scaled back on a pro rata basis. The offeror could not acquire more shares than it initially proposed to buy.

Approval requirement

Where a partial offer may result in the offeror holding 30% or more of the voting rights of a target company, the regulator requires more than 50% of the independent shareholders (by reference to the total issued outstanding shares of the target company) to approve the partial offer. The approval requirement is a separate requirement from the acceptance requirement. A shareholder who wishes to approve the offer must tick a separate box on the acceptance form and indicate the number of shares in respect of which the offer is approved. A shareholder who accepts a partial offer may not approve it, vice versa. In practice, it is usually more difficult to satisfy the approval requirement than the acceptance requirement, since there is little motive for shareholders who do not wish to tender their shares to return the acceptance form to approve the partial offer.

Should you have any questions on the topics covered by this briefing or more generally on the regime for takeovers in Hong Kong, please do not hesitate to contact one of our Greater China Private Equity Partners whose contact details are set out below.

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