Partial Offer for Chong Hing Bank Limited

Takeover Code Lessons

SUMMARY
On October 25, 2013, it was announced that Nomura International (Hong Kong) Limited (the “Nomura”) intends to make a voluntary all cash partial offer on behalf of its client, Yuexiu Financial Holdings Limited (“Yuexiu”), to acquire up to 75% of the shares in Chong Hing Bank Limited (“Chong Hing Bank”) for HK$35.69 per share. This partial offer values Chong Hing Bank at approximately US$2 billion and the maximum 75% shares to be acquired would be valued at approximately US$1.5 billion, which makes this one of, if not the largest, partial offers in the Hong Kong market. In this memorandum, we analyze the reasons for the partial offer and some of the Takeover Code breakthroughs achieved on this occasion.

WHY CHOOSE THE PARTIAL OFFER STRUCTURE?
To date, almost all takeovers in Hong Kong are implemented by way of general offers or schemes of arrangement. A scheme of arrangement is an “all or nothing” approach. If the scheme is successful, the offeror acquires 100% of the target. On the contrary, if the scheme fails, the offeror does not acquire any target shares at all through the scheme. A general offer is made for all the shares outstanding in a target company, and the offeror needs to be prepared to acquire 100% of the target if all shareholders accept the offer. The difficulty with a general offer is that there is a risk that the acceptance level is below the threshold necessary to enable the offeror to exercise compulsory acquisition to squeeze out the minority shareholders, but more than the number of shares the offeror can own to allow room for sufficient number of shares to remain in public hands. In these circumstances, to restore the public float required of a Hong Kong-listed company, the offeror needs to sell-down the shares it had acquired or issue new shares in the target to dilute its stake, typically at a discount to the purchase price and crystallizing an immediate and unpalatable loss. Given the rigidity inherent in the two methods, a partial offer is a welcomed alternative, especially for an offeror who wants to acquire a specific percentage of shares in a target and at the same
time avoid the sell-down risk where there is insufficient public float. By adopting a partial offer structure for up to 75% of Chong Hing Bank, Yuexiu is able to have certainty as to the level of control over Chong Hing Bank post acquisition. Yuexiu is also able to maintain Chong Hing Bank as a Hong Kong-listed entity without the potential costly sell down risks.

**CAN A PARTIAL OFFER TAKE AN OFFEROR FROM NIL TO MORE THAN 50%?**

From the start, doubts were expressed. Doubters said that it was unprecedented in Hong Kong that an offeror could go from having no shares in a target to a statutory control position of more than 50% ownership, and that was evidence that such a structure could not be done. Doubters went on to claim that because there was an express exception in the UK City Code that a partial offer was to be exempted from the mandatory general offer requirements, and that exception was not set out in the Hong Kong Takeovers Code, a partial offer for more than 50% was not allowed in Hong Kong. The doubters were proven wrong. General Principle 2 of the Takeovers Code provides that if control of a company changes or is acquired or is consolidated, a general offer to all other shareholders is *normally* required. However, if one were to read Rule 28.2 of the Takeovers Code, it is clear that it is within the Executive’s contemplation that a partial offer may be an exception to a mandatory general offer as it implies that if a partial offer may result in the offeror obtaining or consolidating control in a manner *otherwise triggering the obligation to make a mandatory offer* then the Executive’s consent will normally be granted only *if* the offeror or persons acting in concert with it has not acquired voting rights in the offeree during the six months prior to the commencement of an offer period.

**CAN A PARTIAL OFFER BE MADE FOR A RANGE RATHER THAN FOR A PRECISE NUMBER OF SHARES?**

Rule 28.7 of the Takeovers Code specifically provides that a partial offer must be made for a *precise number of shares*. Until the Chong Hing Bank case, the Executive’s practice was to permit a waiver from the precise number of shares rule only if the partial offer was not otherwise an exception to triggering a mandatory general offer. In the Chong Hing Bank case, if the precise number of shares rule was to be followed, it would be in the sellers’ interest to set the acceptance condition at 75% to allow the sellers to be able to sell at least 75% of their shareholdings. However, from the buyers’ perspective, an acceptance condition at 75% did not give them certainty of completion as the Liu family vendors only had 50.2% shareholding in the target that they could deliver to the buyers. In order to reconcile the two divergent interests, the acceptance condition for the Chong Hing Bank Partial Offer was phrased (and accepted by the Executive) such that the acceptance condition was set at 50% plus one share but that the offeror undertook to purchase as many shares as are tendered by the target shareholders until 75%, beyond which the normal scaling down rules apply. The arguments presented to the Executive included that an acceptance condition of more than 50% would already provide the offeror with statutory control, and not only deemed control where someone owns between 30% and 50%, and that the condition was phrased...
such that the final number in the range was not one in which the offeror had a discretion over but one which was to be determined purely by the level of acceptances.

**CAN A SHAREHOLDER WITH MORE THAN 50% GIVE ITS APPROVAL FOR THE PARTIAL OFFER SO AS TO DISPENSE WITH THE REQUIREMENT FOR “BOX TICKING” ON THE FORM OF ACCEPTANCE?**

Rule 28.5 of the Takeovers Code provides that for any offer which could result in the offeror holding 30% or more of the voting rights of a company, it should normally be conditional, not only on the specified number of acceptances being received, but also on approval of the partial offer (to be signified by means of ticking a separate box on the form of acceptance specifying the number of shares in respect of which the partial offer is approved), being given by shareholders holding over 50% of the voting rights not held by the offeror and persons acting in concert with it. According to Practice Note 1, the reason for such approval requirement is to ensure that over 50% of the independent shareholders approve the offeror’s proposal to acquire control by means of a partial offer (which can be regarded as an exception of the requirement to make a mandatory general offer). However, such approval requirement may be waived if over 50% of the voting rights of the offeree are held by one “independent shareholder” who has indicated his approval.

There were divergent views as to whether “independent” for these purposes meant shareholders who are not acting in concert with the offeror or whether not acting in concert was only one example of shareholders who are independent and that there were other factors (such as the special deal that was also announced that Chong Hing Bank would sell its headquarter building back to its controlling shareholder) that could affect independence. In the end, common sense prevailed in that if shareholders not acting in concert could tick the box and 50% or more of them indicate that they would, there was no reason to apply a more stringent test for independence on the waiver from the box ticking procedure.

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**ENDNOTE**

1 Sullivan & Cromwell acted for Nomura and was the architect behind the Chong Hing Bank Partial Offer structure.
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