

**HKEX LISTING DECISION**  
**HKEX-LD137-2022 (published in June 2022)**

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| <b>Party</b>         | Company A – a Main Board issuer  |
| <b>Issue</b>         | Whether Company A could proceed with its proposed issuance of shares that was highly dilutive  |
| <b>Listing Rules</b> | Main Board Rule 7.27B  |
| <b>Decision</b>      | The Exchange was satisfied that there were exceptional circumstances for Company A to undertake the proposed issuance of shares under Rule 7.27B |

**FACTS**

1. Company A and its subsidiaries (the **Group**) were principally engaged in the provision of energy saving products and related services. Mr. X was the founder of the Group and had been the single largest shareholder and executive director of Company A since listing.
2. Company A was in financial difficulties. It proposed to repay part of its overdue indebtedness by issuing new shares to Mr. X to raise funds, and to certain creditors to settle the amounts owed to them (together, the **Proposed Issue**). The theoretical dilution of the Proposed Issue was over 25%.
3. The Proposed Issue was subject to independent shareholders' approval. Upon completion of the issue, Mr. X's shareholding in Company A would increase from 10% to over 50%.<sup>1</sup> Company A would continue to operate its existing business under the same management.
4. Company A submitted that the high shareholder's value dilution was exceptional and justified in the circumstances:
  - (a) The Group did not have sufficient funds to repay overdue indebtedness as its business performance and financial position deteriorated in the past two years due to the change in market conditions and the outbreak of COVID-19. The Group had received statutory demands for repayment from some of the creditors. Its auditor had issued a disclaimer of opinion on its financial statements due to the going concern issue.
  - (b) The Proposed Issue formed part of the rescue plan of the Group. With part of the indebtedness to be repaid by the Group using the proceeds from the Proposed Issue, its creditors had conditionally

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<sup>1</sup> Mr. X also applied for whitewash waiver pursuant to Note 1 on dispensation from Rule 26 of the Code on Takeovers and Mergers.

agreed with the principal terms of a scheme of arrangement to settle the remaining indebtedness. Company A was also in discussion with a financing company for a loan facility to support its business operations, subject to the completion of the Proposed Issue.

- (c) Company A had explored other fundraising means but these attempts failed due to its deteriorated financial position. The rescue plan would substantially improve its financial position and provide sufficient working capital to the Group for at least the next 12 months.

## **APPLICABLE LISTING RULES**

5. Rule 7.27B states that:

*“A listed issuer may not undertake a rights issue, open offer or specific mandate placing that would result in a theoretical dilution effect of 25% or more...unless the issuer can satisfy the Exchange that there are exceptional circumstances (for examples, the issuer is in financial difficulties and the proposed issue forms part of the rescue proposal)...”*

6. Rule 7.27B became effective in July 2018. As explained in the Exchange’s Consultation Paper and Conclusions on Capital Raisings by Listed Issuers:

- The Rule was introduced to address concerns about abuses of highly dilutive capital raising transactions to the detriment of minority shareholders. Some highly dilutive issues lacked demonstrable commercial rationale and resulted in the introduction of new controlling or substantial shareholders. This raised questions on whether they were for the purpose of facilitating other activities, rather than to meet the issuers’ capital requirements. In many of these cases, there was no pressing funding need to justify such a high level of value dilution and the directors could not clearly explain how the high value dilution was in the interests of the shareholders.
- The Rule is not intended to restrict legitimate capital raisings. There is an exemption for issues in “exceptional circumstances” where the highly dilutive terms are justified by particular circumstances. This applies to an issuer who is in financial difficulties and the proposed issue forms part of its rescue proposal.

## **ANALYSIS**

7. In this case, the Exchange was satisfied that there were exceptional circumstances for Company A to undertake the Proposed Issue. Based on Company A’s submission, the Group was in financial difficulties and had a pressing funding need. Company A had demonstrated that it had exhausted other fundraising means and the Proposed Issue was in the

interests of Company A and its shareholders as a whole. The Proposed Issue formed part of the rescue plan of the Group to settle overdue indebtedness and support its business operations.

## **CONCLUSION**

8. Company A had demonstrated that there were exceptional circumstances for it to undertake the Proposed Issue under Rule 7.27B.