

Practice Note 7 (PN7) – Treatment of certain assets for the purpose of Rule 11.1(f)

Rule 11 of the Takeovers Code ~~deals with asset valuations.~~ Rule 44 provides that when valuations of assets are given in connection with an offer, details of the valuations must be included in the relevant document and should be properly supported by the opinion of a suitably qualified independent valuer. This helps to ensure that shareholders are provided with sufficient information to reach an informed decision on an offer as required by General Principle 5 of the Codes.

Some aspects of Rule 11 are unique to Hong Kong insofar as it imposes an obligation on a company to obtain an asset valuation in certain circumstances. There is no such requirement in the UK Takeover Code. The obligation to require an asset valuation ~~under Rule 11~~ arises under Rule 11.1(f) which provides that “... a valuation ~~of properties~~ will be required ~~in~~ of the case properties of an offer for a (i) the offeree company with if it has **significant property interests**; and, (ii) in the case of a securities exchange offer, ~~where the offeror company~~ if it has **significant property interests**” (emphasis added). This requirement was introduced into the Codes to reflect the relatively high concentration and volatility of property companies listed in Hong Kong at the time.

Rule 11.1(f) provides further guidance on the meaning of “significant property interests”:

“As a general guide, ~~this should be taken to refer to a company or group of companies,~~ has “significant property interests” if the book value of ~~whose property assets or its consolidated property assets,~~ respectively, **exceeds 15% of the book value of its consolidated total assets** ~~or total group assets, as the case may be~~” (emphasis added).

~~Recently some~~ Some market practitioners ~~have~~ had voiced concerns that strict compliance with Rule 11.1(f) may in some circumstances be unduly burdensome. ~~These practitioners have~~ They suggested that certain assets should not be regarded as property assets for the purpose of calculating the 15% threshold even though they may be listed on a company’s balance sheet as

“buildings” or “plant and buildings”. For example, it has been suggested that account should not be taken of properties of a mining company which are used for smelting or storage purposes or infrastructure such as roads at the mining sites.

The Executive agrees that in some circumstances the strict application of Rule 11.1(f) may be unduly burdensome and should be decided on a case-by-case basis.

With regard to right-of-use (ROU) assets as defined under International Financial Reporting Standard 16 (IFRS 16) ‘Leases’¹, although IFRS 16 treats the right to use the asset under a lease as an asset on the company’s balance sheet, the lessee does not have legal ownership of the underlying leased asset as it remains with the lessor. Given this, ROU assets should not normally be regarded as a company’s property assets for the purposes of the Takeovers Code. It follows that the values of these ROU assets should normally be excluded when determining whether a company has significant property interests of 15% and 50% under Rule 11.1(f).

If parties or their advisers are in doubt as to whether certain assets should be taken into account for the purpose of calculating the ~~15% threshold~~relevant thresholds, they should consult the Executive at the outset of the transaction. The Executive may request to see a list of the assets including a detailed description of their nature and purpose, location, size, book value, salient lease contract terms, and any other characteristics or relevant information which would assist in its consideration of the matter.–

~~20 December 2007~~31 March 2020

¹ The equivalent of Hong Kong Financial Reporting Standard 16 (HKFRS 16) ‘Leases’.