

Title: New Rules on Disposal of Material Assets by Listed Companies

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On December 10 2001, the China Securities Regulatory Commission (CSRC) issued a *Notice on Concerning the Acquisitions, Sales and Swaps of Material Assets by Listed Companies* (the Notice). It is believed the aim is to tackle price manipulation by speculative investors behind assets restructuring of some Chinese listed companies.

Definition of Material Assets

According to Article 1 of the Notice, the following disposals shall be deemed to be a sale, acquisition or swap of material assets: i) the assets to be disposed exceeded 50% of the total assets of such listed company as indicated in its audited consolidated financial reports of the recent financial year; ii) the net value of the assets to be disposed exceeded 50% of the total net assets of such listed company as indicated in its audited consolidated financial reports of the recent financial year; or iii) the income generated by the assets to be disposed exceeded 50 % of the income generated by the core business of such listed company as reflected in its audited consolidated financial reports of the recent financial year, instead of the aggregated income generated by both the core and side businesses as under the previous regulation.

Conditions for Disposal of Material Assets

The Notice requires that any disposal of material assets by listed companies shall only be implemented for the sustainable growth and the benefit of all shareholders of such listed companies. In addition to such general principles, any disposal of material assets shall not give rise to any business competition between the listed company concerned and its de facto controlling shareholder and its connected parties. A listed company shall keep its assets, accounts and personnel independent from its controlling shareholder and the connected parties of such controlling shareholder in implementing any disposal of material assets. Meanwhile, a listed company shall have its own independent procurement, manufacturing and sales system, as well as the independent intellectual property rights after the disposal of material assets.

A listed company shall satisfy the following conditions in disposing material assets: i) it shall be able to satisfy the listing conditions under the laws and listing rules after such disposal; ii) it shall be able to operate its business after such disposal; iii) the subject material assets to be disposed shall have a clean and good title free from any disputes; and iv) there shall be no circumstance in which the interests of the listed company or its shareholders are jeopardized.

Examination Procedures for Back-door Listings

According to Article 8 of the Notice, the following disposals shall be subject to

examination by the Examination Committee of Stock Offering of the CSRC(the committee): i) an acquisition of material assets is implemented with a concurrent sale and the assets to be sold and acquired have both reached or exceeded 70% of gross assets of the listed company as indicated in its audited financial reports of the recent financial year; ii) the assets injected into a listed company reach or exceed 70% of its gross assets as indicated in its audited consolidated financial reports of the recent financial year; iii) a bulk sale of the entire assets and liabilities by a listed company and the acquisition of other assets; or iv) any other disposal of material assets in which the CSRC has found significant problems in the course of its examination.¹ Unless the Committee has no objection to the application, no transaction can be concluded.

Subsequent Offerings after Disposal

A listed company that has undertaken a disposal of material assets can only apply to offer new shares (including the rights issue and the new issue) or convertible bonds after a complete financial year has elapsed since the completion of the disposal. However, such a time requirement can be avoided if a listed company has satisfied all of the following conditions: i) it satisfied all the conditions² for offering new shares prior to the disposal; ii) its reporting accountants have made no qualification in its annual and interim financial reports; and iii) any index of the assets concerned is below 70% of the corresponding item in conducting a material assets test according to Article 1 of the Notice.

In applying for an offering of new shares or convertible bonds, the performance of the assets concerned can be calculated on a *pro forma* basis, provided that the following conditions are satisfied: i) the assets injected into the listed company are in the form of an entire business unit and such business unit has been operated by the same management continuously for more than three years; ii) the operation of the listed company has proven to be steady after the asset injection and the profit generated by the assets injected is not lower than the profitability level of such assets prior to the injection; and iii) a securities house with a lead underwriter licence has been appointed by the listed company for advising its operations, which process has been inspected and accepted by CSRC branch offices.

By such a pro forma approach, it can be seen that a listed company having a poor financial performance may be able to satisfy the stringent financial requirements for a new share offering, such as the three-year profit track record, after an injection of good quality assets or a reverse takeover.

Shareholder Approval and Information Disclosure

The Notice repeats the requirements for the procedures in implementing a material assets disposal by the board, the connected transaction as well as the information

disclosure obligation. The Notice took effect on January 1 2002 and from the same day, the old *Notice on Regulation of sales and Acquisitions of Material Assets by Listed Companies* issued by the CSRC in June 2000 ceased to be effective.

Endnotes:

1. Any disposal that does not fall into the class of transactions requiring a Committee review is still subject to review by the CSRC. Such disposal can proceed, provided that there is no objection by the CSRC after it has completed its review. If the CSRC has found any significant problem of such transaction, it may submit such deal to the Committee for a review.
2. Such conditions are provided under the *Administration of Offerings of New Shares by Listed Companies Procedures* promulgated by the CSRC.