

**HKE~~X~~ GUIDANCE LETTER**  
**HKE~~X~~-GL80-15 (May 2015) (Updated in July 2018)**

<b>Subject</b>	<b>Guidance on the issue of convertible securities by listed issuers</b>
<b>Listing Rules</b>	<b>Main Board Rules 2.03(6), 8.08, 13.27, 13.28, 13.36, 13.32(1), 16.03 and 28.05</b> <b>GEM Rules 2.06(6), 11.23(7), 17.30, 17.32, 17.39, 17.40, 17.41, <u>17.42C</u>, 22.03 and 34.05</b>

**Important note:** *This letter does not override the Listing Rules and is not a substitute for advice from qualified professional advisers. If there is any conflict or inconsistency between this letter and the Listing Rules, the Listing Rules prevail. You may consult the Listing Department on a confidential basis for an interpretation of the Listing Rules, or this letter.*

**A. Purpose**

1. This letter gives guidance on the Rule requirements relating to issues of convertible securities by listed issuers, including convertible and exchangeable bonds, notes and loans and convertible and exchangeable preference shares (collectively “**convertible securities**”). These securities are convertible into new shares of the issuers which are listed on the Exchange. This guidance does not cover the listing of the convertible securities.

**B. Applicable rules**

2. The issue of convertible securities by a listed issuer is subject to shareholders’ approval, either pursuant to a special mandate in relation to the convertible securities or as part of a listed issuer’s general mandate under Rule 13.36 (GEM Rules 17.39 to 17.41). Under Rule 13.36(6) (GEM Rule 17.42C), where the convertible securities are issued pursuant to a general mandate for cash consideration, the initial conversion price must not be lower than the benchmarked price (as defined in Rule 13.36(5) (GEM Rule 17.42B)) of the issuer’s shares at the time of issue.
3. Under Rules 8.20, 16.01 and 28.01 (GEM Rules 11.30(2), 22.01 and 34.05), if a listed issuer proposes to issue convertible securities, it must, prior to the issue of convertible securities, seek the Exchange’s approval for (i) the convertible securities; and (ii) the listing of the shares issuable upon conversion under the terms of the convertible securities (“**conversion shares**”), whether the convertible securities themselves are to be listed or not.
4. Under Rules 16.03 and 28.05 (GEM Rules 22.03 and 34.05), the listed issuer must obtain the Exchange’s prior consent for any proposed change in the terms of the convertible securities, unless the change occurs automatically according to the terms of the convertible securities.

5. Listed issuers must also comply with other specific Rule requirements for convertible securities issued by them under Chapters 16 and 28 of the Rules (Chapters 22 and 34 of the GEM Rules).

## C. Guidance

### (I) *Pre-emptive rights*

6. Under Rules 2.03(6) and 13.36 (GEM Rules 2.06(6), 17.39, 17.40 and 17.41), any new issue of shares (including securities convertible into shares) by an issuer on a non-pre-emptive basis must be approved by shareholders. Shareholder approval may be obtained by either a specific mandate (i.e. an approval of a specific transaction in general meeting) or a general mandate.

#### *Sufficiency of general mandate*

7. If an issuer proposes to issue convertible securities under a general mandate, it must have an unused mandate that is sufficient to cover all conversion shares. This should take into account the conversion price and the adjustment mechanism that may affect the number of conversion shares. We set out below two broad categories of terms under convertible securities and our approach in assessing the issue size of the conversion shares:

- (i) Conventional convertible securities with a fixed initial conversion price, subject to adjustments that are triggered by events within the issuer's control:
  - (a) The initial conversion price for the convertible securities is at a fixed dollar amount. It is subject to customary adjustment provisions triggered by corporate actions that are within the issuer's control, including share consolidations or subdivisions, capital distributions, further issues of securities at less than current market price, etc.
  - (b) In general it is acceptable for an issuer to issue these convertible securities under a general mandate if, at the time of the issue of the convertible securities, 1) the unutilised portion of the general mandate is sufficient to cover the number of conversion shares based on full conversion of the convertible securities; and 2) where the convertible securities are issued for cash consideration, the initial conversion price is not lower than the benchmarked price of the issuer's shares.
  - (c) As the events triggering the adjustments of the conversion price are within the issuer's control, the issuer should not take corporate actions that would result in the number of conversion shares exceeding the mandate limit.
  - (d) The listing approval, if granted by the Exchange, will generally be given in respect of a specific number of conversion shares within the mandate limited. The issuer must adopt appropriate procedures to keep track of the number of conversion shares issued and issuable

under the terms of the convertible securities. It should take this into account before it takes any actions that would trigger the adjustment provisions.

- (e) The issuer's monthly return should appropriately reflect the number of conversion shares issuable upon full conversion of the amount of convertible securities outstanding as at the close of the month, and that it has sufficient mandate to cover these shares.
- (ii) Convertible securities with an automatic price re-set or adjustment mechanism which is not triggered by events within the issuer's control:
  - (a) An example is a "toxic" convertible where the conversion price is re-set with reference to the future trading price of the issuer's shares.
  - (b) ~~If the issuer has no control over any adjustment of the conversion price after the issue of the convertible securities, it should use the lowest possible conversion price to calculate the maximum number of conversion shares issuable upon full conversion of the convertible securities.~~—The issuer must obtain a specific mandate from its shareholders for the issue of the convertible securities if it proposes to issue the convertible securities for cash or it is unable to demonstrate that its general mandate at the time of the issue of the convertible securities is sufficient to cover all conversion shares<sup>1</sup>.

*Proposed changes to convertible securities*

- 8. As mentioned in paragraph 4 above, an issuer must seek the Exchange's approval before it proposes any change to the terms of convertible securities after issue. If the Exchange considers that an issuer's proposal constitutes a material change to the terms of the convertible securities, it will treat the proposal as if it were a new issue of convertible securities. This means that the issuer must obtain shareholder approval for the proposed new issue, unless it has a sufficient unutilized portion of, and is permitted to use, its general mandate at the time of the proposed new issue to cover the number of conversion shares based on full conversion of the proposed convertible securities. (See also Listing Decision LD54-2013)

**(II) Disclosure requirements**

*Announcement for issue of convertible securities*

- 9. If an issuer issues convertible securities for cash, it must publish an announcement in accordance with Rule 13.28 (GEM Rule 17.32). The disclosure should include:
  - (i) all material terms of the convertible securities, including the conversion price and a summary of the provisions for adjustments of the price and/or the number of shares to be issued;

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<sup>1</sup> If the issuer has no control over any adjustment of the conversion price after the issue of the convertible securities, it should use the lowest possible conversion price to calculate the maximum number of conversion shares issuable upon full conversion of the convertible securities.

- (ii) the maximum number of shares that could be issued upon exercise of the conversion rights; and
  - (iii) if the convertible securities are to be issued under a general mandate, details of the mandate. The information should demonstrate the mandate is sufficient to cover the conversion shares to be issued, such as the date of the general meeting approving the mandate, the number of shares that the issuer is authorised to allot or issue under the mandate and other terms and conditions of the mandate, and the unutilised portion of the mandate available for the proposed issue of convertible securities.
10. The above information should also be disclosed in an announcement for a notifiable transaction under Chapter 14 of the Rules (Chapter 19 of the GEM Rules) if the consideration for the transaction involves the issue of convertible securities.

*Announcement for change in terms of convertible securities*

11. After an issuer has issued convertible securities, it should timely announce:
- (i) any change in the terms of the convertible securities (including any adjustment of the conversion price according to the terms of the convertible securities); and
  - (ii) the effect of the change.
12. Where the convertible securities were issued under a general mandate, the issuer should also confirm that it has sufficient mandate to cover the issue of conversion shares after the change takes effect. *(See also paragraphs 7(i)(c), 7(i)(d) and 8 above)*

*Disclosure in financial reports*

13. Issuers are expected to disclose additional information in their annual and interim reports to enable investors to be aware of the dilution impact on the issuers' shares in the event that all outstanding convertible securities were converted as at the relevant year end or period end, including:
- (i) the number of shares that may be issued upon full conversion of the outstanding convertible securities;
  - (ii) the dilutive impact on the then number of issued shares of the issuer and respective shareholdings of the substantial shareholders of the issuer;
  - (iii) the dilutive impact on earnings per share;
  - (iv) an analysis on the financial and liquidity position of the issuer, discussing its ability to meet its redemption obligations under the convertible securities; and

- (v) an analysis on the issuer's share price at which it would be equally financially advantageous for the securityholders to convert or redeem the convertible securities based on their implied internal rate of return (and therefore the securityholders would be indifferent as to whether the convertible securities are converted or redeemed) at a range of dates in the future.

In each case, this information should take into account any provisions permitting payment of interest in kind (assuming a worst-case scenario).

**(III) Public float**

- 14. The public float requirements under Rules 8.08 and 13.32 (GEM Rule 11.23(7)) seek to ensure an open market in the securities for which listing is sought. The Exchange would not give listing approval for an issue of conversion shares if it may lead to a breach of the requirement.
- 15. For example, if an issuer proposes to issue convertible securities to its connected person(s) or a person who would become its substantial shareholder upon conversion of the convertible securities, the issue of the convertible securities may result in the issuer's public float failing to meet the minimum requirement. In these circumstances, the Exchange would not approve the listing of the conversion shares unless the issuer has concrete arrangements to ensure the minimum public float is maintained upon conversion of the convertible securities. An example of an acceptable arrangement would be to set out in the terms of the convertible securities a restriction against any conversion of the convertible securities if such conversion would result in the issuer failing to meet the minimum public float. (*See also Listing Decision LD56-2013*)

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