

The Art of Investment: Tactics for Acquiring PRC Listed Companies

By Wayne Chen & James Weng

Since Group SEB's strategic investment in SUPOR, the first announced takeover of a PRC listed company by foreign investors following enactment of a series of new M&A regulations in 2006, strategic investments in listed companies by foreign investors continue to make news headlines.

The new M&A regulations, particularly the *Measures for the Administration of the Takeover of Listed Companies (the Takeover Measures)* implemented on 1 September 2006, and the Measures for Strategic Investment in Listed Companies by Foreign Investors (**the Strategic Investment Measures**), implemented on 31 January 2006, have had a significant impact on foreign investors' M&A activities in China. Currently, such strategic investment may involve three acquisition methods: subscribing for new shares of the target listed company, purchasing shares from the target's parent company, and making a partial or overall tender offer for other A-shares to achieve the proposed shareholding ratio.

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Private Placements

Under the Strategic Investment Measures, foreign investors may make strategic investments by subscribing for new shares issued by a listed company. Such a private placement must first be approved by the listed company's board of directors and general shareholders' meeting. The company must then obtain tentative approval from the Ministry of Commerce (**MOFCOM**) before applying to the China Securities Regulatory Commission (**the CSRC**) for final approval of the private placement.

When structuring a private placement, timing and pricing mechanisms are critical. The placement's schedule must be carefully planned in

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advance. Usually it takes two or more weeks to obtain approvals from both the board of directors and the general shareholders' meeting. In practice, MOFCOM's approval will normally take more than three months, although the exact length of time may vary. If the acquisition triggers an anti-trust review or relates to national economic security concerns, approval is likely to take much longer. The CSRC's review, which will not start until the placement has obtained MOFCOM's approval, will add several more months to the process. As a result, it usually takes half a year or more to complete a private placement acquisition.

Designing a pricing mechanism is equally important. According to the *Measures for the Administration of Securities Offerings by Listed Companies* promulgated on 6 May 2006, the offering price for private placements shall not be less than 90% of the average price of the shares of the target listed company during the 20 trading day prior to the pricing reference date. However, the pricing reference date is not clearly defined in any of the CSRC's rules. In practice, the pricing reference date is often the date when the listed company announces the approval of the private placement by its board of directors, by the date when the relevant board meeting is convened, or the date when the general shareholders' meeting approves the placement.

This uncertainty leads to a great deal of flexibility in pricing private placements. Normally, the earlier the pricing reference date, the lower the price, creating room for huge profits by financial investors and inside traders. These unreasonable profits, in turn, have drawn the CSRC's attention. It is expected that the CSRC will soon develop new policies to define the pricing reference date and distinguish financial investors from strategic investors. In the case of investment by financial investors, the price reference date might then be postponed to minimize such unfair profits.

Share Transfers by Agreement

The regulatory framework for share transfers by agreement is slightly different from the one governing private placements. Like private placements, transfers of outstanding shares to foreign investors must be approved by resolutions of both the board of directors and the general shareholders' meeting of the listed company. Unlike private placements, transfers by agreement usually do not need the CSRC's approval and are generally able to go forward with MOFCOM's approval alone. Notwithstanding this, if a transfer would give de facto control of a listed company to a foreign investor, an acquisition report and related documents must be submitted to the CSRC for approval.

Under the Takeover Measures, investors must pay attention to the post-transfer share ratio to avoid triggering an unnecessary tender offer. Investors should also be aware of the new disclosure obligations.

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Tender Offers

The Takeover Measures also made changes in the regulation of tender offers. With the introduction of partial tender offers, investors may acquire shares through listed trades on a stock exchange or purchase shares by private agreement, or initiate a tender offer. However, once a foreign investor holds 30% of the target company's equity, it can only acquire additional shares through a tender offer, unless the CSRC grants an exemption.

The Strategic Investment Measures do not indicate whether foreign investors can acquire shares by tender offers. Although the Strategic Investment Measures provide that investors may obtain "A" shares through other methods specified in China's laws and regulations, it remains unclear whether such "other methods" include acquisition by tender offers and whether a foreign investor could make an initiative tender offer. These questions need to be clarified by further interpretation of the CSRC and MOFCOM.

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