Practice Note 19 (PN 19) – Chain principle offer price

There may be instances where, as a result of acquiring statutory control of a company (which need not be a Code company), a person or group of persons may in turn obtain or consolidate control over a second company because the first company holds 30% or more of the voting rights of the second. In such cases, Note 8 to Rule 26.1 provides that the acquirer of the first company may trigger an obligation to make a mandatory general offer for the other company. This is known as a chain principle offer.

The Executive has from time to time been consulted about how to determine the offer price where a chain principle offer has been

"Statutory control" in this Note means the degree of control which a company has over a subsidiary."

Trigger

Under the chain principle, if an investor acquires statutory control of the first company, typically by acquiring or increasing its shareholding to over 50%, it will trigger a chain principle offer for the second company if the criteria under either the substantiality test as set out in (a) above or the purpose test as set out in (b) are met.

Calculation of the chain principle offer price

The offer price should be calculated objectively taking into the businesses and assets involved, in determining a chain principle offer price and consult the Executive when in doubt.

Pacpo formula

In 1993, the Takeovers Panel considered the pricing mechanism of a chain principle offer by China Strategic Investment Limited for the shares of Pacpo Holdings Limited and Hong Kong Building and Loan Agency Limited. The Panel adopted a step-by-step approach which is commonly referred to as the “Pacpo Formula”.

Set out below is an example of an offeror triggering a chain principle offer for an asset-based company:

An Offeror acquires a 10% interest in Company A, increasing its shareholding from 45% to 55%. Company A holds 30% of Company B (ie, 150,000 shares). Both Company A and Company B are engaged in property development and investment.

The acquisition price is $4.00 for each share in Company A. The net assets less non-controlling interests (if any) **(NALNCI)** of Company A is $500,000 and that of Company B is $400,000. The total number of issJ0o0 9a2t1B5(4)-0.Td (aTd (aT25 (o9d.1 (o)-> (s)-5.3 (J0

Steps to calculate the chain principle offer price for Company B:

1. <u>Determine the ratio reflecting the relative values of Company A and Company B</u>

   (a) The value of Company B attributable to Company A is calculated by multiplying the NALNCI of Company B by the percentage shareholding of Company A in Company B:

   $400,000 x 30% = $120,000

   (b) A relativity ratio of 0.24 is obtained by dividing the value of Company B attributable to Company A (as a result of ste811.9 (i)-1.sh e(i)-1.s811.90.6 (d)8 (.7 (4d [(t)-5.1 (N(o)-(e N)3.1 (A

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share is therefore:

$960,000 / 150,000 = $6.40 per share.

The offer price for the chain principle offer for Company B is $6.40 per share.