Restructuring of a Distressed Listed Company

The Corporate Finance & Restructuring team at FTI Consulting in Hong Kong has extensive experience in restructuring and relisting distressed listed companies out of provisional liquidation. Listing status is valuable in Hong Kong and investors, particularly those from mainland China, are often prepared to pay a premium to acquire troubled listed companies. This is because a listed vehicle can be used as a platform to have access to the international capital markets and to facilitate any inbound and outbound investments. A listed entity is also viewed by investors and lenders in China as being more credible.

The restructuring and relisting process out of a provisional liquidation is usually achieved by injecting working capital to reshape the underlying business, undertaking a capital reorganisation and paying out creditors via a scheme of arrangement.

The process typically requires the following skill sets:

- *Financial Accounting* — preparing audited accounts, addressing audit issues and perfecting and implementing internal control processes.
- *Management Accounting* — re-engineering the underlying business and enhancing operations efficiency and budgeting.
- *Legal* — reviewing legal documents involved in the process including scheme documents and court sanction documents as well as addressing any legal proceedings in the liquidation.
- *Corporate Finance* — meeting various listing requirements such as capital reorganisation, public float and underwriting.

There are a lot of hurdles to overcome in the process, particularly when there are tight timeframes set out by the Stock Exchange.

After a listed company is placed into provisional liquidation, it is put into a delisting procedure and trading in its shares is suspended by the Stock Exchange. Under the Practice Note issued by the Stock Exchange, a listed company, subject to provisional liquidation, has 18 months to submit a viable resumption proposal with the Stock Exchange to demonstrate it has sufficient assets and operations for relisting. Its listing will be cancelled if these issues are not addressed to the satisfaction of the Stock Exchange within the stated timeframe.

The key documents in the process are the resumption proposal, the restructuring agreement, circulars and scheme documents. The resumption proposal is the most important document as it sets out the business model and operations, the financial position of the company, the proposed capital reorganisation and debt restructuring. The resumption proposal must also address the issue of sustainability of operations and asset sufficiency to satisfy the Stock Exchange. The other documents are prepared in order to elaborate on different aspects of the contents in the resumption proposal.

The first step of the restructuring process is to find a white knight. Finding an experienced white knight, preferably in the same industry as the listed company, is helpful as significant time can be saved on negotiating the deal structure and commercial terms. Furthermore, the white knight can bring their experience and knowledge to help reignite the underlying business of the listed company, therefore enhancing the chance of the resumption proposal being approved. FTI Consulting in Hong Kong has a pool of investors in different industries who are interested in participating in restructuring and relisting public companies and so generally, we can match an investor with a particular situation in a timely manner.

The second step is to draw up a viable resumption proposal to address the issues of asset sufficiency and business sustainability. These are subjective tests conducted by the Stock Exchange and there are no objective benchmarks to measure against. This position was confirmed by the High Court of Hong Kong in *Sanyuan Group Ltd v the Stock of Exchange of Hong Kong Limited* where it was found that the application of the sufficiency of assets test is entirely at the Stock Exchange's discretion and is not subject to any objective benchmark. The issue of asset sufficiency and debt restructuring is typically addressed via a Court sanctioned scheme of arrangement that settles creditors' claims against the company with the funding provided by the investor under a capital reorganisation.

In terms of business sustainability, in FTI Consulting's experience, it is best to reignite and expand the underlying business of the listed company with the working capital injected by the investor. Any acquisition of a new line of business by the listed company is not recommended as it could be deemed as a "Reverse Takeover" by the Stock Exchange. If this is the case, the relisting process will follow the procedures of an IPO application and hence, the listing conditions for an IPO applicant must be satisfied with all IPO procedures being closely followed. It is a more costly and prolonged process than that of a restructure.

If the underlying business of the listed company is trading or "passive" in nature (such as property investment), it is unlikely to meet the business sustainability test. To enhance the chances of meeting this requirement, it is recommended to expand the business model by building upstream or downstream businesses. An entity which essentially only holds cash or financial assets will also expressively be rejected by the Stock Exchange. It is provided under HKEx Rules that a listed company will not be regarded as suitable for listing if its assets consist wholly or substantially of cash or short-dated securities. The objective of this is to prevent any backdoor listings of unqualified businesses through large-scale fundraisings.

Once the Stock Exchange has granted an in principle approval to the resumption proposal, the next step is to fulfill the conditions set out in the approval before the deadline. These conditions typically include:

- Completion of capital reorganisation, completion of the scheme of arrangement and other transactions contemplated under the resumption proposal;
- Issuance of the circular to shareholders and the passing of necessary resolutions at the general meeting;
- Demonstrate the company has adequate financial reporting and internal control systems; and
- Withdrawal of the winding-up petition and the discharge of provisional liquidator.

The above conditions are generally procedural and in most cases relatively straightforward, however it is important to note that specific timeframes will be placed on when these steps must be achieved by the Stock Exchange and it can be difficult to achieve an extension of these deadlines. FTI Consulting has achieved a number of successful restructurings of distressed listed companies in recent years including The Grande Holdings Limited, Tack Fat Group International Limited (now known as Tack Fiori International Group Limited) and China Packaging Group Company Limited (now known as Central Wealth Financial Group Limited). Our team of experienced and knowledgeable professionals can assist in handling the process in a swift and cost effective manner.

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Vincent Fok
Senior Managing Director
+852 3768 4640
vincent.fok@fticonsulting.com

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