

Cayman Merger Code drives ‘take private’ deals in Asia



By Arwel Lewis and Amelia Hall

The statutory merger route within the Cayman Islands Companies Law has, since its introduction in 2009, provided an attractive means of effecting a takeover. The process is straightforward and allows two Cayman incorporated companies – or even a foreign company in certain circumstances, to merge. The lower merger approval thresholds make it an attractive acquisition option when compared with either a ‘squeeze out’ following a takeover offer or a scheme of arrangement, which has added time and cost issues as it is a court driven process.

Enhancements to the Cayman Islands Companies Law (Companies Law) in 2011 succeeded in making the merger process even more appealing. The amendments reduced the shareholder threshold for passing a statutory merger to a special shareholder resolution requiring only 66 percent / two-thirds approval, absent of any higher threshold in the Articles of the target company.

These changes to the Companies Law heralded a number of so called ‘China Orphan’ deals, where a Cayman incorporated holding company for a mainland PRC business listed overseas is taken into private hands with a view to later relisting the business on the Hong Kong or PRC stock exchanges. Typically, Chinese firms listed overseas – often in the US – tend to suffer from not being sufficiently understood by Western investors, leaving them undervalued and, when combined with the increased costs and regulatory requirements, make a de-listing attractive.

Walkers acted on the take private of Tongjitang Chinese Medicines Company in 2010, resulting in its US Depository shares being delisted from the New York Stock Exchange. This was a landmark transaction, being the first time the Cayman Islands statutory merger regime was used to take a public company into private hands.

Tongjitang was followed by a number of other similar mergers using the Cayman statutory merger regime. In August 2011,

Cayman company Halogen Limited took advantage of the lower shareholder approval threshold and acquired Chemspec International. More recently, the shareholders of Chinese online game developer Shanda Interactive Entertainment voted in favour of a management-led buyout, taking the company back into private hands. The deal in February 2012 was one of the largest ‘take privates’ with the company now valued at some US\$2.3 billion.

As ‘take private’ deals have gained momentum in China, concerns have been raised about the need for detailed due diligence work on target companies, particularly in the wake of the various accounting scandals and fraud allegations in the region. Media reports point to private equity firms engaging private investigators to dig deeper into the affairs of targets, while due diligence fees can be costly due to the increased execution risks.

The Cayman Islands merger process typically requires a new Cayman Islands company to be incorporated as the bidder to merge with – and be subsumed by – the listed Cayman target. A merger agreement is usually entered into between the target and bidder, outlining the transaction and attaching a formal plan of merger, setting out the details of the companies, as well as the key terms of the deal, which must be approved by the directors of each company. If a founder is acting with the bidder, and is also a director of the target, issues arise on the independence of the target board and a special committee of the board should be formed to consider the recommendation to be made to shareholders. Directors will also look to financial advisers for advice as to the fairness of the price offered by the bidder. Shareholder approval of the proposed merger, by way of special resolution, is then required (a 66 / two-thirds majority of those present and voting). Secured creditors will also need to approve the merger.

Given the choppy nature of the equity markets, interest in mergers and ‘take privates’ continues to be strong and we expect this trend to continue given the relative simplicity of the Cayman statutory merger regime.

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