

Part B Consultation Questions

Please indicate your preference by checking the appropriate boxes. Please reply to the questions below on the proposed change discussed in the Consultation Paper downloadable from the HKEX website at:

<https://www.hkex.com.hk/-/media/HKEX-Market/News/Market-Consultations/2016-Present/November-2020-MB-Profit-Requirement/Consultation-Paper/cp202011.pdf>

Where there is insufficient space provided for your comments, please attach additional pages.

Capitalised terms have the same meaning as defined in the Consultation Paper unless otherwise stated.

1. Do you agree that the Profit Requirement should be increased by either Option 1 (150%) or Option 2 (200%)? Please give reasons for your views.

Yes

No

You may provide reasons for your views.

We are of the view that, as an international finance centre and one of the leading stock exchanges, amendments of the Profit Requirement should only be made when all of these conditions are made: 1) the problem(s) aims to be solved is proven to exist; 2) it is the right approach to deal with the problem(s); and 3) it is the right timing. Based on the information contained in the relevant consultation paper, we are of the view that none of the above condition has been met. Set out below are further elaborations of our view.

1. The problems aimed to be solved by increase of the Profit Requirement are not supported by objective data provided in the consultation:

While the consultation paper contained, both in the executive summary and main body, a section called "Reason for change", there is only one piece of statistics referred in such section to support the reason (i.e. Table B in Appendix III) and such statistics at best failed to support the "Reason for change", it may even contradict with it.

Paragraph 20 of the consultation states that : "Since the Market Capitalisation Requirement was increased in 2018...the Exchange has seen an increase in listing applications from Small Cap Issuers that marginally met the Profit Requirement but had relatively high historical P/E ratios as compared with those of their listed peers."

No information has been provided on whether since the Market Capitalisation Requirement was increased in 2018, applications with "high historical P/E ratios as compared with those of their listed peers" is a trend specific for Small Cap Issuers or it is a trend in general, which apply to non-Small Cap Issuers as well, driven in the positive sentiments in the IPO market of Hong Kong. If the high historical P/E ratios of new issuers as compared with those of their listed peers is a general trend, clearly it should not contribute to the "Reason for change" for increasing the Profit Requirement substantially which would mostly affect Small Cap Issuers. Moreover, Table B shows that median historical P/E ratio of non-Small Cap Issuers has been higher than those of Small Cap Issuers in all

the individual year from 2016 to 2019 and Chart B and Chart C of Appendix III further shown that from 2016 to 2019 Small Cap Issuers actually have substantially higher portion with historical P/E ratio lower than 15 times as compared to non-Small Cap Issuers, if we are to view these statistics in isolation, the conclusion should be Small Cap Issuers have in general lower historical P/E ratio than non-Small Cap Issuers.

Paragraph 20 continues to state “In 2018 and 2019, the Exchange received... Main Board listing applications... of which 53% were submitted by Small Cap Issuers (compared to 49% in 2016 and 2017)(see Table B in Appendix III).”

It is observed from Table B that the portion of total listing applications from Small Cap Issuers fluctuated year to year from 2016 to 2019, varying from 42% to 55%. The difference between such portion in 2018 and 2019 (53%) to 2016 and 2017 49% is not significant taken into account that fluctuation exists before the Market Capitalisation Requirement was increased in 2018, such insignificant difference should not be taken as supporting for the “Reason for change” since it is a results of an interaction of many factors.

2. Increase the Profit Requirement is the wrong approach to solve the problem(s)

The consultation seems to imply there are several “problems” which should be solved by increasing the Profit Requirement but it is clear that it is the wrong approach even if such “problems” exists.

Paragraph 3 of the consultation states “... Where a new applicant only marginally meets the minimum thresholds under the Profit Requirement and the Market Capitalisation Requirement, this effectively increased the applicant’s implied historical P/E ratio from 10 times to 25 times”. Paragraph 4 goes on to state “... While these Small Cap Issuers typically justified their higher valuations by reference to potential growth, a number of them failed post listing to meet the profit forecasts they had filed... which gave rise to concerns about the reasonableness of their valuation...”. It is obvious that the first “issue” mentioned above was a direct result of increase of the Market Capitalisation Requirement and a higher implied historical P/E should not itself be a problem of concern. For the concern about failing to meet the profit forecasts issuers filed during listing applications, currently such profit forecasts are reviewed and commented (if necessary) by the Exchange and sent to the SFC under the dual filing system (after reviewed by the relevant sponsors and reporting accountants) to ensure meeting requirements as stated in the Listing Rules, if improvement is needed in relation to profit forecasts, naturally it is the process and standards of preparing and vetting the profit forecasts that need to be reviewed and amended if necessary, not taking this approach but instead seek to increase the Profit Requirement seems to be like the Chinese saying: “斬腳趾避沙蟲” (roughly translated as cutting the toes to avoid the bugs).

It is set out in Appendix I of the consultation the key rationale for not changing the Profit Requirement in consultations done in 2010, 2016 and 2017:

“... the Profit Requirement remained a good indicator of new applicants’ future profitability and no change was made to the Profit Requirement” ;

“It agreed that the Profit Requirement should be maintained mainly because there were no red flags or strong calls from the market to change the requirement”;

“the Profit Requirement is generally a good indicator of a new applicant’s future performance and the current level of the Profit Requirement is on par with the main markets of the overseas exchange”

The above consultations were made as recent as 2017, and we as one of the active sponsor firms in the Hong Kong market see nothing contradictive to the situation as mentioned in the above rationale, and if the rationale of these consultations are to be followed, it is clear that the Profit Requirement should remain unchanged this time as well. Moreover, on the point “there were no red flags or strong calls from the market to change the requirement” as explained above the consultation paper failed to provide objective information to substantiate any red flags nor strong calls to change the Profit Requirement, on the contrary, as further explained below, at the time of this response, based on publicised responses to the consultation available to us and reporting from local newspapers, there are strong calls against increasing the Profit Requirement substantially. On the point “the current level of the Profit Requirement is on par with the main markets of the overseas exchange”, as stated in paragraph 9 (d) of the consultation “although both Option 1 and Option 2 will result in the Exchange having the highest profit requirement when compared with the profit requirements of the Selected Overseas Main Markets on an aggregated basis for the three years of a track record period” is another clear contradiction to the rationale of previous consultations on the same topic.

3. It is clearly not the right timing to increase the Profit Requirement

The consultation acknowledge that “... against the backdrop of the COVID-19 pandemic and the uncertainties arising from the economic and political tensions between the US and China, many companies’ businesses have been adversely affected” and goes go to consult on “temporary conditional relief from the increased Profit Requirement”. While the two issues acknowledged are still currently in development and when and how quickly the world will return to “normal” is still largely unclear, it is simply not the time to take hasty actions to substantially increase the Profit Requirement as it will substantially heighten the risk of barring issuers that would otherwise qualify for listing and would attract substantial investor interests. Even with any “temporary conditional relief from the increased Profit Requirement”, since no one currently alive have ever experienced or even deal with issues similar to COVID-19 and very little if any, the degree of political tensions between the US and China, it would simply be extremely imprudent to expect that any such temporary conditional relief which will inevitable be relied on human judgement would be able to substantially mitigate the negative effects.

During the course of preparation of this response it came to our attention that some prominent members of the industry and society has made public their views / consultation responses, namely Ms. Regina Ip, Mr. David Webb, Charltons (on behalf of 10 Hong Kong Finance Advisers) and the Law Society of Hong Kong which we share many of their views. To avoid duplicating Exchange’s workload, we would not state those views in our response again, but we think it may be help full to do a quick summary of some of those views as below:

- Hong Kong needs to provide a comprehensive and diversified market;
- The proposed increase in Profit Requirement would reduce the diversification of the Hong Kong market and hinder the competitive advantages with other stock exchange in the region;
- The increase in Profit Requirement will restrict Main Board listing to large cap Mainland companies (we also want to highlight that in certain markets such as NYSE and ASX, more relaxed requirements are offered to domestic issuers in sharp contrast to the Exchange’s attitude to local issuers);
- The Exchange has a moral obligation to list any company that meets disclosure and governance requirements;

- A minimum profit requirement has nothing to do with corporate governance and little to do with investment risk;
- It is inappropriate for the Exchange to bar public equity investors to invest in small companies
- The proposed increase in Profit Requirement over-emphasis on “shell company” listings

- The current requirement seems generally on par with other major markets. The proposed changes will result in the Exchange imposing basically the most stringent entry requirements in terms of profit track record

2. Besides the proposed increase in the Profit Requirement, is there any other alternative requirement that should be considered? Please give reasons for your views.

Yes

No

You may provide reasons for your views.

3. Do you agree that the Exchange should consider granting temporary relief from the increased Profit Requirement due to the challenging economic environment? Please give reasons for your views.

Yes

No

You may provide reasons for your views.

As mentioned in our response to question 1 above, we are of the view that since no one currently alive have ever experienced or even deal with issues similar to COVID-19 and very little if any, the degree of political tensions between the US and China, it would simply be extremely imprudent to expect that any such temporary conditional relief which will inevitable be relied on human judgement would be able to substantially mitigate the negative effects. The only temporary relief appropriate is to suspend the increase in Profit Requirement until a more suitable time.

If the Exchange insists in increasing the Profit Requirement, it is noted in HKEx's June 2017 consultation paper titled "Consultation Paper on Review of the Growth Enterprise Market (GEM) and Changes to the GEM and Main Board Listing Rules" (the "2017 Consultation"), transitional arrangements for both GEM issuers and GEM applicants "which may have chosen to list on GEM as a result of GEM's current positioning as a "stepping stone" to the Main Board" has been explicitly stated that both issuers listed on GEM and all GEM applicants who have submitted a valid listing application for listing on GEM before the amendment effective date of the new requirement proposed in the 2017 Consultation, would be subject to the same eligibility requirement for the Main Board in accordance with the Main Board Listing Rules in force as at the date of the 2017 Consultation. However, it seems that for the current consultation it is unclear whether GEM applicants who have submitted a valid listing application for listing on GEM before the amendment effective date of the new requirements proposed in the current consultation will be subjected to the same transitional arrangements (i.e. eligibility for Main Board assessed in accordance with the Main Board Listing Rules in force as at the date of the current Consultation). We are of the view that it is vital to clarify the above ambiguity to the market as soon as possible, to ensure feedback for the current consultation are not made under misunderstanding of such a key arrangement.

4. If your answer to Question 3 is yes, do you agree with the conditions to the temporary relief as set out in paragraph 55? Please give reasons for your views.

Yes

No

You may provide reasons for your views.

- End -