## 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.

   | |
   |---|
   | Please refer to our attached response to Question 1. |

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.

   | |
   |---|
   | Please refer to our attached response to Question 2. |

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.

   | |
   |---|
   | Please refer to our attached response to Question 3. |

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.

   | |
   |---|
   | Please refer to our attached response to Question 4. |

- End -

**Response to Question 1**

The Hong Kong economy is currently in a marked decline with the GDP at a negative growth of -7.5% in 2020 against the significantly lower negative growth of -1.2% in 2019. Such slowdown in the Hong Kong economy is due not only to the the COVID-19 pandemic, but also combined effects of the slowdown of the Mainland economy and the trade war and political tensions between China and the United States. In addition to these overarching economic conditions, Hong Kong's economy has also suffered from many other negative factors in 2019 and 2020. In light of the challenging economic landscape, it is submitted that the Exchange should bear in mind is position as (i) a listed company; and (ii) Hong Kong's exchange controller that :-

(1) as a listed company, the Exchange bears a responsibility to its shareholders to maintain its market leading position by exploring more ways and opportunities to attract under such a tough economic environment in order to maintain its market leading position; and
(2) as an exchange controller, the Exchange should strive to act as a role model of corporate social responsibility in Hong Kong, and understand its responsibility to implement any changes to the securities market in a prudent manner. Given the present economic environment, it is hardly an appropriate moment to implement any aggressive policy or substantial change which may cause self-inflicted damage not only to our own stock market but also to the entire economy of Hong Kong as a whole.

The proposed increase of the Profit Requirement would be contrary to both the Exchange's positions and responsibilities outlined above, for the following reasons:-

**Adverse effects to SMEs in Hong Kong**

Small and medium enterprises (the "**SMEs**") constitute a substantial part of Hong Kong's businesses, and is vital to the economy as drivers for growth and innovation and as employers of the workforce. As such, the Exchange should look to strongly support SMEs together with the Hong Kong government. Although less funds are raised through the listing of SMEs and SMEs are not the Exchange's key service target, the Exchange is indeed the main platform for SMEs to raise funds, expand their businesses and enhance their corporate reputation. The Proposal would drastically reduce the ability of many SMEs to do so on the Main Board, which will affect the recovery and long-term development of SMEs.

Although SMEs could still apply for listing on GEM, GEM has been experiencing structural problems after the amendments to GEM Listing Rules in 2018. In recent years, the number of companies applying for listing on GEM has dropped significantly. In addition, the trading volume of GEM has always been low, which shows that the attractiveness of GEM is insufficient.

One of the reasons is that after amendments to GEM Listing Rules in 2018, a GEM transfer applicant is considered as a new applicant for applying to transfer the listing of its securities from GEM to the Main Board, which indicates that the listing applicants will have to burden additional listing costs and expenses when it switches from GEM to the Main Board in the future, and many companies have therefore given up applying for listing on GEM.

Therefore, without resolving the structural problem of GEM, the Stock Exchange should not consider that SMEs may alternatively apply for listing on GEM and substantially increase the Profit Requirement of the Main Board to preclude SMEs from listing on the Main Board.

**Increase in the value of the shell companies**

The Exchange has concerns for listings of shell companies where listing applicants indirectly reverse engineered to meet the Market Capitalisation Requirement. The amendments to the Market Capitalisation Requirement in 2018 apparently are not an effective way to prevent listings of shell companies as mentioned in the Consultation Paper. The Exchange suggests that the Proposal would resolve the problem.

According to the Consultation Paper, approximately 62% of the Profit Requirement Applications will not be qualified under the Proposal on future potential applications. The substantial decrease of the listed company should lead to an increase in the value of the listing status, which in turn encourages the sale and disposal of listed companies. We therefore have reservations about the Proposal as it does not accurately target the problem of shell companies, which exist across listing platforms globally and cannot simply be identified by a single criteria. We believe that most effective way to prevent listings of shell companies and disposal of shell companies for backdoor listings is robust supervision and enforcement by regulatory authorities. Since shell companies are deliberately structured in such a way to circumvent new listing requirements, the logical result of a change in new listing requirements is that such new requirement would simply be circumvented once again since that is the goal of these shell companies. If this is the case, the Proposal would not prevent the "manufacturers" of shell companies from achieving a listing status, but would preclude SMEs with genuine commercial rationale and potential for growth from entering the capital markets.

**Stepping down from the competition**

At the time of economic recession happening across the world, the Exchange is facing cut throat competition with other stock exchanges as Hong Kong's competitors. While other stock exchanges have been finding ways to relax their admission requirements in order to attract more listings, the Exchange counterintuitively proposes two "options" of increasing the Profit Requirement by either 150% or 200% which would decrease and restrict listings on the Main Board.

We would also like to draw your attention that in contrast with Hong Kong, the Chinese Stock Exchanges (including Shanghai Stock Exchange and Shenzhen Stock Exchange) have undergone reforms in recent years to relax its domestic capital markets. In particular, the amendments to Securities Law of China in 2019 revised the core listing requirement in China from "sustainable profitability" to "sustainable operational capability", which implies that profitability requirements on the Chinese Stocks Exchanges will be relaxed in future. If the Exchange conversely increases its Profit Requirement, more Chinese companies will choose to list on the domestic exchanges in lieu of listing in Hong Kong.

**Response to Question 2**

**The reform of GEM**

After the amendments to GEM Listing Rules in 2018, listings, trading activities and returns on GEM have all substantially declined. Although the Exchange successfully tightened the backdoor listing activities on GEM, the number of companies being listed through the "front door" also substantially decreased, indicating that GEM has become less attractive to even legitimate and genuine companies.

If the Exchange considers that SMEs can still and/or should be encouraged to access the capital market through GEM as it is intended for smaller sized companies, the objective should be to re-activate GEM by improving its attractiveness rather than essentially forcing SMEs to list on an unattractive platform by callously increasing the Profit Requirement of the Main Board and thereby leaving SMEs with no other choice. We suggest that the attractiveness if GEM could be increased through various reforms as described below.

**Reconsideration of the streamlined process**

The Exchange should re-consider whether GEM should be a "stand-alone" board which is completely independent from the Main Board at this stage. While the amendments to GEM in 2018 cracked down backdoor listings which had been achieved through GEM to Main Board transfers, GEM's previous "stepping stone" feature and streamlined process gave companies listed on GEM an efficient avenue to transfer to the Main Board if they could satisfy the Main Board listing requirements, which was a key part of GEM's attractiveness. In order to improve the attractiveness of GEM without making the streamlined process a tool for backdoor listings once again, we suggest that the Exchange considers the possibility of granting exemptions or waivers for streamlined GEM to Main Board transfers to genuine issuers whose controlling shareholder(s) and/or principal business remain unchanged since its listing on GEM (together with any other conditions which the Exchange considers appropriate). The Exchange can also require a longer lock up period on controlling shareholder(s) of GEM issuers if they have successfully transfer to the Main Board as further protection against backdoor listings. By reintroducing the streamlined process, a rational and aspirational connection between the Main Board and GEM would be maintained in order to attract more SMEs to list on GEM, provided that the difference between the listing requirement of the Main Board and GEM should be reasonable.

**Listing of biotech companies on GEM**

We fully support the Exchange to explore more ways to increase its shares in the market and attract listings of new economy companies in Hong Kong. This is also why the Exchange have introduced the changes to permit the listings of dual class shares and pre-revenue biotech companies on the Main Board. To further intensify the policy for listing of new economy companies, the Exchange should consider the possibility of allowing biotech companies which meet half or 2/3 of the market capitalisation requirement of the Main Board, together with other biotech company specific listing criteria, to list on GEM. This would not only increase the attractiveness of GEM for new economy SMEs, but also increase the attractiveness of Hong Kong as a listing venue for new economy companies, ensure GEM remains relevant and active in the coming years, and further distinguish the GEM from the Main Board in line with the Exchange's positioning of the Main Board as the main market for sizeable companies.

Moreover, similar exemptions or waivers can also be granted to biotech GEM issuers whose controlling shareholder(s) and/or principal business remain unchanged since its listing on GEM (together with any other conditions which the Exchange considers appropriate) to transfer to the Main Board through a streamlined process if they could satisfy the listing requirement of the Main Board. As described in the section above, if implemented prudently, the reintroduction of a streamlined process would help revive GEM without the previous loopholes for backdoor listings.

**Requirement for number of shareholders**

Under the current listing regime, the Main Board and GEM must have at least 300 and 100 shareholders respectively at the time of listing. The Exchange may consider to intensify such requirement by increasing the number of shareholders required at the time of listing in order to further increase the cost and difficulty of creating shell companies. In addition to up the cost of creating shell companies, increase in the shareholder requirement would also increase the legitimacy of the companies listed in Hong Kong. We believe that apart from satisfying the listing requirement and the expectations of the regulatory regime, whether an issuer is qualified for listing should also be determined by the open markets and recognition from the general public investors. Furthermore, when more shareholders are involving to offer for sale, there would be more supply and as a result the price of the stock will not be pushed up easily, which would also aid in resolving the price volatility issue of GEM.

**Response to Question 3**

While we have reservations about the Proposal of increasing the Profit Requirement, we fully support granting temporary relief due to challenging economic environment.

**Response to Question 4**

We believe that the temporary relief mentioned in the Proposal is not practicable since it expects the listing applicants to have extraordinary financial performance in the other two financial years to cover the financial year being adversely affected, which means that the listing applicants will actually be required to operate its business in the following manners :-

| | FY 2017 | FY 2018 | FY 2019 | FY 2020 | FY 2021 | FY 2022 | FY 2023 | Total Profit (HK$ million) |
|---|---|---|---|---|---|---|---|---|
| Scenario 1 | O | E | E | A | O | O | O | 1.25 |
| Scenario 2 | O | O | E | A | E | O | O | 1.25 |
| Scenario 3 | O | O | O | A | E | E | O | 1.25 |

* Note: O = Ordinary performance
E = Extraordinary performance
A = Adverse performance

As clearly illustrated by the above table, all the scenarios anticipated would be highly unusual to any company which operates its business in an ordinary manner given that it would have been impossible to foresee or accurately gauge the affects of an act of God such as the COVID-19 pandemic in order to 'prepare' for it by performing especially well in the preceding year(s). Moreover, we also have the following observations on the profit requirements as described in the temporary relief section of the Proposal:-

(1) it is not in the interests of public investors as it is not rational to expect listed issuers to have such dramatically fluctuating performance or to expect public investors to make decisions based on such performances;

(2) it does not take into account that listing applicants may have reasonably suffered from adverse performance for more than one financial year given that the economy crisis of Hong Kong begun as early as 2019, before the COVID-19 pandemic;

(3) even if there are listing applicants which fall within the scenarios mentioned as above, their profit and financial forecasts may not be positive as their business ought to return to normal (rather than the extraordinary or adverse performance as illustrated above), unless their financial performances are far higher than the Profit Requirement of HK$1.25 million.

In conclusion, given that the Profit Requirement is proposed to be substantially increased in such hostile economic environment, it seems that the temporary relief would not only fail to provide relief as intended, but in effect also create an even higher de facto Profit Requirement which would preclude companies which would meet the new Profit Requirement in ordinary situation from accessing the capital markets. SMEs obviously have no chance to be benefited from the said temporary relief.

**Alternative Suggestions**

Considering the influence of the economic downturn, we respectfully suggest the Exchange to temporarily reduce the implied historical P/E ratios of applicants meeting only the minimum thresholds under the Profit Requirement and the Market Capitalisation Requirement to 10 times, in line with that before the change of the Market Capitalisation Requirement in 2018, as a high market capitalisation requirement in effect increases the profit requirement because the P/E ratio of a newly listed issuer cannot deviate too far from its industry comparables for those issuers that have already been listed. The relaxation of the Market Capitalisation Requirement will provide a relief to potential applicants whose financial performance just meet the minimum thresholds under the current Profit Requirement.

For potential applicants whose financial performance is advisedly affected and do not meet the minimum thresholds under the current Profit Requirement, the Exchange may provide a temporary streamlined process, subject to the conditions we suggested in our response to question 2 (together with any other conditions which the Exchange considers appropriate), to permit the newly listed issuers to transfer from GEM to the Main Board, which in turn encourages those suffered potential applicants to list on GEM temporarily and allow them to transfer to the Main Board if they could ultimately satisfy the listing requirement of the Main Board after the economic crisis.

The Exchange should also consider to initiate the consultation about the reform of GEM and reconsider the increase of the Profit Requirement upon the reform of the GEM at the time when global economy is recovered.