

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 the appendix hereto.

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 the appendix hereto.

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.

We will not respond to this question because we do not support the drastic increase of the Profit Requirement.

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.

We will not respond to this question because we do not support the drastic increase of the Profit Requirement.

- End -

Appendix

28 January 2021

Corporate and Investor Communications Department
Hong Kong Exchange and Clearing Limited
8th Floor, Two Exchange Square
8 Connaught Place
Hong Kong

Re: Profit Requirement CP

Dear Sirs,

Re: Consultation Paper on Main Board Profit Requirement published by Hong Kong Exchange and Clearing Limited in November 2020 (the “Consultation Paper”)

We refer to the Consultation Paper and would like to make the following submission. Terms used in this submission shall have the same meaning as those defined in the Consultation Paper.

Our firm is supportive of market reforms that reflect the development of the market in a proportionate manner. But the proposed changes set out in the Consultation Paper go too far, particularly given the current economic challenges posed by COVID-19.

PROFIT REQUIREMENT

The Exchange notes that the Profit Requirement has not been adjusted for 26 years and argues it is time for reform. But we do not believe the case has been made to significantly increase the Profit Requirement. Since the prior 2017 Consultation Conclusion, there have been no substantive developments that would require the proposed change. Indeed, the challenging economic environment calls for stability. We are however open in principle to a more limited increase of the Profit Requirement, as set out in this letter.

We believe that the adoption of the Option 1 or Option 2 would exclude a large number of prospective listing applicants, and damage the leading role played by the Exchange. As a leading financial market operator, the Exchange’s role in providing a platform for a diverse size of companies is a vital one for firms and investors. It would be a mistake to restrict its focus to list only companies with a high market valuation.

The Exchange should not adopt Option 1 nor Option 2 but consider a more moderate increase in the Profit Requirement as set out below.

Position of the Exchange

The Exchange has positioned itself as a leading global financial market operator providing world-class facilities for trading and clearing securities and derivatives. Its mission is to provide a platform for companies that require funding through raising capital from the market.

Although high market value listed companies contribute to the development of the brand of the Exchange, a healthy and free market should consist of different sized companies. Regulatory concerns in the abstract are not sufficient reasons for banning the smaller companies to raise capital in the Hong Kong market.

While it may be true that the liquidity of small to medium sized companies is weak, the trading in such securities meets a demand on the part of investors seeking high risk investment for a higher return. The Exchange discharges its important regulatory objective by imposing the disclosure requirements and raising queries in the vetting process. It is not the duty of the Exchange to guarantee investments are low risk or risk-free. It is the responsibility of the investors to choose the investment according to their respective risk tolerance level.

As a leading financial market operator, the Exchange should present a diverse offering to investors and the opportunity for different sized companies to raise capital. As you will appreciate, the Exchange has hitherto provided such a platform. And some firms have gone on to become sizeable corporations in the market. For example, Xinyi Glass Holdings Limited (stock code: 868) (“**Xinyi Glass**”) has recorded a tremendous growth and spun-off a few subsidiaries that are also listed on the Exchange. If the Exchange had not provided a platform for small cap companies, the development of Xinyi Glass or companies with similar potential might have been hindered and the chance to become a sizeable corporation would have lost.

History for adjustment of Profit Requirement

Although the Profit Requirement has not been adjusted for 26 years, the Exchange did explore the case for adjusting the Profit Requirement in 2002 and 2017 respectively. It was concluded in both consultations that no changes were necessary.

Paragraph 119 of the 2017 Consultation Conclusion stated that it is not unreasonable to require an applicant to have a higher implied historical P/E ratio if it is close to meeting only the minimum requirements. This would indicate that, despite this, the market has a high degree of faith in the applicant’s future prospects and such faith should not be overruled by the inability to meet the profit forecast by certain listed companies.

We see no reason to change this analysis. And we would note that other stock exchanges have not followed the Exchange’s lead to raise the profit requirement.

Regulatory concerns

Over the past years, the Exchange has gained knowledge and expertise in screening out the ineligible listing applicants. As mentioned in paragraph 34 of the Consultation Paper, among the 437 Ineligible Applications, only 253 (58%) obtained a listing. The Exchange has been conducting its function in IPOs by vetting and screening out the ineligible applicants effectively. In view of this, there is no convincing argument to increase the profit requirement.

Furthermore, the Exchange implemented a series of rules to attack backdoor listing since 2015. By increasing the period for triggering the RTO, restricting companies to issue securities in a

large scale, and regulating cash companies, the number of listed companies sold has been largely reduced. In view of this, we would argue that the raising the Profit Requirement as an additional measure is redundant.

The Consultation Paper notes there are concerns about the rebate to investors who subscribed high P/E companies. We do not believe this is a legitimate reason for the proposal. It is the job of the enforcement agents, such as Securities and Futures Commission or the Independent Commission Against Corruption, to investigate and regulate market misconduct. It is unnecessary to pursue this objective through raising the threshold for listing.

Unlike the IPO registration system, where the regulatory authority is only responsible for reviewing the information provided by the issuance applicant of whether information and materials have fulfilled the obligation of information disclosure, the Exchange has retained the vetting and discretionary power to approve or reject any listing application. From the paragraph 34 of the Consultation Paper, we can infer that this has enabled the Exchange to effectively control the quality of the listed issuer. Again, there is no need to impose a higher Profit Requirement.

Comparison with other Exchanges

The Exchange has reiterated in the 2017 Consultation Conclusion that it considered the profit requirement was on par with main markets in overseas exchanges and therefore no adjustment was made in 2017. Given that most of these main markets have not adjusted their profit requirements, it is unclear why the Exchange seeks to do so.

Proposed Range of Profit Requirement

We would like to reiterate that we agree to the increase of the Profit Requirement but the amount proposed under Option 1 and Option 2 are too high and demanding.

Having taken into account the average P/E ratio of HSI of approximately 16.30 times for the period from 2 January to 27 January 2021, we propose to adjust the profit requirement to HK\$70,000,000 for three years in aggregate and HK\$30,000,000 for the last financial year.

Consequence of raising the Profit Requirement in a drastic manner

If the Exchange were to increase the Profit Requirement by adoption of Option 1 or Option 2, it would prompt affected companies to seek capital through other financial markets. This would undermine the position of the Exchange as a leading financial market operator. It would also deny companies, in particular, Hong Kong companies, the option to enjoy an established financial infrastructure in Hong Kong, an infrastructure to which these companies have contributed.

2020 has been a hard year for most industries and there were a lot of redundancy or pay-cut in small to medium sized professional firms, including financial advisory and legal firms. A significant increase of the Profit Requirement, as proposed, would further strike the job market. All economic actors in Hong Kong have a duty to support the economy in such challenging times by, among other things, creating job opportunities. With these proposals, the Exchange risks undermining this effort, dealing a blow to the vulnerable job market in financial industries.

OTHER ISSUES

Transition Period

COVID-19 has adversely affected the economy globally and the sign of fully recover is remote. Some companies may have worked out their business plan for listing on the Exchange, the adoption of the new Profit Requirement will certainly affect their plan. We suggest to have a transition period for at least two years to give time to the market to adapt to the change and potential applicants to revise their business plan in order to prepare for the listing.

Market Capitalisation Requirement

We believe it is time to review the Market Capitalisation Requirement. The Exchange raised the Market Capitalisation Requirement from HK\$200 million to HK\$500 million in 2017 without regard to the opposition from the market practitioners. In the 2017 Consultation Conclusion, the Exchange mentioned that there were 100 responses and 50% of which supported the proposal to raise the Market Capitalisation Requirement from HK\$200 million to HK\$500 million, it is worth to note that such 50% is quite arbitral. So far as we note, the 50% support was calculated with reference to the number of respondents, however, a few respondents opposing this proposal represented a considerable number of firms or individuals, e.g. Addleshaw Goddard (Hong Kong) LLP and Charltons represented 20 and 3 practitioners respectively, which will effectively alter the results of the proportion for support and against the proposal if all these practitioners had made their submission individually. However, the Exchange just repeated the reasons set out in the 2017 Consultation Paper and increased the Market Capitalisation Requirement as proposed.

The Exchange proposed to raise the Profit Requirement partly because of the Market Capitalisation Requirement. As the proposed Profit Requirement goes too far, we would like to invite the Exchange to listen to the voice from the market practitioners (in particular those small and medium sized potential listing applicants, financial advisory and legal firms) by revisiting the Market Capitalisation Requirement.

Conclusion

Given the reasons above, we would be glad if the Exchange will accept our following proposals:

1. To adjust the profit requirement to HK\$70,000,000 for three years in aggregate and HK\$30,000,000 for the last financial year;
2. To provide not less than 2 years transition period for the implementation of the new Profit Requirement; and
3. To review and revisit the Market Capitalisation Requirement as soon as possible.