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.

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.

   Given the reasons set out in the reply to Question 1, the listing requirement shall be tightended at this stage.

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 the reasons set out in paragraph 1.6 in the Appendix.

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.

It is suggested that the temporary relief should be applied as a relief to the existing Profit Requirement (instead of the increased Profit Requirement). Such relief shall also be granted to GEM applicants. Please refer to the reasons set out in paragraph 1.6 in the Appendix.

- End -

APPENDIX

1. The Exchange's intention to preserve and protect the Main Board as Hong Kong's premier listing board is appreciated. Nonetheless, given the reasons discussed below, it is suggested that the proposal shall not be implemented at this stage. It is suggested that the Exchange may wait and give additional time to (i) review the effectiveness of existing measures against manufacturing of shell companies and (ii) conduct a more comprehensive consultation by the time when the potential adverse impact of the COVID-19 pandemic is clearer. Unless otherwise defined herein, capitalised terms used herein shall have the same meanings as those defined in the Consultation Paper.

1.1 **Data quoted in the Consultation Paper do not provide compelling reasons to increase the Profit Requirement**

1.1.1 The Exchange observed that there has been 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 (see paragraph 20 of the Consultation Paper).

1.1.2 However, valuation of the issuers may be affected a number of factors on a case-by-case basis, such as macroeconomic and geopolitical factors which are beyond the control and expectation of the issuers at the time when the valuation is determined. Following the IPO fund raising, issuers will be able to utilise the IPO proceeds to further expand their businesses, hence an additional premium shall be given to the valuation on top of their historical P/E ratio.

1.1.3 One of the Exchange's key concern is that while these Small Cap Issuers typically justified their higher valuations by reference to potential growth, <u>a number of them failed post listing to meet the profit forecasts they had filed with the Exchange as part of their listing applications, which gave rise to concerns about the reasonableness of their valuations</u> (see paragraph 21 of the Consultation Paper).

1.1.4 However, it is noted that the key data quoted in the Consultation Paper in this regard have not been discussed and analysed comprehensively. For example, in paragraph 9(c) of the Consultation Paper, it is disclosed that (since 2016), for Profit Requirement Applications that were listed as of 30 June 2020 and which have published their annual financial results post listing, a higher proportion (60%) of the Eligible

Applications under Option 1 met or outperformed the profit forecasts they had filed with the Exchange as part of their listing applications, as compared to Ineligible Applications under Option 1 (37%). However, the latter figure (37%) also covers listed issuers which had a Market Capitalisation of less than HK$500 million (i.e. issuers whose listing application were submitted prior to 15 February 2018 or under transitional arrangements). Given the purpose of the consultation is to increase the Profit Requirement of <u>applicants with a Market Capitalisation of HK$500 million or above</u> and that concern of the Exchange is related to the high P/E ratio of <u>listed issuers having a Market Capitalisation of HK$500 million or above under the current regime</u>, the data of listed issuers with Market Capitalisation of lower than HK$500 million (under the old regime) are not relevant at all and should not be considered for the purpose of the Consultation Paper. In fact, the Exchange should only consider the data of listed issuers with Market Capitalisation of HK$500 million or above under the current regime.

1.1.5 In paragraph 34 of the Consultation Paper, the Exchange set out the statistics as to Ineligible Applications (had Option 1 been implemented) which failed to meet their profit forecasts. After taking out the 69 issuers with Market Capitalisation of less than HK$500 million at the time of listing under the old regime, 59% and 53% of Small Cap Issuers and non-Small Cap Issuers failed to meet their profit forecasts. It is not a significant difference. In addition, 12% of non-Small Cap Issuers failed to meet their profit forecasts by over 50%, which is much more serious than the situation of Small-Cap Issuers.

1.1.6 Based on the above, there is no compelling evidence that Small-Cap Issuers had a significantly higher tendency to prepare exaggerated profit forecast with a view to support their P/E Ratio.

1.1.7 Similarly, in paragraph 39 of the Consultation Paper, the Exchange set out the statistics as to Eligible Applications (had Option 1 been implemented) which failed to meet their profit forecasts. Out of such issuers, 73 non-Small Cap Issuers failed to meet their profit forecasts. Such figure is even higher than the number of Small-Cap Issuers which were Ineligible Applications under Option 1 (i.e. 71). Although in terms of percentage, Small Cap Issuers are more likely to fail to meet profit forecasts than Non-small Cap Issuers, it should be noted that the number of such Small Cap Issuers is small (i.e. 7 out of 14) and may not provide any conclusive evidence that their profit forecasts are generally exaggerated. It suggests that there is no conclusive evidence that the size and profit level of the listing applicants may be directly relevant to the Exchange's concern as to the ability to meet profit forecast.

1.1.8 The chart below summarises the number and % of Small Cap Issuers and non-Small Cap Issuers (listed between 2016 and 2019 and subsequently failed to meet their profit forecasts after listing) as discussed above:

	Small Cap Issuers (with Market Capitalisation between HK$500 to 700 million)	**Non-Small Cap Issuers (with Market Capitalisation over HK$700 million)**
Ineligible Applications	71 (59%)	31 (53%)
Eligible Applications	7 (50%)	73 (39%)

1.1.9 The data in the Consultation Paper do not unequivocally proves that the valuation of Small-Cap Issuers is generally supported by exaggerated profit forecast. In particular, when the data of Small-Cap Issuers are compared with those of Non-small Cap Issuers, it is arguable whether all listing applicants have a similar chance for failing to meet their profit forecasts (regardless of their scale of operation and Market Capitalisation).

1.1.10 Accordingly, the data in the Consultation Paper do not provide compelling reasons to increase the Profit Requirement.

1.2 The existing minimum Market Capitalisation requirement was implemented since 2018. Additional time may be needed to review its effectiveness following further tightening the listing requirements

1.2.1 The existing minimum Market Capitalisation requirement was implemented in February 2018. In respect of the Exchange's concern on the number of Small Cap Issuers with unusually high P/E ratios, in 2018 and 2019, the number of Profit Requirement Applications and number of Small Cap Issuers did not significantly increase (see paragraph 5 of Appendix III of the Consultation Paper).

1.2.2 Historical P/E ratios for Small Cap Issuers dropped significantly in 2019. 76% of them had a historical P/E ratio below 15x (see Chart B of Appendix B of the Consultation Paper). Such change (as compared only 49% of Small Cap Issuers' historical P/E was below 15x in 2018) indicates that applicants' historical P/E ratio is gradually returning to the level before the increase of Market Capitalisation requirement.

1.2.3 The data for 2020 have not been provided in the Consultation Paper. Nonetheless, given the unprecedented situation impacted by COVID-19 pandemic in 2020, it is suggested that additional time should be given to observe (i) the effectiveness of the existing minimum Market Capitalisation requirement implemented since 2018, and (ii) whether the number of Small Cap Issuers with unusually high P/E ratio would continue to decrease.

1.2.4 In the 2017 Consultation Paper, the Exchange proposed to retain the existing Profit Requirement while the minimum Market Capitalisation requirement was increased from HK$200 million to HK$500 million. In paragraphs 55 and 56 of the 2017 Consultation Paper, the Exchange quoted the view of the Listing Committee in June 2016 that there did not appear to be compelling reasons to change the existing Profit Requirement.

1.2.5 Given the overall P/E ratio of Small Cap Issuers has decreased in 2019 and gradually returning to the level back in 2016 and 2017 (as discussed in paragraph 1.2.2 above), it appears that the Exchange shall reconsider the underlying rationale in 2017. It is suggested that additional time shall be given to the market and the Exchange to observe whether its concern will continue.

1.3 Rules against backdoor listing and continued listing criteria implemented in October 2019. Additional time and information may be needed to review their effectiveness before further tightening the listing requirements

1.3.1 As to the Exchange's concern that Small Cap Issuers were engineered to meet the Market Capitalisation requirement in order to manufacture potential shell companies for sale, it is noted that a number of rules to couple with such situation from various perspective were implemented since October 2019.

1.3.2 In particular, there was a transitional period of 12 months from 1 October 2019 for the more stringent rules for continued listing criteria. Accordingly, the full effects of these rules have not yet been observed and examined. In 2020, over 30 companies (on Main Board and GEM) were delisted pursuant to the cancellation of listing procedures. As at 31 December 2020, eight companies are in delisting procedures under Practice Note 17 to the Listing Rues while 16 de-listings were approved by the Listing Committee (see the Status Report on Delisting Proceedings and Suspensions on the Exchange's website). It is suggested that these procedures have started to impose significant pressure on the manufacturing of shell companies. The Exchange shall consider to observe the effectiveness of such rules for a longer period of time.

1.3.3 The above rules targeted to couple with the issue of shell companies at the stage of subsequent injection of new businesses into the issuer and against the continued listing of issuer with no substantive business. As compared with the proposal in the Consultation Paper (which increases the threshold as at listing), these rules and requirements only apply after listing and will not increase the difficulty for listing or impose any additional burden on the applicants while they are preparing for the listing application. Therefore, these rules and requirements would not impact the potential listing of applicants with genuine business and funding needs or deter their interest to consider listing in Hong Kong.

1.3.4 Given (i) the rules against backdoor listing and continued listing criteria hey were only recently implemented in October 2019, (ii) unprecedented impact of COVID-19 pandemic which may generally affect the operation and work of listed issuers and professional parties such that the effectiveness of these new rules might not be fully reflected, and (iii) these rules would result in a smaller impact on applicants with genuine business and funding needs, it is suggested that additional time shall be given to review their effectiveness.

1.4 Tightening of listing requirements will adversely affect the competitiveness of the Hong Kong stock market

1.4.1 In Tables A and B of Appendix II of the Consultation Paper, the Exchange provided a detailed comparison of listing requirements of a number of overseas Main Markets and the Main Board.

1.4.2 None of these overseas Main Markets have announced any plan to tighten the threshold of listing in the coming year. COVID-19 has adversely affected global economy comprehensively in 2020. Although the Hong Kong and other overseas governments have provided supports and subsidies to private companies and that it is expected that vaccine may be on board in 2021 , it is expected that global economy will continue to be adversely affected by the COVID-19 pandemic in 2021. According to a press release of the World Bank on 5 January 2021, a downside scenario in which infections continue to rise and the rollout of a vaccine is delayed could limit the global expansion to 1.6% in 2021 (https://www.worldbank.org/en/news/press-release/2021/01/05/global-economy-to-expand-by-4-percent-in-2021-vaccine-deployment-and-investment-key-to-sustaining-the-recovery). It is expected that equity fund raising will continue to be a solution for companies with funding needs.

1.4.3 "China Anchored, Globally Connected and Technology Empowered" are the three pillars of the Exchange (see HKEx Strategic Plan 2019-2021). The Exchange aims to "attract global liquidity to Hong Kong by providing broader and more effective access to Asia Pacific underlying assets, creating a comprehensive and competitive one-stop shop for China and Asian exposures". The Exchange will inevitably end up competing with other overseas stock exchanges in the course of attracting overseas companies to list in Hong Kong.

1.4.4 The Consultation Paper did not provide any information regarding the potential decrease of issuers from the emerging markets following implementation of the increased Profit Requirement. The Consultation Paper only provides an overall impact analysis of proposed increase in Profit Requirement which discusses the total number of Ineligible Applications, without providing additional information such as breakdown of geographical locations and industry sectors.

1.4.5 The trend of listing in Hong Kong is still at a developing stage for companies in the emerging markets outside the PRC. The principal places of business of all of the ten largest issuers in 2020 are located in the PRC. Market capitalisation of Mainland enterprises as compared with market total increased from 73.2% by end of December 2019 to 80.1% by end of December 2020 (see HKEx Monthly Market Highlights on the Exchange's website). It may be an indicator that the Hong Kong stock market has been less popular for overseas issuers (as compared with issuers from the PRC) in 2020.

1.4.6 Worse still, it is expected that the continuous economic and political tensions between the US and China may further lower the interests of overseas companies to consider listing in Hong Kong. Under such unfavourable circumstances, the Exchange should avoid tightening of the threshold for listing in Hong Kong too frequently. A frequently changing threshold for listing would deter the interest of overseas companies to prepare for listing in Hong Kong (because they may waste significant time and resources preparing for listing and end up discovering that they are not eligible for listing under a new threshold). The increased Market Capitalisation requirement was implemented in 2018. If there is an additional increase in Profit Requirement in 2021 (i.e. less than 3-year time since the increase in Market Capitalisation requirement), potential applicants (in particular overseas applicants which are not familiar with Hong Kong market) may lose interest in the Hong Kong stock market.

1.4.7 The Consultation Paper provides a comparison of listing requirements with other overseas Main Markets. However, it does not discuss from marketing and strategic perspective as to how the Exchange can maintain or enhance its competitiveness in attracting overseas applicants to Hong Kong.

1.4.8 To conclude, it may not be the appropriate timing to tighten the listing requirements and to increase the Profit Requirement.

1.5 Additional time and discussion are needed in order to review the position of GEM

1.5.1 The Exchange considers that ineligible applicants can still access the capital market by listing on GEM, which is intended to be a capital raising platform for early development companies and small or mid-sized companies that are not able to meet the Main Board eligibility requirements (paragraph 47 of the Consultation Paper).

1.5.2 While the Exchange sought markets' view and discussed the listing requirements of GEM In the 2017 Consultation Paper, the Exchange and the market did not specifically discuss the potential of forcing such significant potential Main Board applicants to seek listing on GEM instead. The 2017 Consultation Paper focused on discussing the transfer mechanism and the Market Capitalisation and other listing requirements.

1.5.3 At the same time in 2017, Question 4 of the New Board Concept Paper sought respondents to provide their "views on the proposed roles of GEM and the Main Board in the context of the overall listing framework". The Exchange's conclusion from the feedback is that the role of the Main Board as Hong Kong's premier listing board should remain intact, while GEM continues to serve a legitimate purpose for the capital raising needs of SMEs from non-New Economy sectors (see paragraph 117 of the Consultation Conclusions of the New Board Concept Paper).

1.5.4 However, it should be noted that neither the 2017 Consultation Conclusions nor the New Board Concept Paper discussed or proposed to significantly increase the profit requirement as a threshold for listing on Main Board (instead, the 2017 Consultation Paper discussed whether or not to "retain" the current Profit Requirement). The 2017 Consultation Paper focused on the issues discussed above while the New Concept Paper focused on introducing a new board for new-economy companies (which may be pre-profit), and whether such companies may be listed in a new board or in Main Board or GEM pursuant to a new chapter of the Listing Rules.

1.5.5 Option 1 and Option 2, on average, would have eliminated 62% (462) of the Profit Requirement Applications (see paragraph 9(a) of the Consultation Paper). As at the date of this submission, there are less than 400 companies listed on GEM. Whether the existing nature of GEM as well as its market acceptance would be capable and suitable to cater the needs for listing from such applicants is unclear. This is a matter which will fundamentally change the nature and market dynamics of GEM. Such radical change needs a separate and comprehensive consultation and shall not be implemented at this stage.

1.5.6 Moreover, the 2017 Consultation Conclusions and the New Board Concept Paper did not use the amount of net profit as an indicator to differentiate companies as premier, SMEs etc., let alone urging companies which can meet the current Profit Requirement on Main Board to seek listing on GEM.

1.5.7 While the Exchange's objective to preserve and protect the Main Board as Hong Kong's premier listing board is appreciated, it is suggested that a more comprehensive conclusion from different angles such as introducing an addition board to the potential ineligible applicants (similar to the conclusion conducted in 2017) is necessary.

1.6 Effectiveness of the temporary relief is in doubt (if it is to be applied with reference to the increased Profit Requirement)

1.6.1 As discussed in the Consultation Paper, results of operation of potential applicants might have been affected by the adverse effects since 2020. The objective of the temporary relief is to allow companies which are temporarily affected by COVID-19 pandemic and uncertainties arising from the economic and political tensions between the US and China to be listed in Hong Kong (Chapter 2 of the Consultation Paper).

1.6.2 The proposed condition for the temporary reliefs that listing applicants' aggregate profit during the track record period shall meet the Aggregate Profit Threshold (i.e. HK$125 million under Option 1 or HK$150 million under Option 2) would not provide any benefit to potential applicants which fail to meet the existing Profit Requirement as a result of the COVID-19 pandemic.

1.6.3 Given the objective of the relief is to cope with the unprecedented impact COVID-19 pandemic and uncertainties arising from the economic and political tensions between the US and China, it is suggested that such relief shall be granted with respect to the existing Profit Requirement (instead of being a remedy to companies which may not meet the increased Profit Requirement).

1.6.4 Both Option 1 and Option 2 represent a significant increase from the existing Profit Requirement. Given the significant impact of the COVID-19 pandemic and uncertainties arising from the economic and political tensions between the US and China, the speed of economic recovery in 2021 and 2022 is highly uncertain and will be subject to factors which are beyond the control of the potential applicants. It is doubtful whether they could meet the proposed conditions of the temporary relief with the Aggregate Profit Threshold of HK$125 million under Option 1 or HK$150 million under Option 2. Hence, the number of potential applicants who could meet the proposed conditions of temporary relief is in doubt. The Consultation Paper does not discuss how many listing applicants may be eligible for the temporary relief in the near future (say in 2021 and 2022). Having considered the above factors, it may not be an appropriate time to increase the Profit Requirement.

1.6.5 Moreover, the proposed increased Profit Requirement will be applicable to applicants from all kind of industry sectors and backgrounds. As compared with the introduction of a new chapter of the Listing Rules for Biotech companies and secondary listings, the impact is much bigger since it will limit the opportunities of listing of potential applicants from all kinds of background. The Consultation Paper was published in late

2020. If the new rules are to be implemented in 2021 or 2022, the time and costs incurred by a large number of potential applicants for preparation of listing may be wasted. It is suggested that if any increase of Profit Requirement is to be implemented, a longer transitional period shall be given.

1.6.6 It is suggested that the Exchange shall announce the details of the temporary relief to potential applicants (which fail to meet the final year profit requirement in 2020) as soon as possible in the first quarter of 2021. Such measure will facilitate potential applicants to decide whether they should continue with the preparation for listing in 2021 and other relevant works. It is also suggested that the Exchange shall grant similar relief to GEM applicants.