Response of Tung Tai Group Limited to the Hong Kong Stock Exchange Consultation Paper 'A Listing Regime for Companies from Emerging and Innovative Sectors'

The initiative of Hong Kong Exchanges and Clearing Limited (HKEx) in seeking to diversify the types of company listing on the Exchange, and to attract issuers from new sectors offering high growth potential, including tech and biotech companies, is very much welcomed. As a leading international exchange, and the preferred international listing venue for Mainland companies, the importance of Hong Kong facilitating the listings of the successful companies of the future cannot be emphasized enough. Hence, the proposed steps to remove the current bars to listing for companies with WVR structures and biotech companies should result in the modernization of the Exchange and greater representation of modern growth industry companies, for the benefit of issuers and investors alike.

We are nevertheless disappointed that no measures to allow the listing of smaller and medium-sized innovative companies will be adopted. As indicated in the consultation conclusions to the New Board Concept Paper, there was considerable support for the proposal which would have allowed the listing of companies in sectors where high R&D costs often delay revenue generating capability. While biotech is a clear example of this type of company, there are many others, particularly in the technology sector. It is therefore hoped that the proposals for biotech companies can be extended in the future to a broader category of companies.

Capitalised terms used herein have the same meaning as in the Consultation Paper.

A. Proposals for listing pre-revenue biotech companies

2017 saw greater numbers and volumes of Biotech IPOs. Nasdaq currently leads the world in biotech company listings with 357 such companies listed as at 7 March 2018. Biotech sector growth is strong and at least 30 biotech listings are expected on Nasdaq in 2018. [1] The sector is however increasingly driven by Asia and a number of Chinese biotech companies have listed on Nasdaq including immunotherapy company BeiGene, Shanghai-based Zai Lab and Hutchison China MediTech. Given the requirements of the Shanghai and Shenzhen Stock Exchanges for listing applicants to have been profitable for three years, HKEx's proposal to allow biotech companies to list at the pre-revenue stage should establish the Exchange as a worthy alternative to Nasdaq for Chinese biotech companies wishing to go public. Media reports that some two dozen biotech companies are currently considering a Hong Kong listing, including the potential US$1 billion listing of the biopharma unit of China's Tasly Pharmaceutical Group, suggest that the reforms could allow Hong Kong to regain some of the ground lost to Nasdaq in Chinese biotech sector listings.

[1] Nasdaq Marketinsite. "Nasdaq's head of healthcare listings shares 2018 predictions for biotech IPOs". 13 March 2018.

Hong Kong would also be an obvious listing venue choice for the growing number of biotech companies in other parts of Asia, such as Taiwan, South Korea and Singapore. From issuers' perspective, Hong Kong's nexus with China and access to international investors, as well as the potential future extension of Hong Kong-China stock connect, make it highly attractive. The listing of biotechs will have the major advantage of fostering biotech expertise among investors, analysts, valuers and bankers facilitating Hong Kong's development as a biotech hub.

Comments on the proposals

1. Participation in Post-IPO fund raisings by pre-IPO investors

A concern raised by venture capital and private equity investors who are accustomed to participating in post-IPO fundraisings of Nasdaq-listed biotech companies without restriction, is the potential barrier posed by Hong Kong's connected transaction rules given that the *de minimis* exemption under Listing Rule 14A.76 does not apply to new securities issues. The concern is that the restriction on participation in secondary fundraising rounds will leave Nasdaq as the preferred option in some cases.

2. Valuation and Auditing Issues

An area for exploration is how equivalence will be achieved in the valuation of biotech assets. Consideration needs to be given in particular to practices for capitalising development costs, an area in which market practice varies widely in different jurisdictions: capitalisation occurring at a much earlier stage in the A share market than in the US market, for example.

B. Proposals for Listing Innovative Companies with WVR Structures

We strongly support HKEx's proposals to remove the bar on WVR structures which will hopefully establish Hong Kong as the offshore listing venue of choice for Chinese tech companies, which has long been its position for Chinese companies operating in traditional sectors. Whatever the potential criticisms of WVR structures, to disallow them would be to deprive Hong Kong investors of access to China's most successful enterprises.

Comments on the proposals

1. Corporate WVR Beneficiaries

HKEx's commitment to a further market consultation within three months of the implementation of the revised Listing Rules on the issue of corporate beneficiaries of

WVR[2] is very much welcomed. The current bar on corporate beneficiaries of WVR is perceived by many as a fundamental flaw in the proposals which would prevent a considerable number of tech sector companies from listing on the Exchange. While many tech companies currently fit the proposed model with an individual acting as founder, controller and CEO of the company, there are also many which are spin-outs from tech unicorns which will be precluded from listing under the rules currently proposed. We therefore urge HKEx to address this as soon as possible given the absence of a comparable restriction for WVRs listing on Nasdaq, or under the proposals put forward for listing WVRs in Singapore.

2. Permitted WVR Structures

WVRs are defined under the proposals to include "share-based structures" (such as dual class share structures) and "non-share based structures" (which would include provisions giving WVR holders control of board decisions). However, non-share based structures will not be allowed for new listing applicants, while secondary listing applicants already listed in New York or on the premium segment of the LSE's main market will be allowed with either a share-based or non-share based structure. This leads to the apparently incongruous situation that a company such as Alibaba Holdings, which has a non-share based structure, would only be permitted to list in Hong Kong via a secondary listing once it is already listed in the US or UK. Hong Kong investors are thus denied the opportunity to invest at IPO, arguably the investment stage at which they are most likely to secure a profit. This would appear to imply that regulation of these companies on the primary listing market is in some respect superior to that in Hong Kong which is manifestly not the case, particularly in the case of Nasdaq which has a very different listing regime to Hong Kong.

In the case of WVR structures such as that of Alibaba, which consisted of the founders' right to nominate directors for appointment to the board, subject to shareholders' approval in general meeting, it could be argued that this gives a far lesser degree of control than a dual class share structure where founders' voting rights far outweigh those of non-WVR shareholders. The bar on such structures for IPO applicants would thus appear illogical and we urge HKEx to reconsider. This would of course also require reconsideration of the proposed suitability requirements that WVR beneficiaries must be individuals who are (i) directors of the company at IPO and (ii) play an active executive role and have materially contributed to its ongoing growth. Incidentally, it is noted that while the former requirement (i) is reflected in the draft Listing Rules, the latter is not. Is

[2] At paragraph 51 of the Consultation Paper.

it intended that the requirement of paragraph (ii) be a Listing Rule requirement for WVR applicants?

3. Cap on Founders' Interest

While the proposed minimum 10% economic interest is supported, we do not agree with the proposed 50% cap on WVR beneficiaries' interest which could disqualify from listing a number of the companies Hong Kong is seeking to attract. If a cap is to be imposed, this should be set considerably higher, at least 80%.

4. Restriction on Qualifying Regimes for Concessionary Route to Secondary Listing

The proposals for the secondary listings of companies already listed on qualifying exchanges currently restrict those exchanges to NYSE, Nasdaq and the premium segment of the LSE main market. Consideration should also be given to including other stock exchanges attracting tech company listings such as Nasdaq Nordic, currently the most popular European exchange for tech listings, and Euronext Paris.

C. Lack of Opportunities for Early Stage Companies

We are highly disappointed that small and medium-sized new economy companies outside the biotech sector will not be given an opportunity to list in Hong Kong.

Efforts to provide a comprehensive and diversified market for smaller growth companies, as well as for large, established companies, have been repeatedly thwarted in Hong Kong. The GEM market, initially established as a light-touch, caveat emptor market for smaller growth companies, has been gradually eroded by the imposition of the cash flow requirement in 2006 and continuing obligations which are identical to the Main Board with the additional compulsory requirement for quarterly reporting. Strong market support for an AIM style market as proposed in HKEx's January 2006 Discussion Paper on the Growth Enterprise Market, albeit limited to professionals only out of concerns for retail investor protection, was however dismissed in favour of the recently discarded stepping-stone model. AIM is currently the leading international market for growth companies, as it was in 2006 when the decision was made not to pursue this model for Hong Kong. In 2017, 49 IPOs on AIM raised £2.1 billion, a 97% increase in funds raised compared to 2016. These included the £393 million IPO of logistics company, Eddie Stobart, the largest AIM IPO since 2005. AIM and AIM Italia provided 69% of EU growth

company finance in 2017.[3] We would therefore urge HKEx to continue to consider ways for Hong Kong to provide a listing venue similar to AIM, which could provide a similar role to AIM in Asia for the many SMEs in new economy sectors.

With the developments in the tech industry, the need for a community supporting the small company sector is now greater than ever and a growth company board would be instrumental in achieving that. GEM has for all intents and purposes failed as a listing venue for early stage companies. This position has been consolidated in the revised listing rules which came into effect in February 2018 which has repositioned GEM as a venue for established small and medium companies, rather than the growth companies for which it was originally intended to cater. The inherent difficulties for smaller companies in satisfying HKEx's suitability requirements in terms of demonstrating sustainability for example, coupled with the expense of listing due largely to the extensive sponsor due diligence requirements, have also rendered GEM listing difficult, expensive and sometimes unattainable for many smaller companies.

A key driver of the proposed reforms is the fact that Hong Kong lags other international listing venues, notably New York, in listing new economy companies and the proposals are clearly a step in the right direction. We would however argue that it is not enough to only list those companies which are already a success. If Hong Kong wants to be at the forefront of the tech revolution, it must innovate to provide a diversified market for companies at all stages. A public platform is the most efficient fund-raising platform for companies, yet under the current regime, it is not available except to companies which are already generating revenues. In the absence of a listing platform in Hong Kong, these companies will list elsewhere. Whether they do so in China or the US, Hong Kong will lose some of the most vital companies of the future and deprive its investment community of the chance to participate in their growth.

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[3] LSE. "London IPO Market Soars in 2017". 29 December 2017.