

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:

<http://www.hkex.com.hk/eng/newsconsul/mktconsul/Documents/cp2017062.pdf>

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

1. Do you agree with the proposal to re-position GEM as a stand-alone board and hence remove the GEM Streamlined Process for GEM Transfers and re-introduce the requirements to (a) appoint a sponsor to conduct due diligence for GEM Transfers; and (b) publish a "prospectus-standard" listing document such that GEM Transfer applications are treated as a new listing application (without requiring the applicant to conduct an offering)?

☒ Yes

☒ No

Please give reasons for your views.

To re-position GEM - Yes. Currently GEM has completely lost its function as the fund raising platform for growth enterprise, or any growing companies. Investors have also formed a view about the GEM that it's an inferior listing platform to the Main Board. Such inferior label keeps a number of institutional investors away from GEM, making the valuation of GEM low, and resulted in a vicious cycle. To reposition GEM as an early stage fund raising platform for growth companies, it is essential for the Exchange to correctly identify the needs of such growth companies and, more importantly, the targeted investors of such companies and to tailor the new GEM to cater for those needs. For example, if New Board Pro is a board allow WVR structure but Main Board will continues to disallow such structure, should the GEM be positioned as a board available to general public investors but at the same time also allowing WVR structure by way of removing the requirement of Rule 11.25 of the GEM Listing Rules and at the same time requiring that all classes of shares of such listing applicant must be listed simultaneously (like the case of Swire Pacific A and B on the Main Board)? This can also eliminate the needs for setting up New Board Premier which essentially is a Main Board which allows WVR structure.

Also, as mentioned in my comments to the New Board Concept Paper, the growth potential of a company should not be assessed by the financial figures or whether the company is doing business in a particular industry, but instead focus on the potential and/or the actual business needs of such company. Taking into account the expected positioning of GEM and the proposals set out in the New Board Concept Paper, GEM needs to be more appropriately positioned to target the companies that are more mature than those targeted by the New Board Pro as set out in the New Board Concept Paper, but still yet to be ready for listing on the Main Board ("GEM Targets") given that the new GEM will be accessible by the general public investors.

(a) Appoint a sponsor for GEM Transfers - Yes. Currently, the listing requirement for GEM listco is more or less the same as that of the Main Board. If GEM is repositioned to target the GEM Targets, I would expect that the listing requirement would be more stringent than those of New Board Pro but more relax than that of the Main Board in order to help such GEM Targets to raise funds for growth easier as well as reducing their burden to prepare for a listing. On the assumption that there are possible difference in listing requirement among the New Board Pro, GEM and Main Board I support that a sponsor is needed.

(b) publish a "prospectus standard" listing document - Yes and no. Given that the GEM Transfers are already listed companies, the listing document should have a "prospectus standard minus" standard, i.e. a Main Board prospectus with some exemptions granted such as "History and Development" can be exempted, while "Business" and "Financial Information" can allow a reduced level of discussion given that the GEM Transfers have been periodically publishing financial results and management discussion and analysis of the GEM Transfers already.

2. Do you agree with the proposal to require all GEM Transfer applicants to have (a) published and distributed at least two full financial years of financial statements after their GEM listings; and (b) not been subject to any disciplinary investigations by the Exchange in relation to a serious breach or potentially serious breach of any Listing Rules for 24 months before they can be considered for a GEM Transfer?

☒ Yes

☐ No

Please give reasons for your views.

Agree with the view stated in the Consultation Paper

3. Do you agree with the proposal to retain the current track record requirement under the GEM Listing Rules (i.e. two financial years)?

☒ Yes

☐ No

Please give reasons for your views.

Agree. There would be inadequate financial information for general public to assess the potential GEM listing applicant if the track record period is less than two years. Companies with less than two years track record should be diverted to New Board Pro in view of its possible higher risks.

4. Do you agree with the proposal to retain the current practice of not requiring a GEM applicant that can meet the Main Board admission requirements to list on the Main Board instead of GEM?

☒ Yes

☐ No

Please give reasons for your views.

Agree. Potential listing applicants should have the freedom to choose which platform to list on.

5. Do you agree with the proposal to increase the Cashflow Requirement from at least HK\$20 million to at least HK\$30 million?

☐ Yes

☒ No

Please give reasons for your views. We invite suggestions on other potential quantitative tests for admission to GEM.

Assuming that GEM will no longer be a stepping stone for listing applicant to "promote" to the Main Board, GEM will then be in direct competition for Main Board or even New Board for listing applicants. Raising the Cashflow Requirement to HK\$30 millions means that, assuming that listing applicant still prefers Main Board to the GEM given the "fame" of GEM as well as the Profit Requirement is retained at existing level, GEM Targets are the companies that have more than HK\$10 million depreciation charges and working capital changes. For asset-light companies with little working capital they may even be able to meet the Main Board listing requirement before meeting the GEM listing requirement. If that's the case I can't see how Exchange can position GEM as a listing platform between the New Board Pro and the Main Board.

This proposal indicates that the Exchange is still unclear about how to and where should GEM be positioned. If the GEM will be a listing platform positioned between the New Board Pro and the Main Board, the listing criteria should be align with that of the Main Board but with a discount on the quantitative requirement (assuming there's no quantitative requirement for New Board Pro as per the New Board Concept Paper), say a two-year track record period with the most recent year recording HK\$10 million profit, with an alternative testing of most recent year revenue of HK\$100 million plus HK\$10 million cashflow from operations (all figures arbitrary, for illustrative purpose only). See my comments on Q12 below for further discussion.

6. Do you agree with the proposal to increase the minimum market capitalisation requirement at listing from HK\$100 million to HK\$150 million?

☐ Yes

☐ No

Please give reasons for your views.

No comment. Indeed it is funny that, taking the New Board Proposal in consideration together, the New Board Pro that targets professional investors only requires a minimum market capitalisation of HK\$200 million but the GEM that targets the general public investors only has a minimum market capitalisation requirement of HK\$150 million. Does this means that the New Economy high-fliers that even the Exchange considers to be valuable will only be made available for professional investors? Isn't this proposal re-enforcing the impression of the general public that GEM is an inferior board and shooting GEM's own feet?

7. Do you agree with the proposal to increase the post-IPO lock-up requirement such that controlling shareholders of GEM issuers:

- (a) cannot dispose of any of their equity interest in a GEM issuer within the first year of listing; and
- (b) cannot dispose of any interest in the subsequent year that would result in them no longer being a controlling shareholder as defined under GEM Listing Rule 1.01?

☒ Yes

☐ No

Please give reasons for your views.

Agree with the view stated in the Consultation Paper

8. Do you agree with the proposal to introduce a mandatory public offering mechanism of at least 10% of the total offer size for all GEM IPOs?

☒ Yes

☐ No

Please give reasons for your views.

Agree as this is to align with the requirement of the Main Board

9. Do you agree with the proposals to align the GEM Listing Rules on:

- (a) placing to core connected persons, connected clients and existing shareholders, and their respective close associates with those under Appendix 6 to the Main Board Listing Rules and Guidance Letter HKEX-GL85-16 "*Placing to connected clients, and existing shareholders or their close associates, under the Rules*"; and

☒ Yes

☐ No

Please give reasons for your views.

Agree as this is to align with the requirement of the Main Board

- (b) the allocation of offer shares between the public and placing tranches and the clawback mechanism with those in Practice Note 18 to the Main Board Listing Rules?

☒ Yes

☐ No

Please give reasons for your views.

Agree as this is to align with the requirement of the Main Board

10. Do you agree with the proposal to increase the minimum public float value of securities from HK\$30 million to HK\$45 million?

☒ Yes

☐ No

Please give reasons for your views.

Agree but subject to my comment on Q6 above

11. Do you agree with using the Profit Requirement to determine eligibility to list on the Main Board?

☒ Yes

☐ No

If not, what alternative test should be used? Please give reasons for your views.

Fine to continue to use Profit Requirement as one of the measures to determine eligibility. However, the Consultation Paper has ignored and failed to consider in totality that the existing alternative eligibility tests under LR8.05(2) and (3). The overwhelming choice of Profit Test for listing on the Main Board as mentioned in paragraph 16 of the Consultation Paper is the results of extremely unbalanced requirement among the three tests currently available for listing applicants. The other two tests that consider the revenue of a listing applicant has a fundamental assumption that the company is large but for whatever reason it is not making profit like Meitu (1357:HK) or making not enough profit yet like China Literature (Application proof prospectus uploaded on 3 July 2017). As there's no mention of these two tests in the Consultation Paper, I'd assume that the Exchange considers these two tests serve the purpose of allowing companies that are not making profit but are target of the Main Board to be listed. That means the Exchange considers that a company with HK\$500 million revenue making no or inadequate profit but with a market capitalisation of HK\$4 billion (or HK\$2 billion with cashflow from operation of HK\$100 million) is appropriate for Main Board. If this is the appropriate size of a company that the Main Board wish to target, why would the Exchange considers it appropriate for another company making HK\$20 million in the most recent year with a valuation of 25x Price-Earning ratios ("P/Es") (giving the proposed revised minimum market capitalisation of HK\$500 million) in the same league of those company? Does the Exchange genuinely believe that raising the P/Es to 25x will be effective for screening out the marginally qualify listing applicants that ultimately will become "shells"? Even at HK\$500 million there is still a HK\$200 million "profit" comparing to the latest "shell price" of around HK\$700 million quoted in the market. Raising the minimum market capitalisation will increase the cost of making "shells", but the problem is not addressed.

I agree that there should be different sets of eligibility requirements to cater for the difference in business nature of different companies in different industries and using Profit Requirement is probably a good way for the vast majority of the listing applicants, but keeping everything unchange only indicates that the Exchange has failed to consider the totality of facts. See my comment to Q12 below for further discussions.

12. If you agree to retain the Profit Requirement, do you agree that the current level of profit under the Profit Requirement should remain unchanged?

☐ Yes

☒ No

Please give reasons for your views.

See my comments to Q5 and Q11 above.

If the Exchange would like to keep the Profit Requirement unchanged, an additional cashflow requirement should be added for LR8.05(1) because I can't think of any reason that can explain why a company recording HK\$500 million revenue needs to have HK\$100 million of cashflow from operations during the track record period (where the room for manipulating revenue and cashflow are much lesser than profit as there're tons of non-cash adjustments before arriving at the profit from the revenue) and a much higher requirement of market capitalisation (four times the proposed revised HK\$500 million market capitalisation) at listing while, in the extreme case, a company making HK\$50 million profits during the track record period doesn't even need to have any cashflow from operations where a GEM listing applicant will have to record HK\$30 million cashflow from operations in a shorter timeframe (2 years track record period for GEM versus 3 years track record period for Main).

See my comments to Q16 below for further discussion.

13. Do you agree with the proposal to increase the minimum market capitalisation requirement at listing for Main Board applicants from at least HK\$200 million to at least HK\$500 million?

☐ Yes

☐ No

Please give reasons for your views.

No comment. See my comments to Q11 and Q12 above.

14. Do you agree with the proposal to proportionately increase the minimum public float value of securities for Main Board applicants from HK\$50 million to HK\$125 million?

☒ Yes

☐ No

Please give reasons for your views.

Agree but subject to my comments on Q11, Q12 and Q13 above.

15. Do you agree with the proposal to increase the post-IPO lock-up requirement such that the controlling shareholders of Main Board issuers:

- (a) cannot dispose of any of their equity interest in a Main Board issuer within the first year of listing; and
- (b) cannot dispose of any interest in the subsequent year that would result in them no longer being a controlling shareholder as defined under Main Board Listing Rule 1.01?

☒ Yes

☐ No

Alternatively, do you believe that it is not appropriate to extend the post-IPO lock-up requirements for Main Board applicants, given that they are less likely to have the characteristics identified in the 2016 Suitability Guidance Letter because of their larger size and our proposal to raise the minimum market capitalisation requirement to HK\$500 million.

Please give reasons for your views.

Agree with the proposal on increasing the post-IPO lock-up.
For the alternative view, as mentioned in my comments to Q11 above, the existing data shows that companies with market capitalisation above HK\$500 million are less likely to have the characteristics identified in the 2016 Suitability Guidance Letter simply because the "shell makers" will use minimal cost to get the "shell" built, and that means to give the listing applicants a HK\$200 million market capitalisation which is just enough for meeting the listing eligibility requirement. With HK\$200 million "profit" left on table even after raising the minimum market capitalisation to HK\$500 million, there's still motivation for making "shells" and thus concluding that "after raising the minimum market capitalisation requirement to HK\$500 million the listing applications will less likely to have the characteristics identified in the 2016 Suitability Guidance Letter and therefore not required to extend the post-IPO lock-up requirement" is flipping the cause and consequence.

16. Do you agree that the proposals for the Main Board should be considered independently irrespective of the outcome of the proposals for GEM?

☐ Yes

☒ No

Please give reasons for your views.

The positioning of GEM is so embracing now that if, the Consultation Paper goes through without modification, the positioning of GEM and Main Board will be even closer, rather than more differentiated. For example, it is not uncommon for a company with HK\$30 million cash flow to record HK\$20 million profit. This means there will be even less companies that will fulfill GEM listing requirement without fulfilling Main Board listing requirement. Given the current market perception of GEM, companies that can fulfill both listing requirement will go to the Main Board. Together with the possible roll out of the New Board Pro under the Concept Paper, GEM may simply goes completely dead given the less and less room for GEM to develop.

To sum up, based on the current proposals set out in the Consultation Paper and New Board Concept Paper, the future listing platform offered by the Exchange will be as follow:

Private Market: For professional investors to exchange information of companies valued under HK\$200 million and not ready for general public, which I can't see any benefit for existing venture capitals or early stage investors to use it.

GEM: For general public, minimum market capitalisation of HK\$150 million, making HK\$30 million cashflow from operations in the last two years.

New Board Pro: For professional investors to trade, minimum market capitalisation of HK\$200 million, no financial requirement.

Main Board and New Board Premier: For general public, making HK\$50 million profit over the last three years with no cashflow requirement

So for GEM, there exists some kind of companies that are generating cash from operations and are less risky for general public to invest in, but at the same time they are not attractive for venture capitals and early stage investors (as their market value are lower than the New Board Pro threshold), and not accounting-wise profitable or large enough for Main Board? In this case ain't GEM becoming a dumpster of low growth potential (high flyers will be captured by the New Board Pro venture capitals and early stage investors as the additional HK\$50 million valuation means nothing to them), small sized companies (those a bit larger will be able to go to the Main Board) for general public?

- End -