

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.

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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.

For (a), we prefer to keep the present requirement. We should encourage GEM listed companies to make the transfer applications instead of discouraging it. If they are able to fulfill the Main Board Profit Requirement after just one complete financial year, it implies they keep performing very well upon their GEM listing in terms of profitability. This is the type of companies that our market and the regulators we should welcome to have them listed on the Main Board. We see no reason to be against it instead.

For (b), to align our view in (a) above, we consider the current requirement is sufficient.

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.

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.

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.

As referred to in paragraph 12 of chapter 3 of the Consultation Paper, 70% (85 of 121) of Selected GEM Issuers recorded aggregate operating cash flow before changes in working capital of HK\$30 million and above in the last two financial years immediately before they were listed on. In other words, approximately 30% (36 of 121) of such Selected GEM Issuers would not be able to meet the proposed Cashflow Requirement of HK\$30 million. We consider the effect of such proposed change would cause quite a number of proposed GEM listing applicants (which are mainly small and mid-sized companies, the category that our current government is seeking to assist) to be unqualified for fulfilling the Cashflow Requirement of HK\$30 million which represents an increase of 50% from the current Cashflow Requirement. We also consider that such substantial increase in the magnitude of the Cashflow Requirement would only disqualify some of the proposed listing applicants but not to attract more applicants with stronger cashflow performance for making GEM applications. We understand and agree that cash flow remains an appropriate indicator for business viability for small and mid-sized companies and the proposed change aims to improve the overall quality of GEM. On balance, we would suggest increasing the Cashflow Requirement to HK\$25 million.

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.

In line with our proposed Cashflow Requirement of HK\$25 million in Q5 above, we suggest the minimum market capitalization requirement be increased to HK\$125 million.

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.

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.

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.

- (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.

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.

It appears that quite a number of GEM listing applicants have been raising funds by offering 25% of the new issued share capital through placing and/or public offer. The current minimum public float value of securities of HK\$30 million represents 30% of the current market capitalization requirement. If the GEM listing applicant is offering 25% of its new issued share capital at listing, in order to fulfill the current minimum public float value of HK\$30 million, it would be required to command for a market capitalization of not less than HK\$120 million. Similarly, if the proposed minimum public float value of HK\$45 million was adopted, the implied market capitalization would become HK\$180 million if the GEM listing applicant chose to offer 25% of its securities at listing and this would again exceed the new proposed market capitalization of HK\$150 million. In order not to cause confusion and complicate the market capitalization requirement, we suggest adopting a pragmatic approach by setting the minimum public float value as 25% of the market capitalization requirement. It is also noted that the minimum public float value for Main Board application of HK\$50 million represents 25% of the current market capitalization requirement of HK\$200 million. Following our suggestion of the minimum market capitalization requirement of HK\$125 million in Q6 above, we would therefore suggest the minimum public float value be revised to HK\$31.25 million.

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.

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.

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.

Profit Requirement has been one of the major listing criteria for Main Board applicants, the current level of which is HK\$20 million for the latest financial year. When determining the market capitalization of a listing applicant, it is common for sponsors and bookrunners to adopt a comparable approach by using price-earnings multiple benchmarking with the selected companies engaging in similar business activities. Based on the current level of minimum market capitalization of HK\$200 million, if the listing applicant is making a net profit of HK\$20 million, the implied price-earnings multiple of which would need to be a minimum of 10 times in order to fulfill the listing requirement. The price-earnings multiples of different companies engaging in different industries would vary. Some may command a single-digit price-earnings multiple and certain hot-picks at the then market sentiment may achieve a high end double digit figures. Also, the general price-multiples may also be affected by the overall market performance. As such, the increase in the average market capitalization during the past years may be triggered by a number of reasons coupled with the then market circumstances.

As referred to in paragraph 21 of chapter 5 of the Consultation Paper, 13% of direct applicants would have been excluded if the minimum market capitalization requirement was increased from HK\$200 million to HK\$500 million. It appears that the effect of such increase would not cause a large number of proposed Main Board applicants (which are companies engaged in various industries) to be unqualified for fulfilling the proposed minimum market capitalization requirement of HK\$500 million. However, we do not agree to taking this as a (or one of the) basis in determining the threshold of the minimum market capitalization requirement. The proposed revision represents an increase of 250% from the current minimum market capitalization requirement which we consider it is too onerous to the market. Taking a school as an example, the passing mark of an examination paper should not be raised even if all students score a passing mark and even if it has to be raised, it should not be set with reference to how many students could then be failed with the new passing mark. For our capital market, we all wish to get more quality applicants to be listed on the Main Board (which is positioning as a market for larger companies). By raising the minimum market capitalization requirement to HK\$500 million, the implied price-earnings multiple of a just qualified Profit Requirement listing applicant of making a net profit of HK\$20 million for its latest financial year would become 25 times. Apparently, depending on the industry which it is engaged in, this implied price-earnings multiple of 25 times is usually considered exceedingly high, making the existing applicant not able to attract sufficient investors during the bookrunning though it is able to fulfill the Profit Requirement. Without a more convincing basis for making such changes, we would propose to maintain the current minimum market capitalization requirement of HK\$200 million or at most, raise it to become HK\$250 million (being a 25% increase).

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.

In line with our views given in Q13 above, we would suggest the minimum market capitalization requirement to be unchanged or at most increase to HK\$62.5 million.

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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.

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.

We consider that the positioning, together with the relevant proposals, of each of the GEM and Main Board should be considered as a whole instead of treating them independently. Market would be confused if the two boards could not be differentiated and changes (in particular the positioning) were not making concurrently.

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