

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.

We do not agree with the proposal to re-position GEM as a stand-alone board and removal of GEM streamlined process of transfer to Main Board based on the below reasons.

First, the removal of the streamlined process may discourage certain small and mid-sized companies to list in Hong Kong. Such companies grow and mature as a listed company they thus have been scrutinized before their transition to Main Board. Removing the transfer mechanism will make the process of board transfer costly and less efficient.

Second, we have studied of transfers from the GEM Board to the Main Board throughout FY08 to FY16. The average transfer rate from FY09 to FY16 was 4.4%, less than the rate of H2 FY08 (7.8% and 14 companies). Given the fact that the percentage and number of transfers are both relatively low, we are concerned that the transfers will become even less after the removal of the streamlined process.

Nevertheless, we recommend tightening the transfer mechanism, for instance, by imposing a certain scale of due diligence covering the latest three financial years for companies which have been subject to disciplinary action or investigation by the Exchange in the latest three financial years.

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.

Publishing financial statements for at least two full financial years should be mandatory to avoid abuse of the streamlined transfer process by, for example "shell" companies. We also believe that applicants should not have been subject to any disciplinary action by the Exchange due to a serious breach or potentially serious breach of the Listing Rules or other regulations for 24 months before the transfer to ensure a healthy GEM market.

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.

We agree with the proposal to retain the current track record requirement for two years. We believe two years is a reasonable track record period for small and mid-sized companies. Increasing the track record period will increase the costs of GEM listing applications and will discourage such companies to come to Hong Kong.

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.

Yes. We believe that the choice of board a listing applicant chooses to list should be determined by the applicant as it will have its reasons.

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.

GEM should be the listing platform for small and medium-sized enterprises ("SME").

The proposed increase in the cashflow requirement from at least HKD20 million to HKD30 million will significantly impact potential listing applicants to GEM. For example, if the HK\$30 million cash flow requirement were applied, there would be 9 out of 34, 19 out of 45 and 18 out of 35 GEM listed companies which fail to meet the listing requirements during FY15, FY16 and H1 FY17 (see Appendix I). The uplifted cashflow requirement will not resolve the quality issue of GEM but will in fact discourage certain listing applicants originally meeting the HK\$20 million cash flow requirement to list in Hong Kong and to choose another stock exchange.

On the other hand, we believe that stricter requirements on the IPO lock-up period and mandatory public offering percentage may be effective to prevent the abuse of "shell" companies.

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. In fact the uplift of the minimum market capitalization requirement may impose higher demand on the profit level of GEM listing applicants (since market practitioners in practice consider market capitalization with reference to profit level), which is in contrary to the original intention of less stringent demand on profitability for GEM listing applicants.

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.

Yes. Based on the general observation that shell companies usually cash out during the first year after listing, we consider that a stricter requirement of the IPO lock-up period would be an effective approach to prevent "shell" companies with perceived premium attached to a listing.

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.

Yes. We agree with the proposal to introduce a mandatory public offering mechanism of at least 10% of the total offer size for all GEM IPOs. It is considered as another effective measure to prevent high concentration of shareholding and "shell" companies in addition to increased post IPO lock-up period. This requirement may also reduce the post-listing price volatility for GEM issuers.

This mandatory mechanism may cause higher listing costs for small and mid-sized companies though.

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.

Yes, based on the rationale of no preferential treatment to core connected persons, connected clients and existing shareholders and their respective close associates.

- (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.

Yes. The clawback mechanism should be consistent with Main Board Listing Rules.

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.

No. Our view is in line with our replies to question 6.

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.

Not applicable.

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.

Yes. We agree that there is no compelling reason to change the current profit level. The profit level requirements represent a reasonable expectation of size of Main Board listing application while any increase of such requirements may cause potential listing applications to switch to other overseas exchanges for listing if they cannot meet the increased requirements.

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. The uplift of the minimum market capitalization requirement may impose higher demand on the profit level of Main Board listing applicant (since market practitioners in practice consider market capitalization with reference to profit level). Any increase of such requirements may cause potential listing applications to switch to other exchanges for listing if they cannot meet the increased requirements.

The jump from at least HKD200 million to HKD 500million is substantial and seems not reasonable. From 2015 to 2017 first half, there were around 54% to 63% of listed companies in Main Board with P/E ratio of lower than 15 times (including no profits generated companies and transfer from GEM). Assuming the huge jump of market capitalization to HKD500 million, these companies may be required to increase profit level to 2.5 times to achieve equivalent market capitalization for listing. We believe the companies affected by the proposed increase in minimum market capitalization will be those with annual profit level between HKD30 million to 50 million. For the traditional industries such as property construction and manufacturing, they may not be able to attain such high level of profit or P/E ratio. (Please refer to Appendix II and III for details.)

With uncertainty, especially in P/E multiple to the listing applicants, the listing applicants may determine to withdraw from listing or to list in other exchanges, which is not be in the interest of Hong Kong.

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.

No, based on our replies to question 13.

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.

Yes. Although GEM has a different positioning compared with Main Board, we believe a consistent requirement on post-IPO lock-up will give a positive message to the market that the intention to maintain market stability by relevant rules are equally applied to both GEM and Main Board.

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

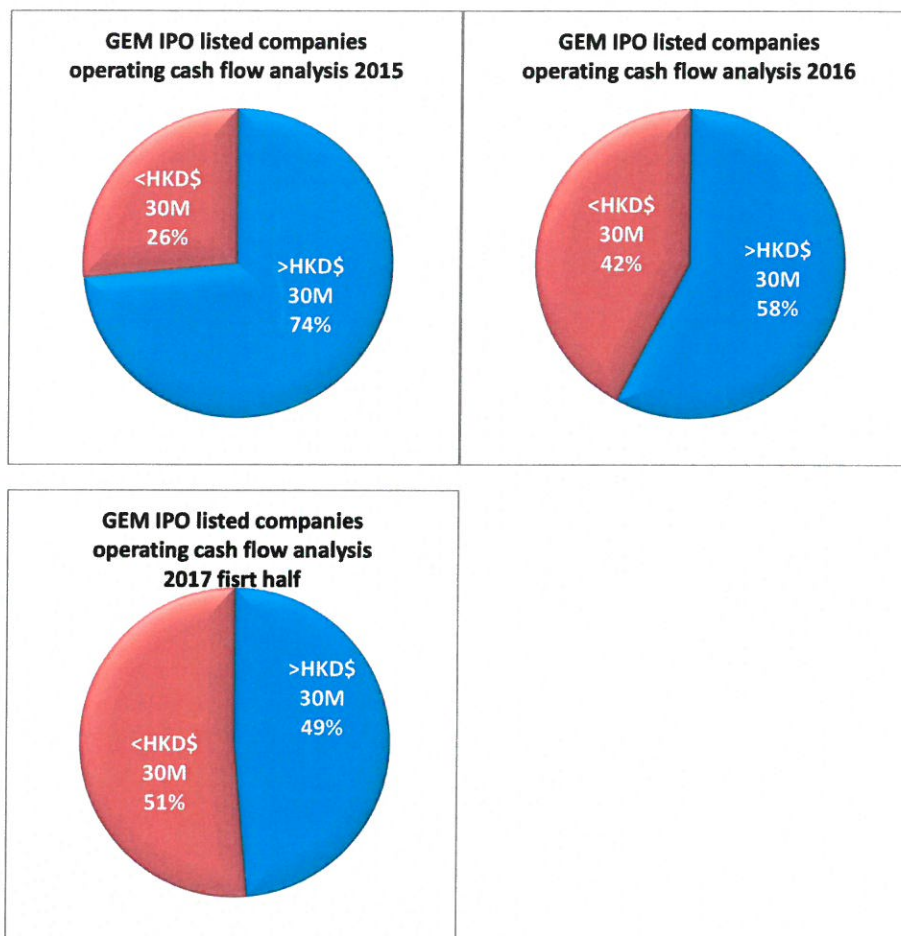
Please give reasons for your views.

No. Any proposal for changes in listing rules of Main Board and GEM should be considered together, especially in certain areas that are related to both boards such as transfer from GEM to Main Board and consistency of rules to protect shareholders as a whole.

- End -

Appendix I

GEM IPO listed companies operating cash flow analysis

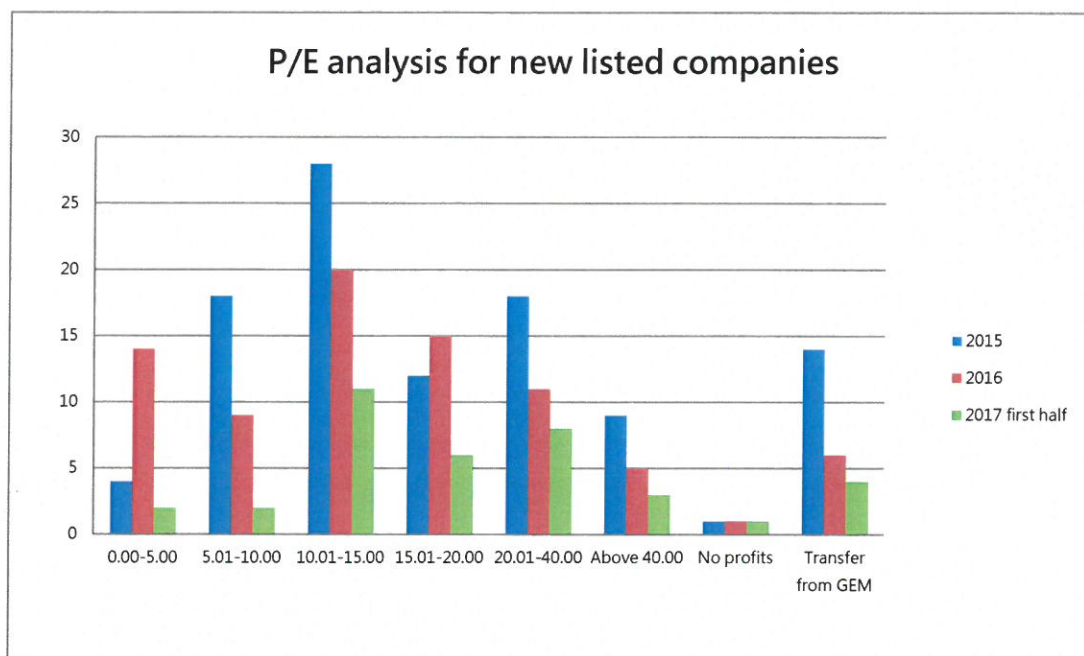


GEM IPO listed companies operating cash flow analysis						
HKD	2015		2016		2017 first half	
>HKD\$30M	25	74%	26	58%	17	49%
<HKD\$30M	9	26%	19	42%	18	51%
Total	34	100%	45	100%	35	100%

Source: HKEx IPO new listing summary and RSM analysis

Appendix II

P/E analysis for new listed companies



P/E analysis for new listed companies			
P/E	2015	2016	2017 first half
0.00-5.00	4	14	2
5.01-10.00	18	9	2
10.01-15.00	28	20	11
15.01-20.00	12	15	6
20.01-40.00	18	11	8
Above 40.00	9	5	3
No profits	1	1	1
Transfer from GEM	14	6	4
Total	104	81	37

Appendix III

Main board IPO latest financial year earnings analysis

Main board IPO latest financial year earnings analysis						
In HKD	2015		2016		2017 first half	
Below HKD50million	17	16%	24	30%	13	35%
Between HKD50million to HKD100million	21	20%	14	17%	5	14%
Larger than HKD100million	52	50%	37	46%	15	41%
Transfer from GEM	14	13%	6	7%	4	11%
Total	104	100%	81	100%	37	100%

Source: HKEx new listing summary and RSM analysis

