HKEX 香港交易所

May 2021

Consultation Conclusions

The Main Board Profit Requirement

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EXECUTIVE SUMMARY

Purpose

1. This paper sets out conclusions to the consultation on the Exchange's proposal to increase the Profit Requirement.

Background

2. The Profit Requirement is one of the three pivotal financial eligibility tests, which forms part of the robust qualitative and quantitative assessment the Exchange performs to determine the suitability of listing applicants to list on the Main Board. From the perspective of market segmentation, the Profit Requirement serves an important function by ensuring that companies relying on this eligibility test have attained a minimum level of operational scale and growth commensurate with the positioning of the Main Board.

3. The Hong Kong and global economies have experienced vigorous yet resilient growth and developments in the past few decades. The Market Capitalisation Requirement has had a five-fold increase since its introduction in 1989 to preserve the distinctiveness of the Main Board and its position as a market for larger companies that can meet Hong Kong's highest market standards. In contrast, the Profit Requirement has not been revised to take into account significant changes in the economy and other market developments since its implementation in 1994, when the Main Board was the only fund-raising and trading platform operated by the Exchange before the Growth Enterprise Market was launched in November 1999.

4. The Market Capitalisation Requirement is one of the requirements which must be complied with by listing applicants relying on the Profit Requirement to list on the Main Board. Following the most recent increase in the Market Capitalisation Requirement in 2018, without a corresponding adjustment to the Profit Requirement, the implied historical P/E ratio of companies just meeting the two requirements increased significantly from 10 times to 25 times. There has since been an unexpected surge in listing applicants that marginally met the Profit Requirement and only managed to fulfil the Market Capitalisation Requirement with very high historical P/E ratios (as compared to those of their listed peers) at their IPOs. While these listing applicants typically justified their higher valuations with optimistic profit forecasts they had filed with the Exchange, a number of them failed to meet their profit forecasts post-listing. Given companies relying on the Profit Requirement to list generally demonstrate compliance with the Market Capitalisation Requirement based on the offer price, there were regulatory concerns about whether the valuations of these listing applicants were reverse-engineered to fulfil the Market Capitalisation Requirement when there was no sufficient public interest from the market for their securities at such price, which in turn called into question the listing applicant's suitability for listing, a fundamental listing principle under the Listing Rules.

5. The Exchange and the SFC have also become aware of certain misconduct following the misalignment between the Profit Requirement and the Market Capitalisation Requirement. These include the orchestration of "ramp-and-dump" schemes which more commonly involve IPOs of companies with small market capitalisations. In some

problematic cases, there was information suggesting that the perpetrators might have used the IPO placing tranche to allocate shares to controlled placees in order to (a) artificially satisfy the initial listing requirements under the Listing Rules, creating a false market for the shares; or (b) corner the shares to better enable market manipulation after the shares were listed. Further, over the past two years, unusually high commissions were paid to the underwriters in some of these problematic IPOs. These high underwriting commissions, along with other listing expenses, were disproportionate to the net IPO funds raised. There was information suggesting that in some cases, a portion of the underwriting commissions and other listing expenses might have been used to partially finance arrangements underlying the misconduct. Lastly, given the relatively significant listing expenses incurred by some Small Cap Issuers, and the under-reporting in their listing documents in some cases as evidenced by subsequent disclosures in their post-listing financial results, it is also questionable whether fund-raising through a listing on the Main Board is effective for these issuers.

6. These regulatory issues highlight the need to re-evaluate whether the current Profit Requirement is at an appropriate level taking into account the market positioning of the Main Board and the Exchange's role to uphold the quality of the market. In light of the above, the Exchange published the Consultation Paper on 27 November 2020 which sets out, among other things, the Exchange's proposal to increase the Profit Requirement. The consultation period ended on 1 February 2021.

Market feedback

7. The Exchange received 115 non-duplicated responses to the Consultation Paper from a broad range of respondents that were representative of all stakeholders in the Hong Kong capital market, of which 69% were institutional respondents and 31% were individual respondents. A list of all respondents (other than those who requested anonymity) is set out in **Appendix I**.

8. Whilst a majority of the respondents did not support the quantum of the proposed increase in the Profit Requirement or the urgency to implement such proposal in 2021, they acknowledged the Exchange's goal for the pursuit of market quality. The respondents provided a wide range of views which have served to inform a way forward.

Proposal to increase the Profit Requirement (Consultation Paper Question 1)

9. 17% of the respondents were supportive of the proposal to increase the Profit Requirement primarily because they believe that the Profit Requirement should be increased taking into account the inflation rate, economic growth of Hong Kong and increase in the Market Capitalisation Requirement since 1994 when the Profit Requirement was introduced, and that the proposed increase, coupled with the enforcement regime, would help enhance overall market quality and would be in the interest of the investing public. An increase of the Profit Requirement by 150% (Option 1) was preferred among these respondents.

10. 83% of the respondents did not support the proposal although their reasons for doing so varied considerably.

Alternative requirements (Consultation Paper Question 2)

11. 58% of the respondents indicated that the Exchange should consider alternative requirements. Overall, 27 respondents suggested a lower level of increase of between 20% and 100% in the current Profit Requirement, such that the Aggregate Profit Threshold would be between HK$60 million and HK$100 million.

Temporary conditional relief (Consultation Paper Questions 3 and 4)

12. 54% of the respondents supported the introduction of a temporary conditional relief from an increased Profit Requirement. Some of these respondents also suggested amending the current Profit Spread (a 60%:40% split) by imposing a higher profit requirement for the final financial year than for the first two financial years of the track record period.

Exchange's views on key comments

13. The concerns of the respondents mainly surrounded the impact on the ability of SMEs and traditional companies to list in Hong Kong. They did not consider GEM a viable alternative to the Main Board as a listing platform. They also questioned the appropriateness of the timing of the change in light of the current economic conditions. Some respondents were concerned that the Exchange's competitiveness vis-a-vis other major exchanges might be compromised. Some respondents also commented that increasing the Profit Requirement was not the right approach to address the valuation and shell issues given a stringent and comprehensive post-listing regulatory regime was already in place.

14. The Exchange's views on these matters are discussed below. A detailed analysis is set out in Chapter 2.

Listing of SMEs

15. As the only recognised stock exchange in Hong Kong, the Exchange is responsible for upholding and continuously enhancing the quality of the Hong Kong capital market. The Exchange also has a statutory obligation to act in the interest of the public, with particular regard to the interest of the investing public. As such, it is inevitable that the Exchange is not able to cater for companies of all sizes, and to support and enable listings of all businesses, without due consideration of market quality issues and investor protection concerns.

16. The Exchange does not believe the proposal to increase the Profit Requirement would deprive suitable SMEs of the opportunity to list in Hong Kong based on the following:

    (a) a number of the listing applications received between 2016 and 2019 relying on the Profit Requirement were SMEs and would still have been able to meet the Profit Requirement proposed in the Consultation Paper; and

    (b) GEM, as a second board of the Exchange, is specifically positioned as a capital raising platform for SMEs. This is in line with the international practice where the second board of an overseas market is established to facilitate SMEs' (including local companies) access to the capital market.

GEM as an alternative listing venue

17. While there has recently been a significant decrease in the number of new GEM listings, this could be attributed to the lack of interest in “shell companies” due to the regulatory actions taken by the Exchange and the SFC as well as the removal of the streamlined transfer process from GEM to the Main Board in 2018. The new regulations are designed to curtail “shell” manufacturing and not to prohibit suitable companies from listing on GEM. We believe that GEM remains a viable alternative listing venue for companies that are not able to meet the Main Board financial eligibility requirements. We note the following:

    (a) (i) companies that elected to list on GEM from 2019 to 2020 achieved an average public subscription rate of 58 times; (ii) the median annualised turnover ratio of GEM issuers in 2019 and 2020 (23% and 26%) were comparable to that of Main Board issuers (24% and 27%); and (iii) 9% of all listed GEM issuers as of 31 March 2021 recorded an increase in market capitalisation as compared to the time of listing <u>and</u> exceeded HK$500 million; and

    (b) the cost of listing, regardless of whether the listing is on the Main Board or GEM, is correlated to the extent of due diligence and other work required to be performed by the professional parties, which is largely dependent on the complexity and scale of the listing applicant’s structure and business.

The Exchange’s competitiveness

18. Any increase in the Profit Requirement would not compromise the Exchange’s competitiveness vis-a-vis other overseas exchanges, in particular:

    (a) the regulatory framework of each exchange is the product of its development history and is designed to capture the needs of its capital market. The Exchange has implemented different listing regimes that best offer domestic and overseas issuers of varying sizes, features and industries access to the Hong Kong capital market. The proposal to increase the Profit Requirement will reinforce the Main Board as a market catering for companies of a larger scale, with sufficient shareholder protections and a diversified issuer base; and

    (b) the eligibility requirements for the Main Board and Selected Overseas Main Markets are not directly comparable as different exchanges impose a combination of different criteria on listing applications. Further, the listing criteria of different exchanges, including the profit or market capitalisation requirements, should not be assessed in isolation without taking into account the overall regulatory regime, the investor demographics and other socio-economic features of the different markets.

Valuation and shell issues

19. Post-listing enforcement actions alone could not undo the harm inflicted by poor quality companies on aggrieved investors. A robust gate-keeping approach together with post-listing regulation are crucial to address the concerns highlighted in the Consultation Paper and this paper to protect the interest of the investing public.

Listing of companies from traditional industries

20. Companies in traditional industries will continue to be welcomed to list on the Main Board as evidenced by the fact that traditional companies made up over 65% of the total number of IPOs in each year from 2017 to 2020.

Way Forward

21. As mentioned in paragraph 8 above, although stakeholders in the Hong Kong capital market may not necessarily agree with the quantum and the timing of the Exchange's proposed increase in the Profit Requirement, they are not against improving the quality, and ensuring the diversity, of the capital market in Hong Kong.

22. As explained in the Consultation Paper, the Exchange is mindful that the proposed increase in the Profit Requirement will affect companies at an early development stage or SMEs which intend to list on the Main Board. The Exchange nevertheless has a role to play in maintaining the quality of the Main Board by setting appropriate initial listing criteria to attract companies of the desired profile and to protect the interest of the investing public. We are also committed to maintaining the Exchange's competitiveness by having regard to, among other things, stakeholders' expectations and international best practices.

23. After careful consideration of the respondents' feedback about the quantum and timing of the proposed increase in the Profit Requirement set out in the Consultation Paper, the Exchange has decided to modify the proposal as follows:

    (a) **A smaller increase in the Profit Requirement** – the Exchange is of the view that it is appropriate to increase the Profit Requirement by 60%, resulting in an Aggregate Profit Threshold of HK$80 million, and to amend the Profit Spread to a 56%:44% split such that the minimum aggregate profit required for the first two financial years of the track record period will be HK$45 million and that for the final financial year will be HK$35 million, which translates into an implied historical P/E ratio of approximately 14 times (in line with the average P/E ratio of the Hang Seng Index between 1994 and 2020) (collectively, the "Modified Profit Increase");

    (b) **Implementation date** – the Modified Profit Increase will become effective on 1 January 2022; and

    (c) **More flexible relief from the Profit Spread** – the Exchange will also be prepared to grant a relief from the Profit Spread on case-specific circumstances to provide flexibility to companies, rather than through a set of fixed conditions.

24. The Exchange and the SFC will continue to monitor the situation after the implementation of the Modified Profit Increase and may revisit the Profit Requirement at a later time if circumstances warrant a review. Further details of the Modified Profit Increase are set out in paragraphs 100 to 108 in Chapter 3.

25. In addition to the above, the Exchange will work with the SFC in combating regulatory issues discussed in the Consultation Paper and this paper (such as unreasonably high valuations) through the following:

(a) **Review of estimated valuations** – the Exchange and SFC will continue to critically review listing applicants' estimated valuations at the time of listing (especially those with relatively high historical P/E ratios against those of their listed peers) to ascertain their ability to comply with the Market Capitalisation Requirement and sufficiency of investor interests at the offer price;

(b) **Joint Statement** – heightened scrutiny of listing applications displaying one or more of the features as explained in the Joint Statement published by the Exchange and the SFC today which sets out, in more detail, the scope and nature of the concerns referred to in the Consultation Paper and this paper, and how the regulators may deploy their respective powers (including rejection/ objection powers) in such circumstances;

(c) **SFC's regulatory framework** – enhanced focus on the supervision of intermediaries involved in book-building and placing activities in IPOs as part of SFC's regulatory framework with a view to identifying malpractices and misconduct; and

(d) **The Exchange's disciplinary regime** – as detailed in the Conclusions Paper on Review of Listing Rules Relating to Disciplinary Powers and Sanctions published today, the Exchange has introduced changes to the disciplinary regime of the Exchange to better enable the delivery of an effective regulatory response in respect of different types of misconduct. There will be an increased emphasis on holding individuals accountable in relation to Listing Rule breaches and additional circumstances where disciplinary sanctions can be imposed on parties subject to the Exchange's disciplinary regime.

26. In response to market feedback about GEM, the Exchange will also launch a review of GEM and carefully consider the matters raised by respondents to the Consultation Paper, including comments relating to GEM's positioning and the market perception of GEM. If this review concludes that changes to the GEM Listing Rules are necessary, the Exchange will publish a consultation paper to seek market feedback on appropriate reforms.

Implementation of Rules

27. The amended Main Board Listing Rules, which include the Modified Profit Increase and consequential amendments to paragraph 3(c) of Practice Note 15 of the Main Board Listing Rules, are set out in **Appendix IV** and will become effective on 1 January 2022. Any Main Board listing applications (including renewals of previously submitted applications or GEM Transfer applications) submitted on or after 1 January 2022 will be assessed under the Modified Profit Increase.

28. The Exchange thanks respondents for their valuable comments to the consultation and will continue to seek regulatory solutions that achieve the widest possible consensus and benefit the Hong Kong capital market as a whole.

CHAPTER 1 INTRODUCTION

Background

29. The Profit Requirement is one of the three pivotal financial eligibility tests, which forms part of the robust qualitative and quantitative assessment the Exchange performs to determine the suitability of listing applicants to list on the Main Board. From the perspective of market segmentation, the Profit Requirement serves an important function by ensuring that companies relying on this eligibility test have attained a minimum level of operational scale and growth commensurate with the positioning of the Main Board.

30. Despite the vigorous yet resilient growth and developments of the Hong Kong and global economies in the past few decades, the Profit Requirement has not been revised to take into account significant changes in the economy and other market developments since its implementation in 1994, while the Market Capitalisation Requirement has had a five-fold increase since its introduction in 1989 to preserve the distinctiveness of the Main Board and its position as a market for larger companies that can meet Hong Kong's highest market standards.

31. The most recent increase in the Market Capitalisation Requirement was in 2018, from HK$200 million to HK$500 million, following the 2017 Consultation Conclusions Paper. This increase was to provide a clear distinction between the companies listed on the Main Board and GEM[1], after the increase of the GEM market capitalisation requirement from HK$100 million to HK$150 million, which would have been very close to the then Market Capitalisation Requirement. The Market Capitalisation Requirement is one of the requirements which must be complied with by listing applicants relying on the Profit Requirement to list on the Main Board.

32. As the current Profit Requirement has not been increased in tandem with the Market Capitalisation Requirement, the implied historical P/E ratio of companies just meeting the two requirements increased significantly from 10 times to 25 times, which is very high compared to the market average. Since 2018, there has been an unexpected surge in listing applicants that marginally met the Profit Requirement and only managed to fulfil the Market Capitalisation Requirement with very high historical P/E ratios (as compared to those of their listed peers) at their IPOs. While these listing applicants typically justified their higher valuations by reference to potential growth supported by optimistic profit forecasts they had filed with the Exchange, a number of them failed to meet such profit forecasts, and/ or recorded a considerable decrease in share prices (and hence market capitalisation) post-listing (the relevant analysis is set out in paragraph 71). Given companies relying on the Profit Requirement to list generally demonstrate compliance with the Market Capitalisation Requirement based on the offer price, there were regulatory concerns about whether the valuations of these listing applicants were reverse-engineered to fulfil the Market Capitalisation Requirement when there was no sufficient public interest from the market for their securities at such price, which in turn called into question the listing applicant's suitability for listing, a fundamental listing principle under the Listing Rules.

[1] 2017 Consultation Conclusions Paper, paragraph 117

33. The Exchange and the SFC have also become aware of certain misconduct following the misalignment between the Profit Requirement and the Market Capitalisation Requirement. These include:

(a) the orchestration of "ramp-and-dump" schemes[2] which more commonly involve IPOs of companies with small market capitalisations. In some problematic cases, there was information suggesting that the perpetrators might have used the IPO placing tranche to allocate shares to controlled placees in order to (i) artificially satisfy the initial listing requirements under the Listing Rules, creating a false market for the shares; or (ii) corner the shares to better enable market manipulation after the shares were listed;

(b) over the past two years, unusually high commissions were paid to the underwriters in some of these problematic IPOs. These high underwriting commissions, along with other listing expenses, were disproportionate to the net IPO funds raised. There was information suggesting that in some cases, a portion of the underwriting commissions and other listing expenses might have been used to partially finance arrangements underlying the misconduct. In the absence of such arrangements, some listing applicants might not satisfy the relevant requirements under the Listing Rules, and the IPO price and valuation might be substantially lower than what were stated in the prospectus. In some cases, the share price dropped substantially on the first trading day to a level which more closely reflected the company's true market value; and

(c) given the relatively significant listing expenses incurred by some Small Cap Issuers, and the under-reporting in their listing documents in some cases as evidenced by subsequent disclosures in their post-listing financial results[3], it is also questionable whether fund-raising through a listing on the Main Board is effective for these issuers.

34. The inflated valuations of these issuers also gave rise to concerns as to whether the IPO price discovery process had been undermined by certain activities, such as offering of rebates to investors or manufacturing of an artificial shareholder base, which are against the fundamental principle of the Listing Rules that the issue and marketing of securities should be conducted in a fair and orderly manner. Further, if the valuation achieved by an issuer upon listing is not genuinely supported by the market, such listing is not in the interest of the investing public and would affect the overall quality of the Main Board.

35. These regulatory issues highlight the need to re-evaluate whether the current Profit Requirement is at an appropriate level taking into account the market positioning of the Main Board and the Exchange's role to uphold the quality of the market. Further, as the Profit Requirement has remained unchanged since its implementation in 1994 as

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[2] A "ramp-and-dump" scheme is a form of stock market manipulation where fraudsters use different means to "ramp" up the share price of a listed company and then induce unwary investors to purchase the shares that the fraudsters then "dump" at an artificially high price. The schemes are typically conducted using social media platforms.

[3] In a number of cases involving Small Cap Issuers, the estimated listing expenses represented over 40% of the gross IPO proceeds; and some issuers' actual listing expenses disclosed in the first annual reports post-listing were higher than that disclosed in their prospectuses by up to 10%.

mentioned in paragraph 30, the Exchange's proposed increase in the Profit Requirement will further distinguish issuers listed on GEM and those on the Main Board, and is in line with our objective of positioning the Main Board as the main market to attract sizeable companies that can meet higher eligibility standards.

36. In view of the market positioning of the Main Board and the issues mentioned above and following discussions with the SFC, the Exchange published the Consultation Paper on 27 November 2020 to seek views on, among other things, the increase of the Profit Requirement by either 150% (Option 1) or 200% (Option 2). The consultation period ended on 1 February 2021.

37. Further, to address the issues mentioned in paragraphs 32 to 34, the Exchange and the SFC will (a) continue to critically review listing applicants' estimated valuations at the time of listing (especially those with relatively high historical P/E ratios against those of their listed peers); (b) heighten scrutiny of listing applications displaying one or more of the features as explained in the Joint Statement published by the Exchange and the SFC today; (c) enhance focus on the supervision of intermediaries involved in book-building and placing activities in IPOs as part of SFC's regulatory framework with a view to identifying malpractices and misconduct; and (d) make appropriate use of the Exchange's disciplinary regime, which is now being enhanced to better enable the delivery of an effective regulatory response in respect of different types of misconduct. The Exchange may exercise the discretion to reject a listing application if questions raised regarding share placement and price discovery process are not satisfactorily addressed, or the basic conditions of listing under the Listing Rules are not met, and/ or the SFC may also object to the listing application on the ground of non-compliance with the Listing Rules or on public interest grounds.

Proposals

38. The Consultation Paper presented two options to increase the Profit Requirement as detailed in Table 1 (Consultation Paper Question 1):

Table 1: The Exchange's proposed options to increase the Profit Requirement

	Current Profit Requirement	**Option 1**	**Option 2**
Proposed increase (%)		150%[4]	200%[5]
	HK$ million		
In aggregate for the first two financial years	30	75	90
For the final financial year	20	50	60
Total	**50**	**125**	**150**
Implied historical P/E ratio[6]	25 times	10 times	8 times

4 Based on the percentage increase in the Market Capitalisation Requirement from HK$200 million to HK$500 million in 2018.

5 Based on the approximate percentage increase in the average closing price of the Hang Seng Index from 9,541 in 1994 (when the Profit Requirement was introduced) to 27,569 in 2019.

6 Assuming both the Profit Requirement and the Market Capitalisation Requirement are exactly met.

39. Besides the proposed increase in the Profit Requirement, the Exchange also sought the market's views on:

(a) whether there is any other alternative requirement that should be considered for the increase in the Profit Requirement (Consultation Paper Question 2);

(b) whether the Exchange should consider granting a temporary relief from the Profit Spread of the increased Profit Requirement due to the challenging economic environment (Consultation Paper Question 3); and

(c) the conditions to the temporary relief (Consultation Paper Question 4).

Number of Responses and Background of Respondents

40. The Exchange received 115 non-duplicated responses to the Consultation Paper from a broad range of respondents that were representative of all stakeholders in the Hong Kong capital market:

Table 2: Number and percentage of responses by respondent category

CATEGORY[7]	NUMBER OF RESPONSES	PERCENTAGE
INDIVIDUALS		
Corporate Finance Staff	12	10.4%
Lawyer	10	8.6%
Retail Investor	4	3.5%
Accountant	3	2.6%
HKEX Participant Staff	1	0.9%
Investment Management Staff	1	0.9%
Listed Company Staff	1	0.9%
Others	4	3.5%
Total Individuals	*36*	*31.3%*
INSTITUTIONS		
Law Firm	22	19.1%
Corporate Finance Firm	19	16.5%
Professional Body/ Industry Association	16	13.9%
Accountancy Firm	8	7.0%
Listed Company	4	3.5%
HKEX Participant	3	2.6%
Investment Management Firm	3	2.6%
Others	4	3.5%
Total Institutions	*79*	*68.7%*
Total	**115**	**100.0%**

[7] The Exchange has used its best judgment to categorise each respondent under the most appropriate description based on information available.

41. A list of respondents (other than those who requested anonymity) is set out in Appendix **I.** Except for four respondents who requested the Exchange not to publish their submissions, the full text of all submissions are available on the HKEX website:

https://www.hkex.com.hk/News/Market-Consultations/2016-to-Present/Responses_May_2021_2?sc_lang=en

Methodology

42. The Exchange performed a qualitative analysis to enable us to properly consider the broad spectrum of respondents and their views. A qualitative analysis enabled the Exchange to give due weight to responses submitted on behalf of multiple persons or institutions and the underlying rationale for a respondent's position.

43. The Exchange also performed a quantitative analysis to determine the support, in purely numerical terms, for the proposals in the Consultation Paper. For the purpose of our quantitative analysis, we counted the number of responses received, not the number of respondents those submissions represented. For example, a submission by a professional body was counted as one response even though that body may represent many individual members.

44. Further details of our methodology are set out in **Appendix II**.

45. This paper should be read in conjunction with the Consultation Paper, which is posted on 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?la=en

CHAPTER 2 MARKET FEEDBACK AND ANALYSIS

46. In this chapter, the Exchange provides (a) a summary of the key comments from respondents to each of the questions in the Consultation Paper, setting out the background of the respondents and the reasons for their views, where provided; and (b) a corresponding qualitative analysis of the comments and the Exchange's responses.

47. For the purpose of the analysis in this chapter, Table 3 sets out the key information on the impact of Option 1 on all listing applications relying on the Profit Requirement to list on the Main Board that were submitted between 2016 and 2019 which totalled 745 listing applications (i.e. **Profit Requirement Applications**); while Table 4 sets out the Profit Requirement Applications which were subsequently listed as of 30 June 2020, which totalled 463 issuers.

48. **Eligible Applications** refer to Profit Requirement Applications which would meet the increased Profit Requirement under Option 1 if implemented; while **Ineligible Applications** refer to Profit Requirement Applications which would not meet the increased Profit Requirement under Option 1 if implemented.

Table 3: Impact of Option 1 on the Profit Requirement Applications

	Eligible Applications	Ineligible Applications	Total
Number of Profit Requirement Applications (% of 745 Profit Requirement Applications)	308 (41%)	437 (59%)	745 (100%)
Breakdown of Profit Requirement Applications by market capitalisation at the time of the listing application:			
- Less than HK$500 million	8	141	149
- Between HK$500 million and HK$700 million	30	203	233
- Above HK$700 million	270	93	363

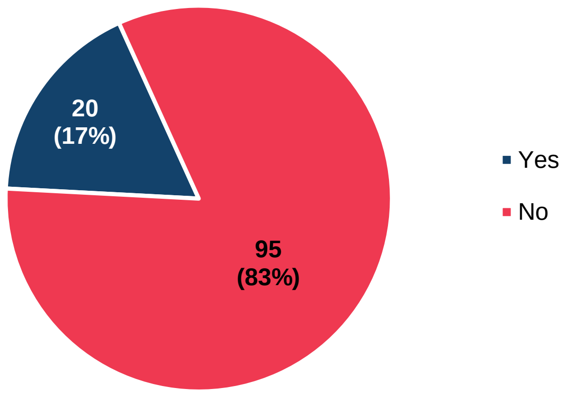
49. **Eligible Issuers** refer to Profit Requirement Applications that were subsequently listed as of 30 June 2020 and would meet the increased Profit Requirement under Option 1 if implemented; while **Ineligible Issuers** refer to those that were subsequently listed as of 30 June 2020 but would not meet the increased Profit Requirement under Option 1 if implemented.

Table 4: Impact of Option 1 on the Profit Requirement Applications that were subsequently listed as at 30 June 2020

	Eligible Issuers	Ineligible Issuers	Total
Number of listed Profit Requirement Applications	210	253	463
(% of 463 listed Profit Requirement Applications)	(45%)	(55%)	(100%)
(% of 745 Profit Requirement Applications)	(28%)	(34%)	(62%)
Breakdown of market capitalisation at the time of the listing application:			
- Less than HK$500 million	5	94	99
- Between HK$500 million and HK$700 million	15	101	116
- Above HK$700 million	190	58	248

Question 1	Do you agree that the Profit Requirement should be increased by either 150% (Option 1) or 200% (Option 2)?

Chart 1: Responses to Question 1



Key Comments

50. 20 respondents[8] were supportive of this proposal. Most of these respondents preferred Option 1, one preferred Option 2, and the remaining five did not indicate a preference. In general, the reasons provided by the respondents supporting the Exchange's proposal were primarily focused on improving the quality of issuers listed on the Main Board and are summarised as follows:

[8] Comprised 11 institutions including corporate finance firms (two), law firms (three) and professional bodies/ industry associations (four), and nine individuals.

(a) the Profit Requirement should be increased taking into account the inflation rate, economic growth of Hong Kong as well as the increase in the Market Capitalisation Requirement since 1994 when the Profit Requirement was introduced. In particular, the Aggregate Profit Threshold of HK$50 million was determined in view of the economy and corporate demographics 26 years ago (at which time the Main Board was the only listing platform in Hong Kong), but such quantitative threshold is no longer in line with the current state of the economy as well as the Main Board's position as the main market in Hong Kong;

(b) the proposed increase in the Profit Requirement together with the Exchange's enforcement regime would help reduce "shell-making" activities, uphold overall market quality and boost investors' and issuers' confidence in the Hong Kong capital market as the misalignment between the current Profit Requirement and Market Capitalisation Requirement would be narrowed;

(c) although the proposal would result in some Small Cap Issuers being unable to list on the Main Board, such companies would still have alternative funding channels such as venture capital investments, or GEM as an alternative listing venue. In respect of GEM, some institutional respondents also commented that the Exchange should formulate a plan to enhance GEM and make it a more viable and attractive capital raising platform for SMEs;

(d) post-listing enforcement actions alone could not undo the harm inflicted by poor quality companies on aggrieved investors, and delisting issuers' shares would be damaging to investors. An increase in the Profit Requirement should work hand in hand with the enforcement regime to help uphold the overall quality of the Hong Kong capital market; and

(e) with regards to some comments in the market that SMEs would no longer be able to raise funds from the capital market after the proposed increased in the Profit Requirement, the Exchange's mandate is to ensure investor protection and facilitate growth and development in the Hong Kong capital market and not focus only on stakeholders who do not necessarily represent the interests of public investors. The Exchange's social responsibility is also not solely towards SMEs, or the professionals serving them, some of which may have an unjustified bias against GEM and/ or have apparent conflicts of interest in relation to the proposed increase in the Profit Requirement.

51. 95 respondents[9] were against this proposal. These respondents were mainly concerned about the negative impact of any increase in the Profit Requirement, including SMEs and traditional companies being denied from listing on the Main Board whilst they did not consider GEM a viable alternative listing platform, the appropriateness of the timing of the proposal in light of the current economic conditions, and compromising the Exchange's competitiveness vis-a-vis other major exchanges. Some respondents also commented that an increase in the Profit Requirement was not the right approach to address the valuation and shell issues given a stringent and comprehensive post-listing

[9] Compared 68 institutions including professional bodies/ industry associations (12), corporate finance firms (17) and law firms (19), and 27 individuals.

regulatory regime was already in place. We set out their major feedback and our responses in paragraphs 52 to 83.

A. Listing of SMEs

52. A majority of the respondents had concerns that the Exchange's proposal to increase the Profit Requirement would deprive SMEs of a Main Board listing. 67 respondents[10] commented that the proposal would be unfair to SMEs considering:

(a) SMEs, including smaller technology and innovative companies, would be denied access to the capital market, which would negatively affect Hong Kong's economy;

(b) the listings of profitable SMEs on the Main Board should not be denied given pre-revenue or loss-making companies are allowed to list on the Main Board; and

(c) the Exchange, as a monopoly, has a social and moral duty to serve all businesses equally regardless of their size, and to support and enable the listings of companies of different businesses.

Our responses

53. The Exchange does not believe the proposal to increase the Profit Requirement would deprive suitable SMEs of the opportunity to list in Hong Kong. Based on our analysis, approximately 12% of the Eligible Applications were SMEs[11]. Further, while the Profit Requirement was the only financial eligibility test available when it was first introduced in 1994, the Exchange has since introduced alternative financial eligibility tests for listing on the Main Board and established GEM as a listing platform for less established companies. Therefore, SMEs which would not have been eligible to list on the Main Board under the increased Profit Requirement based on their profit records would have the choice to seek to list on GEM.

54. The Profit Requirement is to ensure that companies relying on this eligibility test to list on the Main Board have attained a certain minimum level of operational scale and growth. Pre-revenue and pre-profit companies do not rely on the Profit Requirement to list, but they will only be eligible to list if they can demonstrate compliance with other eligibility and suitability requirements under the relevant Listing Rules and related guidance materials[12]. Imposing different eligibility requirements for specific types of

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[10] Comprised 50 institutions including corporate finance firms (11), professional bodies/ industry associations (11) and law firms (16), and 17 individuals.

[11] See Table 3 – Eligible Applications with market capitalisation of HK$700 million or below.

[12] Examples:

(a) A pre-revenue biotech company is required to fulfil a number of industry-specific pre-conditions (e.g. having developed at least one core products beyond concept stage and meaningful pre-IPO investments by at least one sophisticated investor that remains at listing as set out in Guidance Letter HKEX-GL92-18), attain a significantly higher market capitalisation (HK$1.5 billion compared to the Market Capitalisation Requirement) and public float (HK$375 million excluding subscriptions by existing shareholders and cornerstone investors) than those applicable to Main Board listing applicants relying on the Profit Requirement (Rules 18A.03 and 18A.07).

(b) A mineral company must demonstrate that it has at least a portfolio of indicated resources or contingent resources that are "*meaningful*" and "*of sufficient substance to justify a listing*". Such resources must be companies enables the Exchange to ensure that there are sufficient investor safeguards with respect to companies with different risk profiles, while tailoring a listing regime that could cater for a more diverse range of issuers in the Hong Kong capital market.

55. The Exchange's unique role as the only recognised stock exchange in Hong Kong should not be equated with a social and moral duty to serve company of all sizes, and to support and enable listings of all businesses, without due consideration of market quality issues and investor protection concerns. The Exchange is responsible for upholding and continuously enhancing the quality of the Hong Kong capital market. The Exchange also has a statutory obligation to act in the interest of the public, with particular regard to the interest of the investing public[13].

56. Therefore, the Exchange has carried out its obligations through various listing reforms[14], including the proposal to increase the Profit Requirement in the Consultation Paper, with the aim to support and enable the listings of companies with different businesses and industries, and at the same time to strike a balance between diversifying the issuer base available for investors, and ensuring market quality with sufficient shareholder protection standards.

57. As explained in the Consultation Paper, GEM, as a second board of the Exchange, is specifically positioned as a capital raising platform for SMEs and other companies which are not able to meet the eligibility requirements under the Main Board Listing Rules. This is in line with the international practice where the second board of an overseas market is established to facilitate SMEs' (including local companies) access to the capital market. Our review of the Second Boards indicated that a majority of the issuers listed on these boards are SMEs and the Exchange's market differentiation between the Main Board and GEM is consistent with the international approach.

B. Timing of the proposal

58. Over half of the respondents[15] were of the view that now is not an appropriate time to introduce the proposal due to the impact on the economy of social incidents in 2019, the ongoing COVID-19 pandemic, as well as the uncertainties arising from the Mainland China-US political tensions.

59. Some respondents commented that any plan to increase the Profit Requirement should be deferred until there is reasonable certainty that the economy has recovered to pre-COVID-19 levels. Others indicated that the proposal would be detrimental to corporate finance players in Hong Kong (e.g. professional accountants, legal practitioners,

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identifiable under a recognised reporting standard and substantiated in a report prepared by a professionally qualified person in accordance with such standard (Rule 18.03(2)).

[13] Section 21 of the Securities and Futures Ordinance.

[14] For example, (a) reform of the then Growth Enterprise Market, publication of guidance materials and revision to the Listing Rules for listed issuers to tackle the prevalent shell creation phenomenon and to preserve market integrity since 2016; (b) the increase in the Market Capitalisation Requirement in 2018 to better distinguish Main Board and GEM issuers; (c) the introduction of a new listing regime in 2018 to attract companies from emerging and innovative sectors; and (d) the consultation paper published on 31 March 2021 (link) to seek market feedback on the Exchange's proposals to enhance and streamline the listing regime for overseas issuers.

[15] 59 respondents, which comprised 47 institutions including professional bodies/ industry associations (10), corporate finance firms (12) and law firms (15), and 12 individuals.

underwriters and sponsors) as a large number of Small Cap Issuers would no longer be eligible to list on the Main Board, which would directly impact them, resulting in a higher unemployment rate in the corporate finance industry.

Our responses

60. The Exchange recognises the impact on the global and local economies brought about by the COVID-19 pandemic and the uncertainties arising from the Mainland China-US political tensions. This has been taken into account in the Consultation Paper as reflected by the proposal to introduce a temporary relief from the profit spread under an increased Profit Requirement.

C. The Exchange's competitiveness

61. 57 respondents[16] commented that the proposal would weaken the Exchange's competitiveness vis-a-vis other overseas exchanges with different arguments presented. In particular:

    (a) some overseas exchanges offer domestic issuers of different sizes ready access to the capital market. In particular, (i) NASDAQ has three distinctive tiers - Nasdaq Global Select Market, Nasdaq Global Market and Nasdaq Capital Market, each with its specific financial, liquidity and corporate governance requirements for the listing of companies of different sizes; and (ii) LSE's main market has three segments - the Premium, Standard and High Growth Segments, each tailored to different capital raising requirements. LSE's AIM market is a platform for SMEs and growth companies to access the capital market;

    (b) the proposal set out in the Consultation Paper would result in the Main Board having the most stringent profit requirement in comparison with the Selected Overseas Main Markets. Furthermore we are currently the only exchange to require listing applicants to satisfy both the Market Capitalisation Requirement and the Profit Requirement;

    (c) there would be increased competition from ChiNext and STAR Board, which have lower profit requirements; and

    (d) the proposal of either Option 1 or Option 2 would have made more than half of the 745 Profit Requirement Applications ineligible for listing on the Main Board.

Our responses

62. The regulatory framework of each exchange is the product of its development history and is designed to capture the needs of its capital market. Similar to major overseas exchanges such as NASDAQ and LSE, the Exchange has implemented different listing regimes that best offer domestic and overseas issuers of varying sizes, features and industries access to the Hong Kong capital market, as detailed in paragraph 56. Therefore, the Exchange believes that the proposed increase in the Profit Requirement would not negatively affect Hong Kong's competitiveness, but rather benefit Hong Kong,

[16] Comprised 48 institutions including professional bodies/ industry associations (nine), corporate finance firms (12) and law firms (16), and nine individuals.

from a market quality perspective, as an international financial centre by reinforcing the Main Board as a market catering for companies of a larger scale, with sufficient shareholder protections and a diversified issuer base.

63. There is a misconception that the proposed increase in the Profit Requirement would culminate in Hong Kong having the most stringent initial entry criteria amongst the leading exchanges[17]. As explained in the Consultation Paper[18], the eligibility requirements for the Main Board and Selected Overseas Main Markets are not directly comparable as different exchanges impose a combination of different criteria on listing applications. For example, while the minimum aggregate profit required for listing on the NASDAQ Global Select Market or NYSE (for domestic issuers[19]) under the profit test ranges from US$11 million to US$12 million (i.e. approximately HK$85 million to HK$93 million), these markets also require a free float of at least US$40 million (i.e. approximately HK$310 million) in public hands, which is significantly higher than the minimum public float of HK$125 million for Main Board listing applicants[20].

64. The listing criteria of different exchanges, including the profit or market capitalisation requirements, should not be assessed in isolation without taking into account the overall regulatory regime, the investor demographics and other socio-economic features of the different markets. For instance, in contrast to the Hong Kong market, the securities regulations in the US are primarily disclosure-based, underpinned by a class action regime.

65. ChiNext and STAR Board, which are viewed by some respondents as competitors of the Main Board, also have very different eligibility requirements. For example, the lowest eligibility requirement of STAR Board is a minimum market capitalisation of RMB1,000 million together with a minimum profit or operating revenue test. Together with our analysis in paragraph 63, most of the Ineligible Applications do not fall under the industry specifications, namely high tech, emerging and innovative, as required by ChiNext and Star Board, nor would they meet the applicable eligibility requirements of most of the Selected Overseas Main Markets should these Ineligible Applications consider listing on such overseas markets.

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[17] If same requirements were to be compared for illustrative purposes, the proposed Profit Requirement under Option 1 and the Market Capitalisation Requirement would not be the most stringent as compared to the profit-related eligibility requirements of some Selected Overseas Main Markets, ChiNext and STAR Board (see Table A in **Appendix III** for details):
(a) Profit Requirement – the minimum profit required for the latest financial year of the track record period under Option 1 (HK$50 million) is lower than that of SGX (pre-tax earnings of approximately HK$170 million) and NYSE (pre-tax earnings of approximately HK$194 million for foreign issuers); and
(b) Market Capitalisation Requirement – the Main Board's HK$500 million requirement is lower than that of NASDAQ (approximately HK$1,242 million), NYSE (approximately HK$3,881 million for foreign issuers), SGX (approximately HK$850 million), ChiNext (approximately HK$1,200 million) and STAR Board (approximately HK$1,200 million).

[18] Consultation Paper, paragraphs 40 to 42 and Appendix II.

[19] Foreign private issuers may also list under the NYSE's domestic company listing standards.

[20] Listing Rule 8.08(1).

D. Valuation and shell issues

66. 56 respondents[21] commented that the proposal was not the right approach to address valuation and shell issues. The general view was that sufficient regulations had been introduced by the Exchange to tackle these issues and in particular:

(a) the current regime had already adequately addressed the shell issues, including through the issuance of GL68-13A, the reform of GEM to remove the streamlined process of GEM Transfers and an increase in the Market Capitalisation Requirement in 2018, combined with the SFC's front-loaded regulatory approach to backdoor listings and shell activities, and changes to the Listing Rules and guidance letters on reverse takeovers and back door listings;

(b) the regulators should tackle market misconduct, such as shell manufacturing or arrangements to rebate investors, through disciplinary and enforcement actions, instead of increasing the Profit Requirement which would disadvantage potential issuers from raising capital in the market;

(c) the proposal was based on the premise that larger companies were of better quality, or lower risks than smaller companies while there was no objective evidence that demonstrated a correlation between the size of an issuer and its quality; and

(d) the P/E ratio should be determined by the market, and there was no empirical evidence to support an implied historical P/E ratio of 10 times under Option 1 to be the Main Board profit threshold given that (i) different industries would have different P/E ratios; and (ii) a listing applicant's prospects, rather than its historical P/E ratio, would be more important for making an investment decision.

Our responses

<u>Regulatory regime to address valuation and shell issues</u>

67. As pointed out by some respondents, the Exchange has in recent years amended the Listing Rules on post-listing behaviours (i.e. back-door listing and reverse takeovers) and adopted a more rigorous review process on listing applications from Small Cap Issuers that exhibit shell-like features by, where applicable, requiring additional disclosure in the listing document or rejecting the listing applications. Although these measures have addressed some of the regulatory issues, both the Exchange and the SFC continue to devote significant resources to the identification of, and enforcement actions against, IPO-related misconduct post-listing. However, post-listing enforcement actions alone could not undo the harm inflicted by poor quality companies on aggrieved investors, and delisting issuers' securities would be damaging to investors.

68. Therefore, besides the regulatory approach mentioned in paragraphs 66(a) and 67, the Exchange believes a robust gate-keeping approach should be adopted to address the regulatory concerns highlighted in the Consultation Paper and this paper to protect the interest of the investing public. We agree that, while neither the Market Capitalisation

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[21] Comprised 43 institutions including professional bodies/ industry associations (nine), corporate finance firms (nine) and law firms (14), and 13 individuals.

Requirement nor the Profit Requirement would guarantee good corporate governance standards or continued success of an issuer's business post-listing, these requirements provide investor protection by ensuring listing applicants have attained a minimum level of operational scale and growth based on their profit records, before their securities are offered to the public in Hong Kong.

Correlation between the size of an issuer and its quality

69. It is inevitable that any increase in the Profit Requirement would result in some smaller companies no longer being eligible for a Main Board listing. The Exchange's proposal is not simply based on the premise that larger companies are of better quality or lower risk. The proposal was made against the backdrop of the issues noted since the increase in the Market Capitalisation Requirement in 2018 as detailed in paragraphs 32 to 34, which highlighted the need to re-evaluate whether the current Profit Requirement should be aligned with the Market Capitalisation Requirement, and whether it was at an appropriate level as an eligibility criterion for listing on the Main Board. The Exchange was also of the view that the proposed increase was reasonable given that the current Profit Requirement had remained unchanged for more than 26 years since it was first introduced in 1994, while there has been a five-fold increase in the Market Capitalisation Requirement from HK$100 million to HK$500 million over the years since its first introduction.

70. The Exchange remains convinced (in view of the analysis of the post-listing performance of the 210 Eligible Issuers and 253 Ineligible Issuers under Option 1 as set out in paragraph 71 below) that an increase in the Profit Requirement would be conducive to ensuring that the post-listing performance of Eligible Issuers more closely matches that expected of Main Board issuers.

71. The Eligible Issuers (a majority (90%) of which were non-Small Cap Issuers), in general, performed better than the Ineligible Issuers (a majority (77%) of which were Small Cap Issuers) in the following aspects[22]:

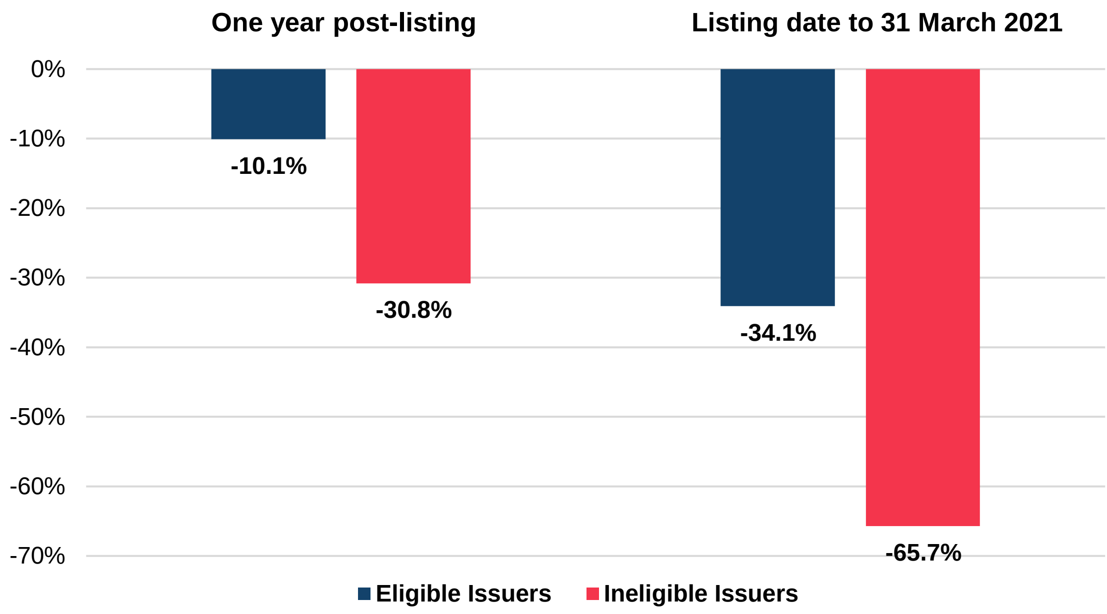
(a) **share price performance post-listing** – Eligible Issuers outperformed Ineligible Issuers when their share prices post-listing were compared with their IPO prices, both one year post-listing and up to 31 March 2021:

(i) one year post-listing – the median relevant price change from the IPO price (compared with the Hang Seng Composite Industry Index) of Eligible Issuers was -10.1%, as compared to -30.8% for Ineligible Issuers; and

(ii) listing date to 31 March 2021 – the median relevant price change (compared with the Hang Seng Composite Industry Index) of Eligible Issuers was -34.1%, as compared to -65.7% for Ineligible Issuers:

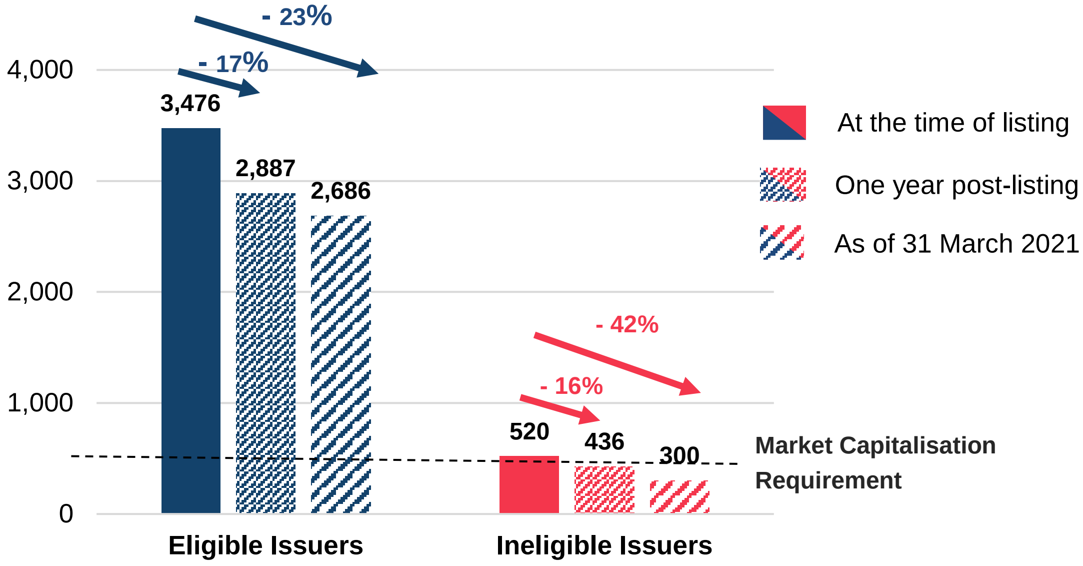
[22] For the purpose of this analysis, the data is based on those as of 31 March 2021, unless otherwise stated. Where applicable, median instead of average was used to eliminate the effect of outliers.

Chart 2: The median relevant price change (compared with the Hang Seng Composite Industry Index) one year post-listing, and listing date to 31 March 2021



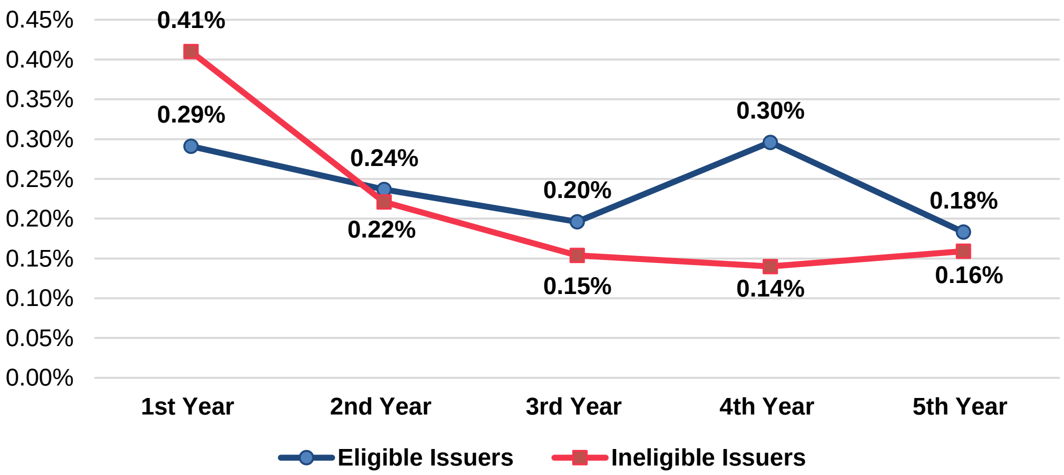
(b) **market capitalisation post-listing** - the median market capitalisation of the Eligible Issuers decreased by 17% from HK$3,476 million at the time of the listing application to HK$2,887 million one year post-listing, while the Ineligible Issuers also recorded a similar extent of decrease of 16% from HK$520 million at the time of the listing application to HK$436 million one year post-listing. However, the decrease in the median market capitalisation since listing to 31 March 2021 was more significant for the Ineligible Issuers (42% from HK$520 million at the time of the listing application to HK$300 million as of 31 March 2021) than the Eligible Issuers (23% from HK$3,476 million at the time of the listing application to HK$2,686 million as of 31 March 2021):

Chart 3: Median market capitalisation one year post-listing[23] and as of 31 March 2021[24] (HK$ million)



(c) **liquidity post-listing** – although the Ineligible Issuers recorded higher average daily trading volume (as a percentage of total number of issued shares) in the first year immediately post-listing than the Eligible Issuers (0.41% vs. 0.29%), such level of liquidity did not sustain and decreased significantly thereafter. In the second to fifth year, the level of liquidity of Ineligible Issuers was consistently below that of the Eligible Issuers, with an average of 0.17% vs. 0.23%:

Chart 4: Average post-listing liquidity



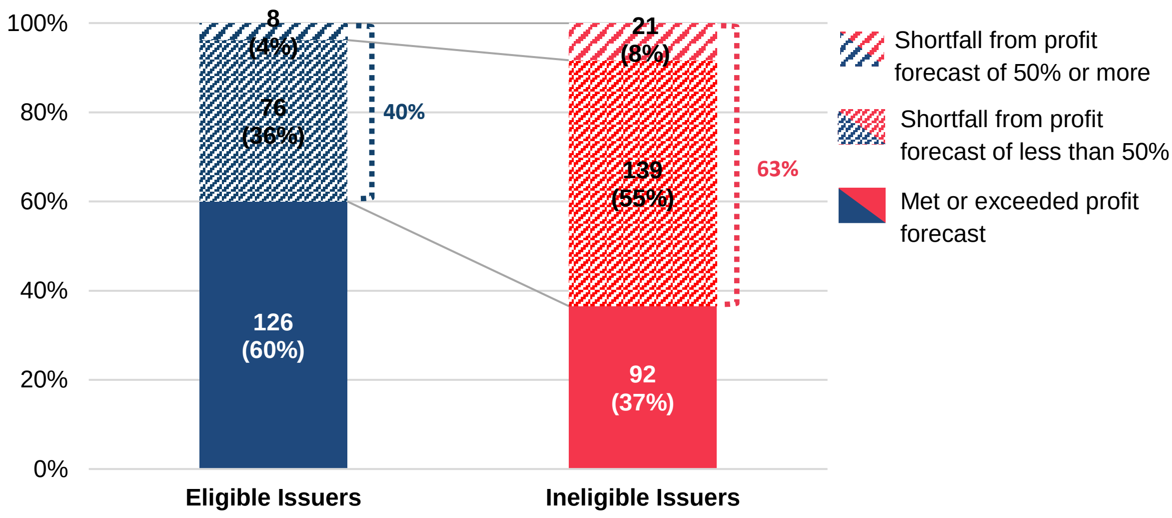
[23] As stated in Table 4, 94 Ineligible Issuers (37%) had proposed market capitalisation at the time of the listing application below HK$500 million as they were subject to the then Market Capitalisation Requirement of HK$200 million. Excluding these 94 Ineligible Issuers, the median market capitalisation of the remaining 159 Ineligible Issuers (i.e. those with proposed market capitalisation at the time of the listing application of at least HK$500 million) had decreased by 20% from HK$600 million to HK$480 million one year post-listing.

[24] Excluding the 94 Ineligible Issuers mentioned in footnote 23, the median market capitalisation of the remaining 159 Ineligible Issuers had decreased 33% from HK$600 million to HK$403 million as of 31 March 2021.

(d) **financial performance post-listing**

(i) shortfall from profit forecast – a higher proportion of Ineligible Issuers failed to meet the profit forecasts filed with the Exchange as compared to the Eligible Issuers (63% vs. 40%). Further, 8% of the Ineligible Issuers recorded a shortfall of 50% or more, as compared to 4% for Eligible Issuers:

Chart 5: Difference between Adjusted Net Profit and profit forecast

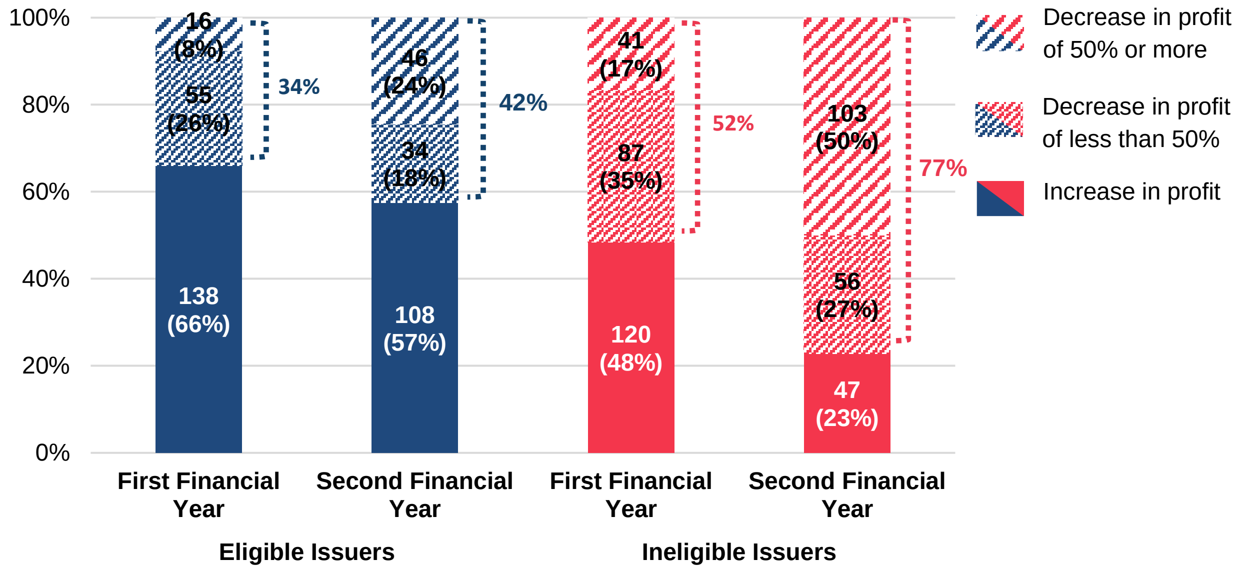


(ii) decrease in Adjusted Net Profit – for the first financial year post-listing[25], a higher proportion of Ineligible Issuers recorded a decrease in Adjusted Net Profit compared to the Eligible Issuers (52% vs. 34%). The difference was significantly more pronounced in the second financial year post-listing[26] (77% vs. 42%). Further, the majority of the Ineligible Issuers which recorded a decrease in Adjusted Net Profit reported a decline of more than 50%.

[25] Of the 463 Profit Requirement Applications that were listed as of 30 June 2020, 457 (209 Eligible Issuers and 248 Ineligible Issuers) had published their first financial year results post-listing.

[26] Of the 463 Profit Requirement Applications that were listed as of 30 June 2020, 394 (188 Eligible Issuers and 206 Ineligible Issuers) had published their second financial year results post-listing.

Chart 6: Adjusted Net Profit in first and second full financial year post-listing



(e) **trading suspension and cancellation of listing** – as of 31 March 2021, of the 463 Eligible Issuers and Ineligible Issuers, the trading of seven issuers was suspended mainly due to a delay in announcement of results, the investigation of certain audit issues and financial difficulties, and one issuer was delisted due to a failure to, among other things, conduct an investigation into an undiscovered transaction and resolve financial difficulties. Of these eight issuers, five were Ineligible Issuers (of which four were under trading suspension and one was delisted) and only three were Eligible Issuers (all under trading suspension).

72. The above analysis supports the Exchange's belief that the valuations at the time of listing of some Small Cap Issuers were set at an unreasonably high level and as such their share prices and hence market capitalisation could not be supported by the market post-listing, resulting in losses to investors. Inflated valuations also gave rise to concerns that the price discovery process may have been undermined by the possible offering of rebates to investors to entice them to take up shares, and suspected abusive behaviours such as manufacturing of an artificial shareholder base i.e. headcount planting, to comply with the Listing Rules. In light of the above, the Exchange believes an increase in the Profit Requirement will help address some of the regulatory concerns, and is in line with the objective to position the Main Board as the main market to attract sizeable companies that can meet higher market standards.

<u>Implied historical P/E ratio</u>

73. The Exchange would like to clarify that the proposal does not require the historical P/E ratios of all Main Board IPOs to be at or below 10 times. It is designed to restore the implied historical P/E ratio of Main Board listing applicants that only marginally meet both the Profit Requirement and the Market Capitalisation Requirement to the same level as that before the increase in the Market Capitalisation Requirement in 2018. Under the current Profit Requirement, listing applicants that marginally meet the Profit Requirement would need a historical P/E ratio of about 25 times (based on the profit for

the most recent financial year) at the time of listing in order to meet the Market Capitalisation Requirement which is significantly higher than the average P/E ratio of the Hang Seng Index between 1994 and 2020 (14 times), and the listing applicants would usually substantiate their high P/E ratios with optimistic profit forecasts for the following financial year. If the Profit Requirement were to be increased as proposed by the Exchange, the minimum P/E ratios that marginal listing applicants would need in order to meet the Market Capitalisation Requirement would be lowered and such listing applicants might effectively substantiate their P/E ratios at the time of listing with their historical financial performance and the valuations of their market comparables, so their profit forecasts were not overly optimistic as compared to historical performances.

74. The fact that many of the Small Cap Issuers performed poorly post-listing as evidenced in paragraph 71 raises doubts on the reasonableness of their valuations at the time of listing. In particular, Ineligible Issuers are predominantly from non-high growth industries such as consumer goods and services industry, property and construction industry and the industrial sector. As explained in paragraph 32, many of these listed issuers had significantly higher valuations at IPO as compared to their listed peers. Considering that these Ineligible Issuers are not from industries that are usually expected to have high growth, they were not able to sustain their pre-listing valuations after listing as evidenced by their post-listing performance.

E. Listing of companies from traditional industries

75. 17 respondents[27] were of the view that the proposal would reduce the listing of companies in traditional industries on the Main Board, and the Main Board would only serve to mainly attract biotech and new economy companies from Mainland China. This would reduce diversity in the market and choices in IPOs for the investing public, which would affect Hong Kong's attractiveness as an international financial centre.

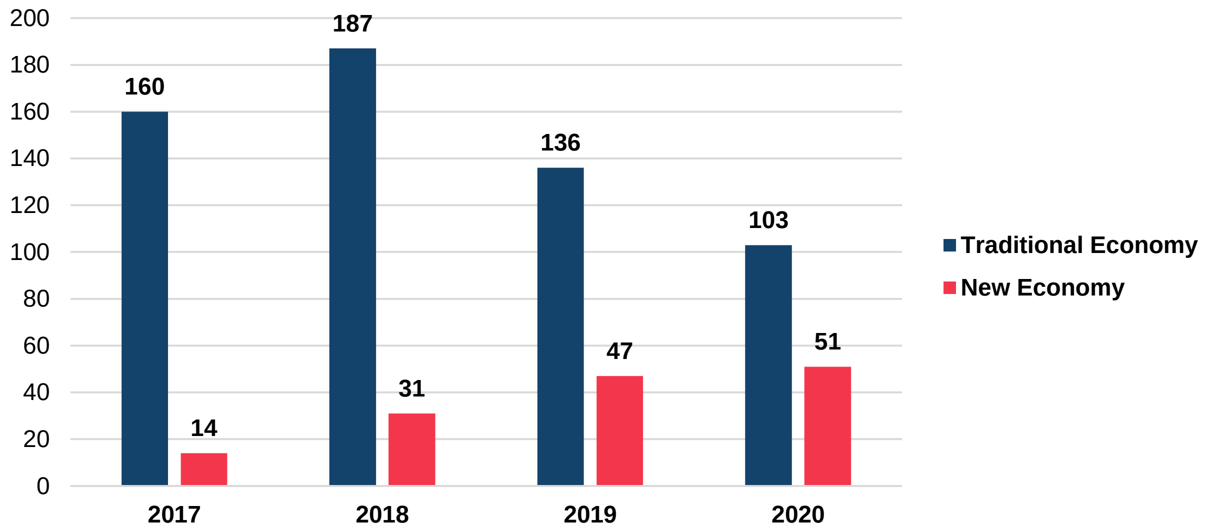
Our responses

76. As detailed in paragraph 56, the Exchange continues to develop and enhance Hong Kong's position as an international financial centre. One of our strategies in recent years is to attract different types of companies to list in Hong Kong. In 2018, the Exchange introduced the new listing regime for new economy companies. This strategy has been successful, as illustrated by the fact that from 2018 to 2020, 129 new economy companies (including healthcare and biotech firms) were listed in Hong Kong, raising a total of HK$549 billion and accounting for 55% of IPO funds raised in Hong Kong during the period[28].

77. The success of the new listing regime mentioned in paragraph 76 above and the listing of traditional companies are not mutually exclusive. In particular, from 2017 to 2020, (a) the size of the overall Hong Kong capital market grew from HK$128 billion to HK$398 billion; and (b) companies from traditional industries contributed to over 65% of the total number of IPOs in each of these years, as illustrated in Chart 7:

[27] Comprised 15 institutions including corporate finance firms (four) and law firms (four), and two individuals.
[28] Source: IPO Express Issue 3 on January 2021 published by the Exchange (link).

Chart 7: Number of IPOs[29]



78. Further, traditional companies that cannot meet the increased Profit Requirement may consider listing on GEM or relying on other financial eligibility tests under the Main Board Listing Rules. Therefore, the Exchange's proposal would not result in any adverse effect on the overall diversity of companies to be listed in Hong Kong.

F. GEM as an alternative listing venue

79. 52 respondents[30] were of the view that GEM was not a viable alternative listing venue for companies that would not be able to meet an increased Profit Requirement. In particular:

(a) after the repositioning of GEM as a stand-alone board in 2018, GEM was no longer an attractive listing platform and the number of listings, as well as the level of liquidity and trading volume, had since been reduced;

(b) listing on GEM and the subsequent compliance (including quarterly reporting) were costly; and

(c) the Exchange should perform a holistic review of GEM and consider ways to provide a viable listing venue for SMEs, including re-introducing GEM as the "stepping stone" to the Main Board.

Our responses

<u>GEM as an alternative listing venue</u>

80. We acknowledge that there has recently been a significant decrease in the number of new GEM listings (from 75 in 2018 to eight in 2020). Before the GEM reform in 2018, there was suspected manipulation of certain GEM issuers' share prices to increase their market value to the point where they could be eligible to be transferred to the Main

[29] Source: IPO Express Issue 3 on January 2021 published by the Exchange (link).

[30] Comprised 47 institutions including corporate finance firms (nine), professional bodies/ industry associations (12) and law firms (15), and five individuals.

Board. The removal of the streamlined transfer process for GEM issuers, together with other regulatory actions by the Exchange and the SFC, may have dampened interest in GEM shell companies and driven down their values, and led to a drop in demand for them[31]. As such, companies that marginally met the current Profit Requirement would rather seek to list on the Main Board, whilst marketing their securities at a higher price in order to meet the higher Market Capitalisation Requirement.

81. Based on the following statistics, we believe that GEM continues to be a viable alternative listing platform for companies that are not able to meet the Main Board financial eligibility requirements:

(a) **funds raised** – a total of 98 GEM IPOs from 2019[32] to 2020 raised IPO funds of HK$63.5 million on average, with an average public subscription rate of 58 times, while six issuers recorded subscription rates of 100 times or more in the public subscription tranches[33]. Further, the total amount of funds raised (including IPO and post-IPO equity fund raising) by all GEM issuers in 2019 and 2020 represented 6% of GEM's aggregate market capitalisation as of 31 December 2020[34], higher than that for Main Board issuers (2.5%)[35];

(b) **liquidity post-listing** – the average daily trading volume (as a percentage of total number of issued shares) of GEM issuers between 2019 and 2020 was 0.20%, with a median annualised turnover ratio[36] of 23% in 2019 and 26% in 2020, which was comparable to that for Main Board issuers (24% in 2019 and 27% in 2020[37]); and

(c) **market capitalisation** – as of 31 March 2021, the market capitalisation of 9% of all listed GEM issuers (366) was higher than that recorded at the time of listing and exceeded HK$500 million.

Cost of listing on GEM

82. In response to comments that it is generally costly to list and maintain a listing on GEM, the Exchange would like to clarify that the cost of listing in Hong Kong, as well as compliance with the continuing obligations under the Listing Rules, are mainly driven by the extent of due diligence and other work required to be performed by the professional parties, which to a large extent is dependent on the complexity and scale of the listing applicant's structure and business, considering the listing requirements for GEM and Main Board are largely similar. Absent any other factors, the cost of listing on GEM is

[31] Source: *Hong Kong's Small-Cap IPO Numbers Drop as Crackdown Takes Effect* published by Bloomberg on 8 March 2019 (https://www.bloomberg.com/news/articles/2019-03-08/hong-kong-s-small-cap-ipo-numbers-drop-as-crackdown-takes-effect).

[32] We used data starting from 2019 because GEM was repositioned with effect from February 2018 and taking into account the transitional arrangements as set out in the 2017 Consultation Conclusions Paper, a number of GEM issuers were listed in 2018 under the previous regime.

[33] Market Statistics on GEM's website (https://www.hkgem.com/statistics/e_default.htm).

[34] Market Statistics on GEM's website (https://www.hkgem.com/statistics/e_default.htm).

[35] HKEX's Annual Market Statistics 2020 (link).

[36] Annualised turnover ratio is a measure of liquidity of a stock calculated by dividing its average daily market turnover by its average market capitalisation and multiplied by the number of trading days within a year.

[37] Source: Bloomberg.

generally lower than that for the Main Board on the basis that (a) the Listing Rules only require a two-year track record period for GEM listing applicants while a three-year track record period is required for Main Board listing applicants; and (b) GEM listing applicants tend to engage local accounting firms[38].

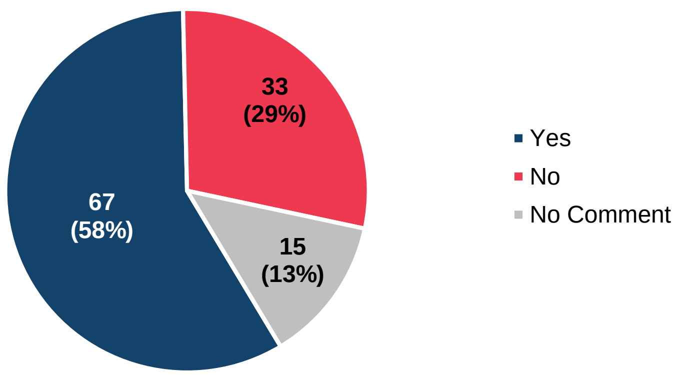
83. Based on the information submitted to the Exchange by GEM listing applicants and Small Cap Issuers that applied for a Main Board listing between 2018 and 2020, a listing on GEM is generally less costly than a Main Board listing:

(a) the average listing expenses of GEM listing applicants (HK$27 million) are about 25% lower than those of Small Cap Issuers on the Main Board (HK$36 million); and

(b) the average fees charged by reporting accountants for IPOs of GEM listing applicants (HK$2.8 million) are approximately 28% lower than the fees charged to Small Cap Issuers on the Main Board (HK$3.9 million).

Question 2	Besides the proposed increase in the Profit Requirement, is there any other alternative requirement that should be considered?

Chart 8: Responses to Question 2



Key Comments

84. 67 respondents[39] indicated that the Exchange should consider alternative requirements to Option 1 and Option 2.

85. Overall, 27 respondents[40] suggested the Exchange to consider a lower level of increase as an alternative to the Exchange's proposed Option 1 or Option 2. Some of these 27 respondents provided specific suggestions on the extent of increase, with

[38] Based on the information submitted to the Exchange by GEM listing applicants between 2018 and 2020, the average listing expense is approximately HK$27 million, comprising mainly legal advisors' fee (35%), sponsor fee (19%), underwriter's fee (13%) and reporting accountant's fee (10%).

[39] Comprised 48 institutions including accountancy firms (seven), professional bodies/ industry associations (9), law firms (12) and corporate finance firms (14), and 19 individuals.

[40] Including 21 respondents to Consultation Paper Question 2 and six respondents who suggested a lower increase in the Profit Requirement in their responses to other questions in the Consultation Paper.

basis. The level of increase suggested by these respondents, where provided, is between 20% and 100% in the current Profit Requirement, with an average of 53%, such that the Aggregate Profit Threshold would be approximately HK$77 million.

86. Further, six respondents indicated that they would support an increase of less than 150%.

87. Respondents also provided the following suggestions:

(a) adopting a more stringent review process on the profit forecast memorandum submitted by listing applicants that have a higher than average historical P/E ratio, or imposing additional disclosure requirements on such listing applicants (e.g. basis and assumptions of profit forecast and valuation in the listing document);

(b) taking enforcement actions against sponsors that create "shell" companies, inflated valuations and artificial shareholder base, as a strong and effective enforcement regime would help deter abusive behaviours and preserve the high quality of the capital market, or extending the lock up period under Main Board Rule 10.07(1) to tackle shell issues; and

(c) reducing the Market Capitalisation Requirement.

Our responses

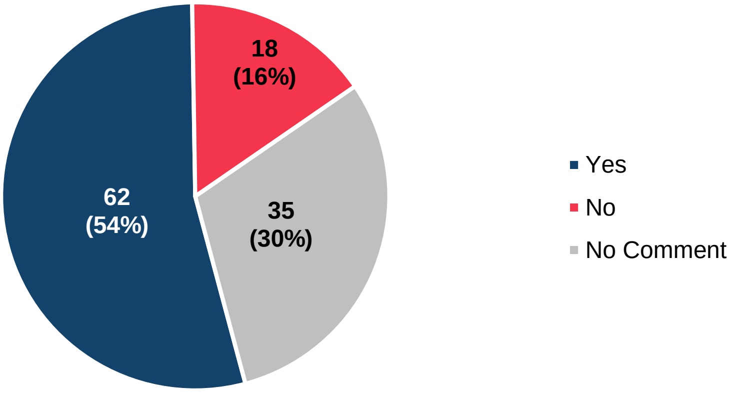
88. The Exchange agrees with the respondents advocating a strong enforcement regime to tackle the concerns raised in the Consultation Paper. As such, the Exchange will work with the SFC in combating regulatory issues discussed in the Consultation Paper and this paper, including (a) continue to critically review listing applicants' estimated valuations at the time of listing (especially those with relatively high historical P/E ratios against those of their listed peers); (b) heighten scrutiny of listing applications displaying one or more of the features as explained in the Joint Statement published by the Exchange and the SFC today; (c) enhance focus on the supervision of intermediaries involved in book-building and placing activities in IPOs as part of SFC's regulatory framework with a view to identifying malpractices and misconduct; and (d) make appropriate use of the Exchange's disciplinary regime, which is now being enhanced to better enable the delivery of an effective regulatory response in respect of different types of misconduct (details are set out in paragraphs 110 to 119 in Chapter 3).

89. However, the Exchange does not believe extending the lock up period would adequately address the fundamental concerns on shell creation as this would only delay an issuer in becoming a shell[41]. The Exchange also does not agree with the suggestion to reduce the Market Capitalisation Requirement in view of the support received as set out in the 2017 Consultation Conclusions Paper[42].

[41] Paragraph 4.3 of GL68-13A.
[42] 2017 Consultation Conclusions Paper, Chapter 2 paragraph 111.

Question 3	Do you agree that the Exchange should consider granting temporary relief from the increased Profit Requirement due to the challenging economic environment?

Chart 9: Responses to Question 3



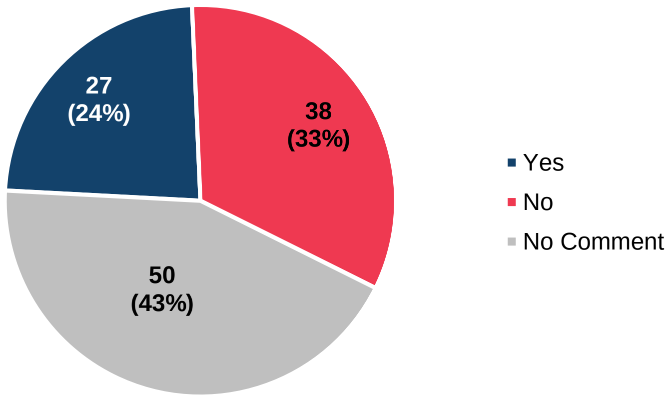
90. 62 respondents[43] were supportive of the proposal to introduce a temporary conditional relief from an increased Profit Requirement. 18 objected to the temporary conditional relief proposal as well as the increase in the Profit Requirement. The remaining 35 did not provide any comments.

91. Some of these respondents also suggested amending the current Profit Spread by imposing a higher profit requirement for the final financial year than for the first two financial years of the track record period. They suggested a maximum of 43% (for the first two years) and 57% (for the final year) and a minimum of 53% (for the first two years) and 47% (for the final year).

Question 4	If your answer to Question 3 is yes, do you agree with the conditions to the temporary relief as set out in the Consultation Paper?

[43] Comprised 46 institutions including law firms (15) and corporate finance firms (15), and 16 individuals.

Chart 10: Responses to Question 4



92. 27 respondents[44] supported the conditions to our proposed temporary relief. 38 did not agree with the proposed conditions and some were of the view that certain conditions were overly stringent. The remaining 50 did not provide any comments.

Key Comments

93. Some respondents commented that certain conditions to the temporary relief are overly stringent:

(a) **profit forecast** – it will be difficult to provide a reliable or accurate forecast in view of the uncertainty of the economic condition amidst the COVID-19 pandemic. As such, the sponsors will not be willing to provide the required confirmations on profit forecasts; and

(b) **positive cashflow** – the requirement for a listing applicant to have positive cash flow in the last year would exclude potential listing applicants from the hardest hit sectors (such as airlines, cruise lines, hotels, restaurants, cinemas, casinos and the entertainment sectors) from the temporary relief.

Our responses

94. The Exchange's rationale behind the specific conditions to a temporary relief to an increased Profit Requirement are as follows:

(a) **profit forecast** – as explained in paragraph 73, under the current Profit Requirement, listing applicants that marginally meet the Profit Requirement would usually substantiate their high P/E ratios with optimistic profit forecasts for the following financial year. If the Profit Requirement were to be increased as proposed by the Exchange, the P/E ratios of marginal listing applicants might be supported by their historical financial performance and valuation of market comparables even if their profit forecasts were not overly optimistic as compared to historical performances. However, if the Profit Spread were disapplied under the proposed temporary relief, the profit for the final year of the track record period might be lower than that required, resulting in a higher historical P/E ratio, and investors might need to place greater emphasis on an issuer's profit forecast to

[44] Comprised 20 institutions including corporate finance firms (three) and law firms (nine), and seven individuals.

assess the reasonableness of its valuation. To deter any possible over-valuation of the issuer (which would be misleading to potential investors) through inflation of the profit forecast, the Exchange would critically evaluate, among other things, the profit forecast memorandum of an issuer to assess the reasonableness of its P/E ratio, and may require the issuer to disclose its profit forecast in the listing document. Publication of a profit forecast is in line with the requirement under the Listing Rules[45] on disclosure of material information that is necessary to allow investors to make an informed decision; and

(b) **positive cashflow** – cashflow is one of the important indicators of the sustainability of a listing applicant's business. Companies that record positive cash flow generated from operating activities (in the ordinary and usual course of business before changes in working capital and taxes paid) demonstrate their ability to grow, and that they are able to either reinvest in themselves or pay dividends to shareholders.

[45] Main Board Rule 2.13 (GEM Rule 2.18).

CHAPTER 3 WAY FORWARD

Our Common Goal

95. It is apparent from the responses to the Consultation Paper that all Hong Kong market stakeholders wish to improve the quality and diversity of choice offered by our market. It is only the manner in which this is best achieved where there is a difference of opinion. We thank respondents for their valuable comments to the consultation and will continue to seek regulatory solutions that achieve the widest possible consensus and benefit the Hong Kong capital market as a whole.

Approach Adopted

96. The Consultation Paper was issued against a backdrop where we observed a surge in listing applications from Small Cap Issuers that marginally met the Profit Requirement and only managed to fulfil the Market Capitalisation Requirement justified by very high historical P/E ratios as compared with those of their listed peers after the Market Capitalisation Requirement was increased in 2018.

97. While these Small Cap Issuers typically justified their higher valuations by reference to optimistic potential growth, a number of them failed, post-listing, to meet the profit forecasts they had filed with the Exchange, which gave rise to concerns about the reasonableness of their valuations (e.g. whether they were indeed supported by a genuine expectation of growth) and their suitability for listing.

98. The Exchange acknowledges the strength of respondents' concerns regarding the level of increase in the Profit Requirement we proposed to address this issue. Nevertheless, the issues identified in the Consultation Paper and this paper will persist if the Exchange does not take any action.

99. The Exchange, as the only recognised stock exchange in Hong Kong, is responsible for upholding and continuously enhancing the quality of the Hong Kong capital market. The Exchange also has a statutory obligation to act in the interest of the public, with particular regard to the interest of the investing public[46]. As the front line regulator, it is imperative that the Exchange fulfils its responsibility and obligation. After careful consideration of the respondents' feedback about the quantum and timing of the proposed increase in the Profit Requirement set out in the Consultation Paper, we have decided to balance the major considerations and adopt the following approach, with the aim of continuing to develop Hong Kong as an international market that provides sufficient investor safeguards and at the same time opportunities of growth and development for companies of different types and sizes.

Modified Profit Increase

100. The Exchange believes an increase in the Profit Requirement should be implemented. However, the Exchange acknowledges the concerns raised by respondents and also

[46] Section 21 of the Securities and Futures Ordinance.

the alternative increase to the Profit Requirement and adjustment to the Profit Spread suggested by some respondents as set out in paragraphs 85 and 91.

101. After considering this feedback and the following factors, in consultation with the SFC, the Exchange has decided to increase the Profit Requirement by 60% resulting in an Aggregate Profit Threshold of HK$80 million. The Modified Profit Increase was decided primarily based on the following factors:

(a) the proposed increase is in line with the 61% increase (2019: 60%) in the monthly composite consumer price index (which is a commonly used measure of inflation) from September 1994 (68.6) to December 2020 (110.7)[47];

(b) the Modified Profit Increase would result in fewer Profit Requirement Applications being ineligible to list on the Main Board (as illustrated in Charts 11 and 12), which is the concern raised by a majority of the respondents (paragraph 61(d)); and

(c) the Aggregate Profit Threshold of HK$80 million is within the range of the alternatives (HK$60 million to HK$100 million), and the percentage increase of 60% is not significantly different from the average 53% increase proposed by some respondents mentioned in paragraph 85 above.

102. In view of the regulatory concern with regards to the high implied historical P/E ratio of certain marginal listing applicants, the Exchange has also decided to adjust the current Profit Spread from 60%:40% to 56%:44%, which would also be more conducive to attracting companies of the desired business scale and growth. This will result in an aggregate profit requirement for the first two financial years of HK$45 million and the profit requirement for the final financial year of HK$35 million. Accordingly, the implied historical P/E ratio for a listing applicant that meets these minimum thresholds will be 14 times, which is in line with the average P/E ratio of the Hang Seng Index between 1994 and 2020[48].

103. Table 5 sets out a comparison of the Modified Profit Increase and revised Profit Spread with our proposals in the Consultation Paper:

[47] Source: Census and Statistics Department of HKSAR.

[48] Based on the month-end weighted average P/E ratio of Hang Seng Index between 1994 and 2020 in the Hang Seng Index website (link).

Table 5: Comparison of the Modified Profit Increase with the proposals in the Consultation Paper

	Current	**Modified Profit Increase**	**Option 1**	**Option 2**
Proposed increase (%)		60%	150%	200%
	HK$ million			
In aggregate for the first two financial years	30	45	75	90
For the final financial year	20	35	50	60
Total	**50**	**80**	**125**	**150**
Profit Spread	60%:40%	56%:44%	60%:40%	60%:40%
Implied historical P/E ratio[49]	25 times	14 times	10 times	8 times

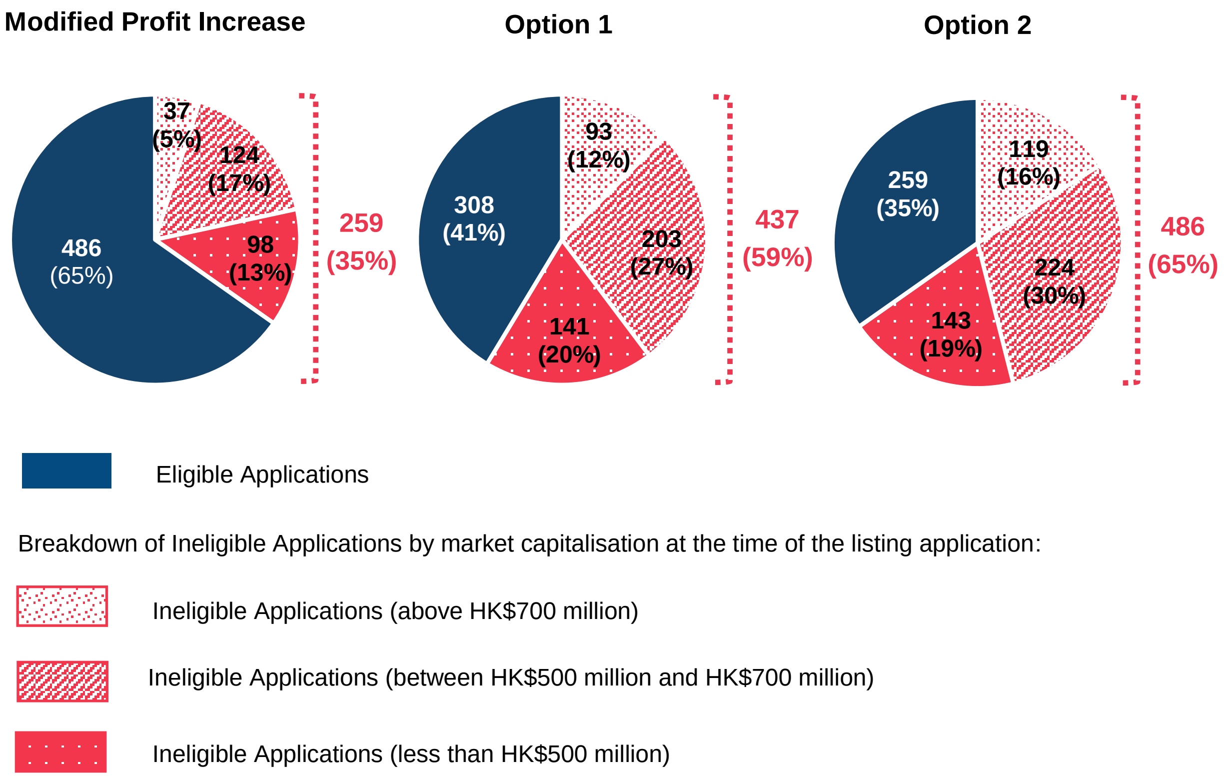
104. **Appendix IV** sets out the amended Main Board Listing Rules, which include the Modified Profit Increase and consequential amendments to paragraph 3(c) of Practice Note 15 of the Main Board Listing Rules.

105. The impact of the Modified Profit Increase (with the adjusted Profit Spread) would be as follows:

(a) 259 (35%) of the 745 Profit Requirement Applications would have been ineligible to list on the Main Board, compared to 437 (59%) under the Exchange's proposal of a 150% increase (Option 1). Of these 259 Profit Requirement Applications, 98 had a market capitalisation of less than HK$500 million[50], and 124 had a market capitalisation of between HK$500 million and HK$700 million, all being Small Cap Issuers; and

[49] Assuming both the Profit Requirement and the Market Capitalisation Requirement are exactly met.
[50] These listing applications were subject to the then Market Capitalisation Requirement of HK$200 million.

Chart 11: Impact of the Modified Profit Increase on Profit Requirement Applications as compared to other options



(b) 141 (30%) of the 463 listed Profit Requirement Applications would have been ineligible to list on the Main Board, compared to 253 (55%) under the Exchange's proposal of a 150% increase (Option 1). Of these 141 listed Profit Requirement Applications, 68 had a market capitalisation of less than HK$500 million[51], and 54 had a market capitalisation of between HK$500 million and HK$700 million, all being Small Cap Issuers.

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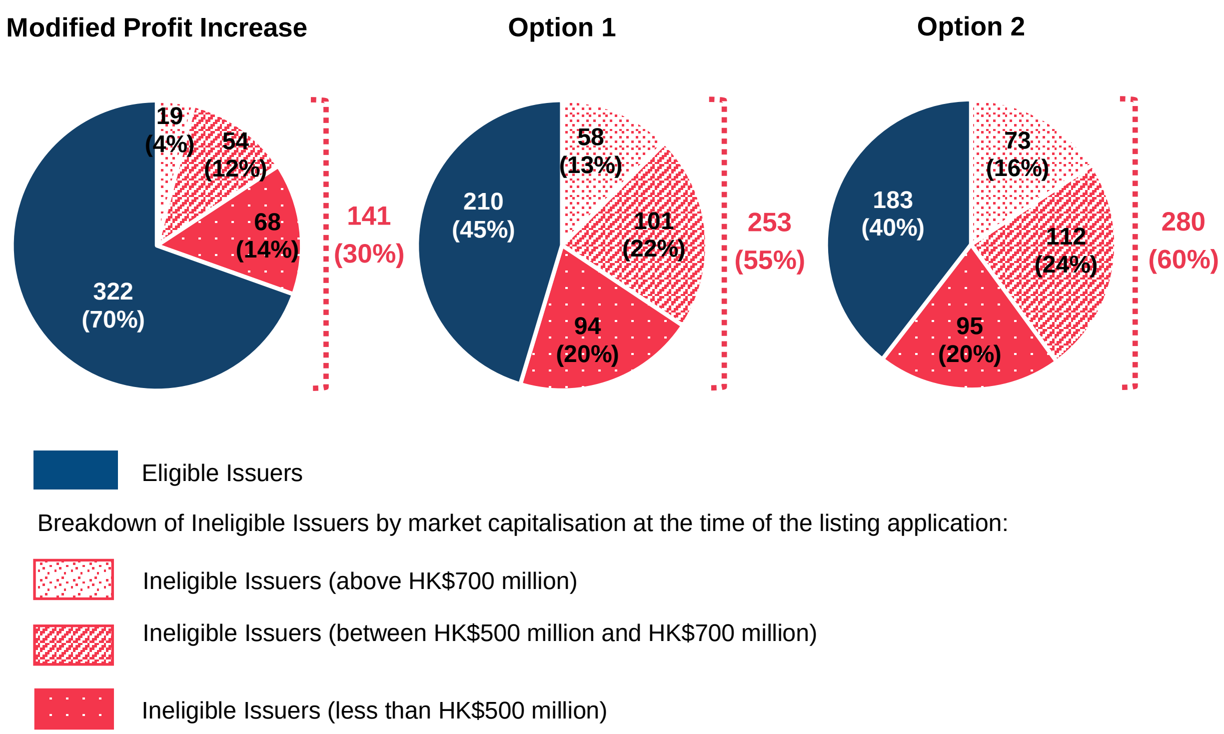
51 These listing applications were subject to the then Market Capitalisation Requirement of HK$200 million.

Chart 12: Impact of the Modified Profit Increase on Profit Requirement Applications that subsequently listed as compared to other options



106. The Exchange will be prepared to grant relief from the Profit Spread on case-specific circumstances rather than through a set of fixed conditions, provided that the listing applicant meets an increased Aggregate Profit Threshold of HK$80 million. In this respect, the Exchange will ordinarily, among other things:

(a) evaluate the listing applicant's business nature and the underlying reasons for its inability to meet the Profit Spread (e.g. growth stage companies and companies whose businesses have been severely affected by the COVID-19 pandemic and current economic downturn); and

(b) impose conditions where appropriate, including disclosure of the listing applicant's profit forecast in the listing document.

107. In considering an application for a waiver from the revised Profit Spread under the Modified Profit Increase, the Exchange (a) will critically assess the need to include a profit forecast in the listing document to enable investors to make an informed decision on the position and prospects of an issuer; and (b) may make enquiries on how the issuer's IPO price was determined with reference to the book-building process.

108. The Modified Profit Increase and the revised Profit Spread will be implemented on 1 January 2022. Any Main Board listing applications (including renewals of previously submitted applications or GEM Transfer applications) submitted on or after 1 January 2022 will be assessed under the Modified Profit Increase. A listing applicant will not be permitted to withdraw its listing application before it lapses and resubmit the listing application shortly thereafter before the effective date of the Modified Profit Increase

such that the listing application will be assessed in accordance with the current Profit Requirement for a longer period.

109. The Exchange and the SFC will continue to monitor the situation after the implementation of the Modified Profit Increase and may revisit the Profit Requirement at a later time if circumstances warrant a review.

Review of Estimated Valuations

110. The Exchange and SFC will continue to critically review listing applications from listing applicants with relatively high historical P/E ratios (including GEM Transfer applications), and compare their estimated valuations against those of their listed peers. In particular, the Exchange will critically evaluate, among other things, these issuers' profit forecast memoranda to assess the reasonableness of their valuations and, where applicable, require issuers to disclose their profit forecasts in their listing documents (as explained in paragraph 94(a)). For GEM Transfer applications, the Exchange will take into account any unusual increase in a GEM Transfer applicant's share price performance during the track record period, and where the applicant and its sponsor(s) are not able to provide reasonable and satisfactory explanations for the unusual share price movements, the Exchange may not approve the GEM Transfer application[52]. These are relevant to the assessment of an issuer's compliance with the Market Capitalisation Requirement and the sufficiency of investor interest requirement, both of which are prerequisites for initial listing.

Joint Statement

111. The Exchange and the SFC published the Joint Statement today, which sets out, in more detail, the scope and nature of the concerns referred to in the Consultation Paper and this paper.

112. The Joint Statement raises awareness of "ramp-and-dump" schemes which were suspected to be orchestrated at an early stage in the IPO process with the aim of later manipulating the share price. In some cases, shares were apparently allocated in the placing tranche to controlled accounts which were seemingly financed in part by funds diverted from the unusually high underwriting commissions or other listing expenses paid as part of the IPO process. Following an initial surge after listing, the share prices often fell well below the IPO prices, causing substantial losses for many investors, and afterwards trading turnover usually shrank to a negligible level.

113. These problematic features are more commonly found in newly listed stocks where the issuers marginally met the Market Capitalisation Requirement and had very high historical P/E ratios at IPO. A listing application displaying one or more of the features set out in the Joint Statement will attract heightened scrutiny and enquiries from the Exchange and the SFC to ascertain whether there is sufficient genuine investor interest in the listing applicant and its securities, and an adequate spread of shareholders to enable an open, fair and orderly market to develop following its listing.

114. The Exchange may exercise the discretion to reject a listing application if questions raised regarding the share placement and price discovery process are not satisfactorily

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[52] See FAQ Series 5, No. 21 (link) for details.

addressed, or the basic conditions of listing under the Listing Rules are not met. The SFC may also object to the listing application under section 6(2)(a) of the Securities and Futures (Stock Market Listing) Rules on the ground that the listing application does not comply with the Listing Rules. Separately, the SFC will assess whether it should exercise its power to object to a listing application on public interest grounds.

Other Enforcement Measures

115. Enforcement actions target wrongdoers without placing further regulatory burdens on those that have good records of compliance. For this reason, several respondents to the Consultation Paper stated that stronger enforcement measures were their preferred method of addressing regulatory issues.

116. Both the Exchange and the SFC will step up their efforts to tackle regulatory issues associated with problematic IPOs.

Regulatory measures on book-building and placing activities

117. There will be an enhanced focus on the supervision of intermediaries involved in book-building and placing activities in IPOs as part of SFC's regulatory framework with a view to identifying malpractices and misconduct. As stated in the Joint Statement, intermediaries involved in problematic IPOs with features discussed in the statement might be prioritised for more in-depth inspection to assess their compliance with the applicable legal and regulatory requirements.

Enhancements to the Exchange's disciplinary powers and sanctions

118. The Exchange published today the Conclusions Paper on Review of Listing Rules Relating to Disciplinary Powers and Sanctions, which set out changes to be made to the disciplinary regime of the Exchange to better enable the delivery of an effective regulatory response in respect of different types of misconduct. All but one of the proposals received majority support. The Exchange concluded that we will adopt all the proposals in the consultation paper, with one modification.

119. There will be an increased emphasis on holding individuals accountable in relation to Listing Rule breaches and additional circumstances where disciplinary sanctions can be imposed on parties subject to the Exchange's disciplinary regime. In particular, this will augment the range of reputational sanctions available, and ensure that disciplinary action can be brought against individuals, including members of senior management who are not directors, who cause or knowingly participate in a contravention of the Listing Rules. This would facilitate action against those who participate in the problematic behaviour identified in the Joint Statement.

GEM Review

120. Many respondents to the Consultation Paper stated that a large increase in the Profit Requirement would exclude many SMEs from listing in Hong Kong, and they did not consider GEM a viable alternative listing platform to the Main Board.

121. Following the publication of the 2017 Consultation Conclusions Paper, GEM was repositioned as a stand-alone board for SME listings. It is apparent from the responses

to the Consultation Paper that there is still work for the Exchange to do to improve the viability of GEM as an alternative to the Main Board.

122. The Exchange will therefore launch a review of GEM and carefully consider the matters raised by respondents to the Consultation Paper, including comments relating to GEM's positioning and the market perception of GEM. If this review concludes that changes to the GEM Listing Rules are necessary, the Exchange will publish a consultation paper to seek market feedback on appropriate reforms.

DEFINITIONS

TERM	DEFINITION
"2017 Consultation Conclusions Paper"	Consultation Conclusions Paper on Review of the Growth Enterprise Market (GEM) and Changes to the GEM and Main Board Listing Rules (December 2017) (link)
"Adjusted Net Profit"	net profit after tax excluding listing expenses and other material one-off items
"**Aggregate Profit Threshold**"	minimum aggregate profit in the track record period under the Profit Requirement
"AIM"	LSE's growth market that is designed to help small companies access capital from the public market
"ASX"	Australian Securities Exchange
"Catalist"	a sub-market of the SGX that aims to attract fast growing companies
"ChiNext"	a sub-market of the SZSE which targets innovative companies with high growth potential
"Consultation Paper"	Consultation Paper on Main Board Profit Requirement (November 2020) (link)
"COVID-19"	Coronavirus disease 2019
"Eligible Applications"	Profit Requirement Applications which would meet the proposed Profit Requirement under Option 1
"Eligible Issuers"	Eligible Applications that were listed as of 30 June 2020
"Exchange"	The Stock Exchange of Hong Kong Limited, a wholly-owned subsidiary of HKEX
"FCA"	Financial Conduct Authority of the United Kingdom
"GEM"	GEM operated by the Exchange
"GEM Transfer"	a transfer of an issuer's listing of securities from GEM to the Main Board
"GL68-13A"	Guidance Letter HKEX-GL68-13A (Guidance on IPO vetting and suitability for listing) (link)
"historical P/E ratio"	a listing applicant's expected market capitalisation at the time of listing divided by the Adjusted Net Profit for the last financial year of the track record period
"HKEX"	Hong Kong Exchanges and Clearing Limited

"Ineligible Applications"	Profit Requirement Applications which would not meet the proposed Profit Requirement under Option 1
"Ineligible Issuers"	Ineligible Applications that were listed as of 30 June 2020
"IPO"	initial public offering
"JASDAQ"	JASDAQ Securities Exchange operated by the TSE
"Joint Statement"	Joint Statement on IPO-related misconduct issued jointly by the Exchange and the SFC on 20 May 2021
"KONEX"	Korea New Exchange, an early stage SME and venture board operated by the KRX
"KOSDAQ"	Korea Securities Dealers Automated Quotation, a board operated by the KRX that caters to technology and IT start-ups and SMEs
"KRX"	Korea Exchange, a stock market in South Korea
"listing document"	a Prospectus, a circular and any equivalent document (including a scheme of arrangement and introduction document) issued or proposed to be issued in connection with an application for listing
"Listing Rules" or "Rules"	the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (Main Board unless otherwise stated)
"LSE"	London Stock Exchange
"Main Board"	Main Board operated by the Exchange
"Market Capitalisation Requirement"	Listing Rule 8.09(2) which requires a new listing applicant to have an expected market capitalisation at the time of listing of at least HK$500 million
"Modified Profit Increase"	a 60% increase in the Profit Requirement, with the minimum amount of profit attributable to shareholders of (a) HK$35 million in the most recent financial year; and (b) HK$45 million in aggregate in the two preceding financial years
"MOTHERS"	Market of The High-growth and Emerging Stocks operated by the TSE
"NASDAQ"	Nasdaq Stock Market, a stock market in the US that has three tiers - Nasdaq Global Select Market, Nasdaq Global Market and NasdaqCX
"NYSE"	New York Stock Exchange
"Option 1"	the proposed option of a 150% increase in the Profit Requirement
"Option 2"	the proposed option of a 200% increase in the Profit Requirement

"**P/E ratio**"	the ratio of a company's share price to the company's earnings per share
"Profit Requirement"	Listing Rule 8.05(1)(a) which requires a new listing applicant to have a minimum amount of profit attributable to shareholders, currently (a) HK$20 million in the most recent financial year; and (b) HK$30 million in aggregate in the two preceding financial years
"**Profit Requirement Applications**"	745 Main Board listing applications which relied on the Profit Requirement submitted between 2016 and 2019 (both inclusive) [53]
"Profit Spread"	the spread of the profit between the first two financial years and the final financial year of the three-year track record period under the Profit Requirement
"Prospectus"	has the same meaning ascribed to it in Section 2(1) of the Companies (Winding Up and Miscellaneous Provisions) Ordinance
"Second Boards"	10 second boards of overseas exchanges comprising AIM (LSE), Catalist (SGX), ChiNext and STAR Board (SZSE), JASDAQ, MOTHERS and Tokyo PRO (TSE), KONEX and KOSDAQ (KRX) and TSXV (TMX).
"Selected Overseas Main Markets"	six overseas main markets comprising ASX, FCA (premium listed securities), NASDAQ Global Select Market, NYSE, SGX (Main Board) and SSE (Main Board)
"SFC"	Securities and Futures Commission
"SGX"	Singapore Exchange Limited
"Small Cap Issuer"	an issuer that applies to list on the Main Board pursuant to the Profit Requirement with a proposed market capitalisation at the time of listing of equal to or less than HK$700 million
"SMEs"	small and mid-sized companies
"SSE"	Shanghai Stock Exchange
"STAR Board"	Shanghai Stock Exchange Science and Technology Innovation Board of SSE
"SZSE"	Shenzhen Stock Exchange
"TMX"	TMX Group Limited, a stock exchange operator in Toronto that operates the Toronto Stock Exchange and the TSXV
"Tokyo PRO"	Tokyo PRO Market, operated by the TSE to provide financing opportunities to companies with growth potential

[53] Include GEM Transfers, listings by introduction, very substantial acquisitions and reverse takeovers that are deemed to be new listings under Listing Rule 14.54 and a listing application submitted by a listing applicant after its previous listing application has lapsed for more than three months.

“TSE”	Tokyo Stock Exchange
“TSXV”	TSX Venture Exchange, a public venture capital market for emerging companies operated by TMX
“US”	the United States of America

APPENDIX I LIST OF RESPONDENTS

INSTITUTIONS

Accountancy Firm

1. Deloitte
2. Ernst & Young
3. Grant Thornton Hong Kong Limited
4. KPMG
5. Moore Advisory Services Limited
6. PricewaterhouseCoopers

7. to 8. 2 accountancy firms *(names not disclosed at respondents' request)*

Corporate Finance Firm

9. Addleshaw Goddard (Hong Kong) LLP (on behalf of 13 corporate finance firms and 275 licensed persons whose names were not disclosed)
10. Ample Capital Limited
11. Ballas Capital
12. Central China International Capital Limited
13. Charltons (on behalf of Alliance Capital Partners Limited, Altus Capital Limited, Anglo Chinese Corporate Finance Limited, Asian Capital Limited, Frontpage Capital Limited, Kingsway Capital Limited, Oriental Patron Asia Limited, Somerley Capital Limited, Yu Ming Investment Management Limited and VMS Securities Limited)
14. China International Capital Corporation Hong Kong Securities Limited
15. Kingston Corporate Finance Limited
16. Lego Corporate Finance Limited
17. Maxa Capital Limited

18. to 27. 10 corporate finance firms *(names not disclosed at respondents' request)*

HKEX Participant

28. I-Access Investors Limited
29. Guosen Securities (Hong Kong) Capital Company Limited
30. China Tonghai Securities Limited/ China Tonghai International Financial Limited/ 2 HKEX participants *(names not disclosed at respondents' request)*

Investment Management Firm

31. Masan Capital Limited

32. to 33. 2 investment management firms *(names not disclosed at respondents' request)*

Law Firm

34. Akin Gump Strauss Hauer & Feld LLP
35. Cleary Gottlieb Steen & Hamilton (Hong Kong)
36. Commerce & Finance Law Offices/ Eric Chow & Co/ Jia Yuan Law Offices/ Jingtian & Gongcheng (PRC)/ Jingtian & Gongcheng LLP (HK)/ Jun He Law Offices/ JunHe LLP/ Silk Road International Capital Limited/ TC Capital International Limited/ Tian Yuan Law Firm/ William Ji & Co. LLP/ Zhong Lun Law Firm/ 4 law firms *(names not disclosed at respondents' request)*
37. Deacons
38. Gallant

39. Howse Williams
40. Hui & Lam LLP
41. Khoo & Co.
42. Kwok Yih & Chan
43. Loong & Yeung
44. M.B. KEMP LLP
45. ONC Lawyers
46. Patrick Chu, Conti Wong Lawyers LLP
47. Slaughter and May
48. Wan & Tang
49. Withers
50. to 55. 6 law firms *(names not disclosed at respondents' request)*

<u>Listed Company</u>

56. Melco International Development Limited
57. SHK Hong Kong Industries Limited
58. to 59. 2 listed companies *(names not disclosed at respondents' request)*

<u>Professional Body/ Industry Association</u>

60. Asia Securities Industry & Financial Markets Association (ASIFMA)
61. Association of Chartered Certified Accountants Hong Kong
62. CFA Society Hong Kong
63. Hong Kong General Chamber of Commerce
64. Hong Kong Institute of Certified Public Accountants
65. Hong Kong Institute of Chartered Secretaries
66. Hong Kong Institute of Directors
67. Hong Kong Investment Funds Association
68. Hong Kong Professionals and Senior Executives Association
69. Hong Kong Securities Association
70. Hong Kong Securities Professionals Association
71. The British Chamber of Commerce in Hong Kong
72. The Chamber of Hong Kong Listed Companies
73. The Hong Kong Venture Capital and Private Equity Association
74. The Institute of Securities Dealers/ Success Securities Limited
75. The Law Society of Hong Kong

<u>Others</u>

76. New People's Party
77. SWCS Corporate Services Group (Hong Kong) Limited
78. The Professional Commons Ltd.
79. 1 other *(name not disclosed at respondent's request)*

INDIVIDUALS

Accountant
80. Alvin Lau
81. to 82. 2 accountants *(names not disclosed at respondents' request)*

Corporate Finance Staff
83. Rabo Leung
84. Steven Lo Wing Shing
85. to 94. 10 corporate finance staff *(names not disclosed at respondents' request)*

HKEX Participant Staff
95. 1 HKEX participant staff *(name not disclosed at respondent's request)*

Investment Management Staff
96. 1 investment management staff *(name not disclosed at respondent's request)*

Lawyer
97. Ernest Chung
98. Howard Lau
99. Larry Kwok
100. Rosanna Chu/ Bonnie Yung/ Jason Wang
101. to 106. 6 lawyers *(names not disclosed at respondents' request)*

Listed Company Staff
107. 1 listed company staff *(name not disclosed at respondent's request)*

Retail Investor
108. Lo Chun Kit
109. to 111. 3 retail investors *(names not disclosed at respondents' request)*

Others
112. David Webb/ Ng Kai Pong/ 1 individual (*name not disclosed at the respondent's request*)
113. V F Moore
114. to 115. 2 other individuals *(names not disclosed at respondents' request)*

APPENDIX II METHODOLOGY

Purpose of the Exchange's Methodology

1. In reviewing and drawing conclusions from the consultation responses, the Exchange's goal is to ensure that we come to a balanced view in the best interest of the market as a whole and in the public interest.

2. The effectiveness of this process depends on the submission of original responses from a broad range of respondents that give considered and substantive reasons for their views. The Exchange's methodology, accordingly, aims to accurately categorise respondents and identify different viewpoints. In line with the Exchange's past publicly stated practice, this requires a qualitative assessment of the responses in addition to a quantitative assessment.

Identifying the Category of Respondent

3. In this paper, respondents are categorised according to whether their responses represented the view of:

   (a) an institution or an individual;

   (b) for institutions one of the following: "Accountancy Firm", "Corporate Finance Firm", "HKEX Participant", "Investment Management Firm", "Law Firm", "Listed Company", "Professional Body/ Industry Association", or "Others"; and

   (c) for individuals one of the following: "Accountant", "Corporate Finance Staff", "HKEX Participant Staff", "Investment Management Staff", "Lawyer", "Listed Company Staff", "Retail Investor", or "Others".

4. The Exchange used its best judgment to categorise each respondent using the most appropriate description above based on the information available.

5. The Exchange categorised "Professional Body/ Industry Association" as a single group rather than strictly assigning them individually to other categories (e.g. by assigning accountants' associations to the "Accountancy Firm" category). This is in line with the Exchange's past practice. Subjective judgment is required to assign professional bodies to other categories and some do not fit easily with other categories of respondents. Nevertheless the Exchange has attempted, in this paper, to accurately reflect the opinions of various sections of the market by mentioning certain professional bodies in the context of categories to which they are most closely related.

6. It is not the Exchange's practice to categorise "Investment Management Firm" by assets under management for the purposes of analysing consultation responses, as the Exchange believes that the size of an institution's global assets does not mean that the Exchange should necessarily attach more insight to their arguments or viewpoint. This would also raise issues as to the treatment of representative bodies that have considerable variances

in number and type of members. Similarly, it is not the Exchange's practice to categorise professional bodies by the size and nature of their membership.

Qualitative Analysis

7. The Exchange performed a qualitative analysis to enable it to properly consider the broad spectrum of respondents and their views. A qualitative analysis enabled the Exchange to give due weight to responses submitted on behalf of multiple persons or institutions and the underlying rationale for a respondent's position.

Quantitative Analysis

8. The Exchange performed an analysis to determine the support, in purely numerical terms, for the proposals in the Consultation Paper. For the purpose of its quantitative analysis, the Exchange placed each response into one of the three following categories based on the content of the response with respect to each of the Consultation Paper proposals: (a) support; (b) against; or (c) no comments.

9. For the purposes of its quantitative analysis, the Exchange counted the number of responses received and not the number of respondents those submissions represented. This means:

   (a) a submission by a professional body is counted as one response even though that body/association may represent many individual members;

   (b) a submission representing a group of individuals is counted as one response; and

   (c) a submission by a law firm representing a group of market practitioners (e.g. sponsor firms / banks) is counted as one response.

10. However, when undertaking qualitative analysis of responses, the Exchange has taken into account the number and nature of the persons or firms represented by other respondents.

11. The Exchange's method of counting responses, not the respondents they represent, is the Exchange's long established publicly stated policy.

Anonymous Responses

12. 49 respondents requested anonymity (see **Appendix I** for the number of these respondents by category).

13. Out of these 49 anonymous respondents,

   (a) 48 respondents requested that their responses be published anonymously. We included these responses in the list of responses published on the HKEX website, identified by category only (e.g. "Law Firm"); and

(b) one respondent requested that its submission not be published on the HKEX website. We have not provided a hyperlink to the response on the webpage listing the responses to this paper.

14. Three respondents did not request anonymity but requested that their submissions not to be published on the HKEX website. We have not provided hyperlinks to these responses on the webpage listing the responses to this paper.

15. We counted these responses for the purpose of both our quantitative and qualitative assessment of responses.

APPENDIX III JURISDICTIONAL COMPARISON

Table A Comparison of the Profit Requirement[1] with the profit-related eligibility requirement of the Selected Overseas Main Markets, ChiNext and STAR Board[2]

Market	Three Years Profit in Aggregate (HK$ million)	Final Year Profit (HK$ million)	Market Capitalisation (HK$ million)	Nature of requirement
Main Board (current)	50	20	500	Profit Requirement and Market Capitalisation Requirement
Main Board (Modified Profit Increase)	80	35	500	
Main Board (Option 1)	125	50	500	
Main Board (Option 2)	150	60	500	
ASX	6[3]	3[4]	90[5]	Standalone profit requirement
FCA (premium listed securities)	No requirement	No requirement	7[6]	No profit requirement
NASDAQ Global Select Market	85[7]	17[8]	1,242[9]	Standalone profit requirement
NYSE (domestic issuers)	93[10]	39[11]	1,552[12]	Standalone profit requirement
NYSE (foreign issuers)	776[13]	194[14]	3,881[15]	Standalone profit requirement
SGX (Main Board)	No requirement	170[16]	850[17]	Standalone profit requirement, or profit and market capitalisation requirement
SSE (Main Board) [18]	36	No requirement	NA	Profit requirement with issued share capital requirement, together with either revenue or cash flow requirement
SSE (STAR Board) [19]	60 (aggregate of last two years)	No requirement	1,200	Profit requirement and market capitalisation requirement, or market capitalisation/ profit/ revenue requirement
SZSE (ChiNext) [20]	60 (aggregate of last two years)	No requirement	1,200	Standalone profit requirement, or market capitalisation/ profit/ revenue requirement, or market capitalisation/ revenue requirement

[1] For comparison purpose, the threshold under the Profit Requirement during the track record period is aggregated.

[2] For comparison purpose, the amounts of minimum profit/ market capitalisation required in the Selected Overseas Main Markets, ChiNext and STAR Board are converted into Hong Kong dollars.

[3] To meet the profit requirement, an applicant must have (a) aggregate profit from continuing operations for the last three full financial years of at least AUD1 million (HK$6 million) (Rule 1.2.4 of ASX Listing Rules); and (b) profit from continuing operations for the 12 months to a date no more than two months before the date the applicant applied for admission of at least AUD0.5 million (HK$3 million) (Rule 1.2.5 of ASX Listing Rules).

[4] See footnote 3.

[5] To meet the assets requirement, an applicant must have net tangible assets of at least AUD4 million (HK$ 24 million) or a market capitalisation of at least AUD15 million (HK$90 million) (Rule 1.3.1 of ASX Listing Rules).

[6] The expected aggregate market value of all shares (excluding treasury shares) to be listed must be at least GBP0.7 million (HK$7 million) (Rule 2.2.7 of UK Listing Rules).

[7] To meet the profit requirement, an applicant must have (a) aggregate income from continuing operations before income taxes of at least US$11 million (HK$85 million) over the prior three years, (b) positive income from continuing operations before income taxes in each of the prior three years, and (iii) at least US$2.2 million (HK$17 million) income from continuing operations before income taxes in each of the two most recent years (Rule 5315f(3)(A) of Nasdaq Stock Market Rules).

[8] See footnote 7.

[9] To meet the market capitalisation and asset requirement, an applicant must have (a) a market capitalisation of at least US$160 million (HK$1,242 million), (b) total assets of at least US$80 million (HK$621 million), and (c) stockholders' equity of at least US$55 million (HK$427 million) (Rule 5315f(3)(D) of Nasdaq Stock Market Rules).

[10] To meet the profit requirement, an applicant must have (a) aggregate pre-tax earnings for last three years of at least US$10 million (HK$78 million), and minimum pre-tax earnings in each of two most recent years of at least US$2 million (HK$16 million) and positive amounts in last three years; or (b) aggregate pre-tax earnings for last three years of at least US$12 million (HK$93 million) and a minimum of US$5 million (HK$39 million) in the most recent year and US$2million (HK$16 million) in the next most recent year (Rule 102.01C (I) of NYSE Listed Company Manual).

[11] See footnote 10.

[12] To meet the market capitalisation requirement, an applicant must have a market capitalisation of at least US$200 million (HK$1,552 million) **(**Rule 102.01C (II) of NYSE Listed Company Manual).

[13] To meet the profit requirement, an applicant must have aggregate pre-tax earnings for last three years of at least US$100 million (HK$776 million) and minimum pre-tax earnings in each of two most recent years of at least US$25 million (HK$194 million) (Rule 103.01B (I) of NYSE Listed Company Manual).

[14] See footnote 13.

[15] To meet the market capitalisation and revenue with cash flow requirement, an applicant must have (a) a market capitalisation of at least US$500 million (HK$3,881 million); (b) at least US$100 million in revenues during the most recent 12 month period; and (c) at least US$100 million (HK$776 million) aggregate cash flows for the last three years, where each of the two most recent years is reported at a minimum of US$25 million (HK$194 million) (Rule 103.01B (II) of NYSE Listed Company Manual).

[16] To meet the profit requirement, an applicant must have aggregate pre-tax profit of at least S$30 million (HK$170 million) for the last year (Rule 210 (2)(a) of SGX Listing Rules).

[17] To meet the market capitalisation and profit requirement, an applicant must be profitable in the last year and have a market capitalisation of at least S$150 million (HK$ 850 million) (Rule 210(2)(b) of SGX Listing Rules).

[18] An applicant must have aggregate profits over last three consecutive years exceeding RMB30 million (HK$36 million) with positive profit for each year (Article 26(1) of the Measures for Administration of Initial Public Offering and Listing of Securities《首次公开发行股票并上市管理办法》).

[19] To meet the profit requirement, an applicant must have (a) aggregate profit of at least RMB50 million (HK$60 million) for the last two years with positive profit for each year, and a market capitalisation of at least RMB1 billion (HK$1.2 billion); or (b) positive profit for the last year, operating revenue of at least RMB100 million (HK$120 million) and a market capitalisation of at least RMB1 billion (HK$ 1.2 billion) (Rule 2.1.2 of STAR Board Listing Rules).

[20] To meet the profit requirement, an applicant must have (a) aggregate profit of at least RMB 50 million (HK$60 million) for the last two years with positive profit for each year; or (b) positive profit for the last year, operating revenue of at least RMB100 million (HK$120 million) and a market capitalisation of at least RMB1 billion (HK$1.2 billion) (Rule 2.1.2 of ChiNext Listing Rules).

Chapter 8

EQUITY SECURITIES

QUALIFICATIONS FOR LISTING

Preliminary

…

Basic Conditions

…

8.05 The issuer must satisfy either the profit test in rule 8.05(1) or the market capitalisation/revenue/cash flow test in rule 8.05(2) or the market capitalisation/revenue test in rule 8.05(3).

The profit test

(1) To meet the profit test, a new applicant must have an adequate trading record under substantially the same management and ownership. This means that the issuer, or its group (excluding any associated companies and other entities whose results are recorded in the issuer's financial statements using the equity method of accounting), as the case may be, must satisfy each of the following:

(a) a trading record of not less than three financial years (see rule 4.04) during which the profit attributable to shareholders must, in respect of the most recent year, be not less than ~~HK$20,000,000~~HK$35,000,000 and, in respect of the two preceding years, be in aggregate not less than ~~HK$30,000,000~~HK$45,000,000. The profit mentioned above should exclude any income or loss of the issuer, or its group, generated by activities outside the ordinary and usual course of its business;

(b) management continuity for at least the three preceding financial years; and

(c) ownership continuity and control for at least the most recent audited financial year.

…

The Stock Exchange of Hong Kong Limited

Practice Note 15

to the Rules Governing the Listing of Securities
(the "Exchange Listing Rules")

Issued pursuant to rule 1.06 of the Exchange Listing Rules

PRACTICE WITH REGARD TO PROPOSALS SUBMITTED BY ISSUERS TO EFFECT THE SEPARATE LISTING ON THE EXCHANGE OR ELSEWHERE OF ASSETS OR BUSINESSES WHOLLY OR PARTLY WITHIN THEIR EXISTING GROUPS

…

3. Principles

The principles, which apply equally whether the entity to be spun off is to be listed in Hong Kong or overseas, are as follows:

…

(c) The remaining business of the Parent

…

Where the Parent, excluding its interest in Newco, cannot meet the minimum profit requirement of rule 8.05, the Exchange may grant a waiver to the Parent if the Parent is able to demonstrate that it, excluding its interest in Newco, fails to meet the minimum profit requirement of rule 8.05 due solely to a significant market downturn. The Parent must also demonstrate that the circumstances that led to its inability to meet the minimum profit requirement was temporary and is not likely to continue or recur in the future or that appropriate measures have been taken by the Parent to negate the impact on its profit of the market downturn (as the case may be). In addition, the Parent, excluding its interest in Newco, must have an aggregate profit attributable to shareholders of not less than ~~HK$50 million~~HK$80 million in respect of any three out of the five financial years immediately preceding the spin-off application.

Note: For the purpose of meeting the minimum aggregate profit requirement referred to above, the Parent must satisfy the following criteria:

(a) the profit/loss in the three consecutive financial years immediately preceding the spin-off application must in aggregate amount to a net profit of not less than ~~HK$50 million~~HK$80 million; failing which

(b) the profit/loss in any three of the four consecutive financial years immediately preceding the spin-off application must in aggregate amount to a net profit of not less than ~~HK$50 million~~HK$80 million; failing which

(c) the profit/loss of any three of the five consecutive financial years immediately preceding the spin-off application must in aggregate amount to a net profit of not less than ~~HK$50 million~~HK$80 million.

The relevant profit/loss is the profit/loss attributable to shareholders of the Parent after excluding the Parent's interest in Newco, and should exclude any income or loss of the Parent generated by activities outside the ordinary and usual course of its business.

In the case of (b) or (c) above, the Parent must demonstrate that the profit/ loss of any financial year whose profit/loss is not taken into account in the calculation of the minimum net profit of ~~HK$50 million~~HK$80 million was affected by the significant market downturn.

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