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Our Ref LTCL/CMAG

29 January 2021

Dear Sirs

Re: Consultation Paper on the Main Board Profit Requirement

KPMG welcomes the opportunity to respond to the Consultation Paper on The Main Board Profit Requirement ("Consultation Paper"). Unless otherwise noted, terms used in our responses herein shall have the same meanings as those defined in the Consultation Paper.

In summary, we are in support of the objective of the proposals to enhance the quality of Hong Kong capital market and to address market manipulation arising from the misalignment of the current Profit Requirement with the Market Capitalisation Requirement. Meanwhile, we suggest the Exchange to explore other means to facilitate the listing of "new economy" early-stage companies and to rejuvenate GEM in making it a more viable and attractive alternative for small and mid-sized companies.

Increase of Profit Requirement – Option 1 is preferred among the two proposals

The existing Profit Requirement was introduced in 1994 and has been adopted ever since despite the requirement of minimum market capitalisation increased five-fold from HK$100 million to HK$500 million during the same period. This has created a misalignment and could potentially attract manipulation of profit forecasts and valuations by listing applicants for the sake of satisfying the Market Capitalisation Requirement. Any occurrence of such would have a negative impact on the overall quality of Main Board listings and would jeopardize the interest of the investing public.

We agree that the aforementioned market manipulation activities could to a certain extent be tackled by narrowing the misalignment. Among the two proposed options in the Consultation Paper, Option 1 (HK$125 million) is preferred having considered that a substantial portion of Main Board listing applicants would already be eliminated even if a lower threshold was adopted. It comparatively strikes a better balance between market quality and impact on the market stakeholders.

We would also like to highlight the importance of enforcement actions in tackling market misconducts, including inflated valuations and artificial shareholder base. A strong and effective enforcement would help deter abusive behaviours and preserve the high quality of our capital market.

Rejuvenation of GEM to serve small and mid-sized companies

Since the repositioning of GEM as a "stand-alone" board for small and mid-sized companies in 2018, GEM listing applications and new listings have significantly reduced. Market practitioners are suggesting that the illiquidity and sub-par reputation of GEM as the root causes for driving investor interest away from GEM. As a result, GEM is currently not viewed as a practical alternative by many companies who are ineligible to list on the Main Board. While the increase of Profit Requirement could further differentiate the Main Board as Hong Kong's "premier" board, it may at the same time draw away interest from those good quality companies that do not meet the financial eligibility requirements from raising capitals through listing in Hong Kong.

We recommend the Exchange formulate a plan to rejuvenate GEM and turn it into a more viable and attractive capital raising platform for small and mid-sized companies alongside with the proposed increase of Profit Requirement. As a well-established international financial centre, Hong Kong should target to serve the funding needs of a wide spectrum of companies of different sizes and to avoid measures that could potentially widen the gap between the two extreme ends.

"New economy" early-stage companies – To explore new means to accommodate their needs

In the Consultation Paper, it is suggested that those early-stage companies which are not able to meet the Main Board eligibility requirements can still access the capital market by listing on GEM. However, those "new economy" early-stage companies always have an option to go for listing on U.S. exchanges (e.g. NASDAQ Global Select Market), which has long been a preferred option over GEM. In addition, the conclusion of new board concept paper released in 2017 ("New Board Conclusion") has confirmed GEM's position is to serve small or mid-sized companies from non-"new economy" sectors only. GEM is not positioned to accommodate the needs of and being viewed as an attractive option by "new economy" early-stage companies.

In order to enhance competitiveness among the peers to attract good quality "new economy" early-stage companies, the Exchange should further explore other means to facilitate their listings, such as reviewing the regime for listing pre-revenue companies (other than those in the bio-tech sector) as suggested in the way forward of the New Board Conclusion.

Temporary relief from Profit Requirement – An adequate response to the 2020 market downturn

In light of the unprecedented situation brought by COVID-19 pandemic across the globe and the resultant economic downturn, we support the Exchange's proposal to introduce a temporary conditional relief from the profit spread in the increased Profit Requirement and the conditions thereto to facilitate the listing of quality companies.

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Conclusion

It is of vital importance that we preserve the high level of quality of our capital market, which is the cornerstone for Hong Kong to maintain the position as one of the world's leading equity fundraising destinations. Nevertheless, it is equally important to enable our listing regime to serve the legitimate capital markets needs of corporates in different development stages. Therefore, we recommend the Exchange to consider the Profit Requirement alongside with the listing regime for early-stage and small or mid-sized companies holistically. In view of the potential impact to be brought by the Consultation Paper on certain market stakeholders, we would not oppose to a longer transitional period or later effective date to ease the transition and to allow time for considering other accompanying measures to cater the funding needs of companies from different sectors and stages.

We look forward to seeing the conclusions in relation to this Consultation Paper.

Yours faithfully

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