Part B Consultation Questions

Please indicate your preference by checking the appropriate boxes. Please reply to the questions below on the proposed change discussed in the Consultation Paper downloadable from the HKEX website at:
https://www.hkex.com.hk/-/media/HKEX-Market/News/Market-Consultations/2016-Present/November-2020-MB-Profit-Requirement/Consultation-Paper/cp202011.pdf

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

Capitalised terms have the same meaning as defined in the Consultation Paper unless otherwise stated.

1. Do you agree that the Profit Requirement should be increased by either Option 1 (150%) or Option 2 (200%)? Please give reasons for your views.

   ☐ Yes

   ☑ No

   You may provide reasons for your views.

We do not agree on the increase in the Profit Requirement due to the following reasons:

A. Highest profit requirement among major exchanges discourage new issuers from getting listed in Hong Kong

While we appreciate the Exchange keeps introducing other eligibility requirements to attract different type of companies to list in Hong Kong from time to time, based on Table 1 under paragraph 16 of the Consultation Paper, we noted that 82% of the applicants used Profit Requirement for their submission. It is generally in line with the market practice of investment bank or sponsor to judge whether an applicant would have sufficient demand in an IPO since investors still considered profitability as one of the key criteria when making their investment decision. By increasing the Profit Requirement, even under Option 1, would result in the Exchange having the highest profit requirement on an aggregated basis compared to the Selected Overseas Main Markets. The phrase "new economy" has appeared six times in the Consultation Paper to illustrate the proposed change is unlikely to affect applicant in new economy. It is highly questionable on the rationale of such changes as it could be viewed as Hong Kong discourage companies, in particular those do not fall under "new economy", to listed on the Main Board in the long run.

Given Hong Kong has been one of the most reputable and sophisticated stock markets in the world, we believed our market should not shine away from any traditional industry or small-mid cap issuers given investors' appetite may change from time to time. In fact, many of the key players in the new economy today also grown from a small-mid cap issuer. We believed investors appreciate Main Board continues to comprise of issuers from different sectors and with different size so the investment communities can decide their own investment objective and holding period. If the Exchange wants to encourage more companies from new economy to get listed in Hong Kong, it should at the same time accept a higher valuation for our IPO applicants rather than adopting a higher profit requirement to normalise the P/E back to 8 to 10 times. The proposed change will force those potential issuers with moderate profit but not able to use market capitaisation/revenue test or other alternative test under 8.05 of the Listing Rules to list elsewhere.

B. Regulators cannot presume all Small Cap Issuers are linked to shell companies

Another reason for the change as stated in paragraph 5 of the Consultation Paper is to address the regulatory concern on the purpose of IPOs for Small Cap Issuers as it could be viewed as manufacture of shell companies, their IPO valuations are effectively a reverse engineering process without genuine demand and listing of such companies is not in the interest of the investing public and will affect the overall quality of the Main Board listings. It would be unfair to rule out the development of potential issuers simply due to the perception of regulator on their listing purpose. To improve the quality of the issuers, regulator should ensure there is sufficient disclosure in the issuers' prospectus while the issuers should comply with the relevant listing rules over the use of proceeds after listing. These measurements are already in place under the current regulatory regime to safeguard the investors. It is mentioned under paragraph 6 of the Consultation Paper that regulators are aware of possible malpractice during IPO. However, we have confidence that our regulators have sufficient expertise and will be able to impose necessary measurement to monitor and stop any market misconduct in associate with those problem during the price discovery process.

We are of the view that the outset of the proposed change is to increase the difficulty of shell manufacturing. However it will at the same time discourage listing of Small Cap Issuers on the Main Board. We believed regulators in Hong Kong have successfully curbed the activities of so-called shell transactions by means of increasing the market capitalisation at the time of IPO to HK$500 million since 2018 and by tightening the vetting process or through other measurement as stated in paragraph 23(b). Shell operation is driven by the demand for a listing status in Exchange as getting listed is impracticable for some entities. We cannot rule out the possibility of increasing demand on Main Board shell in the future but based on our market intelligence, the consideration for a Main Board shell has dropped by almost 50% in two years since 2018 and there is fewer shell transaction in the market. Such credit should be given to the measurements imposed by the regulators. If the benefit of manufacturing a listed-shell is not attractive enough, we believe there is no longer any motivation for anyone to manufacture shell company. As such, implementing the proposed change to control the shell manufacturing activities seems to be redundant while increasing the Profit Requirement will discourage company with potential and moderate profitability to raise fund in Hong Kong. Given it will be more difficult to get listed on the Main Board after the proposed change, there could be a back fire that the shell price will increase due to limited supply thus induce more shell manufacturing activities again.

C. Valuation should be determined by investors and not regulators

One of the reasons for the proposed change as stated in paragraph 3 to 4 of the Consultation Paper is that Small Cap Issuers were issued at a higher implied P/E and there is regulatory concern on the reasonableness of such valuation. We are of the view that Hong Kong being one of the most well-regulated and sophisticated stock markets, investors and issuers should be able to achieve a balance between themselves in pricing an IPO based on the disclosure approved and supervised by the regulators. If there is insufficient market demand for an IPO, no matter it is a Small Cap Issuer or not, it would not be able to launch successfully even if the regulators consider such valuation is reasonable. From the issuers' perspective one would prefer to list in a market where investors are willing to accept a higher valuation. If the regulator overweight its view on the reasonableness of Small Cap Issuer's valuation, say back to historical P/E of 10 times (under Option1) or 8 times (under Option 2) as stated in paragraph 25, it would hinder the development or fund raising activities for potential issuers in Hong Kong thus reduce the overall competitiveness or even attractiveness of our market-driven Exchange. A relativly lower valuation usually applies to industry like property or banking , which represented the majority of the index stocks in Hong Kong in the past. We believed the regulators should not be bounded by the historcial valuation of majority of companies listed Hong Kong when judging the reasonableness of valuation for any new issuers. Afterall, valuation of a company listed in a sophisticated market like Hong Kong should be driven and priced by investors, not regualtors.

D. Unrealistic to expect non-eligible applicants under Option 1 or 2 will opt for GEM

Paragraph 10 of the Consultation Paper mentioned small-mid size companies can still access the listing on GEM. We believed most of the issuers with good potential will not opt for GEM given 1) liquidity issue of GEM; 2) many institutional investors have constraint to invest in companies listed on secondary board like GEM; and 3) migration from GEM to Main Board become more costly. Based on the statistic from the Exchange, there were 75, 15, 8 GEM IPO in 2018, 2019 and 2020 respectively while the average daily turnover of GEM was approximately HK$350 million in 2020 or 0.26% compared to an daily average of HK$130 billion in Main Board. Such drastic dropped in the number of GEM IPO was likely resulted from the removal of "stepping stone" position of GEM in 2018. Given Option 1 is already the highest profit requirement comparing to the Selected Overseas Main Market, we believed most of the issuers that cannot qualify for Option 1 will simply change their listing plan to other Selected Overseas Main Market rather than GEM.

E. New change will reduce our competitiveness against other major stock exchanges

By increasing the Profit Requirement to the highest benchmark comparable to other major stock exchanges in the world, one of the immediately drawback we can expect is fewer potential issuers will consider listing in Hong Kong. Based on public information, there were 138 companies listed on the Main Board by way of IPO in 2020 (without counting the migration from GEM), the quantity was already less than other selected stock market as further discussed below.

We noted the regulator only include SSE as the comparable market in China in the Selected Overseas Main Markets. However, due to the recent regulatory reforms by the China Securities Regulatory Commission including the introduction of registration-based IPO system in ChiNext and the launch of STAR Board in SSE, we see more potential Main Board issuers have decided to list on those two boards recently. Some issuers even exploring to list in US using Special Purpose Acquisition Company (SPAC). When other major exchanges are promoting fund raising activities for potential issuers without considering their size, we see the Exchange is moving towards an opposite direction by just focusing on large cap issuers. The growth in the number of new IPO in other comparable major stock market illustrated below remains robust while Hong Kong has recorded a drop in the number of new IPO in 2020.

	HK Mainboard	*A Shares	SSE	SZSE	ChiNext	STAR	*US	Nasdaq
2016	86	227	103	124	78	-	171	117
2017	99	438	215	223	141	-	256	154
2018	133	105	57	48	29	-	331	230
2019	149	203	125	78	52	70	322	240
2020	138	396	235	161	107	145	730	467

* A shares include SSE and SZSE while STAR forms part of SSE, ChiNext forms part of SZSE and Nasdaq forms part of US
Source: Wind

With fewer issuers interested to list in Hong Kong, the workload of the Listing Division, market participants and other professional parties in the financial industry will shrink drastically. However, the regulator is prepared to accept such impact on future potential application as illustrated under paragraph 9(a) of the Consultation Paper where the proposed change would have eliminated 62% of the Profit Requirement Application.We are surprised to see our regulators are aware and be prepared to accept reduction on the number of listing application. In fact, if the human resources in our regulators are not sufficient to deal with increasing workload from new application, we believe there are sufficient local talents or college graduates from all over the world are willing to develop their career in our capital market. As the regulators in Hong Kong, one should also consider on how to maintain the overall competitiveness and professionalism in our capital market, increase the jobs offering and training opportunities in our financial industry for the next generation, and most importantly, to formulate a long-term strategy to maintain our leading position as the international financial centre. Reducing the issuers' interest to get listed in Hong Kong will adversly impact the positioning of Hong Kong and reduce the training and job opportunties for young people in our market.

F. Positioning Main Board with only sizeable companies is not favourable to Hong Kong in the long run

Paragraph 48 stated the regulator would like to position the Main Board as the main market to attract sizeable companies. Back in 2014, regulators in Hong Kong has not adopted certain changes in our regulatory regime in time such that Alibaba Group decided to pursue its listing plan in US. Not until Chapter 8A was introduced later in April 2018 to accommodate companies with WVR structure, the Exchange has been able to attract some of the Chinese companies listed in US to obtain secondary listing in Hong Kong recently including Alibaba Group, JD.com, Inc., NetEase, Inc. etc.. While large-cap issuers seeking for secondary listing is only a temporary opportunity for our stock market, the Exchange should not give up the opportunities to attract those small-mid cap companies with potential but yet achieving the Profit Requirement under Option 1 or Option 2 to use Hong Kong as their primary listing place. In order to strengthen Hong Kong's position as an international financial centre as well as an intermediate in Greater Bay Area of China to bridge the global investors with the capital requirement of potential issuers, especially those small-mid cap enterprise in China which has limited access to foreign capital, we sincerely hope the regulator to position the Exchange as one of the most transparent and investors-driven capital markets in the world with diversity and embracing issuers from different countries and size rather than just focusing on serving sizeable companies.

2. Besides the proposed increase in the Profit Requirement, is there any other alternative requirement that should be considered? Please give reasons for your views.

☑ Yes

☐ No

You may provide reasons for your views.

We had discussion with many potential issuers after the publication of the Consultation Paper, including both small-mid cap and large-cap companies, and noticed they were exploring to pursue their listing plan in other markets, including but not limited to, NASDAQ, A-share including STAR and ChiNex while at the same time many existing Main Board companies had delisted through privatisation (22 in 2020 and 10 in 2019). We believed one of the reasons for them to consider listing in other exchanges or not staying in the Exchange is lower valuation and thinner liquidity as compared to other markets. Improving IPO valuation and post-listing liquidity should be the priority to strengthen Hong Kong's position as an international financial centre. Paragraph 11 of the Consultation Paper mentioned the proposal will improve the overall quality of Main Board Issuers, which will be conducive to promoting post listing liquidity. We believed index stocks and large-cap companies of every major exchanges are enjoying a better liquidity thus by focusing on listing large companies in Hong Kong is not a solution to improve the overall liquidity in our market.

Exchange had previously introduced Stock Connect to allow eligible investment communities in China to invest in Main Board Issuer had improved the liquidity for some of those qualified issuers on the Stock Connect list. Exchange may want to consider to expand the list of companies under the Stock Connect to improve the post IPO liquidity. In addition, Exchange may consider introducing mechanism similar to Stock Connect for participating in IPO to improve the liquidity for new issuers. Exchange has been the intermediate to bridge the investors from all over the world with the capital requirement of issuers, in particular companies with business mainly located in Greater China. We believe providing a broader spectrum of companies with good potential, not necessaryily bounded by the initial market capitalisation or scale of profit, in our stock market is the best way to attract investors to conduct trade in Exchange.

Notwithstanding to our reasons addressed above, if the regulators consider attracting sizeable companies is the best way to improve our market, we sincerely hope the regulator to reconsider the timing of proposing such changes and the magnitude of increase over the Profit Requirement. Given COVID is still adversely affecting the business operation and economic activities globally, there could be a potential distortion on the profitability trend of an issuer if the regulator or investors were just relying on the recent financial performance in 2020 or even 2021. We do not see the urgency for the Exchange to implement the proposed change at this moment when COVID may potentially benefit or jeopardise some of the issuers' business during the epidemic thus their profitability may be an outliner during the track record period under the application. In terms of magnitude, given the change will result in Hong Kong having the highest profit requirement and if the regulators still consider increasing the Profit Requirement is the only way to improve the quality of our market, we will suggest to adopt 50% or even lower of the proposed increase under Option 1 in order to maintain competitiveness of the Exchange against other comparable stock exchanges.

3. Do you agree that the Exchange should consider granting temporary relief from the increased Profit Requirement due to the challenging economic environment? Please give reasons for your views.

☑ Yes

☐ No

You may provide reasons for your views.

4. If your answer to Question 3 is yes, do you agree with the conditions to the temporary relief as set out in paragraph 55? Please give reasons for your views.

☐ Yes

☑ No

You may provide reasons for your views.

No, as stated in our reply to Question 2 above, given COVID is still impacting the normal business operation of various businesses and will continue to distort the profitability of potential issuers in the near future, the Exchange should consider to extend the transitional arrangement to a much longer period, rather than just three consecutive financial years between 2018-2022. Given there are still uncertainty on the duration and potential distortion from COVID on the issuer's profitability, maybe the Exchange should reconsider the timing of proposing the change on Profit Requirement instead of granting an one-off transitional period which is not sufficient to cover the on-going impact from the challanging economic environment.

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