

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.

Please refer to Annex 1 for details.

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.

Given the reasons set out in the paragraph 1.1.4 in Annex 1, if the motive is to reduce the implied historical P/E ratios of applicants meeting only the minimum thresholds under the Profit Requirement and the Market Capitalisation Requirement to be eight to ten times (as mentioned in paragraph 8 of the Consultation Paper), it is suggested the Exchange to reconsider the minimum expected market capitalisation upon listing on the Main Board given no further change to the Profit Requirement is imposed at this stage.

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.

Please refer to paragraphs 1.4.1 to 1.4.6 in Annex 1.

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.

Please refer to paragraphs 1.4.1 to 1.4.6 in Annex 1.

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Annex 1

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

<p>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.</p>	
A:	No
Reasons:	<p>1.1 The market may need additional time to review the effectiveness following the implementation of the existing minimum Market Capitalisation Requirement implemented since 2018 before any material changes in listing requirements</p>
	<p>1.1.1 In the 2017 Consultation Paper, the Exchange proposed to retain the existing Profit Requirement while the minimum Market Capitalisation Requirement was increased from HK\$200 million to HK\$500 million. In paragraphs 55 and 56 of the 2017 Consultation Paper, the Exchange quoted the view of the Listing Committee in June 2016 that there did not appear to be compelling reasons to change the existing Profit Requirement.</p> <p>1.1.2 The Market Capitalisation Requirement was implemented in February 2018. In respect of the Exchange’s concern on the number of Small Cap Issuers with unusually high P/E ratios, in 2018 and 2019, the number of Profit Requirement Applications and number of Small Cap Issuers did not significantly increase (see paragraph 5 of Appendix III of the Consultation Paper).</p> <p>1.1.3 In addition, although there was an increase in historical P/E ratios for Small Cap Issuers in 2018 (see paragraph 21 of the Consultation Paper), the overall P/E ratio dropped significantly in 2019 such that 76% of them had a historical P/E ratio below 15x (see Chart B of Appendix III of the Consultation Paper).</p> <p>1.1.4 The same set of data for 2020 has not been provided by the Exchange. Nonetheless, it is noted that various constituent indices of Hang Seng Index (except Hang Seng Tech Index relating to stocks from new economy) have shown downward trend since 2019. Furthermore, given the unprecedented situation impacted by COVID-19 pandemic in 2020 and the continuous tension between China and US, it is suggested that additional time should be given to observe the effectiveness of the</p>

	<p>Market Capitalisation Requirement implemented since 2018, and whether the number of Small Cap Issuers with high P/E ratio would continue to decrease. It is also suggested that the Market Capitalisation Requirement should be in line with the overall market capitalisation of universe of securities listed on the Exchange.</p>
	<p>1.2 Additional information is needed to justify some of the analysis and reasons cited for the proposal in the Consultation Paper</p>
	<p>1.2.1 In addition, the Exchange observed that there has been an increase in listing applications from Small Cap Issuers that marginally met the Profit Requirement but had relatively high historical P/E ratios as compared with those of their listed peers (see paragraph 20, the Consultation Paper). The Exchange also noted that while these Small Cap Issuers typically justified their higher valuations by reference to potential growth, <u>a number of them failed post listing to meet the profit forecasts they had filed with the Exchange as part of their listing applications, which gave rise to concerns about the reasonableness of their valuations</u> (see paragraph 21 of the Consultation Paper).</p> <p>1.2.2 Valuation of the issuers may be affected by a number of factors. Following the IPO fund raising, the issuers will be able to utilise the IPO proceeds to further expand their businesses hence an additional premium shall be given to the valuation on top of their historical P/E ratio.</p> <p>1.2.3 The Exchange considered that the issuers' failure to meet their profit forecasts may give rise to concerns about the reasonableness of their valuations. The Exchange provided some data in this regard. However, it is noted that some key data in this regard have not been comprehensively presented and discussed in the Consultation Paper. For example, in paragraph 9(c) of the Consultation Paper, it is disclosed that for Profit Requirement Applications that were listed as of 30 June 2020 and which have published their annual financial results post listing, a higher proportion (60%) of the Eligible Applications under Option 1 met or outperformed the profit forecasts they had filed with the Exchange as part of their listing applications, as compared to Ineligible Applications under Option 1 (37%).</p>

- 1.2.4 However, the latter figure also covers listed issuers which had a Market Capitalisation of less than HK\$500 million (i.e. issuers whose listing application were submitted prior to 15 February 2018 or under transitional arrangements). Given the concern of the Exchange is related to the high P/E ratio of listed issuers having a Market Capitalisation of HK\$500 million or above under the current regime, it is ambiguous as to what the result would be if the figure consider solely on listed issues which had a Market Capitalisation of over HK\$500 million. We believe the Exchange should consider and focus only on the data of listed issuers with Market Capitalisation of HK\$500 million or above under the current regime. It also did not provide any data on the extent of how much the profit forecast was exceeded or missed.
- 1.2.5 In paragraphs 34 of the Consultation Paper, the Exchange set out the statistics as to Ineligible Applications (had Option 1 been implemented) which failed to meet their profit forecasts. By considering the 178 issuers with Market Capitalisation of at least HK\$500 million at the time of listing, it is noted that 59% and 53% of Small Cap Issuers and non-Small Cap Issuers respectively failed to meet their profit forecasts, which is not a significant difference. In addition, 12% of non-Small Cap Issuers failed to meet their profit forecasts by over 50%, which is even more than the Small-Cap Issuers, which had 5% failed to meet their profit forecasts by over 50%. Based on the percentages above, it is observed that there is no compelling evidence nor correlation which shows that Small-Cap Issuers had (i) lower a lower capability to meet their respective profit forecast after listing; or (ii) a significantly higher chance to prepare exaggerated profit forecast with a view to support their P/E Ratio as compared with non-Small Cap Issuers.
- 1.2.6 In paragraphs 39 of the Consultation Paper, the Exchange set out the statistics as to the post-listing performance of 208 Eligible Applications (had Option 1 been implemented). However, only 19 (representing 9%) of such issuers were Small Cap Issuers. It should be noted that the number of such Small Cap Issuers is small and may not provide any conclusive statistical evidence. It also begs to suggest that the increase in profit requirement may all but eliminate Small Cap Issuers and in effect increase the market capitalization Requirement again after it was merely just implemented in 2018. On the other hand, out of the 189 non-Small Cap Issuers issuers, 73 failed to meet their profit forecasts. Such figure is even higher than the number of Issuers with a market

capitalisation at the time of listing between HK\$500-700 million which were Ineligible Applications under Option 1 and failed to meet the profit forecast (i.e. 71). It suggests that there is not enough conclusive evidence to suggest that the size and profit level of the listing applicants may be directly relevant to the Exchange's concern as to the ability to meet profit forecast. In fact, whether profit forecast can be met and the long-term stability/development of a company is subject to other objective and external factors such as the then macro-economy, government policies, sociological reasons and technology changes post-listing on the Exchange, which cannot be fully reflected nor solely measured by historical profit.

1.2.7 From industry overview of prospectuses of many listing companies or listing applicants of various industries and some government statistic bureau, it is noted that most of the industries merely experienced single-digit growth in past few years. Therefore, the required growth of business scale as implied by the percentage increase in the Profit Requirement under both Option 1 and Option 2 appears inconsistent with the trend of most of traditional industries. Hence, the uplift of the Profit Requirement would discourage small-to-mid players in traditional industries which tend to undergo prudent or stable organic growth in their business from seeking equity capital from public in Hong Kong if the position of GEM remains unclear in future (as explained in 1.2.8 and 1.5 below). Furthermore, it would be unfair to assume that most of the small-to-mid players seek to list simply to realise the perceived value of the listing status, rather than with the objective of seeking long-term growth of their business.

1.2.8 Over the past few years, regulator and market operator have put emphasis on quality of GEM applicants/issuers and price volatility of GEM stocks in order to protect interest of investors. It is noted that the Hang Seng GEM Index has shown a downward trend in past few years with no significant improvement in trading volume. Without any positive measures by the Exchange to regain confidence of investors in GEM, it is concerned that whether quality companies which do not meet the Profit Requirement in future would choose to be listed on GEM given GEM is currently positioned by the Exchange to accommodate small and mid-sized companies to which a higher investment risk may be attached and GEM may be more susceptible to high market volatility.

1.2.9 To conclude, the above data provided by the Exchange does not provide

compelling reasons which unequivocally proves increasing the Profit Requirement would increase the likelihood of issuers meeting their profit forecast. Rather, an increase in Profit Requirement seems to act to eliminate all Small Cap Issuers altogether. In paragraph 8 of the Consultation Paper, it was mentioned that the implied historical P/E ratios of applicants meeting only the minimum thresholds under the Profit Requirement and Market Capitalisation Requirement would be reduced to 8-10 times. However, it does not provide detailed discussion and analysis on the applicants who may be justified for a higher P/E ratio but would be disqualified from applying for the Main Board as a result of the proposed change in Profit Requirement. After all, valuation is subject to a wide range of factors and there are a number of valuation models in addition to P/E ratio and there may be potential high growth applicants which may be disqualified from applying for the Main Board as a result of the proposed change in Profit Requirement. As suggested in the 2017 Consultation Conclusion, “it is not unreasonable to require an applicant to have a higher implied historical P/E ratio if it is close to meeting only our minimum requirements. This would indicate that, despite this, the market has a high degree of faith in the applicant’s future prospects.” (see paragraph 119 of the 2017 Consultation Conclusion) Accordingly, the Exchange may need further information in this regard and consider whether to allow more time for the effect of the increase in market capitalization requirement in 2018 to set in before making further significant changes to the listing requirement so soon.

1.3 Comparison with stock exchanges in other jurisdictions

- 1.3.1 In Tables A and B of Appendix II of the Consultation Paper, the Exchange provided a detailed comparison of listing requirements of a number of overseas Main Markets and the Main Board.
- 1.3.2 While these requirements of these overseas Main Markets varies and that some of them may set a higher minimum profit requirements, none of them have announced any plan to tighten the threshold of listing in the coming year. COVID-19 has adversely affected global economy comprehensively in 2020 and it is anticipated that global economy will continue to be adversely affected in 2021. Hence this is not an appropriate time to introduce measures that could exacerbate the current situation. It is expected that equity fund raising will be a solution for

companies with funding needs.

- 1.3.3 “China Anchored, Globally Connected and Technology Empowered” are the three pillars of the Exchange (see HKEx Strategic Plan 2019-2021). The Exchange aims to “attract global liquidity to Hong Kong by providing broader and more effective access to Asia Pacific underlying assets, creating a comprehensive and competitive one-stop shop for China and Asian exposures”. It is believed that the Exchange may continuously compete with other overseas stock exchanges while implementing the “Globally Connected” strategy in the course of attracting overseas businesses to list in Hong Kong.
- 1.3.4 While there were a number of overseas companies from emerging markets (e.g. South East Asia) listed on the Main Board in recent years, the Consultation Paper did not provide any information regarding the potential decrease of issuers from these emerging markets. The Consultation Paper only provides an overall impact analysis of proposed increase in the Profit Requirement which discusses the total number of Ineligible Applications, without providing additional information such as breakdown of geographical locations and industry sectors.
- 1.3.5 According to Table 6 in the Consultation Paper, the minimum profit required for the last three financial years of Main Board already ranks the third among the six Selected Overseas Main Markets following NASDAQ and NYSE but ahead of SSE (Main Board). Given significant portion of listing applicants/issuers are based in China, it appears to be more relevant and meaningful to compare with listing requirements of SSE (Main Board). If quality companies from other jurisdictions are welcome to be listed on the Main Board, further study on the profitability and profit requirements of other stock exchanges (i.e. in addition to the six Selected Overseas Main Markets) should be conducted.
- 1.3.6 In addition, Hong Kong investors are less familiar with businesses in these emerging markets as compared with businesses in Hong Kong or the PRC. Having a Profit Requirement at the current level would provide a greater confidence to the public and investors that these companies are profit making and viable. At the same time, the trend of listing in Hong Kong is still at a developing stage for companies in these emerging markets. A frequently changing threshold for listing would deter the interest of companies to prepare for listing (because they may waste significant time and resources preparing for listing and

	<p>subsequently discover that they are not eligible for listing under a new threshold). The increased Market Capitalisation Requirement was introduced in 2018. If there is an additional increase in the Profit Requirement in 2021 (less than 3-year time since the increase in Market Capitalisation requirement), potential applicants (in particular overseas applicants which are not familiar with Hong Kong market) may lose interest in the Hong Kong stock market. This will reduce the competitiveness of the Hong Kong stock market in attracting potential listing applicants and may have an adverse impact on the secondary market.</p> <p>1.3.7 The Consultation Paper provides a comparison of listing requirements with other overseas Main Markets, but it does not provide detailed discussion and analysis from marketing and strategic perspective to maintain the Exchange's competitiveness in attracting overseas applicants to Hong Kong. It is suggested that additional analysis in these areas shall be provided so that the public and investors may have more complete picture.</p> <p>1.3.8 Accordingly, it may not be the appropriate timing to tighten the listing requirements and to increase the Profit Requirement as it is not clear whether and how such change may adversely affect the competitiveness of the Exchange to continuously attract potential applicants globally.</p>
	<p>1.4 Transitional arrangement is needed to avoid any confusion and difficulties for the implementation of the temporary relief while increasing the Profit Requirement at the same time</p>
	<p>1.4.1 As discussed above, global economies and operations have been comprehensively affected since 2020. Potential applicant who could meet the existing Profit Requirements might have started preparation for listing application with a track record period from 2018 to 2020, however their profits for 2020 might have been adversely affected and failed to meet the net profit requirement in the final year. As set out in the Consultation Paper, the objective of the temporary relief is to provide an opportunity to companies which are temporarily affected by COVID-19 and uncertainties arising from the economic and political tensions between the US and China (Chapter 2 of the Consultation Conclusion).</p>

- 1.4.2 The proposed condition for the temporary reliefs that listing applicants' aggregate profit during the track record period shall meet the Aggregate Profit Threshold (i.e. HK\$125 million under Option 1 or HK\$150 million under Option 2) would not provide any benefit to potential applicants which meet the current Profit Requirement and impacted by the adverse condition in 2020 or thereafter.
- 1.4.3 Given the objective is to cope with the unprecedented impact COVID-19 and uncertainties arising from the economic and political tensions between the US and China, it is suggested that such relief shall be given to companies which could have met the current Profit Requirement (instead of being a remedy to companies which may not meet the increased Profit Requirement).
- 1.4.4 The increase of Profit Requirement would impact the opportunities of listing of potential applicants comprehensively in all kinds of industry sectors and backgrounds. If the new rules are to be implemented in 2021, time and costs on preparation incurred by such potential applicants would have been wasted. It is therefore suggested that if any increase of the Profit Requirement is to be implemented, a longer transitional period shall be offered.
- 1.4.5 Both Option 1 and Option 2 represent a significant increase from the current Profit Requirement. Given the significant impact of the COVID-19 and uncertainties arising from the economic and political tensions between the US and China, it is unclear how many applicants which may consider that they can meet the condition of the temporary relief as to the Aggregate Profit Threshold (i.e. HK\$125 million under Option 1 or HK\$150 million under Option 2). Having considered the above factors, it is suggested that changes to this fundamental listing eligibility requirements, which are likely to have an overall impact on the Hong Kong capital market, should be the subject of a more extensive consultation. Hence it may not be an appropriate time to increase the Profit Requirement.
- 1.4.6 The temporary relief should be based on wider discussion and research on the impact of COVID-19 (both extent and the recovery time) and relationship between China and US particularly the recent change in president of US. Therefore, it is premature to determine which years are subject to the temporary relief (in fact the uplift of the Profit Requirement). It is suggested that even if any new profit requirement is to be introduced, the Exchange shall first announce a transitional

	<p>arrangement to the market such that potential applicants which fail to meet the new profit requirement (but still meeting all existing listing requirements) can decide its fundraising on the Main Board and business plan and after wider discussion and research, announce, if any, the change in listing requirements and temporary relief .</p>
	<p>1.5 Additional time of review and complementary measures are needed from the Exchange in order to regain investors' confidence on GEM stocks</p>
	<p>1.5.1 The Exchange considers that ineligible applicants can still access the capital market by listing on GEM, which is intended to be a capital raising platform for early development companies and small or mid-sized companies that are not able to meet the Main Board eligibility requirements (paragraph 47 of the Consultation Paper).</p> <p>1.5.2 While the Exchange sought markets' view and discussed the listing requirements of GEM. In the 2017 Consultation Paper, the Exchange and the market did not specifically discuss the potential of forcing such significant potential Main Board applicants to seek listing on GEM instead. The 2017 Consultation Paper focused on discussing the transfer mechanism and the Market Capitalisation and other listing requirements.</p> <p>1.5.3 At the same time in 2017, Question 4 of the New Board Concept Paper sought respondents to provide their "views on the proposed roles of GEM and the Main Board in the context of the overall listing framework". The Exchange's conclusion from the feedback is that the role of the Main Board as Hong Kong's premier listing board should remain intact, while GEM continues to serve a legitimate purpose for the capital raising needs of SMEs from non-New Economy sectors. (see paragraph 117 of the Consultation Conclusions of the New Board Concept Paper)</p> <p>1.5.4 However, it should be noted that neither the 2017 Consultation Conclusion nor the New Board Concept Paper discussed increasing the profit as a threshold for listing on Main Board. The 2017 Consultation Paper focused on the issues discussed above while the New Concept Paper focused on introducing a new board for new-economy companies (which may be pre-profit), and whether such companies may be listed in a new board or in Main Board or GEM pursuant to a new chapter of the Listing Rules.</p>

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| | <p>1.5.5 The 2017 Consultation Conclusion nor the New Board Concept Paper did not use the amount of net profit as an indicator to differentiate companies as premier, SMEs etc., let alone forcing companies which can meet the current Profit Requirement on Main Board to seek listing on GEM.</p> <p>1.5.6 While the Exchange's objective to preserve and protect the Main Board as Hong Kong's premier listing board is appreciated, it is suggested that a more comprehensive conclusion from different angles such as introducing an addition board to the potential ineligible applicants (such the conclusion in 2017) is necessary.</p> <p>1.5.7 Option 1 and Option 2, on average, would have eliminated 62% (462) of the Profit Requirement Applications (see paragraph 9(a) of the Consultation Paper). As at the date of this submission, there is less than 400 companies listed on GEM. Whether the existing nature of GEM as well as its market acceptance would be capable and suitable to cater the needs for listing from such applicants is unclear. GEM operates on the philosophy of "buyers beware" and "let the market decide" based on a strong disclosure regime. This is a matter which will fundamentally change the nature and market dynamics of GEM and needs a separate consultation.</p> |
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