PATRICK CHU, CONTI WONG LAWYERS LLP
朱國熙、黃錦華律師事務所
(有限法律責任合夥)
SOLICITORS & NOTARIES

Units 2804-07, 28/F, Man Yee Building,
No. 68 Des Voeux Road Central, Central, Hong Kong
香港中環德輔道中 68 號萬宜大廈 28 樓 2804-07 室
[redacted]
www.pclawyers.com.hk

Date: 29 January 2021

BY EMAIL (response@hkex.com.hk)

Hong Kong Exchanges and Clearing Limited
8th Floor, Two Exchange Square
8 Connaught Place
Central
Hong Kong

Dear Sirs,

Re: Consultation Paper on the Proposed Increase in the Main Board Profit Requirement

We write to submit our responses to the consultation paper on the proposed increase in the Main Board Profit Requirement (the "**Consultation Paper**") issued by The Stock Exchange of Hong Kong Limited (the "**Exchange**"). Unless specified, terms used in this letter have the same meaning attributed thereto in the Consultation Paper.

We are pleased to submit our following responses to the Consultation Paper:

Question 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.*

Response 1 No, we understand the Exchange has a genuine concern which we will sum up below but the Profit Requirement is not the root of the problem. In fact the existing Profit Requirement is on par with the main markets of the overseas exchange and the impact of an increase in profit requirement may have a sufficient negative impact on the market. The Exchange's concern should instead be dealt with by a more holistic and case-by-case approach rather than an overkill for every issuer.

The Exchange's arguments for an increase in Profit Requirements are summed up as follows:

1. The misalignment of the Profit Requirement results in ever-increasing P/E ratio over the years and the reasonableness of P/E ratio is in question, particularly for Small Cap Issuers.

2. Inflated valuation may not reflect the expected market clearing prices and raise regulatory issues.

3. Valuations of Small Cap Issuers may simply be reverse engineered to meet the Market Capitalisation Requirement in order to manufacture potential shell companies for sale after listing given the perceived premium attached to the listing status.

4. The increase in the Profit Requirement will further distinguish between issuers listed on GEM and 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 market standards. The proposal will therefore improve the overall quality of Main Board issuers, which will be conducive to promoting post-listing liquidity. This will also increase investors' confidence in the market and strengthen Hong Kong's position as an international financial centre.

Reasonableness of P/E ratio and valuation should be better tackled with robust vetting. Even though there are many Small Cap Issuers in the last few years, they could be genuinely listed with the intention to raise funds for the development of their underlying businesses as stated in the profit forecasts.

The problems we are facing are not just about the black-letter rules – it relates to inflated valuations, abuse of rules and other market misbehaviours. What we need are robust vetting and meticulous scrutiny and not a rule change.

As for the last reason, we have to compare the Profit Requirement with other Selected Overseas Main Markets. With either Option 1 or Option 2, it will result in the Exchange having (a) the highest profit requirement when compared with the profit requirements of the Selected Overseas Main Markets on an aggregated basis for the three years of a track record period; and (b) the second highest profit requirement for the final year of the track record period after SGX which, however, only has profit requirement for the last year. Even for Option 1, the three years in aggregate is as high as HK$125 million, the second one being NYSE, which is HK$93 million, so it is more than 20% higher (not to mention the fact that post-tax profit for Profit Requirement is used rather than pre-tax profits adopted by other main market overseas). Even with our present Profit Requirement, we are now right in the middle of the Selected Overseas Main Markets and therefore it is more on par with other main market overseas.

According to the impact analysis, the proposed increase in the Profit Requirement showed that Options 1 and 2 would have resulted in 59% (437) and 65% (486) of the Profit Requirement Applications being ineligible for listing between 2016 and 2019, respectively. Even for Option 1, we are talking about more than half of the applications might have turned down between 2016 and 2019. The impact of such an increase is huge in terms of the number of issuers affected and will shut the door for many issuers. Although the change may not have great impact on market capitalisation as the inapplicable applications only accounts for 3% of the aggregate market capitalisation of the Main Board issuers under Option 1, such Small Cap Issuers with their profits may have great growth potentials, so it is the number of issuers that are being turned down that are of great concern. As they all strive to increase their market capitalisation by listing on the Main Board, the proposed change may slow down their growth.

Further we believe it is not the best time to increase Profit Requirement during the COVID-19 pandemic. Even though the Exchange may grant temporary relief, COVID-19 may continue to affect companies in 2021 or even later, subject to the industries concerned. Given such an adverse macro-economic situation, it is better and more practical for the Exchange to revisit this topic when the pandemic is under control or over.

Question 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.*

Response 2 Yes. We support a holistic (by taking into consideration all factors – not just Profit Requirement, to determine shell creation activities) and case-by-case approach (by looking into the facts of each case). We agree that the Exchange should adopt a heightened vetting approach and heavily scrutinise the commercial rationale for listing and the reasonableness of P/E ratios of Small Cap Issuers. We support the Exchange for issuing the revised Guidance Letter HKEX-GL68-13A (Guidance on IPO vetting and suitability for listing) in April 2018 to curb shell creation activities. We also support the Exchange to continue to adopt a more robust approach on the application of Rule 13.24 of the Listing Rules to suspend the trading of shares of, and delist, existing listed issuers that have a very low level of operation and/ or carry on businesses that do not have substance. While guidance letters set out further compliance matters to guide the potential/listed issuers, they can also be a quicker and more flexible approach to stamp out any malpractice as soon as one sees it.

Question 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.*

Response 3 Yes, the COVID-19 pandemic significantly affects many companies directly or indirectly (through their trading partners, suppliers and target customers) and such companies may otherwise be economically sound with great potentials but only suffer from a temporary economic setback.

Question 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.*

Response 4 Yes, we would like to add that the Exchange may take into consideration that the adverse economic situation may continue in 2021.

Should you have any queries, please feel free to contact our [redacted]

[redacted]