

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 strongly disagree that the Profit Requirement should be increased by either Option 1 or Option 2 as proposed in the Consultation Paper (“**Proposed Increase**”) for the following reasons.

1. Closing the Main Board to Hong Kong companies

In the Consultation Paper, the Exchange proposed to increase the Main Board Profit Requirement by either 150% or 200%. This entails that companies would have to meet at least HK\$50 million in the most recent financial year in order to be eligible for listing. According to the Exchange’s own analysis, the Proposed Increase would have eliminated 62% of listing applications relying on the Profit Requirement between 2016 and 2019 if it were increased according to the Consultation Paper. Even after taking into account the number of applications that would not have met the new market capitalisation requirement of HK\$500 million, the proportion of applications driven out remains significant.

Despite the lengthy paper, the Exchange presented no analysis on the number of domestic companies that would be eligible for listing after the implementation of the Proposed Increase. It begs the question of whether the Exchange has done enough market research on the number of local companies capable of meeting the new profit requirement, or that the number is so appallingly low for it to be included in the Consultation Paper.

As the sole stock exchange in Hong Kong, the Exchange has the duty to serve

domestic companies and offer them access to an effective capital market. While the Exchange prides itself on being the world's number 1 IPO venue, the increased threshold under the Proposed Increase without offering a realistic alternative would leave many local companies with no suitable venue to list on, and this would go against the core function and duty of the Exchange.

2. GEM is not an alternative

The Consultation Paper seems to suggest that GEM can be an alternative for affected companies to access the capital market, but in our view this option is neither sufficient nor suitable. Ever since the introduction of higher admission requirements in 2018, the number of companies choosing to list on GEM has dwindled drastically. As of December 2020, there were only 368 companies listed on GEM with a daily average turnover value of only HK\$355 million. In the past year of 2020, there were only a total of 8 new listings on GEM. Given the lack of traction of GEM, it simply is not a realistic or effective alternative for domestic companies to list on, especially those that have a three-year profit of HK\$50 million but below HK\$125 million.

3. Devastating impact on the corporate finance industry

Not only would the Exchange's proposal adversely impact potential issuers wishing to list, but it would devastate the entire corporate finance industry, including sponsors, lawyers, accountants, valuers, investors and public relations professionals who act for them. According to the Exchange's analysis, 437 listing applications would have been rendered ineligible for listing between 2016 and 2019 under Option 1. If we assume the average IPO listing expenses to be HK\$25 million, fees of over HK\$10 billion would have been removed from the value chain of professional parties in those 4 years. This would have a far-reaching societal impact on not only the financial industry, but also the entire economy of Hong Kong. Many smaller firms would be forced out of business, leaving more unemployed, which is not beneficial to Hong Kong as a whole.

The economy in Hong Kong has already suffered unprecedented challenges brought on by the COVID-19 pandemic throughout the past year. Many sectors are struggling to keep afloat. Rather than alleviating the burden to the Hong Kong economy, the Proposed Increase would be another blow to the corporate finance industry, further hindering the Hong Kong economy from recovery.

4. Responsibility of the Exchange

As a large corporation in Hong Kong, the Exchange has the corporate social responsibility to create more job opportunities for the local community, but the Proposed Increase has the effect of doing the opposite. While the Exchange's effort and success in attracting listings of high profile companies from mainland China is worth noting, the Exchange cannot overlook the values of local companies including small and medium sized enterprises ("SMEs"). According to the Trade and Industry Department, there are over 340,000 SMEs in Hong Kong and they account for more than 98% of Hong Kong's business establishments. These SMEs provide jobs to around 45% of the total workforce in the private sector of Hong Kong. It would be wholly unjust that, instead of encouraging and accommodating local issuers, the

Exchange is purporting to exclude the very companies that account for a large portion of local economic activity. This would go against the prided purpose of the Exchange, which is to *“promote and progress our financial markets and the communities they support for the prosperity of all.”*

5. Reducing competitiveness of Hong Kong

While the Exchange aspires to increase the competitiveness of the Hong Kong market against other market players, the Proposed Increase would in effect make it one of the most difficult markets to list on, reducing the competitiveness for all but the largest listing applicants from mainland China. Not only would either option give the Exchange the highest aggregate profit requirement for the three-year track record requirement of the Selected Overseas Main Market, but given that Hong Kong’s profit test, unlike most of the other Selected Overseas Main Markets, is based on post-tax figures, this would make meeting the new Profit Requirements even more onerous. The Main Board is also the only market requiring listing applicants to satisfy both a profit and a market capitalisation requirement, this makes it even further out-of-reach to most.

6. Over-emphasis on shell-listing

One of the rationales behind the Proposed Increase seems to be the Exchange’s concern that the listing of the Small Cap Issuers are not with the *“intention to raise funds for the development of their underlying businesses as stated in the profit forecasts”* but that *“their valuations were simply reverse engineered to meet the market capitalization requirement to manufacture potential shell companies for sale after listing given the perceived premium attached to the listing status”*. However, the Exchange has well considered and has imposed abundant measures to restrict shell activities over the years. This is evident by the amendments of the Listing Rules (including but not limited to the reverse takeover amendments and the extended lock up period for controlling shareholders in IPO cases). The Exchange has also issued and updated multiple guidance letters (including but not limited to HKEX-GL68-13A and HKEX-GL68-13) in the recent years to limit these shell activities. The overzealous need to further crackdown on the market for shell companies is unfounded, as the market has largely collapsed. Even if the Exchange is adamant about extinguishing the shell market, it should not be done through a broad-brush approach that would have an unintended effect of disadvantaging SMEs who wish to list for legitimate reasons.

7. Big companies are not necessarily better

The Proposed Increase seems to premise on the assumption that larger companies are better, and that they pose less risks to investors than their smaller counterparts. This cannot be correct. Market misconducts and inflated profit forecast are not exclusive to SMEs or Small Cap Issuers. According to the Exchange’s own analysis in the Consultation Paper, a significant proportion (39%) of the Eligible Applications under Option 1 with a market capitalisation of over HK\$700 million failed to meet their profit forecast. Not only does this show that inflated profit forecast is not an issue limited to SMEs, it also means that closing off the Main Board to SMEs would not root out such regulatory concern. Further, the malpractices of fund misappropriation,

price rebate and false pricing are also notable in sizable listing applicants, only that the amount involved and hence consequences resulted are substantially greater.

8. Other market misconduct concerns

The Consultation Paper pointed towards incidents of rebate offers to investors and the manufacturing of artificial shareholders to justify the need for the Proposed Increase. However, these incidents are not substantiated. If there is evidence of market misconduct, it should be handled through proper investigation and appropriate disciplinary actions. These bare allegations should not be used to promote changes that will restrict potential issuers from raising capital from their domestic market.

Given all the above reasons, we strongly urge the Exchange to put the current proposal set out in the Consultation Paper on hold and reconsider any future plans of reform.

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.

As explained in our response to Question 1, we strongly oppose the Proposed Increase.

Instead, we would suggest the Exchange conduct a holistic review of its market structure and reorganise it in a way to provide a diversified and comprehensive market capable of listing domestic and overseas issuers of every size.

The Exchange may consider introducing a tiered-market structure, and segment the Main Board into a premium and a standard segment, where the premium segment would list very substantial companies and the standard segment would maintain the existing profit requirement and a reduced market capitalisation requirement. The Main Board is already segmented in providing different entry criteria for companies with weighted voting rights, mining, infrastructure, and pre-revenue biotech companies. Further segmentation would not be a radical step. The Exchange can also consider repositioning GEM as an attractive SME board by simplifying its listing requirements and restoring an easier transfer process to the Main Board. This would make the Hong Kong market more inclusive and thus more competitive in the long run.

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.

The fact that temporary relief arrangements are proposed is a strong indication that now is not the time for reform, let alone a substantial increase to the Profit Requirement for listing. If there is to be a review, it would only be appropriate at a time when the economy has recovered to levels before the COVID-19 pandemic.

If, however, the Exchange does move ahead with its proposals, we would support the granting of temporary relief.

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.

The proposed conditions set out in paragraph 55 are too onerous to offer real relief to potential issuers.

Condition (a) requires an applicant to meet the Aggregate Profit Threshold (i.e. HK\$125 million under Option 1 or HK\$150 million under Option 2). This would be too difficult to meet given the current economic challenges.

Condition (b) requires that an applicant to have a positive cash flow during 2020. This would no doubt exclude potential applicants from industries that had suffered most during the COVID-19 pandemic, including airlines, hotels, food and beverage, entertainment and tourism industries. This condition would render the relief unfair and thus should be removed.

Given the impact of the COVID-19 pandemic is persisting into 2021, condition (d) that requires an applicant's track record period to have at least six months falling within 2020 should be revised to "falling within 2021".