新民黨
New People's Party

27 January 2021

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

Re : Profit Requirement CP (By E-Mail and Mail)

Dear Sir / Madam,

<u>Re : The Main Board Profit Requirement</u>

I have pleasure attaching New People's Party's submission on Profit Requirement CP.

Sincerely,

[redacted]

新民黨
New People's Party

New People's Party's submission on The HKEX's Main Board Profit Requirement

Introduction

1. The New People's Party (NPP) is deeply concerned about the negative impact the HKEX's Main Board Profit Requirement proposals are likely to have on Hong Kong's economic development, especially growth opportunities for SMEs. For this reason, although the NPP is not a market participant, we decided to set out below our reservations.

Reasons for Our Objection

2. NPP fully understands that the present proposals are a continuation of the 2017 consultation on the Main Board Listing Eligibility Requirements and review of the Growth Enterprise Market (GEM). Following the 2017 consultation, the Market Capitalization Requirement was increased from HK$200 million to HK$500 million with effect from 15 February 2018.

3. We see little justification or market support for raising the Profit Requirement at this stage. The two Options floated by the HKEX - 150% increase to an aggregate profit of HK$125 million in three years under Option 1, or HK$150 million in three years under Option 2 - are excessive and would eliminate a lot of the SMES or small cap issuers from the local economy. The whole exercise seems to be driven by the HKEX's self-interest rather than a genuine desire to improve the quality or governance of the companies listed on the Main Board. The ability of a company to meet the HKEX's Profit Requirement at the time of listing is no guarantee that the company would continue to be profitable or well governed.

4. For bio tech companies going for listing, these can be pre-revenue (as well as pre-profit). When it comes to risk, large pre-revenue or pre-profit companies present significant risks to investors and they do not necessarily have better quality than small cap issuers. Out of the 26 listed biotech companies on HKEX, as at 30 November 2020, the share price of 12 was below their IPO price, with one having dropped nearly 80%. The above illustrates that small cap issuers should not be viewed as the chief culprit for harming shareholders' interests and banned from listing.

5. The HKEX's Profit Requirement proposals would make the Exchange's Profit Requirement the highest aggregate profit requirement for the three-year track record requirement of the Selected Overseas Main Markets, surpassing those of the New York Stock Exchange and the London Stock Exchange. The HKEX should be well aware that in Hong Kong's current tough business environment, few local companies would satisfy the proposed Profit Requirement, whether under Option 1 or 2. Does this mean that the HKEX has decided not to continue to service the local economy, and focus only on chasing the tech/biotech or e-commerce giants of Mainland China?

6. The proposed higher profit requirements will not only affect IPO applicants but also existing companies. A holding company that contemplates a spin-off of a subsidiary to unlock value would find it harder to do so. This would weaken our market effectiveness for value discovery and fund-raising.

7. Listed issuers which do not fulfill the ongoing listing requirements (on grounds of not maintaining a sufficient level of operations or assets) would have much greater difficulty in identifying businesses or assets profitable enough for a reverse takeover so as to re-comply with listing requirements, and would face delisting. Many such companies are long-listed companies experiencing a temporary business downturn. Denying them the chance to maintain their listing status would be grossly unfair to their shareholders.

8. We are particularly unhappy about a preoccupation which seems to run through the whole exercise - to focus on the listing of "New Economy" companies, such as the tech or biotech giants from Mainland China, and to close the door to the small cap issuers from the traditional local industries. This, in our opinion, is unconscionable, given that the HKEX is a public utility benefiting from a monopoly granted by the government. Like other public utilities which have been listed (notably the MTR Corporation Limited), the HKEX seems to have equated its institutional interest with the public interest, to the neglect of its primary public function of providing the pipeline or conduit for companies to grow through funds raised through public offerings.

9. Some of the so-called "New Economy" companies coming to Hong Kong are still incurring losses and may continue to incur losses after listing. They can list in Hong Kong because their market cap at the time of IPO is large enough, so if companies with losses can be

listed, why should we reject companies with profits? Further, we should be encouraging more start-ups to list in Hong Kong and enable them to have access to the capital market.

10. The HKEX's Profit Requirement proposals would be more acceptable if Hong Kong had two boards, one catering for 'Premium" large companies and another for small cap issuers. The GEM was supposed to perform the latter function. But with HKEX's gradual reform of the GEM commencing in 2008, it has become increasingly difficult and expensive for SMEs to list on the GEM. As for start-ups, these were rendered ineligible for listing with the introduction of the HK$20 million operating cash flow requirement for GEM listing applicants in 2008. This was further increased to HK$30 million in February 2018. As a result, Hong Kong does not provide a viable listing venue for the emerging companies for which it was originally intended to cater.

11. In recent years, the image of GEM has been much tarnished and GEM companies are labelled or perceived as potential shells or lacking investment value. As a result, the value of GEM as a listing platform has all but diminished. The removal of GEM as a stepping stone to the Main Board has further hindered investors' interest in GEM companies and applicants' interest to list on GEM. In 2020, there were only 8 newly listed companies on GEM, compared to 15 in 209 and 75 in 2018. The downtrend is irreversible. GEM now lacks the traction to attract companies and investors.

12. This situation is especially unsatisfactory given that both the Exchange and the GEM are owned by one company, whereas in New York, the NYSE and NASDAQ are owned by different companies. The consultation paper gives the impression that HKEX no longer wants the business of small companies, as it has become extremely profitable handling the listing of large cap giants from Mainland China.

13. We question the wisdom of the HKEX in putting all of its eggs in one basket by focusing on "New Economy" giants. HKEX might become collateral damage if these giants come under the sanctions of the US or other powerful economies. The HKEX should not abandon local SMEs, nor lose sight of potential business from the Greater Bay Area and the Belt and Road countries or from other parts of the Asia Pacific Region.

14. We note that one of the reasons for the proposed much enhanced Profit Requirements is to address problems posed by the listing of shell companies. But any malpractices arising from the listing of shell companies should be dealt with by the SFC though its enforcement actions, as it has done in regard to companies exposed by David Webb's "Enigma 50" companies. With the recent tougher requirements on Delisting and Backdoor Listing or Reverse Takeover restrictions, the sale of shell companies has, to a large extent, been penalized under these restrictions, The "shell" market has died down significantly. The solution should in any event not lie in the further tightening of listing rules for new applicants.

15. Despite HKEX's reservations about shell companies, we note that the NYSE allows Special Purpose Acquisition Companies (SPACs) to list, while the stock exchange of Singapore is reportedly planning to launch a consultation on SPACs shortly, with a view to becoming the first major exchange in Asia to allow SPACs to list. This would suggest that shell companies or SPACs do have some intrinsic value in meeting market demand.

16. The HKEX's Profit Requirement recommendations, if implemented, would sharply reduce the number of local companies eligible for listing. This would have a ripple effect on the business of sponsors, legal, accountancy and other professional firms as well as other related businesses. This negative chain reaction is the last thing we want when our economy is already struggling with a painful downturn.

Our Recommendations

17. Having regard to the industry feedback we have picked up and our assessment of the negative impact of the HKEX's Profit Requirement proposals, we recommend that:-

    A. As a first step, the Profit Requirement proposals should be put on hold. In addition, HKEX should undertake a holistic review of the market structure. The Profit Requirement of the Main Board can only be revised upward when there is a viable alternative for local SMES. GEM in its present degraded form is not a viable alternative listing platform for SMEs. HKEX should look into developing a genuine, tiered market structure to provide real solutions for SMEs wishing to access the stock market.

B. As the operator of the sole stock exchange, HKEX must fulfill its requisite duties of serving the public interest, particularly in regard to local businesses and practitioners.

C. We learned that in 2020, SPACs helped Wall Street achieve record underwriting fees. Thanks to a regulatory change, last year SPACs raised US$82B in the US, almost half of the US$167B raised in IPOs during that time. The considerations for allowing SPACs and RTOs in Hong Kong should be studied, in line with international practice.

D. More compulsory training should be given to individuals appointed as directors of listed companies. More INEDs should be appointed to the Board of Directors of listed companies. At the same time, a limit should be placed on the number of the boards of directors of listed companies an INED can be allowed to serve.

E. As part of its expedited delisting mechanism, the Stock Exchange should also review whether we can allow companies delisted from the Stock Exchange to continue to trade over-the-counter. This gives minority shareholders a last chance to trade themselves out of their positions and salvage any residual share value while majority shareholders explore company resurrection plans.

F. The transfer of regulatory functions to the SFC should be studied to avoid conflict of interests on the part of the HKEX. There is an inherent conflict of interest between HKEX's profit maximization objective as a listed company, a public utility and regulator. There should be segregation of duties as well as checks and balances for better protection of the public interest.

G. Main Board companies only have interim and final results reporting. However, the smaller GEM companies have to do quarterly reporting. We suggest that the interim and final reporting requirement should be applied to all listed companies.