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Hong Kong Exchanges and Clearing Limited
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Our Ref LTCL/CMAG

16 December 2022

Dear Sirs,

Re: Consultation Paper on Listing Regime for Specialist Technology Companies

KPMG welcomes the opportunity to respond to the Consultation Paper on Listing Regime for Specialist Technology Companies. Unless otherwise noted, terms used in our letter shall have the same meanings as those defined in the Consultation Paper.

We have considered the proposals in totality and we are in strong support of creating a new channel for Specialist Technology Companies to list in Hong Kong and the general direction the Exchange is heading with its proposals to achieve the objectives of its proposed Specialist Technology Regime.

In recent years, "hard-tech" sectors mentioned in the 14th Five-Year Plan (2021-2025) for National Economic and Social Development have gained strong momentum in both the Chinese Mainland and the US[1]. Companies from these national strategic emerging sectors, which are referred to as Specialist Technology Companies in the Consultation Paper, generally require heavy investment in R&D and have a longer product development cycle. Specialist Technology Companies that do not have a track record of revenue and/or profit are unable to raise capital under the existing listing regime in Hong Kong, which had resulted them in seeking listings on stock exchanges in other jurisdictions.

Hong Kong, as a premier global capital formation centre, will need to adapt to the latest market trends and attract listings from a more diverse range of companies, in particular high growth sectors like Specialist Technology Companies. On the other hand, the high quality of our capital market is the cornerstone of our success. We believe a balanced approach, which recognises the importance of a fair and efficient market for Hong Kong to stay competitive globally and, at the same time preserves the high regulatory standards to protect investors, should be adopted in developing the new listing regime for Specialist Technology Companies.

Under this premise, we have set out the following comments and suggestions to facilitate further discussion and development of the Specialist Technology Regime.

[1] FSDC Paper No.52 "Hong Kong as an International Financial Centre - Enhancement of Hong Kong's IPO offerings" (March 2022)

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Eligibility of listing – provide the Exchange the discretion to determine the listing eligibility on a qualitative basis when the quantitative assessment produces an anomalous result

On the whole, we are supportive to the proposals to introduce a number of pre-defined quantitative thresholds, such as the minimum market capitalisation and the minimum R&D investment, for evaluating the applicant's listing eligibility under the Specialist Technology Regime. These objective measures provide clarity to and reduce uncertainty for market participants and listing applicants. We also consider it is appropriate to impose more stringent requirements and additional safeguards for Pre-Commercial Companies due to their heightened risks.

While each quantitative threshold has its own objective, in some situations, anomalous results may be produced when all these thresholds are put together for the eligibility assessment. An example would be an applicant that has already reached the Commercialisation Revenue Threshold during the latest audited interim period but that would still be categorised as a Pre-Commercial Company simply because it has marginally missed on the required revenue level in the most recent audited financial year.

In view of the above, we recommend the Exchange should exercise discretion to disregard a quantitative threshold when it produces an anomalous result to the listing eligibility assessment and grant exemption to applicants on a case-by-case basis. The Exchange may provide examples of situations where exemptions may be granted in a guidance letter.

Minimum market capitalisation for Pre-Commercial Companies – a lower threshold may be preferable as the current proposal would exclude a considerable number of targeted companies

With the regulatory concerns over valuation and viability of products and services of Specialist Technology Companies, we consider the proposal of referencing the valuation of a "unicorn" (i.e. valuation greater than US$1 billion) by setting a minimum market capitalisation requirement of HK$8 billion at listing for Commercial Companies to be reasonable.

We agree that Pre-Commercial Companies are subject to higher risk and uncertainty and therefore an uplift of the minimum market capitalisation requirements is justifiable. Nevertheless, the proposed minimum market capitalisation of HK$15 billion at listing would likely be a high hurdle for many Pre-Commercial Companies, which may limit the number of applicants that utilise the new listing chapter.

We have benchmarked against the listings of Biotech Companies under Chapter 18A from the launch date of the regime up to November 2022. Of the 53 issuers, 13 issuers (25%) and 24 issuers (45%) had a market capitalisation at listing of over HK$15 billion and HK$8 billion-HK$15 billion respectively. Among those with market capitalisation of HK$8 billion-HK$15 billion, only one of them can meet the Commercialisation Revenue Threshold at listing. While it is understood that Biotech Companies are not directly comparable with Specialist Technology Companies, the above data indicate that a significant number of companies may have been missed out if they had been put under this proposed regime due to insufficient market capitalisation.

With the objective of enhancing the competitiveness and promoting diversification of the Hong Kong capital market, the Exchange may consider a lower threshold of between HK$8 billion to HK$15 billion (e.g. HK$12 billion) to make the regime more attractive and inclusive.

Minimum R&D investment for Pre-Commercial Companies – introduce a tiered threshold approach based on annual revenue

We support the proposal to impose a minimum R&D investment requirement on the applicant during the track record period to align with the policy objective to facilitate the listing of Specialist Technology Companies that are heavily involved in R&D activities. We also agree that a higher minimum R&D ratio should be applied to Pre-Commercial Companies recognising the fact that early-stage companies should exhibit higher proportion of R&D activities than more mature companies.

While 50% does not seem to be an unreasonable threshold for companies with no revenue to demonstrate that they are primarily engaged in R&D activities, it could be an onerous burden on certain Pre-Commercial Companies that have started generating revenue during the track record period.

When Pre-Commercial Companies commence production and sales activities, more operating expenditures would be incurred, which would then drive down the R&D ratio -- assuming the R&D investment remains at a similar level in absolute terms. It would be increasingly difficult for a Pre-Commercial Company to meet the 50% threshold when it generates more revenue during the track record period until it reaches the Commercialisation Revenue Threshold, in which case it will turn into a Commercial Company subject to a much lower threshold of 15%.

We believe that the above situation is not the intended outcome of the minimum R&D investment requirement. Instead of imposing a single 50% threshold for all Pre-Commercial Companies, we recommend the Exchange to consider introducing a tiered threshold approach based on the annual revenue achieved by the Pre-Commercial Companies in individual years during the track record period. For example, the minimum R&D ratio may be set at 50%, 35% and 25% for annual revenue of less than HK$50 million, HK$50 million-HK$150 million, and HK$150 million-HK$250 million, respectively.

In addition, we suggest that the Exchange allows expenses that are one-off in nature or not incurred in the ordinary and usual course of the applicant's business (e.g. listing expense) to be excluded from the total operating expenditure for the purpose of R&D ratio calculation, similar to the approach towards Profit Test.

Conclusion

We are in full support of the Exchange's continuous efforts to evaluate the listing framework with reference to the latest market trends and developments. The various initiatives that have been launched have been instrumental in enhancing the competitiveness and status of Hong Kong as an international financial centre. We believe the proposed reform for Specialist Technology Companies is travelling in the right direction and could copy the success of the 2018 Listing Reforms for innovative and emerging companies.

We look forward to seeing the conclusion in relation to the Consultation Paper on Listing Regime for Specialist Technology Companies. Should the Exchange wish to discuss any of our comments and suggestions, please do not hesitate to contact [redacted]

Yours faithfully

[redacted]