

**Response to the  
Consultation Paper on the  
Growth Enterprise Market**

**CCIF CPA Limited  
31 October 2007**

## Response to Consultation Questions

**Q1(a) Positive operating cash flow from operating activities of HK\$20 million in aggregate for the latest two financial years?**

**Q1(c) Market capitalization of at least HK\$100 million?**

The initial listing requirements for GEM should be less restrictive than that of the MB in order to provide a platform for companies that cannot meet the criteria for listing on the MB, including quality growth companies which have achieved a certain scale of operations, to gain access to public capital. At the same time, it should be elevated from the existing requirements to raise the quality and image of GEM, with the ultimate goal to reposition GEM as the second board.

The proposed \$20 million operating cashflow requirement for GEM applicants is a new quantitative admission requirement on financial performance. It is obviously less stringent than the profits requirement, in particular for companies with relatively high tax payment and significant non-cash expenses. It is also less stringent than the \$100 million cashflow requirement for Main Board ("MB") applicants which choose to apply Rule 8.05(2) of the MB Listing Rules.

On the other hand, the proposed market capitalization of at least \$100 million represents a more than 100% increase from the existing \$46 million requirement (for GEM applicants with a 24 month active business pursuit) and is half of the market capitalization requirement of \$200 million for MB applicants.

According to available public information, 232 companies have been successfully listed on GEM during the period from 1999 to 2006. Out of these 232 companies, 192 remained listed on GEM as at early October 2007, 17 have already migrated to MB while the remaining 23 have either been delisted or privatised.

The HKEx used the 6 GEM successful applicants in 2006 to test the reasonableness of the \$20 million operating cashflow requirement. Apparently, no similar analysis was performed for the proposed market capitalization requirement.

We do concur that using the 2006 statistics is meaningful as it reflects the most current situation. However, there were only 6 successful applicants in 2006. As such, the findings derived thereon may not be representative. In addition, based on a 1 year statistics, we are unable to identify the trend, if any, established over a period of time.

In light of this, we have performed an analysis on the 192 existing GEM issuers, which were granted the listing status during the period from 1999 to 2006, as to how well they would be able to comply with these 2 proposed requirements had these requirements been in place at the time.

Based on our analysis, it appears that approximately 56 of them, representing 29% of the 192 existing listed issuers, would probably have met both requirements had these requirements been in place at the time. If we look at these 56 listed issuers by year of listing, we noticed that successful applicants in recent years would probably be more able to meet these requirements. While only 16% of the successful applicants in 2002 would probably have met both requirements, the % has escalated to 42% for both 2003 and 2004, reaching the level of 56% for 2005 and a record high of 83% for 2006. This is probably due to the fact that the market has over the years gradually adjusted itself to a higher entry level than that imposed by the HKEx. GEM applicants in recent years are more sizeable and with stronger financial performance than in the old days.

Based on this finding and bearing in mind that the overall objective is to reposition GEM as a stepping stone to MB, we consider the 2 proposed requirements appropriate and reasonable.

## Response to Consultation Questions

### **Q1(b) The latest two financial years under substantially the same management?**

Under the existing GEM Listing Rules, a new applicant must demonstrate that it has actively pursued one focus line of business under substantially the same management and ownership for a period of at least 24 months immediately preceding the date of listing application (the “active business pursuit”). The 24 month period may be reduced to 12 months where the applicant is able to satisfy certain conditions as spelt out in the GEM listing rules.

On the other hand, there is no such “one focus line of business” requirement for MB issuers, although, in practice, the issuer must have a core business.

We understand that the proposed deletion of the “one focus line of business” requirement is replaced by the following proposed requirements:

- i) “the latest two financial years under substantially the same management” requirement; and
- ii) ownership continuity and control for the most recent financial year. (See response to Q1e.)

As such, the revised requirement does not only bring GEM in line with the MB but also allow more flexibility and is more attractive to potential GEM applicants. We have no objection to the proposed change.

### **Q1(d) Public float of at least HK\$30 million and 25% (or 15%-25% if the issuer has a market capitalization of more than HK\$10 billion)?**

We concur that a minimum public float has to be maintained at all times in order to ensure and maintain an open market in the listed securities.

From hitherto to now, GEM issuers have been subject to less stringent minimum public float requirement than MB issuers. The proposed revised minimum public float will affect potential GEM issuers with market capitalization in excess of \$4,000 million and not more than HK\$10 billion, as under the current requirement they are subject to a minimum public float at the higher of 20% and \$1,000 million (i.e. with effective minimum public float of 20% to 24.99%) while the proposed minimum public float for these GEM issuers is 25%. (For the impact on existing GEM issuers, please refer to response to Q5).

In order to ensure and maintain an open market for both the MB and GEM, we consider it reasonable and appropriate to impose the same minimum public float % for both boards.

At the same time, in order to bring in line the same minimum public float requirement for the two boards, we suggest that the requirement of a minimum value of HK\$30 million of public float be deleted.

### **Q1(e) Ownership continuity and control for the most recent financial year?**

This is in fact a modification of the 24 months active business pursuit requirement under the existing GEM Listing Rules in order to bring GEM in line with the existing MB requirement. As such, we have no objection to the proposed change. (Also see response to Q1(b).)

## Response to Consultation Questions

### **Q1(f) A minimum of 100 public shareholders?**

A minimum of 100 public shareholders is an existing requirement for GEM issuers with a 24 month active business pursuit. While the requirement of having a minimum of 300 shareholders for GEM issuers with a 12 month active business pursuit will be deleted, the proposed additional criteria of not more than 50% of the securities in public hands at the time of listing can be beneficially owned by the three largest public shareholders is in line with the existing MB requirement. As such, we have no objection to the proposed change.

### **Q1(g) Retaining the present free choice on offering mechanism and underwriting?**

Under the existing MB Listing Rules, a new applicant may not list by way of a placing if there is likely to be significant public demand for its securities.

Consideration should perhaps be given to extend this requirement to GEM applicants to bring GEM in line with MB.

### **Q1(h) Retaining the requirement for a sponsor?**

Agreed. Under the prevailing Listing Rules, MB and GEM, a new applicant must appoint a sponsor to assist it with its initial application for listing.

A sponsor plays a very important role during the listing process. A sponsor does not only have to use reasonable endeavors to address all matters raised by the HKEx in connection with the listing application in a timely manner, but also have to ensure, among other things, all information provided to the HKEx during the listing application process is true in all material respects and does not omit any material information. Furthermore, a sponsor has to conduct due diligence inquiries to put itself in a position to be able to make the declaration referred to GEM Rule 6A.13. As such, it is of utmost importance to retain the requirement for a sponsor.

### **Q1(i) Reporting on achievement of business objectives in first two annual reports after listing?**

Under the prevailing Listing Rules requirement, GEM issuers are required following their first admission to listing on GEM to disclose in their annual accounts and half-year report for the first 2 financial years after listing a detailed statement by the directors as to the company's progress by comparison of actual business progress to the information provided in the statement of business objectives together with an explanation of any material differences.

The proposed improvement to require the GEM issuers to report in their first two annual reports after listing on the achievement of its plan objectives is considered most appropriate, as shareholders and potential investors would be able to invest on a more informed basis.

Along this line, consideration should perhaps be given to extend the proposed reporting to cover half-year reports during the first 2 financial years after listing.

### **Q1(j) Keeping the requirement for GEM issuers to retain a compliance adviser (until after the dispatch of the annual report for the second full financial year after listing)?**

Under the existing GEM Listing Rules, a GEM listed issuer is required to appoint a Compliance Adviser for the period commencing on the date of initial listing of its securities and ending on the date on which the listed issuer send to its members the company's annual report for the second full financial year after listing. In the case of a MB listed issuer, the appointment of a Compliance Adviser is required until after the dispatch of the annual report for the first full financial year commencing after listing.

## Response to Consultation Questions

The Compliance Adviser is responsible to provide guidance and advisory service with due care and skill to the listed issuer on a timely basis in circumstances as specified in Rule 6A.23 of the GEM Listing Rules, including circumstances involving the publication of any regulatory announcement, circular or financial report. Compliance adviser also help ensure compliance with the applicable listing rules, codes and guidelines. As such, we consider it necessary to retain this requirement.

GEM companies have hitherto been growth enterprises, the term of appointment of the compliance adviser for 2 full financial years after listing is considered appropriate. However, with the proposed introduction of certain core requirement and the enhanced continuing obligations upon the proposed repositioning of GEM, the quality of potential GEM applicants will be more established. In light of this, we consider the term of appointment of a Compliance Adviser should be reduced to the first full financial year to bring it in line with the MB.

**Q1(k) Reduction of the bar on fundamental changes in business activity by one year, ie from two years after listing to one year?**

Agreed. GEM companies should be allowed the same flexibility as MB issuers to decide on the continuance or change(s) in business activities upon expiry of the one year period after listing.

**Q2. Do you agree that GEM listing applications should be approved by the Listing Division on its own, without the involvement of the Listing Committee?**

The Board of Directors of the HKEx has arranged for all of its powers and functions in respect of all listing matters in relation to MB and GEM to be discharged by the Listing Committee and the GEM Listing Committee respectively.

On the other hand, the Listing Committee and the GEM Listing Committee have arranged for certain of their powers and functions to be discharged by the Listing Division and the Chief Executive of the HKEx. (With effect from May 2003, the two Listing Committees were reformed with a common membership, the "Listing Committee").

We understand that the Listing Committee has so far reserved the power to approve all applications for listing from a new applicant. The Listing Division is responsible to process the application, but approval rests with the Listing Committee. This mode of arrangement has been long established.

We consider the current arrangement appropriate as there is clear segregation of duties, with listing applications being processed by the Listing Division and approval rests with an independent Committee consisting of members who are professionals with expertises from a large variety of business sectors, including, among others, the investment banking sector, the auditing and advisory sector, the legal sector and etc.

The Chairman and Deputy Chairmen are nominated by the Listing Nominating Committee and appointed by the Board of Directors of the HKEx (the "Board"). On the other hand, members of the Listing Committee are appointed by the Board. As such, approval process has been in the safe hands of the Listing Committee whose decisions are most objective, impartial and conclusive.

Over the past years, GEM applications have been handled by the GEM Listing Committee and latterly the Listing Committee effectively and on a timely basis. We do not see a need to change the existing arrangement upon the repositioning of GEM as a stepping stone to the MB.

## Response to Consultation Questions

### Q3. Do you have any suggestions on further streamlining the new admission process for GEM?

The admission process for GEM has hitherto been in line with the MB.

We consider that under the current admission process, listing applications have been dealt with effectively and on a timely basis. To quote an example, in the past, IPO applications had to be reported back to the Listing Committee upon completion of vetting of the additional information for the stub period. It has come to our notice that this requirement is no longer required if there is no unusual / abnormal matters that require the attention of the Listing Committee.

### Q4. Do you agree with the proposed revised continuing obligations of GEM?

<b>Proposed enhanced continuing obligations for GEM</b>			
<b>Existing Main Board</b>	<b>Existing GEM</b>	<b>Proposed GEM</b>	<b>Our response</b>
<ul style="list-style-type: none"> <li>■ Annual results (within 4 months), half-yearly results (within 3 months)</li> <li>■ Disclose in newspapers (to be abolished and HKEx website)</li> </ul>	<ul style="list-style-type: none"> <li>■ Annual results (within 3 months), half-yearly and quarterly results (within 45 days)</li> <li>■ Disclose via GEM website</li> </ul>	<ul style="list-style-type: none"> <li>■ (As for existing GEM)</li> </ul>	<ul style="list-style-type: none"> <li>■ The reporting requirement and deadlines for MB should be revised to bring MB in line with GEM and with international practice, thus enabling shareholders and potential investors to make investment decisions on an informed and timely basis.</li> </ul>
<b>Other major information disclosure</b>			
<ul style="list-style-type: none"> <li>■ Disclose price-sensitive information, connected transactions and notifiable transactions</li> <li>■ Respond to unusual price movements or trading volume</li> </ul>		<ul style="list-style-type: none"> <li>■ (Unchanged)</li> </ul>	<ul style="list-style-type: none"> <li>■ Agreed</li> </ul>
<b>Other corporate governance requirements</b>			
<ul style="list-style-type: none"> <li>■ 3 independent non-executive directors; at least 1 has financial expertise</li> <li>■ An audit committee at least 3 non-executive directors, 1 with financial expertise</li> <li>■ Full-time qualified accountant</li> <li>■ Company secretary</li> <li>■ Pre-emptive rights</li> <li>■ Compliance with corporate governance code provisions, reasons for non-compliance</li> <li>■ Compliance with the model code on directors' dealings</li> </ul>		<ul style="list-style-type: none"> <li>■ (Unchanged)</li> </ul>	<ul style="list-style-type: none"> <li>■ Agreed</li> </ul>
<ul style="list-style-type: none"> <li>■ (No compliance officer)</li> </ul>	<ul style="list-style-type: none"> <li>■ One ED must be compliance officer</li> </ul>	<ul style="list-style-type: none"> <li>■ (As for existing GEM)</li> </ul>	<ul style="list-style-type: none"> <li>■ Agreed</li> </ul>

## Response to Consultation Questions

### Q4. Do you agree with the proposed revised continuing obligations of GEM? (cont'd)

<b>Proposed enhanced continuing obligations for GEM (cont'd)</b>			
<b>Existing Main Board</b>	<b>Existing GEM</b>	<b>Proposed GEM</b>	<b>Our response</b>
<b>Minimum public float</b>			
<ul style="list-style-type: none"> <li>■ 25% of total issued share capital, or 15%-25% of total issued share capital for MC &gt; HK\$10b</li> </ul>	<ul style="list-style-type: none"> <li>■ MC ≤ HK\$4b: 25%</li> <li>■ MC &gt; HK\$4b: higher of HK\$1b and 20%</li> </ul> <p>For companies listed before 1/10/2001:</p> <ul style="list-style-type: none"> <li>■ MC ≤ HK\$1b: 20%</li> <li>■ MC &gt; HK\$1b and ≤ HK\$1.333b: HK\$200m</li> <li>■ MC &gt; HK\$1.333b: 15%</li> </ul>	<ul style="list-style-type: none"> <li>■ (As for Main Board)</li> </ul>	<ul style="list-style-type: none"> <li>■ See response to Q1(d)</li> </ul>
<b>Sponsor/adviser</b>			
<ul style="list-style-type: none"> <li>■ Appoint a compliance adviser till dispatch of annual report in respect of first year after listing</li> </ul>	<ul style="list-style-type: none"> <li>■ Appoint compliance adviser till dispatch of annual report in respect of second year after listing</li> </ul>	<ul style="list-style-type: none"> <li>■ (As for existing GEM)</li> </ul>	<ul style="list-style-type: none"> <li>■ The regulatory regime of GEM should be no more onerous than the MB. With the repositioning of GEM as a stepping stone to the MB, GEM companies will be more established upon the introduction of certain core requirement and the enhanced continuing obligations. Accordingly, the term of appointment of the compliance adviser should be reduced to bring it in line with the MB.</li> </ul>

## Response to Consultation Questions

### Q4. Do you agree with the proposed revised continuing obligations of GEM? (cont'd)

<b>Proposed enhanced continuing obligations for GEM (cont'd)</b>			
<b>Existing Main Board</b>	<b>Existing GEM</b>	<b>Proposed GEM</b>	<b>Our response</b>
<b>Business activity</b>			
<ul style="list-style-type: none"> <li>■ No fundamental change in principal business activities within 1 year after listing, unless with SEHK waiver and independent shareholders' prior approval</li> <li>■ Comply with spin-off requirement of separate listing of assets/businesses of the existing group</li> </ul>	<ul style="list-style-type: none"> <li>■ No fundamental change in principal business activity for 2 years after listing, unless with SEHK waiver and independent shareholders' prior approval</li> </ul>	<ul style="list-style-type: none"> <li>■ (As for Main Board)</li> </ul>	<ul style="list-style-type: none"> <li>■ Agreed, GEM issuers should be allowed the same flexibility as MB issuers to decide on the continuance or change(s) in business activities upon expiry of the one year period after listing.</li> </ul>
<b>Sufficiency of operations</b>			
<ul style="list-style-type: none"> <li>■ Sufficient operations or tangible assets, intangible assets</li> </ul>	<ul style="list-style-type: none"> <li>■ Sufficient operations</li> </ul>	<ul style="list-style-type: none"> <li>■ (As for Main Board)</li> </ul>	<ul style="list-style-type: none"> <li>■ Agreed</li> </ul>
<b>Vetting announcements</b>			
<ul style="list-style-type: none"> <li>■ Pre-vetting of certain types of announcement is required under the Listing Rules</li> </ul>		<ul style="list-style-type: none"> <li>■ (Unchanged)</li> </ul>	<ul style="list-style-type: none"> <li>■ Agreed. Where there are changes to the types of announcement that are subject to pre-vetting, listed issuers and their compliance advisers to be informed on a timely basis.</li> </ul>



## Response to Consultation Questions

**Q5. Do you agree that existing GEM issuers should be required to comply with the proposed revised continuing obligations (except the public float requirement) immediately? Is the proposed three-year “grace period” for complying with the public float requirement appropriate?**

**I. Proposed revised continuing obligations (except the public float requirement)**

The changes brought about by the proposed enhanced continuing obligations for GEM issuers are relatively minor. Save for the public float requirement, the proposed continuing obligations are either the same as or revised from the existing obligations in order to bring GEM in line with the MB.

We consider it fair and equitable for existing GEM issuers to comply with the proposed enhanced continuing obligations with immediate effect and that a “grace period” be given in the case of the public float requirement.

**II. The public float requirement**

To increase the minimum public float of GEM issuers to the proposed level which is to a large extent in line with the MB would create pressure on the following 2 categories of existing GEM issuers:

- i) those listed after 1.10.2001 with market capitalization over \$4,000 million, as they are currently subject to minimum public float at the higher of 20% and \$1,000 million (i.e. with effective public float of 20% to 24.99%); and
- ii) those listed before 1.10.2001, as they are currently subject to minimum public float of 20% / \$200 million / 15% (i.e. with effective public float of 15% to 20%), depending on the size of market capitalization.

Based on a rough estimate based on available public information disclosing market capitalization (as of early October 2007) of the 192 existing GEM issuers, it appears that there are probably not less than 70 GEM issuers which belong to either category (i) or category (ii).

Based on our understanding, it is not an easy task to restore public float. However, in the absence of the existing exact public float % of each of these GEM issuers, their detailed shareholding structures and the possible alternatives available to them to increase their public floats, it is difficult for us to comment on whether a three year “grace period” is sufficient.

In light of this, we consider it fair and equitable for the HKEx to implement a mechanism to deal on a case by case basis with the existing GEM issuers which after their best endeavours are unable to increase the public float to the proposed level after the expiry of the “grace period”.

**Q 6. Transfer from GEM to Main Board**

**(a) Do you agree with the following criteria for transfer of listing from GEM to the Main Board (i) meeting Main Board admission requirements; (ii) listing status on GEM for two years; (iii) no material rule breaches for the preceding years?**

The need to fulfill criteria (i) & (iii) is self-explanatory and does not need any elaboration. However, we do not see the need to be listed on GEM for two years as part of the condition to be transferred to the MB.

## Response to Consultation Questions

### Q6. Transfer from GEM to Main Board (cont'd)

- (b) Do you agree that the process for transfer of qualified companies from GEM to the Main Board should be streamlined?**

We consider that under the current transfer process, transfer applications have been dealt with effectively and on a timely basis.

- (c) Do you agree that the process of transfer should be treated as an announcement by the issuer, to be prevetted and approved by SEHK's listing Committee?**

Absolutely. It is fundamental and essential that all transfers be prevetted by the Listing Division and approved by the Listing Committee. The announcements by the GEM issuer in relation to the transfer help ensure existing shareholders and potential investors be informed on a timely basis and thus be able to make investment decisions on an informed basis.

- (d) Should HKEx require confirmation by a licensed financial adviser of the company's compliance with Main Board admission requirements (such as shareholder spread) where such compliance is not evident from already-published information? Or should HKEx seek to rely directly upon assurances of the directors?**

We believe that information provided by the company which is a listed issuer is accurate and up to date. At the same time, assurance from the company's directors is absolutely reliable. However, as a matter of prudence, information which is not available public information should be subject to independent confirmation by another party. In this connection, a licensed financial adviser is considered the most suitable and appropriate party to provide such confirmation.

- (e) Do you have any other suggestions in respect of the transfer process?**

No other specific suggestions.

### Q7. Do you agree that the Main Board and GEM Listing Rules should eventually be merged into a single rule book?

Absolutely. We understand that the GEM Listing Rules basically follows that of the MB. The suggestion to merge the two sets of rules is considered most useful and appropriate from the user's perspective.

### Q8. Do you have any other comments or suggestions on the further development of GEM as a second board?

No other specific suggestions.