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 opposed to the proposed increases in the Profit Requirement.

The Exchange has the obligation to provide capital market access

The Exchange operates a monopoly on the operation of capital markets in Hong Kong and has an obligation to service all companies which meet the listing requirements to access the stock market through an IPO. Therefore, the aggregate market capitalization at the time of listing of all Ineligible Applications representing a small percentage of the aggregate market capitalization of Main Board Issuers should not form part of any consideration or analysis in supporting a revision of the Profit Requirement.

Large collateral damage to genuine SME listing candidates amidst dwindling shell manufacturing

The Rules and guidelines of the Exchange governing reverse takeover have been tightened tremendously and have substantially negatively affected the value of a shell company and the value proposition of manufacturing potential shell companies. As stated in the Consultation, the Exchange has adopted a heightened vetting approach and heavily scrutinizes the commercial rationale for listing and the reasonableness of P/E ratios of Small Cap Issuers. This approach has also significantly increased the difficulty in successfully manufacturing a shell company. Accordingly, the proportion of Small Cap Issuers which genuinely seek a listing to raise funds for the development of their underlying business, and which successfully obtained listing approvals, is now much larger than those (if any) manufacturing a shell company. Hence, given the current rules and regulations in place to crack down the manufacture of shell companies, the increase of the Profit Requirement to further curb a dwindling number of shell companies manufacturers while denying a larger group of genuine listing candidates market accessibility is not justified.

The Exchange should not neglect SMEs and smaller tech and other innovative companies which play a significant role in the economies of Hong Kong and mainland China. As indicated in the Consultation Paper, Option 1 and Option 2 would have disqualified from listing 59% (437) and 65% (486), respectively, of companies applying for listing under the Profit Requirement between 2016 and 2019. The proposals will effectively close the Main Board to Hong Kong and Chinese SMEs. Denying these SMEs access to the Exchange as a fund-raising platform is ill-advised, both from Hong Kong's own perspective and that of China, given that Hong Kong is tasked with playing an important fund-raising role for enterprises in the Greater Bay Area.

<u>GEM is not an alternative</u>

That GEM does not provide a viable alternative market is apparent in the declining numbers of companies listing on GEM each year. For the GEM market to be developed as a viable alternative for smaller companies, its listing process and procedures will require a radical overhaul.

<u>Impact on the corporate finance community</u>

The implementation of the proposals in their present form is likely to needlessly close the Hong Kong market to many smaller Hong Kong and China-based businesses. This not only adversely affects these potential issuers but also the local legal practices, accounting firms and financial advisers who act for them, and to the extent fewer issues take place, it will adversely affect others such as printers, translators, caterers and hotels. This will have far-reaching societal effects and a significant impact on the corporate finance industry in Hong Kong.

<u>Negative impact on currently listed companies</u>

The Exchange's policy of delisting companies which fail to lift the suspension of trading in their shares within eighteen months (twelve months for GEM) and the treatment of companies whose accounts are qualified or disclaimed has already greatly increased the risks of investing in smaller listed companies, which is likely to be reflected in the volatility of their share prices. The imposition of much higher profit requirements is also likely to influence how the sufficiency of operations are to be assessed under Listing Rule 13.24 in the future. This too is likely to affect the valuations of such companies and the volatility of their traded share prices, particularly if they start to operate at a loss.

<u>Proposal</u>

The Exchange's proposals for the Main Board cannot be considered in isolation and must be looked at in conjunction with their implications for the companies they will exclude from the Main Board. We propose a holistic review and radical reorganisation of the Exchange's markets with a view to ensuring that the Exchange provides a comprehensive and diversified market capable of listing Hong Kong and overseas issuers whatever their size. Potential reforms to achieve this should repositioning GEM as an attractive SME board open to start-up and growth companies whatever their jurisdiction of incorporation.

If there is to be an increase in the profit requirement, we suggest increasing the final year's requirement to no more than HK$30-35 million and the aggregate requirement for years 1 and 2 to between HK$40 and HK$50 million.

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.

Reposition GEM

We suggest a rejuvenation of GEM including:

- Reposition GEM as a second board for small and/or growth stocks, similar to NASDAQ when it was formed, to attract such companies in the Greater Bay Area and the region to list;

- Simplifying the listing requirements so as to make listing more efficient and less costly. This should focus in particular on avoiding the uncertainty surrounding the issue of "suitability", the interpretation of which has become highly subjective;

- Removing quarterly reporting which is expensive and time-consuming. It is anomalous to have a higher obligation than for the Main Board, especially in view of the obligation to release price sensitive information promptly and continuously. Quarterly reporting also increases the black-out period for connected shareholders, bringing the restriction on dealing for such shareholders, often an important source of liquidity to 5 months in the year;

- Replacing the positive operating cashflow requirement with a minimum profit requirement (say HK$5 to 10 million, and two years of profitability with aggregate profit of HK$8 to 15 million). For small and/or developing companies, or even a mid-size company that meets the current Profit Requirement, operating cashflow may be tight because of the need to reinvest or to support the growth of the business. It is difficult to generate the magnitude of positive operating cashflow to meet the current cashflow condition. A profit requirement coupled with the requirement for a longer business history may be more suitable in defining the small to midsize companies that the second board would want to target; and

- Restoring the "light touch" means of "promotion" to the Main Board. Companies which are able to meet the Main Board's financial tests should not need to issue a further prospectus.

Rationale for listing

Guidance Letter 68-13A should be revisited. There are many perfectly valid reasons to list apart from raising new funds to finance the expansion of a business like the need for a capital raising platform, enhance access to loans and debts, enhance corporate governance, enhance corporate reputation, and succession planning. Despite previously acknowledging owners' desire to realise their investment as a legitimate reason for listing, the Exchange now effectively discourages offers for sale when they are specifically permitted under the Listing Rules. This has the effect of forcing all new issuers to raise new equity funds through the initial public offer process, whether they need them or not. We do not consider that potential issuers should be effectively prevented from being listed through an offer for sale of existing shares only and ask that the Exchange reconsider its policy in this regard.

Revise market capitalization requirement

Market capitalization should not be used as a yardstick to measure quality. Market capitalisation is subject to industry and market conditions. One cannot say that a company which has a higher market capitalization because it is in a higher P/E industry sector has better quality than a company with a higher profit but lower market capitalization because it is in a low P/E industry sector. A minimum market capitalisation of HK$500 million may preclude many companies from listing during a poor market. We consider that reducing the minimum market capitalisation is one of the solutions to the perceived problem of valuation inflation.

<u>Open up the Stock Connect</u>

Overseas and institutional investors have been contributing to an increasing share of the Hong Kong stock market. Arguably these are not fans of small to midsize listed companies, and liquidity of small and midsize companies rely to a larger extent on local retail investors. Local retail investors only account for 13.6% of the cash market in 2019, dropping from 15.8% in 2016 though rebounded from 10.3% in 2018. As companies with PRC businesses account for a large portion of the listed companies on the Exchange, PRC retail investors could be considered as local retail investors for the purpose of Hong Kong. Opening up the Stock Connect to more, if not all, Hong Kong listed companies should increase the liquidity for small and midsize companies significantly. This should also further enhance the Exchange's overall liquidity, as well as strengthen it's position against the Shanghai and Shenzhen stock exchanges.

<u>Number of placees</u>

The Exchange should revisit the minimum number of placees under the Placing Guideline in Appendix 6 to the Rules. 100 placees is difficult to obtain in midsize transactions let alone smaller issuances. We suggest revising the number down coupled with a higher minimum public offer portion to ensure fair market distribution and avoid over concentration of shares upon an IPO.

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.

Covid-19 pandemic is incomparable to the global economic crisis of 2007 to 2008, it has a far more widespread and devastating impact that has yet to see a turnaround. Worldwide governmental measures of social distancing, mandatory restriction of opening hours and capacity utilization, city lock downs, travel bans, have severely affected companies and staff in many industries like retail, catering, tourism, air transportation and hospitality. The economic relief adopted by governments are for survival of companies and their staff rather than to boost economic revival. The Exchange should consider granting temporary relief of the existing Profit Requirement let alone increasing it. The Exchange should also consider granting further relief to companies under suspension or considered to have insufficient operations to submit resumption/continuing listing proposals.

If the Exchange ultimately proceeds with its proposals (or revised proposals to raise the financial eligibility criteria), we would support granting temporary relief.

However, we believe that the relief arrangements should not simply be confined to the effects of the pandemic during 2020. The difficulties caused by the coronavirus pandemic are expected to continue into 2021 and potentially beyond.

With regard to the proposed transitional arrangements set out in Chapter 3 of the Consultation Paper, we advocate a three-year transitional period – the same as the transitional period allowed for the transfer of GEM companies to the Main Board following the February 2018 Listing Rule amendments. This would provide relief for companies which at the date of the Consultation Paper were making preparations to list on the Main Board within the next few years.

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 Aggregate Profit Threshold condition requires companies to be able to beat the proposed Profit Requirement and is therefore a more stringent measure as opposed to a relief. We further consider that the profit requirements should remain unchanged until the economy has recovered from the pandemic and disagrees with the proposed condition under paragraph 55(a).

The proposed temporary relief measures will require potential issuers to show that they generated a positive cashflow during 2020 (paragraph 55(b)). This would appear to exclude automatically potential issuers from the hardest hit sectors such as airlines, cruise lines, hotels, restaurants, cinemas, casinos and the entertainment sector generally.

Disclosure conditions set out in paragraph 55e(i) and (ii) are ambiguous as the impact is not economical or manmade but an act of nature and governmental intervention. We do not understand how a listing applicant can satisfactorily disclose the likelihood of the event happening again and the mitigating measures that can be put in place.

Given that the pandemic’s impact is extending into 2021, paragraph (d) should be revised to refer to six months of the track record period falling within 2021 rather than 2020.

We disagree with the proposal to require a profit forecast to be included in the listing document (paragraph 55(e)(iii)) which will need to be reported on by the company’s auditors and subject to a sponsor confirmation as required by the Listing Rules.

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