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 do not agree with the proposal to increase the Profit Requirement by either Option 1 (150%) to HK$125 million or Option 2 (200%) to HK$150 million for the reasons set out below.

Excluding smaller companies from listing on the Main Board and limiting their business development

Following the introduction of new chapters to the listing rules in 2018, the Exchange has in recent years tried to attract companies from overseas (including the Mainland China) and companies engaging in different industries, in particular biotech companies and new economy companies, to list in Hong Kong. We welcome the agenda of attracting potential listing applicants with diverse backgrounds. At the same time, we consider that the opportunities for smaller companies engaging in other industries in Hong Kong, Asia and other regions to list on the Main Board and to raise capital in Hong Kong for their business development should not be deprived of.

Some of the smaller companies are not classified as biotech companies and/or new economy companies and cannot benefit from the new regime introduced by the Exchange in 2018. It should be recognised that many of them also play an important role in their respective industries and jurisdictions, engaging in core industries and making contributions to the economic development in Hong Kong, Asia and other regions. They also have a genuine need to raise capital to expand their business or enhance their profile and/or liquidity which could be achieved through listing on the Main Board. We note the Exchange's regulatory concern as to the creation of potential shell companies. It is respectfully submitted that depriving all smaller companies of the opportunity to list on the Main Board to avoid their becoming of potential shell companies would not be in the interest of the smaller companies with genuine needs for listing, and also the public investors who intend to diversify their investment through investing in Main Board-listed companies of different sizes and from different industries.

Companies in Hong Kong have been facing many challenges to survive in the market, such as the social movement in Hong Kong commenced in 2019, the outbreak of COVID-19 since late 2019 and the intense relations between China and the U.S. It is believed that, the Exchange, as the sole operator of stock market in Hong Kong, should take the role of supporting and facilitating the growth of companies in Hong Kong, in particular the small and medium-sized companies in Hong Kong. Increasing the current Profit Requirement significantly would inevitably exclude this group of companies from listing on the Main Board and limit their business development, which in turn, would not be in the interest of Hong Kong as a whole.

Weakening the competitiveness of the Main Board

The current Profit Requirement of HK$50 million for the three-year track record period in aggregate is the third highest amongst the Selected Overseas Main Markets. Increasing the Profit Requirement by either options will result in the Main Board having the highest profit requirement on an aggregated basis for the three-year track record period, being HK$125 million or even HK$150 million, which is far higher than those of NASDAQ (being HK$85 million) by at least HK$40 million and NYSE (being HK$93 million) by at least HK$32 million.

As the current Profit Requirement is higher than most of the other overseas markets, we are of the view that the Exchange should maintain the current Profit Requirement. Increasing it by either options will not only make it unduly burdensome for the Main Board applicants, but also weaken the competitiveness of the Main Board as potential Main Board applicants would seek to list in overseas markets instead of the Main Board.

Diversity of listing issuers and investors is a key to the prosperity of Hong Kong stock market and risk management. The proposal of increasing the Profit Requirement significantly would drive away a group of companies of different backgrounds from listing on the Main Board, which is not beneficial to the long term development of the local financial market and relevant industries. In case the current Profit Requirement is increased significantly, the mix of Main Board listing applicants may be tilted towards certain industries which by nature carry larger business volume. It may also result in a less diversified and vibrant financial market in Hong Kong and lead to an over reliance on listing applicants from Mainland China with high profits or on mega-sized IPOs.

Therefore, we are of the view that, in order to enable the financial market in Hong Kong to become more vibrant and diverse and reinforce Hong Kong's position as a leading global financial centre, the Exchange should maintain the current level of Profit Requirement.

The proposal would not effectively tackle the listed company quality issues

It is understood that the proposal to increase the Profit Requirement is aimed at improving the quality of the Hong Kong stock market. However, it would be unfair to attribute the quality issues to listing of smaller companies. Being a listing applicant or listed company which is smaller in size in terms of profits, market capitalisation, operation or other financial or operational figures at a particular point of time does not necessarily mean that such company is of poorer quality. The growth potentials of companies which are smaller in size, the prospects of the industries they are engaged in and their needs for capital raising and apply for listing on the Main Board for the purpose of long-term business growth should not be totally denied.

Listing on GEM is not an alternative

The Exchange suggested that smaller companies which cannot meet the increased Profit Requirement as proposed can still access the capital market by listing on GEM. In reality, listing on GEM is not an attractive option for listing applicants, in particular, those which are or would be eligible to apply for listing on the Main Board under the current Profit Requirement, due to the more stringent post-listing compliance obligations as compared to those of the Main Board and the inability to be transferred to the Main Board in an efficient manner in terms of cost and workload. Many applicants do not view GEM as a viable alternative to the Main Board because of its relatively inactive market and low trading volumes in general. Accordingly, it is likely that companies which cannot meet the increased Profit Requirement as proposed by the Exchange would rather abandon the listing plan in Hong Kong altogether instead of applying for listing on GEM.

Not an appropriate time to increase the Profit Requirement

In light of the economic downturn in 2020 and 2021 due to the outbreak of COVID-19, it is uncertain when will the market fully recover from the pandemic, especially for industries such as tourism, hotel, airline, food & beverage and retail.

As set out in the Consultation Conclusions on Review of the Growth Enterprise Market (GEM) and Changes to the GEM and Main Board Listing Rules (December 2017) (the "**2017 Consultation Conclusions**"), more than half of the respondents had expressed that they agreed to maintain the Profit Requirement which was on par with the majority of the key overseas markets. After the 2017 Consultation, the Hong Kong economy was, to a larger extent, adversely affected by the social movement in Hong Kong commenced in 2019, the outbreak of COVID-19 since late 2019 and the intense relations between China and the U.S. It appears to be inappropriate or unjustifiable to increase the Profit Requirement at this point of time.

In 2009, the market was adversely affected by the financial crisis and the Exchange proposed to consider granting waivers to the Main Board listing applicants from complying with the profit test requirements. The current market condition is similar to that of 2009, if not worse. It would appear unreasonable for the Exchange to refuse to grant waivers to applicants from complying with the current Profit Requirement, and to raise the Profit Requirement substantially to hinder companies from listing on the Main Board.

While it has been difficult for companies to maintain their profit level as compared with previous years, it is expected that it would be more challenging to further increase the profitability significantly for companies in most industries and regions. In view of the current economic situation, we consider that it is not an appropriate time to increase the Profit Requirement. It is suggested that the Exchange should re-consider the extent of the proposed increase of the Profit Requirement and the timing of effecting any proposed increase of the Profit Requirement, and where necessary, to publish another consultation paper in respect of any proposed change in the Profit Requirement when the market fully recovers from the pandemic.

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For the reasons set out above, we are of the view that the Exchange should maintain the status quo on the Profit Requirement.

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.

The high implied historical P/E ratio, being one of the main reasons for the subject proposal mentioned in the Consultation Paper, is mainly due to the drastic increase in the minimum market capitalisation requirement from HK$200 million to HK$500 million in 2018, which was viewed by many as a controversial decision. Back in 2017, some opposing respondents had raised the concerns that the 2.5 times increase in the minimum market capitalisation requirement would prevent smaller profitable companies with good potential from listing on the Main Board and affect the Main Board’s competitiveness and attractiveness. We consider that, increasing the Profit Requirement to lower the implied historical P/E ratio will likely further lower the attractiveness of the Main Board rather than rectifying the problems.

As such, we suggest that the Exchange should take this opportunity to review the decision in 2017 which took effect in 2018 and consider to decrease the minimum market capitalisation requirement from HK$500 million to HK$300 million.

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.

We would like to reiterate that we do not agree that the Profit Requirement should be increased by either options as set out in the Consultation Paper.

As stated in our response to Question 1 above, many companies have been facing great difficulties to survive in the market in the recent years due to various reasons, including but not limited to the social movement in Hong Kong, the outbreak of COVID-19 and the intense relations between China and the U.S. In view of the volatility of the pandemic situation, it is difficult to foresee when the pandemic would end in Hong Kong and globally and when the global economy would recover fully from the pandemic back to the condition before the outbreak of COVID-19 in late 2019. For Hong Kong companies, the market is affected more significantly and the prospects of the market is even more unpredictable due to the social movement and other political factors.

In the circumstances, we strongly suggest the Exchange to grant the current and potential listing applicants temporary relief from the Profit Requirement even if the current Profit Requirement is not increased, similar to what the Exchange did in 2009 in response to the financial crisis. Due to the prolonged adverse impact on the global economic environment brought by the outbreak of COVID-19, it would be impossible for a number of listing applicants to even meet the current level of Profit Requirement, not to say the increased Profit Requirement as proposed by the Exchange. Listing applicants with smaller business size may have no choice but to suspend their listing plans, which have been prepared for months or years with million dollars of professional fees and other relevant expenses incurred, or to consider to list in other financial markets with lower profit requirements and/or with more appropriate relief measures.

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.

We would like to reiterate that we do not agree that the Profit Requirement should be increased by either options as set out in the Consultation Paper.

Regardless of whether the Profit Requirement is increased, we suggest that the proposed relief condition set out in paragraph 55(d) of the Consultation Paper should apply to all current and potential Main Board listing applicants with track record periods having at least six consecutive months that fall within the calendar year 2020 and at least six consecutive months that fall within the calendar year 2021. The market conditions were negatively affected due to the volatility of the global pandemic situation in 2020. It is expected that the market conditions will continue to be negatively affected in the first half year of 2021 or throughout 2021.

As regards the proposed relief condition in relation to aggregate Profit Requirement set out in paragraph 55(a) of the Consultation Paper, we suggest that, in view of the unstable economic environment over the globe and the reasons set out in our response to Question 1 above, the aggregate Profit Requirement for the track record period should not increase at all before the recovery of the market from the COVID-19 disruption.

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