SLAUGHTER AND MAY

Response to the November 2020 Consultation Paper on

The Main Board Profit Requirement

by The Stock Exchange of Hong Kong Limited

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Introduction

We refer to the Consultation Paper on the Main Board Profit Requirement (the "**Consultation Paper**") issued by The Stock Exchange of Hong Kong Limited (the "**Exchange**") in November 2020. Our comments to the Consultation Paper are set out below for the Exchange's consideration. Unless otherwise specified, capitalised terms have the meanings given to them in the Consultation Paper.

Response to the Consultation Paper

Question 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.

Our response:

We agree that the Profit Requirement should be increased as it has remained unchanged since 1994 and has not kept up with inflation. If a choice must be made between Option 1 and Option 2, we would support Option 1 for the practical reasons that (i) the percentage increase is smaller and would be more palatable to the market; and (ii) the gap between the profit requirement of the Exchange and those of NYSE and NASDAQ would be smaller, and would therefore have a lesser impact on the Exchange's competitiveness.

However, we also query the methodology behind Options 1 and 2 – it appears rather arbitrary to link the profit test to the market capitalisation requirement or the average closing price of the Hang Seng Index. We believe that using the general inflation rate (e.g. consumer price index) as a benchmark would be more appropriate, as it is more relevant to the real economy where listing applicants operate their businesses and generate their profits. During the period from 1994 to 2020, the Composite CPI in Hong Kong increased from 67.2 to 110.5 (representing an increase by 64%). You may also consider taking into account the inflation rate in other jurisdictions (e.g. mainland China) as many listing applicants have businesses outside of Hong Kong.

Question 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.

Our response:

The Exchange's fundamental concern is about listing applicants trying to inflate their valuations and profit forecasts in order to get listed on the Main Board. Increasing the Profit Requirement is one way to stop such companies from getting listed, but it is also unfair to shut the door for all other companies who are genuinely seeking a listing and are not artificially inflating their valuations or profit forecasts. The Exchange should therefore consider using alternative methods to directly tackle the valuation/profit forecast issues, although these alternatives would require further thought and may have their own limitations. For example, the Exchange may consider making it compulsory for marginal listing applicants to disclose the profit forecast in the prospectus if they fail to demonstrate reasonable basis for their forecast. At present, listing applicants can choose whether to disclose the forecast in the prospectus or simply file it in private with the Exchange. Requiring the forecast to be disclosed in the prospectus should put more pressure on listing applicants and sponsors to get it right.

In addition, the Exchange should consider ways to rejuvenate the GEM Board to make it more attractive to investors and listing applicants. At present, because the GEM Board is perceived to be unattractive and there is no direct migration path to the Main Board, ineligible listing applicants do have a very strong incentive to inflate their valuations and profit forecasts in order to get listed on the Main Board. As an alternative to the GEM Board, the Exchange can also consider setting up a new SME board for good but smaller companies and allowing them to migrate to the Main Board using simplified procedures if they become eligible for the Main Board in the future.

Question 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.

Our response:

We agree that the Exchange should consider granting temporary relief from the increased Profit Requirement due to the Covid-19 pandemic. It is obvious that many businesses across different industries have been seriously disrupted by the pandemic. Good quality and sizeable companies which would otherwise have been eligible for listing should not be deterred from listing purely because of the sudden market downturn.

Question 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.

Our response:

Although it is difficult to predict when the pandemic will end, it does appear from currently available information that the pandemic will at least continue to affect economic recovery for most parts of 2021. We would therefore suggest that the relief be extended to cover 2021 (or at least the first half of 2021, depending on the virus situation), and Conditions (a) and (d) will have to be revised accordingly. Other than this, we agree with the conditions being proposed.

1 February 2021