ACCA Think Ahead

Corporate and Investor Communications Department
Hong Kong Exchange and Clearing Limited
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Dear Sir \ Madam

Consultation Paper on The Main Board Profit Requirement

On behalf of ACCA Hong Kong, we would like to submit our recommendations regarding the captioned consultation paper.

ACCA Hong Kong is supportive of the review of the Main Board Profit Requirement which has remained at the same level for the past 26 years since it was first introduced in 1994. However, we are of the view that neither Option 1 nor Option 2 is a satisfactory revision of the current requirement for the following reasons:

1. With the outbreak of Covid-19 that has brought upon unprecedented challenges to many industries and disrupted the global economy, this might not be the right timing for the proposed increase of Profit Requirement for listing. By increasing the minimum Profit Requirement, as indicated in the consultation document, 62% of the Profit Requirement Applications would not be able to meet the criteria and be eliminated from listing. As such, raising the Profit Requirement under the current economic condition would deprive enterprises from listing in the capital market to raise funds to prepare for the business recovery in the post pandemic era. This not only hinders their long-term recoveries but also slows down the overall Hong Kong economic rebound. Given the present subdued economic conditions, few candidates are anticipated to meet the revised Profit Requirement. We consider that Profit Requirement revision should only be holistically considered after the economy fully recovers from the pandemic.

2. Healthy capital markets do not only serve the large corporates, state-owned enterprises or companies from the new economy but also the small and medium enterprises (SMEs) who have sound business models and promising growth potential. These SMEs should be able to leverage on the capital market to raise funds to expand their businesses, improve their brand names and enhance their market positions. This function of the capital market has long been an efficient means that help many Hong

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Kong local enterprises develop successfully to become international brands. When the Profit Requirement is raised as proposed, the Main Board of HKEx would have become one of the most stringent financial eligibility criteria in the world for initial public offerings (IPO). Many SMEs would be deprived from raising capital through listing on the Main Board, which creates an obstacle to the long-term growth of Hong Kong enterprises and could also potentially drive them away to other stock exchanges.

3. We understand that Growth Enterprise Market (GEM) is designed to offer a listing option for SMEs that do not fulfil the requirements for listing on the Main Board. However, after the 2017 reform, the trading volume of GEM reduces substantially, leading to its ability to raise capital being questioned. And there is no more convenient transitional arrangement available for eligible GEM issuers moving from the GEM Board to the Main Board. When the cost of listing on the GEM Board is similar to that of the Main Board, with a lower transaction volume and a lack of transitional arrangement to the Main Board, listing on the GEM Board becomes less appealing to many applicants. This is evidenced by the significant reduction in the number of applicants of GEM listing since 2017. Henceforth, when SMEs are unable to be listed on the Main Board as a result of a higher Profit Requirement and the GEM Board is also not an attractive option to them, they will be forced to turn to other stock exchanges. This is not beneficial to the long-term development of Hong Kong as an international financial centre. As such, we consider a holistic approach be adopted to review of the Profit Requirement, the potential reform of the GEM Board and total Market Capitalisation of the Main Board such that an overall picture of Hong Kong's capital market as a whole should be evaluated.

4. One of the justifications for the increase of Profit Requirement is that the Market Capitalisation Requirement was increased from HK$200 million to HK$500 million while the Profit Requirement remained unchanged, which effectively increased an applicant's implied historical P/E ratio from 10 times to 25 times. However, companies that are perceived to have promising growth potential should be able to command for high P/E ratios. It is the investors' judgment and market reaction that determine an appropriate P/E ratio of an investee company. A pre-determined and regulated range of P/E ratios will make the Hong Kong capital market less competitive when compared to other overseas stock exchanges.

5. The Option 1 proposal of 150% increase in the Profit Requirement, being based on the exact percentage increase in the Market Capitalisation from HK$200 million to HK$500 million, may be an over-simplified approach. When the Profits Requirement is reviewed, other factors, such as the consumer price index (CPI), should be taken into consideration. According to the Census and Statistic Department of Hong Kong, the CPI

in 2019 was 110 while according to the Trading Economics, the CPI of Hong Kong in 1994 was 75, representing an increase of 47% over the past 25 years. To apply such mechanism for an increase in the review of the Profit Requirement, the new level for the last financial year should then be HK$29 million (an increase of 47% from the current requirement of HK$20 million). We reiterate that CPI is only one of the many ways that can be considered to derive the revised Profit Requirement. We recommend the Hong Kong Exchange and Clearing Limited (HKEX) consider adopting a more holistic review of this listing eligibility.

6. Many private equity funds are willing to invest in high risk, high potential but lower profits startup companies with a view to liquidate their investments upon future floatation of these startups in the stock market. Should the Profit Requirement be raised substantially, it implies that a higher entry barrier and chance of successfully listing these startups diminishes. This in turn discourages private equity funds managers to invest in startups and slows down the development of the startup eco-system which is crucial for Hong Kong to emerge as an innovative hub of the Asia Pacific region.

7. With the significant increase in the Profit Requirement, many listing applicants will be eliminated, which obviously poses a major blow to the professional services sector, including but not limited to the professional accountants, legal practitioners and the underwriters, whose revenue depends largely on provision of services to companies in the listing process. According to the Census and Statistics Department, the professional services sector, one of the four key industries in the Hong Kong and the driving force of Hong Kong's economic growth, providing impetus to the growth of other sectors and creating employment, was accounted for 12% of Hong Kong's local GDP in 2018. A blow to the professional services sector would not only increase the unemployment rate, especially in this already challenging time of Covid-19 outbreak, but also slow down the GDP growth and economic recovery of Hong Kong in near future.

8. We understand the rationale of increasing the Profit Requirement is to enhance market quality through screening out poor quality issuers with low profit level. Yet there is no guarantee or direct relationship that companies initially meet a high Profit Requirement would have good future growth potential. There are many cases that blue-chip listed companies turn into losses during economy downturn and when market demand shifts. Instead of screening out poor-quality applicants through raising the Profit Requirement, we should focus on attracting promising applicants from a wider range of industries into the capital market to diversify the business risk and weather the economic cyclical downturn.

9. We fully understand the concern associated with shell activities, where companies seek for listing just to monetise the premium attached to the listing status rather than to genuinely raise funds and develop their businesses. While this only involves a small number of Small Cap Issuers, which should be tackled by HKEx and SFC through strengthening enforcement efforts to identify and ban potential applicants who manipulate these rules. We are of the view that majority of applicants for listing should not be penalised and deprived of any fund-raising opportunities by the unnecessary stringent requirement, which will also reduce the attractiveness of our stock market and sacrifice the efficiency of our capital market.

We understand and are supportive of the review of the Main Board Profit Requirement. Nevertheless, we are of the view that such review should be conducted in a holistic approach that consider multiple perspectives including the eligibility criteria for Main Board listing as a whole, the role and function of the GEM Board and the overall competitiveness of the Hong Kong capital market.

Should there be any questions, please do not hesitate to contact the undersigned at [redacted].

Yours faithfully

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