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.

Please refer to the additional pages.

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.

If prevention of shell creation is one of the main objectives underlying this Consultation, the Stock Exchange may consider increasing the moratorium periods of 6 months plus 6 months in Rule 10.07(1) of the Main Board Listing Rules.

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.

No comment.

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.

No comment.

- End -

Response of Rossana Chu, Bonnie Yung and Jason Wang to

Stock Exchange Consultation Paper – The Main Board Profit Requirement

Additional pages to Q1

It is not an appropriate timing to substantially increase the Profit Requirement for the following reasons:

1. There is a huge difference between the current Profit Requirement (HK$30 million + HK$20 million) and either Option 1 (2.5 times of the current Profit Requirement) or Option 2 (3 times of the current Profit Requirement). Such a "sudden and very substantial" increase will disrupt the listing plans of many potential applicants which can meet the current Profit Requirement (but not the new requirement even under Option 1) and are about to submit listing applications in the next one or two years. It is not easy at all for them to adjust its business models to increase its profits considerably in the near future to fulfil even the Option 1 requirement.

   Additionally, private investors (including private equity and venture capital funds) may have plans to use Hong Kong listing as an exit for their investee companies which are not of mega size. A fund normally has a limited term and the fund manager has to find exits for the fund investments before the fund term expires. The massive increase in the Profit Requirement may seriously interrupt their exits in form of Hong Kong listing. Eventually, the fund manager may have to seek other exit alternatives resulting in less return to the fund, or arrange the investee companies to list on another stock exchange such as in Australia and Singapore which have lower profit thresholds.

   Funds may even be more reluctant to invest in "new economy" companies at their premature stages because it becomes a long way for those companies to achieve Main Board listing due to the increased Profit Requirement. Ultimately, that may also hinder the technology development of Hong Kong.

   Any increase in listing qualification should not be huge and sudden at the same time. The reputation of the Stock Exchange and even Hong Kong as an international financial centre may be damaged because such an abrupt change will disrupt genuine listing plans of the mid or small-sized companies. More importantly, the proposal reduces predictability of the Stock Exchange's rules.

2. In order to maintain stability and predictability of the listing qualifications, the Stock Exchange may consider (a) increasing the Profit Requirement slightly (e.g. not more than 30% of the existing Profit Requirement) and (b) announcing the time schedule for subsequent gradual increases in the Profit Requirement. This allows enterprises

to decide whether and when to submit Main Board listing applications. Practitioners in the market may also find it easier to adapt.

3. GEM is not a solution or a reasonable alternative, at least in the near future. GEM fails to secure a proper positioning or any special features to attract sufficient number of listing applications with high growth potential. Its reputation as a fund raising platform is weak, especially in view of its relatively low liquidity as compared to the Main Board and the listing platforms in other jurisdictions. A lot of funds engaging in investments of listed securities do not even include GEM listed companies in their mandates for investments. Many private equity funds do not take GEM as an exit option for their investee companies. Instead of applying for listing on GEM, those early development companies and small or mid-sized companies that are not able to meet the Main Board eligibility requirements will just switch to the listing platforms elsewhere, which will eventually lead to the loss of the Hong Kong Stock Exchange of a substantial number of decent small to mid-sized companies, thus, the conclusion that the proposed increase of the Profit Requirement will not have a material impact on the overall capital market as set out in the Consultation Paper is not correct.

4. According to《关于金融支持粤港澳大湾区建设的意见》 (Opinions on Financial Support for the Development of the Guangdong-Hong Kong-Macao Greater Bay Area) published by the People's Bank of China, the China Banking and Insurance Regulatory Commission, the China Securities Regulatory Commission and the State Administration of Foreign Exchange in May 2020, innovative enterprises in the Greater Bay Area are encouraged to list in Hong Kong.

   However, a "new economy" enterprise may find it very difficult to reach the new Profit Requirement (even Option 1) for a Main Board listing in the near future. Thus, the high Profit Requirement is not conducive in promoting Hong Kong as a listing conduit for Greater Bay Area enterprises engaged in a "new economy" industries or in their early stages of development.

5. The Consultation Paper mentions several times that the Small Cap Issuers or the smaller applicants are engaged in "traditional" industries but not in a "new economy" industry. While having quality "new economy" companies listing on the Main Board is a welcome trend, it is not necessary to drive away listing applicants engaged in traditional industries.

   As there is no restriction in the listing qualifications against an applicant engaging in a traditional industry, the Profit Requirement should not be increased to a level that shuts the Main Board door to most of the mid or small-sized companies engaged in traditional industries.

6. Even for the “new economy” segments, there are only very limited circumstances under the Main Board Listing Rules for a company not meeting the Profit Requirement to have the opportunity to list on the Main Board. Raising the Profit Requirement is not conducive to, or in line with, the Hong Kong’s appeal for developing local “new economy” companies which do not fall within such limited circumstances.

7. It will be an irony if the “Hong Kong” Stock Exchange requires a profit level that is prohibitive to most Hong Kong-based enterprises wishing to list on the Main Board and utilize the Main Board facilities to raise funds. This is especially so when the Stock Exchange occupies a monopolized position in the stock exchange segment of Hong Kong. If a Hong Kong company, whether operating in a “new economy” or traditional industry, cannot meet the new Profit Requirement, there is no other stock exchange to go to in Hong Kong for a “main” listing before the image of GEM is substantially improved.

8. The Stock Exchange might be happy to see that it has attracted in recent years certain mega-size listing applications as well as the plans to list in Hong Kong of certain PRC-based companies listed in the US. However, the exchange in the past 12 months also experienced the largest number of privatization during the past decade.

   In addition, many PRC-based enterprises prefer to list in the Mainland rather than Hong Kong, for different reasons which are not necessarily relating to the Main Board carrying Small Cap Issuers or issuers engaged in traditional industries.

   That essentially means enterprises have mixed feelings on the Main Board of the Hong Kong Stock Exchange. Hong Kong may not be able to remain a “preferred” listing bourse from the perspective of PRC-based enterprises including those in “new economy” industries. Thus, there is no room for the Stock Exchange to be complacent with the current achievements by narrowing down Main Board listing applications to the larger ones.

9. Market capitalization is not the most suitable indicator for gauging the quality of an issuer. Market capitalization is the product of the investing public’s collective behaviour and the result of many factors which may not linked to the profit performance of issuers.

   Also, the market capitalization of individual issuers can be volatile and may change in a manner that does not correlate with the issuer’s profitability. For example, there are quite a number of Main Board issues with stable profits, and yet their market capitalization drops continuously in recent years, resulting in their market capitalization being well below their net asset value. One probable reason is that their businesses carry little room for high-growth imagination or are not “attractive” enough to the investors.

On the other hand, the market witnessed in the last 18 months steep increases in market capitalization of certain companies which did not demonstrate significant breakthroughs in their profitability or business development.

10. The objective of a regulator should focus more on the corporate governance of issuers, rather than aiming at high market capitalization or preferring certain types of industries over others in respect of listing applications. Investors' preference on any industry may change within a relatively short period of time.

    A high market capitalization is not the most desirable indicator for gauging the performance of a stock market. In certain circumstances, a high market capitalization implies an elevated level of market speculation and price volatility.

11. The variety in P/E ratio demonstrates the investing public's sentiments on the whole economy, the different industries and the individual issuers. Such diversity of issuers is necessary for any stock exchange to play its role to facilitate economic development.

12. The Stock Exchange has mentioned in the Consultation Paper that in light of the increase of the Market Capitalization Requirement, some Small Cap Issuers that marginally met the Profit Requirement had relatively high historical P/E ratios as compared with those of their listed peers, and that the regulatory concern is whether these Small Cap Issuers were genuinely listed with the intention to raise funds for the development of their underlying businesses as stated in the profit forecasts, or whether their valuations were simply reverse engineered to meet the Market Capitalization Requirement in order to manufacture potential shell companies for sale after listing given the perceived premium attached to the listing status. However, as mentioned above, market capitalization is not the most suitable indicator for gauging the quality of an issuer, instead of trying to "fix the problem" by proposing the increase of the Profit Requirement, the Stock Exchange may consider to review whether the current Market Capitalization Requirement is indeed appropriate.

13. There might be isolated cases of manufacturing shell companies by way of Main Board listings in the past, and yet the Stock Exchange should not stereotype all or most of the smaller listing applications. Listing may raise a company's reputation among its customers, suppliers, employees, recruits, banks, regulators and other stakeholders, and put the company in a better competitive position – these objectives are genuine. Seeking a listing by a smaller applicant is therefore not necessarily for shell creation.

    Prevention of shell creation should be achieved by other measure such as those set out in paragraph 23(b) of the Consultation Paper, instead of by substantially raising the Profit Requirement and driving away most smaller listing applications.

14. For a company already listed on the Main Board which wishes to spin off a subsidiary for separate listing, the remaining group (not counting in the spun-off subsidiary) will have to fulfil the Profit Requirement. With the revised Profit Requirement in place, a listed issuer will find it more difficult to raise funds for the subsidiary by way of a spin-off and separate listing.

15. The past 12 months is a very difficult for most enterprises, whether they operate in Mainland China, Hong Kong or other jurisdictions. An enterprise, which could have fulfilled Option 1 new requirement if no COVID-19 pandemic and the China-US trade frictions had occurred, might not be able to do so under the current circumstances even with the temporary relief because the China-US trade frictions and COVID-19 may leave adverse implications on the its profitability for a period much longer than one year (2020). Now is probably the most untimely moment of considerably raising the Profit Requirement.

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