

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/MarketConsultations/2016-Present/November-2020-MB-ProfitRequirement/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.

The reasons of disagreeing the increase of the Profit Requirement, either on Option 1 or Option 2, are as below:

1. Proposed increase of the Profit Requirement strikes a heavy blow on the international financial hub

The proposed increase of the Profit Requirement is drastic and excessive and will make the Exchange the most difficult international financial market to list securities and substantially reduce its competitiveness as international financial centre in Asia. As mentioned in the Consultation Paper, either Option would give the Exchange the highest aggregate profit requirement for the three-year track record requirement of the Selected Overseas Main Markets. The Exchange will also have the second highest profit requirement for the final year of the track record period (lower than SGX). It must be noted under the current regime of Hong Kong, that the profit test requirement in Rule 8.05(1)(a) of the Listing Rules is based on profit attributable to shareholders and must exclude any contribution from any associated companies and other entities whose results are recorded in the applicant's financial statements using the equity method of accounting. The NYSE and NASDAQ earning requirement is based on the listing applicant's pre-tax earnings and neither NYSE and NASDAQ require exclusion of associated companies' profits.

With the proposed increase of Profit Requirement, the Exchange seems to place its focus and favour only on large enterprises and not afford the opportunity for the listing of small or medium-sized companies on the Main Board. It is also noted that the percentage ratio set out in Option 2 is “based on the approximate percentage increase in the average closing price of the Hang Seng Index from 9,541 in 1994 when the Profit Requirement was introduced to 27,569 in 2019”. It must be pointed out that the increase of closing price of the Hang Seng Index has no indicative meaning in the profit earning of a company. The profit earning of companies would still be largely affected by the global and local economies, the costs of operation etc., especially most sectors of the economy have been devastated by the COVID-19 pandemic globally, simply referring to the increase of Hang Seng Index without considering the realistic business operation and unprecedented uncertainty in the global markets could not justify such drastic move on the eligibility of potential applicants.

Interestingly, as compared to other Selected Overseas Main Markets, the Exchange is taking a more preservative approach on rather embracing dynamistic listing vehicles. Those markets (for example, the NASDAQ and the SGX) have deployed or considered the listing of special purpose acquisition companies (“SPACs”)¹. SPACs are in fact shell companies that raise capital through an IPO to acquire an existing entity. After the funds are raised, the sponsor of a SPAC would typically have certain period to “de-SPAC” by identifying a target company and completing a merger or acquisition. If a suitable deal is not found, the SPAC would be liquidated with funds returned to shareholders.] The Exchange has not been considered as an option for SPACs in Asia because of its tight rules on “backdoor” listings, imposed over concerns about listed cash shells. In fact, rather than diversifying the Hong Kong market by offering a suitable listing platform for small medium enterprises (“SMEs”), high growth-yield companies and innovative companies, the Exchange’s proposals further risk limiting the competitiveness and inclusiveness of Hong Kong’s capital market.

2. Proposed increase of the Profit Requirement bars the SMEs quality applicants seeking fund-raising from IPO

The proposed increase in the Profit Requirement of Main Board is drastic and would significantly impact the SMEs, especially good quality local or oversea SMEs seeking to raise capital in the Exchange. As indicated in the Consultation Paper, Option 1 and Option 2 would have disqualified 59% and 65% of applicants for listing under the Profit Requirement between 2016 and 2019 respectively.

SMEs have been playing a significant role in the economic development of Hong Kong. Fundamentally changing the fund-raising landscape means denying access of SMEs to raise fund in Hong Kong and neglecting the needs of local economic driving fuel. The proposed changes in the Profit Requirement would also significantly impact the Mainland private enterprises seeking fund-raising in the Exchange. According to the paper “Hong Kong’s role in supporting the fund-raising of Mainland private enterprises” of the HKEX published on 13 June 2019², it is stated that “Mainland private enterprises (“MPES”) are integral to the real economic growth in the Mainland,

especially during the current transitions to a new economy... Offshore channels, particularly Hong Kong, are important to MPEs". For the purpose of fund-raising, the Exchange would be the only platform for the Small Capital Issuers, Hong Kong SMEs and MPEs.

The increase in the Profit Requirement proposal presumes that only large companies with higher revenue are necessarily of higher quality and impose lesser risk to the investors and this presumption is not validly found. SMEs are not necessarily less regulated and more dangerous to the markets. The giant caps were all once small enterprises. The increase of profit threshold presents an image of favouring applicants with deep pockets, private equity backing, giant tech companies or the financial muscles of the government and neglect the fund-raising needs of SMEs with good quality, especially local enterprises. Either Option 1 and Option 2 would make the Exchange the highest aggregate profit requirement for the three-year track record requirement compared with the Selected Overseas Main Markets, this would in effect be discouraging and disadvantaging Hong Kong enterprises engaging in activities that contribute to the real economic development, such as retail, catering, infrastructure, tourism, financing, property etc. from raising capital in the domestic market.

3. Manufacturing shell companies to sell post-listing

The Exchange concerns that Small Cap Issuers may have been inflating their valuations in order to manufacture shell companies to sell post-listing. The amendments to the continuing listing criteria have been made in Rule 13.24 of the Listing Rules preventing the listing and continued listing of "shell companies" which may become vehicles for backdoor listings.

In fact, the changes in the market capitalisation requirement in 2018 and tightened reverse takeover rules reflected in the Listing Rules and guidance letters in 2019 have sufficiently deal with the problems of listing shell creation.

The point comes to how effective would a higher Profit Requirement deter the post-listing shell selling activities. Assuming implementing the proposed Profit Requirement, less successful listing cases will be on the Hong Kong market and greater value will be added to the "shells" of the existing listed companies and it is foreseeable that the possibility of trading existing listed status would revive.

That said, if it is in the opinion of the Exchange that further actions should be taken to curb the shells selling activities after listing, it may consider to further extend the post-IPO lock-up period for the controlling shareholder(s).

Even if higher Profit Requirement were introduced and thus increases of the time and costs for manufacturing the shell to sell post-listing, it comes to the questions whether the higher Profit Requirement is the answer to the problem of listed shells selling activities. As stated above, regulatory controls from the Exchange and SFC have substantially deter such activities and the regulators may further enhance the reporting

and disclosure requirements on listed issuers. If the problems could be solved by strengthening the regulatory control, it would be prejudicial to the SMEs and Small Cap Issuers being barred from access to the Main Board of the Exchange.

4. The problems of GEM

It is suggested that *“the proposed increase in the Profit Requirement will affect companies at an early development stage or small or mid-sized companies which intend to list on the Main Board. These companies can still access the capital market by listing on GEM, which is intended to be a capital raising platform for early development companies and small or mid-sized companies that are not able to meet the Main Board eligibility requirements”* (paragraph 10 of the Consultation Paper).

The Exchange considers that GEM offers an alternative for SMEs. In fact, the inadequacy of GEM market implies that it does not provide a viable alternative venue. The listing application process on GEM is lengthy and costly and is almost identical to a Main Board listing application. No differentiation between Main Board and GEM when it comes to stringent regulatory control and burdensome reporting requirements. There is also a trend of declining numbers of companies listing on GEM each year, namely, 80 companies listed on GEM in Year 2017, 75 companies listed on GEM in Year 2018 and only 15 GEM listed companies in Year 2019.³ The SMEs are left with no choice but to raise a relatively far small amount of capital from the market due to low market liquidity.

Further, the characteristics of GEM is as *“a market designed to accommodate companies to which a higher investment risk may be attached than other companies listed on the Stock Exchange.”* (Rule 2.20 of GEM Listing Rules). It is the position of GEM to encourage companies with ‘lesser’ quality financials to list. As stated above, the number of GEM listed issuers is decreasing each year, the smaller and lower liquidity obviously do not attract professional institutional money which requires high-quality financials. The proposed higher Profit Requirement would further enlarge the gap between the Main Board and GEM without better positioning GEM itself in the stock market. We suggest that better positioning GEM market and simplifying regulatory constrain and listing process for GEM applicants would be a more attractive alternative for potential applicants.

5. Implications on the corporate finance industry

The proposals on the Profit Requirement not only adversely affect these potential applicants but is also devastating to the sponsors who act for them, legal practitioners, accounting firms, and the whole chain of stakeholders of corporate finance industry, including but not limited to, research companies, valuers, printers, translators, public relation companies, caterers etc. As stated in the Consultation Paper, Option 1 and Option 2 would have disqualified 59% and 65% of applicants for listing under the Profit Requirement between 2016 and 2019 respectively, if either Option would be implemented, it would have been devastatingly affected the business chain of the

professional parties, underwriters and brokers in the finance field. This would also have impacted the income of the trading fee, transaction fee, and taxable duties of the regulatory authorities. The needless changes of the Profit Requirement would have sweeping consequences on the corporate finance industry and jeopardise the livelihood of many others and tax base in Hong Kong.

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 N/A

You may provide reasons for your views.

As per our views to Question 1, we strongly disagree with the proposed options to increase Profit Requirement. We suggest to maintain the status quo of the Profit Requirement under the 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 N/A

You may provide reasons for your views.

As per our views to Question 1, we strongly disagree with the proposed options to increase the Profit Requirement. We believe the Exchange is aware of the impact on the financial performance of many potential applicants as a result of the COVID-19 pandemic, the fact that the Exchange has considered the question of temporary relief from the increased Profit Requirement indicates that it is exactly not the right time to such needless drastic changes.

The lockdown of cities, halt of productions, breaks of supply chains severely hit most business sectors globally during 2020 and its impacts will continue to last for an uncertain period of time. The survivability of the companies and businesses in various sectors and the recovery of the global and local economies are questionable.

We therefore suggest to maintain the status quo of the Profit Requirement under the Listing Rules.

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 *N/A*

You may provide reasons for your views.

Please see our reply to Question 3.

¹ Singapore steps up bid to become Asia Spacs hub, Financial Times, 20/01/2021

(<https://www.ft.com/content/18d51d14-4f2d-4a28-853d-b2eaf3b0eb00>)

² Hong Kong's role in supporting the fund-raising of Mainland private enterprises" of the HKEX, 13/06/2019 (https://www.hkex.com.hk/-/media/HKEX-Market/News/Research-Reports/HKEx-Research-Papers/2019/CCEO_MPE_201906_e.pdf?la=en)

³ HKEX Fact Book 2019 (https://www.hkex.com.hk/-/media/HKEX-Market/Market-Data/Statistics/Consolidated-Reports/HKEX-Fact-Book/HKEX-Fact-Book-2019/FB_2019.pdf)