

Consultation Paper

The Main Board Profit Requirement



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DEFINITIONS

| TERM | DEFINITION |
|--|---|
| “2002 Consultation Paper” | Consultation Paper on Proposed Amendments to the Listing Rules relating to Initial Listing and Continuing Listing Eligibility and Cancellation of Listing Procedures (July 2002) (link) |
| “2004 Consultation Conclusions” | Consultation Conclusions on Proposed Amendments to the Listing Rules relating to Initial Listing Criteria and Continuing Listing Obligations (January 2004) (link) |
| “2009 Profit Requirement Waiver Announcement” | HKEX News Release “Possible Waiver for Profit Test Requirement for Initial Listing Applicants on the Main Board” (5 June 2009) (link) |
| “2017 Consultation Paper” | Consultation Paper on Review of the Growth Enterprise Market (GEM) and Changes to the GEM and Main Board Listing Rules (June 2017) (link) |
| “2017 Consultation Conclusions” | Consultation Conclusions on Review of the Growth Enterprise Market (GEM) and Changes to the GEM and Main Board Listing Rules (December 2017) (link) |
| “Adjusted Net Profit” | net profit after tax excluding listing expenses and other material one-off items |
| “Aggregate Profit Threshold” | minimum aggregate profit in the track record period under the Profit Requirement |
| “Alternative Requirements” | Market Capitalisation Revenue Cashflow Requirement and Market Capitalisation Revenue Requirement |
| “ASX” | Australian Securities Exchange |
| “COVID-19” | Coronavirus disease 2019 |
| “Eligible Applications” | Profit Requirement Applications which would have met the proposed Profit Requirement under Option 1 and/or Option 2 |
| “Exchange” | The Stock Exchange of Hong Kong Limited, a wholly-owned subsidiary of HKEX |
| “FCA” | Financial Conduct Authority of the UK |
| “forecast P/E ratio” | a new applicant’s expected market capitalisation at the time of listing divided by the Adjusted Net Profit for the financial year immediately after the end of track record |

| TERM | DEFINITION |
|-----------------------------------|--|
| | period, as disclosed in the profit and working capital forecast memorandum submitted by the applicant to the Exchange |
| “FY” | financial year |
| “GEM” | GEM operated by the Exchange |
| “GEM Eligible Issuers” | has the same meaning as Eligible Issuers as defined in Listing Rule 9A.01A, which include: (a) all issuers listed on GEM as at 16 June 2017; and (b) all GEM applicants who have submitted a valid listing application for listing on GEM as at 16 June 2017 and subsequently listed on GEM pursuant to such application or a renewal of such application, who are entitled to the transitional arrangements set out in Appendix 28 to the Listing Rules |
| “GEM Transfer” | a transfer of an issuer’s listing of securities from GEM to the Main Board |
| “historical P/E ratio” | a new applicant’s expected market capitalisation at the time of listing divided by the Adjusted Net Profit for the last financial year of the track record period |
| “HKEX” | Hong Kong Exchanges and Clearing Limited |
| “Ineligible Applications” | Profit Requirement Applications which would not have met the proposed Profit Requirement under Option 1 or Option 2 |
| “IPO” | initial public offering |
| “Listing Committee” | a committee appointed by the board of directors of the Exchange that exercises all the powers and functions of the board in relation to listing matters |
| “listing document” | a Prospectus, a circular and any equivalent document (including a scheme of arrangement and introduction document) issued or proposed to be issued in connection with an application for listing |
| “Listing Rules” or “Rules” | the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (Main Board unless otherwise stated) |
| “Main Board” | Main Board operated by the Exchange |

| TERM | DEFINITION |
|---|---|
| “Market Capitalisation Requirement” | Listing Rule 8.09(2) which requires a new applicant to have an expected market capitalisation at the time of listing of at least HK\$500 million |
| “Market Capitalisation Revenue Cashflow Requirement” | Listing Rule 8.05(2) which requires, among other things, a new applicant to have a minimum market capitalisation of HK\$2 billion at the time of listing, revenue of at least HK\$500 million in the most recent audited financial year, and an aggregate cash flow from operating activities of at least HK\$100 million for the three preceding financial years |
| “Market Capitalisation Revenue Requirement” | Listing Rule 8.05(3) which requires, among other things, a new applicant to have a minimum market capitalisation of HK\$4 billion at the time of listing and revenue of at least HK\$500 million in the most recent audited financial year |
| “NASDAQ” | Nasdaq Stock Market, a stock market in the US that has three tiers - Nasdaq Global Select Market, Nasdaq Global Market and NasdaqCX |
| “NYSE” | New York Stock Exchange |
| “Option 1” | the proposed option of a 150% increase in the Profit Requirement |
| “Option 2” | the proposed option of a 200% increase in the Profit Requirement |
| “P/E ratio” | the ratio of a company's share price to the company's earnings per share |
| “Profit Requirement” | Listing Rule 8.05(1)(a) which requires a new applicant to have a minimum amount of profit attributable to shareholders, currently (a) HK\$20 million in the most recent financial year and (b) HK\$30 million in aggregate in the two preceding financial years |
| “Profit Requirement Applications” | 745 Main Board listing applications which relied on the Profit Requirement ¹ submitted between 2016 and 2019 (both inclusive) ² |

¹ Include GEM Transfers, listings by introduction, very substantial acquisitions and reverse takeovers that are deemed to be new listings under Listing Rule 14.54.

² A listing application submitted by an applicant after its previous application has lapsed for more than three months is considered a new application.

| TERM | DEFINITION |
|---|---|
| “Prospectus” | has the same meaning ascribed to it in Section 2(1) of the Companies (Winding Up and Miscellaneous Provisions) Ordinance |
| “Rule Amendment Effective Date” | the date on which the proposed Rule amendments set out in this consultation paper will come into force (if adopted), which will be on or after 1 July 2021 |
| “Selected Overseas Main Markets” | six overseas main markets comprising ASX, FCA (premium listed securities), NASDAQ Global Select Market, NYSE, SGX (Main Board) and SSE (Main Board) |
| “SFC” | Securities and Futures Commission |
| “SGX” | Singapore Exchange Limited |
| “Small Cap Issuer” | an issuer that applies to list on the Main Board pursuant to the Profit Requirement with a proposed market capitalisation at the time of listing of equal to or less than HK\$700 million |
| “SSE” | Shanghai Stock Exchange |
| “UK” | the United Kingdom |
| “US” | the United States of America |

EXECUTIVE SUMMARY

Purpose

1. This consultation paper solicits market feedback on the following Exchange's proposals to:
 - (a) increase the Profit Requirement; and
 - (b) introduce temporary conditional relief from the Profit Requirement if our proposal to increase the Profit Requirement is adopted.

Profit Requirement

2. The Profit Requirement was introduced in September 1994. The Profit Requirement was maintained after two public consultations and two reviews by the Listing Committee on the Main Board's eligibility requirements that were conducted between 2002 and 2017, mainly because the market and the Listing Committee were of the view that the Profit Requirement continued to be a good indicator of an applicant's performance and no change was considered necessary. **Appendix I** sets out the history of the Profit Requirement.

Reasons for change

3. After the publication of the 2017 Consultation Conclusions, the Market Capitalisation Requirement was increased from HK\$200 million to HK\$500 million effective from 15 February 2018 while the Profit Requirement remained unchanged. Where a new applicant only marginally meets the minimum thresholds under the Profit Requirement and the Market Capitalisation Requirement, this effectively increased the applicant's implied historical P/E ratio from 10 times to 25 times.
4. Since the Market Capitalisation Requirement was increased in 2018 without a corresponding increase in the Profit Requirement, the Exchange has seen an increase in listing applications from Small Cap Issuers that marginally met the Profit Requirement but had relatively high historical P/E ratios as compared with those of their listed peers. These Small Cap Issuers were typically small or mid-sized companies in traditional industries. In particular, the Profit Requirement Applications submitted by Small Cap Issuers in 2018 recorded significantly higher historical P/E ratios, which we believe was in response to the increased Market Capitalisation Requirement. While these Small Cap Issuers typically justified their higher valuations by reference to potential growth, a number of them failed post listing to meet the profit forecasts they had filed with the Exchange as part of their listing applications, which gave rise to concerns about the reasonableness of

their valuations (e.g. whether they were indeed supported by a genuine expectation of growth).

5. 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 Capitalisation Requirement in order to manufacture potential shell companies for sale after listing given the perceived premium attached to the listing status. If the valuation achieved by an issuer upon listing is not genuinely supported by the market, such issuer's share price may decrease significantly shortly after listing, which could result in losses to investors and hurt investors' confidence in the potential for price appreciation of the relevant shares. Inadequate market demand may also lead to thin trading and low liquidity of the shares, making the relevant shares more susceptible to speculative trading and excessive market volatility post listing. As such, the listing of an issuer with a valuation that is not genuinely supported by the market is not in the interest of the investing public, and will affect the overall quality of the Main Board listings.
6. In addition, the inflated valuations also raise the regulatory concern of whether the IPO offer prices genuinely reflect the expected market clearing prices. In certain cases the price discovery process may have been undermined by the possible offering of rebates to investors to entice them to take up shares, and suspected abusive behaviours such as manufacturing of an artificial shareholder base have been noticed. All of these are against the fundamental principle under the Listing Rules that the issue and marketing of securities should be conducted in a fair and orderly manner, and also give rise to concerns that the relevant investors were not independent and were procured to facilitate the creation of potential shell companies for sale, market manipulation or insider dealing post listing.

Proposal

7. A key underlying cause of the issues discussed in paragraphs 4 and 5 is the misalignment of the Profit Requirement (which has remained at the same level for the past 26 years) with the revised Market Capitalisation Requirement (which was increased five-fold from HK\$100 million in 1994 to HK\$500 million in 2018). Further, the issues discussed in paragraph 6 also call for an evaluation of whether the current Profit Requirement should be aligned with the increased Market Capitalisation Requirement to ensure that it remains at the right level as an eligibility requirement for the Main Board.
8. To address these issues, the Profit Requirement should be increased and we propose two options for such an increase:

- (a) **Option 1** - 150%, based on the percentage increase in the Market Capitalisation Requirement from HK\$200 million to HK\$500 million in 2018. This will increase the minimum amount of profit attributable to shareholders to (a) HK\$50 million in the most recent financial year; and (b) HK\$75 million in aggregate in the two preceding financial years, and reduce the implied historical P/E ratios of applicants meeting only the minimum thresholds under the Profit Requirement and the Market Capitalisation Requirement to 10 times, in line with that before the change of the Market Capitalisation Requirement in 2018.
- (b) **Option 2** - 200%, 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. This will increase the minimum amount of profit attributable to shareholders to (a) HK\$60 million in the most recent financial year; and (b) HK\$90 million in aggregate in the two preceding financial years, and will reduce the implied historical P/E ratios of applicants meeting only the minimum thresholds under the Profit Requirement and the Market Capitalisation Requirement to 8 times.

Analysis of impact of the proposed options

- 9. We have performed an analysis of the impact of the two proposed options on the 745 Profit Requirement Applications submitted between 2016 and 2019 (both inclusive) and observed the following key findings (**Appendix III** sets out further details of the Profit Requirement Applications):
 - (a) although Option 1 and Option 2, on average, would have eliminated 62% (462) of the Profit Requirement Applications and might be expected to have a similar impact on future potential applications, we note the following:
 - (i) approximately 30% of these Ineligible Applications would not have been eligible under the current regime because these applications had proposed market capitalisations of less than HK\$500 million and relied on the previous Market Capitalisation Requirement of HK\$200 million to submit their listing applications; and
 - (ii) of the remaining 70% Ineligible Applications, most were Small Cap Issuers (46%) with proposed market capitalisations between HK\$500 million and HK\$700 million, and the remaining 24% were non-Small Cap Issuers. None of these applicants was engaged in a “new economy” industry;
 - (b) the aggregate market capitalisation at the time of listing of all Ineligible Applications under Option 1 that have been listed was approximately HK\$184 billion which only accounted for 3% of the aggregate market

capitalisation of Main Board issuers newly listed between 2016 and 2019 (both inclusive) at the time of their respective time of listing, as compared to HK\$2,675 billion for Eligible Applications under Option 1 (38%);

- (c) for Profit Requirement Applications that were listed as of 30 June 2020 and which have published their annual financial results post listing, a higher proportion (60%) of the Eligible Applications under Option 1 met or outperformed the profit forecasts they had filed with the Exchange as part of their listing applications, as compared to Ineligible Applications under Option 1 (37%); and
 - (d) although both Option 1 and Option 2 will result in the Exchange having the highest profit requirement when compared with the profit requirements of the Selected Overseas Main Markets on an aggregated basis for the three years of a track record period, as compared with being third under the current Profit Requirement (lower than NYSE and NASDAQ), we will continue to have the second highest profit requirement for the final year of the track record period (lower than SGX). Similar to the Selected Overseas Main Markets, the Profit Requirement is only one of the Main Board eligibility tests and there are other eligibility tests available to sizeable and/or new economy companies that may not meet the increased Profit Requirement under either Option 1 or Option 2 (e.g. the Alternative Requirements).
10. We believe either of the proposed options to increase the Profit Requirement can effectively address the issues detailed in paragraphs 4 to 6 while not having a material impact on the overall capital market. We are mindful though 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.
11. The increase in the Profit Requirement will further distinguish between issuers listed on GEM and the Main Board and is in line with our objective of positioning the Main Board as the main market to attract sizeable companies that can meet high market standards. The proposal will therefore improve the overall quality of Main Board issuers, which will be conducive to promoting post-listing liquidity. This will also increase investors' confidence in the market and strengthen Hong Kong's position as an international financial centre.

Temporary Relief

12. We recognise that against the backdrop of the COVID-19 pandemic and the uncertainties arising from the economic and political tensions between the US and China, many companies' businesses have been adversely affected. Therefore, subject to the adoption of our proposal to increase the Profit Requirement, the Exchange proposes to introduce a temporary conditional relief from the increased Profit Requirement as set out in Chapter 2, which will facilitate the listings of quality companies that are temporarily affected by the pandemic and the current economic downturn.

Transitional Arrangements

13. To minimise the impact of our proposal to increase the Profit Requirement on companies that have commenced plans to apply for a Main Board listing relying on the current Profit Requirement, we will introduce transitional arrangements as set out in Chapter 3 if our proposal to increase the Profit Requirement is adopted.

Request for comments

14. We would like to invite public comments on the proposals to increase the Profit Requirement. **Appendix IV** sets out the proposed amendments to the Main Board Listing Rules. Any final Rule amendments and details regarding implementation would be published in a consultation conclusions paper after we have considered the public's views. When providing your comments please give reasons for your views. We also welcome any alternative suggestions.

Proposed timetable and next steps

15. Responses to this consultation paper should be submitted to us by **1 February 2021**. The Exchange will take into account these responses and comments before deciding upon any further appropriate action and publishing a consultation conclusions paper.

CHAPTER 1: PROPOSAL TO INCREASE THE PROFIT REQUIREMENT

Current requirements

16. Under Listing Rule 8.05, new applicants may be considered eligible for listing on the Main Board by satisfying, among other things, the Profit Requirement or the Alternative Requirements. Over the years, we have expanded our listing regime and introduced other eligibility requirements to attract different types of companies to list in Hong Kong (e.g. Chapter 18A for biotech companies). Table 1 shows the breakdown of the number of applicants that submitted listing applications between 2016 and 2019 based on the various financial eligibility requirements.

Table 1: Summary of use of financial eligibility requirements for Main Board applications submitted between 2016 and 2019

| Financial Eligibility Requirements | Main Board Applicants | |
|---|-----------------------|------------|
| | Number | % |
| Profit Requirement | 745 | 82 |
| Market Capitalisation Cashflow Requirement | 7 | 1 |
| Market Capitalisation Revenue Requirement | 37 | 4 |
| Others ³ | 119 | 13 |
| TOTAL | 908 | 100 |

17. An applicant relying on the Profit Requirement must also meet the Market Capitalisation Requirement. The combination of these requirements is intended to be a comprehensive examination of (a) an applicant's historical performance, i.e. the Profit Requirement which shows a new applicant's audited profit during its track record period; and (b) a forward looking indicator of the market's potential interest in the applicant, and provides information on its P/E ratio.

Reasons for change

18. In the 2017 Consultation Paper, the Exchange consulted on⁴:

³ "Others" includes applications under Listing Rule 8A.06, Chapter 18, Chapter 18A, Chapter 19C, Chapter 20 or Chapter 21 of the Listing Rules.

⁴ 2017 Consultation Paper, Chapter 5, paragraphs 4 to 27.

- (a) whether the Profit Requirement should still be used as a Main Board eligibility requirement or whether alternative tests should replace it; and if the Profit Requirement was to be retained, whether any change in the level of profit under the Profit Requirement should be made; and
- (b) whether the Market Capitalisation Requirement should be raised from HK\$200 million to HK\$500 million and a proportionate increase made to the minimum public float value from HK\$50 million to HK\$125 million.
19. In view of market responses, no change was made to the Profit Requirement because a majority of the respondents supported maintaining the current threshold mainly because it was on par with the main markets of the overseas exchanges⁵, while the Market Capitalisation Requirement was increased from HK\$200 million to HK\$500 million effective from 15 February 2018. Where a new applicant only marginally meets the minimum thresholds under the Profit Requirement and the Market Capitalisation Requirement, this effectively increased the applicant's implied historical P/E ratio from 10 times to 25 times⁶.
20. Since the Market Capitalisation Requirement was increased in 2018 without a corresponding increase in the Profit Requirement, the Exchange has seen an increase in listing applications from Small Cap Issuers that marginally met the Profit Requirement but had relatively high historical P/E ratios as compared with those of their listed peers. In 2018 and 2019, the Exchange received a total of 464 Main Board listing applications relying on the Profit Requirement to list on the Exchange (compared to 281 Main Board listing applications in 2016 and 2017), of which 53% were submitted by Small Cap Issuers (compared to 49% in 2016 and 2017) (see Table B in **Appendix III**).
21. These Small Cap Issuers were typically small or mid-sized companies in traditional industries. In particular, the Profit Requirement Applications submitted by Small Cap Issuers in 2018 recorded significantly higher historical P/E ratios (see Chart B in **Appendix III**), which we believe was in response to the increased Market Capitalisation Requirement. While these Small Cap Issuers typically justified their higher valuations by reference to potential growth, a number of them failed post listing to meet the profit forecasts they had filed with the Exchange as part of their listing applications⁷, which gave rise to concerns about the reasonableness of their valuations (e.g. whether they were indeed supported by a genuine expectation of growth).

⁵ 2017 Consultation Conclusions, paragraphs 104 to 106.

⁶ Based on the relevant Market Capitalisation Requirement (HK\$200 million or HK\$500 million) divided by the minimum profit required in the last financial year under the Profit Requirement (i.e. HK\$20 million).

⁷ Listing Rule 11.17 requires listing applicants to provide the Exchange a profit forecast memorandum covering at least the most recent financial year that ends post listing.

22. 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 Capitalisation Requirement in order to manufacture potential shell companies for sale after listing given the perceived premium attached to the listing status. If the valuation achieved by an issuer upon listing is not genuinely supported by the market, such issuer's share price may decrease significantly shortly after listing, which could result in losses to investors and hurt investors' confidence in the potential for price appreciation of the relevant shares. Inadequate market demand may also lead to thin trading and low liquidity of the shares, making the relevant shares more susceptible to speculative trading and excessive market volatility post listing. As such, the listing of an issuer with a valuation that is not genuinely supported by the market is not in the interest of the investing public, and will affect the overall quality of the Main Board listings.
23. A key underlying cause of the issues discussed above is the misalignment of the Profit Requirement (which has remained at the same level for the past 26 years) with the increased Market Capitalisation Requirement (which was increased five-fold from HK\$100 million in 1994 to HK\$500 million in 2018⁸). Specifically:
- (a) the inflated valuations discussed in paragraph 21 raise the regulatory concern of whether the IPO offer prices genuinely reflect the expected market clearing prices. In certain cases the price discovery process may have been undermined by the possible offering of rebates to investors to entice them to take up shares, and suspected abusive behaviours such as manufacturing of an artificial shareholder base have been noticed. All of these are against the fundamental principle under the Listing Rules that the issue and marketing of securities should be conducted in a fair and orderly manner, and also give rise to concerns that the relevant investors were not independent and were procured to facilitate the creation of potential shell companies for sale, market manipulation or insider dealing post listing; and
 - (b) although the assessment of an applicant's valuation is subject to various macro-economic and company-specific factors, we had adopted a heightened vetting approach and heavily scrutinised the commercial rationale for listing and the reasonableness of P/E ratios of Small Cap Issuers. In this regard, the Exchange had also revised Guidance Letter

⁸ In 2004, the Market Capitalisation Requirement was first increased from HK\$100 million to HK\$200 million. At that time, Listing Rules 8.08 and 8.09(1) required a minimum of 25% of an issuer's shares be at all times held by the public and that these shares must have a market capitalisation of at least HK\$50 million at listing. A HK\$200 million requirement was proposed because 25% of HK\$200 million is HK\$50 million. In 2018, the Market Capitalisation Requirement was further increased from HK\$200 million to HK\$500 million.

HKEX-GL68-13A (Guidance on IPO vetting and suitability for listing) in April 2018 to curb shell creation activities⁹. Further, the Exchange will also continue to adopt a more robust approach on the application of Listing Rule 13.24 to suspend the trading of shares of, and delist, existing listed issuers that have a very low level of operation and/ or carry on businesses that do not have substance¹⁰. However, the current misalignment may result in more potential shell companies being listed as explained in paragraph 22.

Proposal

24. Against the background and issues as discussed in paragraphs 16 to 23, the Profit Requirement should be increased and we propose the following two options:
- (a) **Option 1** - 150%, based on the percentage increase in the Market Capitalisation Requirement from HK\$200 million to HK\$500 million in 2018. This will reduce the implied historical P/E ratios of applicants meeting only the minimum thresholds under the Profit Requirement and the Market Capitalisation Requirement to 10 times, in line with that before the change of the Market Capitalisation Requirement in 2018.
 - (b) **Option 2** - 200%, based on the approximate percentage increase in the average closing price of the Hang Seng Index¹¹ from 9,541 in 1994 when the Profit Requirement was introduced, to 27,569 in 2019. This will reduce the implied historical P/E ratios of applicants meeting only the minimum thresholds under the Profit Requirement and the Market Capitalisation Requirement to 8 times.

⁹ News Release, 13 April 2018 ([link](#)).

¹⁰ The Consultation Conclusions on Delisting and Other Rule Amendments was published in May 2018 and the new delisting regime became effective from 1 August 2018, pursuant to which the Exchange may cancel the listing of an issuer if it has been continuously suspended for 18 months (for Main Board issuers) or 12 months (for GEM issuers).

¹¹ Source: Bloomberg

25. Table 2 sets out details of the two proposed options:

Table 2: Proposed options to increase the Profit Requirement

| | Current | Option 1 | Option 2 |
|---|----------------|-----------------|-----------------|
| Proposed increase (%) | | 150% | 200% |
| | HK\$ million | | |
| In aggregate for the first two financial years | 30 | 75 | 90 |
| For the last financial year | 20 | 50 | 60 |
| Total | 50 | 125 | 150 |
| Implied historical P/E ratio (based on the Market Capitalisation Requirement) ¹² | 25 times | 10 times | 8 times |

26. There are no material regulatory concerns on other features of the Profit Requirement, namely: (a) the spread of profit between the first two financial years and the last financial year; (b) the use of post-tax (rather than pre-tax) profit; (c) the exclusion of the contribution of associated companies and other entities whose results are recorded in a new applicant's financial statements using the equity method of accounting; and (d) the exclusion of profit or loss generated by activities outside a new applicant's ordinary and usual course of business.

Analysis of impact of the proposed options

Profit Requirement Applications

27. Between 2016 and 2019, there were 745 Profit Requirement Applications, of which 382 (51%) were submitted by Small Cap Issuers. The majority of these Profit Requirement Applications were in traditional industries. The top three industries of the Profit Requirement Applications by Small Cap Issuers are property and construction (30%), consumer goods (18%) and industrials (18%); while the top three industries of those that are non-Small Cap Issuers are consumer services (23%), consumer goods (21%) and property and construction (17%). **Appendix III** sets out further details of the Profit Requirement Applications.
28. Our impact analysis of the proposed increase in the Profit Requirement showed that Options 1 and 2 would have resulted in 59% (437) and 65% (486) of the Profit Requirement Applications being ineligible for listing, respectively. Charts 1, 1.1 and 1.2 show the proportion of Profit Requirement Applications that would have been eligible or ineligible under Option 1 and Option 2, respectively:

¹² Assuming both the Profit Requirement and the Market Capitalisation Requirement are marginally met.

Chart 1: Effect of proposed increase on Profit Requirement Applications

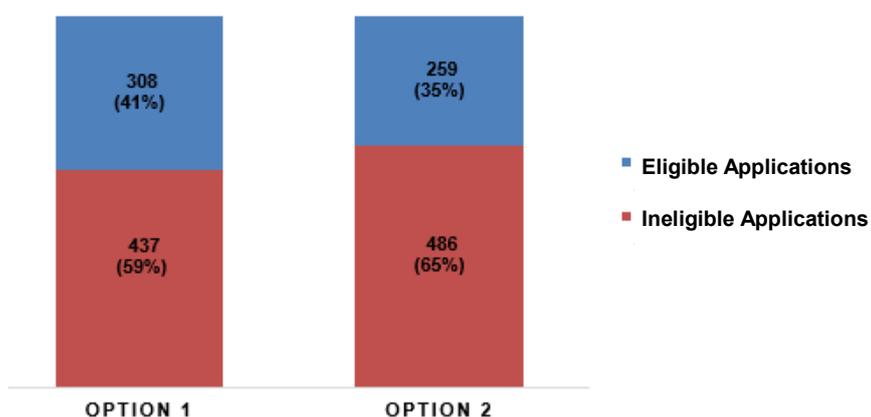


Chart 1.1: Effect of Option 1 on Profit Requirement Applications in each year between 2016 and 2019

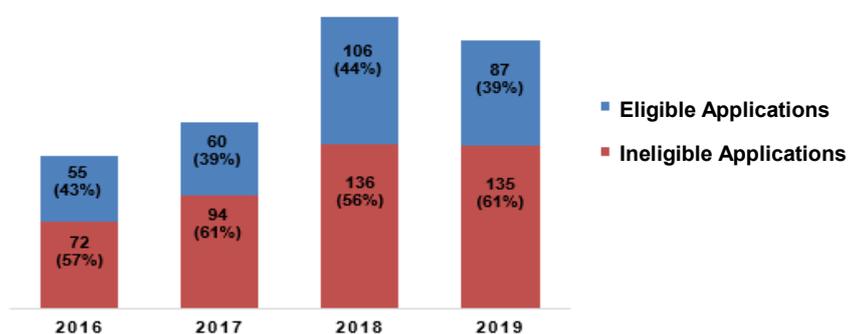
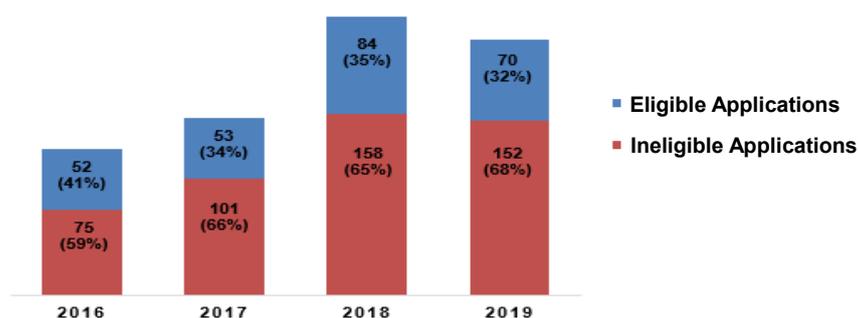


Chart 1.2: Effect of Option 2 on Profit Requirement Applications in each year between 2016 and 2019



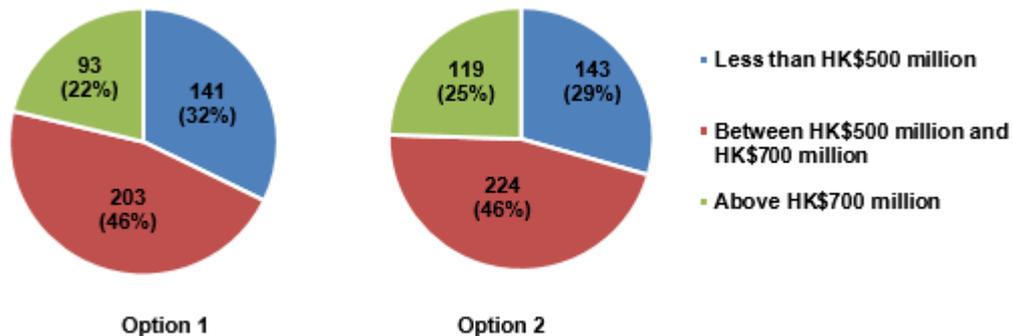
29. We further evaluated the market capitalisations¹³, historical P/E ratios, business natures and post-listing performances of the Ineligible Applications as well as the Eligible Applications under each option to better assess their respective impact.

¹³ Based on the low end price of the offer price range, where applicable.

Ineligible Applications

30. There would have been 437 and 486 Ineligible Applications under Option 1 and Option 2, respectively. Chart 2 shows the market capitalisations of these Ineligible Applications under each option:

Chart 2: Distribution of Ineligible Applications based on proposed market capitalisations at the time of listing



31. 32% (Option 1) and 29% (Option 2) of the Ineligible Applications had proposed market capitalisations of less than HK\$500 million. These applications were submitted prior to 15 February 2018 or under transitional arrangements¹⁴ and therefore were able to rely on the previous Market Capitalisation Requirement of HK\$200 million. These applicants would not have been eligible under the current Market Capitalisation Requirement of HK\$500 million even if the Profit Requirement is not increased.
32. Under both options, 46% of the Ineligible Applications were Small Cap Issuers with proposed market capitalisations between HK\$500 million and HK\$700 million. Their median market capitalisations were HK\$512 million (Option 1) and HK\$518 million (Option 2), and their median historical P/E ratios were 14 times under both options. None of these applicants was engaged in a “new economy” industry.
33. 22% (Option 1) and 25% (Option 2) of the Ineligible Applications were non-Small Cap Issuers and had proposed market capitalisations above HK\$700 million. Their median market capitalisations were HK\$1,234 million (Option 1) and HK\$1,358 million (Option 2), and their median historical P/E ratios were 27 times (Option 1) and 26 times (Option 2). None of these applicants was engaged in a “new economy” industry.

¹⁴ As set out in 2017 Consultation Conclusions, paragraph 146.

34. By way of illustration, amongst the 437 Ineligible Applications under Option 1, 253 (58%) obtained a listing¹⁵:
- (a) these issuers' aggregate market capitalisation at the time of listing was HK\$184 billion (52% was contributed by Small Cap Issuers) which only accounted for 3% of the aggregate market capitalisation of Main Board issuers newly listed¹⁶ between 2016 and 2019 at the time of their respective listings (approximately HK\$7,100 billion); and
- (b) 247 of these 253 issuers had published their annual financial results post listing¹⁷. 63% of these issuers failed to meet the profit forecasts they had filed with the Exchange as part of their listing applications. As compared with non-Small Cap Issuers, a higher proportion of Small-Cap Issuers failed to meet the profit forecasts:

Table 3: Post-listing performance of the 247 Ineligible Applications under Option 1 that were listed and which have published results post listing¹⁸

| Market capitalisation at the time of listing (HK\$ million) | No. of issuers | Met or exceeded profit forecast (No. (%)) | Shortfall from profit forecast (No. (%)) | | | |
|---|----------------|---|--|-----------------|----------------|------------------|
| | | | <30% | 30% - 50% | > 50% | Total |
| <500 | 69 | 15 (22%) | 39 (57%) | 9 (13%) | 6 (8%) | 54 (78%) |
| 500-700 | 120 | 49 (41%) | 56 (47%) | 9 (7%) | 6 (5%) | 71 (59%) |
| >700 | 58 | 27 (47%) | 17 (29%) | 7 (12%) | 7 (12%) | 31 (53%) |
| Total | 247 | 91 (37%) | 112 (45%) | 25 (10%) | 19 (8%) | 156 (63%) |

¹⁵ For the purpose of this paper, the listing status of the Profit Requirement Applications is based on data as of 30 June 2020.

¹⁶ Excluding GEM Transfers and listings by introduction.

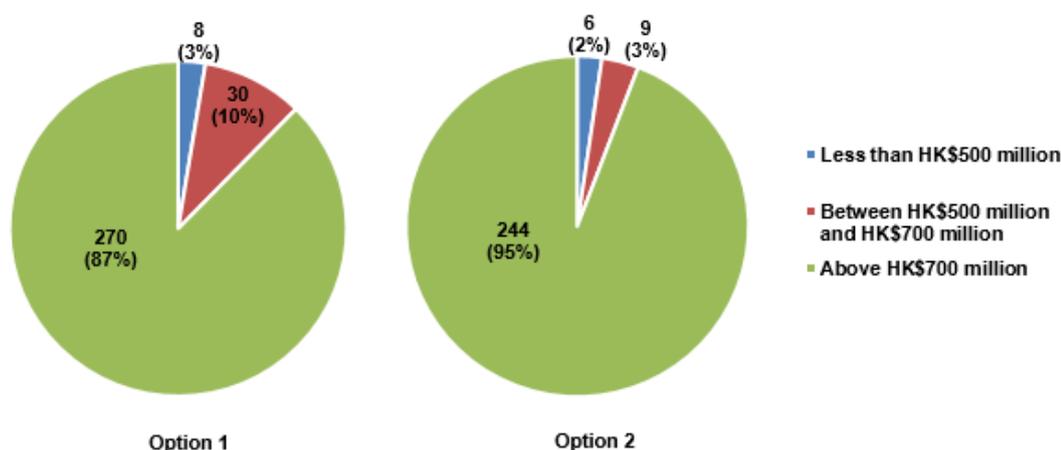
¹⁷ For the purpose of this paper, the publication of annual financial results is based on data as of 30 June 2020.

¹⁸ Based on annual results announcement or annual report published by the issuer.

Eligible Applications

35. There were 308 and 259 Eligible Applications under Option 1 and Option 2, respectively. Chart 3 shows the market capitalisations of the Eligible Applications under each option:

Chart 3: Distribution of Eligible Applications based on proposed market capitalisations at the time of listing



36. Only 3% (Option 1) and 2% (Option 2) of the Eligible Applications had proposed market capitalisations of less than HK\$500 million. As explained in paragraph 31, these applicants would not have been eligible under the current Market Capitalisation Requirement even if the Profit Requirement is not increased.
37. 10% (Option 1) and 3% (Option 2) of the Eligible Applications had proposed market capitalisations between HK\$500 million and HK\$700 million. Their median market capitalisations were HK\$559 million under both options, and their median historical P/E ratios were 8 times (Option 1) and 7 times (Option 2). These applicants had higher market capitalisations and more reasonable P/E ratios than those under Ineligible Applications explained in paragraph 32.
38. A majority (87% (Option 1) and 95% (Option 2)) of the Eligible Applications were non-Small Cap Issuers and had market capitalisations above HK\$700 million. Their median market capitalisations were HK\$3,876 million (Option 1) and HK\$4,185 million (Option 2), and their median historical P/E ratios were 16 times (Option 1) and 15 times (Option 2). These applicants had significantly higher market capitalisations but also lower P/E ratios than the Ineligible Applications as explained in paragraph 33.

39. By way of illustration, amongst the 308 Eligible Applications under Option 1, 210 (68%) obtained a listing¹⁹:

- (a) these issuers' aggregate market capitalisation at the time of listing was HK\$2,675 billion (only 0.4% was contributed by Small Cap Issuers), which is 14.5 times of the Ineligible Applications as explained in paragraph 34(a); and accounted for 38% of the aggregate market capitalisation of Main Board issuers newly listed²⁰ between 2016 and 2019 at the time of their respective listings (approximately HK\$7,100 billion); and
- (b) 208 of these 210 issuers had published their annual financial results post listing²¹. 40% of these issuers failed post-listing to meet the profit forecasts they had filed with the Exchange as part of their listing applications, compared to 63% for Ineligible Applications (see paragraph 34(b)). Further, compared with non-Small Cap Issuers, a higher proportion of Small-Cap Issuers failed to meet the profit forecasts:

Table 4: Post-listing performance of the 208 Eligible Applications under Option 1 that were listed as of 30 June 2020 and which have published results post listing²²

| Market capitalisation at the time of listing (HK\$ million) | No. of issuers | Met or exceeded profit forecast (No. (%)) | Shortfall from profit forecast (No. (%)) | | | |
|---|----------------|---|--|---------------|---------------|-----------------|
| | | | <30% | 30% - 50% | > 50% | Total |
| <500 | 5 | 2 (40%) | 2 (40%) | - | 1 (20%) | 3 (60%) |
| 500-700 | 14 | 7 (50%) | 5 (36%) | 1 (7%) | 1 (7%) | 7 (50%) |
| >700 | 189 | 116 (61%) | 62 (33%) | 5 (3%) | 6 (3%) | 73 (39%) |
| Total | 208 | 125 (60%) | 69 (33%) | 6 (3%) | 8 (4%) | 83 (40%) |

Jurisdictional comparison

40. When a new applicant applies for a Main Board listing using the Profit Requirement, it must also meet the Market Capitalisation Requirement, among other things. The Selected Overseas Main Markets have a standalone test of either minimum profit or market capitalisation, or a combination of a minimum profit requirement with different tests of financial performance.

¹⁹ See footnote 15.

²⁰ See footnote 16.

²¹ See footnote 17.

²² See footnote 18.

41. The initial eligibility requirements for listing on the Selected Overseas Main Markets, namely ASX, FCA²³, NASDAQ Global Select Market, NYSE, SGX (Main Board) and SSE (Main Board)²⁴ are summarised in Table 5 (see Table A in **Appendix II** for details):

Table 5: Comparison of the profit-related eligibility requirement of the Selected Overseas Main Markets and the Main Board²⁵

| Market | Nature of requirement |
|---------------------------------|---|
| Main Board | Profit Requirement and Market Capitalisation Requirement |
| ASX | Standalone profit requirement |
| FCA (premium listed securities) | No profit requirement |
| NASDAQ Global Select Market | Standalone profit requirement |
| NYSE ²⁶ | Standalone profit requirement |
| SGX (Main Board) | Standalone profit requirement, or profit and market capitalisation requirement |
| SSE (Main Board) | Profit requirement with issued share capital requirement, together with either revenue or cash flow requirement |

42. As seen from Table 5, the Selected Overseas Main Markets' eligibility requirements are not directly comparable with those of the Main Board given that:
- (a) the Selected Overseas Main Markets, except for the SSE, set the profit requirements based on a new applicant's pre-tax profit whereas our Profit Requirement is set based on profit attributable to shareholders (i.e. post-tax);
 - (b) for the purpose of satisfying the Profit Requirement, a new applicant must exclude the contribution of associated companies and other entities whose results are recorded in the new applicant's financial statements using the equity method of accounting. The Selected Overseas Main Markets do not explicitly require such exclusion; and

²³ The minimum financial eligibility requirements for admission to a securities market in the UK are set by the FCA, not an exchange.

²⁴ SSE was selected as its eligibility requirements are higher than those of the Shenzhen Stock Exchange.

²⁵ Both the Selected Overseas Main Markets and the Main Board have alternative financial eligibility requirements apart from profit requirement. For the purpose of this paper, we have focused on the comparison the profit requirement (if any) of the Selected Overseas Main Markets with our Profit Requirement.

²⁶ For both domestic and foreign issuers.

- (c) unlike our Profit Requirement, there is no requirement on the profit spread within the track record period in the Selected Overseas Main Markets (where applicable).

43. Table 6 compares the minimum profit requirements and minimum market capitalisation requirements of the Selected Overseas Main Markets with our Profit Requirement (see Table B of **Appendix II** for details). To be clear, the minimum market capitalisation requirements of the Selected Overseas Main Markets remain applicable where alternative financial eligibility tests are used in these markets to their respective profit requirement tests.

Table 6: Comparison of the minimum profit/ market capitalisation requirements of the Selected Overseas Main Markets and the Main Board²⁷

| Market | Three Years in Profit Aggregate (HK\$ million) | Final Year Profit (HK\$ million) | Market Capitalisation (HK\$ million) |
|---------------------------------|---|---|---|
| Main Board | 50 ²⁸ | 20 | 500 |
| ASX | 6 | 3 | 119 |
| FCA (premium listed securities) | No requirement | No requirement | 7 |
| NASDAQ Global Select Market | 85 | 17 | 1,242 |
| NYSE ²⁹ | 93 | 16 | 1,552 |
| SGX (Main Board) | No requirement | 170 | 843 |
| SSE (Main Board) | 35 | No requirement | 58 |

44. As compared with the profit requirements of the Selected Overseas Main Markets, both Option 1 and Option 2 will result in the Exchange having the highest profit requirement on an aggregated basis for the three years of a track record period as compared with being third under the current Profit Requirement (lower than NYSE and NASDAQ). We will continue to have the second highest profit requirement for the final year of the track record period (lower than SGX):

²⁷ For comparison purpose, the amounts of minimum profit/ market capitalisation required in the Selected Overseas Main Markets are converted into Hong Kong dollars.

²⁸ For comparison purpose, the threshold under the Profit Requirement during the track record period was aggregated.

²⁹ We use the least stringent requirement for domestic issuers.

Table 7: Comparison of the minimum profit requirements of the Selected Overseas Main Markets and the Main Board³⁰

| Market | Three Years Profit in Aggregate (HK\$ million) | Final Year Profit (HK\$ million) |
|---------------------------------|---|---|
| Main Board | 50 ³¹ | 20 |
| Main Board (Option 1) | 125 | 50 |
| Main Board (Option 2) | 150 | 60 |
| ASX | 6 | 3 |
| FCA (premium listed securities) | No requirement | No requirement |
| NASDAQ Global Select Market | 85 | 17 |
| NYSE ³² | 93 | 16 |
| SGX (Main Board) | No requirement | 170 |
| SSE (Main Board) | 35 | No requirement |

Summary of analysis

45. The analysis in paragraphs 27 to 39 shows that, in general:
- (a) although Option 1 and Option 2, on average, would have eliminated 62% (462) of the Profit Requirement Applications and might be expected to have a similar impact on future potential applications, we note the following:
 - (i) approximately 30% of these Ineligible Applications would not have been eligible under the current regime because these applications had proposed market capitalisations of less than HK\$500 million and relied on the previous Market Capitalisation Requirement of HK\$200 million to submit their listing applications; and
 - (ii) of the remaining 70% of the Ineligible Applications, most were Small Cap Issuers (46%) with proposed market capitalisations between HK\$500 million and HK\$700 million, and the remaining 24% were non-Small Cap Issuers. None of these applicants was engaged in a “new economy” industry;
 - (b) the aggregate market capitalisation at the time of listing of all Ineligible Applications under Option 1 that have been listed was approximately

³⁰ For comparison purpose, the amounts of minimum profit required in the Selected Overseas Main Markets are converted into Hong Kong dollars.

³¹ For comparison purpose, the threshold under the Profit Requirement during the track record period was aggregated.

³² We use the least stringent requirement for domestic issuers.

HK\$184 billion which only accounted for 3% of the aggregate market capitalisation of Main Board issuers newly listed between 2016 and 2019 (both inclusive) at the time of their respective time of listing, as compared to HK\$2,675 billion for Eligible Applications under Option 1 (38%); and

(c) for Profit Requirement Applications that were listed as of 30 June 2020 and which have published their financial results post listing, a higher proportion (60%) of the Eligible Applications under Option 1 met or outperformed the profit forecasts they had filed with the Exchange as part of their listing applications, as compared to Ineligible Applications under Option 1 (37%).

46. In view of the above, even though the proposed increase in the Profit Requirement will result in it being one of the most stringent financial eligibility tests compared to the profit requirements of the Selected Overseas Main Markets, we believe either of the proposed options can effectively address the issues we currently face in the Hong Kong market. In particular, the options will reduce the implied historical P/E ratios of applicants meeting only the minimum thresholds under the Profit Requirement and the Market Capitalisation Requirement to 8-10 times, similar to the level before the Market Capitalisation Requirement was increased in 2018. Similar to the Selected Overseas Main Markets, the Profit Requirement is only one of the eligibility tests for a Main Board listing and there are other eligibility tests available to sizeable and/ or new economy companies that may not meet the increased Profit Requirement under either Option 1 or Option 2 (e.g. the Alternative Requirements).
47. We are mindful though 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.
48. The increase in the Profit Requirement will further distinguish between issuers listed on GEM and the Main Board and is in line with our objective of positioning the Main Board as the main market to attract sizeable companies that can meet high market standards. The proposal will therefore improve the overall quality of Main Board issuers, which will be conducive to promoting post-listing liquidity. This will also increase investors' confidence in the market and strengthen Hong Kong's position as an international financial centre.

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.

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.

CHAPTER 2: TEMPORARY RELIEF FROM THE PROFIT REQUIREMENT

Background

49. The Profit Requirement is an indicator of the past financial performance and achievement of a new applicant. The profit and trading record can show a new applicant's growth and performance which warrants a listing of its securities on the Exchange. However, the performance of a business can also be affected by various external factors which are beyond the control of its management, such as global recessions or economy downturns.
50. Against the backdrop of the COVID-19 pandemic and the uncertainties arising from the economic and political tensions between the US and China, many companies' businesses have been adversely affected. The Exchange believes impacted companies should be given the opportunity to raise funds from the capital market to help recover and continue to grow their businesses.
51. The Exchange's intent when it published the 2009 Profit Requirement Waiver Announcement on 5 June 2009, and exemptions available to issuers in the case of spin-offs pursuant to paragraph 3(c) of Practice Note 15 to the Listing Rules, were to provide some conditional³³ relief on the Profit Requirement for new Main Board applicants impacted by the 2008 global financial crisis and experienced a one-off reduction in their profits.
52. Good quality and sizeable companies that have had a stable financial performance and a sustainable business model may see their financial results temporarily affected by the market downturn in 2020, becoming ineligible for listing despite having attained an aggregate net profit of no less than HK\$125 million or HK\$150 million during the track record period.
53. As such, the Exchange would like to make available a relief similar to that granted in 2009 to Main Board listing applicants when the Profit Requirement is increased.

Temporary relief from the Profit Requirement

54. The current Profit Requirement requires, at a minimum, the aggregate profit for the first two financial years and the last financial year to account for 60% (HK\$30 million) and 40% (HK\$20 million) of the Aggregate Profit Threshold of HK\$50

³³ If a new Main Board applicant had aggregate profit attributable to shareholders of at least HK\$50 million over its entire three-year track record period (rather than a spread of HK\$20 million in the last financial year and HK\$30 million over the preceding two financial years), and at least one financial year in the track record period included 2008, among other conditions.

million, respectively. This is to ensure such applicant demonstrates a growth trend of its business in order to be eligible for listing³⁴. Please refer to Table 2 in paragraph 25 which sets out the minimum profit spread if the Profit Requirement is increased under both options.

55. Considering potential applicants' financial performances may have been adversely affected by the market conditions in 2020, we will consider granting certain temporary reliefs from the profit spread in the increased Profit Requirement if an applicant is able to meet the following conditions:
- (a) its aggregate profit during the track record period meets the Aggregate Profit Threshold (i.e. HK\$125 million under Option 1 or HK\$150 million under Option 2);
 - (b) it had a positive cash flow generated from operating activities in the ordinary and usual course of business before changes in working capital and taxes paid in the last financial year during the track record period. A company with a sustainable business model is expected to be able to generate positive operating cash flow, otherwise it poses significant risks to the financial success of the company and investors upon listing;
 - (c) it demonstrates that the conditions and circumstances leading to its inability to meet the profit spread in the Profit Requirement are temporary. In this regard, we will assess the profitability in the last financial year/ period (e.g. stub period) as a means of whether the applicant has recovered or is recovering from the adverse market conditions;
 - (d) the track record period must have at least consecutive six months that fall within the calendar year 2020. This is because the relief is for applicants whose financial results during the track record period had been adversely impacted by the negative market conditions in 2020; and
 - (e) adequate disclosure is made in its listing document, including:
 - (i) the likelihood of continuance or recurrence of the circumstances leading to the applicant's inability to meet the spread of the increased Profit Requirement;
 - (ii) measures which were taken or will be taken by the applicant to mitigate the impact of those circumstances on future profitability; and

³⁴ Deteriorating financial performance of a new applicant will give rise to a concern as to the sustainability of its business and hence its suitability for listing under Listing Rule 8.04.

- (iii) a profit forecast³⁵ covering the period up to the forthcoming financial year end date after the date of listing with detailed bases and key assumptions.

56. Table 8 illustrates the different scenarios of the application of the temporary relief for a new applicant with financial year ending on 31 December. For this purpose, we assume:

- (a) the Profit Requirement will be increased by 150% under Option 1;
- (b) the applicant's financial performance in FY2020 was adversely affected; and
- (c) FY2020 forms part of its track record period:

Table 8: Different scenarios where an applicant would have been eligible for listing under the temporary relief

| HK\$ million | FY 2018 | FY 2019 | FY 2020 | FY 2021 | FY 2022 | Total Profit | Reason new Profit Requirement not met |
|--------------|---------|---------|---------|---------|---------|--------------|---|
| Scenario 1 | 45 | 60 | 20 | | | 125 | Last year less than HK\$50 million. |
| Scenario 2 | | 60 | 20 | 45 | | 125 | Last year less than HK\$50 million. |
| Scenario 3 | | | 20 | 45 | 60 | 125 | First two years less than HK\$75 million. |

 Track record period of the new applicant

57. In all cases, an applicant seeking a temporary relief from the Profit Requirement will be required to submit an application to the Exchange for consideration on a case-by-case basis.

| | |
|-------------------|---|
| 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. |
| 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. |

³⁵ As required under Listing Rule 11.17 and paragraph 34(2) of Part A of Appendix 1 to the Listing Rules, (a) the profit forecast must be reviewed and reported on by the applicant's reporting accountants; and (b) the applicant's financial advisers or sponsors must confirm that the profit forecast has been made by the directors after due and careful enquiry.

CHAPTER 3: TRANSITIONAL ARRANGEMENTS

58. Some companies may have commenced plans to apply for Main Board listing relying on the current Profit Requirement. To minimise the impact of the increase of the Profit Requirement on these potential applicants, we will introduce the following transitional arrangements.
59. The Rule Amendment Effective Date will not be earlier than 1 July 2021. Potential applicants that are preparing or planning to apply for listing on the Main Board as at the date of this paper should therefore have sufficient time to prepare and submit their listing application before the Rule Amendment Effective Date.
60. Accordingly, Main Board listing applications (including GEM Transfer applications) will be assessed under the current Profit Requirement if they are submitted before the Rule Amendment Effective Date (proposed to be on or after 1 July 2021) and remain active³⁶ as of the Rule Amendment Effective Date. Such application will be allowed to be renewed³⁷ once after the Rule Amendment Effective Date for continued assessment under the current Profit Requirement. For any subsequent renewals, the application will be assessed under the increased Profit Requirement.
61. As a result of the reform of GEM in 2018, certain transitional arrangements were adopted for GEM Transfers. In particular, under Listing Rule 9A.01A, GEM Transfer applications submitted by GEM Eligible Issuers between 15 February 2018 and 14 February 2021 (both inclusive) are processed under the transitional arrangements set out in Appendix 28 to the Listing Rules, including the market capitalisation requirement of HK\$200 million. Accordingly, GEM Transfer applications of GEM Eligible Issuers submitted on or before 14 February 2021 but which lapse thereafter will no longer be entitled to the transitional arrangements and they will have to comply with the current Profit Requirement and the Market Capitalisation Requirement (HK\$500 million), among other things. However, as the Rule Amendment Effective Date will be after the end of the transitional period (i.e. 14 February 2021), such GEM Transfer applications will also be assessed in the same way as described in paragraph 60.
62. A new applicant will not be permitted to withdraw its listing application before it lapses and resubmits the application shortly thereafter before the Rule Amendment Effective Date such that the application will be assessed in accordance with the existing Profit Requirement for a longer period.

³⁶ This means the application has not lapsed for more than three months, been withdrawn, rejected or returned.

³⁷ Such renewal must be made within three calendar months from the date on which the previous application has lapsed. Otherwise, the applicant's eligibility will be assessed in accordance with the increased Profit Requirement.

63. The Exchange's proposal to increase the Profit Requirement is subject to the views of the market. In the meantime, eligibility of applications for listing on the Main Board will continue to be processed in accordance with the current Profit Requirement, among other tests. The Exchange acknowledges that, if the increase in the Profit Requirement in Chapter 1 of this paper and the transitional arrangements under this Chapter are adopted, there may be an influx of applications for listing on the Main Board ahead of the change in the Profit Requirement. As such, the time required for the Exchange's vetting of Main Board listing applications may be longer.

APPENDIX I HISTORY OF THE PROFIT REQUIREMENT

1994 Consultation

Background

1. Prior to 1994, the Listing Rules required new applicants to have a minimum market capitalisation at listing of HK\$100 million¹ and a track record of adequate duration, which would normally mean three years². The Rules did not have a financial performance requirement.
2. The Exchange had noted that some new applicants were only able to meet the minimum HK\$100 million market capitalisation requirement based on their forecast profit, which was much higher than the profit they had recorded in their track record period. After listing, some issuers were unable to meet their forecasts and some even suffered losses. The Exchange also noted that certain overseas exchanges required new applicants to meet a minimum track record profits³.

Original consultation proposal

3. The Exchange had then consulted on introducing a minimum track record profit as a Main Board eligibility requirement in April 1994⁴. The Exchange explained that implementing a profit requirement would provide a more meaningful definition to the existing requirement for a new applicant to have an “adequate” track record prior to listing.
4. The Exchange originally proposed to implement the following minimum profit requirements only for new applicants that had a minimum market capitalisation of less than HK\$400 million at the time of listing:
 - (a) HK\$25 million for the most recent financial year;
 - (b) HK\$35 million in aggregate for the two preceding financial years; and
 - (c) profit in all three track record years.
5. Some respondents stated that the proposed requirements were too high and that the HK\$400 million exemption would close the market to smaller companies (GEM was not launched until November 1999) and would encourage new applicants to inflate their profit forecasts to be eligible for the exemption.

¹ Main Board Listing Rule 8.09(2) (Third Edition (December 1989) updated in November 1993 by Update No. 4).

² Main Board Listing Rule 8.05 (Third Edition (December 1989) updated in November 1993 by Update No. 4).

³ News Release, 19 April 1994.

⁴ See footnote 3 above.

Consultation conclusions

6. On 1 September 1994, the Exchange published conclusions to its proposals⁵. The Exchange had decided to reduce its proposed requirements to an aggregate profit attributable to shareholders of HK\$30 million in the first two financial years of its track record period and HK\$20 million in the last financial year (i.e. the current requirement). The Exchange also decided not to require profitability in all three years of a track record period, and that the requirement would apply to all new applicants. The Profit Requirement became effective from 15 September 1994.

2002 Consultation⁶ and 2004 Consultation Conclusions⁷

Proposal on greater flexibility in the spread of profit

7. The Exchange proposed to maintain the HK\$50 million minimum aggregate profit requirement, but to allow flexibility in the spread of the Aggregate Profit Threshold such that at least HK\$20 million can be attributable to either the first two financial years or the last financial year.
8. Most respondents supported maintaining the Aggregate Profit Threshold. Some respondents stated that there was no real need to change the spread of the Profit Requirement as the current requirement had been working well and new applicants had been able to meet the existing first two years/ last year spread without much difficulty. The Exchange concluded that it would not change the requirements.

Proposal on test of pre-tax profit

9. The Exchange proposed to test pre-tax profit rather than post-tax profit for the purpose of the Profit Requirement. The Exchange stated that a test of pre-tax profit would be in line with international practices and that post-tax information would, in any event, be disclosed in a new applicant's listing document.
10. Though a majority of respondents supported the proposal, some raised concerns that the use of pre-tax profit effectively lowered the profitability threshold for listing and that taxation might, in some cases, have a significant impact on a new applicant's profit. Other respondents were concerned that the adoption of the use of pre-tax profit for the purpose of the Profit Requirement might cause confusion to the market as post-tax profit was used to derive many other indicators such as P/E ratio and earnings per share. The Exchange concluded, in light of these comments and the fact that the use of post-tax profit had not been problematic, to retain the use of pre-tax profit.

⁵ News Release, 1 September 1994.

⁶ 2002 Consultation Paper, paragraphs 35 to 43 and 59 to 67.

⁷ 2004 Consultation Conclusions, paragraphs 26 to 36 and 45 to 55.

Proposal on raising the minimum market capitalisation requirement

11. The Exchange proposed to increase the minimum market capitalisation requirement for new applicants apply to list pursuant to the Profit Requirement from HK\$100 million to HK\$200 million. At that time, Listing Rules 8.08 and 8.09(1) required a minimum of 25% of an issuer's shares be at all times held by the public and that these shares must have a market capitalisation of at least HK\$50 million at listing. A HK\$200 million requirement was proposed because 25% of HK\$200 million is HK\$50 million.
12. While majority of respondents were neutral to the proposal, some expressed concerns that a significant number of companies might not be able to meet the requirement. Given that the statistics shows a majority of issuers would be able to meet the increased threshold at their time of listing and the proposal would align the relevant requirements under the Listing Rules, this change was implemented in March 2004.

2010 and 2016 Review of Main Board Listing Eligibility Requirements

13. The Main Board listing eligibility requirements were comprehensively reviewed in April 2010 and it was concluded that the Profit Requirement remained a good indicator of new applicants' future profitability and no change was made to the Profit Requirement.
14. As part of the initiatives to improve market quality, the Listing Committee reviewed the Main Board's listing eligibility requirements again in June 2016. It agreed that the Profit Requirement should be maintained mainly because there were no red flags or strong calls from the market to change the requirement. However, it was agreed that further analysis was to be performed and any consideration to amend the Main Board eligibility requirements should be made in conjunction with the review of the Growth Market Enterprise (GEM) at that time.

2017 Consultation

15. In view of (a) regulatory concerns that the Growth Enterprise Market (GEM)⁸ requirements had been exploited by some market players as an opportunity for regulatory arbitrage between the Main Board and GEM; and (b) GEM's then "stepping stone" positioning had achieved limited success, the Exchange published the 2017 Consultation Paper to seek market comments on the proposed reform to GEM and also changes to the Main Board Listing Rules including any change in the Profit Requirement and the Market Capitalisation Requirement to preserve the Main Board's position as a market for larger companies that can meet high market standards. In particular, the Exchange sought the market's views on⁹:
 - (a) whether the Profit Requirement should still be used as a Main Board eligibility requirement or whether alternative tests should replace it;

⁸ Growth Enterprise Market was renamed as "GEM" after the 2017 Consultation.

⁹ 2017 Consultation Paper, Chapter 5, paragraphs 4 to 27.

- (b) if the Profit Requirement was to be retained, whether any change in the level of profit under the Profit Requirement should be made; and
 - (c) whether the Market Capitalisation Requirement should be raised from HK\$200 million to HK\$500 million and a proportionate increase made to the minimum public float value from HK\$50 million to HK\$125 million.
16. The major market responses for the proposals relating to the Profit Requirement and Market Capitalisation Requirement are as follows¹⁰:
- (a) Profit Requirement – a majority of the respondents agreed to retain the Profit Requirement and also agreed to retain the current threshold. The supporting respondents stated that the Profit Requirement is generally a good indicator of a new applicant’s future performance and the current level of the Profit Requirement is on par with the main markets of the overseas exchanges.
 - (b) Market Capitalisation Requirement - half of the respondents agreed with the proposal. The supporting respondents believed that the proposed increase was reasonable given a majority of the Main Board issuers could meet the higher requirement and it would preserve the Main Board’s position as a market for larger companies and increase the Main Board’s competitiveness in attracting large and prominent enterprises to Hong Kong. Some opposing respondents were concerned that the significant increase may affect the Main Board’s competitiveness and attractiveness and the consequential increase of the implied historical P/E ratio from 10 times to 25 times may result in an unbalanced development and composition of industries of issuers listed on the Main Board, as some “old economy” businesses have inherently lower P/E ratios.
17. Considering the market’s views and also taking into account, among other things, the statistics on the historical average market capitalisation of Main Board issuers, it was concluded that no change would be made to the Profit Requirement and the proposal to increase the Market Capitalisation Requirement from HK\$200 million to HK\$500 million was adopted, and the change took effect on 15 February 2018.

¹⁰ 2017 Consultation Conclusions, paragraphs 98 to 120.

APPENDIX II JURISDICTIONAL COMPARISON

Table A: Comparison of initial eligibility requirements of the Selected Overseas Main Markets and the Main Board

| REQUIREMENT | Main Board | ASX | FCA (premium listed securities) | NASDAQ (Global Market) Select | NYSE | SGX (Main Board) | SSE (Main Board) | |
|------------------------------|---|--|---|--|--|--|---|---|
| Summary of comparison | <p>Choice of three tests:</p> <p>(1) Profits Requirement (see #1) and Market Capitalisation Requirement (see #2).</p> <p>(2) Market Capitalisation Revenue Cashflow Requirement (see #2, #4 and #5).</p> <p>(3) Market Capitalisation Revenue Requirement (see #2 and #4).</p> <p>All applicants must have majority of assets not in cash (see #6) and sufficient working capital (see #7).</p> | <p>Choice of three tests:</p> <p>(1) Profits Test (see #1); or</p> <p>(2) Market Capitalisation Test (see #2); or</p> <p>(3) Net Tangible Assets test (see #6).</p> | <p>Applicants must meet the minimum market capitalisation requirement (see #2).</p> <p>75% of the applicant's business must be supported by at least three year historic revenue earning record (see #4);</p> <p>All applicants must control majority of assets (see #6) and have sufficient working capital (see #7)</p> | <p>Choice of four tests:¹</p> <p>(1) Earnings Test (see #1).</p> <p>(2) Market Capitalisation, Revenue and Cash Flow Test (see #2, #4 and #5).</p> <p>(3) Market Capitalisation & Revenue Test (see #2 and #4)</p> <p>(4) Market Capitalisation and Assets Test (see #2 and #6)</p> | <p>US Domestic²</p> <p>Choice of three tests:</p> <p>(1) Earnings Test (see #1).</p> <p>(2) Global Market Capitalization Test (see #2 and #6).</p> | <p>Foreign Issuer³</p> <p>Choice of three tests:</p> <p>(1) Earnings Test (see #1).</p> <p>(2) Valuation/ Revenue Test either (a) or (b) below:</p> <p>(a) "Valuation/ Revenue with Cash Flow Test" (see #2, #4 and #5); or</p> <p>(b) "Pure Valuation/ Revenue Test" (see #2 and #4)</p> <p>(3) Affiliated Company Test (see #2).</p> | <p>Choice of three tests:⁴</p> <p>(1) Profits Test (see #1); or</p> <p>(2) Profits and Market Capitalisation Test (see #2)</p> <p>(3) Market Capitalisation and Revenue Test (see #2 and #4)</p> <p>All applicants must be in a healthy financial position, having regard to whether the Group has a positive cash flow from operating activities (see #5)</p> <p>All debts must be settled prior to listing (see #7)</p> | <p>Profits Test and minimum share capital requirements must be met (see #1 and #2)</p> <p>Choice of two further tests:</p> <p>(1) Revenue Test (see #4); or</p> <p>(2) Cash Flow Test (see #5)</p> <p>Intangible assets must not exceed 20% of net assets as at the balance sheet date (see #6)⁵</p> |

| No. | REQUIREMENT | Main Board | ASX | FCA (premium listed securities) | NASDAQ (Global Market) Select | NYSE | | SGX (Main Board) | SSE (Main Board) |
|-----|---|---|---|--|---|---|--|---|---|
| 1 | Profit test | <p>Profit Requirement - Profit attributable to shareholders of HK\$20m in the most recent financial year and HK\$30m aggregate in the previous two financial years.</p> <p>This post-tax profit should exclude (a) any income or loss generated by activities outside the ordinary and usual course of its business; and (b) the profits of any associated companies and other entities whose results are recorded in the issuer's financial statement using the equity method of accounting.</p> | <p>Profits Test - aggregate pre-tax profit from continuing operations over three financial years of at least A\$1m (HK\$5.57m).⁶</p> <p>Consolidated pre-tax profit from continuing operations for past 12 months of at least A\$500,000 (HK\$2.79m).⁷</p> <p>"Profit from continuing operations" is defined as operating profit (i.e. profit resulting from operations carried on regularly to achieve the objectives of the entity or group) before tax and disregarding profits resulting from an activity that has been or is to be discontinued.</p> | No profit test. | <p>Option 1⁸ - aggregate pre-tax income from continuing operations in prior three years of at least US\$11m (HK\$85.25m)</p> <p>Minimum pre-tax income from continuing operations in each of two most recent years of at least US\$2.2m (HK\$17.05m) and a positive pre-tax income in each of the prior three years</p> | <p><u>US Domestic</u></p> <p>Aggregate pre-tax earnings* for last three years of at least US\$10m (HK\$77.5m), and minimum pre-tax earnings* in each of two most recent years of at least US\$2m (HK\$15.5m) and no losses in last three years</p> <p>OR</p> <p>If loss in third year, aggregate pre-tax earnings* for last three years of at least US\$12m (HK\$93m) and minimum pre-tax earnings* in most recent year of at least US\$5m (HK\$38.75m) and at least US\$2m (HK\$15.5m) in preceding year.</p> <p>*Pre-tax earnings for all applicants must be from continuing operations after minority interest, amortization and equity in the earnings or losses of investees. Specific non-recurring charges/income must also be excluded.</p> | <p><u>Foreign Issuer</u></p> <p>Aggregate pre-tax earnings* for last three years of at least US\$100m (HK\$775m) and minimum pre-tax earnings* in each of two most recent years of at least US\$25m (HK\$193.75m)</p> <p>*Pre-tax earnings for all applicants must be from continuing operations after minority interest, amortization and equity in the earnings or losses of investees. Specific non-recurring charges/income must also be excluded.</p> | <p>Profits Test - aggregate pre-tax profit of at least S\$30m (HK\$170m) for the last year.</p> <p>If an applicant made low profits or losses in the two years before the application due to specific factors which were of a temporary nature and such adverse factors have either ceased or are expected to be rectified upon the issuer's listing, the application may still be considered.</p> <p>In determining the profits, exceptional or non-recurrent income and extraordinary items must be excluded.</p> | <p>Aggregate profits over last three consecutive years exceeding RMB 30m (HK\$36m). Net profits shall be the lower of the amount stated before and after extraordinary items.⁹</p> <p>No cumulative loss for the latest financial period.¹⁰</p> <p>Net profit should not substantially rely on related party in the latest financial year.¹¹</p> <p>Net profit should not be mainly derived from off-balance sheet investment income in the latest financial year.¹²</p> <p>"Net profits" means "net profits attributable to shareholders"¹³ (i.e. after tax).</p> |
| 2 | Aggregate market capitalisation of new applicant | <p>(1) Profits Requirement: At least HK\$500m</p> <p>(2) Market Capitalisation Revenue Cashflow Requirement: At least HK\$2 billion</p> <p>(3) Market Capitalisation Revenue Requirement: At least HK\$4 billion</p> | <p>At least A\$10m (HK\$59.5m).¹⁴ Note: ASX proposes in May 2016 to increase this threshold to A\$20m (HK\$119m).</p> <p>"Market Capitalisation" means the number of securities in the main class on issue multiplied by the price decided by ASX (normally the issue price or sale price</p> | <p>Expected aggregate market value of all securities to be listed: GBP 700,000 (HK\$7.75m)¹⁶</p> <p>(not necessarily global market capitalisation)</p> <p>"Listed" in the context of the UK Listing Rules means "admitted to the official list maintained by the FCA in accordance with the UK Financial Services and Markets Act</p> | <p>(2) <u>Market Cap. Revenue & Cash Flow Test</u></p> <p>Average of at least US\$550m over prior 12 months (HK\$4.26 billion)¹⁸</p> <p>(3) <u>Market Cap. & Revenue Test</u></p> <p>Average of at least US\$850m over prior 12 months (HK\$6.59 billion)¹⁸</p> <p>(4) <u>Market Cap. & Assets Test</u></p> | <p><u>U.S. Domestic</u></p> <p>(2) <u>Global Market Capitalization Test</u></p> <p>Global market capitalization of at least US\$200m (HK\$1.55 billion).</p> <p>"Global market capitalization" is not defined, generally understood as total dollar market value of all outstanding (i.e. issued) shares of a company.</p> | <p><u>Foreign Issuer</u></p> <p>(2)(a) <u>Valuation / Revenue with Cash Flow Test</u></p> <p>Global market capitalization of at least US\$500m (HK\$3.87 billion).</p> <p>(2)(b) <u>Pure Valuation/Revenue Test</u></p> <p>Global market capitalization of at least US\$750m (HK\$5.81 billion).</p> | <p>(2) <u>Profits and Market Cap. Test</u></p> <p>At least S\$150m (HK\$863m)</p> <p>(3) <u>Market Cap and Revenue Test</u></p> <p>At least S\$300m (HK\$1.73b)</p> <p>"Market Capitalisation" is calculated based on the issue price and post-listing issued share capital.¹⁹</p> | <p>No Market Cap. threshold but:</p> <p>CSRC rules require at least RMB 30m (HK\$36m) share capital before issuance.²⁰</p> <p>The Shanghai Stock Exchange requires at least RMB 50m (HK\$60m) share capital after issuance.²¹</p> <p>"Share capital" 股本總額 is the total issued share capital.</p> |

| No. | REQUIREMENT | Main Board | ASX | FCA (premium listed securities) | NASDAQ (Global Market) Select | NYSE | | SGX (Main Board) | SSE (Main Board) |
|-----|---|--|---|--|---|---------------------------------|---|--|--|
| | | | stated in the prospectus). ¹⁵ | 2000 ¹⁷ , i.e. listed in the UK. | Over US\$160m (HK\$1.24 billion) "Market capitalization" is not defined, generally understood as total dollar market value of all outstanding (i.e. issued) shares of a company. | | (3) <u>Affiliated Company Test</u> Global market capitalization of at least US\$500m (HK\$3.87 billion). | | |
| 3 | Market capitalization of each class of securities listed | At least HK\$125m per class of securities listed | No requirement | No requirement | No requirement | No requirement | No requirement | No requirement | No requirement |
| 4 | Revenue | (2) Market Capitalisation Revenue Cashflow Requirement and (3) Market Capitalisation Revenue Requirement At least HK\$500m revenue for most recent audited financial year | No requirement | At least 75% of the applicant's business must be supported by historic revenue earning record for the period of three years stated in accounts. In determining what amounts to 75% of the applicant's business, the FCA will take into account factors such as the assets, profitability and market capitalisation of the business. ²² | (2) <u>Market Cap. Revenue & Cash Flow Test</u> At least US\$110m (HK\$852.5m) in previous year. (3) <u>Market Cap. & Revenue Test</u> At least US\$90m (HK\$697.5m) in previous year. | U.S. Domestic No requirement | <u>Foreign Issuer (2)(a) "Valuation / Revenue with Cash Flow Test"</u> US\$100m (HK\$775m) for most recent 12 month period. (2)(b) <u>"Pure Valuation/Revenue Test"</u> US\$75m (HK\$581.25m) for most recent 12 month period. | (3) <u>Market Cap. and Revenue Test</u> Operating revenue (actual or pro forma) in the latest completed financial year | (1) <u>Revenue Test</u> Cumulative operating income of RMB 300m (HK\$360m) for last three years. ²³ Operating income should not substantially rely on related party in the latest financial year. ²⁴ |
| 5 | Aggregate cash flow | (1) Market Capitalisation Revenue Cashflow Requirement Positive cash flow of at least HK\$100m in aggregate for three preceding years | No requirement | No requirement | (2) <u>Market Cap. Revenue & Cash Flow Test</u> Aggregate in prior three fiscal years at least US\$27.5m (HK\$213.13m). Positive cash flow in each of the prior three years. | U.S. Domestic No requirement | <u>Foreign Issuer (1) "Valuation / Revenue with Cash Flow Test"</u> Aggregate of US\$100m (HK\$775m) for last three years and minimum cash flow of US\$25m (HK\$193.75m) in each of two preceding years | The applicant must be in a healthy financial position, having regard to whether the Group has a positive cash flow from operating activities. ²⁵ | (2) <u>Cash Flow Test</u> More than RMB 50m (HK\$60m) over last three financial years. ²⁶ |
| 6 | Assets | Assets must not consist wholly or substantially of cash or securities with less than one year to maturity | (3) <u>Net Tangible Assets Test</u> Net tangible assets of at least A\$3m (HK\$17.9m) ²⁷ Note: ASX proposes in May 2016 to increase this threshold to A\$5m (HK\$29.75m). Less than half of net tangible assets must | Must control majority of its assets for the period of three years stated in accounts. ²⁹ | (4) <u>Market Cap. & Asset Test</u> Total Assets at least US\$80m (HK\$620m) Stockholders' Equity at least US\$55m (HK\$426m) | U.S. Domestic No requirement | <u>Foreign Issuer</u> No requirement | The surplus arising from revaluation of plant and equipment should not be capitalised or used for calculating the applicant's net tangible assets per share. ³⁰ | Intangible assets (excluding land use rights, marine cultivation rights and mining rights) must not exceed 20% of the net assets at the end of the latest financial period. ³¹ |

| No. | REQUIREMENT | Main Board | ASX | FCA (premium listed securities) | NASDAQ (Global Market) Select | NYSE | SGX (Main Board) | SSE (Main Board) |
|-----|------------------------|--|---|--|---|--|--|---|
| | | | be in cash (or assets in a form readily convertible to cash); or the applicant must have commitments consistent with its business objectives to spend at least half of its cash and assets in a form readily convertible to cash. ²⁸ | | | | | |
| 7 | Working capital | Must have sufficient working capital for 12 months following publication of listing document | At least A\$1.5m (HK\$8.93m) after taking into account budgeted revenue for first full financial year after listing. ³² Note: ASX proposes in May 2016 to require that in addition to the above, for all issuers listed using the assets test must have at least A\$1.5m (HK\$8.93m) after deducting the first full financial year's budgeted administration costs and the cost of acquiring any assets referred to in the prospectus to the extent those costs will be met out of working capital. | Must have sufficient working capital for 12 months following publication of prospectus or listing particulars. ³³ | Same requirements as applicable to NYSE applicants. SEC | Issuer must include in its Registration Statement, filed with the Securities and Exchanges Commission ("SEC"), a statement by the issuer that its working capital is sufficient or a description of how it proposes to provide additional capital. ³⁴ | Prior to listing, all debts owing to the applicant by its directors, substantial shareholders, and companies controlled by the directors and substantial shareholders must be settled. ³⁵ | An issuer shall not have situations which will negatively affect its ongoing profitability. Examples are: 1. Make any significant change to its existing operations or to the products or services it offers, thereby affecting its ongoing profitability; 2. Be subject to any existing or future change to its industrial status or be exposed to any change to the business environment in which it operates, thereby affecting its ongoing profitability; 3. Face significant risks related to any development affecting its ability to obtain or utilize important assets and technologies such as trademarks, patents, exclusive technologies or franchise assets. ³⁶ |

Table B: Comparison of minimum profit requirements of the Selected Overseas Main Markets and the Main Board³⁷

| Market | First Two Years Profit in Aggregate (HK\$ million) | Final Year Profit (HK\$ million) | Three Years Profit in Aggregate (HK\$ million) | Average Profit Per Year (HK\$ million) | Other Requirements |
|---------------------------------|--|----------------------------------|--|--|---|
| Main Board (current) | 30 | 20 | 50 ³⁸ | 16.7 | <ul style="list-style-type: none"> • Can be loss making in either of the first two financial years • Exclude any income or loss generated by activities outside the ordinary and usual course of its business. • Exclude any associated companies and other entities whose results are recorded in the issuer's financial statement using the equity method of accounting |
| Main Board (Option 1) | 75 | 50 | 125 | 41.6 | |
| Main Board (Option 2) | 90 | 60 | 150 | 50 | |
| ASX | No requirement | 3 | 6 | 2 | <ul style="list-style-type: none"> • Profit from continuing operations (i.e. profit resulting from operations carried on regularly to achieve the objectives of the entity or group) before tax • Disregard profits resulting from discontinued activities |
| FCA (premium listed securities) | No requirement | No requirement | No requirement | No requirement | <ul style="list-style-type: none"> • Not applicable |
| NASDAQ Global Select Market | Year 1 – No requirement Year 2 – 17 | 17 | 85 Note: no losses in latest three financial years) | 28.3 | <ul style="list-style-type: none"> • Pre-tax earnings from continuing operations. |
| NYSE - domestic issuers | Year 1 – No requirement Year 2 – 16 | 16 | 78 Note: no losses in the latest three financial years) | 26 | <ul style="list-style-type: none"> • Pre-tax earnings for all applicants must be from continuing operations after minority interest, amortization and equity in the earnings or losses of investees • Exclude certain specific non-recurring charges/ income |
| | Year 1 – No requirement Year 2 – 16 | 39 | 93 | 31 | |
| NYSE - foreign issuers | Year 1 – No requirement Year 2 – 194 | 194 | 775 | 258 | |
| SGX (Main Board) | No requirement | 170 | No requirement | 56.7 | <ul style="list-style-type: none"> • In determining the profits, exceptional or non-recurrent income and extraordinary items must be excluded. • If the issuer recorded low profits/ losses in the two financial years before the application due to specific factors, and those factors were temporary and have either ceased or are expected to be rectified upon the issuer's listing, the application may still be considered |
| SSE (Main Board) | No requirement | No requirement | 35 Note: no losses in the latest three financial years and no cumulative loss for the latest financial period | 11.7 | <ul style="list-style-type: none"> • Net profits shall be the lower of the amount stated before and after extraordinary items |

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- ¹ Nasdaq Stock Market Rules 5315(e) and 5315(f)(3)
² NYSE Listed Company Manual Rule 102.01C
³ NYSE Listed Company Manual Rule 103.01B
⁴ Rule 210 of SGX Listing Rules
⁵ Article 26 of the Measures for Administration of Initial Public Offering and Listing of Securities 《首次公开发行股票并上市管理办法》 (“**IPO Measures**”). The latest amendment was published by the China Securities Regulatory Commission in June 2018.
⁶ Rule 1.2.4 of ASX Listing Rules
⁷ Rule 1.2.5 of ASX Listing Rules
⁸ Applicants to NASDAQ Global Select Market must meet all of the criteria under at least one the three financial standards.
⁹ Article 26(1) of the IPO Measures
¹⁰ Article 26(5) of the IPO Measures
¹¹ Article 30(3) of the IPO Measures
¹² Article 30(4) of the IPO Measures
¹³ “Net profits” is not defined in the IPO Measures. See Rule 18.1(14) of the Listing Rules of Shanghai Stock Exchange
¹⁴ Rule 1.3.1 of ASX Listing Rules
¹⁵ Rule 19.12 (Definitions) of ASX Listing Rules
¹⁶ Rule 2.2.7 of UK Listing Rules
¹⁷ Definition of “listed” in the FCA Handbook
¹⁸ In the case of a company listing in connection with its initial public offering, compliance with the market capitalisation requirements will be based on the company’s market capitalization at the time of listing rather than over the prior 12 months.
¹⁹ Rule 210(2) of SGX Listing Rules
²⁰ Article 26(3) of the IPO Measures
²¹ Rule 5.1.1(2) of SSE Listing Rules
²² Rules 6.1.3, 6.1.3B and 6.1.3C of the UK Listing Rules
²³ Article 26(2) of the IPO Measures
²⁴ Article 30(3) of the IPO Measures
²⁵ Rule 210(4)(a) of SGX Listing Rules
²⁶ Article 26(2) of the IPO Measures
²⁷ Rule 1.3.1 of ASX Listing Rules
²⁸ Rule 1.3.2 of ASX Listing Rules
²⁹ Rule 6.1.4A of UK Listing Rules
³⁰ Rule 210(4)(c) of SGX Listing Rules
³¹ Article 26(4) of the IPO Measures
³² Rule 1.3.3(b) of ASX Listing Rules
³³ Rule 6.1.16 of UK Listing Rules
³⁴ Section 702.01 of NYSE Listed Company Manual, which refers to section 12(b) of the Securities Exchange Act 1934. Issuer is required to describe its internal and external sources of liquidity and make a statement on working capital sufficiency (item 5 paragraph B.1.(a) of Form 20-F)
³⁵ Rules 210(4)(b) of SGX Listing Rules
³⁶ Article 30(1), (2) and (5) of the IPO Measures
³⁷ For comparison purpose, the amounts of profit required in the Selected Overseas Main Markets are converted to Hong Kong dollars.
³⁸ For comparison purpose, the threshold under the Profit Requirement during the track record period was aggregated.

APPENDIX III GENERAL INFORMATION OF PROFIT REQUIREMENT APPLICATIONS

- For the purpose of this consultation paper, the Exchange reviewed a total of 745 Profit Requirement Applications. The key financial data of the Profit Requirement Applications is as follows:

Table A: Key financial data of Profit Requirement Applications

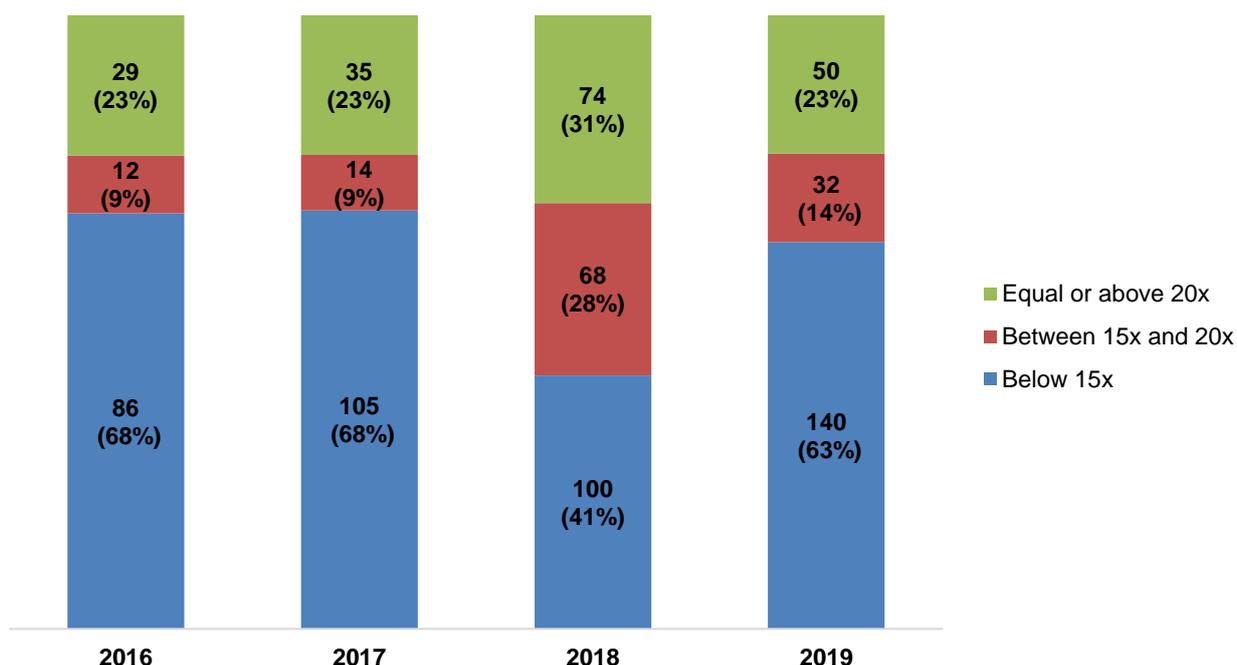
| | 2016 | 2017 | 2018 | 2019 | Average |
|--|-----------|-----------|-----------|-----------|-----------|
| Number of Profit Requirement Applications | 127 | 154 | 242 | 222 | 186 |
| Median ¹ Adjusted Net Profit (HK\$ million): | | | | | |
| - in aggregate for the first two financial years | 72 | 66 | 67 | 68 | 68 |
| - for the last financial year | <u>63</u> | <u>47</u> | <u>55</u> | <u>52</u> | <u>54</u> |
| - total | 135 | 113 | 122 | 120 | 122 |
| Median market capitalisation ² (HK\$ million) | 1,015 | 573 | 765 | 568 | 730 |
| Median historical P/E ratio (Times) | 12 | 12 | 17 | 13 | 14 |

- The aggregated Adjusted Net Profit during the track record period of the Profit Requirement Applications ranges between HK\$113 million and HK\$135 million, which is significantly higher (126% to 170%) than the Aggregated Profit Threshold.
- The median market capitalisation of the Profit Requirement Applications is approximately HK\$730 million, in line with our definition of “Small Cap Issuers” (i.e. companies with market capitalisation of less than or equal to HK\$700 million).
- The median historical P/E ratio of the Profit Requirement Applications is, on average, 14 times. However, the proportion of Profit Requirement Applications with historical P/E ratio above 15 times increased significantly in 2018, after the Market Cap Requirement was increased, as illustrated in Chart A below:

¹ The median (mid-point value of a sample of data) was used as it is less affected by outliers.

² Based on the low end price of the offer price range, where applicable.

Chart A: Historical P/E ratio of Profit Requirement Applications



5. The table below shows information of Profit Requirement Applications of Small Cap Issuers and non-Small Cap Issuers:

Table B: Information of Small Cap Issuers and non-Small Cap Issuers

| | 2016 | 2017 | 2018 | 2019 |
|---|-------------|-------------|--------------|--------------|
| Number of Profit Requirement Applications | 127 | 154 | 242 | 222 |
| Number of Small Cap Issuers (% to total number of Profit Requirement Applications) | 53 (42%) | 85 (55%) | 117 (48%) | 127 (57%) |
| Median market capitalisation of Small Cap Issuers (HK\$ million) | 360 | 364 | 504 | 512 |
| Median historical P/E ratio of Small Cap Issuers (Times) | 10 | 10 | 15 | 12 |
| Number of non-Small Cap Issuers (% to total number of Profit Requirement Applications) | 74 (58%) | 69 (45%) | 125 (52%) | 95 (43%) |
| Median market capitalisation of non-Small Cap Issuers (HK\$ million) | 2,775 | 2,790 | 3,459 | 2,133 |
| Median historical P/E ratio of non-Small Cap Issuers (Times) | 15 | 18 | 19 | 17 |

6. Charts B and C show a breakdown of the historical P/E ratio of Small Cap Issuers and non-Small Cap Issuers by year:

Chart B: Historical P/E ratio of Small Cap Issuers

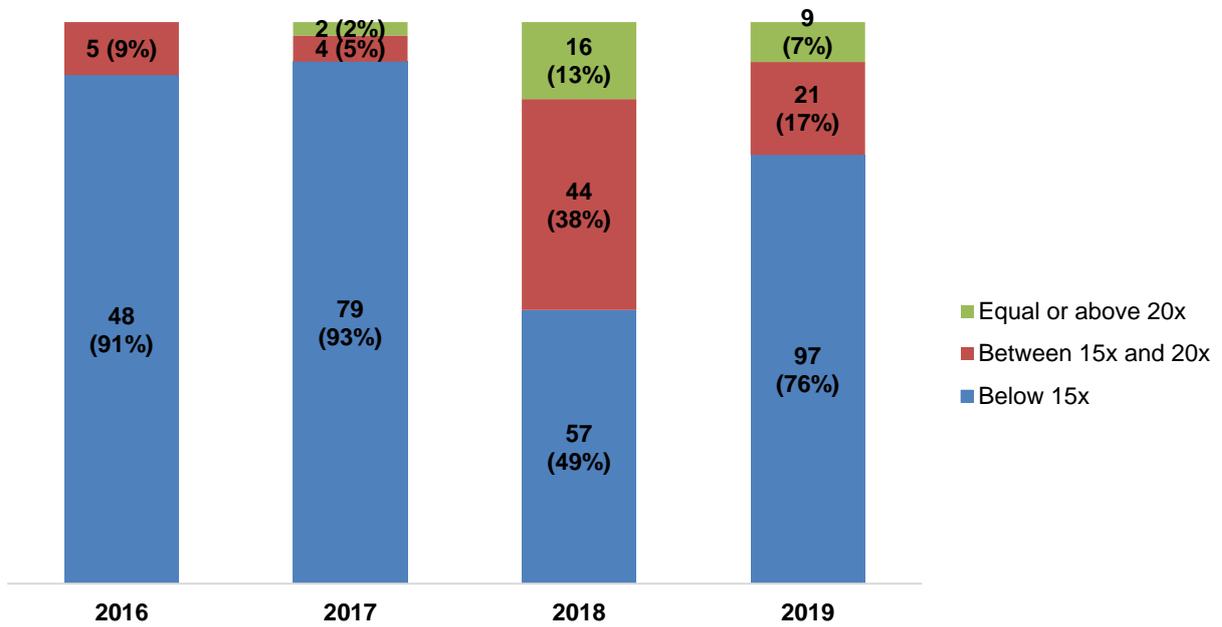
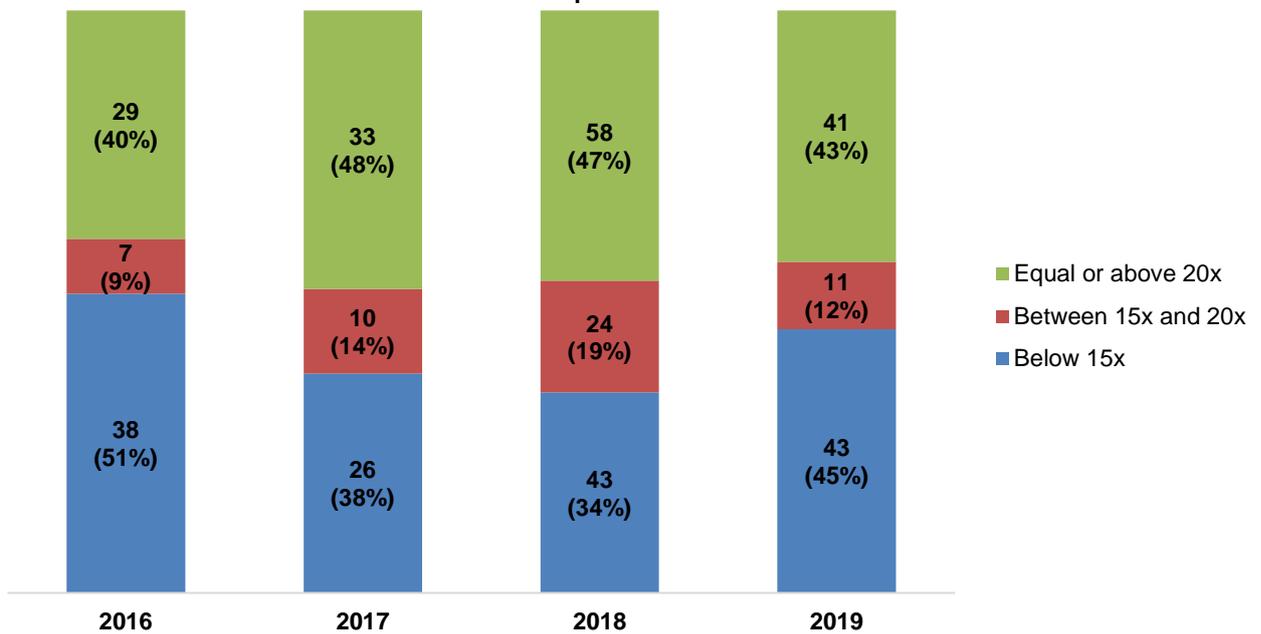
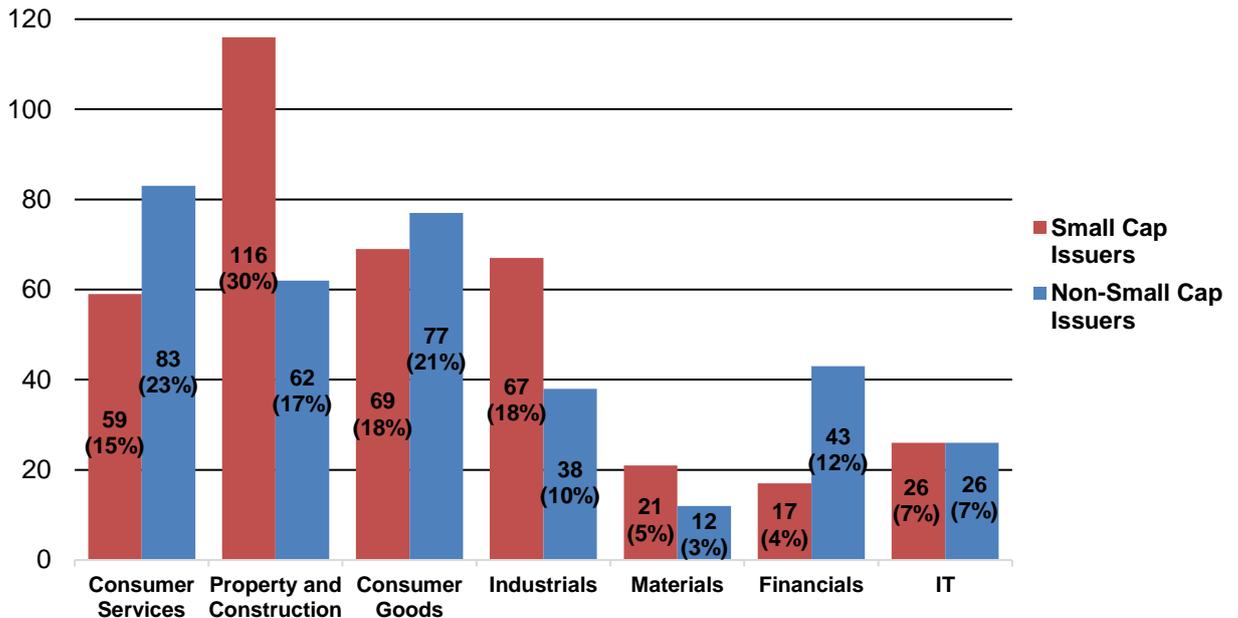


Chart C: Historical P/E ratio of non-Small Cap Issuers



7. Between 2016 and 2019, the top three industries of the Profit Requirement Applications that are Small Cap Issuers are property and construction (30%), consumer goods (18%) and industrials (18%). The top three industries of the Profit Requirement Applications that are non-Small Cap Issuers are consumer services (23%), consumer goods (21%) and property and construction (17%). The breakdown³ is set out below:

Chart D: Industry Sectors of Profit Requirement Applications



³ The top seven industries in Chart D accounted for 96% of the total Profit Requirement Applications. The remaining 4% are from energy, utilities, telecommunications, conglomerates and healthcare services.

APPENDIX IV AMENDMENTS TO THE MAIN BOARD LISTING RULES¹

Chapter 8

EQUITY SECURITIES

QUALIFICATIONS FOR LISTING

Preliminary

...

Basic Conditions

...

- 8.05 The issuer must satisfy either the profit test in rule 8.05(1) or the market capitalisation/revenue/cash flow test in rule 8.05(2) or the market capitalisation/revenue test in rule 8.05(3).

The profit test

- (1) To meet the profit test, a new applicant must have an adequate trading record under substantially the same management and ownership. This means that the issuer, or its group (excluding any associated companies and other entities whose results are recorded in the issuer's financial statements using the equity method of accounting), as the case may be, must satisfy each of the following:
- (a) a trading record of not less than three financial years (see rule 4.04) during which the profit attributable to shareholders must, in respect of the most recent year, be not less than ~~HK\$20,000,000~~[HK\$50,000,000/HK\$60,000,000] and, in respect of the two preceding years, be in aggregate not less than ~~HK\$30,000,000~~[HK\$75,000,000/HK\$90,000,000]. The profit mentioned above should exclude any income or loss of the issuer, or its group, generated by activities outside the ordinary and usual course of its business;
 - (b) management continuity for at least the three preceding financial years; and
 - (c) ownership continuity and control for at least the most recent audited financial year.

¹ We have presented the amendments to Main Board Listing Rules Chapter 8 under both Option 1 and Option 2 as set out in Chapter 1 of this paper. The final amendments shall be subject to the market's view on which option is adopted.

APPENDIX V PRIVACY POLICY STATEMENT

Privacy Policy Statement

Hong Kong Exchanges and Clearing Limited, and from time to time, its subsidiaries (together the "**Group**") (and each being "**HKEX**", "**we**", "**us**" or "**member of the Group**" for the purposes of this Privacy Policy Statement as appropriate) recognise their responsibilities in relation to the collection, holding, processing, use and/or transfer of personal data under the Personal Data (Privacy) Ordinance (Cap. 486) ("**PDPO**"). Personal data will be collected only for lawful and relevant purposes and all practicable steps will be taken to ensure that personal data held by us is accurate. We will use your personal data which we may from time to time collect in accordance with this Privacy Policy Statement.

We regularly review this Privacy Policy Statement and may from time to time revise it or add specific instructions, policies and terms. Where any changes to this Privacy Policy Statement are material, we will notify you using the contact details you have provided us with and, where required by the PDPO, give you the opportunity to opt out of these changes by means notified to you at that time. Otherwise, in relation to personal data supplied to us through the HKEX website or otherwise, continued use by you of the HKEX website or your continued relationship with us shall be deemed to be your acceptance of and consent to this Privacy Policy Statement, as amended from time to time.

If you have any questions about this Privacy Policy Statement or how we use your personal data, please contact us through one of the communication channels set out in the "Contact Us" section below.

We will take all practicable steps to ensure the security of the personal data and to avoid unauthorised or accidental access, erasure or other use. This includes physical, technical and procedural security methods, where appropriate, to ensure that the personal data may only be accessed by authorised personnel.

Please note that if you do not provide us with your personal data (or relevant personal data relating to persons appointed by you to act on your behalf) we may not be able to provide the information, products or services you have asked for or process your requests, applications, subscriptions or registrations, and may not be able to perform or discharge the Regulatory Functions (defined below).

Purpose

From time to time we may collect your personal data including but not limited to your name, mailing address, telephone number, email address, date of birth and login name for the following purposes:

1. to process your applications, subscriptions and registration for our products and services;
2. to perform or discharge the functions of HKEX and any company of which HKEX

is the recognised exchange controller (as defined in the Securities and Futures Ordinance (Cap. 571)) ("Regulatory Functions");

3. to provide you with our products and services and administer your account in relation to such products and services;
4. to conduct research and statistical analysis;
5. to process your application for employment or engagement within HKEX to assess your suitability as a candidate for such position and to conduct reference checks with your previous employers; and
6. other purposes directly relating to any of the above.

Direct marketing

Where you have given your consent and have not subsequently opted out, we may also use your name, mailing address, telephone number and email address to send promotional materials to you and conduct direct marketing activities in relation to HKEX financial services and information services, and financial services and information services offered by other members of the Group.

If you do not wish to receive any promotional and direct marketing materials from us or do not wish to receive particular types of promotional and direct marketing materials or do not wish to receive such materials through any particular means of communication, please contact us through one of the communication channels set out in the "Contact Us" section below. To ensure that your request can be processed quickly please provide your full name, email address, log in name and details of the product and/or service you have subscribed.

Identity Card Number

We may also collect your identity card number and process this as required under applicable law or regulation, as required by any regulator having authority over us and, subject to the PDPO, for the purpose of identifying you where it is reasonable for your identity card number to be used for this purpose.

Transfers of personal data for direct marketing purposes

Except to the extent you have already opted out we may transfer your name, mailing address, telephone number and email address to other members of the Group for the purpose of enabling those members of the Group to send promotional materials to you and conduct direct marketing activities in relation to their financial services and information services.

Other transfers of personal data

For one or more of the purposes specified above, the personal data may be:

1. transferred to other members of the Group and made available to appropriate persons in the Group, in Hong Kong or elsewhere and in this regard you consent to the transfer of your data outside of Hong Kong;
2. supplied to any agent, contractor or third party who provides administrative,

telecommunications, computer, payment, debt collection, data processing or other services to HKEX and/or any of other member of the Group in Hong Kong or elsewhere; and

3. other parties as notified to you at the time of collection.

How we use cookies

If you access our information or services through the HKEX website, you should be aware that cookies are used. Cookies are data files stored on your browser. The HKEX website automatically installs and uses cookies on your browser when you access it. Two kinds of cookies are used on the HKEX website:

Session Cookies: temporary cookies that only remain in your browser until the time you leave the HKEX website, which are used to obtain and store configuration information and administer the HKEX website, including carrying information from one page to another as you browse the site so as to, for example, avoid you having to re-enter information on each page that you visit. Session cookies are also used to compile anonymous statistics about the use of the HKEX website.

Persistent Cookies: cookies that remain in your browser for a longer period of time for the purpose of compiling anonymous statistics about the use of the HKEX website or to track and record user preferences.

The cookies used in connection with the HKEX website do not contain personal data. You may refuse to accept cookies on your browser by modifying the settings in your browser or internet security software. However, if you do so you may not be able to utilise or activate certain functions available on the HKEX website.

Compliance with laws and regulations

HKEX and other members of the Group may be required to retain, process and/or disclose your personal data in order to comply with applicable laws and regulations or in order to comply with a court order, subpoena or other legal process (whether in Hong Kong or elsewhere), or to comply with a request by a government authority, law enforcement agency or similar body (whether situated in Hong Kong or elsewhere) or to perform or discharge the Regulatory Functions. HKEX and other members of the Group may need to disclose your personal data in order to enforce any agreement with you, protect our rights, property or safety, or the rights, property or safety of our employees, or to perform or discharge the Regulatory Functions.

Corporate reorganisation

As we continue to develop our business, we may reorganise our group structure, undergo a change of control or business combination. In these circumstances it may be the case that your personal data is transferred to a third party who will continue to operate our business or a similar service under either this Privacy Policy Statement or a different privacy policy statement which will be notified to you. Such a third party may be located, and use of your personal data may be made, outside of Hong Kong in connection with such acquisition or reorganisation.

Access and correction of personal data

Under the PDPO, you have the right to ascertain whether we hold your personal data, to obtain a copy of the data, and to correct any data that is inaccurate. You may also request us to inform you of the type of personal data held by us. All data access requests shall be made using the form prescribed by the Privacy Commissioner for Personal Data ("**Privacy Commissioner**") which may be found on the official website of the Office of the Privacy Commissioner or via this link

<https://www.pcpd.org.hk/english/publications/files/Dforme.pdf>

Requests for access and correction of personal data or for information regarding policies and practices and kinds of data held by us should be addressed in writing and sent by post to us (see the "Contact Us" section below).

A reasonable fee may be charged to offset our administrative and actual costs incurred in complying with your data access requests.

Termination or cancellation

Should your account or relationship with us be cancelled or terminated at any time, we shall cease processing your personal data as soon as reasonably practicable following such cancellation or termination, provided that we may keep copies of your data as is reasonably required for archival purposes, for use in relation to any actual or potential dispute, for the purpose of compliance with applicable laws and regulations and for the purpose of enforcing any agreement we have with you, for protecting our rights, property or safety, or the rights, property or safety of our employees, and for performing or discharging our functions, obligations and responsibilities.

General

If there is any inconsistency or conflict between the English and Chinese versions of this Privacy Policy Statement, the English version shall prevail.

Contact us

By Post:
Personal Data Privacy Officer
Hong Kong Exchanges and Clearing Limited
8/F., Two Exchange Square
8 Connaught Place
Central
Hong Kong

By Email:
DataPrivacy@HKEX.COM.HK

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