

**WEBINAR:**

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**THE HKEX PROFIT REQUIREMENT PROPOSALS -  
HKEX CONSULTATION ON THE MAIN BOARD  
PROFIT REQUIREMENT**

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# LISTING RULES

## Ch. 8 - qualification for listing

Chapter 8 of the HKEX Listing Rules sets out the minimum requirements that a listing applicant must meet to be considered eligible for listing on the Main Board of the HKEX

- the Profits Test
- the Market Capitalisation/Revenue/Cash Flow Test
- the Market Capitalisation/Revenue Test



# THE CURRENT MAIN BOARD FINANCIAL TESTS

	Profit Test	Market Cap/Revenue/Cash Flow Test	Market Cap/Revenue Test
Profit attributable to shareholders	Profits of HK\$50 million in the last 3 financial years with HK\$20 million in the most recent year and an aggregate of HK\$30 million in the 2 preceding years	-	-
Market Cap	HK\$500 million	HK\$2 billion at listing	HK\$4 billion at listing
Revenue	-	At least HK\$500 million for the most recent financial year	At least HK\$500 million for the most recent financial year
Cash Flow	-	Positive cash flow from operating activities of at least HK\$100 million in aggregate for the 3 preceding financial years	



# THE PROPOSED CHANGES TO THE HKEX PROFIT REQUIREMENT (PROPOSED CHANGES)

	Current HKEX Profit Requirement	Option 1	Option 2
Percentage increase		150%	200%
Aggregate profits attributable to shareholders for financial years one and two	HK\$30 million	HK\$75 million	HK\$90 million
Aggregate profits attributable to shareholders for the last financial year	HK\$20 million	Hk\$50 million	HK\$60 million
<b><u>Total</u></b>	<b><u>HK\$50 million</u></b>	<b><u>HK\$125 million</u></b>	<b><u>HK\$150 million</u></b>

# THE PROPOSED CHANGES TO THE HKEX PROFIT REQUIREMENT

- misalignment between the current Profit Requirement and the increased market capitalisation requirement
- regulatory concerns in relation to the increase in the number of Small Cap Issuers (companies with a market cap of  $\leq$  HK\$700 mln) marginally meeting the current Profit Requirement
- aim to enhance the distinction between the Main Board and GEM
- there are no other regulatory concerns in relation to the profits test under Listing Rule 8.05



# TEMPORARY CONDITIONAL RELIEF CONDITIONS

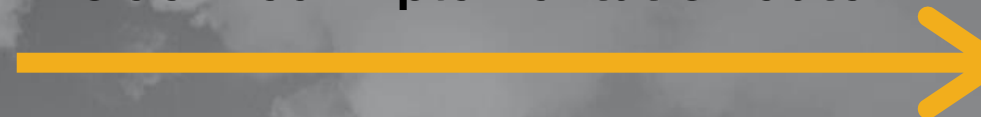
- aggregate profit threshold of HK\$125 million under Option 1 or HK\$150 million under Option 2
- positive cash flow in the ordinary and usual course of business
- the conditions and circumstances affecting the listing applicant's ability to meet the Profit Requirement are temporary
- at least six consecutive months of the track record period must fall within the 2020 calendar year
- additional listing document disclosures are required including a profit forecast

# TRANSITIONAL ARRANGEMENTS

1 February 2021

1 July 2021

No defined implementation date



Responses to the consultation paper to be submitted before 1 February 2021

The earliest date that the Proposed Changes will take effect

# TRANSITIONAL ARRANGEMENTS

- transitional period to ensure that there is little disruption to companies who have already commenced their plans to list
- companies who had started their listing preparations as at 27 November 2020 will have sufficient time to file their applications before the implementation date
- Main Board listing applicants and eligible GEM transfer applicants who submit their respective applications before the implementation date will be assessed according to the current Profit Requirement
- in certain circumstances, GEM transfer applications will be assessed under the current Profit Requirement





# RATIONALE FOR THE PROPOSED CHANGES

## Why the Proposed Changes ?

- the current Profit Requirement has remained unchanged since 1994
- the market capitalisation requirement was increased in February 2018 from HK\$200 million to HK\$500 million
- since the increase in the market capitalisation requirement, there has been a significant increase in applications from listing applicants who only marginally met the Profit Requirement

# RATIONALE FOR THE PROPOSED CHANGES

82%

between 2016 and 2019, 82% of Main Board listing applicants relied on the profit test

51%

of the 82% Profit Requirement applicants 51% were Small Cap Issuers

**The Small Cap Issuers who only marginally met the HKEX Profit Requirement had a relatively high historical P/E Ratio as compared to those of their listed peers**





## PREVIOUS CONSULTATIONS ON PROFIT/ MARKET CAP REQUIREMENTS

- 2002 Consultation
  - Retained current Profit Requirement
  - On par with other leading markets
  - Proposal to use pre-tax profits was not adopted despite support
- June 2017 Consultation
  - Retained current Profit Requirement which was supported by 56% of respondents
    - 13% of respondents favoured increasing the Profit Requirement if the market cap requirement was raised
    - Market cap requirement was increased from HK\$200 million to HK\$500 million (supported by 50% of respondents and opposed by 30%)

# RATIONALE FOR THE PROPOSED CHANGES

## HISTORICALLY HIGH P/E RATIOS

- the Small Cap Issuers justified their higher valuations by reference to potential growth. However, many failed to meet their profit forecasts post-listing
- this called into question the reasonableness of their valuations

# RATIONALE FOR THE PROPOSED CHANGES

## LISTED SHELL CREATION

- HKEX's concern that Small Cap Issuers are engaged in creation of listed shells
- inflated company valuations raise concern of whether or not the IPO offer prices genuinely reflect the expected market clearing prices
- HKEX claims the price discovery process may have been compromised by rebates being offered to investors to entice them to purchase shares
- the HKEX suspects abusive behaviour – the manufacturing of a shareholder base

**These practices go against one of the fundamental principles of the HKEX Listing Rules - that the issue and marketing of securities should be conducted in a fair and orderly manner**





# JURISDICTIONAL COMPARISON

The Consultation Paper compares HKEX's Main Board financial tests with those of 6 overseas main markets

- the Australian Securities Exchange
- the London Stock Exchange (the Premium Segment of its Main Market)
- the NASDAQ (Global Select Market) (**NASDAQ**)
- the New York Stock Exchange (**NYSE**)
- the Shanghai Stock Exchange (Main Board)
- the Singapore Stock Exchange (Main Board)

# HKEX LISTING RULE 8.05 - HKEX PROFIT REQUIREMENT

## HKEX PROFIT REQUIREMENT

- the current HKEX Profit Requirement is lower than both the NYSE and the NASDAQ
- the profits test requirement in Chapter 8 of the HKEX Listing Rules is based on **profit attributable to shareholders**
- HKEX Listing Rule 8.05(1) requires that a listing applicant when calculating **profit attributable to shareholders** must **exclude** any contribution from any associated companies and other entities whose results are recorded in the listing applicant's financial statements using the equity method of accounting

## NYSE AND NASDAQ EARNINGS REQUIREMENTS

- the NYSE and the NASDAQ earnings requirement is based on the listing applicant's **pre-tax earnings**
- neither the NYSE nor the NASDAQ require the exclusion of associated companies' profits



# HKEX LISTING RULE 8.05 - HKEX PROFIT REQUIREMENT

## HKEX

- the Profit Requirement is tied to a market capitalisation requirement and a listing applicant relying on the profit test under Listing Rule 8.05(1) must satisfy the Profit Requirement and a market capitalisation requirement

## NYSE and NASDAQ

- the NYSE and the NASDAQ's earnings test is a standalone test



# HKEX LISTING RULE 8.05 - HKEX PROFIT REQUIREMENT

- if the HKEX Profit Requirement is increased as proposed, HKEX's Main Board will have the highest 3-year aggregate profit requirement of the 6 overseas markets reviewed
- the HKEX is of the view that the increased Profit Requirement will address the regulatory concerns the Hong Kong market is currently facing
- current regulatory concerns include the implied historical P/E ratios and the quality of companies listing on the Main Board



# ANALYSIS OF THE PROPOSED CHANGES

- of the HKEX Profit Requirement Applicants between 2016 and 2019, Option 1 and 2 would have resulted in 59% (437) and 65% (486) of the applicants being ineligible for listing, respectively
- under Option 1 and 2, 46% of the ineligible applications were Small Cap Issuers with proposed market capitalisations between HK\$500 million and HK\$700 million
- comparatively, 10% (under Option 1) and 3% (under Option 2) of eligible applications had proposed market capitalisations between HK\$500 million and HK\$700 million



# ANALYSIS OF THE PROPOSED CHANGES

- 22% (under Option 1) and 25% (under Option 2) of ineligible applications were non-Small Cap Issuers with proposed market capitalisations exceeding HK\$700 million
- 87% (under Option 1) and 95% (under Option 2) of eligible applications were non-Small Cap Issuers with market capitalisations exceeding HK\$700 million
- applicants with market capitalisations of less than HK\$500 million would not have been eligible under the current Market Capitalisation Requirement even if the Profit Requirement is not increased

# ANALYSIS OF THE PROPOSED CHANGES

- the listing applicants that will be impacted the most will be Small Cap Issuers
- HKEX suggests that Small Cap Issuers can still access Hong Kong capital markets as they may alternatively pursue listings on the GEM
- this approach aligns with the goal of the HKEX to further differentiate between Main Board and GEM listings in an effort to improve the overall quality of HKEX Main Board issuers, thereby strengthening Hong Kong's position as an international finance centre



# ANALYSIS OF THE PROPOSED CHANGES

## SPUN OFF NEW ENTITY

- must satisfy all the requirements of the HKEX Listing Rules which apply to new listing applicants
- Chapter 8 qualifications for listing must be complied with

## PARENT COMPANY

- subject to a waiver from the HKEX, the parent company, would itself be required to retain, in addition to its interest in the New Entity, sufficient assets and operations of its own, excluding its interest in the New Entity, to satisfy independently the requirements of Chapter 8 of the HKEX Listing Rules