

## HKEx's consultation conclusions on Main Board Profit Requirement By Dennis Fong | Bosco Leung | Anna Mak

On 20 May 2021, the Stock Exchange of Hong Kong Limited (the "HKEx") published conclusions (the "Consultation Conclusions") to its 27 November 2020 consultation paper (the "Consultation Paper") proposing to substantially increase the profit requirement<sup>1</sup> (the "Profit Requirement") for listing on the Main Board, which is expected to have significant impact on listing applications by small-to-medium sized enterprises (the "SMEs"). After considering and balancing the needs and interests of stakeholders and the public at large, HKEx, in consultation with the Securities and Futures Commission ("SFC"), has decided to increase the Profit Requirement by 60%, from an aggregate profit of HK\$50 million for the three immediate preceding financial years to HK\$80 million (the "Modified Profit Increase"), to be effective on 1 January 2022.

### 1. Proposal to increase the Profit Requirement

The Consultation Paper invited comments from the market on proposals (the "Proposal") that centred on the following, namely whether:

- (i) the Profit Requirement should be increased by 150% (option 1)<sup>2</sup> or 200% (option 2)<sup>3</sup>; or whether other alternative requirement(s) should be considered;
- (ii) in light of such increase, temporary relief from the profit spread of the Profit Requirement so increased should be considered (and if granted, the conditions thereof)

.....  
如果您需要本出版物的中文本,  
请联系:

Publication@llinkslaw.com

.....  
For more Llinks publications,  
please contact:

Publication@llinkslaw.com

<sup>1</sup> Under LR8.05(1)(a) of the Main Board Listing Rules, the minimum amount of profit attributable to shareholders of a new applicant shall be, currently: (i) HK\$20 million for the most recent financial year; and (ii) HK\$30 million in aggregate in the two preceding financial years.

<sup>2</sup> which will increase the minimum amount of profit attributable to shareholders to (i) HK\$50 million in the most recent financial year; and (ii) HK\$75 million in aggregate in the two preceding financial years

<sup>3</sup> which will increase the minimum amount of profit attributable to shareholders to (i) HK\$60 million in the most recent financial year; and (ii) HK\$90 million in aggregate in the two preceding financial years

## 2. Market feedback

The Proposal was, however, not met with much alacrity, but rather, opposing views were raised by a majority of respondents, with doubts being expressed over whether an increase in the Profit Requirement was the right approach to address the valuation and shell issues given a stringent and comprehensive post-listing regulatory regime was already in place. The main concerns raised by the respondents are summarised as follows:

- (i) with GEM, as it currently stands, not being considered a viable alternative listing platform, a considerable number of SMEs and traditional companies might be denied from listing due to the raised bar;
- (ii) the appropriateness of timing of the Proposal in light of the current economic conditions<sup>4</sup>; and
- (iii) the Proposal, once implemented, might risk compromising HKEx's competitiveness vis-a-vis other major exchanges.

## 3. The way forward

### (1) Modified Profit Increase

After considering and balancing the needs and interests of stakeholders and the public at large, HKEx, in consultation with the SFC, has decided to increase the Profit Requirement by 60%, resulting in an aggregate profit threshold<sup>5</sup> of HK\$80 million.

In view of the regulatory concern with regards to the high implied historical P/E ratio of certain marginal listing applicants, HKEx has also decided to adjust the current profit spread from 60%:40% to 56%:44%, such that the aggregate profit requirement for the first two financial years and for the final financial year would be HK\$45 million and HK\$35 million respectively (the "**Revised Profit Spread**"). Accordingly, the implied historical P/E ratio for a listing applicant that meets these minimum thresholds will be 14 times, which is in line with the average P/E ratio of the Hang Seng Index between 1994 and 2020<sup>6</sup>.

The Modified Profit Increase and the Revised Profit Spread will be implemented on 1 January 2022, with implications being that:

- (i) any Main Board listing applications (including renewals of previously submitted applications or GEM transfer applications) submitted on or after 1 January 2022 will be assessed under the Modified Profit Increase; and

<sup>4</sup> with the Hong Kong economy being impacted by social incidents in 2019, the ongoing COVID-19 pandemic, as well as the uncertainties arising from the Mainland China-US political tensions

<sup>5</sup> minimum aggregate profit in the track record period under the Profit Requirement

<sup>6</sup> based on the month-end weighted average P/E ratio of Hang Seng Index between 1994 and 2020 in the Hang Seng Index website

- (ii) a listing applicant will not be permitted to withdraw its listing application before it lapses and resubmit the listing application shortly thereafter before the effective date of the Modified Profit Increase such that the listing application will be assessed in accordance with the current Profit Requirement for a longer period.

## **(2) Relief from the Revised Profit Spread**

HKEx has indicated its willingness to consider granting of relief from the Revised Profit Spread on case-specific circumstances, provided that the listing applicant meets the increased aggregate profit threshold of HK\$80 million. In this respect, HKEx will ordinarily, among other things:

- (i) evaluate the listing applicant's business nature and the underlying reasons for its inability to meet the Revised Profit Spread (e.g. growth stage companies and companies whose businesses have been severely affected by the COVID-19 pandemic and current economic downturn); and
- (ii) impose conditions where appropriate, including disclosure of the listing applicant's profit forecast in the listing document.

In considering an application for a waiver from the Revised Profit Spread under the Modified Profit Increase, HKEx (a) will critically assess the need to include a profit forecast in the listing document to enable investors to make an informed decision on the position and prospects of an issuer; and (b) may make enquiries on how the issuer's IPO price was determined with reference to the book-building process.

## **(3) Other proposed measures**

On the regulatory realm, emphasis would be on the supervision of intermediaries<sup>7</sup>, with actions<sup>8</sup> to be taken against those<sup>9</sup> exhibiting problematic behaviours identified in the Joint Statement<sup>10</sup>.

Also on HKEx's agenda is a review on GEM's positioning, market perception, and its viability as an alternative to the Main Board.

The [Consultation Conclusions](#) and the [Joint Statement](#) are both available on HKEx's website.

<sup>7</sup> intermediaries involved in problematic IPOs with features discussed in the Joint Statement might be prioritised for more in-depth inspection to assess their compliance with the applicable legal and regulatory requirements

<sup>8</sup> with additional circumstances where disciplinary sanctions can be imposed on parties subject to HKEx's disciplinary regime  
<sup>9</sup> including members of senior management who are not directors, who cause or knowingly participate in a contravention of the Listing Rules

<sup>10</sup> joint statement published by HKEx and the SFC on 20 May 2021 highlighting problematic behaviours, such as market manipulation practices, exhibited by listing applicants which will attract heightened scrutiny and enquiries from HKEx and the SFC

If you would like to know more information about the subjects covered in this publication, please contact:



**Dennis Fong**  
+852 2592 1910  
dennis.fong@llinkslaw.com.hk



**Bosco Leung**  
+852 2592 1983  
bosco.leung@llinkslaw.com.hk

**SHANGHAI**

19F, ONE LUJIAZUI  
68 Yin Cheng Road Middle  
Shanghai 200120 P.R.China  
T: +86 21 3135 8666  
F: +86 21 3135 8600

**BEIJING**

4F, China Resources Building  
8 Jianguomenbei Avenue  
Beijing 100005 P.R.China  
T: +86 10 8519 2266  
F: +86 10 8519 2929

**SHENZHEN**

18F, China Resources Tower  
2666 Keyuan South Road, Nanshan District  
Shenzhen 518063 P.R.China  
T: +86 755 3391 7666  
F: +86 755 3391 7668

**HONG KONG**

Room 3201, 32/F, Alexandra House  
18 Chater Road  
Central, Hong Kong  
T: +852 2592 1978  
F: +852 2868 0883

**LONDON**

1/F, 3 More London Riverside  
London SE1 2RE  
United Kingdom  
T: +44 (0)20 3283 4337  
D: +44 (0)20 3283 4323



[www.llinkslaw.com](http://www.llinkslaw.com)



Wechat: LlinksLaw

**WE LINK LOCAL LEGAL INTELLIGENCE WITH THE WORLD**

This publication represents only the opinions of the authors and should not in any way be considered as legal opinions or advice given by Llinks. We expressly disclaim any liability for the consequences of action or non-action based on this publication. All rights reserved.

© Llinks Law Offices 2021