

Time to Abolish Minimum Market Capitalisation Requirement For 8.05(1) Companies

Introduction

In the dynamic and rapidly evolving landscape of global finance, the Hong Kong Stock Exchange (HKEX) has positioned itself as a crucial conduit for capital flows, particularly for Chinese companies seeking to connect with international investors. A healthy capital market should cater to both large and small companies, while actively pursuing companies with large market capitalisation, listings of smaller companies in Hong Kong should also be supported.

One of the long-standing conditions to be listed in Hong Kong is the minimum market capitalisation requirement, currently set at HK\$500 million for the Main Board and HK\$150 million for the Growth Enterprise Market (GEM), for companies meeting the profit requirement (Rule 8.05(1) of the Main Board listing rules) (the “Profit Requirement”) or operating cash flow requirement (Rule 11.12(A)(1) and Rule 11.23(6) of the GEM listing rules). HKEX has also introduced alternative listing requirements for companies that do not meet the Profit Requirement but can meet, inter alia, a higher market capitalisation threshold. As market trading multiples change according to the market environment, the suitability of listing of an applicant meeting the Profit Requirement is prejudiced by a low multiple environment and/or a low multiple sector, which is out of its control. This raises the question regarding the necessity of maintaining this minimum market capitalisation requirement for companies meeting the Profit Requirement in the development of Hong Kong’s dynamic and vibrant capital market.

Minimum Market Capitalisation Requirement at HKEX

The minimum market capitalisation requirement at HKEX was initially set at HK\$100 million in 1994. Over the years, HKEX progressively raised its minimum market capitalisation requirements to HK\$200 million in 2004 for the Main Board and further increased to HK\$500 million in 2018 for the Main Board and HK\$150 million for the GEM. The proposed changes were based on several key factors:

1. Reflecting Market Growth

Since the introduction of the HK\$200 million minimum market capitalisation requirement in 2004, the average size of listed companies has approximately doubled from 2004 to 2016. Setting the new requirement at HK\$500 million in 2018 was intended to align with this growth.

2. Position Main Board for Larger Companies

Raising the threshold aimed to filter out smaller, potentially less stable companies, thereby preserving the distinctiveness of the Main Board and its position as a market for larger companies.

3. Global Competitiveness

The increased requirements were to position the Main Board closer to major overseas main markets, capable of attracting large, established firms from around the world.

For issuers who do not meet the Main Board profit test requirements or are at pre-revenue stage, HKEX adopts a higher hurdle for minimum market capitalisation:

Table 1: Minimum market capitalisation under selected chapters of the Listing Rules

	Chapter 8 - Market capitalisation/rev enue/cash flow test	Chapter 8 - Market capitalisation/rev enue test	Chapter 18A - Biotech Companies	Chapter 18C - Specialist Technology Companies
Minimum market capitalisation requirement	HK\$2 billion	HK\$4 billion	HK\$1.5 billion	HK\$6 billion (HK\$10 billion for pre-commercial company)

This approach is particularly relevant for high-growth sectors like biotechnology and special technology companies that may not have traditional profit metrics but possess significant potential for future growth.

Applying the Minimum Market Capitalisation Requirement to Listed Issuers on the Main Board

Under the current listing requirement under Rule 8.05(1) requiring a minimum profit of HK\$35 million for the final financial year and the minimum market capital requirement of HK\$500 million (the “MMCR”) at the time of listing, the implied minimum historical price-earnings multiple (“P/E”) for an issuer is at 14.3 times.

Set out in Table 2 below are the average sector historical P/E for the period from 1 January 2022 to 5 June 2024 (the reference date used for this paper) and on 5 June 2024 of the 16 sectors classification commonly adopted in Hong Kong, and an analysis of the respective minimum final year profit required to satisfy the MMCR. As shown in the table, there have been times in the past 2 ½ years that the average historical P/E of 14 of the 16 sectors were lower than 14.3 times and companies in these sectors required a much higher historical profit to meet the MMCR. On 5 June 2024, seven out of the 16 sectors require a higher historical profit to meet the MMCR. This is not fair.

In summary, while the MMCR was designed to ensure market stability and attract issuers with significant financial strength, many of the listed issuers do not meet this requirement and it poses significant barriers for issuers in various industries.

Table 2: Average historical P/E by sector on the Main Board

Sector	Average sector historical P/E (x) from 1 January 2022 to 5 June 2024	Implied historical profit required to meet the MMCR at the low end (HK\$ million rounded up)	Average historical P/E (x) on 5 June 2024	Implied historical profit required to meet the MMCR (HK\$ million rounded up)
Communications	14.5 - 51.4	34.6	18.3	27.4
Consumer Discretionary Products	14.2 - 46.3	35.2	15.8	31.7
Consumer Discretionary Retail & Wholesale	9.2 - 43.8	54.4	27.6	18.2
Consumer Discretionary Services	12.5 - 29.4	40.2	13.2	37.9
Consumer Staple Products	14.4 - 29.7	34.7	16.2	30.9
Consumer Staple Services	12.1 - 63.5	41.3	24.4	20.5
Energy	9.3 - 55.1	53.8	12.4	40.4
Financials	9.9 - 17.5	50.7	13.3	37.6
Healthcare	15.4 - 25.6	32.5	15.8	31.7
Industrial Products	11.5 - 28.3	43.6	12.9	38.8
Industrial Services	11.1 - 51.1	45.1	13.1	38.2
Materials	9.2 - 31.0	54.1	14.2	35.3
Real Estate	8.8 - 35.2	56.8	11.9	42.1
Technology	13.3 - 46.3	37.6	17.2	29.1
Telecommunications	8.5 - 16.3	58.8	14.0	35.8
Utilities	9.2 - 22.3	54.3	17.3	29.0
Average	11.4 - 37.0	43.7	14.5	34.5

Source: Bloomberg

Minimum Market Capitalisation Requirement of Major Global Exchanges

To understand HKEX's position in the global financial landscape, it is essential to compare its listing requirements, particularly the minimum market capitalisation threshold, with those of other major exchanges such as New York Stock Exchange (NYSE), Nasdaq, London Stock Exchange (LSE), Singapore Exchange (SGX), Tokyo Stock Exchange (TSE), Shanghai Stock Exchange (SSE) and Shenzhen Stock Exchange (SZSE). Many of these major exchanges provide pathways for issuers to qualify for listing, focusing on financial performance and operational criteria, without the requirement of a minimum market capitalisation.

New York Stock Exchange (NYSE)

NYSE, often referred to as the "Big Board," positioned itself to host many of the largest and most established companies across various sectors. For domestic IPO issuers, NYSE requires that the aggregate market value of publicly held shares be at least US\$40 million. Issuers may choose one of the following two financial standards tests, i.e. the global market capitalisation test, a minimum market capitalisation of US\$200 million; or the earnings test, which NYSE does not require an issuer to meet a minimum market capitalisation. This earnings test requires the issuer to demonstrate (a) an adjusted pre-tax income of at least US\$10 million over the last three fiscal years; (b) at least US\$2 million in

each of the two most recent fiscal years; and (c) the issuer must have positive pre-tax income in each of the prior three fiscal years.

Nasdaq

Nasdaq employs a tiered system to accommodate companies of different sizes and stages of development. The minimum market capitalisation requirements vary by tier and different standards: US\$160 million for the Nasdaq Global Select Market, US\$75 million for the Nasdaq Global Market, and US\$50 million for the Nasdaq Capital Market. However, each tier has its own set of alternative financial performance criteria, including net income, revenue, and cash flow thresholds, which do not require a minimum market capitalisation.

London Stock Exchange (LSE)

LSE operates both the Main Market and the Alternative Investment Market (AIM). The Main Market requires a minimum market capitalisation of £700,000 (about US\$0.9 million) and mandates that companies show three years of revenue generation. AIM, however, does not have a minimum market capitalisation requirement and focuses on the growth potential and business viability of the companies.

Singapore Exchange (SGX)

SGX requires issuers listing on the Mainboard to have a minimum market capitalisation of S\$150 million (about US\$111 million). Issuers must either show a pre-tax profit in the most recent financial year or have revenue of at least S\$300 million (about US\$220 million). The Catalist Board, however, does not have a minimum market capitalisation requirement.

Tokyo Stock Exchange (TSE)

TSE employs a three-tiered system, the Prime Market, intended for large, established companies, requires a minimum market capitalisation of ¥25 billion (about US\$157 million). The Standard Market, which caters to the general market across different industries, does not have a minimum market capitalisation requirement but requires issuers to demonstrate total profits of over ¥0.1 billion (about US\$0.6 million) and a positive consolidated net asset figure in the latest financial year. Furthermore, the Growth Market which caters to high-growth companies, does not have a minimum market capitalisation requirement and only requires ¥0.5 billion (about US\$3.1 million) in market value for tradable shares.

Shanghai Stock Exchange (SSE) and Shenzhen Stock Exchange (SZSE)

SSE and SZSE Main Board offer alternative criteria that do not have a minimum market capitalisation requirement for issuers which satisfy (a) the net profit requirement (i.e. aggregate net profit over RMB 150 million in the past three consecutive years and net profit over RMB 60 million for the most recent year); and (b) the operating revenue/net cash flow requirement (i.e. operating revenue over RMB 1 billion; or total net cash flow from operating activities over RMB 100 million in the past three years). The ChiNext board of SZSE does not require a minimum market capitalisation for issuers with over RMB 50 million in aggregate net profit in the past two consecutive years.

Major global exchanges provide listing criteria that do not necessitate a minimum market capitalisation. These criteria often focus on profitability, revenue generation, cash flow, and other financial metrics. Exchanges like the NYSE, Nasdaq, TSE, SSE, and SZSE offer flexible pathways to listing, catering to issuers of various sizes and growth stages. These criteria ensure that companies can qualify for listing based on their financial health and operational performance, even if they do not meet stringent market capitalisation thresholds.

Our View

As global capital markets evolve, the rigidity of minimum market capitalisation requirements is increasingly coming under scrutiny. For HKEX, these requirements have traditionally ensured that only issuers of substantial size and stability can access its Main Board. However, in today's dynamic economic landscape, this approach might limit the inclusion of issuers that do not necessarily meet these capitalisation thresholds but demonstrate robust financial health through other established metrics.

The MMCR presents significant barriers to entry for quality issuers from sectors that do not enjoy as a high P/E as other industries, such as new economy and biotechnology. These issuers may not have substantial market capitalisation but can show strong profitability or have other indicators of financial health and growth potential. By setting market capitalisation as a rigid requirement, HKEX excludes quality issuers that could otherwise contribute significantly to market diversity.

The MMCR is discriminating against certain companies that meet the minimum profit requirement. For profitable companies, market capitalisation is a product of profit after taxation and P/E. As the macroeconomic environment changes, the P/E of the stock market changes and is out of the control of the issuer. Therefore, using the average historical P/E as shown in Table 2 above, a listing applicant from lower P/E sector with a profit after taxation of more than HK\$35 million for the final financial year cannot meet the MMCR and cannot be listed during a certain stock market cycle. This is unfair to a listing applicant in a lower P/E sector, as an issuer in a high P/E sector with the same profit amount can be listed, while this listing applicant may not.

One significant challenge for a smaller company that fulfils the minimum profit requirement to list in Hong Kong is to demonstrate it also meets the MMCR to the satisfaction of the regulators. This represents significant risk and uncertainty for these potential listing applicants, as there is no certainty that the MMCR will be deemed to be fulfilled at the time of listing application or listing. The MMCR also restricts the ability of these issuers to price their offer at a lower level to attract sufficient interest from investors to complete the IPO. The attractiveness of HKEX versus other exchanges for these companies is seriously hampered.

Leading global exchanges provide compelling examples of alternative approaches, for example, Nasdaq employs a tiered system with varied financial performance metrics, offering pathways for issuers with strong revenue or cash flow despite not meeting market capitalisation thresholds. Other global exchanges, such as LSE's AIM, SGX's Catalist Board and TSE's Growth Market, provide fund-raising platforms for small and medium-sized enterprises and start-ups, entirely foregoing a minimum market capitalisation requirement. NYSE, SSE and SZSE do not have a minimum market capitalisation if certain profit requirements are met.

HKEX can draw from these examples to create a more flexible listing environment. We recommend the elimination of the strict minimum market capitalisation requirement for issuers that meet certain minimum financial criteria (such as demonstrating consistent profitability, revenue or cash flow), subject to a minimum monetary public float requirement at the time of listing, which will be larger than 25% of the issued share capital of the issuer. HKEX can take immediate action by granting a temporary waiver from the strict minimum market capitalisation requirement for companies meeting Rule 8.05(1) and then conducting a market consultation to obtain market feedback and formalise the arrangement.

In conclusion, removing the minimum market capitalisation requirement for issuers who meet certain financial metrics can significantly enhance HKEX's competitiveness to attract and support a diverse range of issuers. This change would allow HKEX to better compete with global exchanges and accommodate the evolving needs of the dynamic and vibrant capital market.

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