

## A Comparison Between Shenzhen SME Companies and Hong Kong GEM Companies

Joseph Lee, Yan Yuhong and Joanna Poon, Research Department of the Supervision of Markets Division<sup>1</sup>

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### Summary

- *All SME companies reported earnings in FY2003, whilst almost half of the GEM companies reported losses. Compared to SME companies, GEM companies in general have lower share prices, smaller market cap and lower market turnover.*
- *The different characteristics and the contrasting performance are mainly attributable to some fundamental differences such as:*
  - *the listing requirements of the SME Board and the GEM Board;*
  - *the rules and regulations governing the two boards; and*
  - *the investor mix and the investor behaviour of the two markets.**The listing requirements as well as the rules and regulations for the SME Board are in general more stringent than those for the GEM Board.*

### Objective of the Study

1. The Small and Medium Enterprise (SME) Board was launched in Shenzhen on 25 June 2004 to assist smaller growth companies in China to raise capital. Some are concerned that there might be competition between the Shenzhen SME Board and the Hong Kong Growth Enterprise Market (GEM) Board. This study aims at providing some basic facts and comparing characteristics of the two markets.

### Background

2. Due to the delay in launching the SME Board, there was a pent up demand for listings. Up to the end of September 2004, 38 companies were listed on the Board. However, IPOs on the Mainland stock markets were suspended during September 2004 – January 2005, as regulators prepared new guidelines governing the pricing of share sales. Listings on the SME Board were also halted for several months. After the resumption of IPOs early this year, there were two new companies listed in March 2005. Since our analysis is up to the end of February 2005, these two newly listed companies are not covered by this study. As of the end of February 2005, the aggregate market cap of the SME Board amounted to US\$5.0 bn. The average daily turnover was US\$35.6 mn in February 2005. Since its inception, the SME Board has raised US\$1.1 bn. The PE ratios averaged 30.

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<sup>1</sup> This paper is for pure fact-finding and research purposes, and is not an attempt to comment on the developments of any markets/companies or interpret the policies concerned. The views expressed in this paper do not represent those of the SFC.

3. In Hong Kong, the GEM Board was launched on 25 November 1999. As of the end of February 2005, there were 205 companies listed on the GEM Board, with a total market cap of US\$8.5 bn. Their average daily turnover in February 2005 was US\$7.6 mn. Since its inception, the GEM Board has raised US\$5.5 bn. The PE ratios averaged 28.

<b>Major Statistics of Shenzhen SME Board and Hong Kong GEM Board (end February 2005)</b>		
	<b>SME</b>	<b>GEM</b>
<b>Number of Listed Companies*</b>	38	205
<b>Market Capitalisation (US\$ bn)</b>	5.0	8.5
<b>Average Daily Turnover during February 2005 (US\$ mn)</b>	35.6	7.6
<b>Amount of Funds Raised since Inception (US\$ bn)</b>	1.1	5.5
<b>Average PE Ratio</b>	30.0	28.0
<b>Average Market Capitalisation per Company (US\$ mn)</b>	132.1	41.7
<b>Average Daily Turnover per Company during February 2005 (US\$ mn)</b>	0.9	0.04

Note: \* Companies delisted or moved to the Main Board are excluded.  
Sources: HKEx, Shenzhen Stock Exchange and Bloomberg

### **Different Characteristics Between the Companies Listed on the Two Boards**

4. Compared to SME companies, GEM companies in general
- have a larger proportion of companies reporting losses;
  - have lower share prices;
  - have smaller market cap; and
  - have lower market turnover.

#### A larger proportion of GEM companies reporting losses

5. The analysis on financial performance is based on 2003 results, because most companies have not announced their 2004 earnings at the time of this paper.
6. Compared to SME companies, the proportion of GEM companies reporting losses is higher.
- All the 38 companies listed on the SME Board reported profits in FY2003. A majority (27 companies or 71.1%) reported profits of less than US\$5 mn.
  - On the GEM Board, 95 companies (46.3%) reported losses in FY2003. 81 companies reported losses of less than US\$5 mn. For the 110 companies reporting earnings in FY2003, 82 companies earned less than US\$5 mn.

<b>Financial Performance of Firms Listed on SME Board and GEM Board (2003)</b>				
	<b>SME</b>		<b>GEM</b>	
	<b>No. of Firms</b>	<b>%</b>	<b>No. of Firms</b>	<b>%</b>
<b>Number of Firms Reporting Earnings/Losses</b>				
<b>Losses</b>	0	0.0%	95	46.3%
<b>Earnings</b>	38	100.0%	110	53.7%
<b>Total</b>	<b>38</b>	<b>100.0%</b>	<b>205</b>	<b>100.0%</b>
<b>Number of Firms and the Amount of Earnings/Losses</b>				
<b>Below US\$-10 mn</b>	0	0.0%	4	2.0%
<b>US\$-10 mn+ to US\$-5 mn</b>	0	0.0%	10	4.9%
<b>US\$-5 mn+ to 0</b>	0	0.0%	81	39.5%
<b>0+ to US\$5 mn</b>	27	71.1%	82	40.0%
<b>US\$5 mn+ to US\$10 mn</b>	10	26.3%	18	8.8%
<b>Above US\$10 mn</b>	1	2.6%	10	4.9%
<b>Total</b>	<b>38</b>	<b>100.0%</b>	<b>205</b>	<b>100.0%</b>

Sources: HKEx, Shenzhen Stock Exchange and Bloomberg

### GEM companies have lower share prices in general

7. Compared to SME companies, GEM companies in general have lower share prices.
- On the SME Board, all listed companies were traded above US\$0.50 as of the end of February 2005.
  - In contrast, on the GEM Board, share prices of
    - 98.1% (201) of the companies were below US\$0.50;
    - 85.4% (175) of the companies were below US\$0.10;
    - 72.2% (148) of the companies were below US\$0.05; and
    - 30.2% (62) of the companies were below US\$0.01.

<b>Comparison of Shenzhen SME Board and Hong Kong GEM Board by Share Price</b>				
<b>Share Prices as of the end of February 2005</b>	<b>SME</b>		<b>GEM</b>	
	<b>No. of Firms</b>	<b>%</b>	<b>No. of Firms</b>	<b>%</b>
<b>Below US\$0.01</b>	0	0.0%	62	30.2%
<b>US\$0.01+ to US\$0.05</b>	0	0.0%	86	42.0%
<b>US\$0.05+ to US\$0.10</b>	0	0.0%	27	13.2%
<b>US\$0.10+ to US\$0.50</b>	0	0.0%	26	12.7%
<b>US\$0.50+ to US\$1.00</b>	6	15.8%	1	0.5%
<b>US\$1.00+ to US\$1.50</b>	16	42.1%	1	0.5%
<b>US\$1.50+ to US\$2.00</b>	9	23.7%	1	0.5%
<b>Above US\$2.00</b>	7	18.4%	1	0.5%
<b>Total</b>	<b>38</b>	<b>100.0%</b>	<b>205</b>	<b>100.0%</b>

Sources: HKEx, Shenzhen Stock Exchange and Bloomberg

### GEM companies have smaller market cap in general

8. Compared to SME companies, GEM companies in general have smaller market cap.
- As of the end of February 2005, the market cap of SME companies ranged from US\$33.5 mn to US\$1,044.3 mn, with an average of US\$184.1 mn.
  - In contrast, on the GEM Board, the market cap of companies ranged from US\$0.9 mn to US\$1,025.5 mn, with an average of US\$42.1 mn.
    - 78.5% (161) of the companies had market cap of less than US\$30 mn (i.e. smaller than the smallest SME company in Shenzhen); and
    - 54.1% (111) of the companies had market cap of less than US\$10 mn.

<b>Comparison of Shenzhen SME Board and Hong Kong GEM Board by Market Cap</b>				
Market cap as of the end of February 2005	SME		GEM	
	No. of Firms	%	No. of Firms	%
Below US\$10 mn	0	0.0%	111	54.1%
US\$10 mn+ to US\$30 mn	0	0.0%	50	24.4%
US\$30 mn+ to US\$50 mn	8	21.1%	14	6.8%
US\$50 mn+ to US\$100 mn	8	21.1%	10	4.9%
US\$100 mn+ to US\$300 mn	14	36.8%	15	7.3%
Above US\$300 mn	8	21.1%	5	2.4%
<b>Total</b>	<b>38</b>	<b>100.0%</b>	<b>205</b>	<b>100.0%</b>

Sources: HKEx, Shenzhen Stock Exchange and Bloomberg

### GEM companies have lower market turnover in general

9. Compared to SME stocks, trading of GEM stocks was in general less active.
- The average daily turnover per SME company was US\$0.9 mn in February 2005.
  - In contrast, on the GEM Board, the average daily turnover of
    - 99.5% (204) of the stocks was less than US\$1.0 mn;
    - 98.5% (202) of the stocks was less than US\$0.5 mn;
    - 91.7% (188) of the stocks was less than US\$0.1 mn;
    - 87.3% (179) of the stocks was less than US\$0.05 mn; and
    - 71.7% (147) of the stocks was less than US\$0.01 mn.

<b>Comparison of Shenzhen SME Board and Hong Kong GEM Board by Turnover</b>				
Average Daily Turnover in February 2005	SME		GEM	
	No. of Firms	%	No. of Firms	%
Below US\$0.01 mn	0	0.0%	147	71.7%
US\$0.01 mn+ to US\$0.05 mn	0	0.0%	32	15.6%
US\$0.05 mn+ to US\$0.1 mn	0	0.0%	9	4.4%
US\$0.1 mn+ to US\$0.5 mn	8	21.1%	14	6.8%
US\$0.5 mn+ to US\$1 mn	17	44.7%	2	1.0%
US\$1 mn+ to US\$5 mn	13	34.2%	1	0.5%
US\$5 mn+ to US\$10 mn	0	0.0%	0	0.0%
Above US\$10 mn	0	0.0%	0	0.0%
<b>Total</b>	<b>38</b>	<b>100.0%</b>	<b>205</b>	<b>100.0%</b>

Sources: HKEx, Shenzhen Stock Exchange and Bloomberg

## **Fundamental Differences Between the Two Boards / Markets**

10. The different characteristics and the contrasting performance are mainly attributable to some fundamental differences such as:
- the listing requirements of the SME Board and the GEM Board;
  - the rules and regulations governing the two boards; and
  - the investor mix and the investor behaviour of the two markets.

### Listing requirements and other rules for the two boards

11. The SME Board is a segment of the Main Board of the Shenzhen Stock Exchange. The listing requirements and other rules for companies on the SME Board are basically the same as those for the Main Board. These include:
- a minimum operating history of 3 years;
  - a history of profits for 3 years; and
  - a minimum market cap of RMB50 mn (this is implicit from the requirements on minimum capital).
12. Relative to the SME Board, the listing requirements and other rules for GEM Board companies are less stringent. Among other things, there is
- a minimum operating history of 2 years;
  - no profit requirement for GEM companies; and
  - a minimum market cap requirement of about HK\$46 mn (this is implicit from the requirements that the minimum public float is HK\$30 mn and that the management shareholders and significant shareholders collectively must hold at least 35% of the issued share capital).

### Investor mix for the two markets

13. Another difference between the two markets is the investor mix and therefore the investor behaviour. The Mainland markets comprise predominantly local retail investors, whereas the Hong Kong markets have a better investor mix.
- At present, the Mainland B-markets are open to both local and foreign investors, but the markets are dominated by local investors. In any case, the B-markets only account for about 1-2% of the total by market cap and by market turnover. The A-markets are semi-open to foreign participation through the Qualified Foreign Institutional Investors (QFII) scheme, but the amount approved is still small relative to the whole market. As of the end of February 2005, there were 27 QFIIs managing funds of US\$3.6 bn, less than 0.8% of total market cap of the Mainland stock markets.

- In Hong Kong, HKEx's survey showed that the share of overseas investors was 36% of the total trading value for the 12 months ending September 2004 (33% institutional and 3% retail), whilst the share of local investors was 56% (22% institutional and 34% retail), the remaining 7% being principal trading.
14. Because the Mainland markets are dominated by local retail investors who tend to be more sensitive to short term market sentiment, turnover velocity is higher in the Mainland than in Hong Kong.
- Turnover on the Mainland markets totaled US\$431.7 bn for the 12 months ending February 2005. With a market cap of US\$464.5 bn as of the end of February 2005, the turnover velocity was 93%.
  - Turnover on the Hong Kong markets totaled US\$421.9 bn for the 12 months ending February 2005. With a market cap of US\$880.4 bn as of the end of February 2005, the turnover velocity was 48%.

## Conclusion

15. Due to the above-mentioned fundamental differences between the Shenzhen SME Board and Hong Kong GEM Board, these two markets are not strictly comparable. It is most important for Hong Kong to maintain its competitive edge. The competitiveness of a market ultimately depends on:
- the quality of issuers;
  - the quality of intermediaries;
  - the quality of investors;
  - the quality of infrastructure;
  - the quality of market operators; and
  - the quality of services providers.
16. If the competitive edges can be maintained, Hong Kong will continue to be a major fund-raising centre for Mainland companies, as it offers:
- access to foreign exchange;
  - a broader investor base;
  - free flow of capital and information;
  - international visibility;
  - a sound legal and regulatory framework that is of international standard;
  - a deep market with a wide product range and liquidity provided by institutional and retail as well as local and overseas investors;
  - a critical mass of professionals and service providers that adopt practices at international standard; and
  - access to the rest of the world whilst benefiting from proximity to the Mainland.