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It's not about if, but where they're going public: Drew Bernstein on Chinese IPOs

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It's been choppy for Chinese IPOs lately. With curveballs such as the U.S. position on Chinese listings and Ant's failed IPO, the pressure is on Chinese companies to prove trustworthiness to investors, officials, and the market.

With the U.S. presidential race ending, Chinese companies are going to feel the impact of a prospective shift in the trade war. If nothing else, the Biden win can at least open doors for multilateral negotiations.

But Chinese companies were quick on the uptake, listing on U.S. exchanges amid shifts in U.S. policy. Chinese companies have raised US$7.4 billion in major U.S. markets as of the start of October this year, far exceeding the $2.6 billion raised last year (excluding delisted companies).

"We don't see any IPO shyness [from] these companies. The question today is not, 'Are they going public?' The question today is, 'Where are they going public?'" Drew Bernstein tells Jumpstart. Bernstein is Co-Chairman of Marcum Bernstein & Pinchuk, an accounting firm servicing China-based companies trading in the United States.

The U.S. is still the gold standard

Prospects were not looking good for U.S.-listed Chinese companies this year. Tightening regulations put 200 of the 217 currently listed Chinese companies at risk of delisting.

And yet, Chinese companies have rushed to IPO in U.S. markets this year. By August, they had already raised over $5 billion in U.S. markets, with several companies pricing above expected range.

"The U.S. has remained the gold standard because it offers things that the other markets don’t,” Bernstein explains. He points to its deeply diversified sources of capital, and the rank credibility that comes with a U.S. listing.

“Further, raising $100 million in the U.S. is not the same as raising $100 million worth of RMB in China,” Bernstein adds.

This is significant for Chinese companies. Over a third of the world’s unicorns are based in China, and Beijing is home to the highest number of startups in the world. Though they’re putting China on the global tech map, these companies have their sights set on markets worldwide.

“Unicorns have mostly global aspirations. And they need capital to do that outside of China. That was one of the more interesting aspects of Ant doing a dual listing in Hong Kong and Shanghai because that was… their way to put their hands on currency that was convertible to dollars,” Bernstein says.

It’s not that straightforward

The evolutionary direction that tech companies take is not so easy to put down on paper. Due to competition and the need for scalability, tech companies are forced to diversify in a way that is difficult to categorize. Superapps like Gojek and Grab, for instance, offer product baskets that include food delivery, entertainment, payments, ride-hailing, and even insurance.

Taking the example of Ant, it embodies this diversification in the financial services space. It offers payments services, retail loans, wealth management services, insurance and even a digital copyright services platform.

This model of starting with one or a few services and then branching out widely is now creating a layer of regulatory complexity.

“Ant was so pervasive in their business plan – in the sense that it touched every part of the Chinese financial system – that China can’t afford to get this wrong. China is never going to put their financial systems at risk for one company, irrespective of how large it is,” Bernstein says.

“The company was so complex that they weren’t able to essentially sit down with the regulators and check off all the boxes. Because the company was so unique, a new category, the boxes weren’t on the checklist, yet,” he adds.

Due diligence and short-selling investment firm Muddy Waters exposed another concern. Earlier this year, markets went into a tizzy after the firm released an 89-page report alleging fraud by Luckin' Coffee. It also went after streaming platform iQIYI and GSX Techedu. Only a week ago, it lambasted livestreaming platform YY Live for bot farming, and faking transactions and users.

The credibility of U.S.-listed Chinese companies has come under the spotlight of regulators and investors alike. And this is not limited to U.S. markets – Ant's failed IPO, which was set to break funding records, showed that Chinese regulators were also willing to pull the plug if they had to.

The issue is that Chinese companies "perpetually under-invest in IPO readiness," Bernstein says. "They take shortcuts in their accounting, their finance teams, their internal controls, their corporate governance process. It comes back to bite them later."

In turn, Chinese markets will not be able to attract the kind of international capital they want without fixing problems of integrity within the markets, he adds.

It's not all bad news, however. Bernstein notes that returns on U.S. IPO investments generally fared better than Chinese IPOS in the U.S. market below the $100 million mark. But for those Chinese companies raising over $100 million, returns have been as high as 70%.

"With half of the unicorns out there Chinese, and those companies each are raising something north of a billion dollars, it's psychologically difficult for the investment banking community to lock themselves out of that," he points out.

The road ahead for Chinese IPOs

Chinese companies don't have too many non-U.S. international avenues for public listings. They cannot match the density of liquidity available at Chinese or American exchanges. The Ant IPO, for instance, was oversubscribed by 870X on the STAR Market, and 389X on the Hong Kong Exchange. It cumulatively received bids over $3 trillion.

"Chinese companies, they're not copycats anymore. These are tech tigers. The amount of capital that they need, I'm not sure there's many other markets in the world that can do that," Bernstein says. "Could they go to other markets? Sure, but they wouldn't get that value."

With the regulatory pressure and the volatility of the trade war mounting, one would expect Chinese companies to look elsewhere. However, rebounding IPO numbers this year, led by Chinese companies, indicate that they are effectively working their way around the challenges.

Chinese stock exchanges accounted for 45% of global IPOs in the first three quarters of the year, CNBC reports. 180 took place in Shanghai alone.

Domestic and U.S. markets continue to make space for Chinese companies despite some major hiccups this year. Investors also continue to be interested in opportunities to buy into listed Chinese companies.

Even so, as these companies jostle to go public before the regulatory clampdown slams the door, it's clear that to keep blockbuster IPO dreams alive, they'll need to adhere to much higher standards.