 by Jean Pierre Verster

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The China dilemma

Last week the US's Securities & Exchange Commission finalised rules regarding the implementation of the Holding Foreign Companies Accountable Act, which was passed in December 2020.

The final rules specify that for companies with securities that publicly trade in the US, the working papers of their auditors must be made available for inspection by the US's Public Company Accounting Oversight Board. Only two major non-US jurisdictions do not allow such inspections by the board, due to data privacy concerns: China and Hong Kong. It means companies with significant operations in China and Hong Kong will be forced to delist from US exchanges.

Let's have a look at some companies affected by the new rules:

DiDi Global

The global ride-hailing platform company, which competes with Uber, listed in the US barely five months ago. DiDi is incorporated in the Cayman Islands but has issued American depositary shares (ADSs) on the New York Stock Exchange. The DiDi Chuxing division became the dominant ride-hailing platform in China in 2016, when it bought Uber China. Uber still holds a significant shareholding in DiDi due to that transaction.

DiDi shares have halved since the IPO, on news that the company drew the ire of Beijing by ignoring concerns raised by Chinese regulators regarding nationalist data privacy and pushing through with the US listing.

Last week, DiDi's board finally caved to regulatory pressure and resolved to delist in the US, but it said its ADSs will be convertible into freely tradable shares on another internationally recognised stock exchange. This process should go relatively smoothly, except for those who cannot hold shares listed on non-US exchanges. They will have to sell their DiDi ADSs before the US delisting, which seems a major reason for the current pressure on the share price.

The forced selling of US-listed Chinese stocks due to recently finalised US rules offers an interesting opportunity

Tencent

While Tencent's primary listing is in Hong Kong, the company also has an unsponsored American depositary receipt (ADR) programme in the US.

In the case of ADRs, a bank issues locally traded depository securities backed by foreign shares bought by the bank. The unsponsored nature of the programme means that Tencent was not a party to issuing the securities in the US and that these ADRs trade over the counter, not on a US exchange.

But the new rules have been written in such a way that even Tencent's unsponsored ADRs will not be tradable in the US. This should not have a material impact on its valuation, given that almost all of the company's shares are traded on the Hong Kong Stock Exchange, rather than via ADRs. The issuing bank will simply allow holders to redeem their ADRs and, in turn, sell the underlying Hong Kong shares to raise the cash proceeds.

Futu Holdings

This company operates two online trading platforms, Futubull, which targets Hong Kong traders, and moomoo, which is available internationally. Futu has been growing strongly due to the recent global surge in retail stock trading. The company is registered in the Cayman Islands and has a sponsored ADR programme on the Nasdaq.

Futu does not have a licence to operate in mainland China (the trading of US stocks from mainland China is banned), but it has many mainland China traders as clients. The company says this is via funds that mainland Chinese already had abroad, and so is allowed, but Beijing might differ with that interpretation. Hong Kong requires new listings to be legally compliant with mainland China regulations, so Futu could have to look for a different jurisdiction for its primary listing.

The angst has put pressure on Futu's share price, which is down more than 80% since February.

Alibaba

The Alibaba share price has fallen back to within a range of where it traded shortly after its US listing in 2014, which was, at the time, the largest IPO ever.

Alibaba also listed in Hong Kong in 2019, after the Hong Kong Stock Exchange abandoned its one-share-one-vote rule and allowed for dual-class shareholder structures. The company has therefore already laid the groundwork to offer US holders of Alibaba ADRs the ability to swap their holdings for Hong Kong-listed shares.

As with DiDi, this is a viable solution for all except those who cannot hold shares listed on non-US exchanges.

But it would be a mammoth swap, as roughly 40% of Alibaba's shares are held via ADRs. Still, Alibaba's homecoming could soothe the company's relations with Beijing somewhat and relieve the recent pressure on its share price.

The forced selling of US-listed Chinese stocks due to the finalised US rules offers an interesting opportunity for those who are comfortable with China's unique brand of capitalism. x

Verster is CEO of Protea Capital Management