Maintaining Hong Kong’s listing STAMPEDE

Hong Kong overtook New York, London and Shanghai as the world’s top IPO market in 2015. However, with potential challenges ahead, including reform initiatives that are expected to be implemented this year, Jemelyn Yadao looks at whether the city can retain its crown.

Illustrations by Annemarie Kleywegt

Braving turbulent global stock markets, Chinese property developer Ronshine China Holdings kicked off 2016 by sealing Hong Kong’s first initial public offering of the year, raising HK$1.81 billion. In the same week, news broke that Jiangsu Hansoh Pharmaceutical, one of the Mainland’s largest companies in the sector, is planning to raise up to US$3 billion in what could be the largest ever Hong Kong health care IPO later this year.

Both deals marked a strong start for Hong Kong, which clinched the title as the world’s largest IPO fundraising hub in 2015. The Hong Kong stock exchange raised a total of US$33.7 billion from IPOs in 2015, the world’s highest, according to data from Dealogic, while the New York Stock Exchange and Nasdaq ranked second and third, raising US$19.6 billion and US$18 billion respectively. Also in the year, IPO and post-IPO fundraising in Hong Kong reached US$1.1 trillion, up from US$942.7 billion in 2014, according to HKEx market statistics.

“The Hong Kong IPO market has been exceptionally strong in 2015, and remains open in 2016 – there were two US$200 million plus IPOs in the first week of this year,” says Tiffany Ng, Analyst at Renaissance Capital, a manager of IPO-focused exchange traded funds in Connecticut. “Activity in Hong Kong has been boosted by the on-again, off-again China A-share market, leading Chinese companies to seek a Hong Kong listing instead.”

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The retail, consumer goods and services sectors provided the majority of new listings in Hong Kong last year, followed by industrial products. Overall, small- and medium-sized enterprises continued to make up the bulk of listings.

However, it was the banks, asset management companies, securities brokerages, insurance and micro-financing companies that raised the most money. “If you look back at the past 10 years there have been some downs and ups. Now we are up again and it’s mainly driven by the financial services sector,” says Maggie Lee, Head of Capital Markets Development Group, Hong Kong, at KPMG China. “Seventeen deals were from the financial services sector last year and they accounted for over 50 percent of total funds raised.”

Secret to success

Experts have attributed Hong Kong’s top ranking partly to Mainland companies looking for an alternative IPO destination in the face of the rollercoaster ride experienced by the Mainland benchmark indices. A series of policies issued by the Chinese government to boost banking liquidity, such as several cuts in lending and deposit rates and its reserve-
requirement ratio, and other favourable measures also boosted Hong Kong IPOs. “For example the introduction of the Shanghai-Hong Kong Stock Connect at the end of 2014 and also the announcement of the China-Hong Kong fund mutual recognition scheme – those were positive news that gave the market a short push resulting in the sentiment and liquidity of the market being very good in the first half,” says Edward Au, Co-Leader of the National Public Offering Group at Deloitte China.

Chinese state-owned companies that were keen on “going global” have also been credited, with Hong Kong continuing to be the exchange of choice for such enterprises. “We saw a lot of listings in the second half with so many SOEs racing to list on Hong Kong’s stock market by the end of China’s 12th Five-Year Plan period,” says Au.

On the other hand, it is noted that Hong Kong’s success was more due to the volume of global IPOs dropping compared to previous years. Global IPOs fell by 2 percent and capital raised dropped by 25 percent, according to EY. “When we compare Hong Kong versus the 2014’s No. 1, the New York Stock Exchange, we can see that even excluding the Alibaba IPO – the largest global IPO ever – New York is still bigger in terms of IPO fundraising compared with Hong Kong for last year.” says Ringo Choi, EY’s Asia-Pacific IPO Leader and a member of the Hong Kong Institute of CPAs. This reflects, he adds, how the global market last year experienced varying performance across regions because of a higher volatility environment.

Looming changes
Many experts are upbeat about the Hong Kong IPO market’s prospects this year. EY notes that 46 companies have already submitted applications to list in 2016. These applicants were from the financial, technology, media and telecommunications, retail and consumer products and various other sectors. Of the companies expected to complete their IPOs this year, EY forecasts that there would be a giant Mainland financial institution and one or more billion-dollar start-ups, also known as “unicorn” companies. EY is forecasting 110 Hong Kong listings in 2016, raising a total of HK$260 billion, while PwC estimates that about 130 IPOs will raise HK$300 billion, placing Hong Kong among the world’s top three bourses.

However, several initiatives will be implemented this year in China, pointing to the further opening up of the A-share market and hence stiffer competition for Hong Kong. These include the Strategic Emerging Industries Board on the Shanghai Stock Exchange, designed to give “Made in China 2025” initiative-supported industries and innovative start-ups easier access to funding. “The fundamental part for this new board is that it likely will not have a profit requirement but have a market capitalization requirement,” says Benson Wong, Assurance Partner at PwC Hong Kong. “It will host companies equivalent to those that usually decide to list on Nasdaq. These would have big potential, so therefore the fundraising part will not be a small amount.”

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China’s planned shift to a registration-based IPO system in March, as opposed to the current approval-based system, could also pose a threat to Hong Kong’s standing. The planned changes will allow the market, instead of regulators, to decide which firms get listed and how many shares they can sell. “This change to a more market driven IPO process should reduce the incentive for Mainland Chinese enterprises to list in Hong Kong,” says Andrew Lam, Director and Head of Business Development of Assurance at BDO and an Institute member. “However, given the current long queue for an A-share IPO, it should have minimal effect on the Hong Kong IPO market in the short to medium term.”

Also, Mainland companies seeking backdoor listings in Hong Kong will be forced to think twice thanks to new guidance issued by
HKEx last December to ban cash companies – with more than half of their assets being cash – from listing. The new rules also mean if any listed company suspends trading to issue a large number of shares to a fresh investor in return for substantial cash, it will not be allowed to resume trading.

Another challenge that Hong Kong faces is linked to the quality of investment in IPOs and the multiplicity of book-runners (the banks that decide which institutional investors get to buy into an IPO) – a striking feature of recent IPOs in the city, says Philippe Espinasse, a former head of equity capital markets of an investment bank and author of *IPO: A Global Guide*.

“In the case of large IPOs, there has been a trend over the last few years in Hong Kong for issuers to appoint too many book-runners. As the overall level of fees remains unchanged, this means that the profitability of these transactions for the individual banks has diminished significantly, which affects their motivation and ability to dedicate significant resources to those deals.” The requirement in Hong Kong for cornerstone allocations to be locked up for six months is also an issue, adds Espinasse. “That will continue to affect the ability of issuers to gather quality anchor demand at an early stage, especially in volatile markets as we are now experiencing.”

Wider economic factors, such as the slowing Mainland economy and the potential of a further rise in U.S. interest rates may also dampen the Hong Kong IPO market this year. “The next probable rate increment will probably be in March or April, and before then a lot of market speculation will affect the market stability and sentiment,” says Au at Deloitte.

Others disagree with the idea of the interest rate hikes having a significant impact. “That’s given the economy in Europe and also the depreciation in renminbi,” says Wong at PwC. “However, as you can see, we have a really volatile market. But we hope to see a stable recovery in the Mainland stock market and the rebound in the investment sentiment in Hong Kong in the second quarter or second half of the year. This will help increase trading volume between Mainland and Hong Kong markets and hopefully reinforce Hong Kong’s position as a fundraising platform with the backing of the Mainland.”

**Open to opportunities**

Whether or not Hong Kong’s IPO market is as strong as last year, CPAs need to keep abreast of the changes in the macroeconomic environment in order to take advantage of IPO windows – known as the period of time when investors are receptive to buying shares in newly public companies – as they open, says Au. “With China’s economy becoming increasingly dynamic, making the listing windows open and narrow, it has become more difficult for both issuers and the professional parties like the accountants to see when’s the right time to list and benefit most from an IPO.”

He also stresses the need for CPAs to understand ever-changing regulations and frameworks, citing Hong Kong’s push to become a corporate treasury hub with tax incentives. “That will create opportunities for CPAs both in the IPO market and treasury market because Hong Kong will become a one-stop-shop for those companies that want to raise money and also want to repatriate funds to their home country through the corporate treasury centres in Hong Kong.”

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Choi at EY highlights that possessing deep industry knowledge couldn’t be more important this year. “There are many different sizes of IPOs coming up in terms of industries. There’s going to be various new companies in financial services, internet banking, trusts, as well as pharmaceuticals and biotech, so CPAs need to be prepared.”

By applying their skills in due diligence, CPAs also have a key role to play in protecting the IPO market on the frontline. “It is difficult for the authorities to screen out those unqualified candidates,” adds Choi. “That’s why we need to exercise our good judgment to protect the public investors’ interests, and act as a watchdog defending the quality of the IPO market.”