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Chinese IPOs raked in $9 billion in U.S. cash, then promptly fell 13% on average

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China-domiciled IPOs raised more than double 2017's total in a year marked by trade clashes with the U.S.

By Therese Poletti

In China, the number 8 is an omen of good luck and prosperity. 2018 was lucky for Chinese IPOs, but not so much for their U.S. investors, who instead found an unlucky 13% decline.

With China representing the largest market in the world, for everything from online education to electric scooters, investors were willing to gamble on Chinese companies in 2018, even as the U.S. and China engaged in a troubling trade war. A total of 33 China-domiciled companies raised $9.167 billion in capital in the U.S. this year, more than double 2017, when 17 Chinese companies raised $3.8 billion, according to Dealogic.

Many of these companies were very lucky, getting access to huge amounts of capital, without being profitable or very friendly to shareholder rights in the U.S. Much like the small internet companies of the dot-com boom era of the 1999-2000 time frame, investors looked to their growth rates and promise of more growth to come. Big losses and no real shareholder rights? Who cares?

Four companies raised in excess of $1 billion in cash in their U.S. debuts: online entertainment service iQiyi Inc. **IQ, -3.25%** ; electric car maker NIO Inc.**NIO, -1.55%** dubbed the Tesla of China; Pinduoduo Inc. **PDD, +1.72%** a mobile platform for discounted group buying; and Tencent Music Entertainment Group**TME, -1.34%** the largest streaming music and online karaoke platform in China, controlled by Tencent Holdings Ltd. **0700, +1.29%**

While the Chinese companies made out well in their IPOs, the boom did not translate after they went public. Dealogic research indicates that the average performance for the Chinese IPOs was a loss of about 13.1% so far this year, compared with U.S.-based IPOs, which are now down 0.77%, as of Dec. 20. Before the latest market gyrations, U.S. IPOs were up 6.1%, as of Dec. 11.

These high-risk companies are not for everyone. Their corporate structure, in order to list in the U.S., are complex. Known as variable interest entities (VIEs), their structures are confusing org charts of various holding companies or subsidiaries, offshore and onshore, typically with a Cayman Islands entity or holding company at the core, because China does not allow foreign investment in certain strategic businesses, such as internet companies. The bottom line is that shareholders have few rights and can only hope for the stocks to gain to get a return on their investments.

“You don’t own the assets, you own the economic benefit through management contracts. The vast majority of the assets remain in control of the Chinese nationals,” said Drew Bernstein, co-founder/managing partner of Marcum Bernstein & Pinchuk, an accounting firm that also advises companies looking to go public in the U.S. “From our experience, the type of investor that invests in the Chinese companies is one that’s going to love growth because they love the numbers. They are not investing in dividends. ... When you have a population of 1.4 billion, the opportunities are just too great.”

With 2019 around the corner, investors will be presented again with a slew of investment opportunities, and IPOs will be high on the list. In tech, 2019 could be the year that many of the biggest unicorn companies finally go public, when the multibillion-dollar valuation ride hailing companies **Lyft Inc. and Uber Technolgies Inc. are the big contenders, after having filed confidentially with U.S. regulators.** Other big names could follow suit, with Pinterest now expected to go public in the spring, **according to The Wall Street Journal.** Palantir Technologies is also **said to be weighing going public next year.** Both Airbnb Inc. and Slack Technologies are reportedly weighing direct listings in the same vein as Spotify, **according to Recode**.

These big-name companies will clearly create more competition for the Chinese deals, but some investors say that there enough appetite for both. In addition, the IPOs of companies like Uber and Lyft will likely inspire their rivals in China, the younger and also private Didi Chuxing and Grab, to take advantage of the U.S. market’s big appetite for Chinese deals.

“If you are a growth investor, looking for a growth asset...this is an asset that could quadruple in value,” said Rohit Kulkarni, managing director and head of research for SharesPost, Inc., a secondary market for privately held shares.

“I doubt many investors were counting on that for Dropbox **DBX, -1.73%** , Spotify**SPOT, +1.19%** etc.,” noting, for example, that **Spotify’s most recent revenue growth had slowed down to 31%**. “It’s not the sexy 100% growth that some investors want.”

While a crop of these IPOs were really large deals in the U.S., the majority of them are not faring very well in post-IPO trading. The biggest losers have been smaller companies or those in competitive businesses, such as Qutoutiao Inc.**QTT, +3.93%** a mobile news aggregator that is focusing on the lower-tier, less affluent cities in China. Its shares are down 74% from its IPO in September, even as revenue grew more than 500% in the third quarter.

Two other stocks that have seen steep declines are Puxin Ltd. **NEW, +3.68%** down nearly 70%, and Sunlands Online Education Group **STG, -0.33%** down 76%. Chinese education company stocks have been hit hard after draft legislation in China caused uncertainties about future merger and acquisitions, a big driver of growth.

So, will U.S. investors decide to continue putting money into these iffy, young Chinese companies, or was 2018 a blip? In 2019, there are some large potential IPOs, including ride-sharing giant Didi Chuxing Technology Co., top news-aggregation app Bytedance and Tik Tok, a hot short-video app that **has reportedly been in discussions about going public next year**.

Those companies could decide to go public in Asia, though, as Meituan-Dianping**3690, -0.34%** and Xiaomi Corp. **1810, -0.15%** did last year, both pulling off large IPOs in Hong Kong. Hong Kong has managed to attract more big companies after Alibaba Group Holding Ltd. **BABA, -1.45%** started a trend of Chinese companies heading for the U.S. to avoid stricter corporate-governance provisions.

“There was this case of sour grapes in terms of how Hong Kong stock exchange lost the world’s largest IPO, Alibaba, because Jack Ma couldn’t give up the dual voting rights,” said Kulkarni, adding that the HKSE changed its rules to attract venture-backed companies with dual-class shares.

Bytedance has been considering going public on the Hong Kong stock exchange, but Kulkarni doesn’t expect the U.S. to lose its current role as a favorite place for Chinese companies to go public however.

“U.S.-listed Chinese unicorns have performed better than the ones in China,” he said.

Considering the overall decline for Chinese stocks after 2018 U.S. IPOs, that is a scary thought. It is going to be a hard to top 2018 in terms of volume of deals and funds raised for Chinese firms, especially if investors take a hard look at early performance, the structure of these companies and the potential for big losses.