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Ant IPO: how US-China trade tensions are driving foreign investment in world's largest public offering

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Despite the looming threat of US financial sanctions against Chinese technology companies, Ant Group's upcoming dual listing in Hong Kong and Shanghai has sent investors into a frenzy.

Thought by analysts to be an environment of mounting antagonism that could curb the ability of Chinese companies to raise foreign capital, the pipeline of stock activity is actually accelerating.

Alibaba, NetEase and JD.com are among the US-listed Chinese companies that have sought secondary listings in Hong Kong in the past year. And Ant Group's US$34.5 billion dual listing – expected to go public this week – will be the world's largest stock market debut ever.

But how long that window of opportunity remains open for Chinese firms remains to be seen.

"There will be investor appetite because Chinese companies are raising the money so long as it remains an option to do so legally," said Drew Bernstein, co-managing partner at Marcum Bernstein & Pinchuk, which exclusively advises Chinese companies. "The door is still open for Chinese companies to raise billions of dollars, but the risk of doing this will be higher if you wait longer."

The tension is due in part to increased pressure by the United States government on state-linked pension funds. In May, the White House directed a board in charge of federal retirement dollars to halt plans to invest in Chinese stocks.

Secretary of State Michael Pompeo has been scrutinising US fund investments in China's tech sector, while US senators have also been calling for inspections to curtail US pension funds from supporting Chinese tech companies.

Despite the pressure from Washington, a raft of US private equity firms backed by the largest US endowment and pension funds invested in Ant's previous funding round in 2018, according to unidentified sources cited by Bloomberg. Silver Lake Management, Warburg Pincus and Carlyle Group, which had each invested at least US$500 million, will own 0.35 per cent, 0.33 per cent, and 0.29 per cent of the company's shares, respectively, upon the completion of Ant's initial public offering (IPO). And they have shown little intention of unwinding their positions.

"The worsening of the relationship between the US and China has raised concerns that there may be increasing regulatory challenges or enhanced restrictions against China and other Chinese technology companies, including us and Alibaba," Ant's IPO prospectus said.

However, analysts say scepticism is mounting over whether US investment curbs on portfolio flows into China will materialise any time soon.

Reflecting the challenges that US government intervention faces, a US appeals court last week rejected a Justice Department request to allow the US government to immediately ban Apple and Alphabet's Google from offering Tencent Holding's WeChat communications and financial app for download in US app stores.

"US investors are challenging the [US] government, so it remains unclear if it really possesses the ability to execute and enforce restrictions of pension fund support for Chinese companies," said Stanley Chan, director of research at Emperor Securities. "As Hong Kong's market gets bigger and bigger, this will attract even bigger global funds to come here and operate in the region."

The oversubscription of the US$17.2 billion institutional tranche of Ant's Hong Kong IPO – prompting it to close the order books one day ahead of its original deadline last Thursday because of frenzied investor demand – reflects Ant's appeal as an investment prospect to foreign investors amid China's strong economic recovery from the pandemic.

Ant's shares are expected to start trading on the STAR Board of the Shanghai

Stock Exchange and the Hong Kong stock exchange on Thursday, following the US election on Tuesday.

Hong Kong's stock market is particularly attractive for Chinese companies looking to secure financing that is denominated in Hong Kong dollars, amid rising US-China trade tensions and greater risks of US scrutiny. In the third quarter, 38 companies went public in Hong Kong and raised US$16.55 billion – a 108 per cent increase from the US$7.97 billion raised in the same period last year, according to data from Refinitiv.

Endowed with liberalised and mature financial regulations, Hong Kong's dollar peg system means the local currency not only is freely convertible, but it can also be sold in exchange for US dollars without losing its value. In contrast, China imposes draconian capital controls meant to limit the flow of US dollars into and out of the country for both Chinese companies and foreign investors.

"Raising hundreds million of dollars worth of yuan is not the same thing as raising hundreds millions of US dollars outside China, especially to multinationals that have grand ambitions of mergers and acquisitions all over the world," Bernstein said. "For companies like Ant doing a dual listing, it's pretty clear the Hong Kong portion is an insurance policy."

However, Bernstein said the Hong Kong stock market still needs to prove itself over time with strong regulatory oversight and corporate governance to build confidence and trust in Chinese-listed companies – a driving force behind US-China tensions.

The international investment community has long been suspicious of the authenticity of the financial information disclosed by Chinese companies and demands a high degree of transparency and integrity in showing the profitability of Chinese business, rather than them merely being a platform of so-called growth and innovation, Bernstein said.

"There's a very high degree of oversight and regulation in the US that gives its markets a premium. If Hong Kong and China want to attract international capital, then they're going to have to do the same," he said. "If they don't, they're not going to be markets, they're going to be casinos."