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How Investors Can Assess the U.S. Threat to Delist Chinese Stocks

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By Craig Mellow

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Bye-bye, Alibaba? Threats to evict some 150 Chinese companies, including the e-commerce giant and other hot tech stocks, from U.S. exchanges are real and mounting. Whether investors should care is another matter.

“We are overweight China,” says Arjun Jayaraman, portfolio manager for the Causeway Emerging Markets fund. “The shareholder value these companies have created has been incredible.”

Moves to delist the Chinese firms are not just political. China, uniquely among major world economies, bars the U.S. Public Company Accounting Oversight Board, or PCAOB, from monitoring corporate audits, considering that a national-security risk.

That can leave non-Chinese investors and analysts poking in the dark through books that differ on fundamentals like accounting for inventories and asset disposals, says Drew Bernstein, whose accounting firm, Marcum Bernstein, works extensively in China: “Chinese audits are done on a completely different basis.”

U.S. authorities and exchanges overlooked these fine points to capture the trading volumes on the Chinese tigers. But a scandal at Luckin Coffee (ticker: LK), the Chinese Starbucks look-alike that admitted inflating revenues by about 40%, evoked meaningful grumbles from the Securities and Exchange Commission.

These escalated dramatically on May 20, when the Senate unanimously passed a bill giving all Chinese companies three years to let the PCAOB in, or be kicked out of U.S. markets. That will probably clear the House and become law this summer.

Chances of Beijing blinking look small. Aside from closed-society instincts, opening corporate records could reveal embarrassing links between the nation's leaders and valuable share packets, says Yung-Yu Ma, chief investment strategist for BMO Wealth Management. "There could be connections to different political figures or their families that they don't want to come out," he comments.

Barring improved relations after the U.S. election, investor favorites like Alibaba Group Holding (BABA), Pinduoduo (PDD), NetEase (NTES), and New Oriental Education (EDU) may decamp for Hong Kong, or maybe London. That could dent future performance, as domestically focused U.S. investors lose interest, thinks BMO's Ma. "Academic research has looked at the advantage that companies get from adding a U.S. listing," he says. "But you could see something like a 5% valuation effect from delisting."

Other investors are less concerned. "The question we're asking is, will Alibaba be the leading e-commerce platform five or 10 years in the future?" says Andrea

Ruggeri, CEO of Infusive Asset Management. “The question of which exchange is probably a bit archaic.”

Alibaba’s shares have rebounded weakly from the February-March global market panic, and are off 6% year to date. That’s because it was out-competed by No. 2 e-commerce platform JD.com (JD), whose logistics proved more reliable for deliveries during Covid-19 lockdowns, Jayaraman says. JD’s stock has soared by nearly half in 2020.

Anyone doubting that a Chinese stock can thrive without a primary U.S. listing need look no further than social-media supremo Tencent Holding (700.Hong Kong), which has returned more than 150% over the past five years. A Hong Kong listing may even have an advantage, Jayaraman argues, thanks to a program that increasingly funnels capital from the Chinese mainland to the offshore territory.

Investors shouldn’t ignore U.S.-China tensions that are re-escalating across multiple fronts. But the idea of crippling Chinese capitalism by denying it New York Stock Exchange or Nasdaq ticker symbols is, indeed, so 20th century.