HUATAI SECURITIES (USA)

**Subject:** Impact of the Recently Passed House Bill on China ADRs

**Date:** December 3, 2020

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On December 2, 2020, the U.S. House of Representatives unanimously approved a bill that would ban trading in shares of foreign companies whose audit papers are not inspected by U.S. regulators for three consecutive years. The measure passed the U.S. Senate in May 2020 and is expected to be signed into law by President Trump. This would affect U.S. listed companies from China, Belgium, and France all of which currently do not allow the U.S. Public Company Accounting Oversight Board (PCAOB) to inspect the audit work.

Huatai Securities (USA) would like to share our views on the impact of this on Chinese companies.

First, some statistics:

- Through December 2, 2020, Chinese companies raised $23 billion on the Nasdaq and NYSE exchanges ($11.3 billion IPO, $11.7 billion follow-on). Total capital raised for the full year will grow as several Chinese companies recently filed to raise follow-on offerings before end of the year, including $1.5 billion by Li Auto. Total capital raise by Chinese companies in the US in 2020 is expected to be second only to the $31.2 billion record raise in 2014 which was skewed by the $25 billion Alibaba IPO[1]. With 28 IPOs by Chinese issuers so far this year, 2020 will be the second most active year after 2018 which had 33;

- As of December 2, 2020, there are more than 200 Chinese companies listed in the U.S., with total market capitalization of $2.23 trillion[2]. This market cap would rank just behind the aggregate market cap of the entire London Stock Exchange, the 8th largest stock exchange in the world.

Parallel tracks of actions in the U.S.:

In the U.S., once a bill is signed into law, the regulatory agencies will release specific regulations and procedures which are designed to implement the law. While legislative actions tend to reflect the political will, actions by regulatory agencies tend to take into consideration the market reality and potential implications.

- Legislative actions – with passage of the bill in both U.S. House and Senate, President Trump is expected to sign it into law;

- Regulatory agency conversations –

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[1] Source: Refinitiv;

[2] Source: S&P Global Market Intelligence

a. The SEC is working on a proposal that could allow Chinese companies to comply without running afoul of Chinese laws that limit information sharing. That would involve a second review, i.e. co-auditing, of company books by accounting firms overseen by PCAOB;

b. The China Securities Regulatory Commission (CSRC) has signaled openness to cooperate with the U.S. on cross-border audit. CSRC sent a new proposal on joint inspection to PCAOB on August 4, 2020. PCAOB has confirmed receipt of the proposal and said it is working actively on it. CSRC has been vocal around not seeking to limit Chinese issuers access to global capital.

<u>Huatai US view:</u>

The recently passed bill has a three-year cushion for PCAOB inspection. We do not see this becoming a full-blown crisis with (a) the new Biden administration coming into power on January 20, 2021, (b) ongoing conversations at the regulatory agency level between the two countries, and (c) U.S. investors and Wall Street remain very constructive around Chinese market exposure.

As such, we see the following:

- Since November 2019, 10 U.S.-listed Chinese companies have added secondary listings in Hong Kong. We expect this trend to continue, especially for large companies. U.S.-listed Chinese companies will also look to add secondary listings in Shanghai;

- Privatizations will also continue but many will take a wait-and-see approach in the short turn. Many Chinese companies that voluntarily delist in the U.S. tend to have thin trading and lackluster stock-market valuations;

- New IPOs by Chinese companies will continue. U.S. investors have strong appetite for Chinese IPOs. Chinese companies that went public in the U.S. in 2020 have traded well in the post-IPO market. The new legislation will likely reduce the number of low-quality issuers out of China who seek to list in the US, and similarly we expect U.S. investors will become more selective and avoid small companies or companies with significant state ownership.