

UPDATE

The China-U.S. listings saga is pushing take-privates into the spotlight

Update prepared by Paul Christopher (Managing Partner, Hong Kong)

Chinese companies with a listing in the United States have found themselves on somewhat of a rollercoaster ride in the last few years. The lucrative flow of initial public offerings (IPOs) that has forged a close relationship between U.S. and Chinese markets in the past 25 years is now threatening to go into reverse gear due to a mix of geopolitical tensions, dipping sentiment and an ongoing regulatory wrangle over adequate audit disclosure.

The long-held fears of U.S. authorities over the reliability of information provided by some Chinese companies finally crystallised in late 2020 with the introduction of the Holding Foreign Companies Accountable Act (HFCAA). The HFCAA gives the U.S. Securities and Exchange Commission (SEC) powers to prohibit trading of public companies that do not submit to an audit inspection by the Public Company Accounting Oversight Board (PCAOB).

While the legislation does not explicitly target Chinese companies, the 200-plus companies with Chinese business listed in the U.S., a vast majority of which are Cayman Islands or British Virgin Islands incorporated, have so far found themselves squarely in its sights due to Beijing's rules against companies listed on foreign exchanges providing the required information.

China has now moved to protect its companies through a deal signed between the PCAOB, the China Securities Regulatory Commission (CSRC) and the Ministry of Finance of the People's Republic of China to allow complete access. Recently it was reported that inspectors from PCAOB have arrived on the ground in Hong Kong, providing a welcome boost to China bulls.

The agreement is a positive step for the Chinese companies that have found themselves in the middle of what is essentially a political issue, but doubts over whether the inspectors will be able to achieve their goals are already being voiced. The PCAOB itself has described the Statement of Protocol that has been drawn up as 'only a first step' and says that the real test will come when the inspectors get to work. This doubt over effective implementation means the companies involved remain in a precarious holding pattern for now and would be well-advised to be as prepared as possible for all potential outcomes.

Taking a company private is one possible path if a forced or voluntary de-listing is anticipated or even implemented. A take-private could mean that the company stays in the hands of the main shareholders or, alternatively, could be a target for private equity or a strategic buyer. Becoming a private company has also been used as a stepping stone for Chinese businesses seeking a re-listing in another jurisdiction, typically bourses in Hong Kong, Shenzhen or Shanghai.

The Cayman Islands statutory merger, which closely follows the Delaware structure, is a popular method of takeover and privatisation for companies listed on the New York Stock Exchange and Nasdaq Stock Market. The process is cost-effective and can be fast. It possesses advantages over a scheme of arrangement. There is also no court process in the merger to contend with although there has been a volume of litigation in the Cayman Islands on appraisal rights.

A company may also opt to seek an alternative primary listing in another jurisdiction such as Hong Kong if it cannot see a future in the U.S. market but wants to maintain the benefits that come with having its main

listing on a well-known bourse. However, while a smooth transition is achievable, all companies will need to consider the depth of liquidity available on any new exchange. For companies that want to hedge their bets, a secondary listing or dual-listing that provides commitment to the status quo but provides a solid backup option could also be a wise move.

As noted, a significant amount of the Chinese companies in question are incorporated in the Cayman Islands or BVI and the flexibility that comes with that is likely to be key in navigating any changes that need to be made. An experienced adviser with deep knowledge of those jurisdictions will be vital in the process of making sure such key strategic moves are properly executed.

Whether Chinese companies ride out the storm or call time on their U.S. listings, managing the risk through a thorough understanding of the laws in their jurisdiction of incorporation will be vital to a successful future.

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