JK Capital Management Ltd.

Week of 2nd November 2020

What's on our mind this week?

Ant breaks IPO records

Last week we commented on the IPO process of Ant group as the books were opening in Shanghai and Hong Kong at the same time to raise USD 34.5bn between the two markets (half in each). The amount was increased later by USD 5.2bn with the exercise of the over-allotment or green shoe option due to the strong demand. Most of the offering was institutional (96% before the green shoe option). On both markets records were broken.

The largest IPO in global financial history attracted over USD 3trn from retail investors in both markets. A record CNY 19.05trn of bids (USD 2.85trn or about 20% of China's GDP) were received from retail investors for Ant's shares on Shanghai's Star Market, 870 times the amount offered to them. In Hong Kong, 1.55m retail investors (20% of the city's population) placed offers for a total of HKD 1.3trn (USD 167.7bn) worth of shares, overbidding by 390 times. In Hong Kong this means more than half of the money in circulation every day in the local financial system is frozen until 5th November when the stock begins trading. On the institutional side demand was just as strong, in Hong Kong it was 30 times oversubscribed.

These results, as astounding as they are, are much in line with expectations as momentum had been building around the name which will become part of all major Asian indices and as the valuation seems reasonable given the growth and quality of the company. We expect the share to do well when it starts trading, some reports mentioning pre-trading activity (the so-called "grey market") at a 50% premium to the IPO price despite late reports of a meeting between Ant Group's founder Jack Ma and representatives of China's regulatory authorities, warning him of increased scrutiny and possible curbs to the company's aggressive growth, especially on the credit side.

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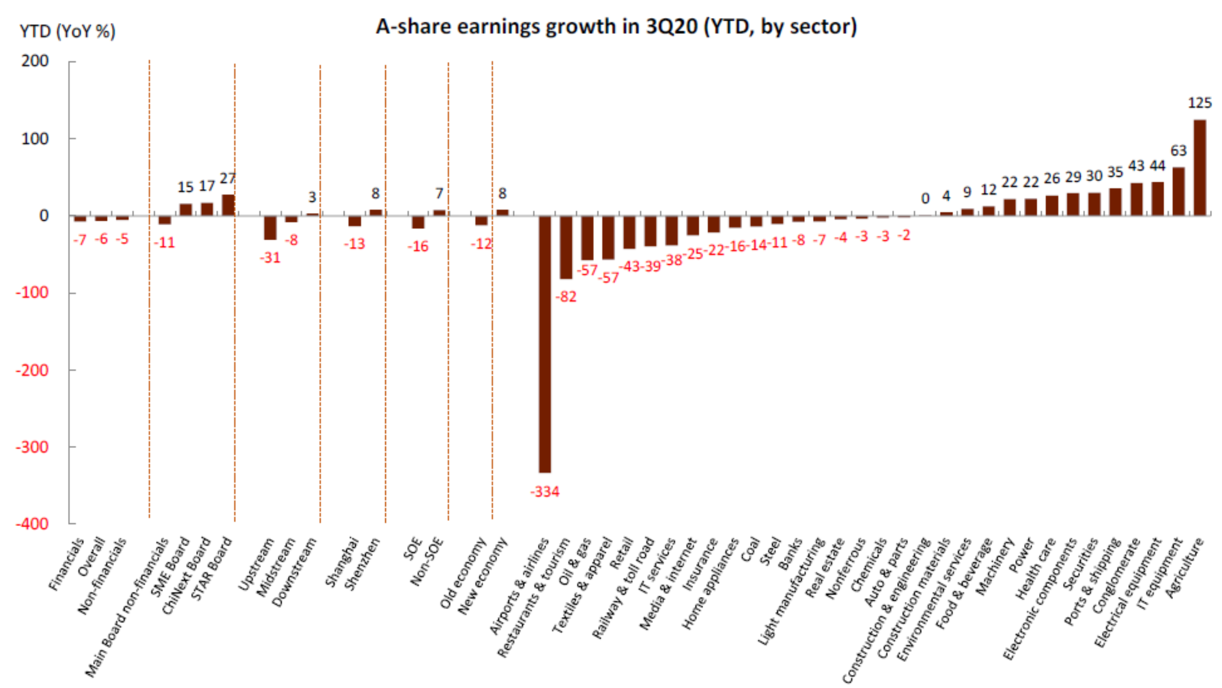
Results season on the A share market

One of the differences between the Hong Kong and Mainland markets is that the companies listed on the latter must report their earnings on a quarterly basis when the ones listed in Hong Kong only do it every 6 months. This is an opportunity for investors to gauge the health of the companies and sectors. It is all the more important this year as it should confirm the good macro numbers reported over the summer.

The earnings did not disappoint as growth turned positive YoY in Q3 2020. On average A-share companies showed a 17% YoY earnings growth in Q3, +3% for financial companies and +30% for non-financial companies which compares with -12%, -23% and +1% in Q2 respectively. Looking at the YTD numbers, earnings of all A-share companies dropped on average by 6% YoY (-7% for financials and -5% for non-financials). This is quite impressive as the economy all but halted during the first half of the year and as global markets remain to this day under significant stress.

The table below shows a breakdown by category and sector of the YTD earnings growth YoY:



Source: Wind Info, CICC Research

Profit margins continue to rise with the deepening of work resumption in China and a rapid increase in capacity utilization rate. It is estimated that the net margin of non-financial companies has recovered to 6.3% in Q3 2020. Obviously, sectors linked to tourism and hospitality are still suffering but it is worth noting that the net margins of upstream petroleum & petrochemical sector as well as that of downstream restaurant and tourism sectors turned positive this quarter.

Inventories remain low, which indicates that companies are still cautious about the recovery. Estimates put them at 18.2% of total assets, the lowest level they have been since 2011. This also indicates that should the rebound of the economy continue a re-stocking momentum may bring additional growth to the industrial and commodity sectors. A-share companies also continued to report capex growth, especially for the agricultural sector as well as the steel, defense, media, electronics, non-ferrous metals, health care, transportation, auto, and home appliances sectors.

Overall, we expect earnings to continue on the recovery path in Q4 despite uncertainties such as the resurgence of Covid in the US and in Europe. China has demonstrated a remarkable resilience over the past months and a high level of decoupling with the rest of the world thanks to its stringent management of the pandemic and its growing reliance on its domestic demand. We are confident it can maintain this momentum.

Source for chart and estimates: Wind info and CICC research – November 2020