Mainland China and Hong Kong IPO Markets Update

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Executive summary

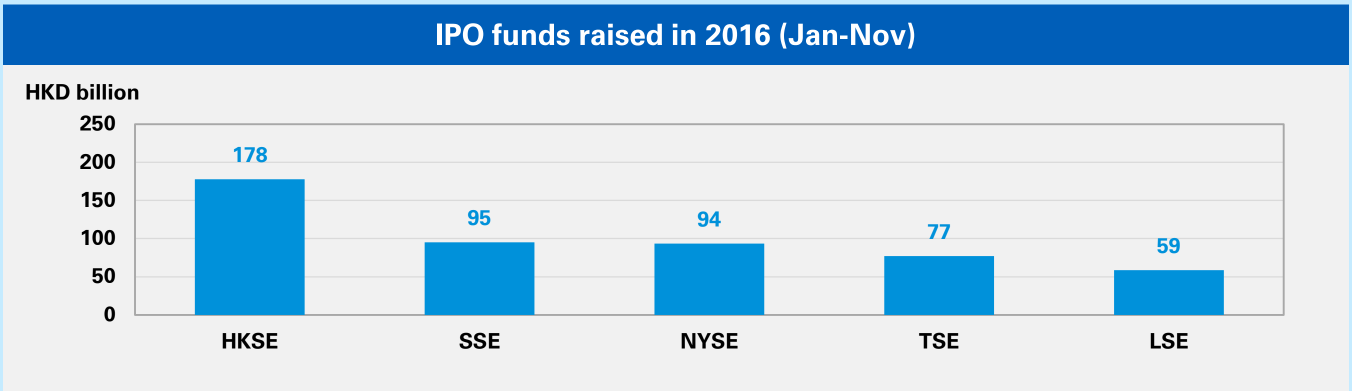
Due to economic and political uncertainty, the global IPO market was relatively sluggish in 2016, and most global exchanges recorded a decline in IPO activities. Though Hong Kong is expecting a fall of around 26% in its IPO funds raised in 2016, the city's exchange maintains its status as the largest IPO market in the world in terms of funds raised. KPMG China is forecasting an estimated 120 IPOs, with funds raised approaching HKD 195 billion in 2016.

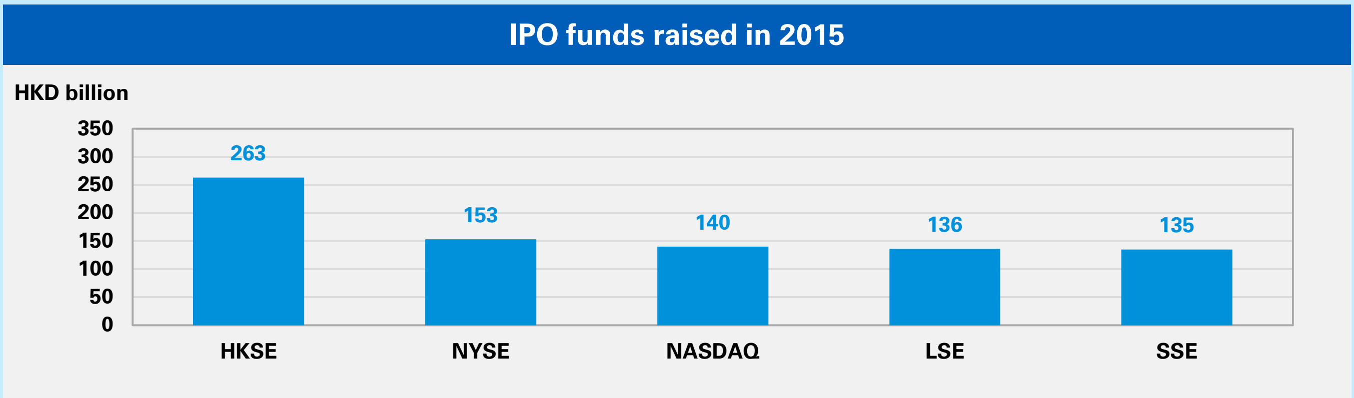
In China, IPO activities began picking up since the resumption of IPO application approvals. The Shanghai Stock Exchange and Shenzhen Stock Exchange will likely raise RMB 105 billion and RMB 50 billion respectively.

China's gross domestic product (GDP) growth remained at 6.7% in the first three quarters, indicating that China's economy has been stabilising in 2016. With its key role in China's economic policies and reform measures, including supply-side structural reform, state-owned enterprise reform and debt-to-equity swaps, China's capital markets will likely be strongly linked to the country's economic development progress. It is anticipated that China's capital markets will maintain their advantage and be set to play a greater role in global capital markets.

Despite the market uncertainties and more stringent regulatory atmosphere, Hong Kong's IPO pipeline remains healthy, with an increasing number of IPO applications. With deleveraging across multiple sectors in China's economy, the demand for equity financing from China enterprises is expected to continue. In addition, the launch of the Shenzhen-Hong Kong Stock Connect and other upcoming initiatives to connect both China and Hong Kong capital markets will boost market liquidity in the longer term. KPMG China expects Hong Kong's IPO market to remain steady in 2017 and to continue being one of the top IPO venues globally.

Global exchanges ranking





Source: Dealogic, HKEx, Capital IQ

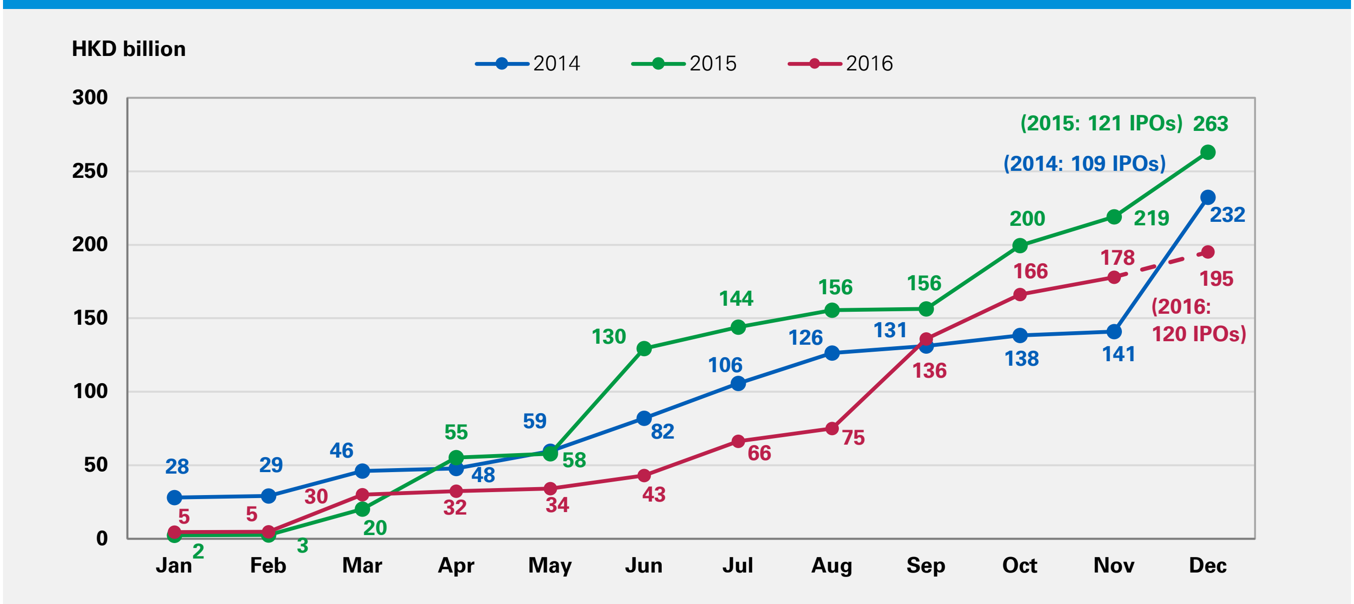
Review of the Hong Kong IPO market

In 2016, Hong Kong has maintained its status as the top global IPO venue in terms of funds raised. This is despite a 26% drop in total IPO funds raised for 2016, which are estimated to be approximately HKD 195 billion, compared with last year's HKD 263 billion, and the lowest in the past three years. Hong Kong's top ranking in 2016 is primarily attributable to the completion of a number of sizeable IPOs, including Postal Savings Bank of China Co., Ltd. (code: 1658), China Resources Pharmaceutical Group Ltd. (code: 3320), China Zheshang Bank Co., Ltd. (code: 2016), China Merchants Securities Co., Ltd. (code: 6099) and Everbright Securities Company Limited (code: 6178). These top five IPOs raised HKD 108.9 billion, representing over half of the expected total funds raised in 2016.

Maintaining the momentum in late 2015, Hong Kong performed steadily in the first quarter of 2016, with 19 IPOs and HKD 30.3 billion raised. In the second quarter, the Hong Kong market became sluggish in the midst of the uncertain economic and political environment, and funds raised dropped to HKD 13.3 billion.

Starting from July, the IPO market in Hong Kong perked up as the US Federal Reserve made the decision to keep interest rates on hold, and the impact of Brexit became noticeable. The improved market sentiment revived momentum, and the number of IPOs tripled in July compared to the monthly average over the first half. Several large IPOs were completed in the third quarter, and funds raised in this quarter totalled HKD 92.4 billion. With the strong IPO pipeline and the traditional high season for Hong Kong's IPO market in the fourth quarter, the number of IPOs is expected to remain at about 120 in 2016, with the expected funds raised approaching HKD 195 billion.

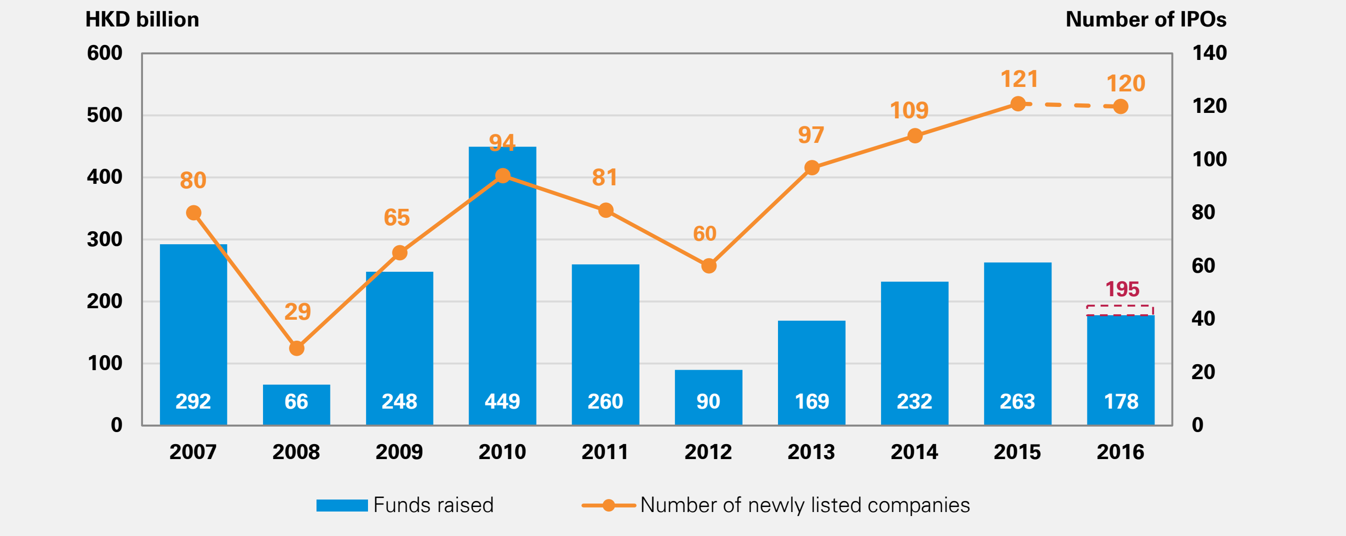
IPO proceeds of Hong Kong's IPO market



Source: HKEx and KPMG analysis

Note: The above analysis is based on the actual number of IPOs on 30 November 2016 and the expected number of IPOs in December 2016.

10-Year trend of IPO activities by number of newly listed companies and funds raised



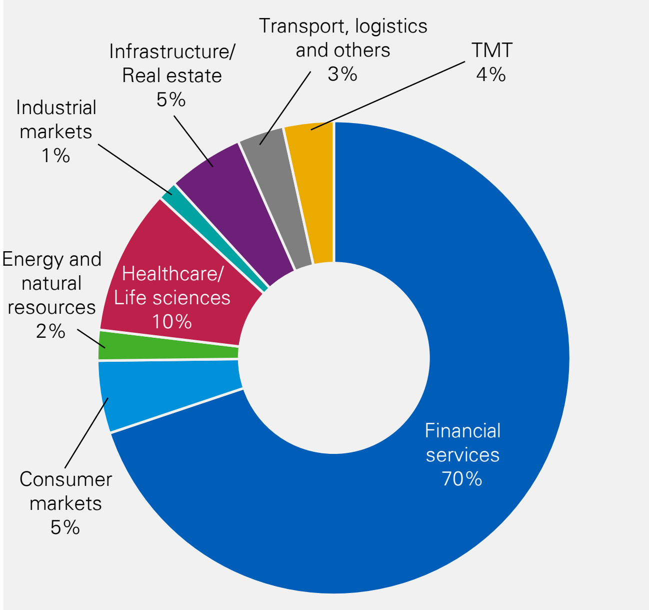
Source: HKEx and KPMG analysis
Note: The above analysis is based on the actual number of IPOs on 30 November 2016 and the expected number of IPOs in December 2016.

The financial services (FS) sector continues to be the major contributor in terms of funds raised in 2016 and dominates sizeable IPOs, with 9 of the top 10 IPOs for the year coming from the FS sector. In 2016, the FS sector contributed nearly 70% of funds raised, up from 54%.

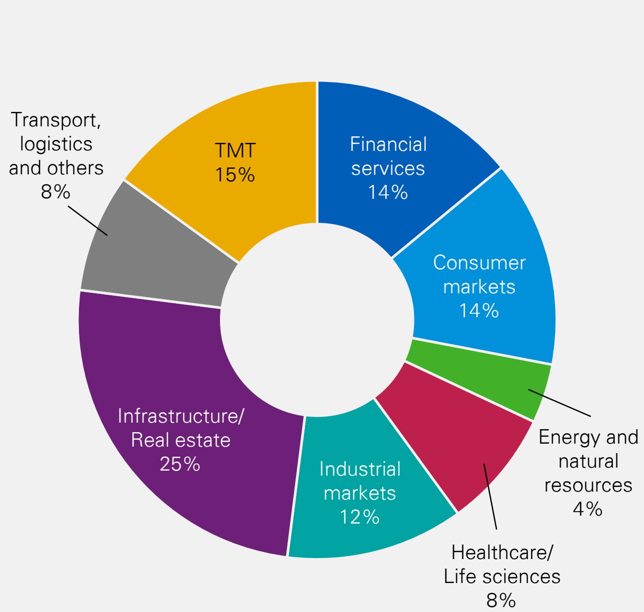
The Healthcare & Life Sciences and the Technology, Media and Telecom (TMT) sectors occupy a position in the Hong Kong IPO market. Large IPOs from these sectors in 2016 include China Resources Pharmaceutical Group Ltd. (code: 3320) and Meitu, Inc. (code: 1357).

The chart below illustrates the funds raised and number of IPOs, analysed by sector, according to listings on the Main Board and Growth Enterprise Market (GEM) Board of Hong Kong Exchanges and Clearing Limited (HKEx).

2016 funds raised by sector

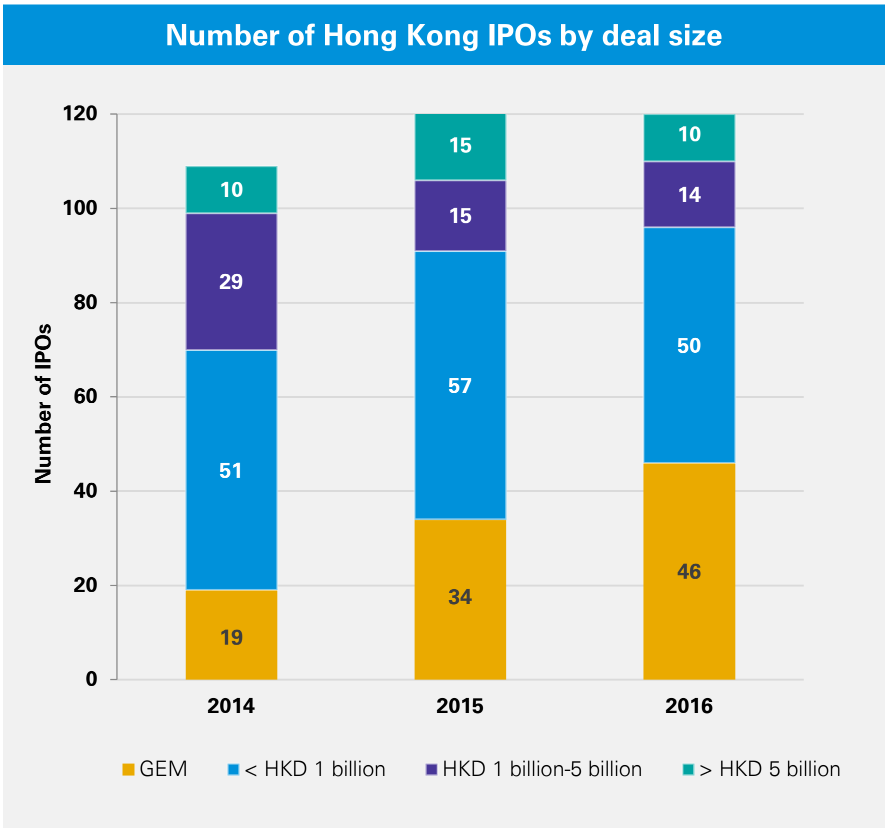


2016 number of IPOs by sector



Source: HKEx and KPMG analysis
Note: The above analysis is based on the actual number of IPOs on 30 November 2016 and the expected number of IPOs in December 2016.

The average deal size in 2016 has been around HKD 1.7 billion, which dropped from HKD 2.2 billion in 2015. The decrease in average deal size is primarily due to the increased proportion of small-cap IPOs with funds raised below HKD 1 billion. Total funds raised from IPOs with deal size over HKD 5 billion are estimated at HKD 152.6 billion, compared to HKD 206 billion in 2015. The chart below illustrates the number of deals, analysed by deal size:



Source: HKEx and KPMG analysis

Note: The above analysis is based on the actual number of IPOs on 30 November 2016 and the expected number of IPOs in December 2016.

Review of the mainland IPO market

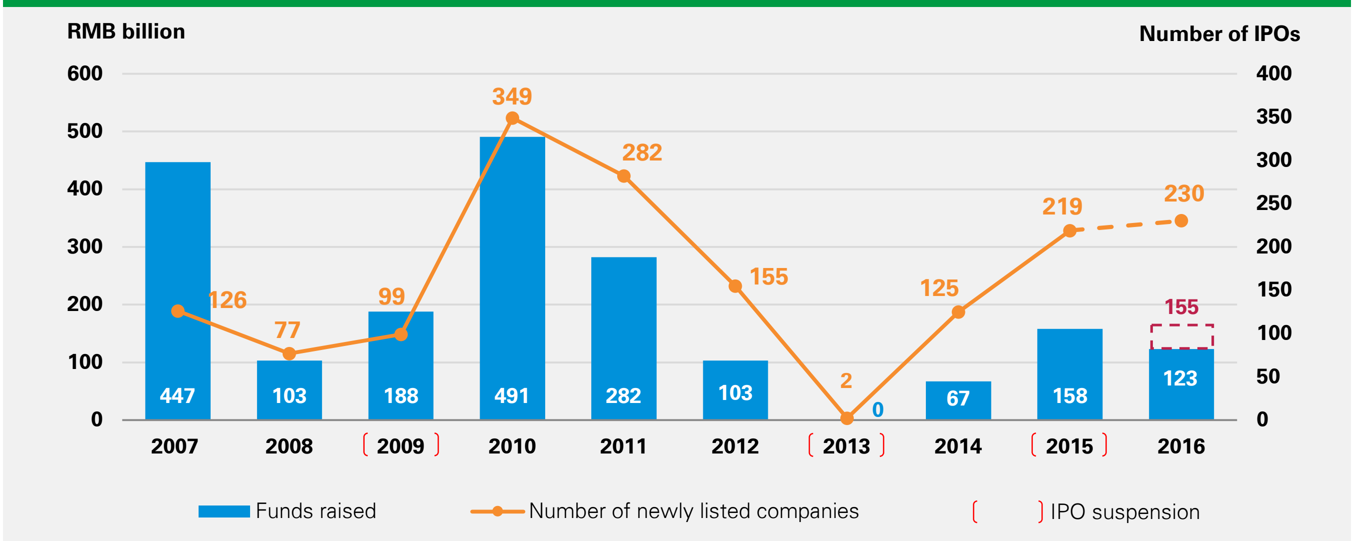
Further to the reopening of new listings in late 2015, IPO application approvals resumed in January 2016 and A-share IPO activities began to pick up from the beginning of the year. The number of IPOs and total funds raised for 2016 are expected to reach approximately 230 and RMB 155 billion respectively, at a comparable level with 2015, though there was a four-month IPO suspension last year.

With concerns about volatility in the equity markets, there were only 70 approved applications in the first half of 2016. A total of 61 companies completed their listings and raised funds of RMB 28.4 billion, 80% less than the corresponding period last year. Both the Shanghai Stock Exchange (SSE) and Shenzhen Stock Exchange (SZSE) recorded a decline in both the number of IPOs and funds raised in the first half.

In the third quarter of 2016, with more IPO application approvals and the return of regional commercial bank IPOs, the A-share IPO market showed a strong momentum with 65 new listings and funds raised of RMB 48.5 billion, which exceeded the performance in the first half of 2016. The momentum continued to the fourth quarter, where there were already 56 new listings in October and November, with total funds raised of RMB 46.3 billion.

By the end of November, 229 entities had received approval for an IPO, while 48 entities were still on their way to completing their listings, with RMB 31.6 billion expected to be raised. For 2016, the IPO proceeds raised by the SSE and SZSE are expected to be approximately RMB 105 billion and RMB 50 billion respectively.

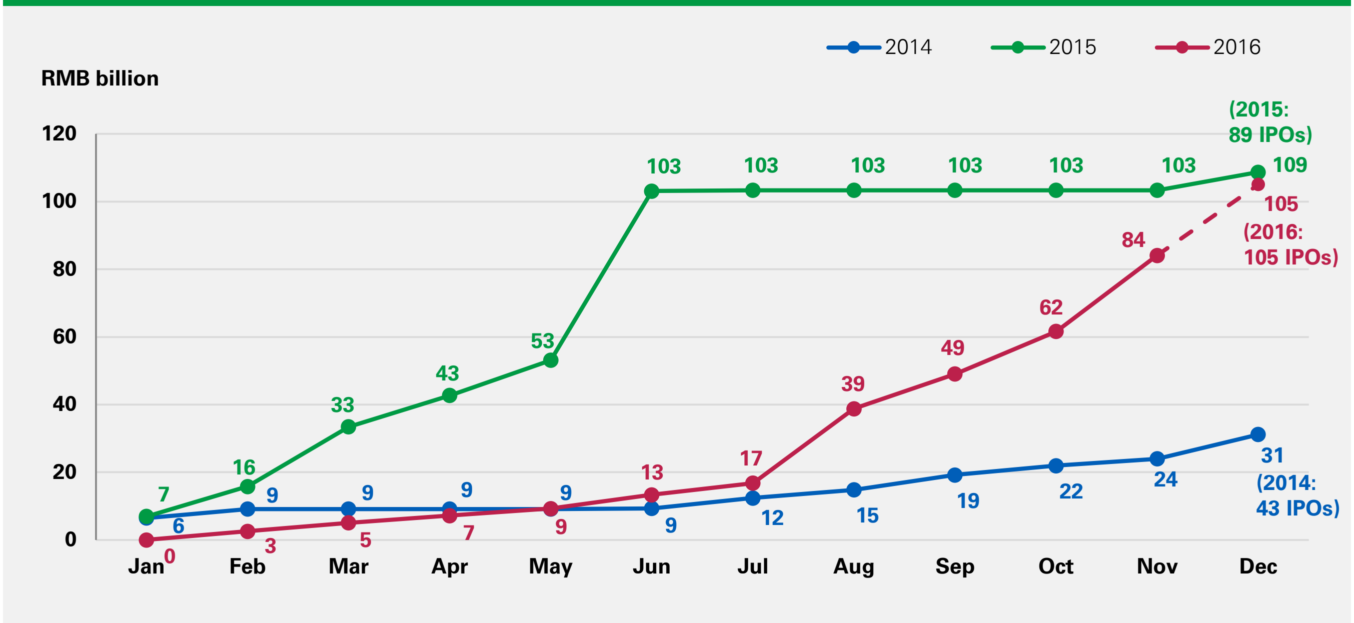
SSE & SZSE: 10-Year trend of IPO activities by number of newly listed companies and funds raised



Source: Wind Info and KPMG analysis

Note: The above analysis is based on the actual number of IPOs on 30 November 2016 and the expected number of IPOs in December 2016.

IPO proceeds of Shanghai Stock Exchange



Source: Wind Info and KPMG analysis
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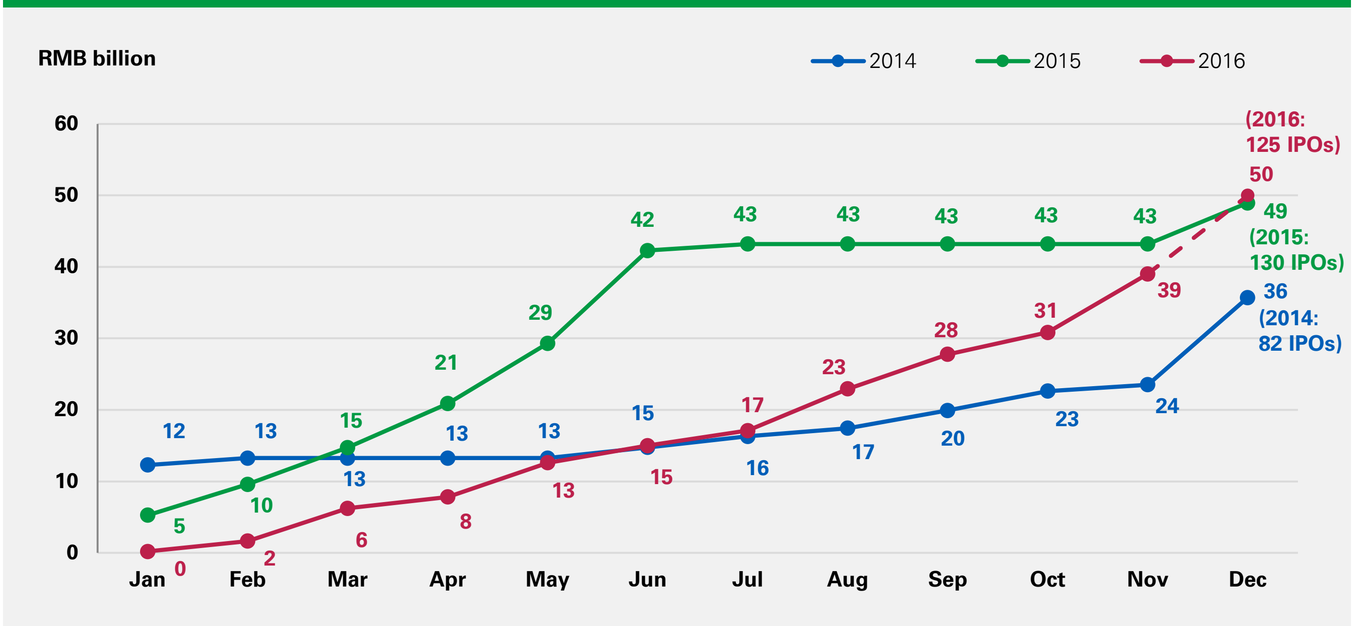
IPO proceeds of Shenzhen Stock Exchange



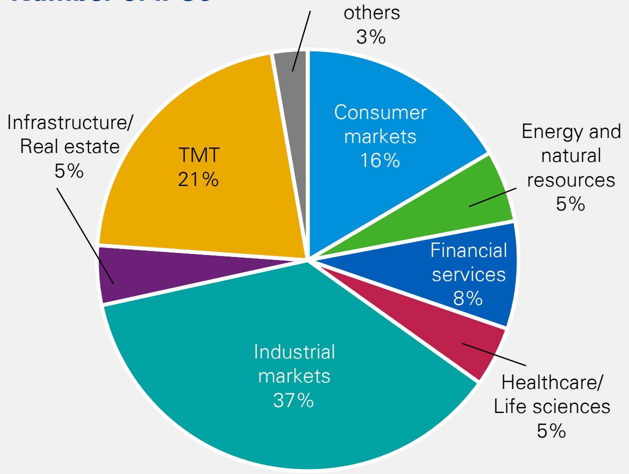
Source: Wind Info and KPMG analysis
Note: The above analysis is based on the actual number of IPOs on 30 November 2016 and the expected number of IPOs in December 2016.

Traditional sectors, including companies from FS, industrial markets (IM) and TMT, continued to be the major contributors to the SSE in terms of funds raised. In August 2016, regional commercial banks returned to the A-share IPO market. Within the three months from August to October, six regional commercial banks completed their listings on the SSE, with aggregate funds raised of RMB 18 billion. In November 2016, the Bank of Shanghai, likely the largest A-share IPO in terms of funds raised for the year, listed on the SSE with proceeds of RMB 10.7 billion. Another nine regional commercial banks' IPOs – including Hong Kong listed banks Shengjing Bank, Huishang Bank and Harbin Bank – have been added to the IPO applications pipeline, and regional commercial bank IPOs are expected to remain positive in the A-share IPO market.

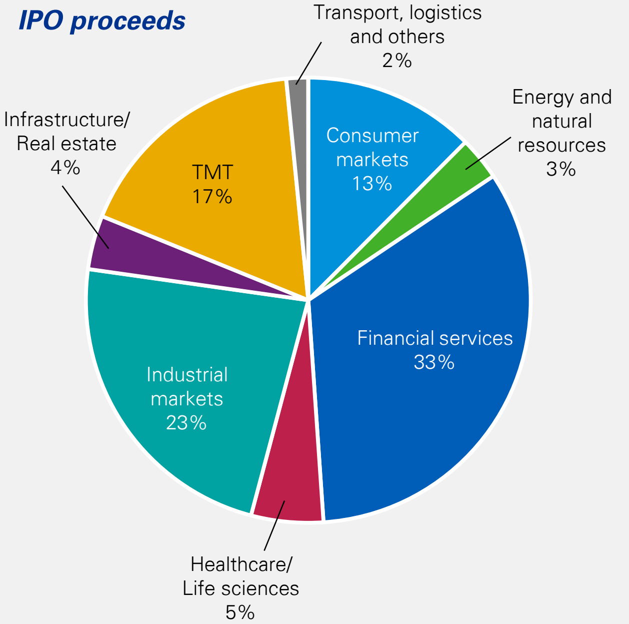
For the SZSE, the TMT and IM sectors remained significant. Similar to 2015, funds raised from the TMT sector accounted for about one-third of total funds raised on the SZSE. Though the contribution from the IM sector declined from 40% to 35%, it is worth noting that high-end manufacturing industries are becoming more prevalent in the IM sector. As one of China's development focuses, high-end manufacturing industries are expected to play a greater role in the IPO market.

SSE

Number of IPOs

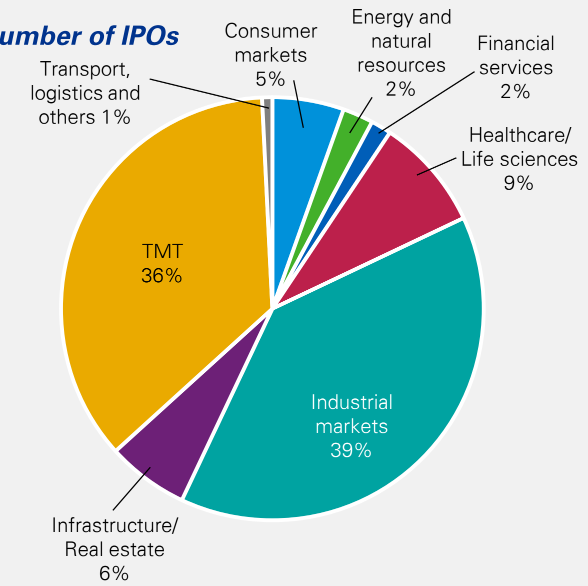


IPO proceeds

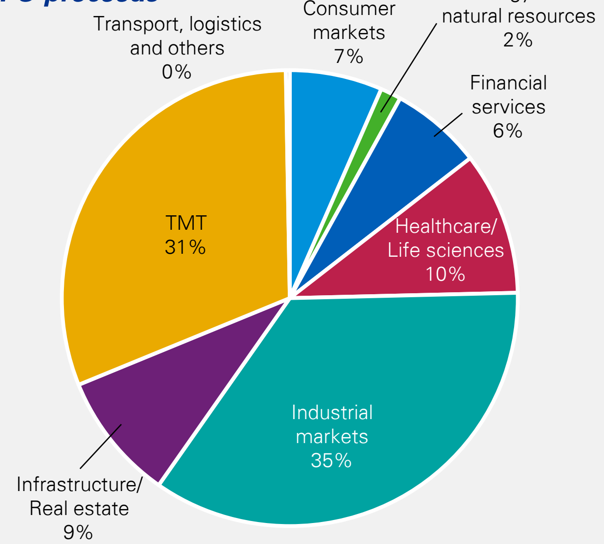


SZSE

Number of IPOs



IPO proceeds



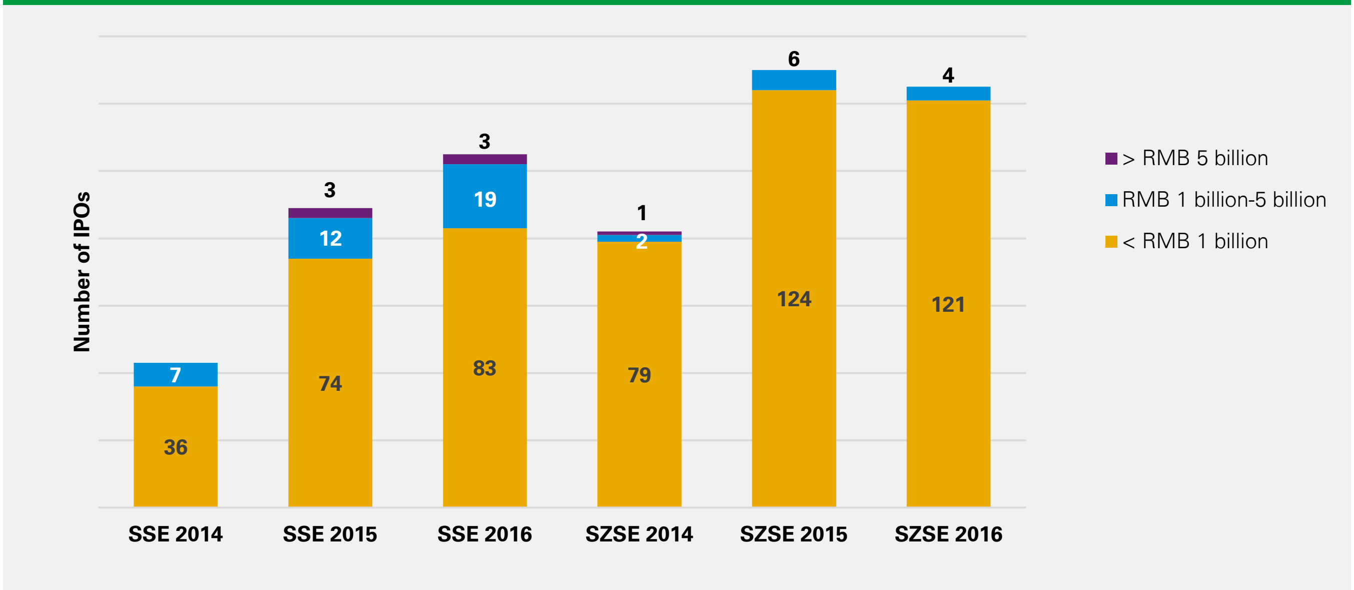
Source: Wind Info and KPMG analysis

Note: The above analysis is based on the actual number of IPOs on 30 November 2016 and the expected number of IPOs in December 2016.

Average deal size in the A-share IPO market was slightly down by 6 percent in 2016. Excluding those IPOs with deal size over RMB 10 billion, the average deal size on the SSE recorded an increment of RMB 0.9 billion from RMB 0.6 billion in 2015. Average deal size on the SZSE remained at a similar level at RMB 0.4 billion.

Despite the return of regional commercial bank IPOs, there were fewer sizeable IPOs in the A-share IPO market in 2016. In 2015, there were three IPOs with deal size over RMB 10 billion, compared to only one in 2016. Continuing with the trend in 2015, smaller deals with proceeds below RMB 1 billion still dominated the A-share IPO market, and the proportion of funds raised from such smaller deals to the total funds raised from January to November 2016 reached 54%, an increase from 48% for the full year 2015.

Number of mainland IPOs by deal size



Source: Wind Info and KPMG analysis
Note: The above analysis is based on the actual number of IPOs on 30 November 2016 and the expected number of IPOs in December 2016.

Outlook for Hong Kong

The long-term impact of Brexit and imminent economic policy changes following the US presidential election have added uncertainties to the global economy. The recent indication from the US Federal Reserve regarding lifting interest rates relatively soon and the stronger US dollar position leading to the capital outflow from the region have brought a certain level of uncertainty to the stock market.

China's positive economic data in the third quarter indicated that its economy is gradually stabilising. In addition, the deleveraging in China has adopted a multipronged approach to cutting enterprise debt, including equity fundraising activities. Demand for financing from China is expected to continue and the number of enterprises from China seeking to list is likely to increase, as evidenced by the strong pipeline in the Hong Kong IPO market. Over half of these IPO applicants originate in China, and have diversified profiles. The Hong Kong IPO market is expected to remain the choice for China enterprises seeking public equity funding.

On the regulatory front, the general atmosphere became more stringent in 2016. In response to the intensified speculative activities in the stock market earlier this year, HKEx issued a guidance letter in June on IPO vetting and suitability for listing, with the aim of formalising its policies on tightening the IPO vetting process for GEM Board and smaller Main Board listings. In 2016, small-cap IPOs with deal size less than HKD 1 billion have been gaining a higher proportion in the market, with a record-high number of new GEM Board listings. By the end of November, active listing applications in Hong Kong reached 146, with more than half from the GEM Board, but the number of successful cases is likely to be adversely affected in the near term by the tightening of the vetting process.

The joint consultation by the Securities and Futures Commission (SFC) and HKEx on the proposed enhancements of HKEx's decision-making and governance structure for listing regulations aroused much debate in the market. The aim of the consultation was to achieve closer cooperation and coordination between the SFC and HKEx, and to streamline and simplify the IPO vetting process. Market participants have diverse views about the consultation content. The SFC and HKEx consultation conclusions will likely be one of the most anticipated regulatory matters in 2017.

The Shenzhen-Hong Kong Stock Connect was officially launched in December. This provides a new channel for international and Hong Kong investors to leverage China's growth by providing access to high-growth Chinese companies in the technology and internet-based sectors. Though the new stock connect scheme, together with the abolishment of aggregate quotas, is not likely to have an immediate effect on the IPO market, the liquidity in both China and Hong Kong's capital markets and the connection between markets will be boosted in the longer term. Chinese companies with funding needs will be able to access a wider and more internationalised investor base.

KPMG China expects Hong Kong's IPO market to remain steady in 2017 and to continue being one of the top IPO venues globally. The actual performance will largely depend on sizeable deals. For 2017, we forecast an estimated 120 IPOs, with about HKD 200 billion being raised.

Outlook for mainland China

The 13th Five-Year Plan set out the objectives for fostering transparent and healthy capital markets, increasing the proportion of direct financing to enterprises, and lowering the leverage ratio. In 2016, China regulators implemented a number of reform measures. With the aim of improving the quality of new listings and better regulating backdoor listing activities, regulators have tightened the scrutiny of IPOs and revised the rules for major asset restructuring. The segmentation of National Equities Exchange and Quotations (NEEQ) has been finalised and implemented to further develop multi-tiered capital markets. In addition, the acceleration of IPO application approvals, together with reforms to the Public Offering Review Committee, may address the long queue in the IPO application pipeline. These measures are paving the way for the introduction of a registration-based system. However, it is expected that the system will only be implemented after other prerequisites are met, including the establishment of a healthy multi-tiered capital market and changes to the existing legal framework.

Multi-tiered capital markets will play a key role in supply-side structural reform and state-owned enterprise reform, though the progress of such reforms is expected to be gradual. Debt-to-equity swap programmes have been introduced to lower the leverage ratio of China's economy, and will support the long-term and continued development of multi-tiered capital markets. China has been striving to achieve an innovation-driven model of economic development, and the *Outline of the 13th Five-Year Plan* has a key goal of raising the share of GDP contributed by the strategic emerging industries to 15% by 2020, double that in 2015. Strategic emerging industries are likely to contribute more to the IPO market in the longer term. China's capital market is going to be deeply tied to the country's economic development progress, while its developments will largely depend on other key reform measures including deepening the ChiNext, NEEQ reform, mechanisms for transferring between markets and the registration-based system.

Both the SSE and SZSE maintained their leading positions among the global IPO exchanges in terms of funds raised in 2016. China's GDP growth remained at 6.7% throughout the first three quarters of 2016, indicating that the China economy has been stabilising. With an IPO pipeline for approvals of nearly 700 companies, strong demand for IPOs exists. In light of stabilising economic growth and various regulatory reform measures, it is anticipated that China's capital markets will maintain their advantage and be set to play a greater role in the global capital markets.

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