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China's IPO market: Q&A with Eric Landheer

In 2009, 33 Chinese companies listed on NASDAQ Asia — and even more are in the pipeline for 2010 — what does this mean for IPO markets in Asia in 2010?

Landheer: China is our largest single source of listings from a foreign country and one of our most important marketplaces.

We are confident that if the markets stabilize and continue to move higher, we could see significantly more listings in the coming year. NASDAQ Asia has approximately 150 companies from Asia-Pacific in total. Greater China accounts for 126 of those, so you can see where the bulk of my focus is.

We do see some potential activity out of India, Korea, Japan and some eventual long-term promise from marketplaces like Vietnam and Cambodia.

In terms of economic reform, we could see developments in those countries along the lines of what we've seen in China. But activity in these other marketplaces pales in comparison to China in terms of both listing applications and volume of potential deals.

Who do you see as the key domestic and foreign investors in these Chinese IPOs, and what are they focusing on?

Landheer: Well it's a completely different investor base.

If you list locally for example in the Shanghai or Shenzhen exchanges, it's predominantly a retail investor base that you are attracting. In Hong Kong, that ratio improves, but it's still an over 50% retail investor base.

By contrast, in the United States you're talking about an 80% to 90% institutional investor base for most of these stocks.

Compared to retail investors, such institutional investors are generally longer term in their views and more patient with the marketplaces during times of volatility. That broad institutional investor base is valuable to Chinese companies, especially when they are trying to build a global brand and a consistent long-term investor base.

As to what institutional investors from the US and from Europe look for — I believe they look for a strong management team and a consistent growth story.

Depending on the industry, they look for certain metrics of profitability and sustainability of that profitability. For example, they look for a "killer app" or product or high barrier to entry in a service industry.

I can't really speak for the domestic Chinese investor, because I can't understand the rationale of some of the PE ratios I see in China right now. I think institutional investors look much deeper into the fundamentals of the company than a retail investor does.

How are institutional investors evaluating the risk-reward

equation in Chinese companies looking to list in the US?

Landheer: Ultimately, investors coming out of the economic crisis are seeking growth.

This is part of the reason that more and more Chinese companies are choosing to list on the NASDAQ — because listing on NASDAQ represents companies that want to be identified with innovation and growth. High listing standards also can give investors a level of comfort, in that they know that the companies have met those higher standards.

There is a level of investor skittishness and nervousness out there in the markets right now.

That has to do with the overall uncertainty surrounding whether corporate profit growth is sustainable, indeed whether the recovery is sustainable. People are wary of additional issues or road bumps, in the form of, major economic troubles perhaps in, Greece, Spain or other European countries.

As long as the overall global economic recovery remains uncertain, and until we work out some of these European issues, then there is going to be continued investor skittishness.

I am not a big believer in the decoupling theory — that Asia can consistently grow by itself right now.

But there are definitely signs that Asia is starting to generate its own momentum in terms of growth. The consumer base and the growth story here in Asia is obviously stronger than that of the US and, in particular, Europe.

How much activity do you see among financial sponsors with regard to Chinese companies?

Landheer: Financial sponsors are extremely active in China.

We are seeing increased activity and the development of new funds being sprouted throughout China.

Whether that indicates a potential bubble down the road is a question that needs to be addressed at some point. However financial sponsors tend to have a certain time frame where they have to develop and execute on an exit strategy.

This is not always in line with what the entrepreneur would like to do in terms of exit strategy or in terms of capital-raising time frame.

What's your view of the Shenzhen ChiNext, geared towards smaller companies and its current high valuations?

Landheer: It's more similar to an OTC or other small-cap market.

It has lower standards than the main boards in both the Shanghai and Shenzhen and is a place for smaller companies that are seeking to attract capital.

Do I believe that the valuations that we've seen there are sustainable or realistic? Absolutely not.

Do I believe that the Chi-Next market will have its own challenges going forward? I do believe so.

However, it is a positive that China has created this new market and provided the ability for smaller and mid-sized enterprises and growth enterprises to be able to list with lower standards and raise capital.

We believe it's merely an evolution of the continued development of the Chinese marketplace.

What have you seen are the major challenges for Asian companies preparing to list?

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Landheer: Companies have an opportunity very early to start acting and working like a public company.

They must focus on:

- Putting the right accounting practices in place
- Having effective investor-relations communications once they become public companies
- Building out their websites and communicate with their current — and potential future — investors
- Establishing independent boards and auditor functions and strong internal controls.

Essentially, they need to think and act like public companies long before they are.