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Chinese tech groups suffer as foreign investors take flight

Geopolitical tension and poor economic recovery drive stock price falls and funding shortages

Chinese online entertainment platform Bilibili was worth $54bn two years ago, as Wall Street investors rushed to bet on the rising tech giant.

Today, the Nasdaq-listed group's market capitalisation has fallen to about $6.5bn, a collapse that has brought forward debt repayments that threaten to sap its remaining cash, leading to drastic cost-cutting at the company.

Bilibili's travails are symptomatic of broader problems across the Chinese tech scene. Overseas investors are selling shares even in profitable internet giants such as Tencent and Alibaba, while becoming reluctant to back the country's most promising start-ups.

Venture capital giant Sequoia Capital last week became the latest group to bow to rising geopolitical tensions between Beijing and Washington, announcing a plan to split its China business into a separate entity.

Adding to the flight of foreign capital is an unsteady economic recovery that has deflated Chinese tech stocks that had briefly jumped on hopes for the country's post-coronavirus pandemic reopening. The downward trend has left employees and investors concerned that the depressed valuations for Chinese tech groups listed in New York and Hong Kong may be long-lasting.

***__"China is getting cancelled and the economy is a dumpster fire,"__ said* a Hong Kong-based equity analyst. He noted that JPMorgan Chase's controversial labelling of Chinese internet stocks as "uninvestable" last year now looked better judged.**

The trend is even hurting cash-rich groups such as Tencent and Alibaba, which have tightened their belts and funnelled savings into share buybacks. Employees at those companies said endless cycles of cost-cutting and sinking pay had hit staff morale.

Recent positive financial updates from the internet giants have done little to lift their stock prices, with Tencent shares down 19 per cent and Alibaba's down 29 per cent from January highs. Since the start of the pandemic, China's 10 largest tech groups have collectively lost $300bn in market value, while their largest US peers have added almost $5tn, according to S&P Capital IQ. For many investors, spiralling US-China tensions are a constant reminder of the fate of those who backed Russian companies, with billions of dollars of value

evaporating soon after Russian president Vladimir Putin ordered a full-scale invasion of Ukraine, leading to crippling western sanctions.

Adding to the complexity are Washington's possible expansion of restrictions on US investment in China, which would add to export controls designed to limit Beijing's access to vital technologies such as advanced semiconductors and chipmaking equipment.

Big foreign investors are backing off as a result, including western pension funds that have historically been leading backers of Chinese tech in both private and public markets.

The Ontario Teachers' Pension Plan, Canada's third-largest pension fund, had almost $1bn invested in shares of Alibaba and Tencent two years ago. Neither company ranks among its top investments today and the group recently cut its Hong Kong-based team, which led such deals.

Warren Buffett has quietly sold down more than half his stake in Chinese electric car group BYD over the past year. Buffett bought and then promptly sold a large stake in TSMC, the Taiwanese chipmaker, this year after re-evaluating "its location" at the centre of a potential US-China geopolitical flashpoint.

Winnie Wu, China equity strategist at Bank of America, agreed that the future did not appear bright for Chinese internet groups in particular. "Stocks and sectors once well-owned by foreign investors are suffering higher cost of capital and more derating," she said.

There are now 252 Chinese groups trading in the US or Hong Kong that meet the definition of a "net-net" — companies with current assets minus total liabilities greater than their market value, according to S&P Capital IQ. This group includes deeply depressed stocks such as Tencent-backed DouYu, a profitable video game streaming platform with $880mn of net cash and a market cap of just $323mn.

"Global long-only [investors] have been out for a long time," one trader at a Chinese brokerage group said of the country's internet stocks.

With the downturn unabating, tech groups have prioritised share repurchases and slimming down. A big Chinese tech investor and director at several leading companies said such strategies were sensible with stock prices so low, adding that he hoped it would help lift share prices so his company could sell long-held positions.

The depressed valuations are most problematic for smaller, unprofitable groups such as Bilibili, where employees said management had cut bonuses and laid off staff while also curtailing business lines as they fought to reach break-even.

The company's cratering share price has made the challenge more acute. Investors who lent the group $2.9bn, betting its stock would continue climbing, now have the option and impetus to recall their convertible notes early.

Bilibili will by mid-June have spent $1.7bn repurchasing the convertible notes, shrinking its cash pile to about $2bn. It faces another $900mn of debt payments next year, potentially

problematic when coupled with its large losses, which totalled almost $900mn over the past 12 months after adjusting for certain non-cash charges. Bilibili declined to comment.

“There is not enough financing to support their cash burn,” said a person close to the company, noting management “lacked imagination on how to grow”. Recommended News in-depthAstraZeneca PLC AstraZeneca defies geopolitics to bet on China Even China’s biggest tech companies are taking drastic action. Alibaba has spent the equivalent of about half of its free cash flow repurchasing shares over the past year and cut 24,000 positions. Employees widely expect the group’s continuing split into six entities will entail further job losses.

Staff said they were being hit doubly hard by the declining value of stock compensation, which for some made up half of their pay, and increasing workloads.

A developer at Tencent said the pay was no longer worth the pressure. “Everyone is doing three people’s work,” he said. “There’s not a lot of cash now so they want to lower costs and raise efficiency. The golden time for internet companies is gone.”