

Initial Returns and the Aftermarket performance of Large Cap Chinese IPOs

IPO's and recently listed companies are an exciting investment space. And, for more reasons than most investors appreciate.

The value of "staggering" new issues from the primary market to the secondary market is well known. Less well known is the fact that recently listed companies tend to continue to outperform the broader market for some period after listing. It is for this reason that recently at least one SFC authorised mutual fund has been established to offer investors access to this effect.

However, what is relatively unknown is that large cap IPO's do particularly well. The purpose of this note is to examine just how well Chinese companies with a market capitalisation greater than US\$1billion have performed at IPO and shortly thereafter.

Panel A sets out some statistics looking at the returns from the issue price to the price of the stock at the end of the first day of trading. As can be seen large firms produce an average return of 34% versus small firms around 13%. Also of interest is that the percentage of "failures", those producing a negative return, is related to size; the larger the company the less the chance of failure.

Panel A : Initial Returns					
Category	N	Mean	Median	Standard Deviation	Percentage Negative
Small firm (<300m)	98	0.1326	0.0793	0.2919	30.61
Medium (300-1000m)	63	0.1256	0.0962	0.2001	20.63
Large firms (>10000m)	36	0.3425	0.1363	0.7640	19.44

* Source IPOX Schuster LLC (www.ipoxschuster.com)

It can be conjectured that there are three key reasons why large cap IPO's do particularly well:

1. Investment banks cannot afford for the issue to fail. No matter what the underwriting fee charged the potential impact of failure is just too large relative to an investment banks balance sheet. As such, large IPO's are priced at the lower end of the possible range. This creates a larger "stag" effect between the primary and secondary market.
2. Large cap IPO's attract the interest of more institutional investors. This has a couple of implications. Firstly, it creates a scramble in the secondary market during the period immediately after listing. This is because this is when liquidity is greatest and large institutional investors that are looking to get set may be active. Secondly, in terms of longer term impact, it may be a part of the registry becomes "secure" in the hands of rational institutional investors which means the counter may not be subject to the same panic sales leading to better average medium term performance.
3. Large cap are more likely to find there way into an index which may attract the support of index funds. For example, Bank of China (3988.HK) only IPO'ed in the middle of last year but is already included in the Hang Seng Index.

Also relative to smaller companies larger companies are more likely to have better corporate governance and are thus less likely to fail. This creates a positive survivor bias effect.

The table below shows the full extent of this large cap effect over various time periods from launch. It can clearly be seen that over each of the time periods large cap IPO's do relatively better than smaller cap IPO's.

	First 6 days	First 3 months	First 6 months
Small Firms	1.6%	0.6%	3.2%
Medium Firms	-1.1%	9.6%	6.0%
Large Firms	3.0%	17.2%	22.8%

* Source: IPOX Schuster LLC (www.ipoxschuster.com)

Whilst IPO's are generally attractive large cap IPO's should be of particular interest to investors.

Note: Dr. Josef Schuster is founder of IPOX Schuster LLC, a financial services firm specialized in Financial Product Design related to IPOs. (www.ipoxschuster.com).