A Study on The Causes of Chapanda Broken IPO

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Abstract. China's new tea industry has recently been exploring overseas listing opportunities, with two companies experiencing breakdowns in their Hong Kong IPOs. ChaPanda, the second new tea beverage company to list, saw a year's worth of turnover evaporate on its first day on the Hong Kong stock market, falling far below investors' expectations. Back in 2021, the IPO of "Nayuki's Tea" on the Hong Kong Stock Exchange also faced a similar breakdown, attributed to overpriced valuations in the new tea beverage industry. These above-average IPO valuations are often influenced by online public opinion and media evaluations, affecting both IPO pricing and stock prices on the first day. Additionally, since the outbreak of the COVID-19 pandemic, mainland companies breaking on their first day of IPOs on the Hong Kong stock market have remained relatively high compared to the overall market. This article uses ChaPanda as a case study to explore the reasons behind the frequent IPO breakdowns in the new tea beverage industry on the Hong Kong stock market. It examines three key aspects: industry background, enterprise valuation efficiency, and investor sentiment, as well as the issuance risks of listing on the Hong Kong Stock Exchange. The aim is to provide practical references and suggestions for reasonable pricing of future IPOs in the same industry.

Keywords: New Tea Industry; Broken IPO; ChaPanda.

1. Introduction

Many scholars at home and abroad have spent a lot of energy and time studying the underpriced issuance behavior of IPOs from multiple perspectives [1]. Loughran et al. found that underpricing of IPOs is a common phenomenon in equity markets around the world, and is particularly common in developing countries, although to varying degrees in countries with different economic developments [2]. Dilesha et al. found that the short-term performance of an IPO in an emerging market is much lower than the probability that an IPO will be underestimated [3]. So far, few researchers have paid attention to the problem of overpricing IPOs, and among the 148 observations from the CSE, IPO underpricing was 29% higher than IPO premium. One of the explanations for the low IPO pricing that is generally accepted by scholars at this stage is the information asymmetry theory. Although there is little research on IPO premium issuance, according to the study of China's A-share market by Su et al., liquid stocks tend to be overvalued when investor sentiment is high, which tends to support sentiment-driven mispricing [4]. It can be shown that investor sentiment will also affect the efficiency of stock pricing to a certain extent, resulting in excessive IPO pricing.

Hong Kong's IPO market has undergone some changes in the last three decades. Prior to the early 90s of the 20th centuries, most IPOs were issued at a fixed price, after which it was left to the discretion of the underwriters and issuers. However, after SEHK amended its new listing rules on 26 June 1998, at least 10% of IPOs were allocated to retail investors, and mandatory terms could be applied under the oversubscription clause, with retail investors being allocated up to half of the shares. While the underwriters in Hong Kong have considerable discretion over the method of allocation of shares in the event of oversubscription, such rights are curtailed when shares are oversubscribed. Based on the Hong Kong IPO market, K. Mazouz et al. found that before the introduction of rebate clauses in Hong Kong stocks [5]. Retail investors were allocated more high-priced products, which somewhat reduced the winner's curse [6].

With the deepening integration of the global financial market, listing in Hong Kong has become the primary choice for mainland enterprises to list overseas. The leading enterprises in China's new tea beverage industry are close to saturation in the domestic market, and many companies are seeking to go out of China, lay out overseas markets, and gather IPOs. According to the "2023 New Tea Drink Study" jointly released by the China Chain Store & Franchise Association and Meituan , the scale of China's new tea beverage consumption market has increased from 53.4 billion yuan in 2018 to 100 billion yuan in 2021, but the growth rate has slowed down significantly, and the financing situation of the new tea beverage industry is not optimistic. Therefore, the successful IPO of ChaPanda has a certain financing advantage compared with other companies and will be favored by investors. However, as an emerging industry, while it has attracted public attention, retail investors also have certain doubts about the company's future development. According to Tomas Vakrman's research, high-profile IPOs differ from other IPOs in that investors will have an overly optimistic market reaction during periods of high sentiment, which can lead to long-term underperformance of stocks to a certain extent [7]. This article takes ChaPanda as an example, starting from the market environment of Hong Kong stocks and the market of the new tea beverage industry, to explain the psychology of investors, and then provide a reasonable explanation for the IPO breakout of ChaPanda.

2. Case Overview

At this stage, it is generally believed that the factors affecting IPO pricing are mainly divided into internal and external factors. Internal factors include corporate fundamentals, and external factors include the market environment. Chao et al. argued that the media also influences the pricing of IPOs and subsequent market performance by disseminating various information to correct investors' irrational decision-making and monitor the behavior of companies [8]. China is the world's arrogant emerging economy with many retail investors. China's online social media platforms have a wide coverage and are one of the important means for retail investors to obtain information, so retail investors are very vulnerable to media reports.

Hong Kong is the only international financial center in China, and the listing of Chinese mainland enterprises in Hong Kong can not only enhance their visibility abroad, but also closely integrate marketization and localization. The IPO offering in Hong Kong is divided into two parts: the Hong Kong Public Offering (HKPO) and the International Offering. The Listing Ordinance requires that the Hong Kong public offering portion account for at least 10% of the IPO. If the subscription enthusiasm for the public offering portion (10%) is very high, the underwriters will have the discretion to call back a certain proportion of the goods allocated to large customers to the secondary market, which is related to the actual overpurchased multiple, which accounts for up to 50% of the IPO. In terms of IPO price, since the IPO pricing of Hong Kong stocks is not subject to valuation restrictions, it is formed by bidding and bidding by institutional investors, and the degree of marketization is high, so the performance of new shares on the first day of listing is differentiated.

On the other hand, there is irrationality in the issuance pricing of Hong Kong listings, and the breakage rate is high. As of 31 December 2023, there were 2,609 listed companies and 73 newly listed companies on the Hong Kong Stock Exchange, all of which were listed on the Main Board. Among them, 36 broke and 15 fell by more than 50%. The Hong Kong stock market and the mainland market have broken IPOs, which shows that the pricing of new IPOs in the primary or secondary markets is not sufficient and unreasonable. The breakage will not only lead to losses for many investors but may also have a certain degree of negative impact on the image, reputation and subsequent market performance of the listed company, and will also cause a series of reactions in the stock market.

China's GDP is increasing year by year (2018-2023), and the level of national consumption is also increasing. Media Research recently released the "2023-2024 Survey and Analysis Report on the Operation Status and Consumption Trends of China's New Tea Industry", which predicts that the size of China's new tea market will reach 37.493 billion yuan in 2025. In 2023, the acceptance of new tea consumer groups will gradually rise, the category will continue to innovate and expand, consumers' enthusiasm for new tea will continue to rise, and the demand will rise, and the domestic new tea market will reach 33.338 billion yuan, which will also drive a significant rebound in new tea investment and financing. However, the competition in the bubble tea industry is fierce, with only 18.8% of bubble tea shops operating sustainably for more than a year. And the new tea beverage industry is different from other catering industries, and its profit method is through store franchise. As the stores in the domestic new tea beverage industry are close to saturation, many brands are eager to seize the opportunity in overseas markets and have piled up Hong Kong stocks. ChaPanda was listed on the Hong Kong Stock Exchange ahead of other peers, but the stock price fell below the issue price on the first day, far below the public's expectations, and also brought huge losses to retail investors.

3. ChaPanda Broken IPO Process

Sichuan ChaPanda Industrial Co., Ltd. (hereinafter referred to as "ChaPanda"), the parent company of the new tea beverage brand ChaPanda, was listed on the main board of the Hong Kong Stock Exchange on April 23, 2024. The listing issue price was HK$17.5 per share, and 0.148 billion shares were issued, raising a total of HK$2.586 billion. Approximately 51% of the net proceeds will be used to improve overall operational capabilities and strengthen the supply chain. About 20% will be used to develop digital capabilities, as well as to appoint and train specialists. As the dairy tea market is nearly saturated, ChaPanda intends to use the remaining funds for brand building and promotion activities, promoting its own coffee brand, and establishing a coffee shop network, product development and innovation in China to seek its own development.

On February 23, 2024, ChaPanda provided listing-related documents to the Hong Kong Stock Exchange and passed the listing hearing of the Hong Kong Stock Exchange in March this year. With a total amount of nearly HK$2.6 billion raised, it will become the largest IPO of Hong Kong stocks since 2024. As of the close of trading on April 24, the share price of ChaPanda fell by 33.7% in the two trading days after its listing, and its market value shrank by about HK$8.7 billion (about 8 billion yuan). For the next month, the stock price continued to fluctuate and fall (see Figure 1).

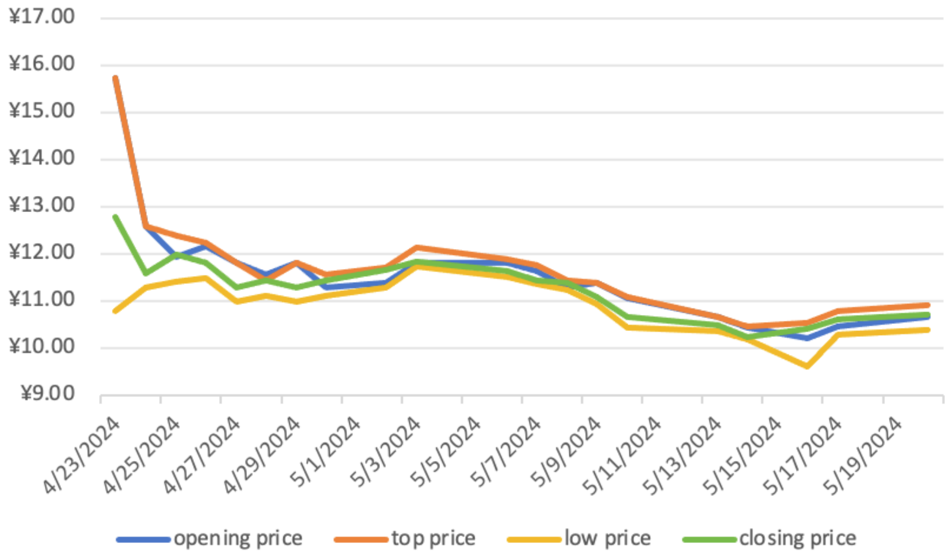

Fig. 1 27-day price trend (excluding holidays) of ChaPanda after its listing.
(Photo/Picture credit: Original)

4. Causes of ChaPanda Broken IPO

ChaPanda is a catering company, and its operating conditions will affect the performance of its listed stock price. The following data comes from the prospectus of ChaPanda, which analyzes the operation and profitability of ChaPanda, asset turnover, R&D investment and the use of raised funds, and other aspects.

Judging from the financial reports and prospectuses of the last three years disclosed by ChaPanda, compared with NAIXUE, which has been losing money for five consecutive years, ChaPanda has achieved continuous growth in revenue and net income, with relatively good operating conditions and high core competitiveness (see Figure 2 and Figure 3). According to Frost & Sullivan, ChaPanda is the third largest freshly made tea company in China, accounting for 6.8% of the Chinese ready-made tea shop market. The market size of China's ready-made tea shop industry in 2023 will be 0.2473 billion yuan, with a CAGR of 25.2% from 2018 to 2023, the industry CR5 will be 40.2%, and the ready-made tea shop industry will account for 64.4% of China's beverage shop industry. In 2023, a total of 1.016 billion cups of milk tea will be sold at ChaPanda stores, with total retail sales reaching about 16.9 billion yuan. As of April 5, 2024, the number of ChaPanda stores has reached 8,016, covering 31 provinces and cities across the country.

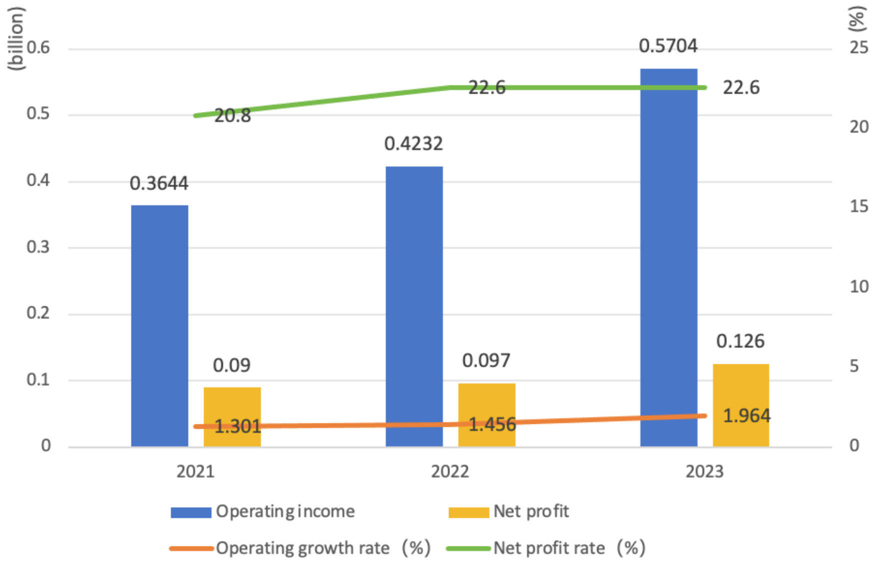

Fig. 2 Operating performance of ChaPanda in 2021-2023 (Photo/Picture credit: Original).

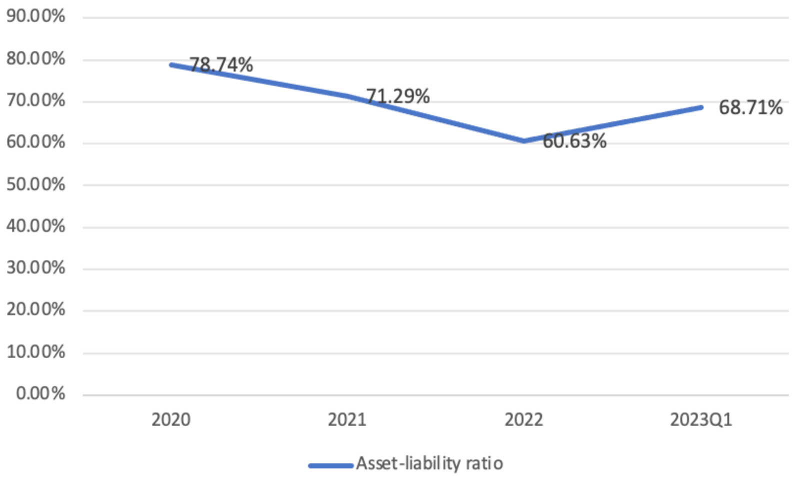

Fig. 3 Asset-liability ratio trend of ChaPanda from 2020 to 2023Q1 (Photo/Picture credit: Original).

Next, this paper will analyze the business situation of ChaPanda from the overall situation of the industry. The new tea beverage industry mostly adopts the franchise model and is oriented to franchisees, so the core competitiveness of the new tea beverage industry lies in whether the franchisees can obtain a better rate of return, so as to quickly seize the market. And this is inseparable from each store, and if each store wants to make a profit in the fierce competition, then only rapid expansion can seize the market. From the point of view of the franchise policy of ChaPanda, the brand franchise contract term of ChaPanda is 5 years, the cooperation fee is 50,000 yuan, the comprehensive service fee and staff training fee for opening are 80,000 yuan, and the one-time investment in the early stage is 375,000 yuan, which is more than 162,000 yuan higher than the early start-up capital of Mixue Ice Cream & Tea in the same industry, and there are fixed operating service costs every month, the investment cost is expensive, and the investment threshold is high. In addition, data from the Guojin Securities Research Institute shows that the store closure rate (the number of stores closed in the current period/the number of stores opened at the beginning of the period) of ChaPanda has increased year by year in the past three years, and it will even surpass Mixue Ice Cream & Tea to reach 4% in 2023. High sunk costs and the risk of store closure are environmental risks that cannot be ignored. According to a report by China Investment, ChaPanda also once bottomed out in cash. As of the end of March 2023, its cash and cash equivalents were only $0.032 billion. In June of that year, ChaPanda completed a strategic financing of 1 billion yuan, and the financial dilemma was alleviated. In the face of such a market, investors may have concerns about the overall development of the industry. However, in the highly competitive new tea beverage industry, compared with other peers, the sinking speed of ChaPanda in the market is also slowing down. According to the data of the Guojin Securities Research Institute, as of January 7, 2024, the number of stores distributed in the fourth and fifth tier cities is less than 10% (see Figure 4), and the store density lags behind the average level of the new tea beverage industry, and according to the prospectus, the annual growth rate of the number of stores of ChaPanda is gradually slowing down, which not only marks the saturation of the new tea industry market, but also can be inferred from this, even if the ChaPanda performs well in financial data, the follow-up profit growth rate in the domestic market will be relatively weak in the future.

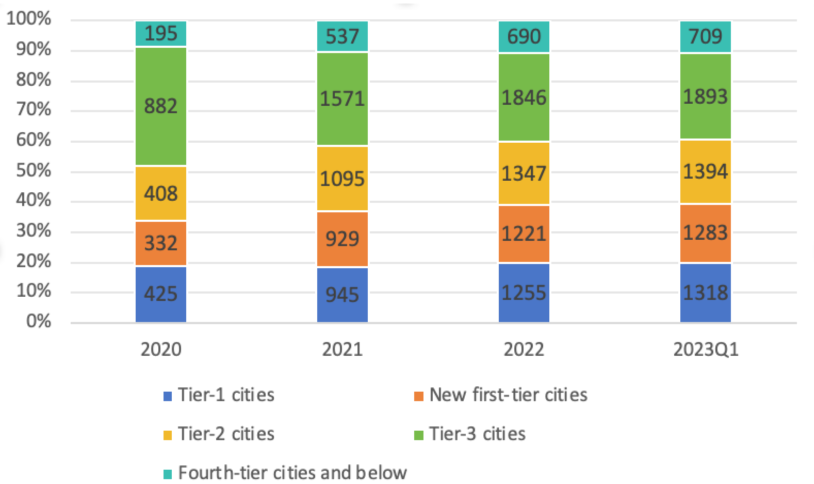

Fig. 4 Distribution of ChaPanda offline stores in Chinese cities (Photo/Picture credit: Original).

On the other hand, there are certain risks associated with the listing of mainland enterprises in Hong Kong, and the amount of funds raised by the Hong Kong Stock Exchange has fallen in the past three consecutive years (see Table 1). The overall environment is sluggish. Because the stock market is a zero-sum game, it is likely to face greater financing risks. According to Yao's research on the listing of mainland enterprises in Hong Kong, there are several main reasons for the large breakdown of mainland enterprises in the Hong Kong-style market [9]. Hong Kong stock market has a market-oriented pricing mechanism and market attributes dominated by institutional investors, which has higher requirements for the fundamentals and growth of enterprises, and the valuation bubble is difficult to sustain; From the perspective of the enterprise itself, taking ChaPanda as an example, the company's high visibility and dazzling financial data lead to overpricing and actual profitability cannot support excessive valuation, resulting in the valuation of the primary market exceeding that of the secondary market. From an investor's point of view, due to information asymmetry and low familiarity with the mainland market, Hong Kong investors may have a low level of recognition and confidence in mainland companies listed in Hong Kong. In addition, as a well-known company in the mainland, ChaPanda has a lot of news coverage before going public, and according to Hiroyuki's study, media coverage has a significant impact on both the plunge and the spike in stock prices [10]. This is particularly evident in China, as a country with a fairly high coverage rate of netizens.

Table 1. Number of new issues and fundraising amount in Hong Kong from 2018 to 2023

	Raised amount (billion HKD)	The number of listed companies
2018	288	218
2019	314.2	183
2020	400.1	154
2021	331.3	98
2022	104.6	90
2023	46.295	68

5. Conclusion

At present, cross-border financing through listing in Hong Kong has become the primary choice for mainland enterprises to list cross-border, and listing in Hong Kong is also the only way for ChaPanda to expand overseas. Based on the background of the Hong Kong stock market, this paper analyzes the reasons for the IPO breakage of ChaPanda, analyzes the industry profile of the company and the macro environment of the Hong Kong Stock Exchange, and believes that the overpricing of the first day of valuation led to the IPO falling below the issue price. The conclusions of this paper are divided into the following points: (1)As a catering brand with franchise model as its main business strategy, in order to stand out and seize business opportunities in the highly competitive new tea beverage industry, the issuer, the underwriting sponsor and the investor are all inclined to high pricing, although the financial data has achieved sustained profitability, but the development in the fierce competition market is not optimistic. (2) The various systems of the Hong Kong Stock Exchange are not suitable for mainland enterprises and there are many information gaps, which to a certain extent affect the pricing efficiency and the decision-making of investors. (3) As a high-profile brand, the media coverage of ChaPanda before and after the IPO also had an impact on its stock price fluctuations on the first day to a certain extent, affecting investors' decision-making. Under the control of the final macro environment, the listing of ChaPanda on the Hong Kong Stock Exchange and the gradual rationality of investors, the stock price finally stabilized at about 10 yuan within a month. The theoretical research on IPO breakage in the academic community is not perfect, and the research on the pricing efficiency of overseas IPOs, including listing in Hong Kong, is also relatively lacking.

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