FINANCIAL REVIEW

Perspective
CHINESE BURN THE RED CAPITALIST, THE ASX AND A $55 MILLION HOLE

Angus Grigg
1,960 words
14 April 2018
The Australian Financial Review
AFNR
First
14
English

The allure of the Beijing boom has provided a cautionary tale for Australian investors, writes Angus Grigg.

Five years ago a Chinese businesswomen came to Australia offering investors access to the mainland's fast-growing e-commerce market and the political connections to make this happen. Like many of her peers among the "Red Aristocracy" Amalisia Zhang had used her family pedigree to enter the business world and in so doing became fabulously wealthy.

But for ASX investors who have given her company, 99 Wuxian, nearly $55 million since 2013, the experience has been less stellar.

After a series of related-party transactions, corporate governance breaches, rapid cash burn and ultimately a deal labelled "not fair" by an independent expert, 99 Wuxian is on its knees, while Zhang appears to have shifted her focus elsewhere.

The ASX has moved to crack down on Chinese companies listing in Australia after a series of failed floats, but for investors in 99 Wuxian there is little left.

The business, once valued at $700 million, has seen its share price decline by 90 per cent over the past three years. It is floundering as a bit player in China's rapidly growing, but highly concentrated, mobile payments market.

In hindsight, the red flags were there for all to see when Zhang and local corporate adviser Ross Benson floated 99 Wuxian on the ASX, via a backdoor listing, in October 2013.

At that time Chinese listings on the ASX were still relatively rare, but a rush would ensue as the mainland's business and political elite sought foreign-denominated assets after the country's two-decade economic boom.

Local investment bankers, broking houses and, to a lesser extent, the ASX accommodated this desire. The narrative around the "China boom" swamped aspects of these floats that at another time may have sounded alarm bells. 99 Wuxian is just such a story.

It was billed as the Bpay of China with 32 million registered users at the time of its float and the potential to be a $4.7 billion company, 15 times higher than its market capitalisation on listing.

The pitch was not all hype. The company did have a unique place in China's rapidly evolving financial services architecture because it offered a secure marketplace for bank customers to top up their mobile phone credit, pay bills or purchase goods from third parties, such as Alibaba.

And in the early days, all looked to be going well as it signed up 50 banks across China, including eight of the 10 largest.

The problem was revenue and the huge gap between how the company defined this crucial metric and the way its auditors saw it.

The auditor prevailed in this not-insignificant dispute and the company's revenue declined by 60 per cent last year to around $24 million.

There was not, however, a corresponding decline in costs.

Indeed, the company's "selling and distribution expenses" almost doubled, while its administration expenses were flat.

"They [the auditors] changed the way we classified revenue," says Benson, who became chairman of 99 Wuxian after the float and answered the AFR Weekend's queries on behalf of Zhang and the company. "So, yes, on the face of it our revenue has more than halved."

And the auditors, BDO, still don't appear entirely convinced, saying there are "risks in relation to the accuracy and completeness of amounts recorded as revenue".

This new classification also raises questions about whether the company correctly accounted for revenue in the past, especially when it was out raising capital.

At the same time 99 Wuxian is showing almost no growth in the "Gross Transaction Volume" on its marketplace, even though it claims in its annual report to be playing in a "huge and fast growing market".

The other oddity, identified by the auditor, is that 99 Wuxian has 62 per cent of its assets tied up in receivables. Such a large balance, which equates to more than three times last year's revenue, would typically make investors nervous and suggests 99 Wuxian has some difficulty getting paid.

BDO said "management judgment" was required to determine if any write-downs to this sum were required.

"Management concluded there was no impairments necessary," the auditor said, while Duncan added the company had never had any problems collecting money.

To understand how 99 Wuxian ended up in Australia, it's worth looking at the operating environment for Zhang and many others like her in 2013, as she sought a listing on the ASX.

The official reason for doing so were Chinese regulations that required the mobile payments arm of a business Zhang was running to be spun off into a separate entity. This entity needed capital and so Zhang sought out Benson and his boutique firm, Investorlink, with an eye to an Australian listing.

This need for capital was certainly a consideration, but the timing can't be ignored either.

As 99 Wuxian was preparing to list on the ASX in October 2013, Xi Jinping was establishing himself as China's top leader and had embarked on a sweeping anti-corruption campaign that would become the largest ever undertaken.

Old factional alliances and the protection these afforded were suddenly in doubt. Many among the elite were nervous and so began looking for an insurance policy. Having foreign denominated assets was a good start.

It was within this atmosphere that Zhang created the Hong Kong entity 99 Wuxian, in which she still holds a 22 per cent stake.

Its sole asset at the time was a 30-year technology licence agreement, which was acquired for around $15 million but then rolled into the listed company with a $400 million valuation.

Such a large mark-up was brushed aside as broking analysts suggested the company should be viewed alongside the likes of Alibaba or its equally giant Chinese e-commerce rival, JD.com.

"99 Wuxian is strategically positioned in one of the most exciting growth industries in the world (mobile-commerce) in one of the fastest growing consumer markets in the world (China)," Foster Stockbroking enthused in a report published in June 2014, which had a buy recommendation and 90¢ price target for the stock.

Such write-ups helped push the stock from its 40¢ listing price to a high of 69¢ in July 2014, valuing it at $700 million and Zhang's stake at $176 million.

This allowed 99 Wuxian to raise a further $25 million at 55¢ a share, a raising done by its most supportive broker, Foster, which acted as the lead manager.

As more Chinese consumers embraced the internet, Foster estimated the company would be generating annual pre-tax earnings of $100 million by 2017. Foster's optimism was way off the mark. In 2017, 99 Wuxian delivered a pre-tax loss of $3.2 million.

Such heroic assumptions made by Foster and others would prove to be just that, as the reality for shareholders gradually became clearer.

Just seven months after putting its clients into the deal, Foster downgraded the stock to a hold and, 18 months after its initial bullish predictions, ceased coverage altogether.

"We stopped covering the stock due to a reallocation of staff resources," said Mark Fichera, the head of research at Foster.

One problem that saw the stock halve in value just months after it had raised capital was the failure of a long-promised deal with UnionPay, China's largest payments provider, for 99 Wuxian to be its exclusive provider of cloud-based point-of-sale technology.

This failure, along with increased competition in the mobile commerce market, saw 99 Wuxian change its focus to employee rewards and loyalty schemes, which saw its financials deteriorate quickly.

From small profits in 2014 and 2015 the company moved into the red in 2016 and stayed there last year, losing 17 million yuan after tax ($3.4 million).

Another warning for ASX investors should have been the role of Benson himself. Not only would he become executive chairman of 99 Wuxian, rather than appointing an independent non-executive chairman, but his firm Investorlink was the main adviser on the float and generated fees of 10.3 million yuan or around $1.75 million in the lead up to and after the listing.

In the past two years the firm has earned a further $500,000 in fees from 99 Wuxian.

The chief financial officer of 99 Wuxian, Ayngaran Kailainathan, also came across from Investorlink before resigning abruptly in January 2016. He declined to comment for this article.

Another of 99 Wuxian's directors at the time of its listing, Tony Groth, was also from Investorlink, adding to the general lack of independence on the board.

Benson defended his dual role, saying the company needed Australians who understood the business on its board and in senior management.

"The only reason I'm on the board is so I can explain the business to Australian investors," he says.

It has been harder, however, for the company to explain an independent expert's report that labelled a business sale by 99 Wuxian as "Not Fair but Reasonable".

According to interviews given by Zhang, the mobile payments market in China had become crowded and so the company had changed direction, embracing the world of digital loyalty programs and other e-commerce services.

This saw 99 Wuxian announce in December 2015 that it would pay $97 million for e-commerce company Jiangsu Offpay, a provider of services and technology for digital marketplaces.

The deal was to be completed in four tranches, the first $34 million of which was to be funded through a loan by Zhang to 99 Wuxian.

The Offpay deal was described at the time as a "unique opportunity" to acquire a "leading" e-commerce company.

But just 10 months later, 99 Wuxian told shareholders it would only be purchasing 40 per cent of Offpay in what it described as a "positive result", without providing any other explanation.

Just weeks later it further updated the market, saying it would sell that 40 per cent stake to Zhang and would book a profit of $7.6 million, a "positive outcome" that would enable it to focus on "customer acquisition" and reduce debt.

But the independent expert required for related party deals had more than a few reservations.

BDO labelled the deal "Not Fair but Reasonable", a term that indicates it is not in the best interests of minority shareholders but the company had few other options.

Benson said the deal never went ahead. He said the company could not raise funds to complete the acquisition, as the market "didn't understand" how to value such Chinese businesses.

Another curious habit of the company was its propensity to borrow money for working capital, at steep interest rates, despite its accounts showing it had about $8 million in cash during 2016 and 2017.

In 2017 the company borrowed about $2 million in three separate "equity-linked loans" at an annual interest rate of 10 per cent, which can be converted into shares. The company then entered into a further two loans at the same interest rate for a total of $560,000 this year.

These will either be very expensive working capital or highly dilutive to existing shareholders.

With the company's share price languishing at 6.4¢, Benson admits the experiment of listing Chinese companies on the ASX has not gone well and he looks forward to the day when he can leave.

"But we're not ready to give up on the Australian market just yet," he says. "We have customers and transaction volume, we now need to translate this into profit."

Document AFNR000020180413ee4e0000t

