IGNITES ASIA

Fidelity, T. Rowe's early bets on ByteDance may soon bear fruit

By Echo Huang September 23, 2020

Fidelity and T. Rowe Price have invested at least US$23.2 million to purchase shares in Chinese social media giant ByteDance via public funds they manage, part of a growing trend of more global fund firms seeking out early-stage investment in high-growth Chinese tech firms ahead of future IPOs.

While such opportunities offer the prospect of attractive returns that are becoming increasingly hard to find in the secondary market, these investments are not without risks, including reputational risks from Chinese firms that fall out of favour with U.S. authorities.

The two U.S.-based managers own shares in ByteDance, which runs video sharing app TikTok, after making a direct investment in the company prior to its rapid global expansion and well before it became caught up in the crosshairs of U.S.-China political tensions.

Three T. Rowe Price funds acquired US$13.8 million worth of ByteDance's shares in 2019 from the tech firm's series E fundraising in the previous year, while a Fidelity fund acquired £7.4 million (US$9.4 million) in ByteDance shares in 2018.

Other high-profile investors such as Softbank and the Canada Pension Plan Investment Board were among the nine leading investors in the 2018 series E fundraising round that gave ByteDance a total of US$3 billion.

But as a result of ongoing tensions over Chinese technology in the U.S., these early-stage investors may be offered an exit route for their illiquid holdings in the expanding tech giant.

ByteDance sold a majority shareholding of TikTok over the weekend to U.S. investors including Oracle and Walmart, after threats from the White House last month to shut the app's U.S. operations before September 20, citing security reasons. As part of a solution to the ultimatum, ByteDance has proposed listing TikTok in the U.S. as part of the deal.

A potential IPO could offer up substantial returns, a prize that is exactly what has lured global asset managers to increasingly seek out opportunities in private Chinese tech over recent years, analysts say.

Jack Ma's Ant Group is the most recent high-profile example of this. BlackRock, Fidelity and T. Rowe Price invested a combined US$1 billion into the Alibaba-affiliated payment giant and were set to earn a 50% return on their investments after the firm went public on the Hong Kong and Shanghai stock exchanges, as reported.

For ByteDance, one of the most aggressive valuations comes from T. Rowe Price's Global Technology Fund, which priced its shares in ByteDance nearly 70% higher a year after the acquisition, the fund's report as of June 30 shows. The fund invested in ByteDance on Jul. 8, 2019 with US$9.6 million for 194,898 shares and its latest estimate of those shares is at US$16.1 million.

Three T. Rowe Price funds, including the Global Growth Stock Fund, Global Stock Fund and Global Technology Fund, together acquired 279,062 shares with US$13.8 million in 2019 from ByteDance's series E fundraising, the funds' filings show.

The holdings in ByteDance from the Global Technology Fund account for just 0.6% of the fund's total portfolio, but that is higher than the proportion in the other two funds.

For Fidelity's China Special Situations strategy, which invested £7.4 million in 2018 to purchase shares of ByteDance, those shares are up 27% in the latest valuation round as of June.

Fidelity notes in the fund's 2019 annual report that it is "awaiting" an IPO of ByteDance. The same fund, which has since 2011 made 10 investments into unlisted firms, recorded an overwhelming 382.7% return from its investment into Alibaba after only holding shares in the tech giant for two years between 2012 and 2014.

Fear of missing out

Traditional public fund managers have been stepping up their investments in private tech firms, looking for growth that has been increasingly hard to find in the secondary market.

William Chua, Debevoise & Plimpton

"In recent years, private companies are waiting longer to come to the market, and mutual fund firms worry that they may miss out on the investment opportunity if they wait until the IPO to invest," says William Chua, Hong Kong-based partner specialising in private equity investments at law firm Debevoise & Plimpton.

Private firms are "delaying their IPOs" until their business is more mature and it could be eight to 10 years before a public debut, doubling that of a decade ago, Chua says.

High-growth Chinese tech firms these days do not really need to rush to go public because they are already pretty comfortable with early private equity investments, says Thomas Fung, Hong Kong-based chief investment officer at China Rise Securities Asset Management.

Thomas Fung, China Rise Securities Asset Management

But by the time they do an IPO, it actually means they have passed the “growing stage” and have entered a “plateau”, which could be a headache for mutual fund managers looking for substantial growth via an investment in the secondary market, Fung adds.

While there are different options for mutual funds to exit such private investments, some argue that the route that makes the most sense is an IPO.

Depending on their mandates, an exit could mean an IPO, a trade sale or a merger and acquisition, Debevoise & Plimpton’s Chua says.

China Rise’s Fung agrees that it makes most sense for a mutual fund manager to sell investors with the potential of an IPO to justify making private investments. If none of the private investments end up listing, people will question “is this a mutual fund, or is it really a private equity fund?” he says.

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Unquantified risks

While U.S. mutual funds can hold up to 15% of their assets in illiquid securities, there has been growing scrutiny around risks of the allocation to illiquid investment in public mutual fund portfolios in many markets.

Investing even a small proportion of a portfolio in early-stage Chinese tech firms is not without risks.

“For mutual funds, these are illiquid investments, so it can be difficult to value as well as cash out if something goes wrong,” says Debevoise & Plimpton’s Chua.

“In the worst case, a mutual fund may have to dispose of public investments to meet redemption requests, whereas for venture capital and private equity funds the capital generally is locked in for a longer term so they don’t face the same issue,” Chua says.

The potential high returns have made it increasingly appealing even if it means managers need to juggle coming up with the right pricing for such illiquid investments, but other risks are harder to quantify.

China Rise’ Fung says investment losses are probably not the most significant factor going forward for mutual funds looking into private Chinese tech, as one private firm investment is unlikely to reach 1% of a fund’s total portfolio, he adds.

Even at a total loss, it is like experiencing two to three bad trades in a month because a mutual fund's monthly volatility can be equal to just around that figure, Fung says.

However, as the U.S. administration continues to shine a spotlight on the operations of Chinese technology firms in the country the possible reputational risk for funds firms as well as the potential risk of fines is more uncertain.

If the underlying firm is placed on a sanction list, a fund manager may be put in a very "unfavourable" position because one might be forced to sell at a lower price. There is also the potential for fines for investing in a company on a sanction list, he adds.

"The loss cannot make up for what you earn [with that small position] in this case," he says.

But some expect the trend of global fund firms seeking out early-stage Chinese tech investment to continue.

Debevoise & Plimpton's Chua says investments into China are still stable and growing, and he expects U.S. mutual funds to continue looking for opportunities in the space.

"At the end of the day, I think investors primarily are focused on the economic return, so unless sanctions are imposed or there is an order to divest, presumably they can continue to hold on to the investment," Debevoise & Plimpton's Chua says, referring to holdings of ByteDance by Fidelity and T. Rowe Price.

"Will people be more cautious? Probably, but it's a very big market opportunity in the grand scheme of things," he adds.

T. Rowe Price did not respond to requests for comment as of press time. Fidelity declined to comment.

Fidelity and T.Rowe invested in ByteDance via funds they manage

Company	Fund	Shares	Cost	Value	Value date	Acquisition date
T Rowe Price	Global Growth Stock Fund	26,185	US$1.3 million	US$1.8 million	4/30/2020	7/8/2019
T Rowe Price	Global Stock Fund	57,979	US$2.9 million	US$4.0 million	4/30/2020	7/8/2019
T Rowe Price	Global Technology Fund	194,898	US$9.6 million	US$16.1 million	6/30/2020	7/8/2019
Fidelity	China Special Situations	N/A	£7.4 million	£7.5 million	3/31/2020	11/2018

Source:fund reports