

China Internet

The shoe has dropped: PCAOB announced unobstructed inspection access

On 15 December, PCAOB issued an announcement that they gained full access for inspection in China during their end of 2022 inspection process, which means China will not be classified as a restricted region for the second consecutive year. PCAOB also announced they will carry out future inspections in early 2023 and beyond, and their decision of identifying China as a restricted region can be issued at any time if full access condition changes. The market was expecting for positive results from PCAOB's inspection, hence Chinese ADRs sold-off on the release of the announcement. PCAOB also announced that they have found some discrepancies which are the usual case as in any other regions during first time of inspection process, and they will have a full report in January 2023.

- **Recap on PCAOB's previous determination and its impact on US-listed Chinese stocks.** Previously adhering to HFCAA, US-listed Chinese stocks were identified by the SEC as they retained a registered public accounting firm to issue audit report where the firm: (1) is located in China and Hong Kong, and (2) the PCAOB has determined on 16 December 2021 that it is unable to inspect or investigate completely because of a position taken by the PRC. The US-listed Chinese stocks will be imposed a trading prohibition if they were identified by SEC for three consecutive years. Most US-listed Chinese stocks were identified by the SEC since beginning of 2022, creating pressure to the sector valuation. KWEB dropped by 47% from Dec 2021 to Oct 2022.
- **Delisting risk of US-listed Chinese stocks has been largely removed.** After completing its reassessment in 2H22, PCAOB notified U.S. SEC to vacate PCAOB's 16 Dec 2021 determination. PCAOB now believes that the current facts and circumstances indicate that 1) in 2022, the PCAOB has been able to conduct inspections and investigations completely; 2) the PRC has not taken a position to restrict PCAOB access. In that case, we believe the US-listed Chinese stocks will no longer bear risk of being forced to be delisted and removed from the SEC's provisional list of issuers identified under the HFCAA by the time they disclosed 2022 annual report in 2023.
- **Support valuation recovery and reduce finance costs.** The market has already reflected the potential positive inspection results since the PCAOB ended the 2-month onsite inspection of the audit work in Hong Kong in early-November. KWEB has soared by 61% since November 2022, reflecting the positive expectation on the US audit inspection as well as the optimization of the COVID-control measures in China.

China Internet Sector

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