Unlocking Shareholder Value: China's Shift towards Prioritising Returns

China update

There were signs of recovering market sentiment and improved liquidity during April, marking a shift from earlier expectations which had assumed a further pullback in the absence of state support following the Two Sessions (annual gatherings of China's political advisory committee and the country's legislature).

- **In April, the MSCI China and MSCI China A Onshore indices rebounded, posting gains of 6.8% and 2.7% respectively.**
- **Sectors which drove the market higher included computers, financials, and healthcare, while coal, oil, and banks underperformed towards the end of the month.**

Chinese companies increase emphasis on shareholder returns

In response to ongoing economic transformation and corporate governance reforms, Chinese companies are shifting focus from pursuing "growth at all costs" to prioritising capital discipline and delivering shareholder returns.

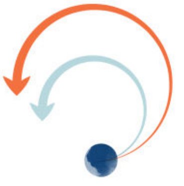
After years of rapid growth and market consolidation, many Chinese companies have entered a more mature and stable growth phase. This transition has led to greater attention to the bottom line (rather than a revenue-driven approach), more disciplined capital allocation, and increased focus on higher dividend payouts and share buybacks to unlock shareholder value.

China's policy environment has provided an additional tailwind to this shift in corporate strategy. In November 2022, the China Securities Regulatory Commission (CRSC) highlighted the continuous reform and improvement of China's capital markets at the Financial Street Forum. State-owned enterprises (SOEs) were advised to prioritise various financial metrics, including return on equity and dividend payouts. Recent directives from the new Chairman at the CSRC called for higher dividends and share buybacks by all listed companies, with increased supervision for non-compliance, reflecting similar state actions in Japan.

These developments highlight a greater emphasis on profitability and shareholder returns among large SOEs like Dong-e-e-jiao, Jiangzhong, and Moutai, who are paying out between 84% and 116% last year's earnings as dividends. Similarly, many listed private enterprises are increasingly returning capital to shareholders through dividends, buybacks, and spin-offs.

Alibaba repurchased $9.5 billion worth of stock during 2023, resulting in a net reduction of 3.3% of its outstanding shares. Moreover, in early 2024, the company approved an additional $25 billion share buyback. Tencent on the other hand, plans to more than double its stock buyback program to at least $12.8 billion in 2024, while Meituan initiated share repurchases for the first time in January 2024.

The first quarter of 2024 witnessed a surge in buyback activities among MSCI China index companies, indicating a significant departure from previous years. Similarly, companies listed on the Shanghai and Shenzhen Stock Exchanges have announced substantial buyback plans. The chart below illustrates the significant increase in payout and buyback compared to historical levels.



China's shift towards prioritising returns reflects broader economic transformations.

Large SOEs are now paying out significant portions of their earnings as dividends.

Controlling shareholders are investing, highlighting confidence in their respective companies' long-term prospects.

Source: FactSet, UBS. Note: MSCI China is used as universe. Red dots representing Nov 2015, Mar 2016 and Feb 2024, actual buyback amount is shown

Source: FactSet, UBS

Furthermore, there have been announcements of share purchases by controlling shareholders who are utilising their own funds to support listed companies. These actions demonstrate long-term confidence in the high quality development of their respective companies.

Implications for manager selection

These developments have implications for manager selection. Historically, China has been a growth market, with the focus on identifying companies that were substantially modernising and innovating. Growth-biased fund managers performed well until the Chinese capital markets turned negative in 2021. In contrast, value managers faced challenges but saw improvements in recent years when they experienced smaller drawdowns compared to highly rated growth companies.

Going forward, we anticipate a balance between growth and value opportunities. Despite economic challenges, innovation persists, offering growth prospects. Meanwhile, we expect value managers to benefit from investing in mature companies that take steps to unlock shareholder value, such as Tencent or Alibaba. Thus, maintaining an even balance between value and growth-biased managers is crucial.

In summary, we anticipate the trend of increased dividends and share buybacks to continue, with more Chinese companies following suit. The combination of improving profitability, a greater focus on shareholder interests, and current undervaluation suggests favourable performance potential for Chinese equities in the medium to long run.

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