

# Arm's IPO set to overcome China backlash

John Crabb, Victoria Thiele August 24, 2023 10:32 PM



## Details of Arm's Chinese operations should not have surprised investors, say bankers

The initial furore over British semiconductor company Arm's exposure to China after it filed its IPO

registration statement with the US Securities and Exchange Commission on Monday is overblown, said ECM sources.

Arm's filing with the SEC was reportedly met by a backlash from prospective investors who claimed the company was overexposed to risk from China. Yet equity bankers argued that, although some concern is justified, the issues were nothing unusual for a company of Arm's size in the microchip sector.

The initial backlash, they said, should not derail the long-awaited listing, which is considered crucial to the global IPO market.

"People are concerned about China exposure, but that's common to every stock in this space," said a banker at one of the syndicate banks on the IPO. "It's a sector topic rather than anything specific to that company. Clearly there will be a debate and questions about this, but I don't think that's unique to Arm."

When it was reported in June that the US government was mooting plans to impose restrictions on exports of artificial intelligence chips to China, California-based chip makers Nvidia and AMD saw their shares fall. Nvidia reported that 25%, or \$7.1bn, of its sales went to China in 2022.

"I'm sure [Arm's exposure to China] will be a priority in the coming days and weeks," said a banker away from the deal, who added that the exposure was not entirely concerning.

Despite the setback in June, Nvidia's share price has risen by over 100% in the last six months — pushing it into a small bracket of trillion dollar-valued tech companies, alongside Apple, Amazon, Microsoft and Alphabet.

"It's [Arm] in a sector that the market has spent most of the year thinking about and wants to own more of: semiconductors and AI," said the first banker. "Some of its peers — Nvidia in particular — have performed incredibly strongly, so it's getting an awful lot of attention."

## **We've lost control, again**

In the filing, Arm outlined that, like Nvidia, it received 25% of its revenue from its Chinese subsidiary, Arm China, in 2022. It was 18% the previous year.

The company outlined that “as a result of this customer concentration, we are particularly susceptible to adverse developments affecting our key customers and their respective businesses, including industry downturns, decreased demand for their products, increased competition, changes in trade protection and other government policies,” while adding that these factors are largely out of their control.

Political actions and US national security policies could severely impact the company’s abilities to conduct this business with the country, the company wrote.

Moreover, Arm China operates independently: it is 48% owned by fellow SoftBank Group subsidiary Acetone, with Arm only holding a 10% non-voting share. This is viewed as making it particularly vulnerable.

Arm ceded control of the company as a result of an accounting scandal that impacted Luckin Coffee and drove the US government to legislate for financial access and the ability to audit Chinese companies listed on its exchanges.

This week president Joe Biden's national security advisor Jake Sullivan called on China to be more transparent about its economy as the country tries to restrict the publication of financial data by its companies. Sullivan said that slower growth in China would have a major impact on the global economy, and company performance must be public.

## **It's not unusual**

But the challenges facing Arm were already well-known. It has always been known that Arm had to spin off its Chinese subsidiary, and the company has since taken steps to distance itself from the situation. While the revelations do signify risk for Arm, they are not some grand revelation.

Investors should therefore not have been surprised by this, said some observers.

“This is the way that subsidiaries and affiliated companies operate in China, and like other nascent emerging markets it is often very convoluted,” said Harry Broadman, an independent corporate director and one-time member of the US Committee on Foreign Investment in the United States, which reviews the national security implications of foreign investments in US. “The fact that someone thinks that they can make a go of it without all of these invisible strings attached is not very surprising.

“The fact that a subsidiary or an affiliated company was under complete Chinese control is hardly unique.”

Indeed, Broadman went as far as to say that Arm should instead be congratulated for being transparent and “showing all the blemishes of the deal”, and that people should not be spooked for “telling it like it is”.

Making an investment as a western company in China is very difficult and requires lots of jumping through hoops, which is essentially what Arm has done in this context.

“The risk is great, and the paperwork that came out with these disclaimers is very forthright in telling potential investors, ‘listen, this is a really difficult issue because we don't control this company, but we want your money’,” he continued. “If you understood the context of China, this situation is not unusual.”

## **Shot in the arm**

If it is able to overcome these challenges, Softbank's flotation of Arm will be the biggest new listing in the US in two years, and potentially a major event for the European market.

“It's one of the biggest deals, if not the biggest deal of the year anywhere, so it's hugely significant for everyone,” said a head of EMEA ECM at one of the syndicate banks on the deal. “If the transaction goes well, it's a big positive sign for the market and an opportunity for people to make some money.”

Softbank is likely to sell 10% of the company, and Arm is expected to achieve a valuation of around \$60bn-\$70bn. The company has a near monopoly on smartphone chips, and Softbank chief executive Masayoshi Son has recently stressed the firm's potential to be a big player in the artificial intelligence sector.

Arm is headquartered in Cambridge, UK, and was listed in London until Japanese conglomerate Softbank took the company private in 2016.

The UK fought hard for Arm to be relisted on the London Stock Exchange, but eventually lost out to New York. Softbank's decision to list in the US was a catalyst for a debate about London's competitiveness as a listing venue for tech companies.