



More experienced buyers
Higher return expectations

2014 Greater China outbound M&A spotlight

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Introduction

The 2014 edition of Deloitte's China outbound M&A report has arrived and survey results show that investors continue to have positive expectations for the year ahead. Although it may be premature to conclude at this point in time that 2014 would yet be another record-breaking year for Chinese outbound investments, the number of completed transactions in the first five months of the year clearly indicates a strong trend for the year.

With a 3 percent GDP growth in the second half of 2013, the U.S. economy has shown signs of steady improvement which may provide a more positive investment environment for Chinese outbound M&A activities in the United States. The average size of Chinese investment in the United States has also been on the rise, for instance, Lenovo's recent U.S. acquisition (in early 2014) valued at US\$2.9 billion was the biggest acquisition ever made by a Chinese company in the U.S. Technology sector¹.

Pace of economic recovery in the Euro zone remains weak and asset prices depressed. As a result, the Euro zone continues to provide vast opportunities for bargain seekers from China. The Manufacturing and Technology sectors are the primary beneficiaries in the Euro zone of Chinese investments. In the first five months of 2014, Chinese firms spent more than US\$3.4 billion in acquisitions in the automotive industry in Western Europe of which Germany took the lion share. Outside the Euro zone, the United Kingdom is ahead of all the other European countries in attracting Chinese FDIs in connection with major real estate projects, in particular London. In January 2014, one of China's property giants Greenland Group announced two major prestigious residential developments in Central London worth US\$2 billion².

Other than China's SOEs, privately-owned enterprises (POEs) in China have taken on an increasingly important role in outbound investments. This phenomenon can be seen in the Consumer Business sector. For instance, Chinese

conglomerate Sanpower Group announced in April that it would acquire an 89 percent stake in the British high-street department store House of Fraser for US\$803 million³.

Conditions in Central Europe, where external trade is heavily dependent on the Euro zone, have been improving since mid-2013. Given the relatively underdeveloped infrastructure in Central Europe, many Chinese firms consider Central Europe as a land rich with large scale construction and transport development opportunities. For instance, earlier this year, state-owned China Railway Signal & Communication Corporation announced that it would acquire a majority stake in the Inekon Group, a Czech tram producer⁴.

It is estimated that Latin America's GDP would grow by about 2 percent in 2014. Lower commodity prices and increasing borrowing costs may end a decade-long boom in the region. Despite its slowing economy, Brazil still boasts one of the largest domestic markets in Latin America that continues to attract Chinese investors. Given the attractive concessions for infrastructure development provided by local governments, Latin America may be able to woo more Chinese firms to invest in local infrastructure projects in the region. An investment group led by China's State Grid Corporation has just won the right to build power lines feeding the Belo Monte Amazon dam in Brazil that is set to be the world's third-biggest hydropower plant⁵.

As mining activities in Australia become more significant in terms of its contribution to its GDP, so would the accessory industries that support such activities such as logistics and transport infrastructure. Earlier this year, Baosteel Resources Australia, a subsidiary of China's Baosteel Group, with Australian-listed haulage company Aurizon Operations acquired the Australian coal and iron ore exploration company Aquila Resources for US\$1.3 billion⁶.

Africa, a continent rich with natural resources, is in the sights of many Chinese investors who are looking for new sources of energy and new resources. To foster closer economic relationships with Africa, Chinese investors (including the Chinese government) are eager to invest in Africa's infrastructure projects which would not only promote goodwill but also benefit China in reaching and securing natural resources required. In May, China announced that it would provide funds for the construction of a railway line linking the Kenyan port city Mombasa to Uganda, Rwanda, Burundi and South Sudan. China Communication Construction Company was selected to be the lead contractor for the US\$3.8 billion railway project⁷.

According to IMF, Asia is still expected to be the growth engine of the global economy in 2014. Japan's economy grew at a faster pace in the first quarter of 2014, which would make 2014 the best year for the economy since the stimulus-fueled growth begun in 2010. China's economic growth accelerated in the second quarter of 2014 to 7.5 percent according to China's National Bureau of Statistics. Following large investments into technology and energy assets, Chinese investors are starting to target mass market communication businesses such as telecommunications, postal services and logistics in Southeast Asia in 2014.

China Mobile announced in June that it would acquire an 18 percent stake in the Thailand-based telecommunication company True Corporation for US\$881 million⁸. Earlier this year, Alibaba Investment, a wholly-owned subsidiary of the Alibaba Group, acquired a 10.36 percent stake in Singapore-based logistics and postal service provider Singapore Post for US\$249 million⁹.

Despite volatility in the international financial markets, it is apparent that Chinese firms, with more years of experience in investing overseas, are becoming more confident and assertive in outbound M&A, with also a higher expectation for investment returns. With these heightened expectations, Chinese investors have become more willing to involve professional advisors in their transactions, in particular, post-merger integration issue resolution of which is believed to be crucial to any successful transaction. Against this background, it would not be unreasonable to project that the average deal size would likely grow and yet the deal volume of such larger deals may grow at a slower clip, reflecting the more judicious investor profile.

Let us now walk you through the trends in the regions and sectors that were examined in this sixth edition of Deloitte's China annual outbound M&A report.



A handwritten signature in black ink, appearing to read 'Patrick Yip'.

Patrick Yip
National Leader
Deloitte China M&A Services



A handwritten signature in black ink, appearing to read 'Dennis Chow'.

Dennis Chow
Chairman
Deloitte Global Chinese Services Group

Executive summary

The 2014 Greater China outbound M&A report covers key trends and significant drivers of outbound M&A and greenfield FDI transactions from Greater China from January 2005 to May 2014. The report shows major findings from an online survey conducted in May 2014, which recorded 100 respondents from Chinese SOEs, POEs, private equities, investment banks and law firms in respect of their views and expectations of Chinese outbound M&A transactions in 2014. The historical data presented in the report was sourced and derived from the independent M&A intelligence provider *Mergermarket* and the information service provider *fDi Markets*. The following is a summary of the key findings and results of our survey.

2014 activity

Chinese outbound investment activity increases over 2014

Chinese outbound investors have been active and, in particular, the outbound M&A deal volume grew in four consecutive quarters since the second quarter of 2013. Furthermore, the total transaction value of Chinese outbound M&A investments and greenfield FDI increased by 24 percent in the first five months of 2014 when compared with that of 2013.

There were 106 Chinese outbound M&A transactions with a total value of US\$31.7 billion in the first five months of 2014. While there were 177 Chinese outbound greenfield FDI deals, their total value was US\$22.5 billion, 29 percentage lower than that seen in M&A.

Total value of Chinese M&A investments is higher than that of greenfield FDI

China's total outbound M&A value has exceeded its total outbound greenfield FDI value since 2010 cumulatively by 33 percent. The volume and value of Chinese M&A deals have grown since 2010 while the greenfield FDI volume and value were stagnant.

Small- and mega-sized deals have grown in numbers

The number of small-sized M&A deals valued up to US\$50 million grew by 65 percent in the first five months of 2014 compared with the same period in 2013. The proportion of mid- and large-sized M&A deals valued between US\$50 million and US\$1 billion dropped, while the share of mega-deals valued over US\$1 billion had climbed gradually to about 8 percent in mid-2014. However, when compared with other developed countries such as the United States or the United Kingdom, the total value of Chinese outbound M&A transactions reached only a quarter of that of the United States, half of the United Kingdom, and was comparable with Germany and Japan from January 2013 to May 2014, according to data from *Mergermarket*.

Chinese investors made the majority of M&A deals in Western Europe while greenfield FDI in the United States

Western Europe was the most attractive market for Chinese outbound M&A investors in the first five months of 2014, which attracted the majority of Chinese outbound M&A deals (25), followed by the United States (17) and Australasia (13). Western Europe also attracted more Chinese M&A deals in term of value (US\$9.7 billion) than the United States (US\$6.1 billion).

For Chinese greenfield FDI deals, the United States attracted the majority of deals in the first five months of 2014, yet the largest greenfield investments valued US\$5.6 billion went to the Southeast Asian market, indicating a strong presence of Chinese firms in the region of Southeast Asia. For instance, in May, Shanxi Haixin Iron and Steel Group, China's major private steel maker, announced that it would invest in a US\$500 million steel mill in resource-rich Indonesia¹⁰. In terms of the deal volume, the United States attracted more Chinese outbound greenfield FDI deals (31), followed by Western Europe (28) and Southeast Asia (27).



Chinese investors focused more on acquiring Consumer Business assets

The Consumer Business sector attracted more Chinese outbound M&A deals (34), followed by Manufacturing (25) and Technology, Media & Telecommunications (18) in the first five months of 2014. On the contrary, the number of Chinese outbound M&A deals in the Energy & Resources sector dropped by 44 percent in the first five months of 2014 compared with the same period in 2013.

Outbound M&A deals in Energy & Resources reached the highest value (US\$8.5 billion) with investments, for instance, of China Petroleum & Chemical Corporation and China Oil and Gas Group in the first five months of 2014, followed by the sectors of Consumer Business (US\$7.8 billion) and Technology, Media & Telecommunications (US\$6.8 billion) including acquisitions, for instance, by COFCO Corporation and Lenovo Group.

The majority of Chinese greenfield deals in the first five months of 2014 were completed in the Manufacturing sector (41) followed by Technology, Media & Telecommunications (35). The largest Chinese outbound greenfield FDI deals worth cumulative US\$10 billion were concluded in the Energy & Resources sector, followed by Real Estate (US\$6.9 billion) including investments, for instance, of China Gezhouba Group and Shanghai Greenland Group.

Looking forward

The number of Chinese outbound M&A transactions is expected to grow

Respondents in the 2014 survey are more optimistic about market dynamics compared with those in the 2013 survey. The majority of respondents believe that the number of Chinese outbound M&A transactions will grow as much as 30 percent in the coming year.

Our survey shows that the expectations of small-sized M&A transactions (up to US\$50 million) have dropped significantly, showing Chinese investors may develop an appetite for larger transactions, especially for targets with higher valuations or with a leading position in their particular industries. Chinese M&A investors expect there will be more mid- and large-sized M&A transactions (US\$150 million-US\$500 million) in the coming year, while the expectations of deals with the value above US\$500 million dropped slightly.

More Chinese investors would probably acquire minority stakes in foreign entities as a way of entering a foreign market.

Ninety-five percent of respondents in the 2014 survey believe that Asia will attract the majority of Chinese outbound M&A investments in the coming year. The majority of respondents believe Africa and the Middle East collectively have the biggest upside potential in attracting Chinese outbound M&A transactions across almost all sectors, especially in Consumer Business, Real Estate and Manufacturing.

Internationalization of the RMB and the positive outlook for economic growth in the United States may create a favorable environment for Chinese outbound investments

Respondents ranked the importance of multiple deal drivers in 2014 quite similar to that in the 2013 survey. However, the ranking of the influence of the Euro zone sovereign debt crisis and China's shift from an export-driven to a consumption-based economic structure has been lower in 2014 when compared with the 2013 survey. On the other hand, respondents believe the internationalization of the RMB and the positive outlook for economic growth in the United States may create a favorable environment for outbound investments in the coming year. In contrast, volatility and uncertainty in the international financial markets may have the most negative impact on Chinese outbound investments.

Based on the 2014 survey, Chinese investors are more confident in making outbound M&A investments. However, the difference in management culture of European and North American targets is expected to be the major

obstacles. Furthermore, respondents are more concerned about financing constraints, exchange controls and convertibility of the Chinese currency. All respondents rated their M&A deals as successful, however, they commented that a higher price was often paid than the actual market value of the target.

More Chinese companies found professional advice crucial

According to the 2014 survey, professional advisors have taken on an increasingly important role in acquisitive transactions where financial/tax due diligence, tax structuring and commercial due diligence are usually seen as a "must". Tax due diligence undertaking, for instance, increased compared with that in the 2013 survey. In addition, respondents said they have paid more attention to post-merger integration issues to more quickly realize a higher return from the transaction. 72 percent of the respondents in the 2014 survey believe over half of the issues identified during the due diligence process will be able to be resolved in the post-acquisition process, a much higher percentage than that in the 2013 survey, indicating more focus put on post-merger integration and, indirectly, reliance on professional assistance relating thereto.

Total transaction value of Chinese outbound M&A investments and greenfield FDI increased by 24 percent in the first five months of 2014 compared with that of 2013

Methodology

Historical analysis

The historical data presented in this report is derived from *Mergermarket*, the independent M&A intelligence provider, and *fDi Markets*, an information service provider.

Greenfield FDI: includes all formally-announced new investments, expansions or joint-venture investments that lead to a new physical presence in the target geography. Merger & Acquisition deals, privatizations and equity investments are excluded.

The data includes all fDi Markets-recorded transactions that led to a physical presence in target geography for the period 1 January 2005 to 31 May 2014.

M&A: Mergers & Acquisition (M&A) deals are included where there is a transfer in ownership of an economic interest in an ongoing business concern.

The data includes all Mergermarket-recorded transactions for the period 1 January 2005 to 31 May 2014.

Transactions with deal values greater than US\$5 million are included. If the consideration is undisclosed, *Mergermarket* includes deals on the basis of a reported or estimated value of over US\$5 million. If the value is not disclosed, *Mergermarket* records a transaction if the target's turnover is greater than US\$10 million.

Only true merger and acquisition deals have been collated. Transactions usually involve a controlling stake in a company being transferred between two different parties. Where the stake acquired is less than 30 percent (10 percent in Asia-Pacific), the deal has been included if its value is greater than US\$100 million.

Transactions such as restructurings where shareholders' interests in total remain the same have not been collated. *Mergermarket* does not track property deals, Letters of Intent, Memorandums of Understandings, Head of Agreement and Non-binding Agreements.

All US\$ symbols refer to U.S. dollars unless otherwise stated.

The report includes deals from the below locations:

- Chinese Mainland (China);
- Hong Kong;
- Taiwan; and
- Macau

It should also be mentioned that Chinese capital may come from other jurisdictions outside of China, thus in official data it is not categorized under Chinese outbound investments.

For the purposes of this report, an outbound transaction is defined as a deal in which the bidder is predominantly located in the Chinese Mainland, Hong Kong, Macau or Taiwan and the target business is predominantly located in any other country or territory aside from the Chinese Mainland, Hong Kong, Macau or Taiwan.

Statistics for the first or second half or quarter of any given year are marked in the forms Hx 20xx or Qx 20xx. For example, any mention of the term "2005 - Q3 2013" in the report indicates that the period in question runs from 1 January 2005 to 30 September 2013. Similarly, any mention of the term "Q1 - Q3 2013" indicates that the period in question runs from 1 January 2013 to 30 September 2013.

A year in review

Chinese outbound investors have been increasingly active since the second quarter of 2013 to date especially in the M&A space. The number of Chinese outbound investment deals grew in four

consecutive quarters on a year-on-year basis and since the second quarter of 2013 there have been significant increases in M&A outbound transactions compared with the same period in 2012 (see Charts 1).

Chart 1 (a): Greater China outbound investments (Q1 2005 – Q2 2014)

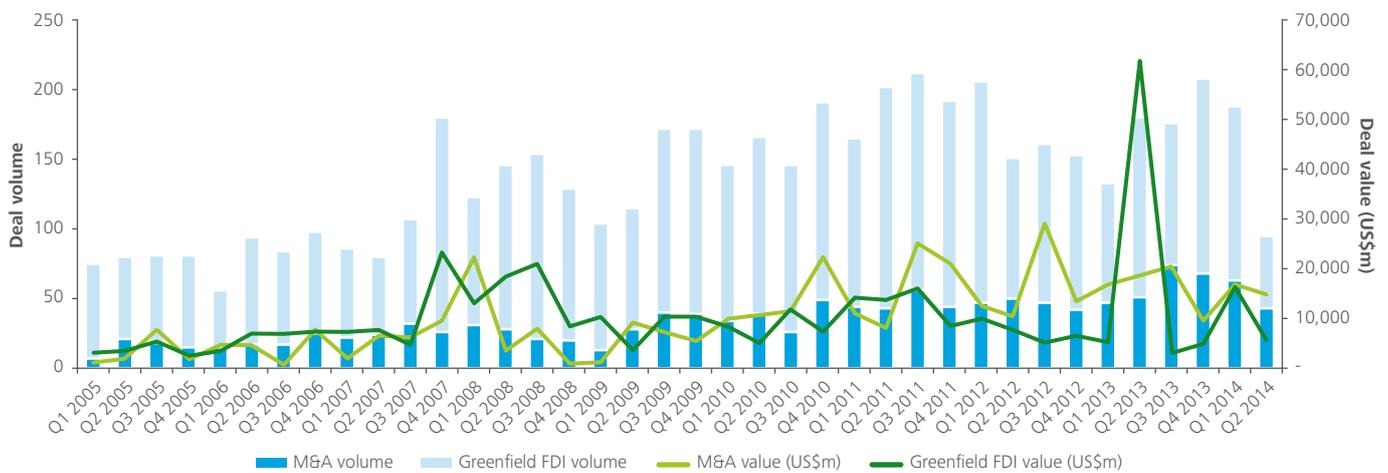
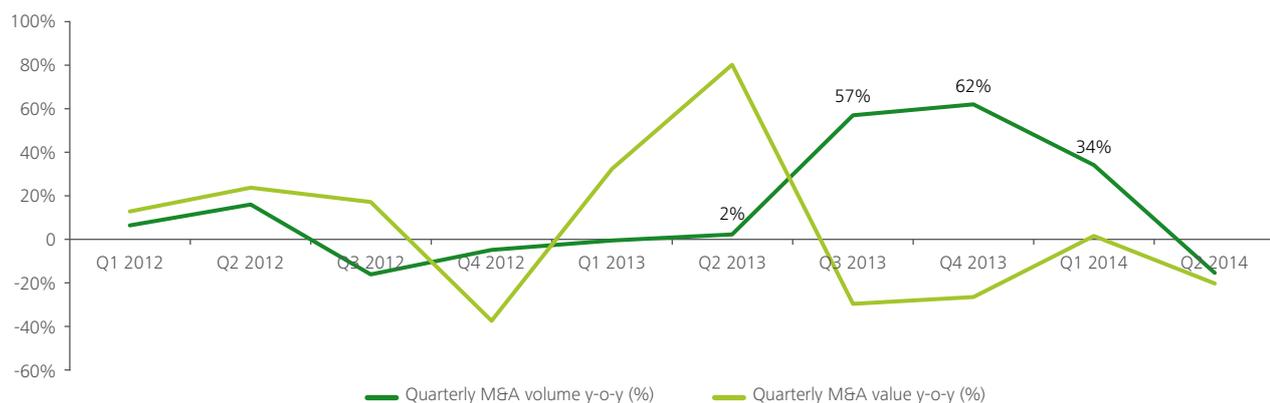


Chart 1 (b): Greater China outbound M&A investments (Q1 2012 – Q2 2014)



Note: Chinese outbound M&A deal volume grew in four consecutive quarters since Q2 2013 on a year-on-year basis, while the outbound M&A value stagnated. Q2 2014 stands for the period from April to May 2014.

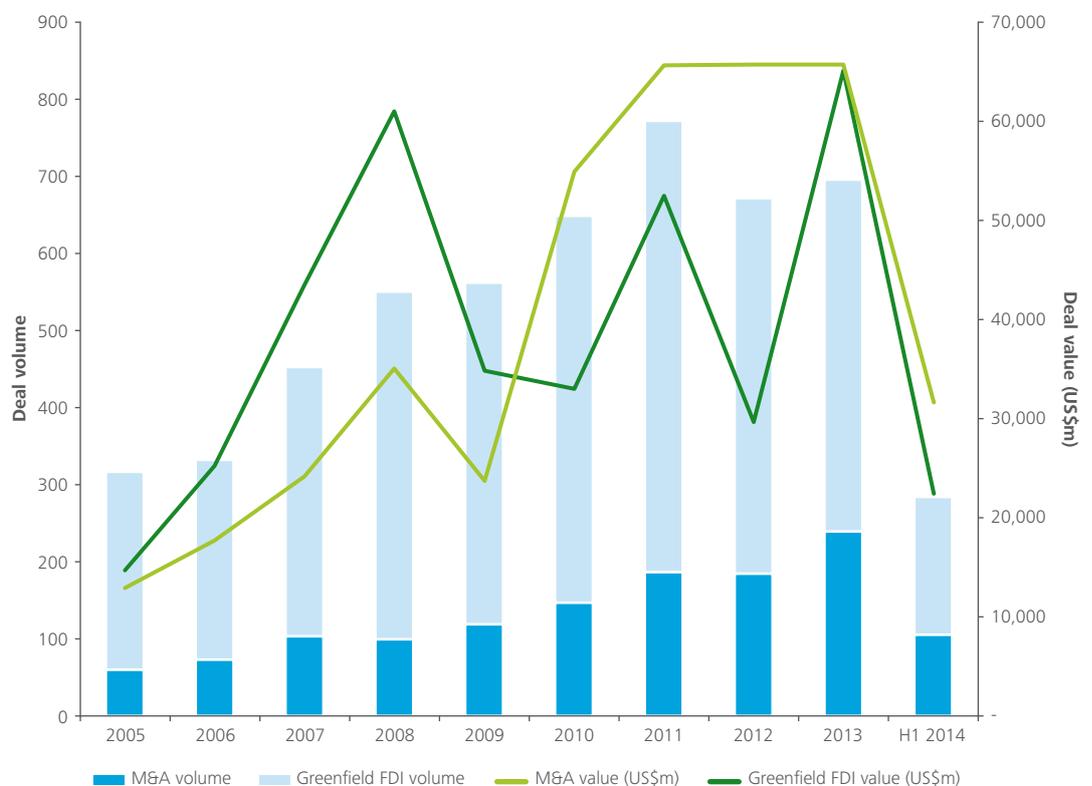
From the third quarter of 2013 to the second quarter of 2014 (until May) there was recorded total of 248 Chinese outbound M&A transactions worth US\$62.1 billion. Comparatively, there were more Chinese outbound greenfield FDI deals (419) completed, but with lower total value (US\$30.6 billion).

China's outbound M&A value has exceeded China's outbound greenfield FDI value since 2010 (see Chart 2). The number of Chinese M&A outbound transactions grew at a compounded annual growth rate (CAGR)¹¹ of 19 percent, more than twice the greenfield FDI rate (outbound greenfield FDI transactions grew at CAGR of 8 percent, respectively) between 2005 and 2013.

The value of Chinese M&A outbound deals grew at a CAGR of 22 percent, three times the greenfield FDI amount (greenfield FDI value grew at a CAGR of 8 percent¹², respectively) in the same period. There was one exception: a single greenfield FDI mega-deal worth estimated US\$50 billion in Nicaragua¹³.

Note: The second quarter of 2013 was comprised of one single US\$50 billion mega-project in Nicaragua (the "Nicaragua deal"). In June 2013, the Hong Kong Nicaragua Canal Development Investment Group (HKND Group) was awarded with a 50-year concession to build and manage the Inter-Oceanic Nicaragua Canal, a waterway through Nicaragua to connect the Caribbean Sea and Atlantic Ocean with the Pacific Ocean. It includes other potential projects such as the construction of ports, free trade zones, an international airport, etc. The \$50 billion-waterway, which is expected to be completed by 2024, would be a higher-capacity alternative to the Panama Canal that is currently being widened¹⁴.

Chart 2: Greater China outbound investments: M&A versus greenfield FDI (2005 – H1 2014)



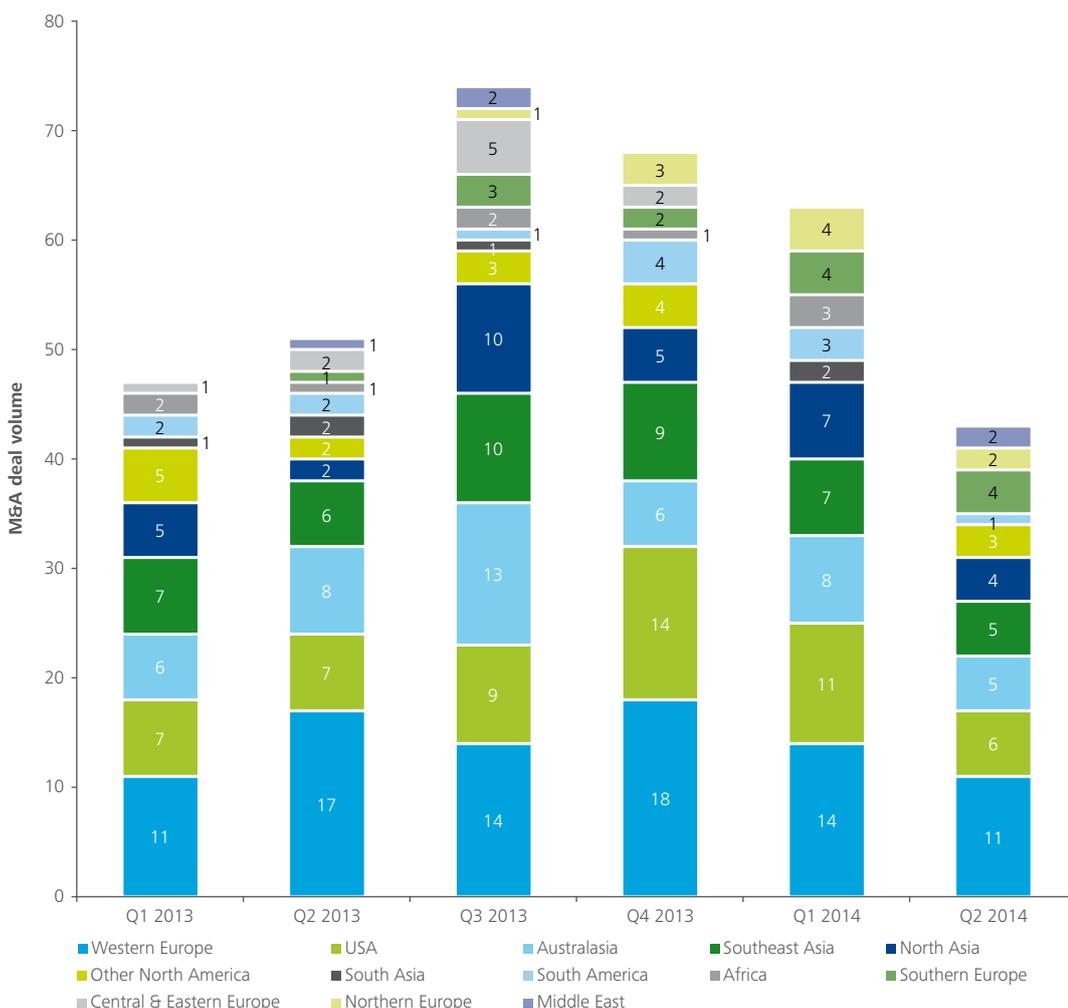
Note: H1 2014 stands for the period from January to May 2014

China's total outbound investment stock remains relatively small compared with that of the most developed economies such as the United States or the United Kingdom¹⁵. Yet between 2008 and 2012 China's outbound investment stock had grown three times that of the United States. China would need 14 years to reach the level of total U.S. outbound stock at the current growth rates. The United States' share of the world's total outbound investment stock was about 22 percent, followed by the United Kingdom (around 8 percent) and Germany (around 7 percent). China's share on total world's outbound investment stock doubled from 1 percent to 2 percent between 2008 and 2012¹⁶.

Chinese M&A deals grew larger from the third quarter of 2013 to the second quarter of 2014 (until May). China's total outbound M&A value reached the levels of Germany and Japan, but it still lacked behind that of the United States and the United Kingdom. In the first five months of 2014 the total value of Chinese outbound M&A transactions remained only one-fifth of the U.S. outbound M&A value, half of that of the United Kingdom, but similar to Germany and Japan. Yet China had much smaller number of outbound M&A transactions when compared with the above-mentioned countries¹⁷.

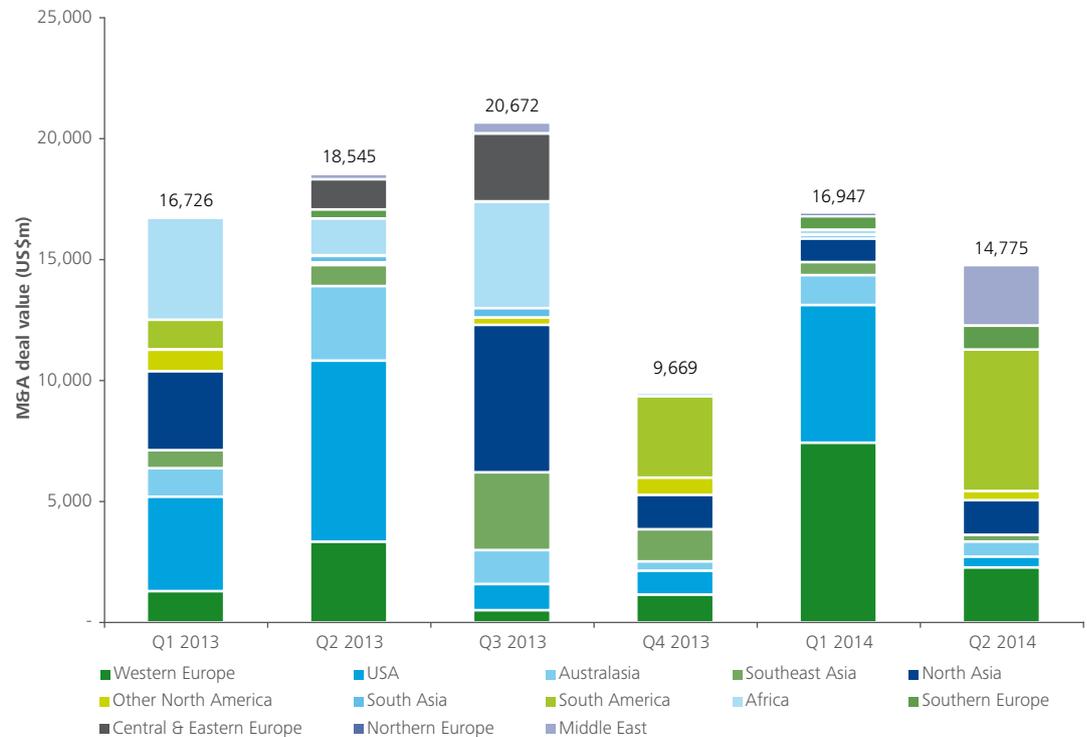
There were 106 Chinese outbound M&A transactions with a total value of US\$31.7 billion in the first five months of 2014.

Chart 3: Greater China outbound M&A deal volume by target region (Q1 2013 – Q2 2014)



Note: Q2 2014 stands for the period from April to May 2014

Chart 4: Greater China outbound M&A deal value by target region (Q1 2013 – Q2 2014)



Note: Q2 2014 stands for the period from April to May 2014

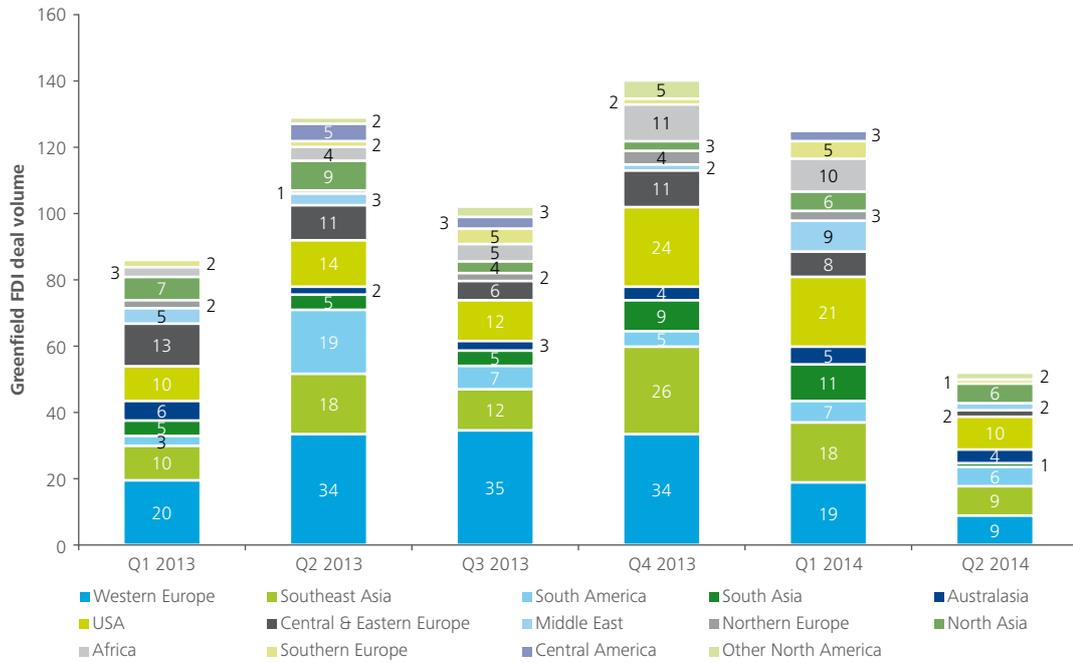
Target region

Western Europe exceeded the United States as the most attractive target market for Chinese M&A bidders in the first five months of 2014. Western Europe attracted the most Chinese outbound M&A deals (25), followed by the United States (17) and Australasia (13) in the same period (see Chart 3). In the same period Western Europe attracted more value from Chinese M&A deals (US\$9.7 billion) than the United States (US\$6.1 billion) and South America (US\$5.9 billion) in the first five months of 2014 (see Chart 4).

When comparing outbound greenfield FDI with M&A transactions, there were more Chinese outbound greenfield FDI deals (177), but with the value 29 percent below that seen in M&A, in the first five months of 2014.

The United States exceeded Western Europe as the most attractive target market for Chinese greenfield FDI investors in the first five months of 2014. The United States attracted the most Chinese outbound greenfield FDI deals (31), followed by Western Europe (28) and Southeast Asia (27) in the same period (see Chart 5). In the same period Southeast and South Asia attracted the most value from Chinese greenfield FDI deals (US\$5.6 billion and US\$3.7 billion, respectively) indicating a strong presence of Chinese firms in the region, followed by Western Europe (US\$2.7 billion) (see Chart 6).

Chart 5: Greater China outbound greenfield FDI deal volume by target region (Q1 2013 – Q2 2014)



Note: Q2 2014 stands for the period from April to May 2014

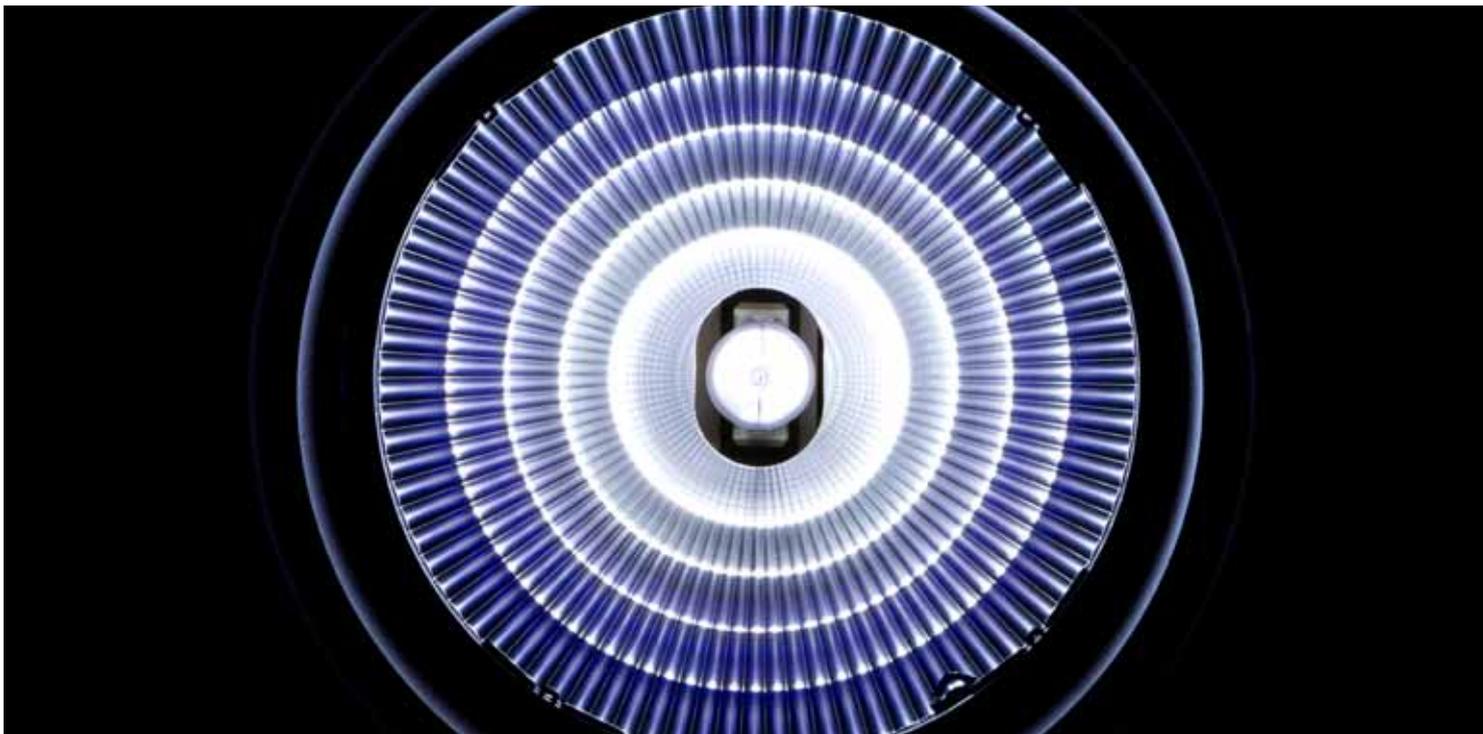
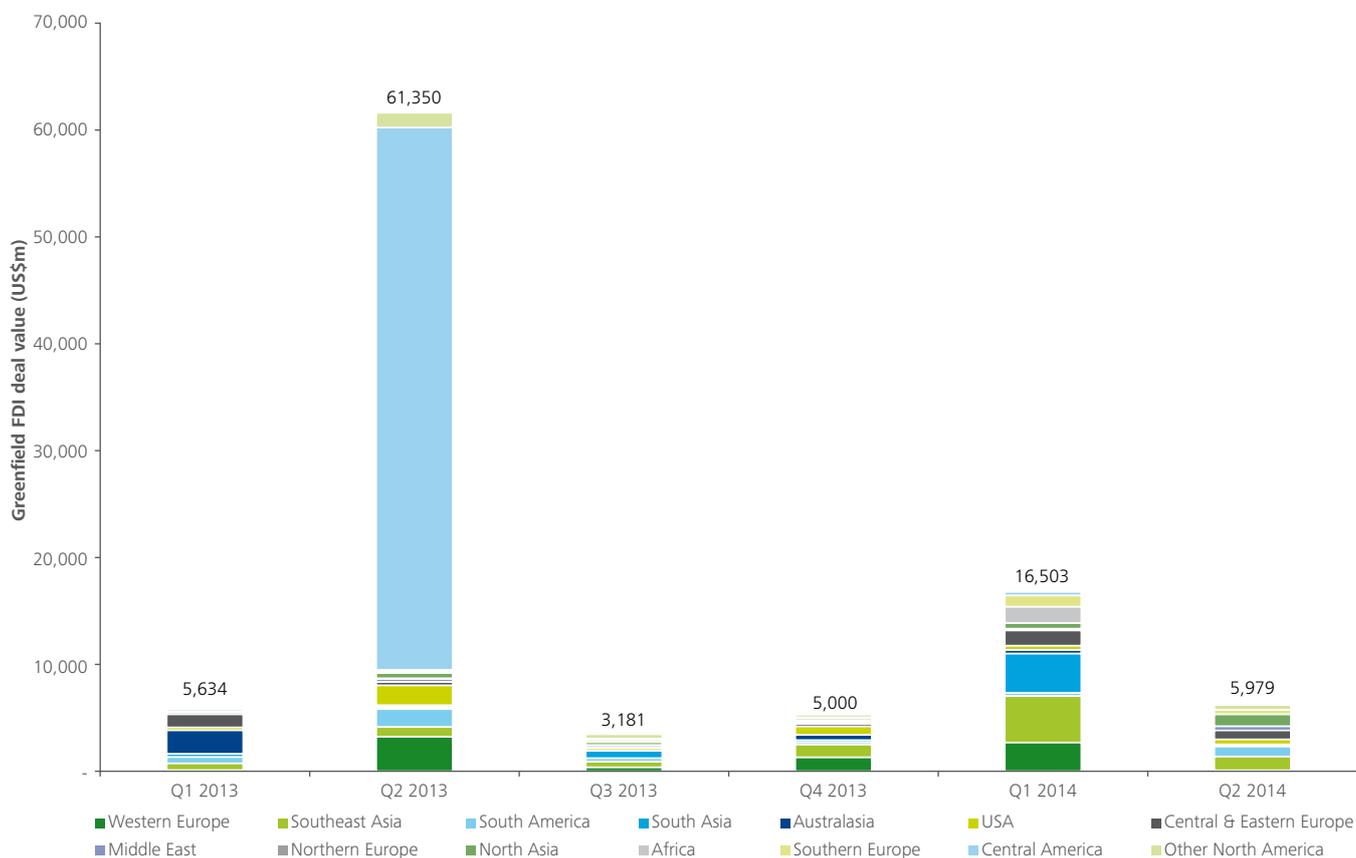


Chart 6: Greater China outbound greenfield FDI deal value by target region (Q1 2013 – Q2 2014)



Note: Q2 2014 stands for the period from April to May 2014

Taking a closer look at the target markets, in which regions were the M&A values significantly exceeding the greenfield FDI? The Chinese outbound acquisition total value between July 2013 and May 2014 exceeded that of greenfield FDI by 102 percent. In the same period Chinese investors preferred to enter the United States, Western Europe, North Asia and Australia markets

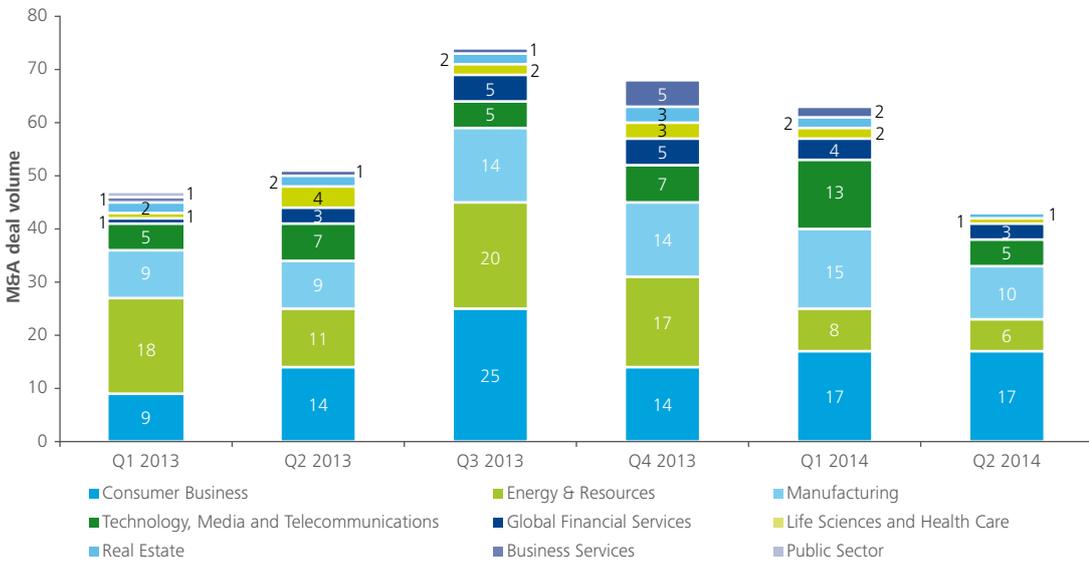
by large acquisitions where the M&A value significantly exceeded that of greenfield FDI. In contrast, South and Southeast Asian markets were popular destinations for Chinese companies who spent almost twice as much in greenfield FDI than in acquisitions in the region indicating their strong physical presence in Southeast Asia in the same period.

Target sector

In the first five months of 2014 the Technology, Media & Telecommunications and Manufacturing sectors gained significant increases both in volume and value compared to the same period in 2013. Despite the number of transactions and their values in the Energy & Resources sector dropping considerably, Chinese M&A deals in this sector remained the most valuable in the same period. The Consumer Business sector attracted the most outbound M&A deals from China (34), followed by Manufacturing (25) and Technology, Media & Telecommunications (18) in the first five months of 2014 (see Chart 7).

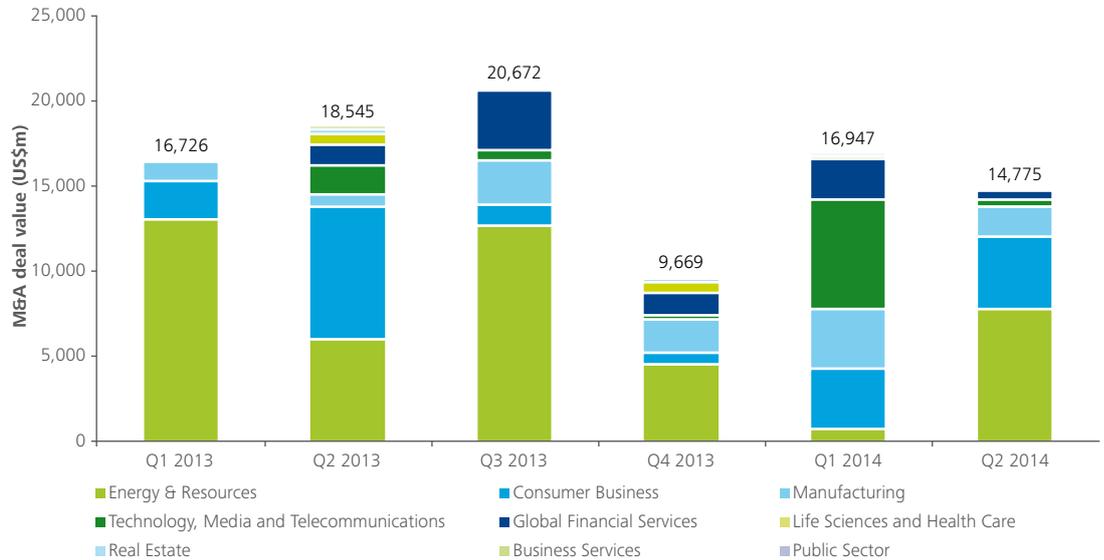
Outbound M&A deals in Energy & Resources remained the most valuable (US\$8.5 billion) in the first five months of 2014 followed by deals in the Consumer Business (US\$7.8 billion) and Technology, Media & Telecommunications (US\$6.8 billion) sectors (see Chart 8). When compared with the same period in 2013, the value of Chinese acquisitions in the Energy & Resources and Consumer Business sector in the first five months of 2014, dropped by 47 percent and 20 percent, respectively. On the contrary, the value the acquisitions grew steeply in Manufacturing and Technology, Media & Telecommunications between the same periods, driven by the acquisitions by Lenovo Group in the United States and Dongfeng Motor Group, the China-based car manufacturer, in France¹⁸.

Chart 7: Greater China outbound M&A deal volume by sector (Q1 2013 – Q2 2014)



Note: Q2 2014 stands for the period from April to May 2014

Chart 8: Greater China outbound M&A deal value by sector (Q1 2013 – Q2 2014)

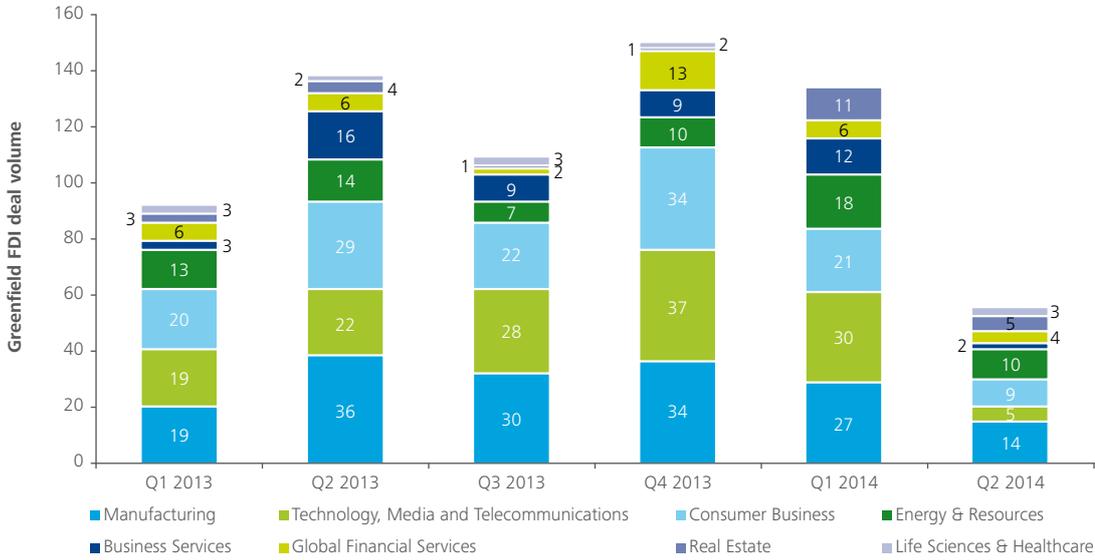


Note: Q2 2014 stands for the period from April to May 2014

In the first five months of 2014 the majority of China's greenfield FDI deals were completed in the Manufacturing sector (41) followed by Technology, Media & Telecommunications (35). When comparing the first five months of 2014 with that of 2013, the number of Chinese outbound greenfield FDI deals grew in the Energy & Resources sector; and in the Real Estate sector, Chinese outbound greenfield FDI deal volume more than doubled.

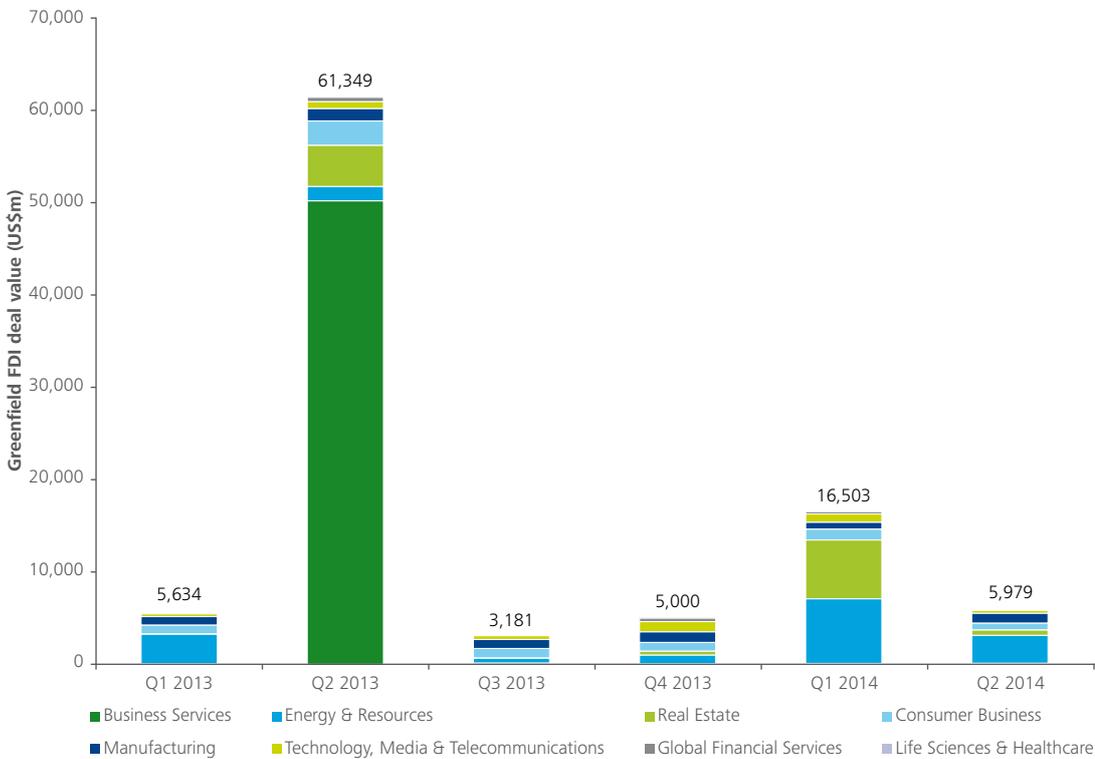
The most valuable Chinese outbound greenfield FDI deals worth a total of US\$10 billion were concluded in the Energy & Resources sector in the first five months of 2014 followed by Real Estate (US\$6.9 billion) and Consumer Business (US\$1.9 billion) (see Chart 10).

Chart 9: Greater China outbound greenfield FDI deal volume by sector (Q1 2013 – Q2 2014)



Note: Q2 2014 stands for the period from April to May 2014

Chart 10: Greater China outbound greenfield FDI deal value by sector (Q1 2013 – Q2 2014)

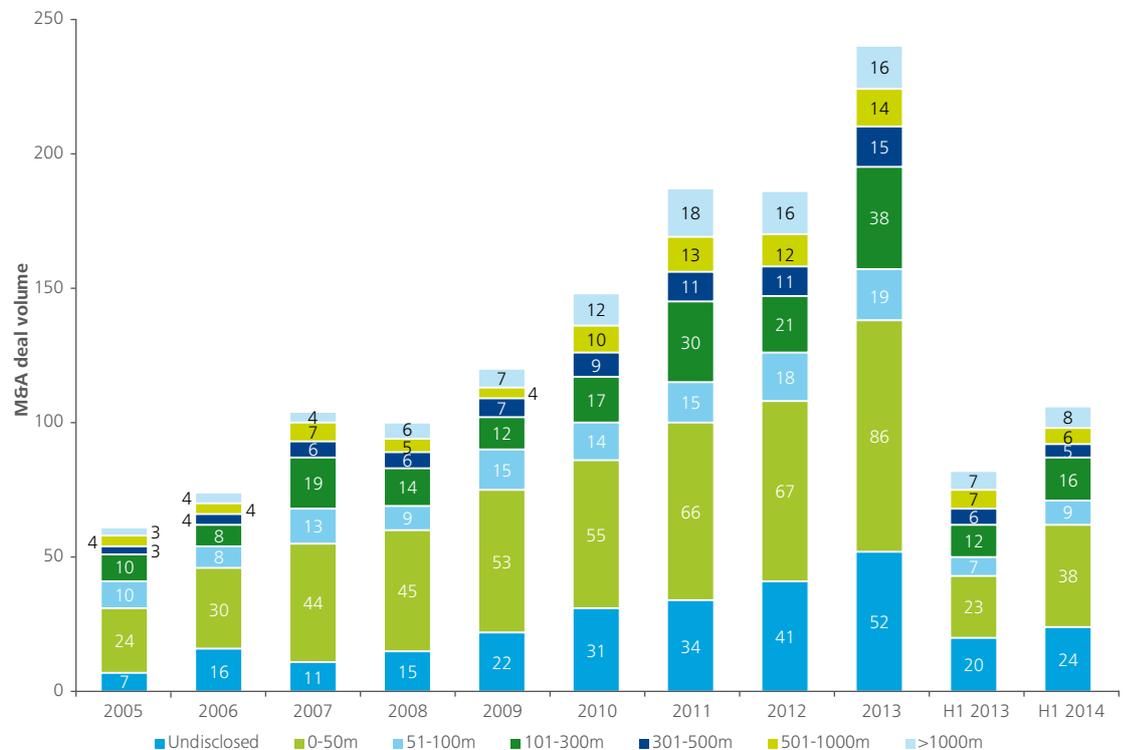


Note: Q2 2014 stands for the period from April to May 2014; the second quarter of 2013 comprises the "Nicaragua deal"

The number of small-sized M&A deals with a value of up to US\$50 million grew by 65 percent in the first five months of 2014 compared with the same period in 2013. The overall number of the Chinese mid- and large-sized M&A deals with a value of US\$50 million to US\$300 million increased between the two periods (see Chart 11). The share

of deals with a value of US\$300 million to US\$1 billion dropped between the same periods. At the upper end of the M&A market, historically, the share of Chinese mega-deals with a value of over US\$1 billion had climbed gradually from 5 percent in 2005 to 8 percent in the first half of 2014.

Chart 11: Greater China outbound M&A deal volume by size (2005 – H1 2014)



Note: H1 2013 and H1 2014 stand for the periods from January to May 2013 and 2014

Table 1: Top 20 Greater China outbound M&A deals (2013 – May 2014)

Rank	Announced date	Target company	Target sector	Target country / jurisdiction	Bidder company	Bidder country / jurisdiction	Seller company	Deal value (US\$m)
1	May 2013	Smithfield Foods, Inc.	Consumer Business	United States	Shuanghui International Holdings Limited	China	NA	6,949
2	April 2014	Xstrata Las Bambas S.A (99.99% Stake)	Energy & Resources	Peru	MMG South America Management Company Limited	Hong Kong	Glencore Queensland Limited; Xstrata South America Limited	5,850
3	September 2013	Kashagan Oil Project (8.33% Stake)	Energy & Resources	Kazakhstan	China National Petroleum Corporation	China	ConocoPhillips Company	5,400
4	March 2013	Eni East Africa Spa (28.57% Stake)	Energy & Resources	Mozambique	China National Petroleum Corporation	China	Eni S.p.A.	4,210
5	August 2013	Apache Corporation (Egypt oil and gas business) (33% Stake)	Energy & Resources	Egypt	Sinopec International Petroleum Exploration and Production Corporation	China	Apache Corporation	3,100
6	September 2013	Seaco SRL	Financial Services	Singapore	Tianjin Bohai Leasing Co., Ltd.	China	Hainan Airlines Group Company Limited	2,954
7	January 2014	Motorola Mobility Holdings, Inc.	Technology, Media & Telecommunications	United States	Lenovo Group Limited	China	Google Inc.	2,910
8	March 2014	Nidera B.V. (51% Stake)	Consumer Business	Netherlands	COFCO Corporation	China	NA	2,847
9	November 2013	Petrobras Energia Peru S.A.	Energy & Resources	Peru	PetroChina Company Limited	China	Petroleo Brasileiro S.A.	2,600
10	March 2013	Caspian Investments Resources Ltd (50% Stake); Mansarovar Energy Colombia Ltd. (50% Stake); Taihu limited (49% Stake)	Energy & Resources	Kazakhstan	Sinopec International Petroleum E&P Hongkong Overseas Limited	Hong Kong	China Petrochemical Corporation	2,559
11	May 2014	Tnuva Food Industries Ltd. (56% Stake)	Consumer Business	Israel	Bright Food (Group) Co., Ltd.	China	Apax Partners LLP	2,485

Rank	Announced date	Target company	Target sector	Target country / jurisdiction	Bidder company	Bidder country / jurisdiction	Seller company	Deal value (US\$m)
12	January 2014	IBM (x86 server business)	Technology, Media & Telecommunications	United States	Lenovo Group Limited	China	IBM Corporation	2,300
13	March 2014	PSA Peugeot-Citroen SA (28% Stake)	Manufacturing	France	Government of France; Dongfeng Motor Group Co., Ltd.	China	NA	2,206
14	September 2013	Uralkali OAO (12.5% Stake)	Manufacturing	Russia	Chengdong Investment Corporation	China	NA	2,008
15	May 2013	Queensland Curtis LNG project (certain interest)	Energy & Resources	Australia	China National Offshore Oil Corporation Ltd.	China	BG Group Plc	1,930
16	January 2013	Pioneer Natural Resources (Wolfcamp asset) (40% Stake)	Energy & Resources	United States	Sinochem International Corporation	China	Pioneer Natural Resources Company Inc.	1,831
17	June 2013	Marathon Oil Corporation (Angolan offshore oil and gas field block 31) (10% Stake)	Energy & Resources	Angola	China Petrochemical Corporation	China	Marathon Oil Corporation	1,520
18	January 2014	Fidelidade - Companhia de Seguros, S.A. (80% Stake); Multicare - Seguros de Saude, SA (80% Stake); Cares - Companhia De Seguros, S.A. (80% Stake)	Financial Services	Portugal	Fosun International Ltd.	China	Caixa Geral de Depositos, SA.	1,358
19	August 2013	Metorex (PTY) Limited	Energy & Resources	South Africa	Jinchuan Group International Resources Co., Ltd.	Hong Kong	Jinchuan Group Co., Ltd.	1,297
20	June 2013	AVR-Afvalverwerking B.V.	Energy & Resources	Netherlands	Consortium led by Cheung Kong Infrastructure Holdings Limited	Hong Kong	Van Ganswinkel Group	1,258

Note: Table correct as of June 2014

Case study: Is the dominance of the United Kingdom as a destination for Chinese outbound investments over its rivals waning?

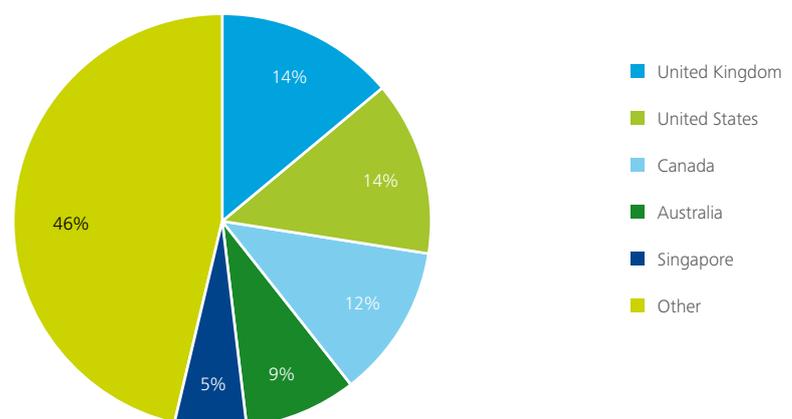
In June 2014, The People's Republic of China Premier Li Keqiang visited London amidst much media hype about the recent explosion of Chinese investments into the United Kingdom and the imminent signing of a series of deals strengthening ties between the two nations. The visit resulted in the signing of about US\$24 billion worth of business deals as well as the setting of new targets to increase bilateral trade to US\$100 billion by the end of 2015¹⁹. The deals included MOUs regarding Chinese investments in rail transport and nuclear energy, approval of an RMB clearing branch to be established in London by the China Construction Bank, and the easing of Chinese visitor visa restrictions. These, along with the other deals that were signed during the three-day summit, represent a maturing of Chinese investment activity into the United Kingdom, with a particular focus on the financial infrastructure required to facilitate additional future Chinese investments into the United Kingdom, as opposed to one-off 'trophy' type transactions.

The US\$2.5 billion investment by China Mingsheng Investment Corporation, one of China's biggest private investment managers, to open a European headquarters along with Nord Engine's announcement that it would open its first international office to invest in European companies and the MOU between Lloyds Bank and the China Development Bank to raise Chinese funds for investment and acquisition of the UK infrastructure projects are all indicative of this process.

The signing of these MOUs, along with other developments that took place during the summit indicates that the pace of China-UK investment flows has seemingly entered into a new phase. In this case study, we examined some of the recent trends that have been shaping Chinese M&A and greenfield FDI investments into the United Kingdom and also look to ascertain what the future holds for Sino-British trade relationships.

The United Kingdom has been punching above its weight in M&A. In the period from January 2005 to May 2014, measured by total Chinese M&A deal value, the United Kingdom has been the number-one destination for China's outbound M&A, even surpassing investments into the United States, albeit marginally. In this period, 89 acquisitions, worth a combined US\$55.2 billion, were undertaken in the United Kingdom, compared to an overall US\$54.5 billion for Chinese investments into the United States and US\$47.3 billion of investments into Canada (see Chart 12).

Chart 12: Chinese outbound M&A deal value by top five recipient countries (2005 - May 2014)



Comparing M&A value to GDP and stock market capitalization, the United Kingdom also outperforms other major players. We ranked the top ten economies by the amount of outbound Chinese M&A investments they attracted between

January 2005 and May 2014 and compared their performance to rankings of GDP (see Chart 13) as well as stock market capitalization (see Chart 14)²⁰. The results can be found below:

Chart 13: The United Kingdom outperforms peers in terms of attracting Chinese M&A investments given its GDP (2005 – May 2014)

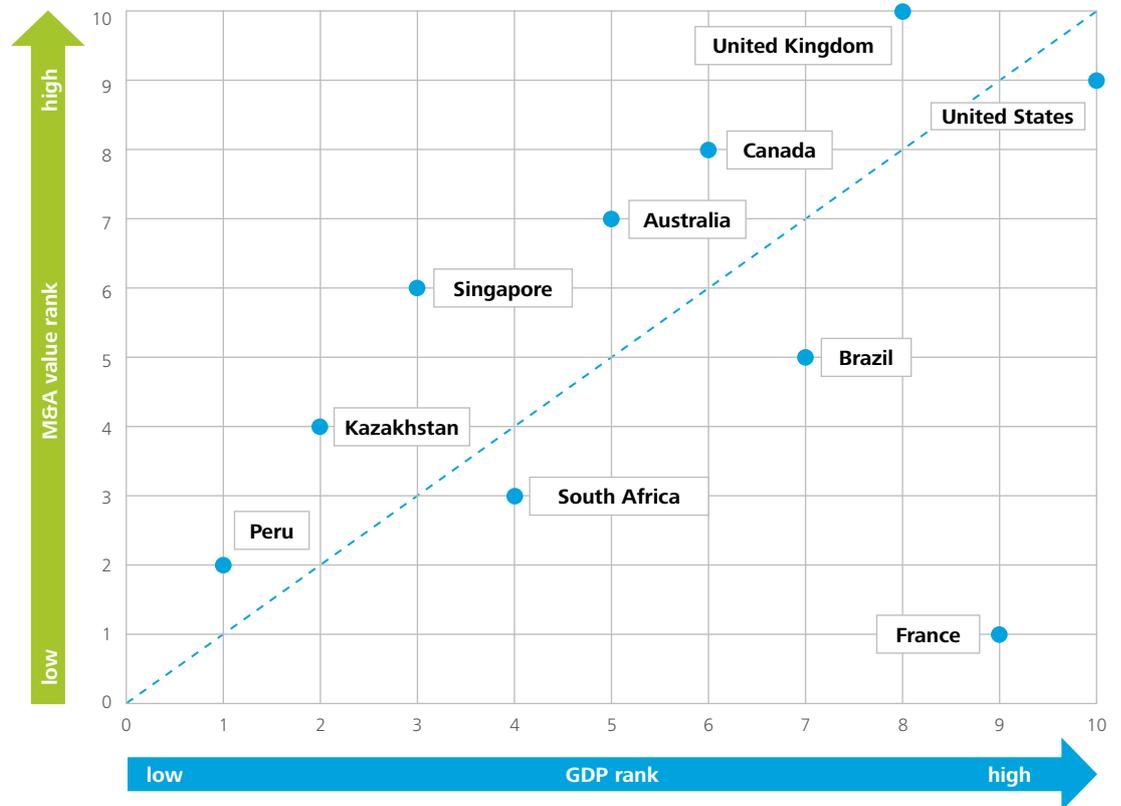
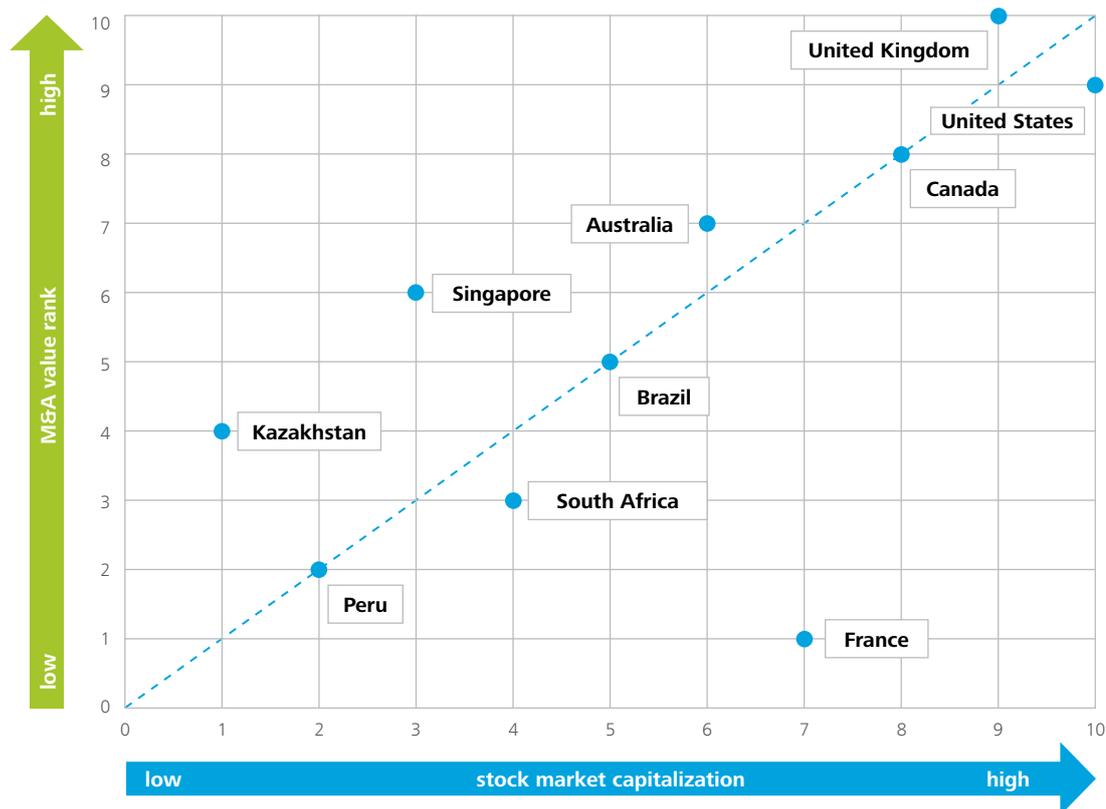


Chart 14: The United Kingdom outperforms peers in terms of attracting Chinese M&A investments given its stock market capitalization (2005 – May 2014)



Whilst the United States was almost equal to the United Kingdom in terms of attracting Chinese outbound M&A investments, the economic size (GDP) of the United States, as well as its stock market capitalization, are more than six times the size of the United Kingdom as well as the London Stock Exchange.

The United Kingdom has continued to offer attractive M&A opportunities to Chinese investors over the shorter term as well. The United Kingdom attracted US\$1.7 billion in value from Chinese M&A transactions in the first five months of 2014²¹.

Hong Kong-based acquirers conduct roughly the same number of the United Kingdom businesses as their Mainland counterparts. Interestingly, since 2005, the balance between Hong Kong-based acquirers and their Mainland counterparts buying in the United Kingdom has been roughly equal, with Hong Kong taking the crown in terms of the actual number of deal transactions (46 compared to 39), with the Mainland ahead in terms of total investment value (US\$28.4 billion versus US\$26.7 billion).

However, it is interesting to note that of the five largest M&A acquisitions to take place in the United Kingdom since 2010, four of them stemmed from Hong Kong bidders. Since then, Hong Kong acquirers undertook 32 deals with a total value of US\$25.2 billion while buyers from Chinese Mainland conducted 26 deals worth a total of US\$9.3 billion.

Obviously, many of these Hong Kong transactions were in fact, conducted by the Hong Kong-listed subsidiaries of Chinese businesses. Taking this into account does change the overall landscape – but only slightly. If Hong Kong-listed businesses that are subsidiaries of Chinese companies are counted as ultimately emanating from the Chinese Mainland, then Mainland bidders have undertaken more than their Hong Kong-based counterparts in terms of deal volumes (30 transactions as opposed to 28). However, when it comes to investments by value, Hong Kong-based buyers still managed to invest US\$24.4 billion versus Chinese Mainland's US\$10.1 billion in the same period.

Of those deals emanating from Hong Kong buyers, the significant majority of them (20 out of 30) were acquisitions in the Energy & Resources and Consumer Business sectors – a finding that was mirrored when looking at what the UK assets Mainland Chinese bidders were interested in.

Chinese buyers conducted the bulk of their acquisitions in the United Kingdom within the Consumer Business sector with purchases of targets within the sector accounting for 28 percent of all Chinese transactions into the United Kingdom over the January 2005 - May 2014 period.

Chinese interest in the UK Consumer Business assets continued unabated in the first five months of 2014, the most notable deal being the Mainland China conglomerate Sanpower Group's US\$803 million acquisition of an 89 percent stake in the British high-street department store House of Fraser²². The deal will also allow the Icelandic investment group Baugur to exit its investment in the store, having purchased the stake in 2006 for US\$662 million²³.

This love of all things British has meant that the United Kingdom retained its lead as the number one destination in Europe in terms of Consumer Business acquisitions, ranking second globally in terms of total Consumer Business investments made over the period from the third quarter of 2013 to the second quarter of 2014 (until May). This however, is perhaps a case of a rising tide lifting all boats as Chinese Consumer Business sector-related investments into Europe have also risen sharply of late, presumably driven by a combination of factors including depressed valuations stemming not only from the Global Financial Crisis of 2008 and 2009, but also the Euro zone Sovereign Debt Crisis of 2011 and 2012.

No one in Greater China knows this better than at Li & Fung, the world's largest clothing retailer, which undertook a raft of international deals over the four short years between 2010 and 2013. Over this timeframe, the Group spent US\$1.1 billion undertaking 12 overseas acquisitions including three acquisitions in the United Kingdom, the largest of these being the US\$190 million purchase of the United Kingdom's Lornamead Group, which manufactures and markets skincare, cosmetics, hair-care and oral-care products in the United Kingdom, Germany and the United States²⁴.

Why did Li & Fung embark on a global buying spree as global financial markets were still reeling from the impact of the Global Financial Crisis? Depressed valuations, coupled with prudent management of Li & Fung's balance sheet, all played their part insofar as they allowed Li & Fung to grow inorganically at a time when practically all other Consumer Business-related companies across the globe were retrenching²⁵. However, Li & Fung was also facing cost pressures itself. As the company noted in its 2010 annual report, "the world has basically been in a low supply cost era for the past 30 years. The change in wage policy in China in 2009 and the subsequent significant higher export prices brings this status quo to an end. To maintain our competitive advantage, Li & Fung will continue to be on the look-out for high-quality cost-effective sourcing markets".

That very same year, Li & Fung undertook a US\$264 million acquisition of the Visage Group Limited, a private-label apparel supplier in the United Kingdom²⁶. According to Li & Fung, the purchase "adds substantial scale to Li & Fung's existing operations... In addition, it has now developed relationships with most of the leading UK retailers..."²⁷

Herein perhaps lies one of the more important trends that is impacting Chinese outbound Consumer Business investments into the United Kingdom – that as Hong Kong-based consumer-focused businesses round out their UK portfolio following the Global Financial, as well as the Euro zone Crisis, their places are increasingly being filled by their Chinese Mainland counterparts.

This point is reinforced very clearly when looking at Li & Fung's new three-year plan (2014 - 2016). One of the points made very early on in the company's 2013 annual report is that "after expanding our global reach, enhancing our range of product offerings and strengthening key customer relationships over the past three years, the Group is poised to accelerate organic growth... Our organic growth strategy is to gain market share from existing customers as they develop and grow their brands..."²⁸

Li & Fung's footsteps come the likes of Sanpower and Bright Food, which acquired the iconic UK breakfast brand Weetabix for US\$1.1 billion in 2012²⁹. These Chinese buyers are looking for products and – increasingly – experiences which they can sell to local consumers, whether or not it is the British breakfast experience in Beijing, an upmarket London department store shopping bonanza, an erudite English-style education³⁰ or a Casino experience³¹ that cannot be found back in China.

David Percival MBE, Managing Director, China International Business Development Group, elaborated that "Chinese Government is supporting investments of Chinese Consumer

Business firms abroad. They are looking to bring resource, brands, technology and expertise back to the domestic market. Examples of the House of Fraser and Weetabix deals are all about the Chinese domestic market. Hence UK brands which are popular can be targets for Chinese buyers."

Since 2005 Chinese Energy & Resources players had focused the bulk of their attention on Australia, undertaking 109 acquisitions there, worth a total of US\$28.6 billion, with 22 of these deals coming to market in 2013 alone. Over the period from 2005 to May 2014, Chinese investors spent US\$40.4 billion acquiring 22 United Kingdom-based Energy & Resources assets, meaning that from a value perspective at least, the United Kingdom ranked second (behind Canada) in terms of attracting Chinese Energy & Resource players.

This obviously ensured that the United Kingdom was well ahead of Germany, France and Italy when it came to this particular sector. In contrast, the largest Energy & Resources-focused transaction outside the United Kingdom that took place in Western Europe over the same period was the US\$3.5 billion acquisition of a 21.35 percent stake in Energias de Portugal SA, the Portuguese state-owned Energy Group, which was announced in December 2011³².

From a United Kingdom perspective, the hunt for energy and resource assets only intensified with time. Since 2010 Chinese bidders undertook 15 deals, worth a cumulative US\$24.4 billion – almost double the number of transactions undertaken during the previous five-year period (seven deals worth US\$16 billion).

This rise in intensity can be attributed to two main investment themes – the increasing desire of Chinese Mainland Energy & Resources players to diversify their reserve holdings across the globe, as well as other, much more financially-driven diversification played by Hong Kong-based power and utilities-focused conglomerates.

Table 2: Chinese M&A of United Kingdom-listed Energy & Resources companies with non-UK-based extraction operations

Year	Target	Bidder	The target's main extraction operations	Value (US\$M)
2010	African Minerals Limited (12.5% Stake)	China Railway Materials Commercial Corporation	Sierra Leone	244
2010	Oxus Gold Plc (59.7% Stake)	Consortium led by Baiyin Nonferrous Group	Uzbekistan	76
2011	Kalahari Minerals Plc	CGNPC Uranium Resources	Namibia	936
2011	Saddleback Mining	Kaisun Energy Group	Tajikistan	22
2011	Caledon Resources	Guangdong Rising Assets	Australia	508
2013	Timan Oil and Gas Plc (23.1% Stake)	Pearl Oriental Oil	Russia	106
2013	Vatukoula Gold Mines	Zhongrun International	Fiji	18

Source: *Mergermarket*

It is perhaps testimony to the ability of the London Stock Exchange to raise funds for mining juniors that half (if not more) of all the Energy & Resources acquisitions made by Chinese buyers in the United Kingdom over the past four years have been of the United Kingdom-listed resources-focused businesses whose main extraction operations exist outside of Europe (see Table 2).

Presumably the focus for Chinese investors remains squarely on resource diversification. In this regard at least, the Alternative Investment Market of the London Stock Exchange (AIM) still has a lot to offer hungry Chinese investors who would still look to diversify their holdings across the world³³.

The second investment theme to be covered also focuses on diversification although in a slightly different sense. In the past four years, a consortium led by Hong Kong-based power and utilities conglomerate Cheung Kong Infrastructure (CKI) had spent US\$20 billion acquiring UK utilities assets – more than the total amount of business deals recently signed during the Chinese Premier's recent visit to the United Kingdom.

So what were CKI looking to do?

CKI listed in Hong Kong in 1996 and up until 2000, pursued a fairly safe strategy of solidifying their Hong Kong operations, while making small acquisitions in China. Between 2000 and 2004, CKI bought up a number of Australian utilities assets before beginning to undertake acquisitions in the UK utilities space (2005 - 2007), such as acquiring Cambridge Water³⁴ and a stake in Southern Water Capital in 2007^{35,36}.

It was only with the onset of the Global Financial Crisis in mid-2007 and over 2008 that the shift in strategy within CKI became discernible – the conglomerate was cash-rich (presumably due to a combination of the benign market conditions that preceded the Global Financial Crisis, rapid economic growth in Asian (home) markets as well as a conservative attitude to capital deployment) and this, combined with torrid market conditions elsewhere, was suddenly in a position to make some large, transformational deals.

As a result, we see the first remarks within CKI's 2009 annual report of 'preparations for some large-scale overseas acquisitions'. In mid-2010, CKI spent US\$322 million buying a 50 percent stake in Seabank Power Station (near Bristol)³⁷. However, the big investment came later on in the year, when a CKI-led consortium³⁸ spent US\$8.8 billion acquiring complete control of Electricite De France's UK distribution network.

Over 2011 and 2012, another CKI-led consortium spent another cumulative US\$8.95 billion acquiring Wales & West Utilities³⁹ and Northumbria Water⁴⁰, noting in the process, nine points for why the business was investing in countries like the United Kingdom:⁴¹

"In regards to geography, the Group looks to invest in countries that offer the following:

- Welcoming environment for foreign investment
- Low sovereignty risk
- Good enforcement of contractual obligations
- Transparent legal systems
- Strong financial frameworks
- Ease of communications
- Familiar business environments
- Well-established regulatory regimes
- Accessibility to local governments

However, by 2013, it would seem like the spate of UK acquisitions was over for CKI. The business continues to make overseas investments but now in its waste management businesses in New Zealand (the US\$410 million acquisition of EnviroWaste Services in 2013⁴²) and waste-to-energy acquisitions in the Netherlands – not of United Kingdom-based targets⁴³.

Chris Aylott, Director, Deloitte UK, commented that "the UK – Hong Kong business relationship is important. For instance, CKI and Hutchinson, who are very much connected to the United Kingdom, are one of the United Kingdom's biggest investors. This is the result of a long standing investment relationship with the United Kingdom."

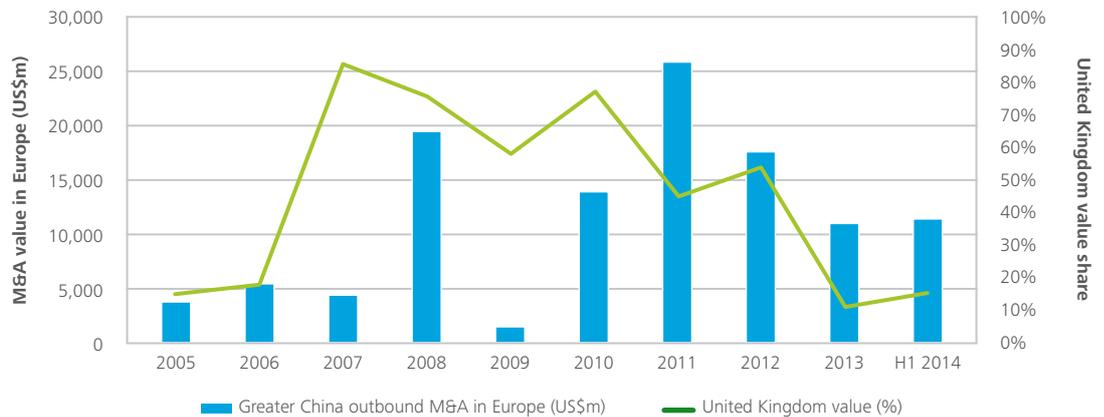
In summary it's interesting to note that CKI undertook a rash of acquisitions of the UK targets but have also now moved on to newer pastures. The CKI's businesses have now (by and large) rounded out their UK portfolio, and it will remain to be seen whether or not Chinese Mainland players are able to fill this vacuum – or whether or not they will seek acquisition opportunities elsewhere in Europe.

Is the dominance of the United Kingdom over its rivals waning? Over the 2005 - 2009 period, the United Kingdom ranked the first in terms of attracting Chinese investments (by value) and was ranked the fifth in terms of the volume of the M&A investment opportunities it attracted. However, since 2012, the United Kingdom has been overtaken by the United States and Canada in terms of value, but has risen in terms of deal volumes into the fourth place.

The United Kingdom retained a lead over its closest European rival Germany, which ranked the fifth in terms of the number of Chinese investments made in the country in the period between January 2010 and May 2014, and the twelfth in terms of investment value. Similarly, over the same period, the Netherlands and France were ranked the ninth and tenth in terms of value and volume respectively.

Nonetheless, the below chart (see Chart 15) would suggest that this dominance is waning. In 2007, the number of Chinese M&A investments into the United Kingdom accounted for over half of all Chinese investments into the whole of Europe. By 2013, this percentage had fallen to 23 percent. The same is true from a value perspective – in 2007, acquisitions of United Kingdom-based targets made up 86 percent of the total M&A spend by Chinese acquirers in Europe. By 2013, this proportion had fallen to a little more than 10 percent.

Chart 15: Chinese M&A investors are increasingly favoring European acquisitions as opposed to those in the United Kingdom (2005 – H1 2014)



Note: H1 2014 stands for the periods from January to May 2014

There has been an explosion of Chinese greenfield FDI in the United Kingdom since 2013. The fact of the matter is that the United Kingdom continues to be an attractive place for Chinese Investors to invest – Chinese greenfield FDI into the United Kingdom has risen sharply of late. The total value of US\$3.6 billion from Chinese greenfield FDI came to the United Kingdom from July 2013 to May 2014.

As of the total value, the United Kingdom is ahead of all the other European countries in terms of attracting Chinese greenfield FDI, these projects are driven partly by infrastructure investments in the energy and transport sectors but above all, by major real estate projects in London (see Table 3).

“That the real estate deals are with a very high value is not surprising,” says Knight Frank’s China head of investment and capital transaction Nick Cao. “Chinese regulations on outward investment take about four to six months to complete, so Chinese investors have to go for the major deals to be competitive.”

There are lots of reasons why the United Kingdom, and particularly London is attractive to Chinese investors. The cooling of the domestic

market, and continuing concerns revolving around frothy property prices in China mean that many Chinese investors are looking elsewhere. “The United Kingdom is considered to be well positioned in the international market,” said Nick. “Cities with large numbers of Chinese emigrants such as London and Sydney are popular, whereas places like Canada, which although has a large number of naturalised Chinese citizens, are less accommodating; especially with regards to tax and other policy restrictions. This essentially means a closed door for Chinese investments.” The United Kingdom’s long leases, stable environment, transparent planning and legal framework offer a safe and stable income for investors as well as opportunities to diversify their portfolio.

According to the UK investment promotion agencies, whilst the early movers were experienced Hong Kong developers, they have been followed up by those from the Chinese Mainland, which see London as the gateway to the rest of the United Kingdom and Europe. As well as having a stable and transparent environment; the United Kingdom’s mature and experienced investment advisory industry is one of the reasons why London has fared well.

Table 3: Recent Real Estate Greenfield FDI projects in the United Kingdom (2005 – H1 2014)

Date Announced	Project	Investors	Deal
Feb 2006 (construction delayed to 2013)	Chelsea Waterfront residential, London	Hutchison Whampoa (Hong Kong)	US\$1.3B new build ⁴⁴
Aug 2012 and November 2013	Greenwich Peninsula, mixed-use, London	Knight Dragon (Hong Kong) and Quintain (United Kingdom)	Initial 60% stake (US\$400M) followed by additional 40% buy out of Quintain ⁴⁵
May 2013	Albert Dock, Asian Business Park, London	ABP, (China)	US\$1.4B new build ⁴⁶
Jan 2014	Nine Elms waterfront, mixed use, London	Dalian Wanda Group (China)	US\$1.1B, new build ⁴⁷
Jan 2014	Rams Brewery, Wandsworth and Canary Wharf, London	Greenland Group (China)	US\$2.0B two new build ⁴⁸

The rationale for some of these deals does seem to vary. Hutchison Whampoa first opened an office in London in 1985 and although they operate in more than 50 countries worldwide, the United Kingdom is the only country where they have operations in each of their five business strands: ports, property, retail, utilities, and telecommunications sectors. Their UK assets are now estimated to be worth more than US\$20 billion and the London Chelsea project will add a major holding to their already substantial portfolio.

Investors from the Chinese Mainland are much newer to the game. Dalian Wanda was founded in 1988, by Chairman Wang Jianlin, and is a major Chinese conglomerate in commercial property, luxury hotels, culture & tourism, and department stores. Back in 2012, Dalian Wanda bought the United States-based AMC Entertainment, a move that was supplemented in 2013 when it bought the United Kingdom-based Sunseeker Yachts⁴⁹. Not content with that, Dalian Wanda bought a Madrid skyscraper from Spain's largest banking

corporation in June 2014⁵⁰. The London property deal, which includes a hotel, compliments their current portfolio and it looks like the first of many, as Wanda attempts to expand into new markets outside China to build their global brand.

Also a huge conglomerate but a SOE, the Greenland Group's London projects look more like those of a traditional developer. The property giant, with holdings in more than 80 cities in China, is now undertaking major developments elsewhere, including projects in the United States, Australia, Thailand, and South Korea. Earlier this year they announced two major prestigious residential developments in Central London, Rams Brewery in Wandsworth and Hertsmere, Canary Wharf^{51,52}. Particularly in the Real Estate sector, London is the first gateway for Chinese businesses going into Europe and Greenland was no exception to the rule. "London is at the economic centre of Europe, so investment here will have global influence," said Greenland Chairman Zhang Yuliang at a press conference in London in January. "We plan to invest further-next in office, hotels and retail."

London is seen as a relatively safe real estate market for those looking for both new development and investment opportunities outside China. It has high liquidity. The UK economy recovered more quickly from the economic downturn and is forecast to grow more quickly than its European counterparts; and with strong tenant demand the prospects for rental growth are greater.

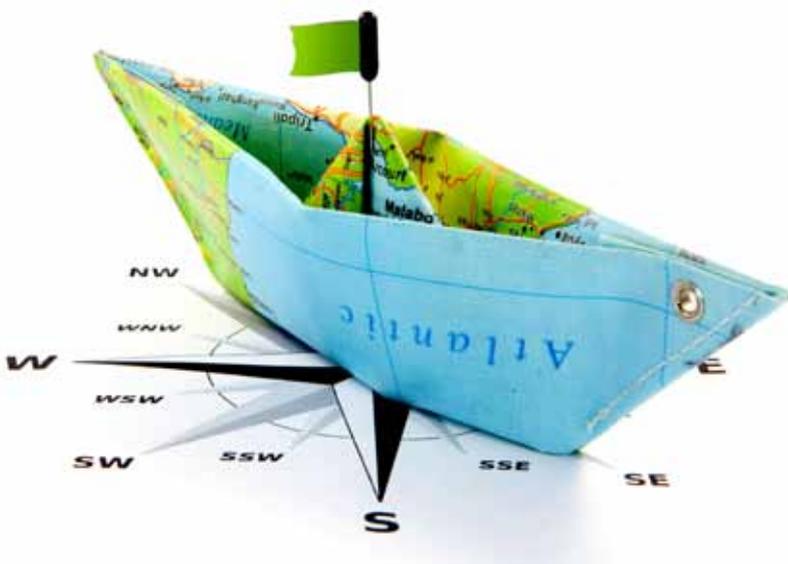
With the growth in Chinese investments in the UK infrastructure and the Real Estate sector, there have been several policy announcements and some changes in inward investment promotion activity that may shape the future of Chinese investments into the United Kingdom.

The Chinese government's publication *Chinese Enterprises Investment Guide to the UK*⁵³ may encourage Chinese investors to consider the United Kingdom over other target destinations. The People's Republic of China Premier Li Keqiang's visit to London in June 2014 certainly showed that the two nations are serious about deepening ties. According to public sources, the rationale for the guide was Beijing's concern that foreign governments might be intimidated by China's SOEs and to support private Chinese small and medium-sized enterprises (SME) to lead the way overseas.

David was quick to mention that "the commercial arm of the UK diplomatic service and the key investment agency UKTI works in partnership with China British Business Council to deliver exports for UK companies and FDI into the United Kingdom. UKTI is in the process of significantly increasing senior resource in China to tackle what is seen as their priority market globally."

At the UK end, there has been a subtle but potentially important policy shift affecting the activities of promotion agencies (see Table 4). Whilst in the past their role was almost entirely focused on attracting investments with at least 50 percent foreign ownership, this limit has been cut to 10 percent (to match the revised OECD criteria) and, in practice it removes the distinction between M&A and greenfield FDI.

Further, there are attempts for the relative success London has had in attracting investment from China to spill out to other regions of the United Kingdom. According to *fDi Markets*, since 2013, more than 75 percent of inward investment deals have been located in the Southeast, including London. In November 2013, the United Kingdom launched the Regeneration and Investment Organisation (RIO), which is tasked to promote infrastructure and real estate development outside London, and prepare a portfolio of 'ready to go' projects for overseas investors⁵⁴. This may encourage some investors to look elsewhere, particularly as yields in London tighten and the major deals in the capital have already been done. There is also talk of policies to restrict foreign investment in speculatively high value residential developments in Central London, often left unoccupied to maximize the investment return. If enacted, this may send out a negative message to investors, or simply spread out potential investment into other parts of the United Kingdom.



Outlook

Despite this possible setback, the signs are positive. With London set to be Europe's RMB hub, other changes to regulations relating to visa schemes and the banking sector look set to follow. The UK government is actively seeking investors to support the National Infrastructure Plan, which covers sectors such as transport,

energy, telecommunications, utilities and flood control. To date we have seen a small number of major players come out of Chinese Mainland and establish a presence in the United Kingdom. There are likely many more to follow. With Chinese institutional investors yet to fully spread their global wings, investment possibilities, particularly in infrastructure and real estate, look bright.

Table 4: Recent selected changes to the UK policy vis-a-vis foreign investment (2011 – H1 2014)

Pilot visa scheme	Selected Chinese travel agents to apply for combined European and UK visas and commence a new 24 hour super priority visa service. (June 2014) ⁵⁵
RMB hub in London	Renminbi Qualified Financial Institutional Investor program initial quota of nearly US\$14B. Creation of a RMB Clearing Bank by China Construction Bank. Bank of England to allow Chinese banks to establish wholesale branches in the United Kingdom. (June 2014) ⁵⁶
Chinese Enterprises Investment Guide to the United Kingdom	Publication of Chinese government, promoting investment into the United Kingdom, with a series of case studies. (April 2014) ⁵⁷ Deloitte had a significant involvement in the preparation of the Guide.
London & Partners	Specialist inward investment agency for London. One-stop shop for encouraging business, events and visitors to London. (April 2011)
Regeneration Investment Organization (RIO)	Inward investment agency for the United Kingdom. To promote real estate regeneration and infrastructure projects outside Central London and to work with Local Enterprise Partnerships (LEPs) to identify a pipeline of projects ready for new investment. (November 2013)

A word from one of Deloitte China's leaders



Derek Lai is the Managing Partner of Deloitte China Southern Region.

Derek Lai, the Managing Partner of Deloitte China Southern Region, opened the discussion with "I am optimistic about Chinese outbound investments. I expect an increasing role of POEs and their acquisitions of advanced technology and best practices so that they could be used in China's domestic market. Chinese POEs are more liberal to undertake outbound transactions and their volume would probably grow. As the cost of manufacturing in China rises, industry leaders would like to climb the value chain as they want to keep sustained positions in the Chinese domestic consumer market. In addition, PRC government support and RMB appreciation are the factors likely to have a positive influence on Chinese outbound investments in the next 3 years."

It is speculated that despite some Chinese investments raising national security concerns in the target country, there can be a solution. For example, the acquisition of Nexen, a Canadian oil and gas company, by China National Offshore Oil Corporation (CNOOC) in February 2013. The parties entered into a mitigation agreement that dealt with the concerns of The Committee on Foreign Investments in the United States. They also submitted a voluntary notice before the deal was closed.

There is an expected increase in Chinese outbound investments in the Consumer Business and Technology, Media & Telecommunications sectors. "This is due to the ease at which domestic approvals can be received in consumer and technology-related industries. As Chinese consumer and technology companies expand globally they will fuel China's export growth, and as a result increase domestic production and ultimately help boost domestic consumption. The domestic real estate market has been overheated and a restrictive policy has been put in place to cool down the market. Investors who find it difficult to source domestic deals will look abroad for potential opportunities."

If Chinese bidders are looking to invest overseas, it is advised to consider the issues of financing, local laws and cultural differences, labor regulations, and how to structure the investment in such a way that the return could be remitted to China in a tax-efficient manner.

"The investor should devise an appropriate exit strategy and implement a post-merger integration plan - a key factor in the success of an M&A deal", Derek concluded.

2014 China outbound investment survey

Survey methodology

In May 2014, *Remark*, the research and publication division of *Mergermarket*, conducted an online survey on behalf of Deloitte China. *Remark* recorded 100 M&A practitioners in Greater China (the Chinese Mainland, Hong Kong, Taiwan and Macau) such as SOEs, POEs, private equities, investment banks and law firms with experience in Greater China M&A transactions. The target audience was in the C-suite executive's space. In order to compare the results with the survey in our 2013 Greater China outbound M&A report, the questionnaire was comprised of the same set of 19 questions from 2013 to examine expectations of M&A transactions. In addition, 4 new questions were added to the survey covering areas such as investment type and whether the investment led to a physical presence in target regions.

Pre-qualifiers

As in 2013, the background of the respondents spanned across the Manufacturing, Energy & Resources, Technology, Media & Telecommunications, Consumer Business and Real Estate sectors. The majority of the respondents were headquartered in Hong Kong, Beijing and Shanghai with more than 2,000 employees.

Survey results

Two sets of survey results from May 2013 and May 2014 were compared in this section.

Key findings

According to the 2014 survey, more Chinese investors will acquire minority stakes in foreign entities as a major way of entering a foreign market.

The number of Chinese outbound M&A transactions is expected to grow. Respondents are more optimistic about the market dynamics in the coming year compared with those in the 2013 survey. Mainstream respondents believe that the number of Chinese outbound M&A transactions will grow as much as 30 percent in the coming year.

Large M&A transactions will probably happen more frequently. Chinese M&A investors expect mid- and large-sized M&A transactions (US\$150 million-US\$500 million) will happen more frequently in the coming year. The expectations of small-sized M&A transactions (US\$5 million-US\$50 million) dropped significantly in the 2014 survey, showing Chinese investors were developing an appetite for larger transactions, especially for targets with higher valuations or with a leading position in their particular industry. The expectations for deals with a value above US\$500 million dropped slightly, showing that Chinese outbound investors may become more cautious when facing significant acquisition opportunities abroad.

Respondents believe Africa and the Middle East collectively have the biggest upside potential to attract Chinese outbound M&A transactions across almost all sectors, especially in Consumer Business, Real Estate and Manufacturing. 95 percent of respondents in the 2014 survey believe that Asia will attract the majority of Chinese outbound M&A investments. Almost all respondents expect the bulk of Chinese outbound M&A will be in the Energy & Resources followed by Consumer Business and Manufacturing in the coming year.

Respondents ranked the importance of multiple deal drivers in 2014 quite similar to that in the 2013 survey. However, the ranking of influence of the Euro zone Sovereign Debt Crisis and China's shift from an export-driven to a consumption-based economic structure was lower in the 2014 survey. On the other hand, respondents believe the internationalization of the RMB as well as positive outlook for GDP growth in the United States will become important deal drivers in the coming year. Volatility in the international financial markets will likely have the most negative impact. Interestingly, the majority of respondents (60 percent) believe the post-crisis economic recovery in Europe will not have any significant influence on Chinese outbound investments, which is in contrast to the expectations in the 2013 survey.

Extending product lines overseas emerged as the most important motivation for outbound investments in 2014, based on the survey. However, respondents still believe that securing resource assets, growing market share abroad and acquisitions of technological best practices are the top objectives. Interestingly, the score for benefiting from potential synergies and accessing the local talent base dropped significantly in 2014, indicating that such objectives will not be top considerations when making investments overseas.

The 2014 survey foresees less obstacles in the coming year compared with the 2013 survey, indicating Chinese investors are more confident in making outbound M&A investments. However, the difference in management culture of European and North American targets is expected to remain as the major obstacles in the coming year, according to the 2014 survey. Furthermore, respondents are more concerned about financing constraints, exchange controls and convertibility of the Chinese currency.

According to the 2014 survey, professional advisors have taken on an increasingly important role in acquisitive transactions where financial/tax due diligence, tax structuring and commercial due diligence are usually seen as a "must". Tax due diligence undertaking, for instance, increased compared with that in the 2013 survey. In addition, respondents said they have paid more attention to post-merger integration issues to more quickly realize a higher return from the transaction. 72 percent of the respondents in the 2014 survey believe over half of the issues identified during the due diligence process will be able to be resolved in the post-acquisition process, a much higher percentage than that in the 2013 survey, indicating more focus put on post-merger integration and, indirectly, reliance on professional assistance relating thereto.



Regulations on Chinese capital outflow

Deloitte spoke to Nora Fu, Partner from Qin Li Law Firm, Chinese law firm which specializes in cross-border legal advisory services, about the regulations on capital transfers and financing for China's outbound investments in 2014. Nora, who has been practising law for over two decades and has significant experience in cross-border transactions, commented that cross-border cash pooling allows multi-national companies to move funds amongst their domestic and overseas group members, so that the member enterprises short of cash can be funded by other members' capital surplus. Furthermore, under current regulation reforms it would be easier for Chinese enterprises to obtain authorization to enter into outbound M&A projects and to receive financing for outbound investments.

Generally, capital outflow is regulated by the State Administration of Foreign Exchange (SAFE) and shall be filed for approval under specific items, such as outbound investment, outbound loans, profit remittances, etc. Capital outflow without any pre-approval or filing is usually not permitted. However, the control policy has been gradually relaxing.

According to the Circular on Further Easing Foreign Exchange Control Policy of Capital Accounts (HuiFa [2014] No. 2), remittance of the upfront expense for outbound investments with an aggregate amount of no more than US\$300 million and below 15 percent of the total Chinese investment amount will no longer require SAFE's approval, which can be processed by a bank based on a SAFE system registration.

For qualified multi-national companies, based on Administrative Provisions on the Collective Operation of Foreign Exchange Funds of Multinational Corporations (For Trial) (HuiFa [2014] No. 23), they are now permitted to open a domestic master account to deposit foreign exchange funds of their domestic member enterprises (the "Domestic Account") and an international master account to deposit foreign exchange funds of their overseas member enterprises (the "International Account") for centralized operation and management. In addition, free transfers are allowed between the International Accounts and any overseas accounts, while transfers between the Domestic Accounts and the International Accounts are subject to the settled quota.

According to the Circular on Supporting the Expansion of RMB Cross-border Business in China (Shanghai) Pilot Free Trade Zone (Yin Zong Bu Fa [2014] No. 22), enterprises incorporated in SPFTZ may set up a two-way cross-border RMB cash pool within their corporate group. Based on their operation and management needs, they may sweep RMB funds generated from production or operating activities and use it for investing activities. However, funds obtained from financing activities are currently not allowed to participate in the cash pool.





As a result of the Administrative Measures on Filing of Outbound Investment Projects of China (Shanghai) Pilot Free Trade Zone (Hu Fu Fa [2013] No. 72), a number of enterprises initiated their outbound M&A projects via subsidiaries set up in SPFTZ taking advantage of the preferential policies. For example, Shanghai Xian Dai Architectural Design Group (Xian Dai Group) completed its acquisition of Wilson Associates, a U.S. design firm, through its subsidiary in SPFTZ within a short period, during which Xian Dai Group completed its filing to the local Ministry of Commerce of the People's Republic of China (MOFCOM) and National Development and Reform Commission (NDRC) in one week, and obtained the SAFE's approval in two days. It was the first cross-border acquisition deal in SPFTZ⁶⁰.

In addition, according to the Catalogue of Investment Projects Approved by the Government (2013 Version) (GuoFa [2013] No. 47) released by MOFCOM, outbound investment projects with total Chinese investment under US\$1 billion only require filing with MOFCOM or its

local branches. In May 2014, the NDRC further relaxed its requirements for outbound investment approval by Administrative Measures for Approval and Filing on Outbound Investment Projects (the "Measures") (Order of the National Development and Reform Commission No. 9).

Regulations

The following regulations are related to China's outbound investments in 2014:

- Catalogue of Investment Projects Approved by the Government (2013 Version) (Guo Fa [2013] No. 47)
- Administrative Measures for Approval and Filing on Outbound Investment Projects (Order of the National Development and Reform Commission No. 9)
- Circular on Further Easing Foreign Exchange Control Policy of Capital Accounts (HuiFa [2014] No. 2)
- Administrative Measures on Filing of Outbound Investment Projects of China (Shanghai) Pilot Free Trade Zone (Hu Fu Fa [2013] No. 72)

Deloitte regional insight



United States

Chris Cooper, Partner, Deloitte & Touche LLP, is the Americas Leader of the Deloitte Chinese Services Group (CSG) who also serves as the national leader for CSG in the United States.

The breadth of the U.S. manufacturing growth bodes well for a GDP rebound

During the past three years, the Federal Reserve (the U.S. central banking system or “Fed”) stimulated the U.S. economy with an extremely loose monetary policy. With interest rates as low as possible, it has turned into a number of extraordinary policies such as “quantitative easing” and “forward guidance” to reduce the cost of borrowing and to boost demand. After a sluggish 1.9 percent growth in 2013, the U.S. economy is expected to grow faster⁶¹, pushed by higher consumer spending⁶², in 2014. Policy towards competition and foreign investment is expected to remain positive with low trade and exchange controls. The breadth of the U.S. manufacturing growth bodes well for a GDP rebound. Markit’s Flash U.S. Manufacturing PMI⁶³ had increased in June 2014 to its highest level in four years, attributed to rising production volumes and improving domestic economic conditions. Positive expectations drove the U.S. equity prices higher by 14 percent since one year ago⁶⁴.

China was the United States’ biggest supplier with a 20 percent share of total imports in 2013⁶⁵, followed by Canada, Mexico and Japan. Chinese firms tend to seek more opportunities to produce goods and services in the U.S. market. Between

January 2005 and May 2014, almost half of all Chinese direct investments in the United States went into the Manufacturing⁶⁶ - particularly electronics components - and Technology, Media & Telecommunications sectors. Yet the most value was typically seen in Energy & Resources – particularly renewable energy and production of chemicals and metal processing, which collectively had a 24 percent share of the total value of Chinese greenfield FDI in the United States (US\$4.8 billion) in the same period.

China’s greenfield FDI stock remained relatively small in the United States and it was US\$19.6 billion between January 2005 and May 2014

The overall inflow of Chinese greenfield FDI to the United States grew at a CAGR of 21 percent from US\$634 million in 2005 to US\$3 billion in 2013 and stood at \$827 million for the first five months of 2014. After a strong fourth quarter in 2013 and the first quarter in 2014, more Chinese investors are expected to enter the U.S. market in 2014. China’s greenfield FDI stock remained relatively small in the United States and it was \$19.6 billion between January 2005 and May 2014. There was a total of 60 Chinese greenfield FDI projects in the United States in 2013 and 32 in the first five months of 2014.

In the first five months of 2014, we saw increases in values for Chinese greenfield FDI deals - especially in subsectors such as biotech, medical devices and consumer electronics - with 11 percent of the total value in the first five months of 2014. For instance, WuXi PharmaTech, a leading Chinese pharmaceutical, biotechnology and medical device R&D company, planned to open a new 4,180-square meter cell therapy manufacturing facility in Philadelphia, Pennsylvania⁶⁸. Additionally, Hisense, a well-known Chinese manufacturer of electronic products, announced the opening of its new assembly plant to serve the U.S. market.

On the contrary, the total Chinese M&A deal value in the United States reached US\$54.5 billion between January 2005 and May 2014. 31 percent of Chinese M&A deals in the United States went to the Technology, Media & Telecommunications sector followed by Manufacturing and Consumer Business. M&A deals in the Energy & Resources sector were typically the most valuable with a 29 percent share of the total value of Chinese M&A deals in United States, followed by Consumer Business and Technology, Media & Telecommunications.

The total Chinese M&A deal value in the United States reached US\$54.5 billion between January 2005 and May 2014

There were 40 Chinese M&A transactions over the period from July 2013 to May 2014 in the United States with an increase in the number of the M&A deals in the last quarter of 2013 and in the first quarter of 2014, which was the most valuable quarter, with US\$5.7 billion in transaction value.

Compared to the first five months of 2013, when most of the M&A deals emerged in Energy & Resources and Consumer Business, the biggest increases in value of Chinese M&A transactions were recorded in Technology, Media & Telecommunications sector, in the first five months of 2014.

The biggest increases in value of the Chinese M&A transactions were recorded in Technology, Media & Telecommunications sector in the first five months of 2014

In the first five months of 2014, two M&A mega-deals were announced by Lenovo Group. In January 2014, the listed China-based manufacturer of computers and smartphones, signed an agreement to acquire Motorola Mobility Holdings, the United States-based company providing technologies, products, and services for mobile and wire line digital communication, information, and entertainment applications, from Google, the listed United States-based company, for US\$2.9 billion⁶⁹. The acquisition rationale was based on Lenovo's plan to strengthen its position in the smartphones business in North America by acquiring research and development techniques that would likely enable Lenovo to also gain key positions in the Latin American and Western European markets. After completion, Lenovo would receive some 2,000 patent assets and the Motorola Mobility brand and trademark. The acquisition has been subject to customary approvals, especially from the Committee on Foreign Investment in the United States (CFIUS) and Hart-Scott Rodino Antitrust Act.

In the second deal, Lenovo had agreed to acquire IBM's x86 server business from IBM, the United States-based multinational technology company, for US\$2.3 billion⁷⁰. The transaction's rationale was based on Lenovo's strategy to grow its PC business and also align with IBM's plan to inject more capital to expand its cloud computing into its data centers worldwide.

Alibaba Group made acquisitions in the mobile and social media space. In March 2014, Alibaba Group, the China-based company engaged in the provision of software, technology and other services in the online business to business marketplace, along with Jerry Yang, the United States-based private individual, and Qualcomm Ventures and Draper Fisher Jurvetson (DFJ), the United States-based venture capital firms, acquired an undisclosed stake in TangoMe, the United States-based company providing mobile video calling services, for US\$280 million⁷¹. The transaction was in line with TangoMe's announced strategy to expand by adding new contents and services to its customers.

In the automotive industry, Chinese bidders targeted - among others - U.S. automotive safety systems. In May 2014, FountainVest Partners, the China-based private equity firm, acquired a stake in Key Safety Systems, the United States-based designer and manufacturer of automotive safety-critical components, from Crestview Partners LP, the United States-based private equity firm, for about US\$800 million⁷².

In January 2014 BAIC Motor Company, the China-based company engaged in manufacturing passenger cars and off-road vehicles, and a subsidiary of Beijing Automotive Industry Holding (BAIH), acquired a 25.02 percent stake in Atieva, Inc., the United States-based company engaged in battery-monitoring software for automobiles and aircrafts⁷³. By these acquisitions, the Chinese firms intended to strengthen their research, design and manufacturing capacity.

In addition, a common theme of Chinese investments in the United States has been to simply acquire assets off-shore that could be leveraged or monetized and then to port the money back to China. Look at the "Shuanghui" case and its IPO as a typical example

The prime motives for Chinese acquisitions in the United States market in the first half of 2014 shifted from securing natural resources to acquiring technological best practices and advanced management experience or talent to expand market share. Chris was quick to mention that "In addition, a common theme of Chinese investments in the United States has been to simply acquire assets off-shore that could be leveraged or monetized and then to port the money back to China. Look at the 'Shuanghui' case and its IPO as a typical example"⁷⁴.

Due to China's slowing economic growth Chinese enterprises need to seek growth overseas. Chris speculated that the relaxation of regulations for capital transfers out of China, an increasing role of Chinese POEs investing overseas, demand for advanced technology and international best practices for China's domestic market would all likely have a positive influence on Chinese acquisitions in the United States in 2014. However, Chris was cautious about making conclusions on RMB currency internationalization as it would be hard to predict these trends. "As the RMB depreciates, there would be more pressure to take capital out of China and invest overseas, utilizing the value of the currency's purchasing power before it depreciates any further."

Regarding the role of Chinese POEs in outbound transactions, Chris commented that "POEs are not replacing SOEs, but there is a growing appetite among Chinese POEs for foreign expansion. POEs account for about one third of the total value of Chinese outbound M&A deals." In November 2013, during the Third Plenary Session, The People's Republic of China President Xi Jinping laid out plans to give POEs a greater role in the Chinese economy. Chinese firms are expected to make more acquisitions to access new technology and skills that would translate into increased hiring and investments into research and development back in China.

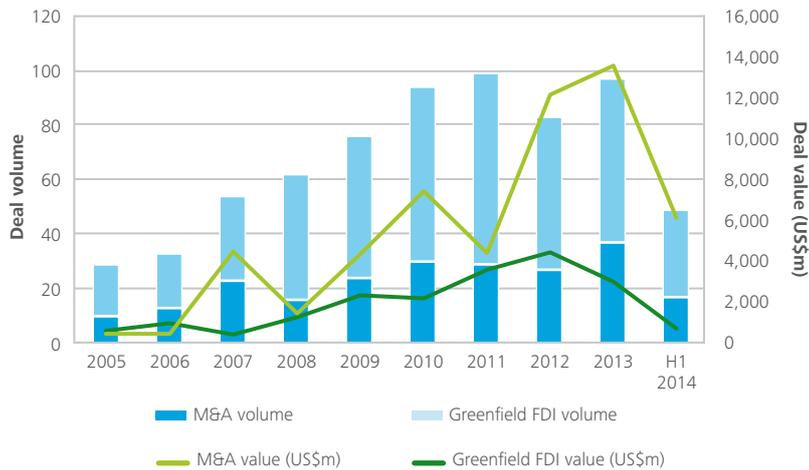
Chris predicts that the ability of Chinese firms to adapt to U.S. markets and management style as well as China's domestic regulatory environment would likely slow Chinese deal flow in the United States, but he disagrees with the statement that Chinese firms faced more difficulties in outbound

Chinese POEs that are leaders in their sectors, such as Lenovo and Alibaba, would not face as many hurdles as they seek acquisitions globally

investments in the United States. "Chinese POEs that are leaders in their sectors, such as Lenovo and Alibaba, would not face as many hurdles as they seek acquisitions globally."

In the largest acquisition by a Chinese company of a U.S. firm to date, the 'Shuanghui' case faced considerable scrutiny and concerns from the U.S. public and policymakers when the Chinese WH Group, a majority shareholder of Henan Shuanghui Investment & Development, bought Smithfield Foods. In cooperation with Smithfield's management, the acquirer was able to consistently convey its message that the deal would not adversely affect Smithfield's operations and product quality in the United States, as well as having no impact on national security. WH Group also worked closely with external advisors behind the scenes to ensure that necessary procedures were implemented and the complex structuring elements of the deal were resolved to meet deadlines. "The acquisition, which cleared regulatory review and was overwhelmingly approved by shareholders, represents an important milestone for the flow of Chinese investment into the United States", concluded Chris.

Chart 16: Greater China outbound investments to the United States (2005 – H1 2014)



Note: H1 2014 stands for the period from January to May 2014

Where is the upside for investments?

Chris expects that Chinese bidders would increasingly look for targets in Manufacturing, Consumer Business, Technology, Media & Telecommunications, Energy & Resources, Real Estate and Life Sciences & Health Care in the United States.

Chris recommends that any potential bidder do research well in advance: "Know the country and its business and regulatory environment, know the local region in which you are planning to invest." Chinese bidders should conduct comprehensive due diligence on the target, understanding that cooperation with local stakeholders and attention to public image are critical factors that can determine success or failure. He added "Be sure that you are equipped with the right management team and experienced external advisors to successfully execute and follow through on the vital work of post-deal integration. Chinese investors should understand local business practices and culture, and leverage advisors."





Australia

Matt Judkins is M&A Partner, Deloitte Touche Tohmatsu, Australia.

Australia's economy has recently been picking up momentum with growth fuelled by the swelling of mining exports⁷⁶. Higher exports of iron ore, Australia's single-largest export commodity, and coal and hydrocarbons - mainly liquefied natural gas (LNG), supported the year-on-year expansion of GDP, giving Australia's strongest performance since the first quarter of 2013.

The mining boom would likely translate into more Australian exports with a higher demand for mining-related logistics services and transport infrastructure

It is expected that the mining boom would likely translate into more Australian exports with a higher demand for mining-related logistics services and transport infrastructure, mainly engineering construction such as ports, railways and roads. However, Australia's government capital spending is expected to remain subdued during 2014 as the federal government seeks to rein in its debt⁷⁷.

Reduced governmental spending may attract more Chinese contractors and investors into ventures with local construction groups to

finance an upgrade of transport infrastructure. In March 2014, Hong Kong-based Noble Group, an agricultural supply chain management specialist listed in Singapore, invested into the development of a new port terminal in Port Kembla, New South Wales. The US\$50 million-facility would be established through a joint venture agreement with Qube, an Australian logistics firm, and would have the capacity to export up to 1.3 million tons of grain annually^{78,79}.

In 2013, China was the largest trading partner for Australia⁸⁰, with 36 percent of Australian exports being soaked up by China. The Australian dollar could be viewed as a proxy for the performance of China's economy. Furthermore, Chinese economic data and global commodity prices would likely have an increasing effect in volatility of the Australian dollar in 2014⁸¹, specifically a faster than expected slowdown in investment growth in the Chinese economy. The international price for coal and LNG may reflect a huge increase in global supply, much of which would be provided by Australia.

Whilst Australian Prime Minister Tony Abbott's first meeting with the People's Republic of China President Xi Jinping in late 2013 was a success, we expect that attempts by more Chinese SOEs to acquire strategic mining and agricultural assets in Australia would likely continue to be closely scrutinized by the government for national-interest concerns.

Australia has attracted stable inflows of Chinese greenfield FDI with a value of about US\$1 billion annually, since 2008

Between January 2005 and May 2014, there were 119 Chinese greenfield FDI deals worth a total value of US\$11 billion in Australia (see Chart 17). Over 66 percent of all greenfield FDI deal value was in Energy & Resources – such as iron ore mining, aluminum production, metals, oil and gas extraction.

Australia has attracted stable inflows of Chinese greenfield FDI with a value of about US\$1 billion annually, since 2008. The value of Chinese greenfield deals in Australia was flat in the fourth quarter of 2013 and the first quarter of 2014.

Chinese investors made two single transactions in Australian Real Estate in the fourth quarter of 2013 and in a customer service-oriented business in Technology, Media & Telecommunications in the first quarter of 2014.

Shanghai-based Greenland Group, a real estate development, energy and finance company, is investing US\$560 million into the construction of a residential and hotel project in Sydney, due for completion in 2017. The property was originally purchased for US\$95 million from Canada-based Brookfield Asset Management⁸². The Sydney Greenland Centre, the 3,970-square meter project will include 470 apartments and 180 rooms in a five star-boutique hotel⁸³.

In February 2014, Vodafone Australia, a subsidiary of Hong Kong-based Hutchison Whampoa, invested an undisclosed amount in the city of Canberra in the telecommunication network and launched a local LTE network⁸⁴.

Between January 2005 and May 2014, there were 187 Chinese M&A deals in Australia with a total value of US\$38.4 billion (see Chart 17). 59 percent of the total number of Chinese M&A projects in Australia were in the Energy & Resources sector – mostly in power transmission and distribution, oil and gas and mining, with a 76 percent share on total Chinese M&A deal value in Australia.

Chinese acquisitions in Australia totalled US\$38.4 billion between January 2005 and May 2014 with the majority of the M&A deals in the Energy & Resources sector

22 percent of all Chinese acquisitions in Australia were in Consumer Business with 13 percent of the total M&A value.

There were 33 major Chinese M&A deals in 2013 with a total value of US\$6 billion and 13 deals in 2014 with a value of over US\$1.9 billion in Australia. After reaching a US\$3 billion-peak in the second quarter of 2013, M&A transaction volume in the first quarter of 2014 was signalling a strong Chinese interest to expand by more acquisitions in the Australian market.



Chinese acquisition deals would typically represent a two-way opportunity; one for the deleveraging target company to pay off debt and two, for the Chinese bidder to secure industrial assets, at a premium, in China's ever-rising demand for resources

In January 2014 State Grid International Development (SGID), the China-based company engaged in the design, procurement and construction of power transmission, completed an acquisition of a 60 percent stake in SPI (Australia) Assets Pty. Ltd., the Australia based company that owns and maintains electricity and gas distribution, and transmission assets⁸⁵.

In July 2014 Baosteel Resources Australia (BSRA), a subsidiary of China's Baosteel Group, and Aurizon Operations, an Australian-listed haulage company, completed an off-market takeover of all ordinary shares of Aquila Resources, an Australian

exploration company with interests in coal and iron ore, valuing the 100 percent equity in Aquila at approximately US\$1.3 billion⁸⁶.

Chinese acquisition deals typically represent a two-way opportunity; one for the deleveraging target company to pay off debt and two, for the Chinese bidder to secure industrial metal assets, at a premium, in China's ever-rising demand for resources.

In April 2014, Shandong Landbridge Group, a China-based company operating in port logistics, petrochemicals, timber trading and real estate development businesses, bid for an 80 percent stake in Westside Corporation (WCL), the listed Australia-based company headquartered in Brisbane, engaged in the exploration and appraisal of coal seam gas (CSG) for US\$108 million. The offer price represented a premium of 31.1 percent over WCL's closing price on 23 April 2014. However, on 5 May 2014 the Australian firm rejected the takeover offer as undervalued⁸⁷.

Matt commented that mining represents almost 11 percent of the Australian economy. Further growth opportunities exist in natural gas, next generation-nuclear and solar business and in the agriculture sector. Also, residential aged care and international education sectors are projected to grow faster than Australia's GDP⁸⁸.

Where is the potential upside for investments?

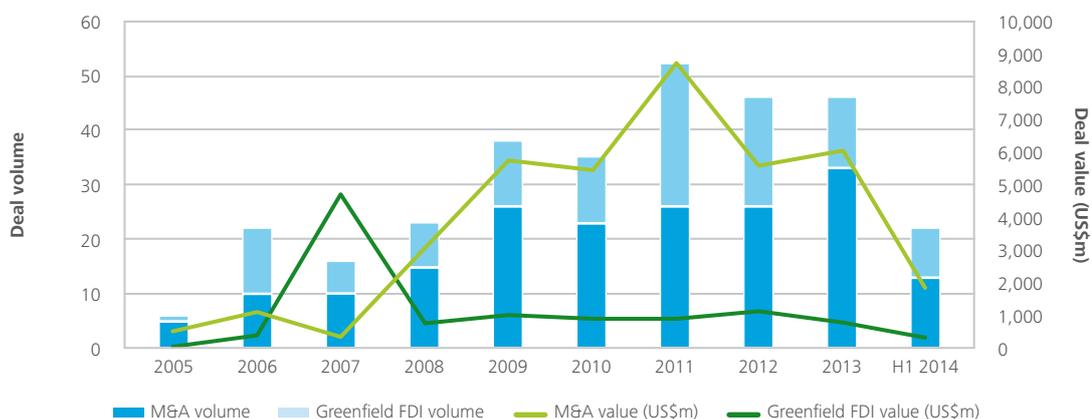
As for the downstream opportunities for services and products that support mining, clean coal has been losing the battle for global market shares with gas and renewable energy. However, Australia has a great potential in vast thermal coal reserves, if there is clean coal technology at affordable costs. Australia has heaps to do in order to bring its gas potential to fruition, thus leading to more opportunities for the transportation and construction sectors. In information and communication technology, Australia is poised to build water-saving sensor systems and disease-resistant crops on its farms, robots and automated systems in mining to implement lower-cost advice models. The financial sector is expected to rise rapidly, reflecting the swelling of Australia's resource-export assisted trade flows⁸⁹. Besides investments targeting natural resources, Chinese bidders were also investing in Real Estate. In January 2014, Fu Wah International Group, the

China-based company engaged in real estate development, acquired Park Hyatt Melbourne for US\$123 million, from Ausco Fitzroy Pty, the Australia-based hotel operator⁹⁰.

Matt added that relaxation of regulations for capital transfers out of China, an increasing role of Chinese POEs investing overseas, and RMB currency internationalization would most likely have a positive influence on Chinese investments in Australia in the next 3 years. On the other hand, Chinese bidders would likely face difficulty dealing with the relatively high transaction costs in the Australian market.

Chinese bidders should recognize that in order to make the investment work, it requires that emphasis be placed on post-acquisition matters. Thus the bidder also needs to perform thorough due diligence to understand local market conditions and take on a whole business approach covering commercial, legal and tax aspects.

Chart 17: Greater China outbound investments to Australia (2005 – H1 2014)



Note: H1 2014 stands for the period from January to May 2014



Southeast Asia

Ernest Kan, Deloitte Singapore's Chief-of-Operations for Clients & Markets, is the Chinese Services Group leader in Southeast Asia.

During the past 12 months, the region of Southeast Asia⁹¹ has been an increasingly attractive destination for Chinese firms, which are looking to extend their footprint in the exploration of natural resources such as oil and gas, coal and gold. Chinese firms made large investments in downstream projects comprised of logistics and energy transmission. Traditionally the region attracted a large number of Chinese greenfield projects in manufacturing industries due to its relatively cheap labor, growing market and sizable population. For instance, Indonesia's population was about 250 million in 2013⁹², and it is unsurprising that their consumer market is the largest in Southeast Asia. At an estimated US\$485 billion in household consumer spending in 2013, it dominates that of Thailand, the region's second-largest market. The vast majority of Indonesians are far from wealthy, with a GDP per head in U.S. dollar terms standing at an estimated US\$3,463 at market exchange rates in 2013⁹³. There is a potential upside since it is expected that there will be a steep rise in demand in the near future.

Between January 2005 and May 2014, the Manufacturing sector including metal processing in Vietnam, Indonesia and Malaysia, and the automotive industry in Cambodia, gained a 30 percent share on the total number of Chinese greenfield FDI projects in Southeast Asia. For instance, in April 2014, China-based Great Wall Motors announced its plans to open a new vehicle assembly plant in Phnom Penh, Cambodia⁹⁴.

The total stock of Chinese greenfield FDI in Southeast Asia reached US\$98.7 billion over the period from January 2005 to May 2014, suggesting a strong presence of Chinese firms

13 percent of the total number of Chinese greenfield deals went into the Financial Services sector and in particular to set up the headquarters of financial institutions in Singapore, Malaysia and Vietnam. During the same period, the value was mainly generated in the Energy & Resources sector – especially in metal processing, oil refining and coal, having a collective 54.6 percent share on Chinese greenfield FDI's total transaction value. The total stock of Chinese greenfield FDI in Southeast Asia reached US\$98.7 billion in the same period, suggesting a strong presence of Chinese firms (see Chart 18).

In the fourth quarter of 2013 and the first quarter of 2014, both volume and value of the Chinese greenfield FDI in Southeast Asia had increased significantly in the Real Estate and Energy & Resources sectors, specifically in mining. In January 2014, Hong Kong-based Verde Resources, an exploration company, announced that it would build a new production facility at its Merapoh Mine in Pahang, Malaysia, to produce an estimated 3,600 gold ounces in 2014⁹⁵. In the same month, China-based Sichuan Henglu Industrial Company, a construction firm, announced that it would establish a joint venture with Myanmar-based Good Plus Star Mining Company to mine lead, in Kalaw, Myanmar⁹⁶.

The total value of greenfield real estate transactions with Chinese investors in Southeast Asia between January 2005 and May 2014 climbed to US\$8.5 billion. In March 2014, China-based Shanghai Greenland Group, a real estate development, energy and finance company, announced an investment of US\$3.2 billion in two property projects in Johor, Malaysia, to build residential and serviced apartments, hotels and commercial facilities⁹⁷.

Between January 2005 and May 2014, the total M&A value of Chinese deals accumulated to a total of US\$31.9 billion in Southeast Asia (see Chart 18). One-third of the total number of Chinese M&A deals during the same period was in the Consumer Business sector, followed by Manufacturing and Technology, Media & Telecommunications. Unsurprisingly, the Chinese M&A deals in Financial Services and Energy & Resources were the most valuable, at 63 percent of the total value in the same period.

Between January 2005 and May 2014, the total M&A value of Chinese deals accumulated to a total of US\$31.9 billion in Southeast Asia

Value and volume of the Chinese M&A deals shot up in the third quarter of 2013, reaching a US\$3.2 billion-maximum for a quarter since 2008.

In the second quarter of 2014, Chinese investors started to target mass market communication businesses such as telecommunications, postal services and logistics. In June 2014, China Mobile, the world's largest mobile phone operator, announced the acquisition of an 18 percent stake in True Corporation Public Company, the listed Thailand-based company headquartered in Bangkok, for US\$881 million. When the acquisition is completed, it will be the first investment China Mobile has made outside of the Greater China in seven years⁹⁸.

Following large investments into Technology and Energy assets, Chinese investors started to target mass market communication businesses such as telecommunications, postal services and logistics in Southeast Asia

In May 2014, Alibaba Investment, a wholly owned subsidiary of the Alibaba Group, the China-based investment holding company with interests in media and the online retail business, signed an agreement to acquire a 10.36 percent stake in Singapore Post, the Singapore-based postal and logistics service provider, for US\$249 million⁹⁹.

Chinese buyers are keen on establishing a platform to expand in the Asia Pacific market, specifically in Singapore. In 2013, Singapore reinforced its position as a regional hub for debt-fundraising and commodity trading by providing favorable tax incentives. As a small and open economy, the country's trading sector is highly dependent on the development in the global economic environment. Singapore is expected to grow by about 4 percent in 2014¹⁰⁰ reflecting faster export growth and an expansion in intra-Asian trade.

Natural resources seem to be a key motive for Chinese buyers especially in Indonesia. In October 2013, China Investment Corporation, a sovereign wealth fund of the Government of China, agreed to acquire a 42 percent stake in PT Bumi Resources Minerals Tbk (Bumi Minerals), the listed Indonesian company engaged in coal mining and oil exploration for US\$257 million¹⁰¹.

Ernest mentioned that Chinese firms were increasingly interested in expanding their logistics and shipping operations, which complemented commodity trading. "Deloitte Singapore has recently been engaged in due diligence transactions for a Chinese SOE acquiring a Singaporean shipping company with business operations in the United Arab Emirates (UAE). We have also helped a Chinese brokerage house entering into the Singapore market through an M&A transaction." In addition, Singapore's mature marine and offshore service industry also attracts Chinese investors. In November 2013, Headland Capital Partner, a Hong Kong-based private equity firm, acquired a 57.5 percent stake in Kreuz Holding, a provider of subsea services to the offshore oil and gas industry, from Swiber Holdings, a contractor and support service provider, for US\$205 million¹⁰².

The acquisitions of shipping companies and subsea services are not new to Chinese bidders. In 2011, Chinese Jiangsu Sanfangxiang Group invested a 25 percent stake in Jurong Aromatics Corporation, a Singapore-based US\$2.4 billion-petrochemical complex, comprised of port and shipping facilities that was expected to start the production of aromatics (light oil from gas fields) during 2014^{103,104,105}.

In the Life Sciences & Health Care sector, in November 2013, CITIC Private Equity Funds Management, the China-based private equity and venture capital firm, acquired a 21.7 percent stake in Biosensors International Group, the listed Singapore-based manufacturer of medical devices for interventional cardiology and critical care, for US\$312 million¹⁰⁶.

The acquisitions of shipping companies and subsea services are not new to Chinese bidders in Southeast Asia

Ernest believes that relaxing regulations for capital transfers out of China in combination with the increasing role of Chinese POEs in overseas investments would most likely have a positive impact on the inflow of Chinese investments into Southeast Asia. "The relatively cheap resources and growing market in Southeast Asian countries may continue to attract Chinese investors, contrasting the overcapacity of production and highly competitive market back in China. As competition among companies in China intensifies, their margins tend to fall", he concluded. In the Real Estate Sector, for instance, rating agency Moody's revised its outlook for China's property market from stable to negative amidst significant slowdown in China's residential property sales in the first four months of 2014, driven mainly by tighter liquidity and increased mortgage rates¹⁰⁷.

Southeast Asia offers new investment opportunities for Chinese contractors and engineering companies. For instance, China's Beijing Enterprise Water Group (BEWG), a Hong Kong-listed engineering company, which set up its headquarters in Singapore for investment expansion in the region, agreed to set up a joint venture company with partners in Indonesia to obtain concession right to invest, construct and operate three water supply plants in Medan City, Indonesia¹⁰⁸.

The market of Southeast Asia has seen Chinese POEs playing an increasing role in outbound investments and would continue the trend along their internationalization process

"Capital transfers out of China were behind several transactions of Chinese POE buyers. The market has seen POEs playing an increasing role in outbound investments and would continue the trend along their internationalization process. As an example, in February 2014, Fosun Group, China's largest privately-owned conglomerate¹⁰⁹, announced its investment in Secret Recipe, the Malaysia-based casual dining restaurant chain for US\$35 million." Ernest added.

Where is the upside for investments?

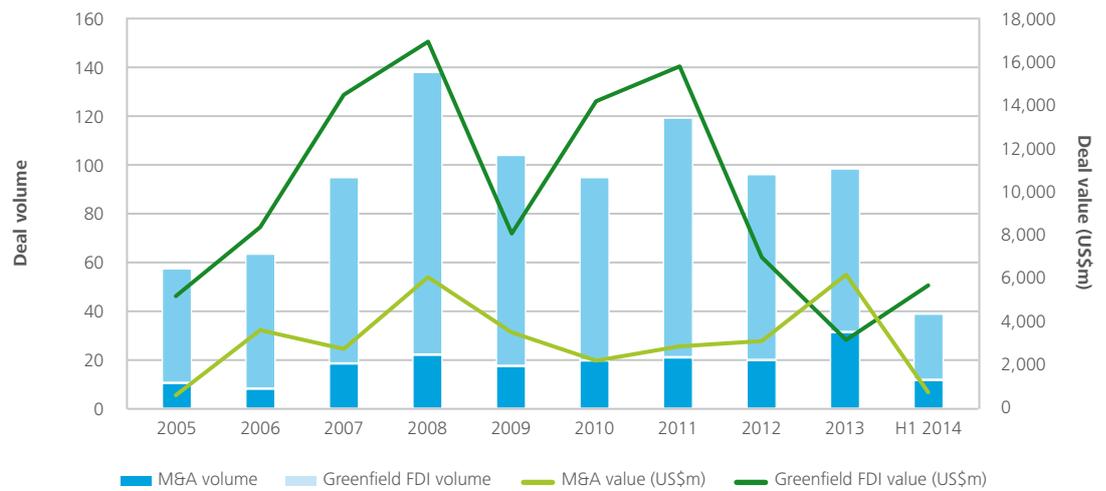
The target sectors in Southeast Asia are diversified but Chinese firms would likely invest in the Manufacturing, Consumer Business, Technology, Media & Telecommunications, Energy & Resources and Financial Services sectors. It is expected that more financial institutions would enter the market, seeking expansion by means of setting up a branch or a representative office in Southeast Asia. For instance, Taiwanese banks are actively expanding security houses from Singapore to other Southeast Asia countries. Indonesia has a big potential to attract more investors due to its sizable population, growing middle class and government stimulus projects.

When asked about what the limiting factors for Chinese investors are in the region of Southeast Asia, Ernest talked about the ability of Chinese firms to adapt to local markets and China's domestic regulatory environment. Compared with other buyers from Asia, Chinese firms are generally new to M&A activities, both in target-identification and transaction execution.

Ernest commented that in the past 12 months Chinese bidders had difficulties in finding the right targets in Southeast Asia due to their lack of understanding on local markets or a clear M&A objective.

Ernest made four concluding points: First, Chinese bidders should have a solid M&A strategy and be clear about objectives in the decision making process. Second, during the sourcing of the right target, engage an experienced consultant or a strategic partner, who understands the local market. Third, in the deal execution stage, establish a regular and direct communication channel between your headquarters and financial advisors. Fourth, in the post M&A stage: consider local accounting standards, tax and labor regulations.

Chart 18: Greater China outbound investments to South East Asia (2005 – H1 2014)



Note: H1 2014 stands for the period from January to May 2014



Africa

Mark Casey, Director, Deloitte & Touche, is Chinese Services Group leader in Southern Africa.

China's exports to Africa have nearly doubled since 2008 and are estimated to have increased to over US\$80 billion in 2014¹¹⁰. Since 2010, China has proposed to invest about US\$100 billion into commercial projects in Africa. Together, the Consumer Business and Energy & Resources sectors total approximately US\$90 billion, or about 90 percent of Chinese commercial activity in Africa since 2010. In particular these sectors include construction of transport infrastructure such as ports and railways; construction of refineries and gas-fired power plants; copper mining and exploration of oil & gas.

According to Deloitte's "African Construction Trends Report 2013", China's construction companies built 12 percent of all projects on the African continent in 2013, while European and American companies built 37 percent. There were 322 different selected construction projects in Africa in 2013 worth US\$222 billion with the majority of projects in South and East Africa. 36 percent of all funding on the continent comes from development finance institutions (DFIs). The Energy & Resources sector was contributing 36 percent of all projects followed by 25 percent in Consumer Business – transport infrastructure. The predominant owners of the projects were 56 percent local government, 17 percent European and American companies and 4 percent public private partnerships (PPP). About 1 percent was held by Chinese owners.

China's construction companies built 12 percent of all projects on the African continent in 2013

Africa's southern region is blessed with exuberant infrastructure development¹¹¹ through which it aims to maintain its economic leadership on the continent. Furthermore, with developmental hubs such as Mozambique and Angola falling under the Southern Africa Development Community¹¹², the region has been working to reinforce its position as a first choice-gateway into Africa.

The Industrial & Commercial Bank of China (ICBC), the world's largest bank, acquired a 20 percent stake in Standard Bank Group (SBG), a South African listed bank, for US\$5.4 billion in 2007¹¹³. This has been one of China's biggest outbound investments to date.

Chinese investments in Africa's Financial Services sector go hand in hand with increasing trade volumes between Africa and China. Mark commented on the RMB currency's internationalization, which would likely have a positive influence on Chinese outbound investments in the next 3 years. The RMB's role in trade finance is expected to grow since it is now ranked as the eighth-most used money for payments in the world¹¹⁴. RMB trade settlements have expanded quickly since it first began in 2009 and the percentage of China's total trade settled in RMB has risen from 12 percent in 2012 to nearly 20 percent at the end of 2013¹¹⁵.

However, even though RMB usage for payments around the world has seen a surge, in absolute terms it still lags behind the U.S. dollar and the Euro, which accounted for 39 percent and 33 percent of global payment transactions until December 2013, compared to just 1.1 percent for the RMB, according to the Society for Worldwide Interbank Financial Telecommunication (SWIFT).

Besides Financial Services, there has been some level of investments in the mining sector in Africa's southern region. For instance, the Chinese company Jinchuan acquired a copper company Metorex for US\$1.3 billion in 2011¹¹⁶ and a consortium of Chinese investors BCX led by Baiyin Non-Ferrous Group are the anchor shareholders with a long-term investment horizon in Gold One International, acquired by Sibanye Gold, the South African gold miner, in 2013¹¹⁷. Nevertheless, China's presence in Southern Africa has yet to come to its full potential in the same way as it has in other parts of Africa.

Chinese firms have been focusing on East and Central Africa, a potential hydropower hub on the continent. The Democratic Republic of Congo (DRC) in particular holds potential due to its strength in the commodities, agriculture, hydropower and water sectors. China is the second largest funder in the region, preceded by DFIs. China funded 17 percent and built 12 percent of all selected construction projects in East and Central Africa.

East Africa is fast becoming a leading African region and a strategic hub of continental growth. East Africa woos investors, construction firms and multi-national corporations. As an aggressive development gains momentum, investors rely on local governments to develop basic infrastructure such as rail, roads, healthcare facilities, housing, real estate and retail space. China is the second largest funder after DFIs and Chinese firms are building 19 percent of all projects currently underway, according to Deloitte's "African Construction Trends Report 2013". The region has some discernible development highlights; Kenya is characterized by a significant roadwork program financed by the African Development Bank. A portion of infrastructure development is designed to connect Kenya to its neighboring countries.

To foster closer economic relationships with Africa, Chinese investors (including the Chinese government) are eager to invest in Africa's infrastructure projects which would not only promote goodwill but also benefit China in reaching and securing natural resources required

East African nations are boosting state spending, seeking private investment and borrowing on international markets to build transportation links that will reduce the cost of trade. To foster closer economic relationships with Africa, Chinese investors (including the Chinese government) are eager to invest in Africa's infrastructure projects which would not only promote goodwill but also benefit China in reaching and securing natural resources required. In May 2014, China agreed to help fund the construction of a railway line linking the Kenyan port city of Mombasa to Uganda, Rwanda, Burundi and South Sudan¹¹⁸. The Export-Import Bank of China has allegedly agreed to provide 90 percent of the projected US\$3.8 billion cost and Kenya plans to finance the remainder. The first part of the line will be a 609-kilometre railway joining Mombasa with the Kenyan capital, Nairobi. China Communications Construction Company was selected to be the lead contractor of the project. In addition, Uganda has invited Chinese companies to compete for as much as US\$8 billion worth of contracts to expand the country's railway network and help improve trade routes with its neighboring countries¹¹⁹.

China has also been a leading contender in lobbying for Kenya's flagship US\$20 billion-project, the Lamu Port South Sudan-Ethiopia Transport Corridor (LAPSSET). The LAPSSET project was first initiated in 2012 by the presidents of Kenya, Ethiopia and South Sudan. China Communications Construction Company won a tender to construct the first three berths at the port¹²⁰.

Between January 2005 and May 2014, there were 216 Chinese greenfield investments in Africa worth a total value of US\$35.4 billion, with 55 percent in Energy & Resources

According to *fDi Markets*, between January 2005 and May 2014, there were 216 Chinese greenfield investments recorded in Africa worth a total value of US\$35.4 billion (see Chart 20), with 55 percent in Energy & Resources. The first quarter of 2014 was strong in terms of deal volume and value with 10 Chinese greenfield projects worth US\$1.5 billion.

According to the Zimbabwean Finance Minister, China Power Investment Corporation was interested in acquiring Rio Tinto Plc coal mine in Zimbabwe and building a US\$2.2 billion-thermal generator. This generator would produce about 1,200 megawatts of power in its first phase of construction and double the power-starved country's capacity¹²¹.

It is expected that the solar plants with a potential output of 2 gigawatts will be constructed in 2014 in Zimbabwe. China-based Zhenfa New Energy Science & Technology, a photovoltaic power specialist, announced that it would establish a US\$250 million-solar power plant in Zimbabwe which would produce 100 megawatts¹²².

China's economic growth has been slowing and Chinese enterprises tend to diversify risk and consequently seek growth overseas. There will likely be more Chinese POEs investing in Africa during 2014 and beyond.

In April 2014, Higer Bus, a subsidiary of China-based Xiamen King Long Motor Group, entered a partnership with Globe Motors Holdings Nigeria, to build – interestingly – a vehicle assembly plant in Lagos, Nigeria. This follows in the footsteps of their first manufacturing project completed in Zambia in 2011. The US\$120 million facility would be built on a 12 hectare site, with the capacity to produce 22,000 buses annually¹²³. The manufacturing plant is expected to be completed by the end of 2015 and would serve the domestic market.

According to *Mergermarket*, there were 36 Chinese M&A deals in Africa between January 2005 and May 2014 with a total value of US\$30.9 billion (see Chart 19). 75 percent of these M&A projects were in Energy & Resources – especially in the mining of metal ore and in oil and gas extraction, followed by the Consumer Business and Financial Services sectors.

There were 36 Chinese M&A deals in Africa between January 2005 and May 2014 with a total value of US\$30.9 billion

China made strategically important acquisitions in the upstream and downstream oil and gas sectors. In March 2013, China National Petroleum Corporation (CNPC), an oil producer and supplier, agreed to acquire a 28.57 percent stake in Eni East Africa, the Mozambique-based oil and gas exploration company, for US\$4.2 billion¹²⁴. As part of the transaction, Eni and CNPC signed a joint study agreement for the development of a Rongchang shale gas block.

After the strong first three quarters of 2013 with a total deal value of about US\$6 billion, the value of Chinese M&A dropped in the last quarter of 2013 and the first quarter of 2014. Chinese M&A activities in Africa during the first half of 2014 were focused mainly on mining.

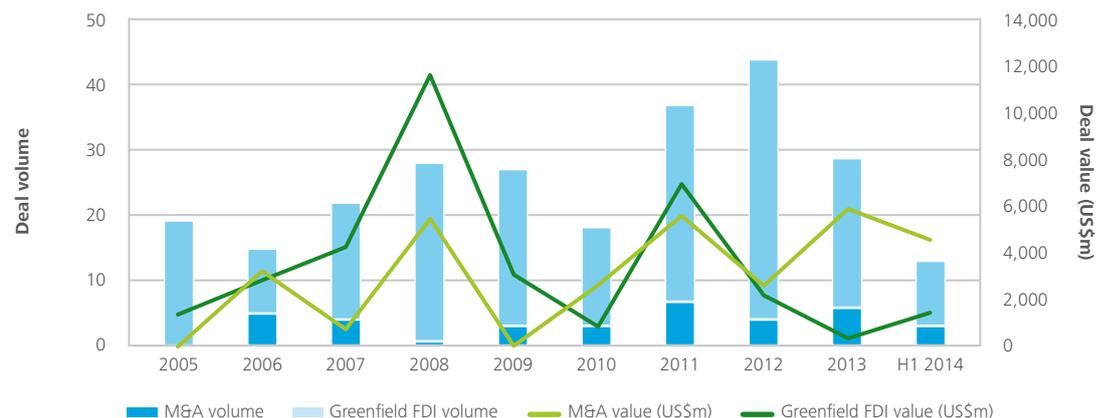
In January 2014, China Uranium Corporation, the China-based holding company having interests in uranium mining operations and a subsidiary of China National Nuclear Corporation (CNNC), agreed to acquire a 25 percent stake in the Langer Heinrich uranium mining operations – a Namibia-based uranium mine for US\$190 million¹²⁵.

Soremi Investments, the Congo-based company that offers mining services for a polymetallic (copper, zinc and lead) deposits, operates as a subsidiary of China National Gold Group Corporation, the China-based company engaged in geological prospecting and mine exploitation, as of December 2013¹²⁶.

Where is the potential upside for investments?

Mark anticipates Energy & Resources, Financial Services, Real Estate and Public Sector would likely attract more Chinese investors in Africa in 2014 and beyond.

Chart 19: Greater China outbound investments to Africa (2005 – H1 2014)



Note: H1 2014 stands for the period from January to May 2014



Latin America & Brazil

Jose Othon Almeida, Partner, Deloitte Touche Tohmatsu, is the Chinese Services Group leader in Brazil.

Despite much needed structural reforms, which would be needed to promote Brazil's economic growth, its large and growing domestic market, diversified economy and fairly stable political environment have made it an attractive destination for Chinese investors. In particular, the investors are looking at the Latin American¹²⁷ market for automotive manufacturing and to explore ambitious concession programs offered by the local government to upgrade infrastructure. Concessions have already been successfully held for the construction of new airports and road expansions; however, Chinese contractors are more interested in and awaiting opportunities to build ports and railways. Tax incentives for foreign and domestic investors favor those that consider Brazil as an export base and China has been both the biggest trading partner and supplier for Brazil with 17 percent shares¹²⁸ in both imports and exports, followed by the United States. Despite gradual monetary tightening in the developed markets and a slowdown in China, global demand for Brazil's commodities may spur Brazil's economic growth in the future, from which China would like to benefit.

Total Chinese greenfield FDI stock in Brazil between January 2005 and May 2014 reached US\$14.8 billion (see Chart 20), which is 19 percent of total Chinese greenfield FDI stock in the whole Latin America in the same period (US\$76.5 billion).

Total Chinese greenfield FDI stock in Brazil between January 2005 and May 2014 reached US\$14.8 billion

Interestingly, the deal total value for Latin America includes one single US\$50 billion mega-project in Nicaragua. In June 2013, the Hong Kong Nicaragua Canal Development Investment Group (HKND Group) was awarded with a 50-year concession to build and manage the Inter-Oceanic Nicaragua Canal, a waterway through Nicaragua to connect the Caribbean Sea and Atlantic Ocean with the Pacific Ocean. It includes other potential projects such as the construction of ports, free trade zones, an international airport, etc.¹²⁹ The US\$50 billion-waterway would be a higher-capacity alternative to the Panama Canal that is currently being widened. Without this mega project in Nicaragua, Brazil's share of China's total greenfield FDI stock in Latin America would climb to 56 percent.

Between January 2005 and May 2014, almost 44 percent of all completed Chinese greenfield FDI projects in Brazil were in Manufacturing and in particular in the automotive and machinery production, followed by 17 percent in the Technology, Media & Telecommunications sector. In terms of deal value, 29 percent were in the automotive manufacturing sector with a total value reaching US\$4.3 billion, followed by 22 percent in the agricultural sector with a total value of US\$3.3 billion.

In August 2013, Foton Aumark do Brasil, which operates as a subsidiary of China's Beiqi Foton Motor, invested US\$108 million to build a manufacturing plant for heavy trucks in Guaíba, Brazil. The facility is expected to be ready in early 2016 and produce 21,000 trucks per year¹³⁰. The same company also signed an agreement with the United States-based engine manufacturer Cummins, to jointly explore the Brazilian market and have planned to build two plants in the country. The new plants will produce trucks and pickups for the entire South American market¹³¹.

Although the manufacturing sector represented 13 percent of Brazil's GDP in 2013, according to a leading Brazilian manufacturer, the sector was expected to suffer from high taxes, poor infrastructure and high labor costs in 2014.

After a strong second quarter in 2013, the inflow of Chinese greenfield FDI projects to Brazil decreased both in volume and values.

Between January 2005 and May 2014, there were 18 Chinese M&A deals in Brazil reaching a total value of US\$18.7 billion (see Chart 20), which was almost half of the total value of Chinese M&A deals in all of Latin America¹³². The majority of these deals were in Energy & Resources and Financial Services (US\$15.9 billion with 86 percent share on total M&A value and US\$2.5 billion with a 14 percent share, respectively).

In the fourth quarter of 2013 and the second quarter of 2014, the number of Chinese M&A deals in Latin America started to take off again, with values reaching new heights after a stagnant period of two years.

After the most valuable acquisition to date, when China Petroleum & Chemical Corporation (Sinopec) purchased a 40 percent stake in Repsol Brasil (worth US\$7.1 billion) in 2010¹³³, new

China made significant acquisitions in Brazil in 2010 and in Peru in 2014 in copper, oil and gas deals

mega deals started to emerge and a few were concluded in the second quarter of 2014. In April 2014, the joint venture between Hong Kong-based holding company MMG and CITIC Metal Company acquired a 99.99 percent stake in Xstrata Las Bambas S.A., a Peru-based copper mining company, from Glencore Queensland for US\$5.8 billion¹³⁴. The acquisition was funded through a combination of equity and long term debt provided by a banking syndicate led by China Development Bank. In line with MMG's growth strategy and long term view of the copper industry, the acquisition brought them closer to their goal at establishing a dominant copper production platform in South America. The transaction proceeds are expected to be used to deleverage Glencore's balance sheet in order to reinvest free capital.

In November 2013, PetroChina Company Limited, a subsidiary of China National Petroleum Corporation, agreed to acquire Petrobras Energia Peru S.A., a company engaged in the exploration and production of crude oil and natural gas, from Petrobras International Braspetro B.V. and Petrobras De Valores Internacional De Espana S.L. for US\$2.6 billion. The transaction would give PetroChina the access to a mature field that has been in operation since 1912 and is also in line with Petrobras' divestment program outlined in its 2013-2017 Business and Management Plan^{135,136}.

Chinese banks have also started to enter into Brazil's commercial banking sector. In October 2013, the China Construction Bank Corporation agreed to acquire a 72 percent stake interest, worth US\$700 million, in Banco Industrial e Comercial¹³⁷. The offering price represented a premium of 20.9 percent to the share price on 30 October 2013, one day prior to the announcement. Banco Industrial e Comercial is a listed Brazil-based commercial bank headquartered in Sao Paulo, engaged in the provision of corporate credit to medium-sized and large corporations.

Where is the potential upside in Brazil?

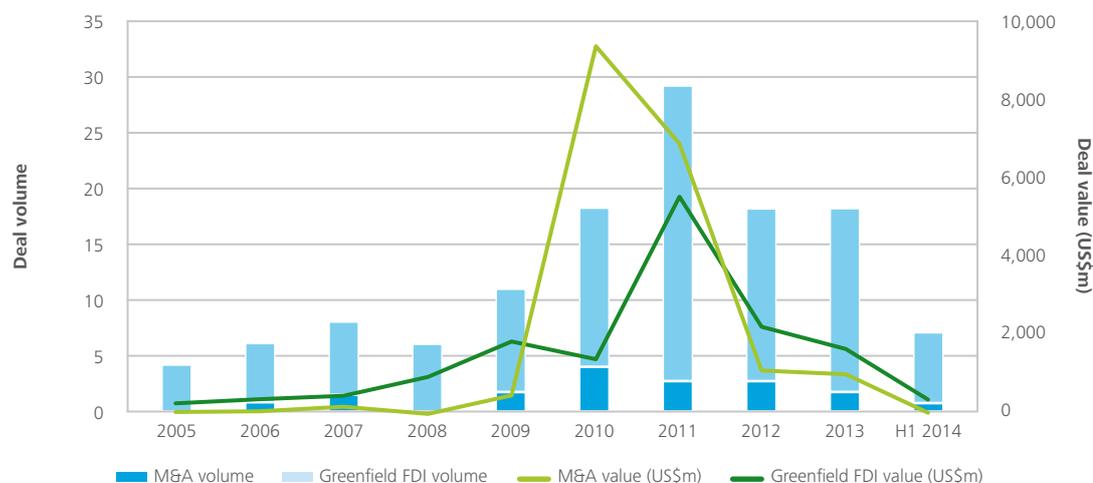
Jose speculates that besides infrastructure development, the Brazilian Manufacturing, Technology, Media & Telecommunications and Energy & Resources industries will offer investment opportunities over the next 3 years. Brazil is Latin America's biggest consumer market; however, there is an exorbitant 'custo Brasil' cost of doing business in the country - largely due to state and federal taxes on imports. To increase business activities, the Brazilian government has introduced new tax incentives for companies ready to assemble products in the country. Despite growing

opportunities, the ability of Chinese firms to adapt to the local market and management style may have an impact on the inflow of Chinese investors.

Chinese companies tend to apply their local Chinese methods of doing business in their overseas projects, which may often bring additional costs and delays. The biggest overseas markets have more structured regulatory systems compared with that in the Chinese markets, yet Chinese executives sometimes underestimate this. Specifically, in the Brazilian market Chinese executives have to understand and comply with the complexity of Brazil's tax environment, labor protection, social system and bureaucracy.

Jose suggests that Chinese companies consult with advisors before making any decision, as it is critical to the success of their investments to understand Brazil's business environment. Unlike the Chinese government, the Brazilian government would not provide support to the firm throughout the course of the investment process. "Do not only look for the lowest price on services or products, this may cost you more in the long run. In Brazil, Chinese bidders should be looking for the right services and products to fit into their business plans for the short-, medium- and long-term objectives. This way you can avoid or at least minimize the risks and additional cost."

Chart 20: Greater China outbound investments to Brazil (2005 – H1 2014)



Note: H1 2014 stands for the period from January to May 2014



Central Europe

Gabor Gion, Partner, Deloitte Co. Ltd., is the Chinese Services Group leader in Central Europe.

It is expected that the region of Central Europe¹³⁸ will remain an attractive destination for Chinese greenfield FDI in 2014. The annual inflow of greenfield FDI from Greater China into Central Europe reached around US\$1.4 billion during 2013. Poland, the Czech Republic and Hungary together attracted the vast majority of Central Europe's total greenfield FDI between January 2005 and May 2014, leveraging on their tax and business incentives. Apart from traditional investors from developed countries such as the United States and the United Kingdom, Chinese companies have been increasingly active in providing greenfield FDI to Central Europe. The share of Chinese greenfield FDI on total capital inflow to Central Europe has grown from below 1 percent in 2005 to over 3 percent in 2013¹³⁹.

The countries of Central Europe are highly dependent on the incipient economic recovery of the Eurozone, which represented more than 50 percent of Central Europe's total exports in 2013¹⁴⁰. Although exports and domestic consumption in Central Europe were rising in the first half of 2014, the region has remained highly dependent on external funding conditions and inflow of foreign capital. There is a large share of greenfield FDI in total external funding for Central Europe that provides a degree of stability, but a high reliance on foreign funding may expose borrowing countries to external shock¹⁴¹. Despite market risk, Central Europe may represent a strategic and highly attractive location with an increasing consumer base¹⁴².

Poland has the largest market in Central Europe. A leading Chinese firm operating in Poland commented that while labor costs were slightly higher in Poland than China, lower exchange rates and transportation costs would offset the difference.

For instance, in May 2014 China's Haining Meikan Knitting Company, a fast growing socks manufacturer, commented that it approached a Polish partner to act as the local manufacturing base for production and distribution in return for Chinese know-how, operating capital and access to the Chinese market. "Having a local manufacturing base in Central Europe would help us expand our production base and use the target's sales channels for product distribution. The label "Made in Europe" would increase the prestige. Some European companies could be struggling in the current volatile economic climate and could welcome our investment. The size of the stake for an acquisition or a joint-venture would depend on negotiations," the company speculated¹⁴³.

Total stock of Chinese greenfield FDI in Central Europe accumulated to US\$11.4 billion from January 2005 to May 2014

Between January 2005 and May 2014, the Technology, Media & Telecommunications, Consumer Business and Manufacturing sectors attracted collectively the majority of Chinese greenfield FDI projects in Central Europe, especially in the automotive industry. Manufacturing projects were the most valuable with a 36 percent share of the total value, in particular automotive original equipment manufacturing (OEM) and consumer electronics with a total value of US\$4.1 billion. Chinese firms also spent US\$2.4 billion in the Energy & Resources sector, namely in renewable energy such as photovoltaic installations. Total stock of Chinese greenfield FDI in Central Europe accumulated to US\$11.4 billion in the same period (see Chart 21).

The number of Chinese greenfield deals has remained at the same level in the first five months of 2013 and 2014, however the investment value grew by significant investments in renewable energy. As a result, China ranked second, after Germany, in terms of investment value brought to Central Europe in the same period. The value of Chinese greenfield FDI reached US\$1.7 billion in the first five months of 2014.

The value of Chinese greenfield FDI deals in Central Europe reached US\$1.7 billion in the first five months of 2014

Romania and Bosnia-Herzegovina have attracted the most valuable greenfield deals from China in the first half of 2014 due to an earlier boom in renewable energy, initiated by generous feed-in tariff programs and concessions provided by local governments. China's Hareon Solar Technology, for instance, announced its investment in Bosnia-Herzegovina. A planned 450-megawatt facility would be developed as part of a joint venture agreement with Switzerland-based Prinz Karl

Thurn und Taxis Management for US\$635 million. The site has 1,000 hectares. The concession was awarded in early 2014 by local Bosnia-Herzegovina government¹⁴⁴.

In Romania, Unisun, a subsidiary of China-based Wuxi Guolian Development Group, opened two new photovoltaic power plants worth US\$276 million to meet the daily projected power needs of more than 10,000 local households¹⁴⁵. Also, Zhejiang Sunflower Light Energy Science & Technology (Sunowe) invested US\$55 million in Romania to establish a 25 megawatt solar park¹⁴⁶.

Due to relatively underdeveloped infrastructure in some parts of the Central European region, Chinese firms came into the Central Europe market on a bid to build power plants, electricity transmission lines and transport infrastructure.

In the first half of 2014, Pinggao Group Company, a subsidiary of China's largest grid developer State Grid Corporation of China (SGCC), won three infrastructure tenders owned by a Polish transmission system operator Polskie Sieci Elektroenergetyczne (PSE) S.A. These transactions made SGCC the most successful Chinese bidder in Central Europe in the same period. In these three projects, SGCC would undertake a combined US\$176 million reconstruction and expansion of a 400/220/110 kV substations, lines, transformers and switchgears in several locations in Poland¹⁴⁷.

Due to relatively underdeveloped infrastructure in some parts of the Central European region, Chinese firms came into the Central Europe market on a bid to build power plants, electricity transmission lines and transport infrastructure

According to Premier Li Keqiang, who attended a trade summit with leaders from Central European countries in Romania in November 2013, the goal was to double the annual value of China's trade with Central Europe by 2015. In 2013, it stood at US\$45.5 billion¹⁴⁸. Also during the Chinese President Xi Jinping's trip to Europe in March 2014, Xi proposed to boost an investment and trade cooperation with Central Europe by building infrastructure and transport logistics¹⁴⁹.

Gabor commented: "A very interesting project has recently been negotiated. A 160 km/h railway line is planned to be built between Budapest and Belgrade by a Chinese contractor. The expected value is about US\$4 billion and it would involve an EU member state (Hungary), a non-EU member state (Serbia), and China."

Central Europe also includes countries on the Balkan Peninsula¹⁵⁰, where Chinese firms have recently been investing the most within Central Europe. China provided a US\$10 billion low-interest credit line for Central Europe countries to fund infrastructure projects and industrial enterprises to facilitate both land and sea transport. As a result, it may create a combined sea and rail transport loop from China through a Greek port of Piraeus^{151,152}. The project, if completed, would eventually shorten sailing time for Chinese cargo ships travelling through the Suez Canal to northern European ports.

The Export-Import Bank of China¹⁵³ has already been involved in projects in Montenegro and Serbia such as road and bridge constructions and in renewable energy projects¹⁵⁴.

Transport Minister of Montenegro and China Road and Bridge Corporation (CRBC) signed an agreement in February 2014 for the design, construction, procurement and installation of equipment and materials for the construction of Bar-Boljare highway, a 44-km section. The offered price for construction was US\$1.1 billion. The Government of Montenegro selected the Chinese companies CCCC and the CRBC as qualified bidders¹⁵⁵. CRBC is also a main contractor for the US\$260 million bridge "Zemun - Borca" on the Danube river, in Serbia¹⁵⁶.

On another note, Balkan Peninsula draws attention due to the projected infrastructure development connected to proposed gas supplies from Russia to Italy. A US\$20 billion pipeline project may connect Russia with the Central Europe region and in a capacity of 63 billion cubic meters of gas a year - about an eighth of the EU's demand - through the Black Sea, Bulgaria, Serbia, Hungary and Slovenia into Italy¹⁵⁷.

The total value of Chinese acquisitions in Central Europe reached US\$1.9 billion between January 2005 and May 2014

The total value of Chinese acquisitions in Central Europe reached US\$1.9 billion between January 2005 and May 2014 (see Chart 21). Chinese bidders focused on the Manufacturing sector in the same period. Aside from one significant acquisition in 2011, the M&A market in Central Europe was unexplored by Chinese firms in the first half of 2014.



The Chinese acquisition of Hungarian petrochemical company BorsodChem by Wanhua Group in 2011 worth US\$2 billion was the largest investment into Central Europe to date¹⁵⁸. Wanhua Industrial Group, the Chinese polyurethane producer, acquired a 58 percent stake in BorsodChem Zrt, the Hungary-based chemical group involved in the production and processing of plastic raw materials and isocyanate, through a call option from Permira, the United Kingdom-based private equity firm and VCP Vienna, the Austria-based private equity firm¹⁵⁹.

In August 2013, Xiangyang Automobile Bearing Company, the China-listed manufacturer of the automotive bearings and spare parts, completed the acquisition of an 89.15 percent stake in Fabryka Lozysk Tocznych Krasnik SA from Agencja Rozwoju Przemyslu SA, a Polish agency for industrial development, worth US\$31.9 million¹⁶⁰.

Central European companies have historically had know-how to produce bulky transport equipment and heavy machinery used in mining industries and public transportation and these firms may be on the target list for Chinese SOEs in 2014

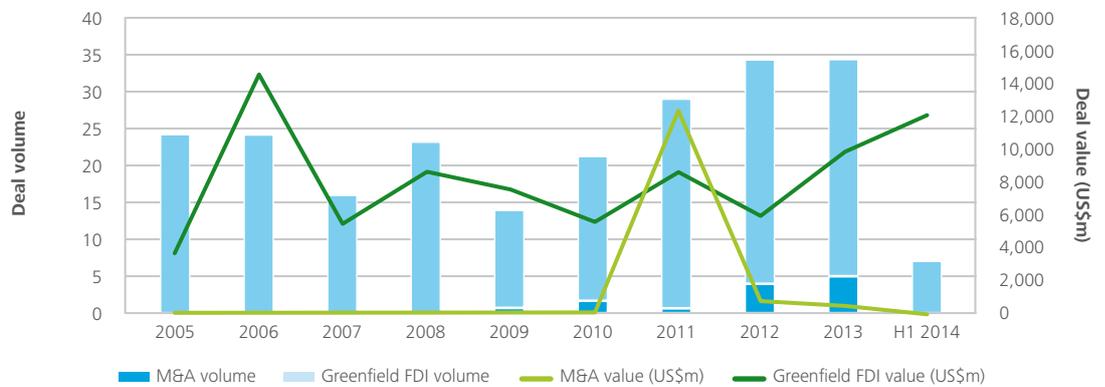
When asked about a potential upside for investments in Central Europe, Gabor elaborated that the Consumer Business, Technology, Media & Telecommunications, Life Sciences & Health Care and Real Estate sectors are expected to attract some Chinese investors in the next three years. "For instance, Chinese firms may target minority stakes in distributors of consumer electronics with established e-commerce platforms, warehousing and sales in the Central Europe market. There are also sophisticated companies in the Life Sciences & Health Care sector in Central Europe, particularly in diagnostics, with an established operation network in the EU market", Gabor further commented.

Deloitte has recently been approached by a major SOE providing systems for transport infrastructure such as high speed railways in China. This SOE wanted to expand its product portfolio for

production of transport equipment, which it did not have, such as rolling stock, by an acquisition in Central Europe. "The Central Europe's companies have historically had know-how to produce bulky transport equipment and heavy machinery used in mining industries and public transportation, and these firms may be on the target list for Chinese SOEs in 2014", Gabor concluded.

According to one Chinese investor with an office in Poland, Chinese investors have been gradually incorporating local advisors into the acquisition process in order to minimize potential transaction risks in the private sector. In the past few years, a typical information channel for Chinese bidders to learn about the Central Europe market was the Chinese embassy, or a Chinese bank. With an increasing number of available targets for acquisitions in Central Europe in 2014 and beyond, the role of local advisors is expected to grow.

Chart 21: Greater China outbound investments to Central Europe (2005 – H1 2014)



Note: H1 2014 stands for the period from January to May 2014



The Middle East

James Babb, Partner, Deloitte & Touche Middle East, is the Chinese Services Group leader in the Middle East.

Between January 2005 and May 2014, Chinese investors spent a total of US\$24.5 billion on greenfield FDI in the Middle East¹⁶¹. Saudi Arabia attracted the most projects (US\$10.2 billion), followed by Iran and the United Arab Emirates (UAE). Although Chinese firms invested frequently in the Consumer Business sector, the most valuable greenfield FDI projects were concluded in Energy & Resources in Iran and Saudi Arabia, making up 82 percent of the total deal value.

In 2009, China National Oil & Gas Exploration & Development (CNODC), a subsidiary of CNPC, signed a US\$1.7 billion deal with the National Iranian Oil Company (NIOC) to develop the North Azadegan oilfield, which is one of the world's biggest deposits of crude oil, according to NIOC¹⁶².

In October 2007, Aluminium Corporation of China (Chinalco), the world's second-largest aluminium producer, invested US\$1.2 billion in Saudi Arabia in an aluminum smelter¹⁶³. Then, in March 2011, the China-based petroleum company Sinopec Corporation entered into a joint venture agreement with Saudi Arabia-based Saudi Aramco to build a full-conversion refinery. The refinery will use 400,000 barrels per day of Arabian heavy crude oil and produce ultra-clean transportation fuels in Yanbu' al Bahr, Saudi Arabia for international and domestic markets¹⁶⁴. This joint venture with Saudi Aramco was Sinopec's first international downstream investment.

After the multibillion dollar deal spikes in 2007 and 2011, the volume and value of Chinese greenfield FDI in the Middle East have been decreasing (see Chart 22); only 10 projects were

completed in 2013 with a meagre total value of US\$454 million, mostly in the Consumer Business, Energy & Resources and Technology, Media & Telecommunications sectors, mainly construction and sales support in UAE (Dubai), Kuwait and Saudi Arabia.

After the multibillion dollar deal spikes in 2007 and 2011, the volume and value of Chinese greenfield FDI in the Middle East have been decreasing

The second half of 2014 is showing more promise, a Hong Kong-based company called Compass Offices, a serviced office building provider, is expected to open a new business center, the Oberoi Centre, in the iconic Burj area of Dubai, UAE, in July 2014¹⁶⁵. China-based GeoHarbour, a building solutions firm engaged in green solutions for the construction sector, has established GeoHarbour Middle East Construction in Dubai. The opening would enable the firm to offer its solutions and green technologies in soft ground improvement and piling foundation works to infrastructure developers across the Middle East¹⁶⁶. Aside from the Real Estate sector, Huawei Technologies, China's global telecommunications equipment provider, announced that it would establish a new joint innovation center in Kuwait to customize its customer experience management solutions in the Middle Eastern market¹⁶⁷.

There were only a small number of Chinese acquisitions in the Middle East between January 2005 and May 2014, however the total value was lifted to US\$7.7 billion by a few mega deals¹⁶⁸ (see Chart 22). After the US\$2.4 billion acquisition of an Israel-listed producer of agricultural chemicals Makhteshim Agan by China National Chemical Corporation (ChemChina)¹⁶⁹, the value of Chinese M&A deals in the Middle East had been rising during 2013 and in the second quarter of 2014.

Almost half of all Chinese M&A deals in the Middle East were in Israel and had a total value of US\$5.7 billion

Almost half of all Chinese M&A deals in the Middle East were in Israel and had a total value of US\$5.7 billion, mainly in the Manufacturing and Energy & Resources sectors; in particular, investments in oil and gas exploration in UAE, Syria and Iraq.

Bright Food Group, the China SOE engaged in the food and real estate industry, made no secret of its plan to acquire overseas food brands. In May 2014, they agreed to acquire a 56 percent stake in Tnuva Food Industries Ltd., Israel's biggest food producer and distributor of dairy and frozen food products, from Apax Partners LLP, the United Kingdom-based private equity firm, for US\$2.4 billion in cash¹⁷⁰. The deal rationale was based on Bright Food's plan to expand its dairy foods business in the Chinese market¹⁷¹ by accessing Tnuva's technological know-how in the dairy production business.

Besides food, Chinese firms are also interested in gaining access to Israeli Financial Services and Life Sciences & Health Care. In August 2013, JT Capital Management, a China-based consortium of investors, agreed to acquire a 32 percent stake in Clal Insurance Enterprise Holdings, the Israel-listed insurance provider, from IDB Holding Corporation, the Israel-listed investment holding company for US\$410 million¹⁷². In April 2013, Sisram Medical, the Israel-based acquisition vehicle formed by Shanghai Fosun Pharmaceutical Group, Chindex Medical Limited and Pramerica-Fosun China Opportunity Fund., L.P., had agreed to acquire up to 95.6 percent stake in Alma Lasers, the Israel-based developer of laser, light and radio frequency-based medical devices, from a consortium of vendors including TA Associate Management, L.P. for US\$240 million¹⁷³. The acquisition will presumably enable the Chinese conglomerate Fosun to enter the medical equipment manufacturing business and further enhance their international competitiveness. Alma Laser would be able to increase its footprint in the Asian market and globally with Fosun's international experience. Furthermore, the Chinese consortium may eventually monetize the acquisition in an IPO¹⁷⁴.

Are the Chinese firms able to adapt to local markets and management in the Middle East?

James commented that the common hurdles faced by Chinese outbound investments include cultural and human resources factors, especially the inability of Chinese firms to adapt to local market conditions, potentially creating long-term harm and loss of value to the firm. Moreover, human resources due diligence is equally important and some of the key priorities must include assessing cultural difference, talent retention, compensation and benefits.

Technology and intellectual property (IP) transfers are considered as important factors while identifying potential targets. The legal issues involved in the transfer and licensing of IP in foreign countries is a pain point for Chinese investors. Hence, it is essential that Chinese investors must have know-how about the ownership of IP assets and the terms and conditions pertaining to enforcement and transferability.

Post-merger regulatory compliance and cultural integration are also key determinants of a successful cross-border transaction.

Where did Chinese bidders face difficulties during the past 12-month period in the Middle East?

The business environment in the Middle East is relatively favorable, however, the foreign investment approval regime, labor issues of the targeted country, lack of knowledge on local laws, and cultural differences all pose challenges for Chinese bidders. This is particularly seen in the construction sector. Construction contractors in the Middle East must understand how to put together a competitive bid. The key challenge that Chinese bidders seem to encounter is the lack of technical know-how on tendering/contracting procedures because they often fail to put together a competitive bid. It is essential for a foreign investor to understand the contracting/tendering legalities involved in order to prepare a competitive bid.

Construction contractors in the Middle East must understand how to put together a competitive bid

The following overview of general tendering/contracting procedures may provide useful suggestions to a prospective Chinese bidder looking to invest in the Middle East.

In Saudi Arabia, it is advised that a comprehensive Request for Proposal (RFP) is prepared, highlighting the company's performance record and ensuring the specifications of the tender floating company are strictly adhered to. Language correctness in the RFP will also weight in when deciding on the winning bid, especially in projects across the hydrocarbon sector. It is also essential for bidders to do a complete background check on the company floating the tender to ensure credibility and safety of their investment.

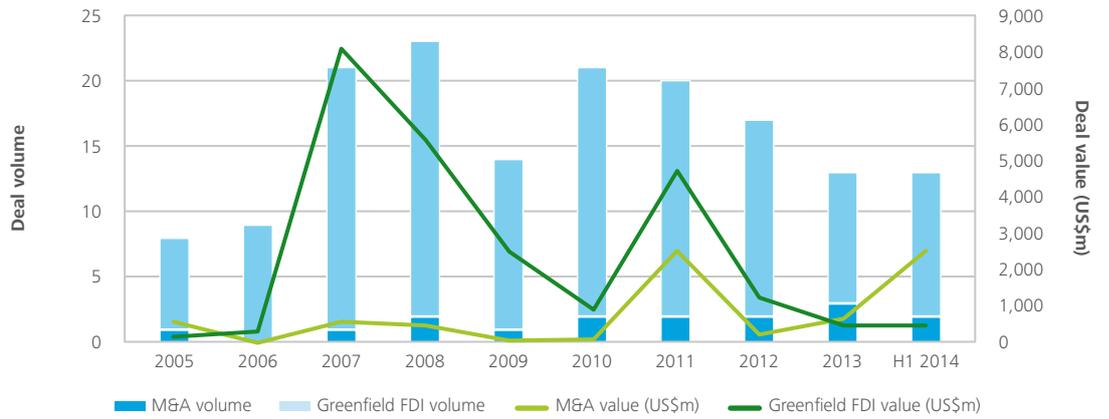
In the UAE, the tendering process involves a multistage procedure that begins with inviting tenders prepared by the government body. The bidders are required to submit their complete profile including technical solutions, delivery timelines, compliance and acceptance of the proposed contract subject to final conditions based on the tender bond.

A strong local partner would reduce risks. Picking the right partner in the Middle East is of paramount importance, more so than in many other markets. In the Middle East, business culture revolves around personal relationships. Often companies do not appreciate this and directly go to business issues or long technical presentations whereas locals like to know more about the people behind the company.

Where is the potential upside for investments?

James sees potential in the Consumer Business, Energy & Resources and Real Estate sectors in the Middle East in 2014 and beyond.

Chart 22: Greater China outbound investments to the Middle East (2005 – H1 2014)



Note: H1 2014 stands for the period from January to May 2014





Germany

Dirk Haellmayr, Partner, Deloitte & Touche GmbH, is the Chinese Services Group leader in Germany.

The People's Republic of China President Xi Jinping visited Berlin in March 2014 to promote cooperation with Germany in the areas of industry, energy supplies and research. His visit pointed out a rising trend of Chinese acquisitions of German mid-sized technology companies¹⁷⁵.

Germany is China's largest European trading partner, importing Chinese goods valued at US\$106 billion in 2012¹⁷⁶. Chinese admiration for the German's attitudes and know-how seem to benefit both sides. Germany represents a highly attractive market for Chinese investors that have looked for technological best practices, advanced management experience and talent for China's domestic market and that pursuit has been the main motive for Chinese buyers coming to Germany.

Germany does not compete by overall volume of Chinese companies in the country with other major developed markets such as the United States and United Kingdom but it attracts Chinese investors in specialized deals that are more technology-driven

Germany does not compete by the overall volume of Chinese companies in the country with other major developed markets such as the United States and United Kingdom but Germany attracts Chinese investors in specialized deals that are more technology-driven, to look for technology upgrades, mostly in the sector of machinery building and automotive car parts. Between January 2005 and May 2014, about 54 percent of all Chinese greenfield FDI projects in Germany went into the Manufacturing sector, especially into industrial machinery and equipment, followed by electronic components, with about 31 percent of the total investment value in Consumer Business. The total value of Chinese greenfield FDI projects in Germany reached US\$3.5 billion between January 2005 and May 2014. In the first five months of 2014, the volume and value of Chinese greenfield FDI deals in Germany decreased when compared with that of 2013 (see Chart 23).

Between January 2005 and May 2014, 70 percent of all Chinese acquisitions in Germany were in the Manufacturing sector. The total acquisition value stood at US\$6.6 billion in the same period.

Compared with greenfield investments, Chinese acquisitions in Germany have become larger. There were a total of 18 announced Chinese M&A investments in Germany in 2013 valued at US\$1.1 billion and 9 transactions in 2014 to date (31 May 2014) with a value of US\$829 million. Both number of deals and value of Chinese M&A transactions in Germany in the first five months of 2014 already showed an increase compared with that of 2013 (see Chart 23).

Compared with greenfield investments, Chinese acquisitions in Germany have become larger in the past 12 months

Germany remains the most attractive market for Chinese M&A investments in Western Europe having attracted the majority of the deals (number of M&A transactions) compared with the United Kingdom, which had gained the largest value in the first half of 2014.

German automotive acquisitions

In the first half of 2014, Chinese firms spent more than US\$3.4 billion in acquisitions in the automotive industry in Western Europe, and Germany gained the largest share on the total number of acquisitions. Chinese firms were shopping for a range of technologies from safety systems to components improving fuel consumption and reducing emissions. As an example, AVIC Electromechanical Systems Company, the China-based transportation equipment maker, acquired Hilite International, the Germany-based company engaged in the development and manufacturing of automotive system solutions for car and truck original equipment manufacturers (OEMs) and first-tier suppliers in the powertrain area of the automotive industry, from 3i Group, the United Kingdom-based private equity and venture capital firm, for US\$644 million¹⁷⁷.

Goodbaby International Holdings, the listed China-based company engaged in the research and development, design, manufacturing of durable juvenile, acquired Columbus Holding (CHG), a German company engaged in the design and sale of car safety seats, baby carriers and strollers, for US\$96 million¹⁷⁸.

Anhui Zhongding Sealing Parts Company (Zhongding), the China-based listed manufacturer of automobile rubber components and other industrial used rubbers, acquired a 80 percent

stake interest in KACO GmbH + Co KG, the Germany-based company that has leading technologies to reduce emissions, from Fundo de Investimento em Participações Mênfis, the Brazil-based investment company, for US\$80 million¹⁷⁹. According to KACO's press release in April 2014, Zhongding would continue to trust in the current management team and structure. The additional financing from the Chinese partner, KACO, will go towards improving its position in the global market.

When asked about factors that would have a positive influence on Chinese deal flow, Dirk mentioned that Chinese enterprises tend to seek growth opportunities overseas due to slowing economic growth in China. Furthermore, a relaxation of regulations for capital transfers out of China and an increasing role of private-owned enterprises investing overseas may boost China's outbound investments.

Due to an increasing volume of mutual trade between Germany and China, Frankfurt would likely become a gateway for more large Chinese SOEs, which are eager to extend their presence in Germany. The city may become a major clearing hub for RMB-denominated trades.

Due to an increasing volume of mutual trade between Germany and China, Frankfurt may become a major clearing hub for RMB-denominated trades

ICBC and Bank of China have already established their new branches in Germany to complete its network in the country. For instance, Bank of China's Frankfurt branch increased equity by US\$160 million in a bid to become the first bank in the Euro area to clear payments in the Chinese currency. It is Frankfurt's goal to become a leading offshore RMB hub after the Bundesbank and the People's Bank of China agreed in March 2014 to cooperate in the clearing and settling of the Chinese currency in Frankfurt¹⁸⁰.

Chinese companies were still not able to fully adapt to the German market and management style. Dirk added that difficulties and challenges for Chinese bidders were a result of a lack of understanding of the overseas market, regulatory environment and the differences in the culture related to human resources. Yet, on a positive note, the issues are often resolved through retaining local management.

As an example, the 150-year-old German company Kiekert, the world's leading producer of latch systems for passenger cars, was acquired by Chinese automotive supplier Lingyun Industrial Group Corporation in March 2012. Some German managers may have naturally worried that the Chinese buyer would just look to take out the technical knowledge and lay workers off their jobs but on the contrary, the Chinese company kept German management, which was the key to their success¹⁸¹. The Chinese market, on the other hand, was extremely important for the Kiekert's expansion in Asia.

Dirk also commented that children of the founders of family-run German companies may have other interests than taking over the business. This recent trend would bode well for those Chinese companies which would succeed them.

German "Mittelstand"

German mid-sized family-run businesses, which are often global leaders in a niche-market, are the right targets Chinese companies would look at. Mittelstand is part of the industrial process, having know-how and industrial best practices. In cooperation with a Chinese company, the venture would create a "win-win" to get the German company to the Chinese market. Chinese investors are not looking at large companies but to this kind of family-run businesses with know-how and technology, experiences and of a smaller scale, with turnover between US\$100 million-500 million. Generally, technology acquired by acquisitions and expansions would be done by greenfield investment, according to Dirk.

As an example, one of the largest transactions so far was the acquisition of the German concrete-pump maker Putzmeister Holding, by China's Sany Heavy Industry in 2012. Shanghai-listed Sany Heavy Industry, a manufacturer of construction equipment, and Chinese conglomerate Citic Group's private-equity arm collectively paid US\$475 million¹⁸² for the German pump maker. The Chinese investor was wise enough to keep local employees and key engineers in the company.

When entering into an M&A transaction, it is essential for Chinese investors to have a good PR strategy and acknowledge the power of many targets' labour unions as influential stakeholders in German businesses. More Chinese companies learned their lesson to maintain a good public image. The Sany-Putzmeister deal worked very well, given by the positive public relations. German companies would welcome strategic investors, not only financial investors.



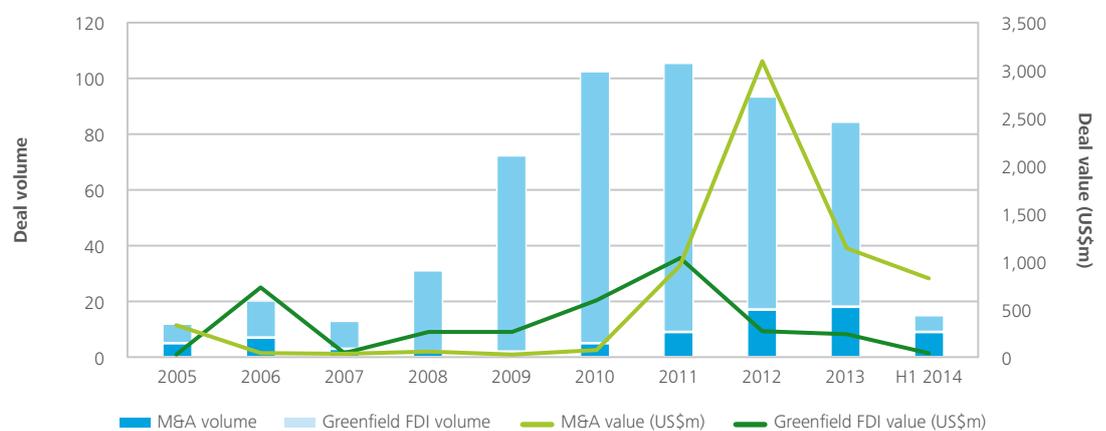
Another example, Chinese Weichai Power has joined KKR and Goldman Sachs Capital Partners as an anchor investor in Kion Group with a 25 percent stake via a US\$885 million shareholder loan of Kion Group converted into equity¹⁸³. The German management of Kion Group with its experience from business in the Chinese Mainland was able to communicate the transaction positively so that it was well accepted by the companies' stakeholders. German companies would invest into a good partnership that could last for decades.

Dirk recommends that any Chinese bidder should conduct diligent market research ahead of making the investment decision, to prepare a detailed business plan, develop a strategy for post-merger integration, and in particular retain key employees and talents in the targeted company.

Where is the potential upside for investments?

Manufacturing, Real Estate, Life Sciences & Health Care would remain potential sectors of interest for Chinese bidders in Germany in 2014 and beyond.

Chart 23: Greater China outbound investments to Germany (2005 - H1 2014)



Note: H1 2014 stands for the period from January to May 2014

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