China M&A Round-Up
Cross-border investment trends

What's the Deal?

Investment Spring: Belt and Road in the 2020s

The second summit

As the new spring rolled across China in late April, Beijing convened the second Belt and Road Initiative summit, bringing together leaders from around the world to initiate or continue their participation in China’s Belt and Road Initiative (BRI) projects. Simply put, the BRI is the most massive foreign investment, and arguably foreign asset acquisition program, in the history of the global financial system. The mechanisms by which BRI projects have led to increased asset acquisition by China’s larger state-owned investors, and the potential impact, are our topics here.

The official numbers provided for the second summit are impressive. Beijing reported that 5000 delegates attended, including 37 world leaders, Russia’s president Vladimir Putin among them, up from 29 at the first summit. Further, Beijing reported over $90 billion in loan commitments under the program were
made by the first half of 2019, and according to Chinese president Xi Jinping’s report, $64 billion just from the second of the summits.

President Xi first announced the initiative in 2013 as the One Belt One Road project (OBOR), linking it to China’s historic silk road and promoting it as a modernized version of China’s physical and cultural links to the outside world. Gradually between late 2015 and early 2017, China promoted a name change to Belt and Road Initiative (BRI), partly in response to sensitivities at home and abroad that the “One” was too Sinocentric and did not reflect the pluralistic nature of the initiative.

**BRI and the new global context**

Understanding BRI can be key to understanding China’s growing role in the world of global investment, ownership, and influence. Since our last comment on the initiative in a “What’s the Deal?” article in November 2018, much has changed in the global environment in which the program is being developed, and this April’s summit in Beijing brought that into focus.

Perhaps first and foremost, the ambitious scale and goals of the initiative have redefined China’s development state from an emerging BRICS economy—Brazil, Russia, India, China, and South Africa—to something in between that and a developed economy. Japan, which had promoted the Asian Development Bank (ADB) for similar if more modest purposes in the region, was slow to warm to BRI. Most recently, Japanese sources have noted that China was still the region’s fourth largest recipient of special low-interest loans from the ADB, even as China established the Asia Infrastructure Investment Bank (AIIB) and was becoming a major lender to other countries in the region and around the world. Hence Japan questioned whether the ADB should continue to classify China as a qualified borrower of subsidized development monies. As the summit unfolded in Beijing, Japan, with support from other countries in the region, announced the concept of a Free and Open Indo-Pacific region (FOIP), promoting open and transparent cross-border investment activities. FOIP addresses most of what have been called the “Seven Challenges of Chinese Investment” in a critical report by a Washington think tank.

Japan was also early in issuing warnings of a BRI “debt trap.” The debt trap critique gained enough traction globally that Xi addressed it directly in his keynote comments at the summit, calling for more careful examination of the commercial viability to promote higher quality BRI investment projects. A mid-2018 study by two Harvard University researchers presented to the US Department of State identified 16 countries where potentially unmanageable levels of debt were being created by BRI projects, and created intentionally, that could give China substantial leverage over those BRI loan recipients.

This phenomenon is not limited to Asia. Europe is an increasingly significant factor in BRI, exemplified by Italy’s attendance at the summit, Italy being the first G7 country to sign on. But BRI has tended to focus on the smaller and weaker economies in Europe. Non-EU European countries that contribute only 6
percent of Europe’s aggregate GDP account for 70 percent of BRI deals in the region, and some countries, like Montenegro, are visibly burdened under soaring debt.9

**Acquisitions: Welcome or not?**

Putting aside geopolitical considerations of Beijing’s intents and motives in promoting and funding such projects, it is useful also to consider the potential economic impact on China itself. Under pressure from the US-China trade war, declining exports, a slowing domestic economy, and mounting debt with continued domestic stimulus, China has through forfeitures or renegotiations taken on effective ownership of major BRI assets, and their liabilities. Adding to the initial loans that China may have trouble collecting in dozens of projects around the world, how will these acquisitions fare in the future? What are their prospects of ever providing an adequate return on capital invested to justify their costs? If not, through what mechanisms will they be sustained?

One of the first and perhaps most instructive examples of this process is the Hanbantota Port Development Project in Sri Lanka. Sri Lanka was among the notably absent countries in the recent summit, even though Sri Lanka has been a major recipient of Chinese financial support even before the formalization of the BRI. In fact, although feasibility studies prior to construction of the Hanbantota port indicated that it would not be commercially viable, construction went ahead. By 2015, new leadership in Sri Lanka struggled to make the payments on the port loans, and in December 2015 Sri Lanka yielded a 99-year lease to China for the port and 15,000 acres of land around it, to escape from the debt payments and in the hope the port could remain operational.10

A similar situation unfolded with the Greek port of Piraeus, one of the most notable BRI projects outside of the Asia Pacific region. Piraeus was never able to command the level of port service that could justify its massive investment, and in June 2016 China’s largest shipping company took a 51 percent controlling stake in the port, making commitments for additional investment in a deal valued at 1.5 billion euros.11 From the beginning of the Piraeus port project, it has been a celebrated example of the BRI goal of establishing better trade connectivity between China and Europe. Yet, according to industry executives, feasibility studies did not justify the project and the additional investment promised by China is not likely to make the port commercially viable, even if more connectivity into central and western Europe is provided. And if substantial subsidies are provided to push expanded operations, the Piraeus port could be increasingly unwelcome and constrained in European shipping circles.12

**What is the impact?**

In 2011, the third BRICS summit took place in Sanya on China’s Hainan Island, and one of the major discussion topics was the incredible success of China’s investment-led development model. This was already the third year of Chinese stimulus spending in the wake of the global financial crisis (GFC), and it was
clear that China’s rapid and significant response spared it much of the potential economic impact of the GFC. The inception of BRI is not disconnected from an interest in exporting this high investment model to other countries that sought to learn from China. And some of the BRI spills have shown a light on the limits of investment-led growth.

These are long-term development issues, and it will likely be years before anyone can speak definitively about the wisdom of choices made on BRI projects. But there are takeaways from developments in recent years, some that raise relevant current issues for governments and major MNCs.

First, the size of China’s economy and its stage of development enable China to withstand the cost of large infrastructure investments that either will not provide a supporting return for a long time or may never. How suitable such investments are for economies that are smaller and at earlier stages of growth is a question. And when loans are no longer manageable for smaller economies, what are the best solutions to serve global interests?

Secondly, it is clear that China continues domestically to promote deleveraging and is working to deal with massive bank assets, much of which may not be serviceable. What will the macro-economic impact be of China taking on in addition ownership or long-term lease obligations for assets abroad that are similarly likely not to offer a return anywhere near what is required to repay their debts? While in these cases much of the investment cost was in RMB and billed by Chinese construction and materials companies, on-going operating costs will be in hard currencies and constitute a growing external obligation.13

Thirdly, in projects like Hanbantota and Piraeus, if China settles into long-term state-funded subsidies to keep the facilities operating without visible commercial success, will this have a distorting impact on the shipping, broader logistics, and trade activities in their regional markets and what will be the response from impacted governments and MNCs? State-funded subsidies to Mainland operations are already an area of contention in the US-China trade discussion. It is potentially more aggravating to deal with such subsidies for major, historically market-based service operations like ports outside the Mainland.

Returning to the second summit in Beijing this spring, China’s leaders showed not only recognition of the some of the criticisms of BRI but also of the potential burdens some earlier projects imposed on China itself in addition to BRI client states. Hopefully, what President Xi expressed in his opening summit remarks will indeed be the guidelines for future BRI projects, promising building infrastructure of high quality, sustainability, risk resilience, reasonable pricing, inclusiveness and accessibility.14 In this way, further acquisitions, intended or not, can be avoided and the contributions that could be made by BRI to global development will be within reach.

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China is under pressure to boost its economy as the trade war escalates, CNN Business, 5/15/2019
Chinese investment in U.S. startups peaks but 'tremendous uncertainty' ahead, Reuters, 5/7/2019
China expands global ambitions with a new phase of Xi’s signature program, CNBC, 4/29/2019

Outbound M&A from China

Consumer
Chinese sports brand Xtep to buy owner of US' K-Swiss for $260 mln, Reuters, 5/2/2019
Naspers swaps MakeMyTrip stake with China’s Ctrip in second India exit, VC Circle, 4/26/2019
China’s Greentown Services acquires 56% of Australia’s Montessori Academy, Deal Street Asia, 4/3/2019

Energy, resources & industrials
China’s CITIC picks up additional stake in Ivanhoe Mines for $453.7 mln, Reuters,
Financial services
Airwallex raises $100 mln, The PE Hub Network, 3/26/2019

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Chinese group to get control of Japan Display after $2.1 bln bailout, Reuters, 4/12/2019

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Comvita to take full control of Chinese joint venture, NZ Herald, 4/10/2019

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Australian lab testing giant cites competition, rule changes for China withdrawal, Caixin, 5/6/2019

Real estate
Singapore’s CDL acquires Shanghai complex as part of $974 mln Mainland deal, Mingtiandi, 5/15/2019
Baoye Group announces disposal of 33% stake in Hebao (Nantong) Real Estate Development, Yahoo News, 3/29/2019

Technology, media & telecommunications
Travel activities startup Klook raises $225 mln led by SoftBank Vision Fund, TechCrunch, 4/8/2019

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Consumer
Singamas sells five subsidiaries for $565 mln in cash to Cosco Shipping, Seatrade Maritime News, 5/7/2019
**Real estate**

Agile Group subsidiary agrees to 3.13 bln-yuan stake purchase deal in China, S&P Global, 5/9/2019

Sunshine 100 JV plans 4.7 bln-yuan sale of China project to Kaisa Group unit, S&P Global, 4/14/2019

Shimao Property subsidiary agrees to buy 51% of Chinese project for 2.79 bln yuan, S&P Global, 4/5/2019

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