July 2017

China M&A Round-Up

Keeping pace, marking milestones

What's the Deal?

The China M&A Round-Up team is proud to announce the addition of a new section to our monthly publication. Called "What's the Deal?", China M&A Round-Up's new series continues with the following article featuring the opinions and analysis of US CSG Senior Advisor Ken DeWoskin.

Changing Focus: China's M&A and Greenfield Investment Targeting

China's entire reform history is barely one generation old, and its history of outbound M&A, greenfield, and external capital market investment activity is much shorter. Even China's sovereign wealth fund, China Investment Corporation (CIC) is relatively young, having been established just ten years ago in 2007. Yet, short as the history of Chinese outbound investment is, including M&A and greenfield initiatives, in the last few years Chinese investment has become a major factor globally. In 2016, Chinese non-financial outbound investment tripled to the US and doubled to the EU, reaching over $160B globally.[1]

PRC supervision of outbound M&A and other investments is implemented in the form of approval requirements by a number of government agencies. Sources report that as many as 16 different approvals are required for a typical outbound investment.[2] Even though the simplification of this process has been in the offing for many years, and progress has generally been made in streamlining the processes, if the transaction requires a large exchange from local to an international currency, the actual on-the-ground experience may be getting tighter rather than more open and predictable.

In addition to the approval process, there is important support in the form of many state bank and investment funds, almost always a part of a sizeable outbound investment. And there is guidance in the form of public and private pronouncements that indicate to Chinese investors what kind of projects are likely to win approval and gain bank support. Large loans from top tier state banks have provided 50% or more of required cash to close multi-billion dollar deals.[3]

The availability of such funds on both interest rate and tenure terms that could be difficult to match from any other sources has two potential impacts. It helps enable Chinese buyers who can access such facilities to support bid premiums that other potential buyers from China and elsewhere would be challenged to match. It also adds a political dimension to decisions to support one investor over another and one potential investment over another for large active Chinese investors, including property developers, insurance companies, and large conglomerates from the travel sector, digital sectors, and industrial sectors. We have seen in many recent news reports clear indication that political forces may be rising in influence on the structure and activities of some of China's biggest outbound investors in the insurance and property development sectors.

In Deloitte's analysis of future trends in outbound investment we take a triangle of forces into consideration. First, there are indications of where official support will likely focus and thus where approvals will likely be forthcoming. These are visible in public campaigns and official pronouncements that speak directly of encouraged sectors, such as strategic acquisitions related to "Made in China 2025" and discouraged sectors, such as real estate, or, more broadly, "unreasonable" additions to conglomerates that bear no relation to existing core business activity.

Secondly, there are evolving trends in supervision and approvals of investments by countries hosting strategic targets and receiving investment from China. Recent examples of bid reviews and some blocks as well as increased public discussion among policy makers indicate increased scrutiny of what for these regulatory agents is inbound investment. This is a fast developing but unmistakable trend, focused on three areas broadly constructed as national security concerns: mineral, energy, and agricultural resources related to secure resource availability and pricing; strategic technologies related to Industry 4.0 and future export competitiveness; and financial service institutions that are important in maintaining orderly cross-global financial transactions.

An underlying driver of increased scrutiny of investment coming from China is the discussion of "reciprocity." In the US and several EU jurisdictions charges have been leveled that China has not met its WTO obligations, dating back to 2001, to open sectors to foreign companies, such as financial services and ecommerce, and that China continues to use long lists of prohibited and restricted sectors as well as intentionally cumbersome licensing requirements to protect domestic enterprises from foreign competition.[4] The impact of these claims has been to try to encourage trade and investment regulators of make demands for "reciprocity" an explicit, key for inbound investment approvals.

Thirdly and finally, macro-economic forces are in play, mostly rooted in China's domestic debt and liquidity issues and manifest in concerns over RMB exchange value and China's Forex holding levels. From many angles of view, China's efforts to curtail RMB to hard currency conversions, capital outflows, and foreign debt accumulation are clearly visible. We have seen examples of large initiatives abandoned for lack of funding and established overseas operations curtailed as a result of inadequate operating capital and paucity of new investment inflows. At the more retail, family investment levels, new practices have been put into effect for individuals seeking to exchange local currency into US$ at the bank window under the annual individual currency conversion quotas.

China's expanding geo-economic engagement is potentially creating a sizeable accumulation of external financial commitments, and these can add to the levels of approved outbound capital flows. These include major commitments to the Chinese-led Asian Infrastructure Investment Bank (AIIB) and a long menu of commitments globally made in China's "One Belt, One Road" (OBOR) program, a number of which were advanced in the recent OBOR conclave in Beijing, where leaders and experts from over 130 countries were reported to have attended to partake in China's external financial campaign.[5] A general lack of detail or clarity on many of the 270 deliverables reported can make it impossible to tally up a total of outbound obligations, but they imply needs in the hundreds of billions of dollars. Concerns over capital outflows alone lead us to believe that 2017 will not see a repeat of the surge in outbound Chinese M&A and greenfield investment that occurred in 2016. China's major official English language newspaper, the *China Daily,* quoted the Ministry of Commerce comment that outbound investment will "steadily slow" in 2017. (2/10/2017).

The exchange value of China's currency determines its buying power abroad. That value is determined daily at two price points by two major inputs, the administrative rate set by China's central bank daily and the actual market rates set in Hong Kong, Singapore, London, and elsewhere for Chinese currency traded outside the Mainland. China's central bank watches external rates carefully, and even engages in some open market operations, either directly or through SOE proxies, because too large a gap between the two exchange rates could create a number of untoward consequences. If as a result of the interaction of these two currency rate processes the RMB maintains an overvalued exchange rate, the buying power of Chinese enterprises and families abroad will be increased, making them uber-competitive buyers in any competition for an asset abroad, be it a residential property or a technology company. And the opposite is true. Should the RMB depreciate to an undervalued exchange rate the RMB cost of assets abroad will become commensurately less attractive to Chinese buyers. Perhaps even more important for the future of outbound investment in many tiers than the policy trends in both China and in target countries are the potential shifts in RMB buying power.

We are not suggesting that outbound investment from China will not continue to be a major force in China's future growth and financial activity in China's major counterparties. To the contrary, we anticipate a stabilization of investment activity at a sustainable level and, arguably, a clearer focus on targets and strategies as well as a settling into more familiar and competitive valuations.

Our point in exploring both the focus and levels of Chinese investment is to help aid readers in identifying and anticipating important trends that might impact their enterprises directly or reshape the global market and competitive landscape in their sectors. In any sector and for any company, acquisition by new owners from the PRC, acquisition of an important competitor by new owners from the PRC, or construction of a new greenfield plant in the neighborhood by a large Chinese enterprise will likely have significant impact on both the intensity and the nature of competition in the sector.

Endnotes

1. Data sourced from Rhodium Group.
2. Jingzhou Tao, "Chinese corporate deals face scrutiny at home and abroad," *Financial Times*, April 2, 2017, https://www.ft.com/content/da11c4de-1572-11e7-b0c1-37e417ee6c76?mhq5j=e1
3. Lianting Tu and Molly Wei, "China's banks help finance $157 billion M&A spree," *Bloomberg*, August 9, 2016, https://www.bloomberg.com/news/articles/2016-08-09/china-s-banks-come-of-age-to-help-finance-157-billion-m-a-spree
4. Wendy Wu, "Is China making life difficult for foreign companies?" *South China Morning Post*, May 2, 2016, http://www.scmp.com/news/china/diplomacy-defence/article/1940397/china-making-life-difficult-foreign-companies
5. Chong Koh Ping, "Chinese President Xi Jinping's Belt and Road forum yields deals with 68 countries and international groups," *The Straits Times*, May 17, 2017, http://www.straitstimes.com/asia/east-asia/chinese-president-xi-jinpings-belt-and-road-forum-yields-deals-with-68-countries-and

Trends to Watch

How China’s biggest brands and businesses want to learn and share, CNBC, 7/17/2017
Five takeaways from China's weekend meeting on financial regulation, Bloomberg, 7/16/2017
China’s export, import growth accelerate in June, The Washington Post, 7/13/2017

Outbound M&A from China

Agriculture
China's CITIC Agri Fund buys Dow corn seed assets for $1.1 billion, Reuters, 7/12/2017

Consumer Products
JD.com pays $397 mln for stake in fashion shop Farfetch, Bloomberg, 7/21/2017

Financial Services
Hong Kong's ZZ Capital buys US index provider Alerian, Reuters, 7/14/2017
Sigurd Microelectronics to fully acquire Bloomeria Limited for S$73.8 mln, Reuters, 7/5/2017

Manufacturing
Hong Kong watchmaker snaps up 'Japan's Tesla' for $114 mln, Nikkei Asian Review, 7/10/2017

Technology, Media & Telecommunications
Hangzhou Liaison Interactive Information Technology Co. invests $179 mln in Newegg Inc., Los Angeles Business Journal, 6/20/2017
Alibaba ups its stake in Southeast Asia’s Lazada with $1 bln investment, TechCrunch, 6/28/2017

Inbound M&A into China

No deals were reported for this period.

China Domestic M&A and Industry Consolidation

Aviation, Transportation & Logistics
China's COSCO Shipping offers $6.3 bln for Orient Overseas Ltd, Reuters,

7/9/2017

Real Estate
China Vanke acquires certain assets of Guangdong International Trust Investment Corp, Reuters, 7/7/2017

Technology, Media & Telecommunications
Paramount China partner Huahua Media sold to Oriental Times Media Corporation, Broadcasting & Cable, 7/14/2017

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