CHINA STEPS OUT

2016 has seen an extraordinary explosion of outbound M&A by Chinese companies. Beijing partner Ling Li – who worked on key foreign investments for a major state-owned energy company before joining A&O's corporate team last year – has seen this trend develop from both sides of the fence. Here she reflects on what lies behind China's growing appetite for overseas assets.

CHINA HAS DRAMATICALLY INCREASED ITS PRESENCE in the global M&A market in recent years, with a surge in both domestic and overseas transactions.

In fact, China's share of the market has grown in ten years from a mere 1.7% to a phenomenal 26% in the first half of 2016, some eight points higher than the same period in 2015.

The most staggering growth in recent times has been on the outbound side. In the first half of the year, Chinese companies launched USD120bn worth of transactions, outstripping the value of deals done in the whole of 2015, where transactions totalled USD112bn.

This extraordinary level of activity was partly down to one deal, ChemChina's highly strategic USD46.5bn acquisition of the seed technology giant Syngenta. It is the biggest-ever outbound deal done by a Chinese enterprise.

Despite its significant contribution to the overall value of transactions this year, this deal is indicative of a wider trend and comes at a watershed moment for Chinese overseas investment, insists Ling Li, a corporate partner in A&O's Beijing office.

"When you analyse the deals done in recent months, what's striking is the extraordinary depth and diversity of transactions across a range of sectors involving a mix of state-owned enterprises (SOEs) and, increasingly, privately owned Chinese companies. This is the new normal for outbound Chinese investment and there's little sign it will go into reverse," she says.

If one looks at the ChemChina–Syngenta deal in detail, that deal in and of itself is a game-changer for the agricultural seeds and crop protection industry.

HOW WE GOT HERE

The factors driving an increase in Chinese investment at home and abroad are complex and reflect significant changes within the country as it makes the transition from an investment-led, export-driven economy to an increasingly complex one, says Ling.

"To begin with, outbound activity was dominated by the big SOEs as they were sent out to secure the raw materials needed to ensure energy security and a reliable supply of commodities for China's manufacturers. But that changed following the global financial crisis," she argues.

At that point – with the rest of the global economy frozen – China became the buyer of choice thanks to its huge foreign exchange reserves. To keep the economy fizzing, the Chinese Government also launched a stimulus programme fuelling demand for infrastructure investment and a growth in capacity across many sectors. It was this pump priming of the economy, coupled with Government sponsorship, which set the groundwork for the search by Chinese companies for higher-value assets.

"We saw a shift in emphasis," says Ling. "Companies were less focused on acquiring raw materials, and instead began concentrating more on buying technologies, products and brands that they could bring back to China to boost their competitiveness at home and abroad."

And, she notes, the Government has encouraged this outbound activity. "They have recognised that it's difficult to quickly build new capabilities organically; it's far easier to do it through acquisitions. And the Government has encouraged state banks' support for a ready supply of relatively cheap financing."

CHOSEN MARKETS, CHOSEN SECTORS

Europe has been a very attractive market for Chinese investors searching for these prized assets, with Germany's vibrant SME sector – the so-called 'mittelstand' – a particular target. As a result, Chinese investment in Europe has soared since 2009 and in 2015 was more than three times higher than investment in the U.S. by Chinese companies.

The hunt for assets has spread to more and more sectors in the process, including hospitality, leisure and sports brands, medical devices, healthcare, automotive, food and beverages and financial services.

The process of growth, however, has not always been entirely straightforward and Chinese investors have had to become increasingly sophisticated to make a success of this outbound expedition.

"For some the learning curve has been pretty steep. In the early days, overseas investments had a pretty mixed record and investors have had to work hard to ensure that they get the right returns on their investments," says Ling. "We've seen investors building specialist M&A teams, learning how to work with advisors and developing post-integration strategies to make sure they capture synergies."

It's also meant becoming more nimble – making faster decisions, deploying capital at a faster pace and taking on higher levels of risk. "In many ways this need to be agile and entrepreneurial has handed an advantage to smaller privately owned companies. The big SOEs are now, to some extent, being hamstrung by lengthier approval processes and by fears they might become embroiled in the Government's anti-corruption crackdown," she says.

What has now emerged is a whole host of potential investors: Chinese listed companies searching for a growth story to plump up their stock price; a range of Chinese privately owned enterprises, some of which are of deep depth and breadth; and Chinese private equity and financial investors ranging from private wealth investment clubs to sovereign wealth funds, insurance companies and large funds backed by some of the largest pools of money in China.

ROADBLOCKS?

Ling is convinced that the recent surge in outbound investment is not a blip and will continue. But she says there are a growing number of potential roadblocks in the way of continued growth, both at home and overseas. Chinese companies will have to handle these with great care.

For instance, national security issues are being raised more frequently in a number of overseas markets, most notably in the U.S., but also this summer in both the UK (over the proposed investment by China in the nuclear power sector) and in Australia over the sale of the New South Wales electricity grid.

The number of proposed Chinese acquisitions sent for review by the Committee on Foreign Investment in the U.S. (CFIUS) continues to climb, particularly around key technologies such as semiconductors. Indeed, there was a 52% increase in such reviews in 2014, the last year for which statistics have been published.

And the reach of CFIUS reviews is being extended beyond national borders, with deals done in other jurisdictions, such as Europe, being drawn into the net.

This is a reflection of growing tensions in U.S.–China relations with both sides taking steps to safeguard their national security. China is, for its part, insisting that foreign investors in its high-tech industries meet much stricter requirements, for example.

Domestic regulation and policymaking is also becoming more of a factor for Chinese companies, she argues.

"China's competition authority has been greatly strengthened in recent years to the point where Beijing is now the world's third most important antitrust capital after Washington and Brussels. And, as we've seen in a number of cases, its jurisdiction reaches well beyond China's borders."

While Chinese companies can still gain access to relatively competitive finance, there's been evidence of growing nervousness in Government ranks about the amount of capital flowing out of China. "That – along with the anti-corruption drive – could have some impact on transaction levels," she says.

But she remains confident that Chinese investors will continue to make a growing mark on global M&A markets in the months and years ahead.

"We remain convinced that Chinese investors will become increasingly adept at negotiating the complexities of doing outbound deals and we see no sign of their appetite for overseas assets diminishing.

"So, even if the level of deal activity doesn't quite match the record-breaking heights seen in the first half of 2016, we expect to see further growth this year and next."

LING LI
Partner, Allen & Overy

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