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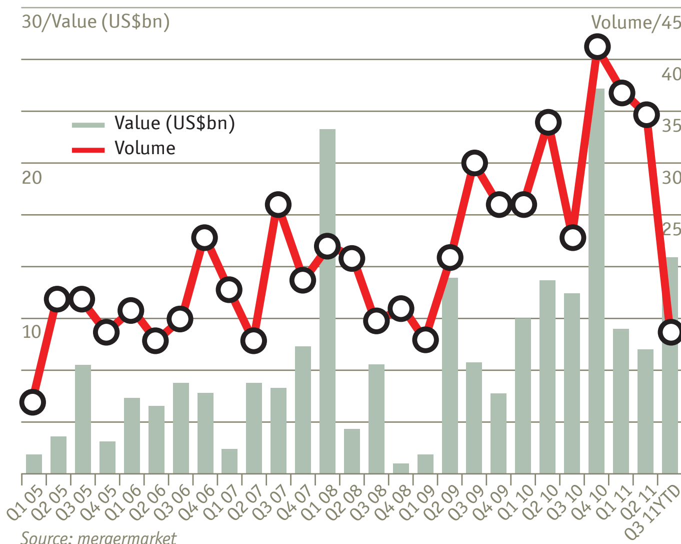
CHINESE OUTBOUND M&A

An Economist Corporate Network management brief

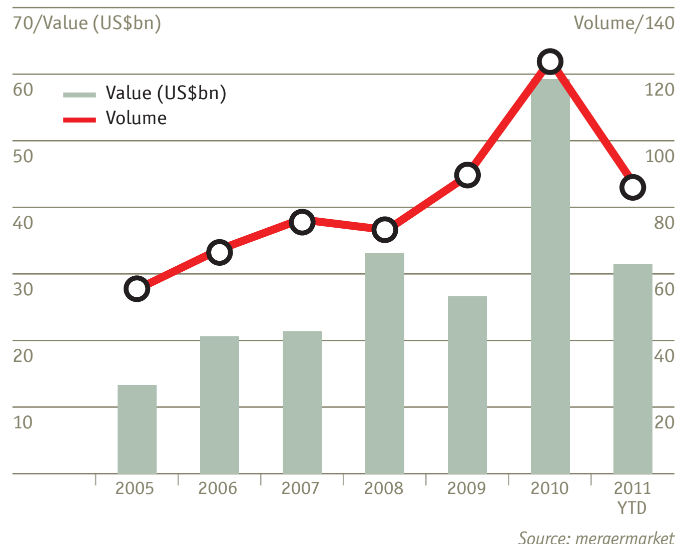
Chinese Outbound M&A

Chinese outbound mergers and acquisitions (M&A) activity is changing the global corporate landscape as Chinese firms' appetite for foreign assets intensifies. In 2005, some 55 Chinese outbound M&A deals were valued at US$13.3bn, 0.7% of total global M&A activity; by 2010, this had grown to 124 deals worth US$59.5bn, over 2% of world total, according to data from mergermarket, a M&A intelligence service. And it continues to grow: the first half of 2011 has seen a half year record of 72 deals worth some US$31.2bn, and deal value in the third quarter as of this writing, at US$14bn, is nearly double the value of the second quarter. Global firms need to adjust their business strategies to account for the growing number of Chinese companies entering the global corporate stage.

Chinese Outbound M&A 2005-2011YTD



Source: mergermarket



Source: mergermarket

The backdrop to the increase in Chinese outbound M&A activity is China's rapid economic growth in recent decades, the country's massive foreign exchange reserves that reached US$3trn in June 2011, as well as the emergence of a new generation of Chinese companies that are determined to become players in the global economy and that receive strong government support for their global expansion.

The government's "going out" strategy involves actively supporting companies looking to invest overseas. Adjusted regulations have enabled potential buyers to secure acquisition financing more easily from China's state-owned banks. To take one example, China Development Bank has loaned US$30bn to state-owned China National Petroleum Corporation (CNPC) to expand its capacity for buying overseas energy resources.

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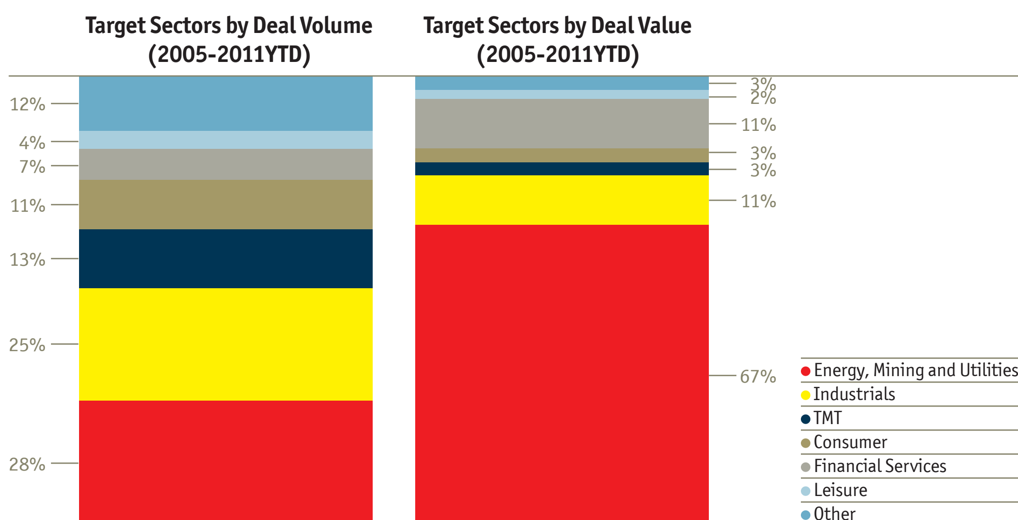
State-owned enterprises (SOEs) dominate Chinese outbound M&A deals, for several interrelated reasons. The first is a factor of China's market maturity: the People Republic's biggest and most advanced companies are still SOEs, and thus have the cash and market presence to move abroad. Secondly, China's global expansion continues to have its own resource security as a core tenet, and SOEs are the largest Chinese companies in the natural resource sector. SOEs, as de facto agents of China's international aspirations, can also more easily access cheap financing from the country's state-owned banks, and have benefited from a series of state policies which encourage SOEs to grow through M&A and restructuring.

Despite the preponderance of state firms taking stakes abroad, there are an increasing number of larger private Chinese enterprises engaging in outbound M&A, particularly in industrial and consumer related sectors.

KEEPING THE ENGINE GOING

The main drivers for Chinese companies engaging in outbound M&A are China's growing demand for natural resources, and the desire to secure know-how, technology and brands. Hence, the increasing number of Chinese enterprises looking for acquisition opportunities abroad are primarily aiming for the natural resources, industrials, high-technology, and consumer related sectors.

The largest share of Chinese outbound M&A (both in volume and value) has targeted the natural resources sector, with an obvious purpose: China is now the largest consumer of both soft and hard commodities globally. The country's rapid development has required massive investment in natural resources to secure supply lines and to sustain its high growth. China needs raw materials not only for its construction boom in residential housing and infrastructure projects, but also as industrial and manufacturing inputs for the production of goods for both local and international markets, as well as to satisfy the demands of its vast and increasingly affluent population.



Source: mergermarket

Although China is a leading producer of aluminum, coal, gold, iron, steel and numerous other minerals, it remains heavily reliant on imports. China is also one of the world's largest oil importers. Unsurprisingly, the three biggest Chinese outbound M&A deals to date have been in the energy and mining sectors (see table), as has been the largest deal this year: China Investment Corporation (CIC, China's sovereign wealth fund) announced a 30% stake in the French energy company GDF Suez for US$4.3bn in August.

Chinese firms have primarily targeted markets where resources have been developed and are easily accessible; Australia and Canada have been two of the most popular destinations for Chinese acquisitions to date. But emerging markets are also increasingly attractive; one of China's largest single outbound deal last year was Sinopec Group's 40% stake in Brazil's Repsol YPF SA, an oil and gas company, for US$7.1bn. In Africa, large deals last year included Wuhan Iron and Steel Corporation's 40% purchase of Mozambique's Zambeze Coal Project for US$1.1bn, and the 51% acquisition of South African platinum developer Wesizwe Platinum by a Chinese consortium consisting of Jinchuan Group and China-Africa Development Fund. Moreover, relatively resource-less Singapore is in fact the most popular Asian country for Chinese investment—because it is used as a platform for Chinese resources investments elsewhere in the region.

Energy security will remain a key concern for China in the foreseeable future, and China's outbound appetite is only very slowly diversifying. The combined value of energy and mining deals since 2005 was 66% of all outbound transactions, and 61% of all deals since 2009.

TOP 3 CHINESE OUTBOUND M&A DEALS

Announcement Date	Target Company	Target Dominant Sector	Target Dominant Country	Bidder Company	Deal Value (US$bn)
01/02/2008	Rio Tinto Plc (12% Stake)	Energy, Mining & Utilities	United Kingdom	Alcoa Inc; and Aluminum Corporation of China	14
07/09/2010	Electricite de France SA (UK based distribution network)	Energy, Mining & Utilities	United Kingdom	Cheung Kong Infrastructure Holdings Limited; Power Assets Holdings Limited ; and Li Ka Shing (private investor)	8.9
24/06/2009	Addax Petroleum Corporation	Energy, Mining & Utilities	Canada	China Petrochemical Corporation	8.8

Source: mergermarket

A less prominent, but progressively important, driver for Chinese companies is the acquisition of technology, know-how, brands, and other intellectual capital: Chinese firms have increasingly targeted machinery and equipment manufacturers, technology, media and telecommunications (TMT), and consumer related companies in developed economies.

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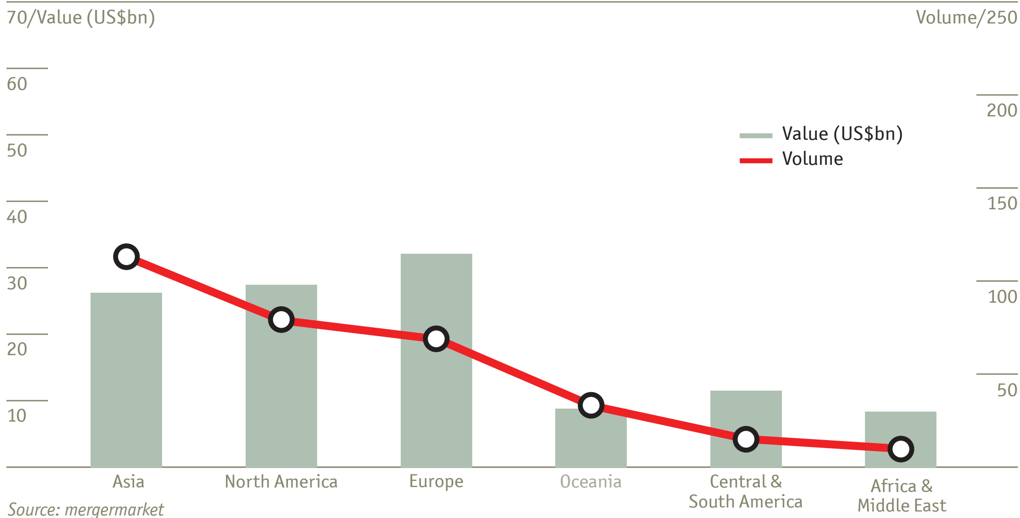
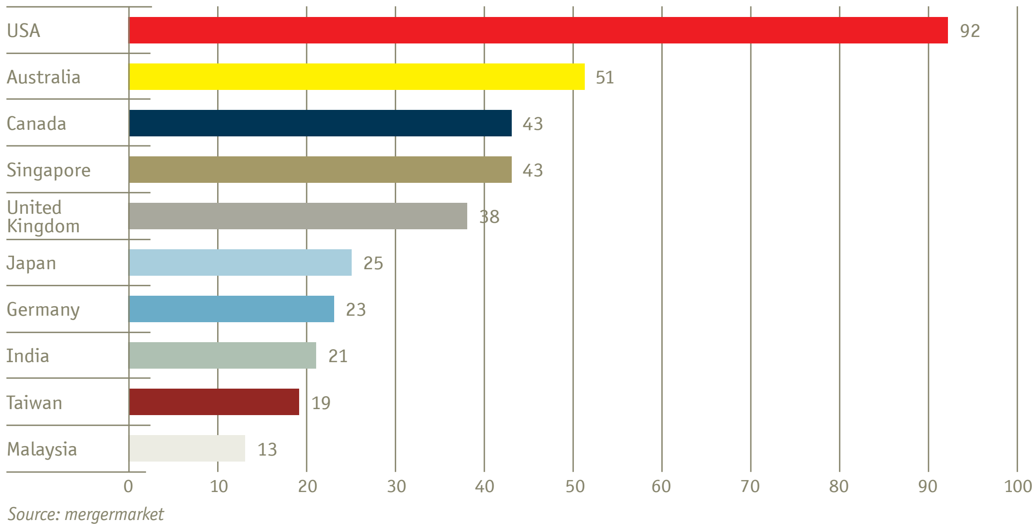
Chinese Outbound M&A by Region (2005-2011YTD)



Source: mergermarket

Top Ten Target Countries by Deal Volume (2005-2011YTD)



Source: mergermarket

This is one reason why the largest number of Chinese outbound deals outside of Asia have been struck in Europe and North America. By country, the United States has attracted the largest share of Chinese M&A deals to date. In the first half of 2011, Chinese outbound M&A deals in Europe more than doubled compared to the same period in 2010. For example, one of the biggest Chinese outbound deals in 2011 so far is China National Bluestar's acquisition of Elkem, a Norwegian silicon supplier, for US$2bn.

Clearly, China's growing global aspirations is beginning to widen in sectoral scope, but the acquisition of intellectual property (IP)-intensive firms is probably more correctly viewed as a way for Chinese firms to gain competitive advantages in the crowded Chinese home market. One example of a deal where a Chinese firm both aspired to global advancement and to gain domestic competitive advantages is Geely's purchase of Sweden's Volvo in 2010. The Volvo acquisition not only helps Geely upgrade its existing capabilities by leveraging Volvo's technologies, engineers and marketers to advance its own brands at the mass market, but it also gives Geely a premium brand to compete with Western carmakers in China.

Chinese outbound acquisitions in the financial services sector are part of this trend. Acquiring foreign banks and equity firms is a strategic way for China's state-owned financial institutions to facilitate Chinese business entry into new markets. Two notable deals in the financial sector include the Industrial and Commercial Bank of China's (ICBC) 20% stake in South Africa's Standard Bank, and China Investment Corporation's minority stake in the Blackstone Group of the USA (see table). The demand for Chinese cross-border financial services has accelerated as a growing number of Chinese companies seek investments in diverse sectors globally.

NOTABLE CHINESE OUTBOUND M&A DEALS

Announcement Date	Target Company	Target Dominant Sector	Target Dominant Country	Bidder Company	Deal Value (US$bn)
25/10/2007	Standard Bank Group Limited (20% Stake)	Financial Services	South Africa	Industrial and Commercial Bank of China Limited	5.4
20/05/2007	Blackstone Group L.P. (Minority stake)	Financial Services	USA	China Investment Corporation	3
09/01/2006	South Atlantic Petroleum (OML 130) (45% Stake)	Energy, Mining & Utilities	Nigeria	China National Offshore Oil Corporation Ltd	2.3
28/03/2010	Volvo Cars Corporation	Industrials & Chemicals	Sweden	Zhejiang Geely Holding Group Company Limited	1.8

Source: mergermarket

Other than automotive, the clean-tech industry is also a favourite target sector. China is the world's top investor in renewable technologies, and the largest manufacturer of wind turbines and solar panels. In 2009, China invested US$34.6bn in clean energy, almost twice as much as the US, the second largest investor. The Chinese government has identified clean energy and energy conservation as two key investment areas in its 12th five year plan. Promoting investments in renewable energy has strategic importance for the Chinese government as it adds to its energy security strategy while promoting the development of another advanced industry specialization to increase China's global competitiveness.

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Germany's advanced manufacturing industry has made it a natural hunting ground for Chinese industrial companies looking to move up the engineering value chain in the clean-tech and renewables space. In 2008, the Chinese wind-turbine manufacturer Goldwind bought a German wind-turbine designer called Vensys. Goldwind's main intention behind the deal was to obtain the capacity to develop bigger turbines for the Chinese domestic market.

Moreover, the rapidly growing demand for consumer products in China has resulted in increasing Chinese outbound dealmaking in consumer related sectors. Earlier this year, Fosun International, one of the largest privately owned conglomerates in China, acquired a 9.5% stake in Greece-based jewelry and luxury goods retailer Folli Follie Group. Fosun CEO Guo Guangchan has said that Folli Follie's concept of 'affordable luxury' will be a perfect match for the growing consumption demands in China. China is predicted to become the world's largest luxury goods market.

DEALING WITH DRAGONS

Chinese firms' growing M&A activity in the global marketplace will shape the global corporate landscape in years to come. The increased number of Chinese companies entering the global corporate stage means both opportunities and challenges for multinational firms.

Opportunities arise for multinational firms when exiting a business that is no longer attractive as Chinese companies may be the best acquiring candidates. In the wake of the global financial crisis, there was a significant rise in Chinese firms buying up underperforming business units from multinationals. Chinese companies saw the crisis as an opportunity to buy distressed assets in developed economies at cheaper valuations. For global firms, the Chinese companies' interest in their businesses presented them with opportunities to raise capital and increase business efficiency.

One recent example of a mutually beneficial deal is the acquisition of Panasonic-owned Sanyo's white goods business by leading Chinese white goods maker Haier. For Panasonic, this represents a strategic choice to allow Sanyo to fully focus on the battery sector. For Haier, the deal means increased market shares in the global white goods market, as well as gaining new technologies, industrial know-how, and an established brand in Asia.

Global firms should also assess opportunities to cooperate with Chinese companies as a partnership could create more value than an outright sale. CIC's aforementioned stake in GDF Suez is set up as a partnership with the two firms entering into a cooperation framework. According to GDF Suez CEO Gérard Mestrallet, the deal will help GDF Suez to access substantial financing resources, and strong networks in China and throughout Asia to accelerate the company's growth in the region.

The partnership deal between China's Fosun International and Folli Follie Group has also created new opportunities. Following the partnership, Folli Follie plans to open more than 250 Folli Follie's retail stores in China in the next three years. Fosun's CEO Guo Guangchan has stressed that Fosun will make good use of its local resources and network to help Folli Follie explore more business opportunities and reach more customers in China who can afford luxury products.

A relationship with a strong Chinese partner could facilitate access not only to the Chinese market, but also to other emerging markets. A partnership may also improve the chances for successful business integration, and it gives both partners an incentive to make the deal work. Before entering such a partnership, however, multinationals need to assess whether cooperating with a Chinese partner would better facilitate the company in achieving its long-term business strategy.

Chinese firms' growing outbound M&A activity also presents challenges to multinational companies. As Chinese companies enter an established global industry they may fundamentally change the competitive dynamics of the market. As a result, global firms need to understand in detail the impact on the industry of new competitors from China, and devise a long-term strategy that takes into account Chinese competition.

However, it is still the Chinese firms that face the greatest challenges in their overseas ventures. Chinese companies are new players in the M&A arena, and often not used to doing M&A deals. Consequently, Chinese companies are less likely to exercise proper due diligence and screening. Another challenge Chinese firms face is lack of information, in particular regarding data about companies for sale and existing opportunities abroad.

Finally, an important barrier for many Chinese companies engaging in M&A deals, especially in the West, is protectionism from local governments. This issue is particularly evident when the acquiring Chinese company is state-owned, and when the deal involves strategic assets in natural resources, advanced technology or other intellectual property. One recent example of a deal that failed due to protectionism is Chinese telecom firm Huawei's attempt to acquire the US server technology company 3Leaf Systems. The deal was blocked by a US government panel on security concerns.

A CHINESE CORPORATE WORLD ORDER

Chinese companies' appetite for foreign assets will continue to increase as they grow more confident in the global marketplace. The natural resources sector will predominate in Chinese outbound M&A deals for the foreseeable future, though intellectual property will be an increasing part of China's broader "resource security" portfolio, particularly in the advanced economies. Global firms need to take into account Chinese competition in their long-term strategies. More importantly, however, multinationals should assess the opportunities outward-looking Chinese firms could bring to their business, whether it is through divestment or new partnerships.

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