Baker & McKenzie

BIRD'S EYE VIEW

Comparing Chinese Investment into **North America** and **Europe**

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EXECUTIVE SUMMARY

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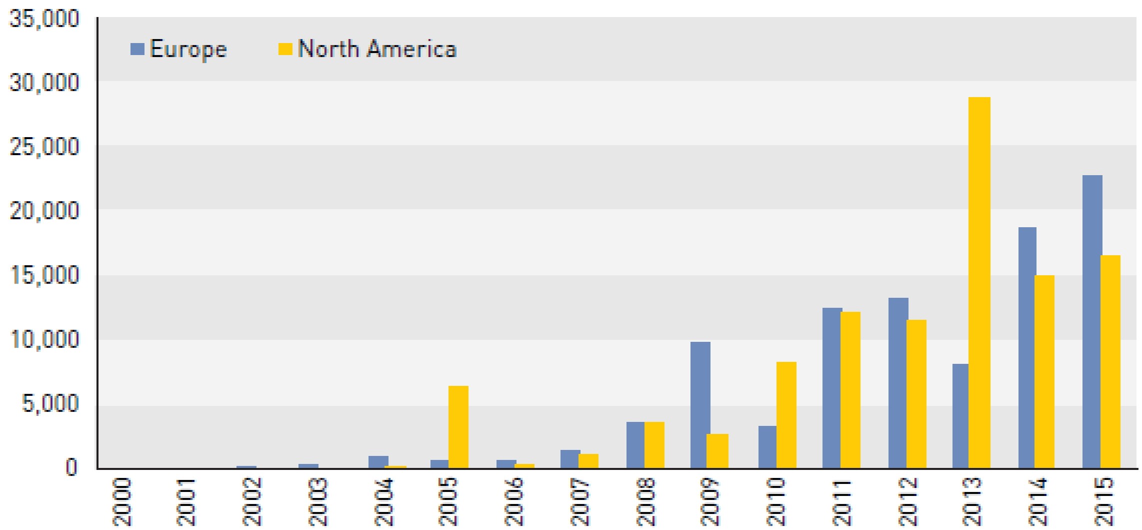
Chinese outbound foreign direct investment (OFDI) has grown rapidly in recent years and is increasingly flowing to high-income economies—particularly Europe and North America. The full report analyzes transactional data for the period from 2000 to 2015 to compare the growth of Chinese investment in Europe and North America, including investment patterns and drivers and economic and geopolitical risk factors that could impact future investment flows. Key findings include:

Chinese investment in Europe and North America, once absent, is now booming

While China's share of Europe and North America's FDI stock remains miniscule, its importance in new annual flows is growing rapidly. Before 2008, Europe and North America received, on average, less than $1 billion of Chinese OFDI per year. In 2015, the combined value of Chinese acquisitions and greenfield projects in both regions totaled $40 billion.

CHINESE OFDI TRANSACTIONS IN EUROPE AND NORTH AMERICA
2000-2015 | Annual aggregate values, USD billion



Source: Rhodium Group

China's footprint in both regions is growing

In North America, Chinese firms have extended their presence from major coastal cities and industry clusters to most of the larger urban areas, as well as an increasing number of rural economies. By the end of 2015, 48 out of 50 US states and 10 of 13 Canadian provinces were hosting Chinese investments. The top three US states for FDI are New York, California and Texas. In Europe, while the "Big Three" economies of France, Germany and the UK continue to register elevated levels of Chinese investment, Chinese investors have also become significant investors in Southern, Northern and Eastern Europe. For example, Chinese investment into Switzerland jumped from virtually zero in 2013 and 2014 to USD1.27 billion in 2015 as Chinese investors took advantage of the financial crisis and the privatization of state assets.

China's economy is propelling interest in new types of overseas assets

After more than three decades of rapid economic modernization, the drivers of China's old growth model–abundant low-cost labor, high returns to basic investment, and massive economies of scale and scope–are weakening. These challenges require China to fundamentally overhaul its growth model to successfully manage the transition from a middle-income to a high-income economy. This transition is proving to be a major driver of Chinese investment patterns in Europe and North America. At the same time, investment patterns in both regions show distinct differences that reflect local economic strengths and specific opportunities in host countries.

Key drivers of Chinese investment include:

- **Upgrade technology and know-how.** Rising factor input costs and impediments to greater economies of scale are putting pressure on Chinese manufacturers to escape their focus on low-end production and move up the value chain. With a high number of small, privately owned companies with world-class technology, Europe is a preferred geography for Chinese investors trying to access advanced manufacturing capabilities. In North America, Chinese companies are focused on information technology equipment, automotive parts, biotechnology, semiconductors and aviation.

- **Get closer to the customer.** Chinese manufacturers are building out local capacities for selling more sophisticated products and services to their European and North American consumers, as well as to the fast-growing middle class at home. In recent years, Chinese investors have largely focused on acquiring Western consumer brands, particularly in industries where manufacturing margins in China are most at risk, including furniture, textiles and fashion, consumer electronics, and major appliances.

- **Gear up for a services boom.** Chinese capital is increasingly flowing to advanced service assets as Chinese companies try to ramp up their competitiveness and benefit from service sector growth in China. North America beats Europe in attracting investment in these areas based on its world-leading assets and brands, including entertainment, healthcare and pharmaceuticals and software.

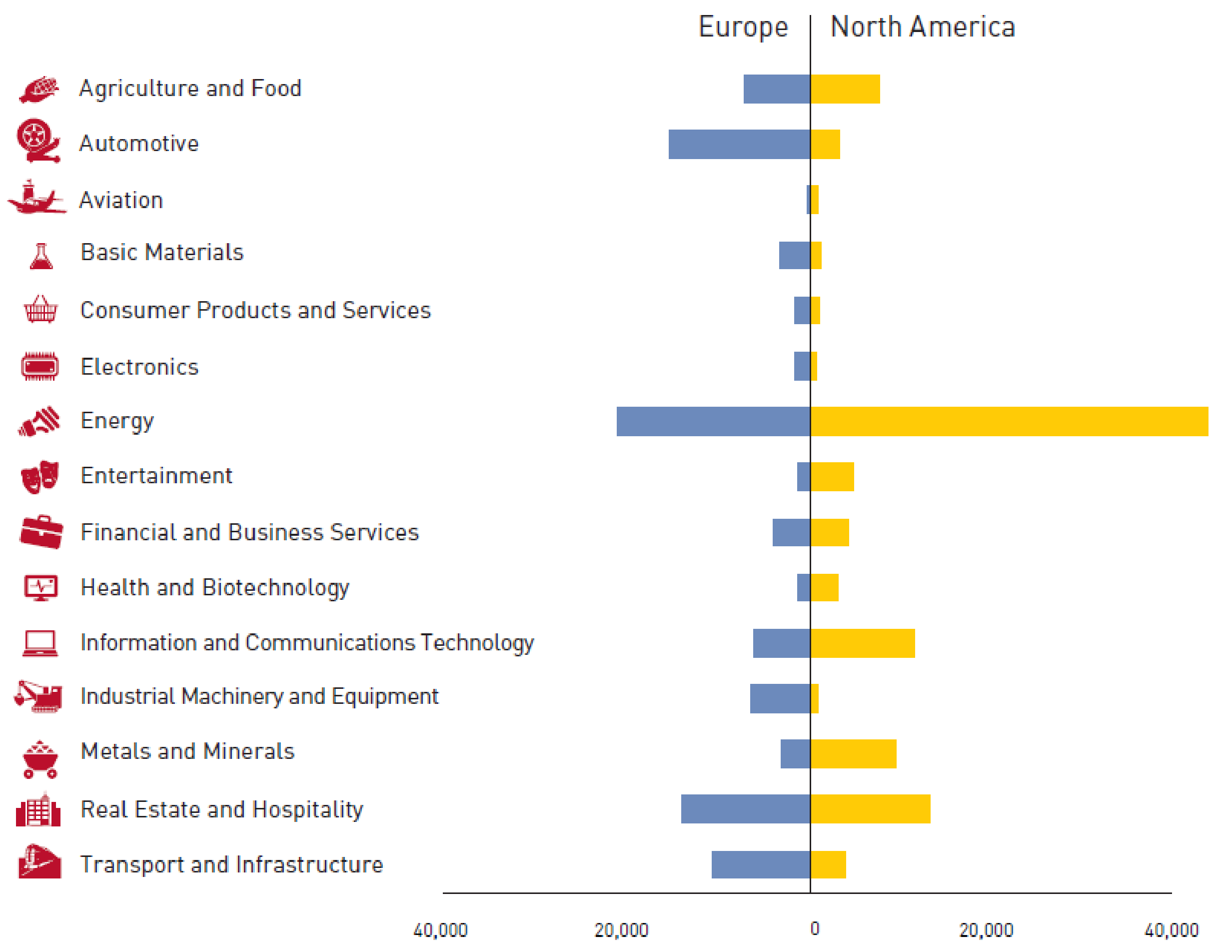
- **Focus on asset diversification and internationalization.** As growth slows in China, Chinese companies are focused on diversifying their asset base. Both North America and Europe have experienced a gradual increase of Chinese investment in sectors that promise relatively stable long-term returns such as real estate. Private investors, state-owned enterprises and sovereign entities have put nearly $18 billion into real estate in both regions over the past five years, compared to less than $1 billion from 2000–2010.

China's industry focus is changing

Chinese outbound investment in natural resources, once substantial, decreased radically starting in 2013. However, the plunge in extractive sector investment was made up for by a robust and broad-based increase of OFDI across all other industries and asset classes. Chinese investors poured a record $40 billion into Europe and North America in 2015, spending $29 billion, or 73% of the total in just four industries across the two regions: real estate and hospitality; automotive; financial and business services; and information technology.

A few industries show similar levels of investment across the two regions since 2000. These include the real estate and hospitality sector ($13.1 billion in Europe and $13.2 billion in North America) and the agriculture and food sector ($7.1 billion in Europe and $7.4 billion in North America). At the same time, Chinese investment patterns in Europe and North America clearly reflect the economic strengths of each region. Europe has been a greater attraction for Chinese investors seeking advanced manufacturing assets (e.g., Automotive, Industrial Machinery, Transport and Infrastructure). North America has received greater investment in advanced services sectors, including ICT, Health and Biotechnology, and Entertainment.

AGGREGATE VALUES OF CHINESE OFDI TRANSACTIONS BY INDUSTRY IN EUROPE AND NORTH AMERICA, 2000–2015 | USD million

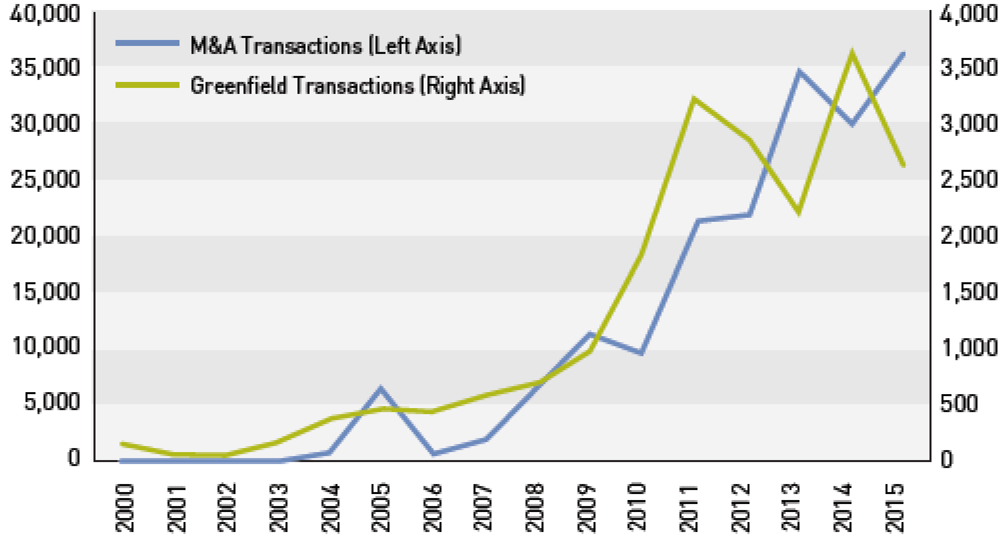


Source: Rhodium Group

Acquisitions still dominate, but greenfield investment jumps

While mergers and acquisitions account for more than 90% of the total value of Chinese OFDI transactions in North America and Europe from 2000 to 2015, Chinese investment in greenfield projects has increased in both regions. Greenfield investment has moved up from under $1 billion per year in 2009 to nearly $3 billion per year in 2015, with a more pronounced increase likely in the coming five years.

VALUE OF CHINESE OFDI TRANSACTIONS BY ENTRY MODE IN EUROPE AND NORTH AMERICA, 2000–2015 | USD million, both regions combined

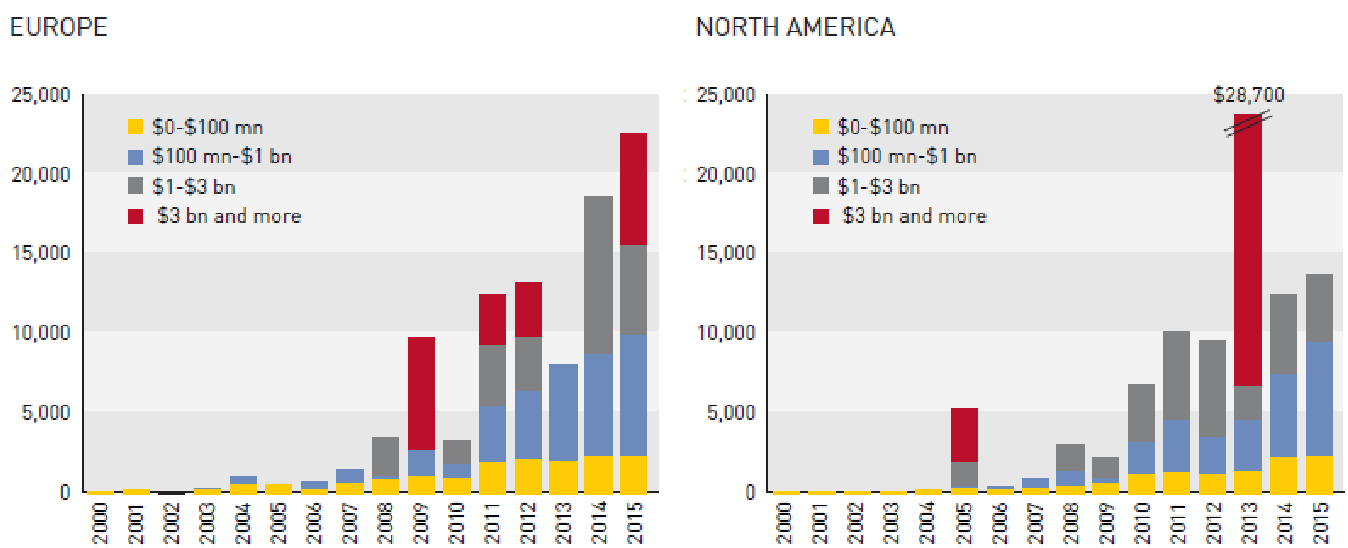


Source: Rhodium Group

Mega deals capture headlines, but small and medium-sized investments drive growth

Transactions with a value of $1 billion and below account for the majority of Chinese investment in both regions in the past two years. The biggest growth in both regions occurred in deals of $100 million to $1 billion, jumping from an average of only three per year before 2011 to 66 deals in 2015. The value grew from virtually zero to more than $3 billion in 2010, jumped to $8 billion in 2011 and 2012, and doubled to more than $16 billion in 2015. For larger deals, Chinese investors continue to prefer to take majority or full ownership.

VALUE OF CHINESE OFDI TRANSACTIONS BY TRANSACTION SIZE IN EUROPE AND NORTH AMERICA, 2000–2015 | USD million

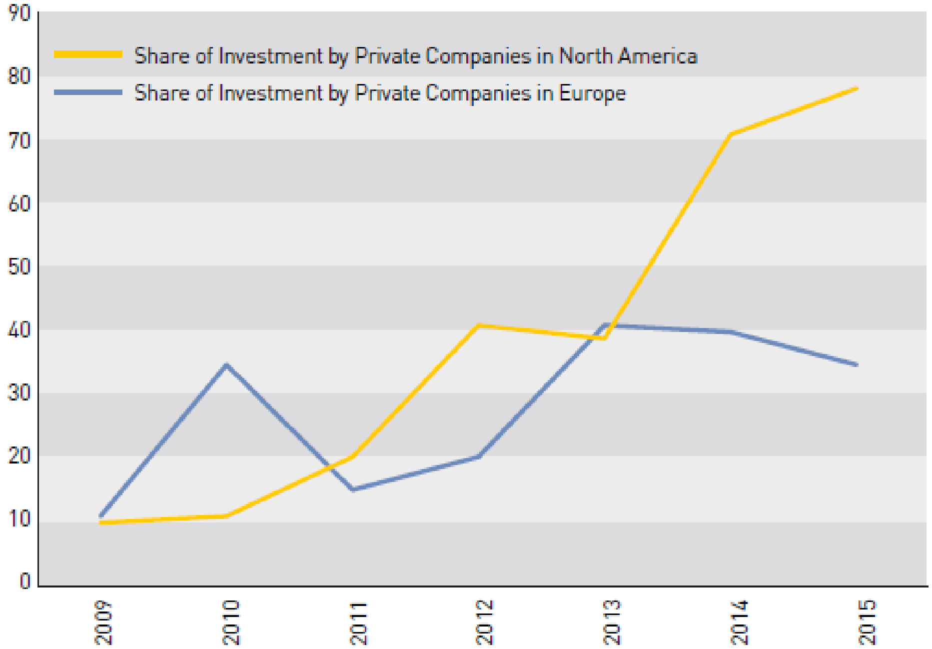


Source: Rhodium Group

The mix of Chinese investors is more diverse, with private investment rising in North America

SOEs have dominated China's global OFDI activities for most of the past decade, accounting for more than 70% of Chinese OFDI in Europe and North America from 2008 to 2013. Private investment, however, has been growing in both geographies, gradually increasing from 12% in 2009 to 53% in 2015. In particular, private sector companies now drive Chinese investment in North America, accounting for 80% of total investment in 2015.

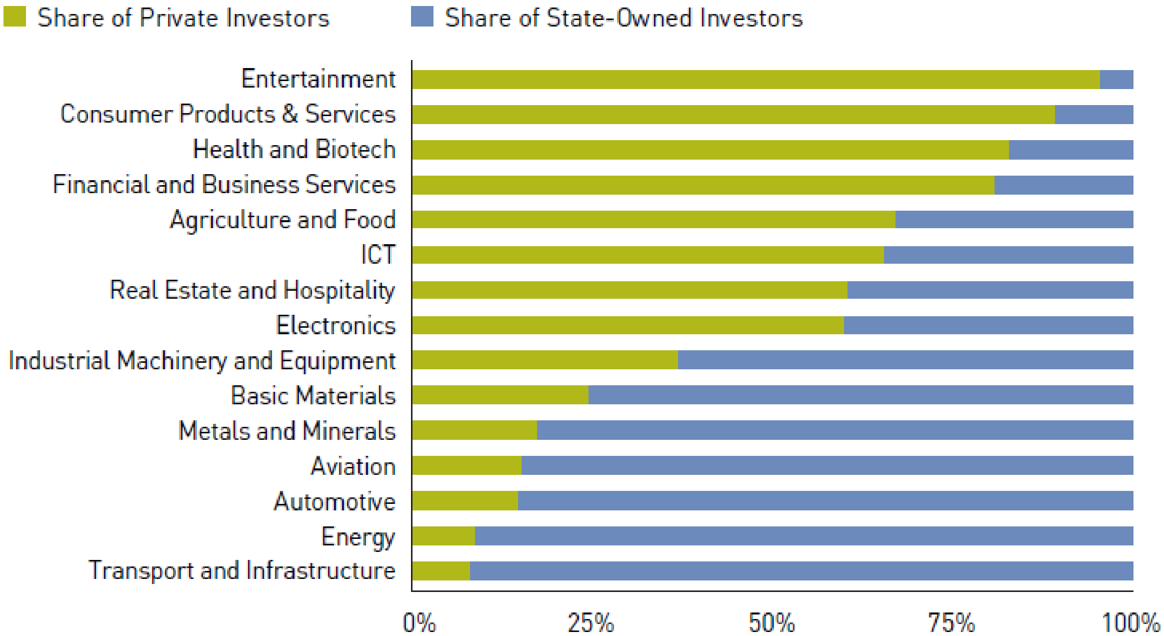
SHARE OF PRIVATE CHINESE INVESTMENT IN EUROPE AND NORTH AMERICA,* 2009–2015 | Percent of total



Source: Rhodium Group

The presence of SOEs and private companies strongly diverges across sectors, mostly mirroring the ownership structures in those sectors in China. Private companies account for the majority of investment in consumer-facing industries (e.g., entertainment, consumer products, healthcare), as well as agriculture and food, ICT, real estate, and electronics. SOEs dominant investment in capital-intensive industries such as energy, infrastructure, and metals, and in manufacturing industries with a legacy of state ownership in China (e.g., aviation, automotive and industrial machinery). One notable outlier is financial and business services. While China's financial sector continues to be dominated by state-owned players, more than two thirds of cumulative investment in North America and Europe originates from private companies.

SHARE OF STATE-OWNED AND PRIVATE COMPANIES IN CHINESE FDI TRANSACTIONS IN EUROPE AND NORTH AMERICA, 2000–2015 | Percent of total cumulative investment from 2000 to 2015

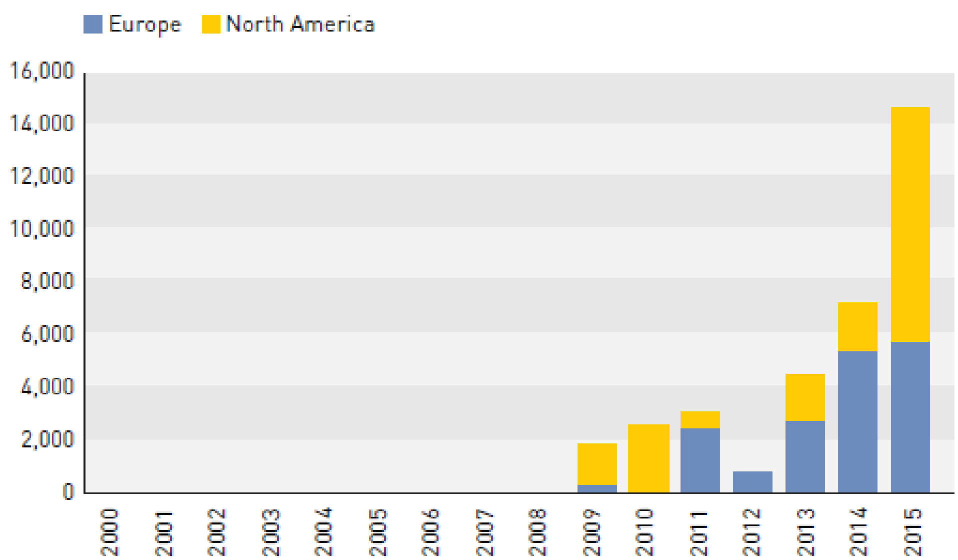


Source: Rhodium Group

Financial investors are playing a greater role

The maturation of China's financial services industry beyond commercial banks and the rapid expansion of credit have created new Chinese financial players managing large pools of capital, including financial conglomerates, trust companies, wealth management firms, insurance companies and private equity funds. Declining returns for investments at home and new policies that reduce regulatory impediments for global investment have incentivized these new players to look outward for opportunities in North America, Europe, and elsewhere.

CHINESE OFDI BY FINANCIAL INVESTORS IN EUROPE AND NORTH AMERICA, 2000–2015 | USD million



Source: Rhodium Group

Government policy and regulations are shaping investment patterns

On the Chinese side, the liberalization and streamlining of OFDI regulations are important prerequisites of the recent boom. Industrial policies, such as the release of the 13th Five Year Plan focused on "Internet Plus" and "Made in China," can also explain certain trends in outbound investment. The Chinese government's role in shaping OFDI flows also extends to the behavior of sovereign entities and specific policy initiatives that encourage investment in certain geographies, such as the recently announced "One Belt, One Road" program aimed at strengthening China's commercial ties with economies along the ancient Silk Road.

On the recipient side, the policies, regulations and attitudes of European and North American countries are shaping the inflow of Chinese capital. While both Europe and North America have a long history of embracing foreign direct investment, European governments have been proactive in promoting the inflow of Chinese OFDI in past years compared to the United States, where the federal government has primarily delegated that responsibility to the 50 states. The readiness of European leaders to sell assets to Chinese investors, forge strategic partnerships, and award them public contracts has also moved the needle in terms of aggregate investment values. In the past five years, Chinese companies have spent $8.6 billion on newly privatized assets in Europe.

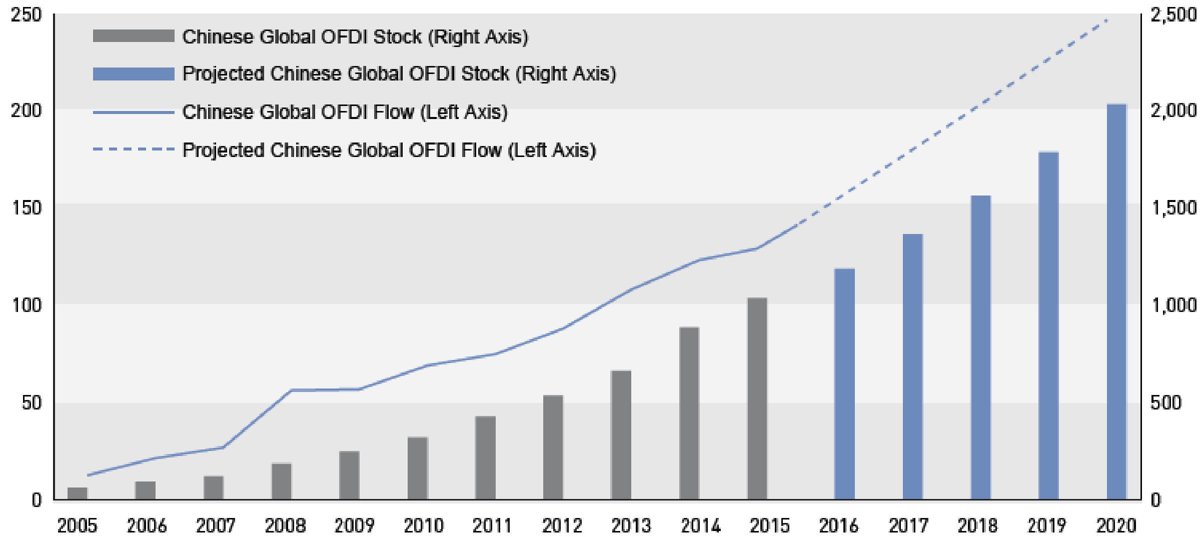
Defensive policies to screen investment for security and economic risks also play a role. In the United States, a few failed transactions have created the perception that Chinese companies are subject to a higher scrutiny by the Committee on Foreign Investment (CFIUS), which can work as impediment for greater investment levels in specific industries. Investment reviews are generally perceived as less onerous in Europe. These realities and perceptions are visible in the observed patterns of Chinese investment. For example, Europe has attracted more than $10 billion of Chinese investment in infrastructure assets, compared to only $3.8 billion in North America. The heavy presence of European companies in North America makes it increasingly important for Chinese buyers to assess CFIUS-related risks for potential acquisitions of European companies.

Mechanisms in place to address potential economic concerns, such as review of deals by competition authorities and restrictions for foreign investment and/or additional regulatory checks applicable to certain industries are also visible in the data.

China's OFDI boom is going strong

China's OFDI boom is still in its early stages and promises many more years of high levels. The first quarter of 2016 was the busiest period on record for Chinese outbound deal making, with announced acquisitions of more than $60 billion in Europe and $30 billion in North America. Recent projections by high-level officials see Chinese outbound FDI growing by another $1 trillion by 2020, which translates into average outflows of $200 billion per year. If those projections hold, Europe and North America can expect to land hundreds of billions of dollars of Chinese OFDI in the coming decade.

PROJECTIONS FOR CHINA'S GLOBAL OUTWARD FDI FLOWS AND STOCK TO 2020* | USD billion



*Source: State Administration of Foreign Exchange, Ministry of Commerce, Rhodium Group; *2015 estimated by combining financial and non-financial OFDI. 2016–2020 data based on projections by Li Keqiang, see Footnote 22.*

At the same time, a few risk factors exist, including the risk that the Chinese government may impose additional capital controls to slow down outflows and growing political risks based on concerns about equal market access. The economic and political factors currently shaping Chinese investment patterns on both sides of the Atlantic will be important to watch: namely, the relative attractiveness of specific industry segments in the context of China's development trajectory, the long-term outlook for economic growth and competitiveness, the evolution of the regulatory and legal environment, and the public attitude toward Chinese investors.