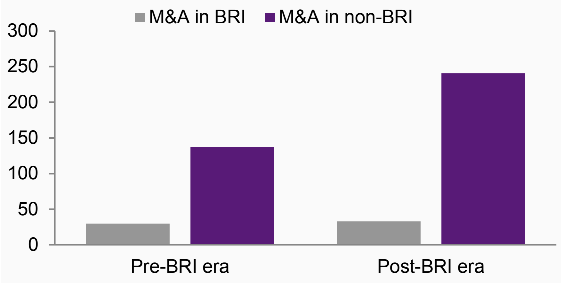
EURASIA

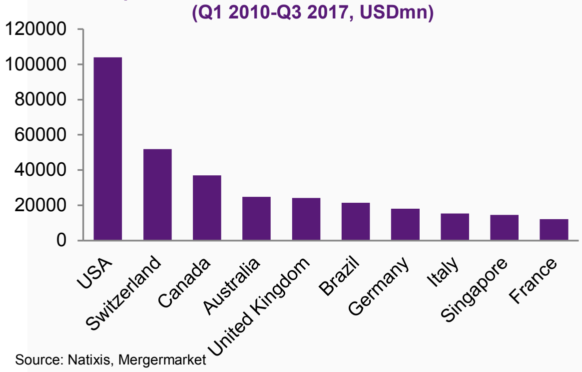
30 October 2017

Chinese overseas completed M&A in BRI (USDbn)



Source: Natixis, Mergermarket

Top 10 destinations for Chinese outbound M&A (Q1 2010-Q3 2017, USDmn)



Source: Natixis, Mergermarket

Belt and Road Watch

CHINA'S MERGERS AND ACQUISITIONS TOWARDS THE BELT AND ROAD : STILL ON THE WAY

China's intrinsic demand for overseas expansion, especially in the form of mergers and acquisitions (M&A), seems to have come to a halt in 2017 after an extremely rapid growth in 2016. The main reason for such sudden stop is the Chinese government's both explicit and implicit restrictions on M&A.

To draw appropriate conclusions on future trends, it is important to note that the restrictions recently imposed by the Chinese government are not geared towards banning outbound foreign direct investment (OFDI) permanently but rather to pour cold water on the overheated "going-out" enthusiasm of Chinese corporates. This is especially the case for purchases of trophy assets without clear relation with China' industrial policy both in terms of sectors and geographies. There are signs that such tight regulation on outbound M&A is likely to be softened soon but the redirection towards certain strategic (high value-added) sectors and certain geographies (mainly Belt and Road) should continue.

Admittedly, despite government's strong support for the Belt and Road Initiative (BRI), there has not yet been strong M&A action among countries in BRI as opposed to others. In fact, the US and the EU have always been the favourite destination for Chinese corporates' overseas expansion. However, this pattern is starting to change towards more interest in BRI. The fear of increased protectionism in the developed world is also behind the Chinese leaders' push for a redirection in the destination of M&A towards BRI. Also, after the Party' Congress, the government is expected to implement more concrete measures, such as implicit subsidies, easier capital movement, etc., to support the BRI, which will facilitate M&A along Belt and Road geographies.

Within the M&A activities in BRI so far, the focus has mainly been on ASEAN countries and, to less extent, Central Asia. The safest country in the region - Singapore - accounted for 23 percent of China's M&A in the BRI alone since 2010. For higher-risk geographies, Chinese companies seem to prefer to engage in project financing than taking the ultimate ownership. All in all, we believe that neighbouring low-risk countries will still be the main target for Chinese M&A in the coming years.

As far as sectors are concerned, energy and industrial sectors have been the most important targets for M&A within Belt and Road geographies, followed by financial services. In this regard, there is no fundamental difference between BRI and non-BRI economies.

All in all, we do not expect the sudden stop in Chinese M&A to last long. However, we do expect a re-direction of the deals towards emerging markets, in particularly those within BRI. In the same vein, M&A will be increasingly redirected to sectors aligned with China's industrial policy.

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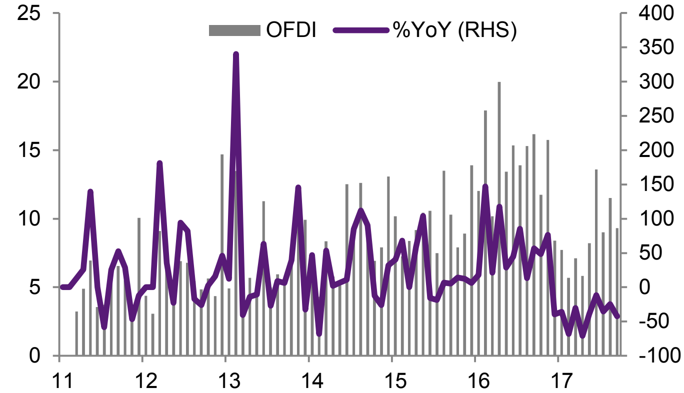
ECONOMIC RESEARCH

Government motivation for China's oversea M&A towards the Belt and Road

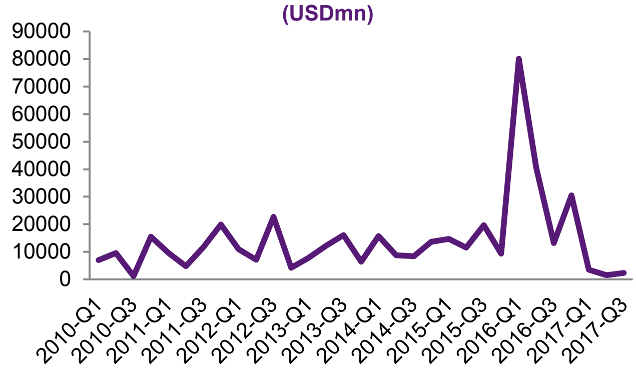
The world has seen a dramatic expansion in China's overseas foreign direct investment (OFDI), especially in the form of mergers and acquisitions (M&As) since 2015 (**Chart 1** and **Chart 2**). This is a consequence of not only China's increasingly massive financial resources and appetite but also decreasing rate of return on investment domestically. The other important reasons are the lack of geographical diversification of Chinese corporates' assets and the very concentrated risk on a slower growing China. Although the expansion came to a sudden halt in 2017, mainly because of government cracking down upon capital outflows, we have reasons to believe that China will continue to engage in large M&A operations in the future.

Chart 1
China Outward FDI



Source: Datastream, Natixis

Chart 2
China's completed outbound M&A (USDmn)



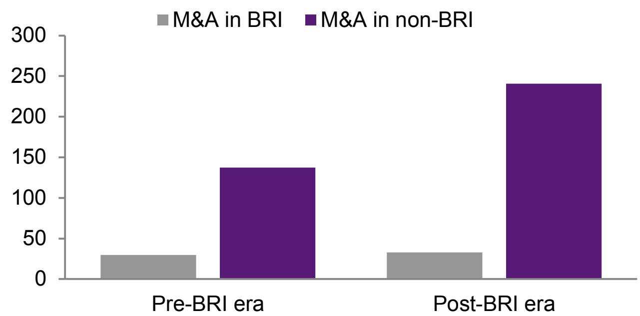
Source: Natixis, Mergermarket

At the same time, the Chinese government's push for the Belt and Road Initiative (BRI) shows a very clear geographical preference. This plan needs to be understood as a major change in terms of China's soft power preferences, away from developed countries. The question, though, is whether Chinese are following the government's direction, i.e., are stepping up investment in the BRI countries rather than in the West.

So far the West is the target for Chinese M&As but the BRI geographies are starting to emerge

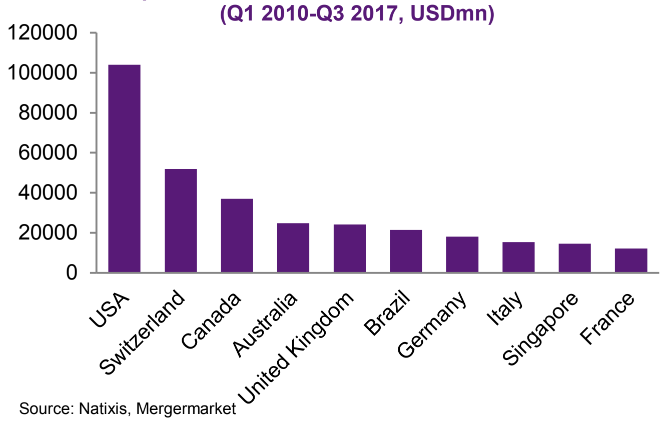
So far no clear change can be perceived in terms of the relative importance of BRI geographies as destination for Chinese M&A before and after the announcement of this major government strategy in late 2013. The West has remained the key destination of Chinese corporates investing abroad (**Chart 3**). The currently top 10 destinations are North America and the EU. The only relevant BRI target has been Singapore (**Chart 4**).

Chart 3
Chinese overseas completed M&A in BRI (USDbn)



Source: Natixis, Mergermarket

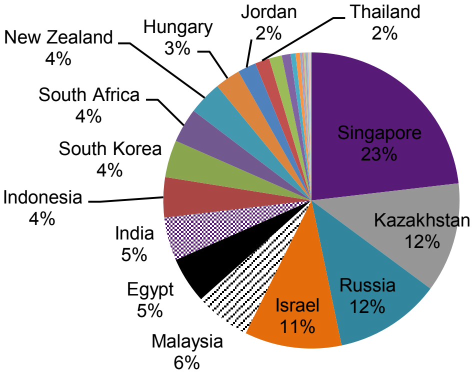
Chart 4
Top 10 destinations for Chinese outbound M&A (Q1 2010-Q3 2017, USDmn)



Source: Natixis, Mergermarket

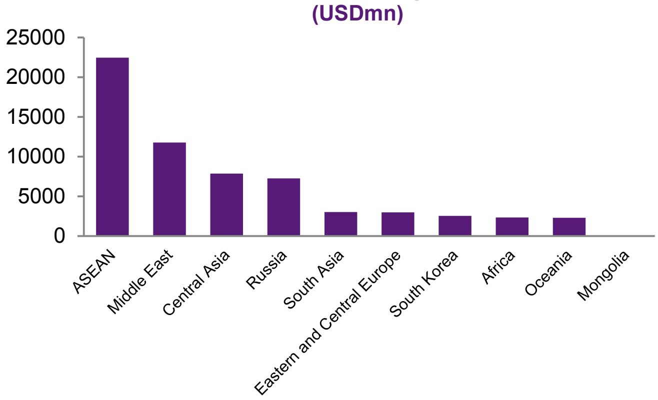
The fact that Singapore tops the ranking of China's M&A in BRI geographies points to the importance of a stable environment for Chinese corporates to invest (**Chart 5**). The same pattern is found for regions, with ASEAN being the largest recipient, as compared to other BRI regions (**Chart 6**).

Chart 5
Distribution of Chinese M&A in the BRI



Source: Natixis, Mergermarket

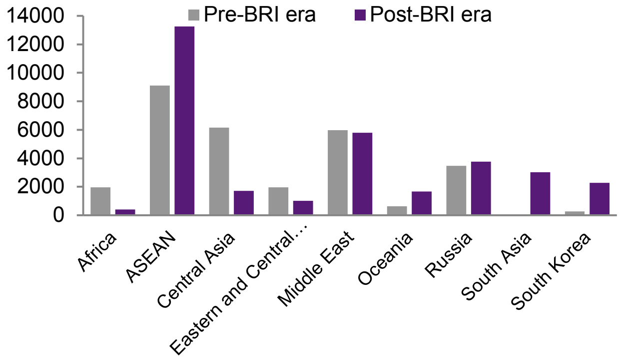
Chart 6
Chinese M&A in the BRI - regional breakdown (USDmn)



Source: Natixis, Mergermarket

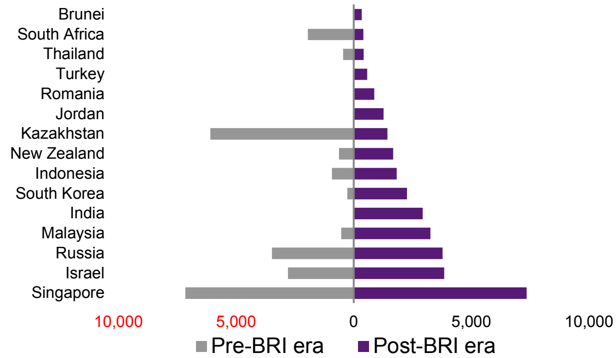
When comparing the evolution before and after the imitative, there is a big increase in Chinese M&As in ASEAN, South Korea and South Asia (**Chart 7**). As for the Middle East, most of the M&As went to Israel especially in the high-tech sectors (**Chart 8**) while project financing seems to have been preferred for the rest of the Middle East (See our previous publication on [the BRI in the Middle East]()).

Chart 7
Distribution of M&A in the Belt and Road before and after the Initiative



Source: Natixis. Mergermarket

Chart 8
Top 10 BRI countries receiving Chinese M&A in the pre- and post- BRI era



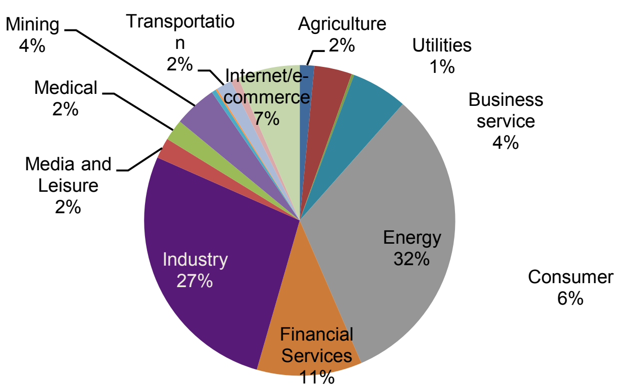
Source: Natixis, Mergermarket

Which sectors is China targeting?

China's overseas M&A expansion is broad based, but with particular focus on strategically important sectors in line with the country's industrial policy. Energy and industrial sectors are the two largest, followed by financial services (**Chart 9** and **Chart 10**). In this regard, there is no fundamental difference between M&A into BRI geographies and others.

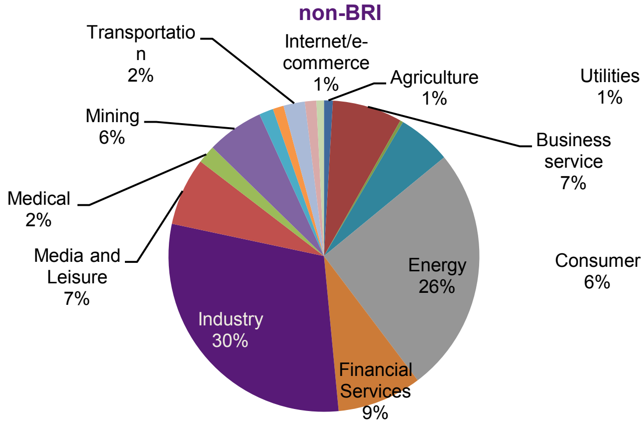
However, there are indeed some peculiarities. The most interesting one is China's preference in the internet/e-commerce sector in BRI geographies, which reaches 7 percent of its total M&As but only accounts for 1 percent in the non-B&R area. The pattern reflects China's difficulty in taking over high-tech companies in the developed market as well. On the contrary, Chinese M&A in the non-BRI area have a much higher share in the media and leisure sectors than in the BRI area (**Chart 11**). However, this trend has come to a sudden stop this year with Chinese government announcement of avoiding "irrational investments" in these sectors, which is unlikely to be lifted soon.

Chart 9
Sectorial distribution of the targetted M&A in the BRI



Source: Natixis, Mergermarket

Chart 10
Sectorial distribution of the targetted M&A in the non-BRI



Source: Natixis, Mergermarket

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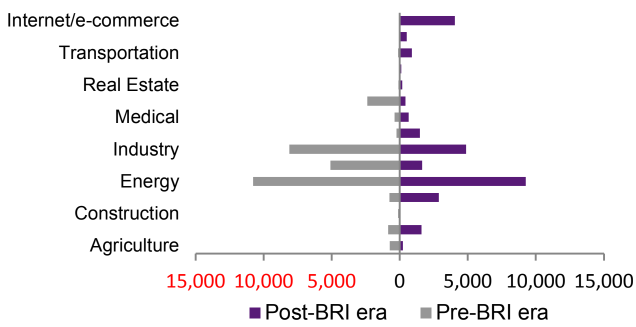
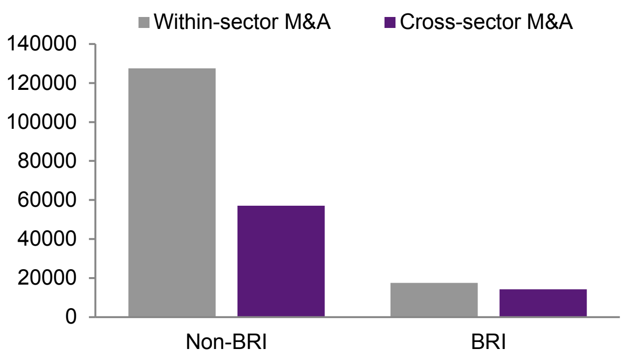
Chart 11
Sector breakdown of M&A in the pre- and post- BRI era



Source: Natixis, Mergermarket

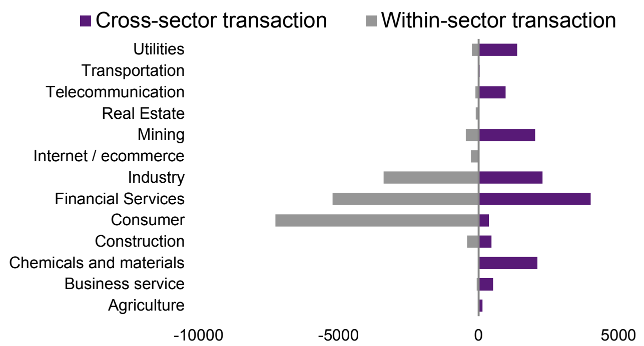
Moreover, the M&As in the BRI have a higher proportion of cross-sector type investments (Conglomerate M&A, especially for financial services and consumer sectors seeking oversea opportunities), whereas in the non BRI countries, the dominant M&As are still within-sector type (**Chart 12** and **Chart 13**). In some sectors, Chinese companies seem to be interested in BRI to extend their businesses across sectors.

Chart 12
Type of M&A: within- versus cross- sector transaction



Source: Natixis. Mergermarket

Chart 13
Within- versus cross- sector M&A transactions



Source: Natixis, Mergermarket

All in all, we do not expect the sudden stop in Chinese M&A to last long. However, we do expect a re-direction of the deals towards emerging markets, in particularly those within BRI. In the same vein, M&A will be increasingly redirected to sectors aligned with China's industrial policy.

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