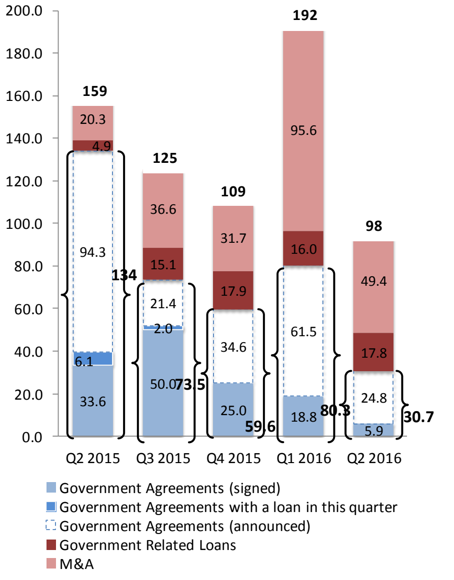
China Outbound Investments Q2 2016

I. Overview

Table 1: Aggregate Value (USD billion)



Q2 Chinese outbound investments USD 97.9 billion, a decrease of 49% from Q1's all time high of USD 191.6 billion. As shown in Table 1, this is also the lowest amount in the past 5 quarters. While the aggregate amount was down, there were volume increases in all 3 components of our research, indicating smaller average deal sizes throughout each component.

M&A/equity had another outstanding quarter, with USD 49.4 billion aggregate amounts. Virtually all of this difference between quarters was related to the USD 44 billion Sygenta transaction in Q1. Volume continued to rise with 231 transactions announced in Q2, an increase of 11.1% from Q1. This again represents an all time high. There were 12 announced transactions over USD 1 billion, which represented 66% of aggregate amounts. Omitting these 12 transactions from Q2 totals, average transaction size was only USD 146 million - so most of the activity remains very much middle market.

Relative to geography, once again, Europe led in aggregate value (54% of total amounts). North America ranked 2nd in aggregate amounts but led in volume (Europe was 2nd). Relative to industries, Consumer led in volume, followed by Technology, while Technology (due to 4 USD 1+ billion transactions) led in amounts.

While all of these signs show a continued upward trend, we have also seen circa USD 30 billion of terminated, withdrawn or rejected transactions since November 2015, across a number of industries. We discuss these emerging trends in our Quarterly Feature section.

There were 18 Government Related Loan Agreements (up 50% from Q1) representing USD 17.8 billion aggregate amounts (up 11.3% from Q1). This quarter saw the first loans from New Development Bank (NDB) and AIIB. There were four policy bank loans over USD 1 billion, two of these to Russia, one to Ecuador and one to Brazil. Four policy bank loans were signed during State visits.

There were 8 total loans by NDB and AIIB. Collectively, these which represented 44.4% of the volume but only 7% of aggregate amounts. Two of the 4 NDB loans were to BRI countries while all 4 AIIB loans were to BRI countries.

There were 11 multi agreement Government Agreements in Q2 representing USD 30.7 billion (our calculations) aggregate value. Volume increased by 120% while stated aggregate value declined by 67%. However, once removing the two major regional pledges in Q1 (Middle East and Mekong Delta), volume was virtually flat from Q1. Russia and Nigeria received 82% of Q2 pledges.

Signed transactions versus pledges were 19% in Q2. However, MoUs for the Russian transactions of USD 18 billion would raise this percentage to totalling 78%.

M&A Transactions / Equity Investments

↓48%

As noted above, Q2 announced outbound M&A aggregate value was USD 49.4 billion, down 48% from the USD 95.6 billion in Q1, mainly due to the acquisition of Syngenta by ChemChina, which represented 45% of aggregate amounts in Q1. After removing the pro forma effects of the Syngenta transaction Q2 amounts fell by only 4.3%. Volume increased by 11.1%, to 231 transactions, our highest volume total ever. This quarter there were 12 other transactions of at least USD 1 billion, totalling USD 32.4 billion (66% of the total), while the remaining 219 transactions comprised USD 17.0 billion aggregate value.

Average deal size (excluding equity investments below USD 10 million with disclosed transaction value) decreased from USD 451 million (excluding the Syngenta transaction) to USD 387 million in this quarter. Omitting the 12 largest USD 1+ billion transactions, the average transaction size was only USD 146 million.

Industry

Technology led by aggregate value with USD 17.6 billion (36% of the total). This sector recorded 4 transactions above USD 1 billion, including the largest of the quarter – the USD 8.6 billion acquisition of a majority stake in Supercell Oy (Finland) by Tencent Holdings.

Industrials ranked #2 with USD 8.6 billion, representing 17% of aggregate amounts. There were 2 transactions in excess of USD 1 billion including the acquisition of a majority stake in KUKA AG by Midea Group (Germany – USD 4.4 billion).

Financials ranked #3 with 15.3% of total aggregate value. There was 1 transaction above USD 1 billion – the purchase of Dah Sing Life Assurance Co Ltd, Macau Life Insurance Co Ltd, DAH Sing Insurance Services Ltd. by Fujan Thai Hot Investment for USD 1.4 billion. Among Financials there were 19 transactions involving Real Estate.

Consumer ranked 4th in aggregate value with 12%. Collectively, these 4 sectors accounted for 81% of Q2 aggregate amounts.

Relative to volume, Consumer ranked #1 with 54 transactions followed by Technology with 47. Industrials ranked 3rd with 43 transactions, followed by Financials with 39. Together these four sectors accounted for around 80% of total volume.

Geographies

Europe ranked #1 in aggregate value, accounting for 54%. For the 5th consecutive quarter North America ranked 2nd with 31% while Asia slightly increased from 7% to 9% of aggregate value. Collectively, these three regions represented 94% of Q2 aggregate value.

North America led again in volume with 84 announced transactions/investments (36% of volume), followed by Europe with 75 (32%). Asia ranked #3 with 52 transactions (23% of volume).

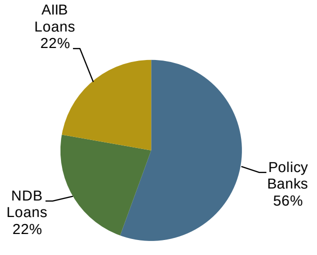
Government Related Loan Agreements

↑11%

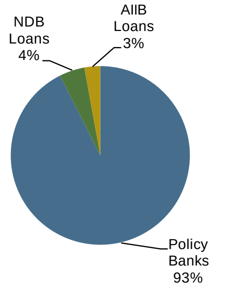
This quarter saw the signing of the first loans by two new entrants, NDB and AIIB. These new entrants mark the first steps in China diversifying away from its policy banks of "buy and hold risk" to risk sharing with other countries/partner banks. This quarter such partners included the Asian Development Bank, the World Bank/IMF and the EBRD.

In Q2, there were 18 signed Government Related Loan Agreements; 10 from policy banks, 4 involving NDB and 4 involving AIIB. The aggregate volume for all 3 represent a 50% increase in volume from Q1. Aggregate amounts of USD 17.8 billion; (USD 16.5 policy banks, 0.8 billion NDB and 0.5 billion AIIB) represented an 11.3% increase from Q1.

Breakdown by Volume



Breakdown by Aggregate Amount



Six of the 10 policy bank loans were to BRI/OBOR countries, 2 of the 4 NDB loans were to BRI countries while all 4 AIIB loans were to BRI countries.

Average loan size varied considerably via the vehicle:

- 10 policy bank loans averaged USD 1.65 billion (4 loans over USD 1 billion, including 1 of USD 10 billion
- 4 NDB loans averaged USD 202 million of NDB exposure
- 4 AIIB loans averaged USD 127 million of AIIB exposure

While asset/project coverage ratios for the 8 new NDB/AIIB loans seem to be publicly available, we could not readily locate public information on maturities or interest rates for the loans NDB or AIIB loans: organisations which apparently aspire to “transparency”.

Government Agreements

↓67%

In Q2, China entered into 11 multi deal Government to Government agreements, split 64% when foreign Government officials were visiting China and 36% when President Xi was visiting those countries (Xi met with leaders from 28 different countries in Q2). These 11 agreements (6 were BRI countries) represent a 120% increase from the number of Government Agreements in Q1.

While accurate data was not readily available for many of these agreements, we have calculated aggregate value of USD 30.7 billion for this quarter. This amount represents a 67% decrease from Q1; however, after removing an estimated USD 50 billion Q1 Middle East and Mekong Delta regional pledges, aggregate amounts for both quarters were virtually flat.

Russia and Nigeria, two countries experiencing financial strain, received 82% of Q2 aggregate pledges.

II. Quarterly feature: Selected Chinese offers / outbound investments announced but not completed

While M&A volumes and aggregate amounts continue to see positive growth, we have begun to notice signs of tightening by local financial services industry regulators, local Governments and CIFUS, leading some Boards electing not to take the risk of signing a transaction with Chinese acquirers. We have just experienced this on one of the transactions on which we are advising.

We set out below information on 9 announced transactions during H2 2015 and H1 2016 representing circa USD 30 billion of aggregate value.

- 5 Terminated, representing USD 11.3 billion
- 2 withdrawn, representing USD 15.9 billion
- 2 rejected, representing USD 2.9 billion

Our analysis covers transactions in the financial services, agriculture, hotels and IT industries.

Relative to financial services, we were well aware of the Dutch regulators concerns on the Vivat/Anbang transaction during 2015; but relative to this group of transactions, we have now also seen concerns raised by Chinese regulators, New York State regulators and Israeli regulators.

CIFUS has also become a more proactive review force with broadened powers. CIFUS rejections or at least risk of review has led some (particularly US) Boards not take a risk of accepting a Chinese acquirer's offer.

Finally, during this time period, the Australian Government has rejected two offers for a Chinese acquirer to acquire a substantial major land owner and beef producer's business in Australia. The 2nd rejection occurred only a few weeks after Prime Minister Turnbull visited President Xi and Premier Li in China.

Terminated

Chinese Acquirer	Target/Country	%	Deal size ($ bn)	Comments
Zoomilon Heavy Industry	Terex / US	100	3.4	After winning a global auction in March, which represented a price 60% higher than the cover bidder, in May Zoomilon terminated its agreement to acquire US equipment maker Terex
Fosun	Phoenix / Israel	52.3	0.5	In June 2015, Fosun agreed to acquire a 52.3% stake in Phoenix, Israel's 4th largest insurer. In February 2016, Fosun terminated the transaction after the transaction was not approved by Israeli regulators
Tsinghua / Unisplendour	Western Digital / US	15	3.8	In September 2015, Tsinghua Holdings subsidiary Unisplendour Corp announced plans to acquire 15% of in Western Digital Corp, a US data storage company (33% premium to the prior day's closing share price). In January 2016, Tsinghua refiled its approval application resetting the time clock for approval. In February, Unisplendour terminated the offer upon learning that CIFUS would review the transaction.
Consortium led by GO Scale Capital	Lumileds / US	80.1	3.3	In March 2015, a consortium of Chinese private equity investors agreed to acquire 80.1% of Lumileds from Philips NV. In October, Philips announced that completion was uncertain due to concerns raised by CIFUS. In Janaury 2016, Philips terminated the agreement due to CIFUS opposition
Dakang Australia Holding Pty Ltd / Australia Rural Capital (Australia)	S. Kidman & Co Ltd / Australia	80	0.3	In mid April 2016, Dakang Pasture Farming and locally owned Australian Rural Capital (ARC)agreed to acquire (80% and 20% respectively of S Kidman and Co, a major Australian agricultural land owner and beef producer. Within 10 days of announcement, Australia's Treasury Secretary rejected the transaction. The prior transaction structure had also previously rejected in November 2015
Totals			**11.3**	

Withdrawn

Chinese Acquirer	Target/Country	%	Deal size ($ bn)	Comments
Anbang Insurance; Primavera Capital; JC Flowers	Starwood Hotels / US	100	14.3	In March 2016, Anbang, together with its partners Primavera Capital and JC Flowers withdrew its binding offer to acquire Starwood Hotels only days after lifting it to over $14 billion
Anbang Insurance	Fidelity and Guaranty Life / US	100	1.6	In November 2015, Anbang and Fidelity and Guaranty Life (FGL) signed a definitive merger agreement in which Anbang agreed to acquire FGL for approximately $1.6 billion in cash. In March 2016, Anbang received transaction approval from CIFUS. In late May 2016, Anbang withdrew its request for approval from the New York State Insurance Department
Totals			**15.9**	

Rejected

Chinese Acquirer	Target/Country	%	Deal size ($ bn)	Comments
Consortium; CR Microelectronics and Hua Capital Management	Fairchild Semiconductor / US	100	2.5	In November 2015, the Board of Fairchild rejected the highest offer from China Resources Microelectronics due to risk that CIFUS would not approve the transaction
Montage Technology	Pericom / US		0.4	In late September 2015, Montage Technology made an offer of $430 million to acquire Pericom Semiconductors. This offer, which was 9% higher than Diodes offer, was made nearly 1 month Diodes and Pericom signed a merger agreement. Montage's offer was rejected by Pericoms's Board-leading Montage to write directly to shareholders in November- a tactic which proved unsuccessful in blocking the Diodes' deal
Totals			**2.9**	

We see continued tightening by both international and Chinese financial services regulators and no changes to CIFUS - if anything - even further tightening until there is a change in US Government and thus more risk to a continuance of this recent trend.

Overview of Grisons Peak

Grisons Peak LLP is a London based merchant banking firm specializing in a number of sectors including financial services (including real estate), pharmaceuticals, infrastructure and consumer. We provide independent advice on cross border M&A, ECM and high yield issues, both public and private. We also selectively co-invest in equity stakes alongside our clients. In the area of merchant banking, Grisons Peak has invested in 7 client related investments across Europe, Asia and the Americas.

We operate via joint ventures and partnerships throughout Europe, the Middle East, Africa and in North Asia. Since its founding in 2003, the firm has advised on over €25 billion transactions across three continents. In the Advisory area, over the past 32 months, the firm has advised on 16 completed transactions and on 26 binding offers, mostly in emerging markets. In the Advisory area, we focus on transaction execution since virtually all of the firm's clients have done business with Grisons Peak or representatives of the firm previously. We also do not advertise as we are very discreet regarding our Advisory clients (hence only a 1 page website for this business).

Grisons Peak LLP launched and began publishing our quarterly research product China Outbound Investments in 2008. While other major database services track Chinese outbound M&A/Equity investments, our Chinese research is unique in that we monitor and analyse M&A/Equity in the context of much larger Government Agreements and Government Related Loan Agreements. Our research has been cited by major financial media including the *Financial Times*, *The Wall Street Journal*, *Reuters*, *IFR, Bloomberg*, *FT Confidential*, *EM Squared, Euromoney*, *IFR Asia*, *The Independent, GTR Review.*

We also proudly hold the distinction of having our firm's research cited by two important Chinese Government press; *Xinhua* and *China Daily*, on two unrelated very visible Chinese policy issues. We frequently release prior investment banking analyses over a section titled “Special Studies”; another link between the two businesses. We have also collaborated with New York University in econometric research on Chinese outbound investments into the USA. We are currently cooperating on an academic study involving all Chinese M&A into the UK (2012-30 June 2016) with Cass Business School, within the City University of London. We see our firm’s USP as providing unique research and analytical skills in both of our core businesses.

Grisons Peak LLP is Authorized and Regulated by the Financial Conduct Authority.

For further information on this, please visit: www.chinainvestmentresearch.org