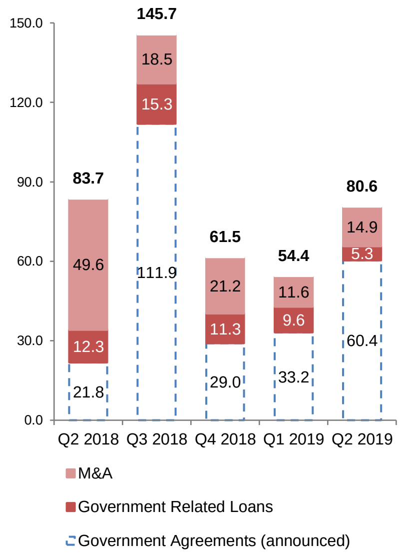
China Outbound Investments Q2 2019

Shift to B2B – China's Shift to B2B – Reconciling President Xi's $64 billion New Projects

Table 1: Aggregate Value (USD billion)



Overview

The key highlight of this quarter was the 2nd Belt and Road Forum, which has already generated a considerable amount of press. We thus have changed the format for this quarter to both utilise our own methodologies of the past 11 years but also to embrace the changes occurring in financing the BRI to validate the key findings in BRI II.

Key findings

- Outbound M&A/equity investments are on pace for a $50-60 billion/year based upon H1 2019, substantially below 2018 outbound and less than 50% of 2018 Chinese inbound FDI of $135 billion. Unlike in Q1, China inbound activity was relatively small and concentrated in asset management. [(1)]
- Bi-lateral policy bank loan issuance continue to plummet both in numbers and in aggregate amounts as BRI funding has shifted to multilateral loans and/or public market issuance – across debt and equity (where possible given current Greater Chinese equity market valuations).
- Not only has such bilateral lending plummeted, we list 7 countries to date in 2019 in which China has either renegotiated prior loans and/or BRI infrastructure contacts.
- The big story this past quarter was the pronounced shift from G2G to B2B. Within the B2B component lies most of the underlying data to reconcile with President Xi's announcement of $64 billion new contracts signed at BRF II (or just prior to or following). Such international B2B agreements should help facilitate international revenue growth for Chinese companies involved.
- We close with similar comments from President Xi, President Putin and Prime Minister Modi when they met together prior to the G20 Summit in Japan.

Chinese Outbound M&A Transactions/Equity Investments

21.6%

$14.9 bn

Q2 aggregate amounts of M&A/Equity investments (into existing companies) increased from a revised $11.6 billion in Q1 to $14.9 billion in Q2 (an increase of 21.6%). Volume fell from 170 in Q1 to 144 in Q2-a decline of 15.3%. This follows a decline by 9.6% in Q1 from Q4 2018 levels.

Amounts were buoyed by the presence of a small number of equity/stake investments of $1 billion or larger:

- CNOOC acquisition of 10% stake in Arctic2 LNG (Russia) for $2.5 billion
- CNPC acquisition of 10% stake in Arctic2 LNG (Russia) for $2.5 billion
- Silk Road Fund acquisition of 49% stake in ACWA Power (KSA) for $1.5 billion
- Ctrip acquisition of a 42.5% stake in MakeMyTrip (India) for $1.15 billion

[1] Unlike other firms, Grisons Peak only counts the Chinese component of outbound not the entire transaction value. For example we include China Telecom's 40% stake in Mislatel under B2B (not $5.4 billion in M&A as Mislatel is a startup which is expected to commence operations in 2020). We also used recent target valuations to calculate investment amounts in Arctic LNG2, ACWA and Makemytrip.com.

The four investments, none of which was for a controlling stake, represented circa 49% of Q2 aggregate Chinese outbound investment.

It is also interesting to examine the smaller end of the activity; 38% of all M&A acquisitions/equity investments in Q2 involved amounts of $10 million or less (after removing the 18 transactions/equity investments with no amounts disclosed). This is up slightly from 36% of Q1 2019 volume.

Chinese Inbound M&A Transactions/Equity Investments

Unlike in Q1, where there were large inbound pledges involved, Q2 showed less activity – with most of it focused in asset management. In April, Morgan Stanley used Alibaba's Taobao to acquire an additional 5.5% stake in its Chinese asset management JV. In May, JP Morgan asset management announced plans to acquire an additional 2% in its Chinese asset management JV, raising ownership to 51%. In June, Vanguard announced a China based JV with Ant Financial (capitalised at $2.9 million) in which Ant Financial would control 51%. Also in June, OakNorth, Baillie Gifford and VCP Advisors announced that they will set up a Wholly Foreign-Owned Enterprise (WFOE) in China.

Industries

For the first time (this decade), Technology led in volume, with 30 transactions/investments, which represented 21% of total volume. This was an increase from 23% of Q1 and Q4 volume. Many of these transactions were small financings – with most not led by Chinese investors.

Healthcare, which includes pharma/biopharma and biotech, ranked 2nd in volume with 17.5%. This is up substantially from the 13% in each of the past two quarters. We saw no healthcare transactions or investments in excess of $100 million this quarter.

Consumer ranked 3rd in volume with 16.1% and represented the third consecutive quarterly decline, from 29% in Q4 to 23% in Q1. This marks the lowest percentage we have seen for years. There were a few transactions/investments over $250 million but no large acquisitions of controlling stakes.

Industrials followed with 14.7%, more than doubling Q1 volume. Transactions were focused in both Europe and throughout both North and Southeast Asia.

Financials continued their declining import, falling from 15% of volume in Q3 and Q4, to 13% in Q1 and now to 11.9% in Q2. Several of these were Hong Kong, Cayman and BVI based financial transactions rather than standard acquisitions of banks, insurers or asset managers.

There were 8 energy transactions in Q2, which saw a significant percentage of aggregate investment including LNG in Russia and solar power in KSA.

Geographies

As expected, Asia was the leading continent of announced transactions, representing 43.7% of total volume. It was home to one of the four announced transactions/investments over $1 billion. It also saw 5 transactions over $250 million. The top destination remained Hong Kong; however, investments were also in Japan, Korea, Vietnam, Singapore, Malaysia, Samoa and Indonesia. India continues to show increasing volumes each quarter. While most of these are small, one of the four in Q2 above $1 billion was in India.

Europe ranked 2nd with 25.7% of announced transactions. There were investments/transactions announced in the UK, Denmark, Sweden, Austria, Italy, Czech, Switzerland, France and Russia. The UK (once again) led in volume, while Russia led in aggregate amounts due primarily to the two large equity stakes into Russia LNG2.

North America was 3rd with 21.5%, down from a decreased 25% of Q1 volume. Most transactions both in Canada and the USA were small in size, and typically were in investor syndicates led by local investors.(2)

The Middle East saw 8 investments; virtually all of these were in Israel. Saudi Arabia saw a significant investment by the Silk Road Fund in ACWA Power, a leading developer, owner and operator of power generation and water desalination plants.

There were 3 announced transactions/investments in Latin America, with a focus on Brazil and Argentina. Mexican projects received investment, but via listed vehicles in the UK and Canada.

Australasia saw 2 investments, both in Australia. Together, these totalled under $20 million in amount. There were no transactions into Africa.

Government Related Loan Agreements

$5.3 bn

45.4%

Similar outbound M&A/equity, Government related loan agreements declined significantly across all of the components in Q2 (despite the 2nd Belt and Road Forum). There were 10 total loans, representing only $5.3 billion. Aggregate amounts declined 45.4% from adjusted Q1 aggregate commitments, which had already decreased by significantly from Q4 2018 levels. This was the 4th consecutive quarter of declines. Volume represented only 50% of Q4 2018 total volume of 20 such loans.

By component, there were 6 policy bank loans in Q2 (consistent with Q1), four AIIB loans (up substantially from Q1) but no NDB loans (down from 5 in Q1). The policy bank loans were clustered around key BRI countries including Bangladesh, Serbia, Egypt and Belarus. Most of these had been under discussion for several months, but signed in/around the BRF in late April.

AIIB loans were to Sri Lanka, Laos and Nepal. None of these were for over $200 million exposure – virtually all involved multilateral institutions.

A much bigger story to date in 2019 is China's renegotiation of existing debt/contracts, details of which we set out below:

- Cameroon – in Q1, China agreed to write off $78 million out of $5.7 billion outstanding
- Congo – signed agreement to restructure $2.7 billion existing Chinese debt
- Djibouti – $800 million loans for railway and pipeline – still under negotiation
- Ethiopia – In April, President Xi and Prime Minister Ahmed of Ethiopia announced that China had written off interest due on loans owed by Ethiopia through the end of 2018
- Malaysia – Under the original East Coast Rail Link (ECRL) deal signed by Najib Razak, in April, Malaysia and China agreed a decrease in the contract by $5.2 billion – negotiations are underway to reduce the 57 billion ringgit CEXIM loan
- Maldives – no real progress to date
- Sri Lanka – $1 billion refinanced using public markets ($4.4 billion issuance in 2019 to date) AIIB committed to only new loan in Q1 – $120 million to a Bangladesh project

[2] Earlier in July, Merger market released H1 China outbound M&A numbers for Europe and the USA of less than $6 billion for H1).

Government/B2B Agreements $60.4 bn

G2G/B2B Agreements

There were a series of G2G – actually virtually all B2B agreements – signed in the weeks before, during and/or after the BFR II – where amounts (in billions) were disclosed:

- Russia ($15.0) – net of the two 10% LNG stakes, spread across energy (LNG focus), agriculture, e-commerce, telecommunications (5G) and finance
- Philippines ($14.4) – 19 B2B agreements with Chinese companies were signed during BRF II which could bring $12.2 billion worth of investments to the Philippines; also in Q2 China Telecom was permitted to invest up to 40% in Mislatel, 100% valuation of $5.4 billion as a virtual start up
- Indonesia ($14.3) – the two countries signed 23 agreements/MoUs on investment and trade cooperation – all B2B
- UAE ($13.4) – related to specific B2B projects/pledges in the KIZAD (Abu Dhabi) and Jebel Ali FTZ (Dubai)
- Ethiopia ($1.8) – B2B power transmission project linking developing Ethiopian SEZs
- Azerbaijan ($0.8) – signed 10 B2B agreements in non-oil sectors

In June, China and the UK signed $0.7 billion in agreements during the 10th UK-China Economic and Financial Dialogue (EFD) in London. Financials led with the most agreements, many of which involved China inbound investments, but also involved energy, education and consumer. During the first day of the EFD, Hautai Securities raised $1.5 billion via a GDR listing on the London Stock Exchange.

While some will argue that since many of the B2B agreements involved Chinese SOEs, and thus represent a different pocket for G2G, what is true is that these are equity investments, not loans, to help drive growth in these international companies, projects and/or plants.

Increased China, Russia and India Collaboration – similar messages to the world

The quarter ended with a China-Russia-India Leaders' Meeting in Osaka. At the meeting, President Xi emphasised that China, Russia and India need to promote a multi-polar world and make international relations more democratic. President Putin remarked that under the current circumstances, Russia, China and India should be firmly committed to upholding the international system with the UN at its core, safeguarding the international order based on the international law, defending the... sovereignty and non-interference in other countries' ..., and opposing unilateralism, protectionism and unilateral sanctions. Prime Minister Modi said that it is in the common interests of India, China and Russia to uphold multilateralism and international law and rules.

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), infrastructure, healthcare 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.

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 58 months, the firm has advised on 24 completed transactions and on 32 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).

In 2008, Grisons Peak founded *China Outbound Investments*, which tracks and analyses Chinese G2G agreements, Chinese Government related loans and M&A/equity investments in a single quarterly report, all of which have been reconciled with original source documents whenever possible. This database also includes bespoke capabilities which measure Chinese Government related loans linked to individual infrastructure/renewable energy projects since 2013. Our research has been cited by many major press including *The Financial Times, FT Confidential, EM Squared, The Wall Street Journal, Bloomberg, China Daily, Xinhua, The South China Morning Post, Australian Financial Review, Euromoney, Thompson Reuters, Global Trade Review, IFR Asia* and several others. Two of the Financial Times articles have been cover page stories; two on Chinese ports and logistics generated over 100,000 paid downloads.

This database has also been used by major universities for academic research regarding Chinese outbound investment in the UK (Cass Business School), the US (New York University) and presented in the UK House of Commons.

In Q1 2018, we published, via GOSS Research, a longitudinal study on Chinese investment into Cambodia – the first such BRI/China country study. Article entitled "Exporting the Chinese Model to BRI Countries".

Since 2017, have presented our research at Cambridge University, University of Edinburgh, London School of Economics and the Shanghai Institute of International Studies, one of the world's leading think tanks.

During 2019 we presented the materials below to major governments, corporates and universities:

- Arctic Circle – Polar Silk Road – East Asian Economic Integration/Increased European Connectivity
- Digital Silk Road – BRI Tech Hubs (1960 – 2020+)
- UN Presentation – Analysis of 6 Projects along the BRI
- HM Treasury – Piraeus Port – Financial Returns to Date
- Digital Silk Road – Emerging BRI Tech Hubs; BRI 2.0
- Chinese Presence in Mediterranean Ports

In Q2, Mr Tillman appeared twice as a guest on CNBC Europe, discussing China inbound in the first appearance, and Hong Kong/GBA as an important component of the overall BRI in his 2nd appearance. Mr Tillman previously appeared on CGTN in Beijing in Q4 2018.

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