



China Sovereign Funds, Outbound M&A:

Challenges and Opportunities

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China: The World's Factory

- **Foreign Direct Investment in China averages over **US\$60 billion / year****

i.e. China averages

US\$1 billion per day in FDI

But did you know:

China now has the world's largest foreign exchange reserves: **US\$1.2 trillion**

That's **20 x** the amount of annual FDI

= **1,200 x US\$1 billion**, or
US\$1,200,000,000,000.00

But did you know:

China's foreign currency holdings increasing by **US\$20 billion/month**

By 2009, China's forex reserves predicted to exceed as much as **US\$2 trillion**

(2000 x US\$1 billion)

Q: What is China considering to make use of these funds?

- ***Up to now:* Most common vehicle is investment in overseas financial instruments and treasury bills**
- **China currently heavily invested in US: US\$350 billion in T-bills, US\$230 billion in government-issued bonds**
- **Beijing's new policy: Don't put all your 'eggs' in one 'basket' (the United States)**

Q: What is China considering to make use of these funds?

Two main directions:

1. **Increase pace, scale of outbound direct foreign investment**
(dubbed China's "Go Out Policy")
2. **Establishment of "Sovereign Funds,"**
similar to funds operated by Singapore, Abu Dhabi, Norway, etc.

“Go Out Policy” Goals and Results

Objectives:

- **Diversify by increasing outbound direct foreign investment, M&A**
- **Sustainable development & mutual benefit**
 - **Combined direct investment overseas presently totals over US\$90 billion**
 - **In 2006, outbound investment totaled US\$21.16 billion, 40% achieved by M&A**
 - **Total for 2006 over 40% higher than the US\$12.3 billion estimated for 2005**
 - **In 2006, US\$17.63 billion invested in non-financial sectors, US\$3.53 billion invested in financial sectors**

Scale of China outbound M&A

- **5,000 Chinese investment entities have set up more than 10,000 companies in 172 countries around the world**
- **Rapid expansion into Africa and Latin America over last few years**

Chinese Investment in Latin America

- **Totaled US\$6.32 billion in 2004**
- **President Hu Jintao has personally promised over US\$100 billion to be invested in Latin America by 2014**
- **In 2006, 60% of China's FDI, or about US\$9.6 billion, went to Latin America**
- **China is Latin America's No. 3 trading partner: two-way trade exceeded US\$40 billion in 2004**

Chinese Investment in Africa

- In 2004, Chinese investment in Africa totaled US\$900 million.
- In 2005 the total grew to US\$6.27 billion
- In 2006, this figure ballooned to US\$11.7 billion, making China Africa's third-largest investor
- *China Daily* has reported the total investment in Africa last year could be as high as US\$50 billion
- China is currently Africa's No. 3 trading partner, with two-way trade exceeding US\$55 billion in 2006
- Only 100 of about 800 Chinese companies investing in Africa are large state-owned enterprises; rest are small/medium private firms

China's Priorities in Outbound M&A activity

- **Business services**
- **Mining, natural resources, oil & gas**
- **Wholesale and retail sectors**
- **Objectives: boost Chinese domestic economy by promoting exports and ensuring access to valuable resources**

Guidance for Chinese Investors

- **Chinese government has urged investors to find local partners and co-investors who understand domestic law, culture and labor environment**
- **Companies urged to stay away from high-profile takeover bids**

Future Trend: Sovereign Funds

- **What is a Sovereign Fund?**
 - **A state approve investment company**
 - **Sovereign funds are professionally managed with the objective of achieving higher investment returns**

China's Sovereign Fund

- = “China, Inc.”
- **One (or more) centralized state investment entities to be set up in 4Q 2007**
- **China will become a ‘passive investor’, outsourcing funds to professional managers**
- **Estimated to start with capitalization of US\$200 billion**

What China Needs

Objectives:

- **Find local partners**
- **Find co-investors**
- **Identify and match investment opportunities and targets**
- **Assist to secure and manage investments**
- **Avoid legal, cultural, labor and public relations problems**
- **Achieve sustainable development and mutual benefit**

Potential Opportunities for TerraLex Members

- **Help Chinese ‘do their homework’ on potential investment targets**
- **Help Chinese understand your regulatory environment: restrictions on foreign ownership, safety and health regulations, stock ownership, etc.**
- **Help Chinese understand your domestic labor environment, i.e., how workers are hired, managed and discharged**

China's Challenges:

- **Many jurisdictions welcome Chinese investment with open arms**
- **But some countries don't welcome Chinese investment and erect obstacles**