



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**