



China Go Abroad (8th issue)

**How does geopolitical
dynamics affect future
China overseas investment?**

November 2018



Building a better
working world



中国并购公会
China Mergers & Acquisitions Association

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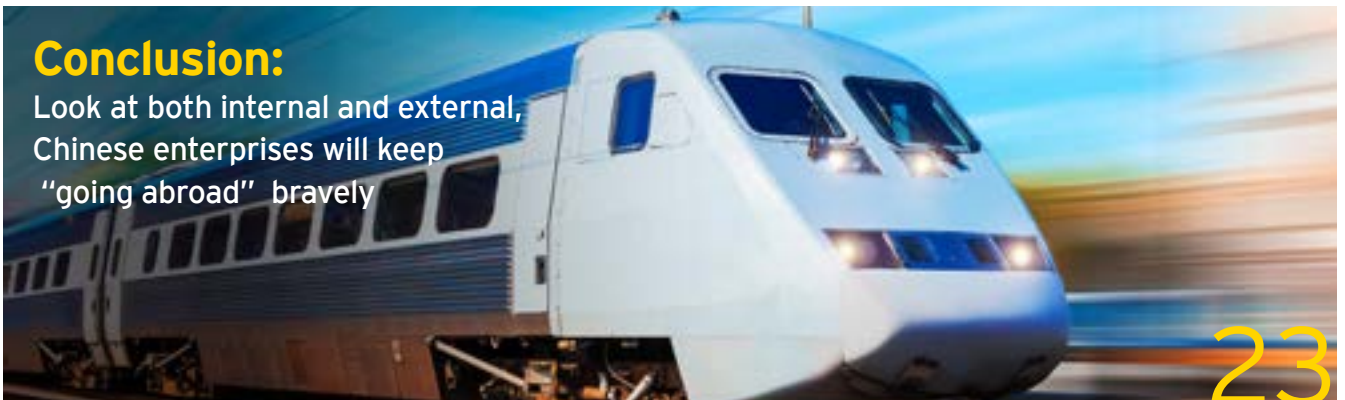
Trend analysis of China overseas investment-from "going out" to "going up "



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Conclusion:

Look at both internal and external, Chinese enterprises will keep "going abroad" bravely



Foreword

When there is a will, there is a way

Since the Third Plenary Session of the 11th Central Committee was held in 1978, China has persistently boosted rapid and sustainable economic development through reform and opening up. From 1978 to 2017, China became the second largest economy in the world as its GDP grew at an average annual rate of 9.5%, which was much higher than the average annual growth of 2.9% in the global economy. The past four decades witnessed the reform and opening up for win-win cooperation among countries. In the international stage, through its roles in the World Trade Organization (WTO), G20*, Asia-Pacific Economic Cooperation (APEC) and the BRICS**, China insists on promoting win-win cooperation through opening up and sharing development opportunities with countries around the world. In recent years, China has contributed more than 30% to global economic growth¹ and has become a major driver for the global economy.

At present, the international environment is facing significant adjustment. With the “America First” policy, there are growing differences in major international issues between the Trump administration and its allies, while emerging economies are enhancing their international influence by building up a new cooperative mechanism. As protectionism is rising and economic globalization is encountering challenges, global foreign direct investment (FDI) has seen a setback. According to the latest World Investment Report released by the United Nations, global FDI fell 23% in 2017, in particular, cross-border M&As saw a decrease by 22%², related trends indicate that the growth in international production and global value chain would slow down. Amid geopolitical dynamics, China's opening up could help countries around the world achieve mutual benefits and sustainable development when the global economy is experiencing a significant adjustment.

The 40th anniversary is a high time for a recharge rather than a destination. “When there is a will, there is a way; no matter how difficult it is, you will succeed if you persist.” EY believes as long as Chinese enterprises remain committed to creating a new international pattern to achieve mutual benefits, win-win cooperation and shared development with the host countries, they will become more powerful and confident when “going abroad”.

* G20 is an international forum consisting of 20 global major economies including China, the European Union, the United States, etc.

**BRICS represents 5 major emerging national economies: Brazil, Russia, India, China and South Africa.



Albert Ng
Chairman, China
Managing Partner, Greater China

Maintaining strategy focus is the key to a bright future

This year marks the 40th anniversary of reform and opening up. In the past four decades, private owned enterprises (POEs) have played a vital role in the success of China, especially in promoting overseas mergers and acquisitions (M&A) and economic globalization. There's no doubt that POEs cannot make remarkable achievements without the government's support and assurance, and the wise, hard-working and persistent entrepreneurs. Currently, POEs are confronting unprecedented challenges in growth and conducting overseas M&As as they are facing with complex situations both internally and externally.

Despite the decreasing global FDI in the past two years, increasing geopolitical risk, and the rising protectionism in 2018, it is a pleasure to see China overseas investment has kept a steady growth momentum moving toward high-quality developments - the increasing investment volume, the optimization of the investment structure, high quality of investments, the continuous endogenous power of overseas investment and the improvement of the investment capability. The overseas economic and trade zone spans across Asia, Europe, Africa and Latin America, the host countries rode on the express train of development. The overseas investment along the Belt and Road (B&R) countries and regions have grown rapidly.

“Making concerted efforts to overcome difficulties”, the China Mergers and Acquisitions Association (CMAA), as the only financial industry association directly administered by the All-China Federation of Industry and Commerce (ACFIC), the CMAA focuses on strategies, seizes new opportunities and understands market dynamics to give full play to its advantages in marketization and specialization, providing countermeasures and suggestions, taking initiatives and responsibilities, applies and implements the spirit of the keynote speech by Xi Jing Ping, general secretary of the Communist Party, in the POEs forum and guided by the Implementation Opinions on *Promoting Reforms and Development of Industry Associations Administered* by ACFIC, the CMAA takes the reform and development of industry associations as an opportunity to help POEs address difficulties and stay afloat. Also, the CMAA commits itself to facilitating the M&A market to move toward a sustained, healthy and regulated development by serving the private economy for stable and sound development.

This year also marks the 15th anniversary of the CMAA. On this occasion, the CMAA will hold the 15th annual meeting themed with “Power of Mergers and Acquisitions in the New Era” in Shenzhen to celebrate the 40th anniversary of China's reform and opening up and salute POEs for their vigorous development in the past four decades as well as all the people who contributed to global M&A activities with determination and persistence.



Wei Lidong
12th Executive Committee Member of ACFIC
Chairman of CMAA
Founding & Managing Partner of Shangrong Capital

¹ Source: Ministry of Commerce (MOFCOM)

² Source: United Nations Conference on Trade and Development (UNCTAD)



In 2018, China overseas investment remained stable despite geopolitical changes and sharp decrease in global FDI, indicating a trend of steady growth and high-quality development.



Executive Summary



Loletta Chow

Global Leader, China Overseas Investment Network

In 2018, China overseas investment remained stable despite geopolitical changes and sharp decrease in global FDI, indicating a trend of steady growth and high-quality development. From January to September 2018, China's outward direct investment (ODI) reached US\$89.1 billion, up 5.8% on a year-on-year (YoY) basis¹, which showed 4 characteristics:

- ▶ The investment volume saw an increase and the structure of overseas investment continued to be optimized, focusing on services and manufacturing sectors. Overseas investment was moving toward high-quality development as irrational investment was curbed
- ▶ With the favorable national policies and increased overseas revenues of POEs, the endogenous power and investment capability of Chinese enterprises to invest overseas have been improved
- ▶ Host countries were entering into the fast lane of the development as overseas economic and trade zones were set up across Asia, Europe, Africa and Latin America
- ▶ The Belt and Road Initiative (BRI) has boosted win-win cooperation and shared development and invigorated the global economy since it was proposed five years ago

In terms of sector, energy infrastructure becomes the key sector for Chinese enterprises to invest overseas. From January to September 2018, the deal value of overseas M&As in the power and utilities sector increased four times YoY to US\$31.3 billion, representing nearly 30% of the total value of China overseas M&As and became the most attractive sector among Chinese investors. In terms of deal volume, there were 136 announced M&A deals in TMT sector*, followed by 107 in the consumer products sector and 63 in the financial services sector, ranking the top three hottest sectors in the first three quarters of 2018³.

By regions, Europe continued to be an attractive destination for overseas M&As. From January to September 2018, Europe led M&As in both value (US\$60.8 billion) and number (181), followed by Oceania (US\$21.8 billion) by announced deal value, increasing nearly three times YoY, while other regions saw a significant decline. In the first three quarters, Portugal, Australia, Germany, Finland and the US ranked top five as the largest investment destinations among Chinese enterprises, accounting for nearly 70% of total deal value as a whole.

EY in collaboration with the CMAA also conducted a survey for an in-depth understanding of Chinese enterprises' overseas development plan. According to the survey, more than 70% of the respondents were optimistic about the future of overseas investment and planned to make overseas investment, however, nearly a half of respondents acknowledged that their investment capabilities needed improvement and there was a demand for high quality talent in overseas investment and experience in "going abroad".

Despite geopolitical changes and uncertainty in the overseas investment environment, more than 70% of the respondents remained confident in "going abroad" and were planning to expand their presence overseas. Sectors that are helpful in transforming and upgrading the real economy will always be the focus areas among Chinese investors. Looking forward, China overseas investment is expected to maintain growth and Chinese enterprises will continue to improve their capabilities to invest overseas, optimize industrial structure and enhance investment quality and benefits.

* TMT sector refers to Technology, Media and Telecommunications, in which "Media" includes media and entertainment in this report

³ Source: ThomsonOne, including data of Hong Kong, Macau and Taiwan and deals include those have been announced but not yet completed

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Review of China outbound investment in the first three quarters of 2018 and outlook

1.1 ODI growth tended to be stabilized

Since late 2016 when relevant departments of the Chinese government had increased scrutiny over the authenticity and compliance of overseas investment, Chinese enterprises saw a setback in overseas investment in 2017. After some time of adjustment, the China overseas investment became stabilized and Chinese investors achieved a total of US\$89.1 billion in ODI, up 5.8% YoY.

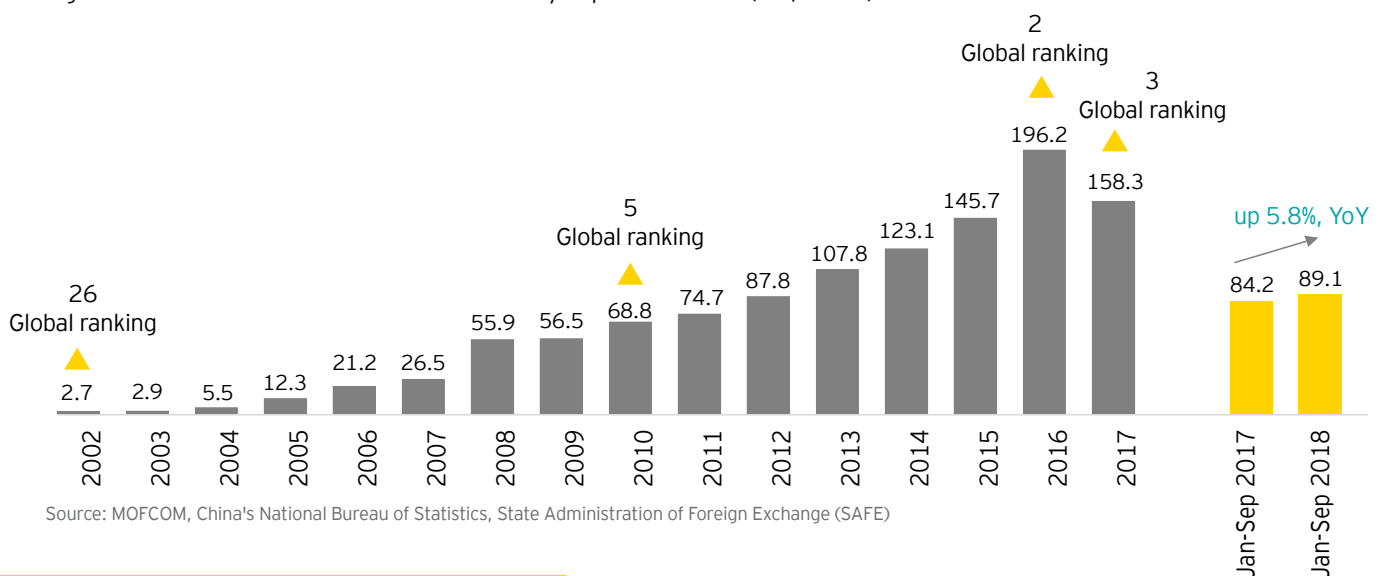
In 2018, China continued to optimize the structure of overseas investment and sustain high-quality development. Leasing and business services, manufacturing and wholesale and retail sectors have dominated the China overseas investment, indicating that Chinese enterprises are shifting from resource-oriented to technology-led overseas investment and building global value chains.

The investment capability of Chinese enterprises was enhanced as momentum sustained

In the first nine months of 2018, favorable national policies and increased overseas revenues of POEs provided an impetus for Chinese enterprises to sustain overseas investment.

1. Favorable policies helped to encourage the vitality of investment. Since the end of 2017, China has released a series of policy documents to regulate and guide Chinese enterprises to invest overseas in a rational manner. The relevant guidelines clarified the encouraged and restricted areas for Chinese enterprises to invest in, enabling them to set clearer goals and explicit strategies for their outbound investment, moving capital to key areas conducive to the real economy's development and invigorating investment.

Figure 1: China's ODI flows from 2002 to January-September 2018 (US\$ billion)

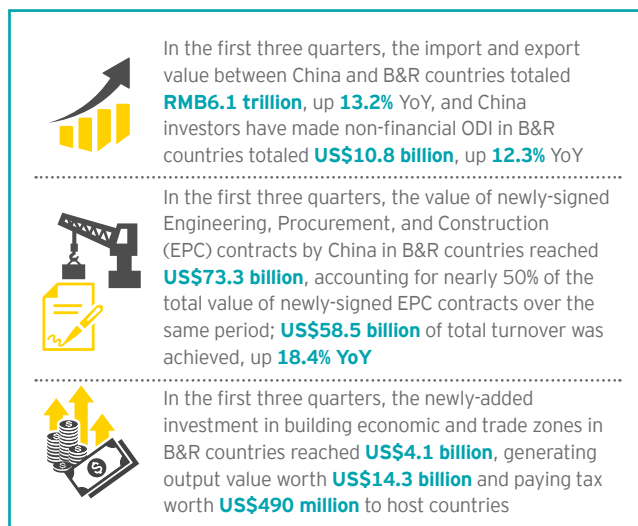




2. Enterprises became more prudent in investment. In 2017, POEs became more prudent in overseas investment as there were 1,503 overseas investment projects engaged by the top 500 POEs in China, down 9.4% while only 231 POEs invested overseas, down 26.4%. However, in total, the top 500 POEs posted US\$790.3 billion in overseas revenues (excluding export), representing a sharp increase from 2016⁴. This reflects that POEs are becoming increasingly mature in doing business overseas which in turn has improved profitability and enhanced internationalization.
3. Enterprises innovated their investment models. In 2018, Chinese enterprises diversified their overseas investment, ranging from greenfield investment, M&A, joint investment to equity swap¹, indicating that the Chinese enterprises with improved investment capability have become more flexible and skilled in using international financial instruments to support their overseas operations.

The BRI injected new vigor to the global economy

It has been five years since the BRI was proposed. Over the past five years, the BRI has boosted win-win cooperation and the shared development between China and countries along the B&R to inject new vigor to the global economy.

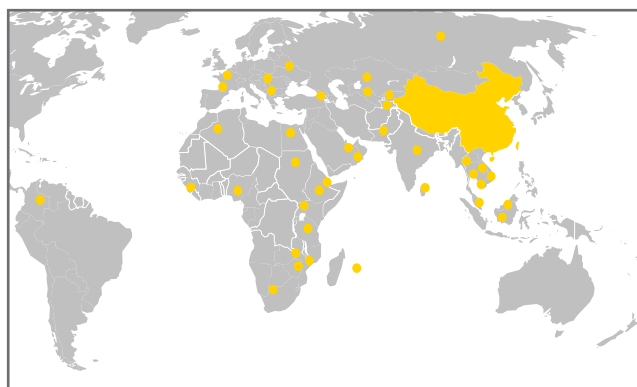


Source: State Council Information Office, MOFCOM

The host countries of overseas economic and trade zones entered into the fast lane of the development

With the changing global economic and industrial landscape and the advancement of B&R construction, overseas economic and trade zones have become a platform for Chinese enterprises to invest in and build partnership overseas, especially for small and medium-sized POEs, helping them mitigate risks when investing overseas. As of September 2018, Chinese enterprises have built 113 overseas economic and trade zones in 46 countries across Asia, Europe, Africa and Latin America and achieved positive results, allowing host countries to ride on the express train of China's progress by boosting shared development and synergizing strategies. As of September 2018, the total investment in overseas economic and trade zones by Chinese enterprises has reached US\$36.6 billion. In total, 4,663 companies are housed in the overseas economic and trade zones, paying tax worth US\$3.1 billion and creating more than 287,000 jobs in host countries¹.

Figure 2: Countries distribution of China overseas economic and trade zones (as of September 2018)



Source: MOFCOM, Xinhuanet.com, EY analysis

⁴ Source: ACFIC

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1.2 Energy infrastructure and TMT are the most favorable sectors for overseas M&As

From January to September 2018, there were 551 overseas M&A deals by Chinese enterprises with a total value of US\$106.9 billion, up 11% YoY, indicating that Chinese investors remained confident in “going abroad”.

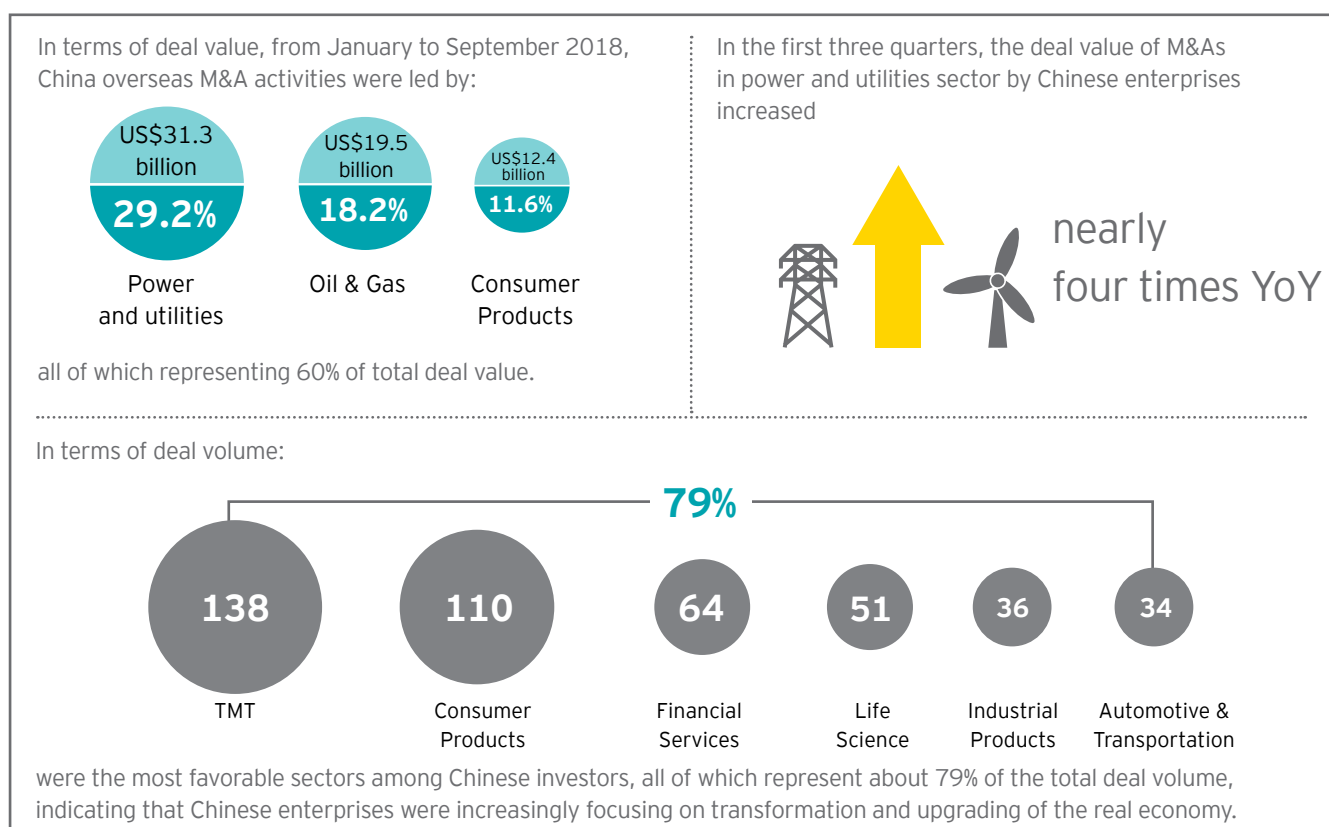


Figure 3: Announced China overseas M&As deal value by sector, January-September 2017 and 2018 (US\$ billion)

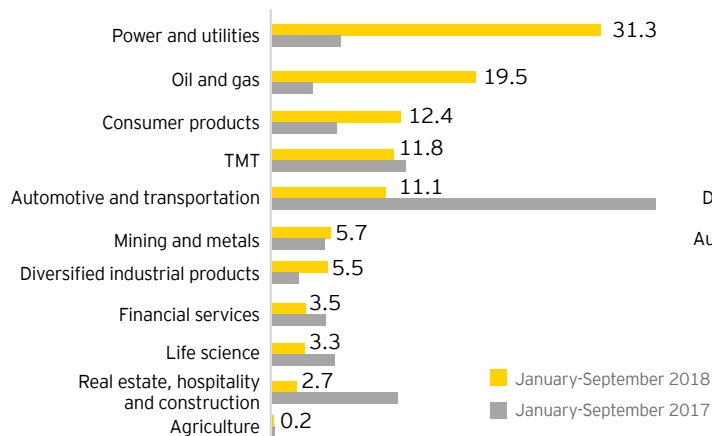
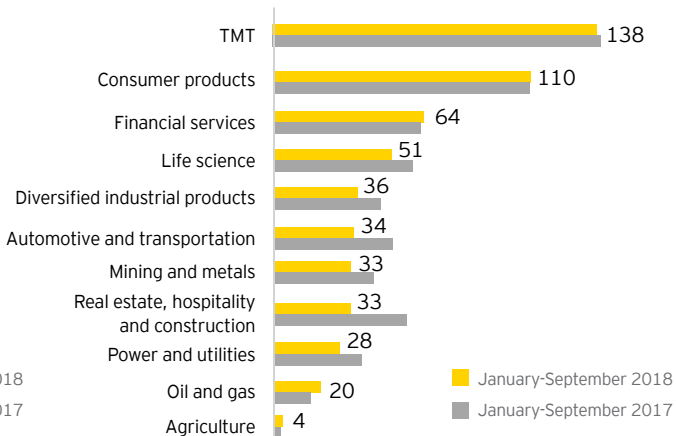


Figure 4: Announced China M&As deal volume by sector, January-September 2017 and 2018



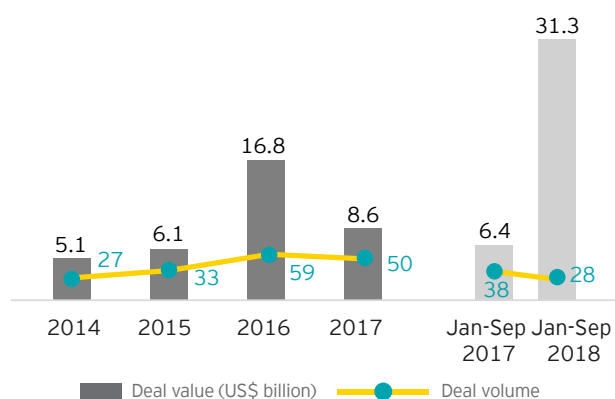
Source: ThomsonOne, including data from Hong Kong, Macau and Taiwan and deals include those have been announced but not yet completed



Power and utilities developed rapidly while renewable energy was favored

In recent years, the investment in power and utilities by Chinese enterprises has grown rapidly. In 2014, the deal value of China overseas M&As in power and utilities sector reached US\$5.1 billion, representing 8% of the total value of overseas M&As of the year, which rose to 29.2% in the first three quarters of 2018³.

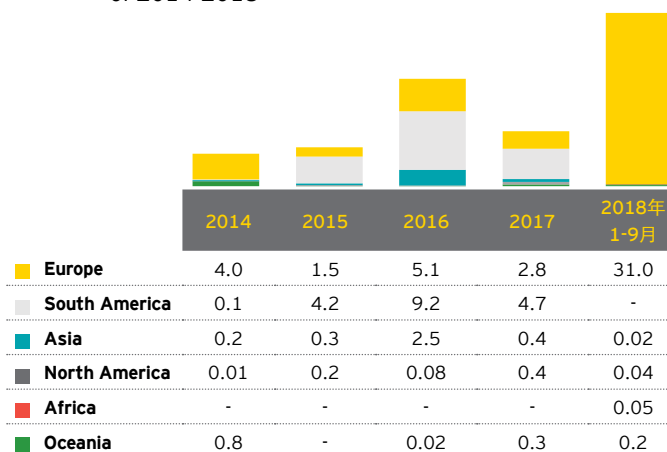
Figure 5: Overseas M&As in power and utilities sector by deal value (US\$ billion) and volume, first three quarters of 2014-2018



Renewable energy is expected to be a leading technology in the next decade and will draw attention from investors in the energy sector. Meanwhile, renewable energy will gain traction from China and host countries as it aligns with their strategies to promote environmental-friendly, low-carbon and clean energy and reduce pollution in China and many other countries in the world. As such, Chinese enterprises will remain interested in investing in the renewable energy sector.

In terms of power and utilities, Europe and South America are becoming the most attractive destinations among Chinese investors. In recent years, the development of the new energy industry has maintained good momentum. Europe has stayed at the frontier of energy transformation in the world driven by its favorable policies for renewable energy and its long-term planning for new energy development. Moreover, its stable political situation and open investment environment have enabled Europe to become the most favorable market among Chinese investors. From January to September 2018, almost all of the China overseas M&As in power and utilities sector were conducted in Europe.

Figure 6: Overseas M&As in power and utilities sector (by deal value) by destination US\$ billion first three quarters of 2014-2018



Source: ThomsonOne, including data from Hong Kong, Macau and Taiwan and deals include those have been announced but not yet completed

Renewable energy has become another key sector for Chinese enterprises to go abroad. In May 2018, China Three Gorges Corporation announced its takeover plan of 76.6% stake in Energias de Portugal (EDP) for US\$29.6 billion and also 17.4% stake in Spain-based EDP Renovaveis for US\$1.3 billion*, both of which came from the renewable energy sector and were the largest announced M&As in power and utilities sector by Chinese enterprises by deal value in the first three quarters.³

* The transaction amount includes the net debt of the target, and the takeover has not yet completed

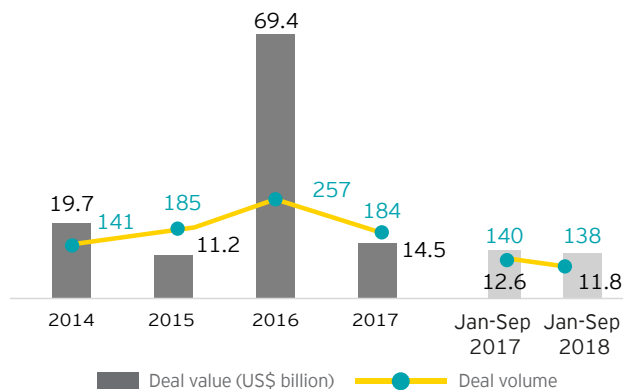
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TMT saw a robust growth in overseas M&As

From January to September 2018, TMT saw 138 announced M&As by Chinese enterprises, representing more than a quarter of total number of announced deals and ranking at the top by sector. In terms of deal volume, TMT has stayed at the forefront since 2014 when it became the largest industry for Chinese enterprises to invest overseas. The value of overseas announced M&As from January to September 2018 amounted to US\$11.8 billion, accounting for 11.1% of the total. As Chinese enterprises move upstream and focus on accessing to advanced technologies to meet the needs of sophisticated consumers, TMT will see a sustained growth.

Figure 7: Overseas M&As in TMT by deal value (US\$ billion) and deal volume, the first three quarters of 2014-2018



For M&As in the technology sector, investors focused more on advanced technologies and international expansion as they pursued targets in the relevant sector, such as:

In April 2018

NetDragon acquired US online learning community Edmodo for US\$140 million to achieve synergies for both and help NetDragon achieve its vision as the largest learning community in the world

In February 2018

Tencent led funding in India's Gaana for US\$120 million, enabling Indian's music market to be part of its globalization strategy and music industry chain

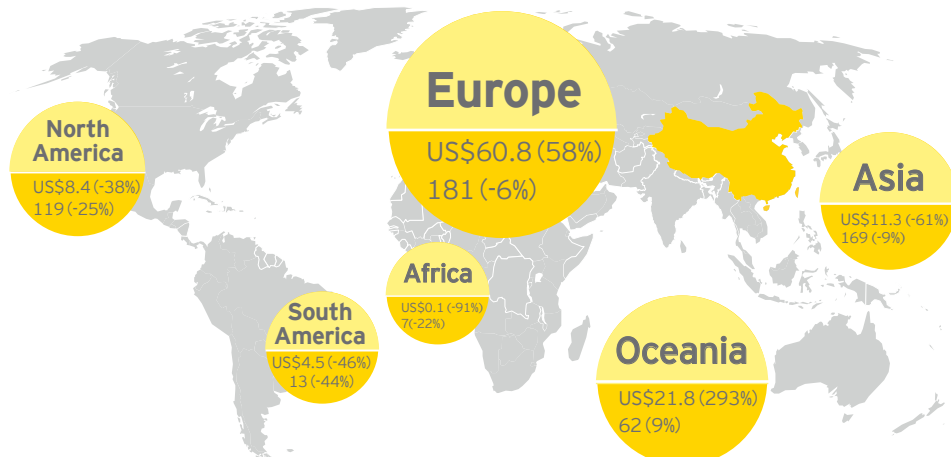
In February 2018

Ant Financial Services invested US\$200 million in India's leading takeout platform Zomato, highlighting it is optimistic about the future of takeout services in India and accelerating its pace in expanding Indian market

1.3 Geopolitical risk became prominent in turbulent environment

Decreased M&A value and volume in some regions underpinned an increase in geopolitical risk

Figure 8: Deal value (US\$billion) and volume of M&As in the first three quarters of 2018 by region (%YoY)



Source: ThomsonOne, including data from Hong Kong, Macau and Taiwan and deals include those have been announced but not yet completed



From January to September 2018, except for Europe and Oceania, Chinese enterprises saw a sharp decrease in announced M&As in Asia, South America, North America and Africa by both value and volume compared to the same time last year. Among them, the M&As deal value fell by 30%.

Europe:

Deal value grew rapidly but the regulatory environment was increasingly complex

Since 2014, Europe has been the preferred destination among Chinese investors for five years. From January to September 2018, Europe led in M&As by Chinese enterprises with deal value rising by 58.2% to US\$60.8 billion and number dropping by 6.2% to 181. Despite the decline, Europe remained the largest region by deal volume. Power and utilities, automotive and transportation and consumer products sectors dominated M&A investment by Chinese enterprises, while Portugal, Germany and Finland were the most popular destinations in Europe among Chinese investors in the first three quarters of 2018.

Chinese investors have been seeking opportunities in Europe while the regulatory environment has become increasingly complex. In September 2017, the European Union (EU) proposed to establish a review framework for foreign investment. Once it is taken into effect, major foreign investment in the EU will have to follow a more stringent review and approval process, especially investment and M&A activities in the TMT, power and utilities, transportation and financial services sectors. In addition, many European countries including Germany, Italy, the UK and France are amending or modifying their review and approval frameworks, which tend to be more stringent than before.

Despite the continued impact of cross-border investment by Chinese enterprises, tighten regulations will provide guidance for enterprises to make the right investment overseas, which will also enable enterprises to become more prudent in cross-border investment and pay more attention to the differences in culture and legislation in different countries. This will enhance Chinese enterprises to compete in international markets in the long run.

Oceania:

Energy sector saw a growth in deal value while TMT and infrastructure sectors experienced setback

From January to September 2018, the deal value of overseas M&As by Chinese enterprises in Oceania amounted to US\$21.8 billion, increasing nearly three times YoY, while the number of announced M&A deals rose by 8.8% YoY to 62. By sector, 80% of the M&As in Australia came from the oil and gas sector.

With rising protectionism around the world and severe challenges faced by the opening up in multi-lateral markets, Australia has shown concern over Chinese capital especially in key infrastructure sectors that involve with national security. In August 2018, Australia released **5G Security Guidance to Australian Telecommunication Operators**, which is undertaking an extensive review of the national security risks to relevant network techniques. Subsequently, some Chinese enterprises were banned from providing 5G technology to Australia. The policies towards foreign capital have created an impact on China investment in Australia. Chinese enterprises would hope that the new Australian government could hold a more open attitude to foreign investment and build a favorable business environment for Chinese enterprises to invest and do business in Australia.

Asia:

Decline in both deal value and number and geopolitical risk became prominent

From January to September 2018, the deal value of M&As in Asia by Chinese investors amounted to US\$11.3 billion, down 61.2% YoY, while the number of announced deals decreased by 9.1% to 169 from a year earlier. By sector, TMT, oil and gas and financial services became the most attractive sectors among Chinese investors. By country, India, Thailand and South Korea were the most favorable destinations. The deal value of M&As in India increased nearly three times, focusing on TMT, life science and financial services.

As the traditional destination of M&A, Asia represented 67% of total overseas investment stock by Chinese enterprises.⁵ However, Chinese investors have been facing challenges in Asia. In 2019, there will be general elections in Thailand, India and Indonesia and mid-term election in Philippines. In the short term, Chinese enterprises are expected to face increasing political, economic and social risks in Asia.

North America:

Deals and investment saw a setback

From January to September 2018, the deal value of M&As in North America by Chinese enterprises amounted to US\$8.4 billion, down 38.1% while the number of announced deals fell 25.2% YoY to 119. After coming into power, the Trump administration has shown an uncompromising attitude towards China and the world and suspended the acquisitions of American companies by foreign capital for national security reasons. Since 2018, the US has called off several projects invested by Chinese capital.

Pursuant to the Foreign Investment Risk Review Modernization Act (FIRRMA) passed this year, the US government will further intensify risk review on national security, focusing on foreign investment in key technology, telecommunications, national defense and aviation sectors, as well as key infrastructures. The Committee on Foreign Investment in the United States (CFIUS) will be increasingly empowered. Under this complicated situation, there will be uncertainty about Chinese investment in the US in 2019 and Chinese enterprises are expected to face more regulatory and political challenges in conducting M&As in the US in the future.

⁵Source: National Development and Reform Commission (NDRC)

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Trend analysis of China overseas investment-from "going out " to "going up"

In 2016, the scale of China overseas investment reached its peak after a wave of investment. Later in the year, the Chinese government strengthened policy guidance on overseas investment to slow down Chinese enterprises' overseas investment, and advised enterprises to improve their investment structure with more focus on the strategic overseas layout and global resources allocation. Looking ahead, "going abroad" is still an important step in the globalization of Chinese enterprises.

Since 2018, the global landscape has changed dramatically with increasing geopolitical risks. A series of uncertain factors such as the Sino-US trade dispute and Brexit are affecting Chinese enterprises' decisions on overseas investment. At the same time, it is critical for Chinese enterprises to further improve internationalization and acquire overseas investment experience and professional talents in order to "go abroad" with higher quality to achieve better investment return.

In order to better understand the future development and planning of China enterprises in overseas markets, EY and the CMAA jointly conducted this survey. It targets at the Chinese companies that have intentions to carry out or involved in related activities in overseas investment, and have administrative staff and management personnel who directly participate in overseas investment business. Enterprises respondents are summarized into different categories:

POEs (above-scale)⁶: 38%
POEs (below-scale)⁶: 24%

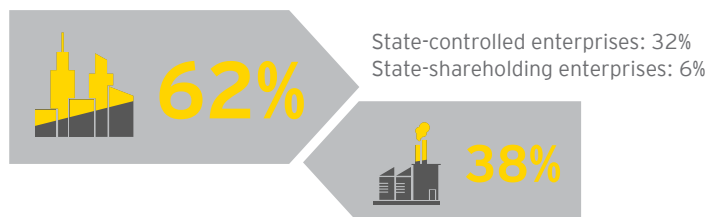
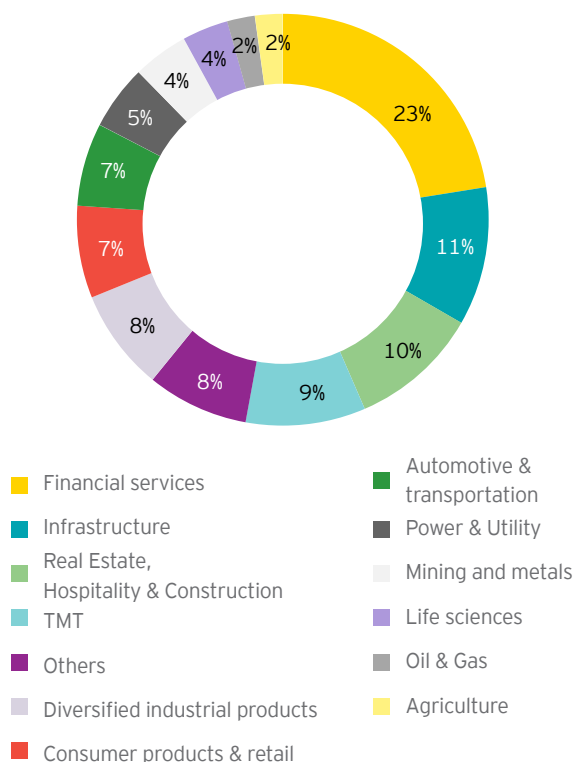


Figure 9: Respondents by sector



⁶ As per China National Bureau of Statistics' definition, enterprises above the designated size include: 1) industrial enterprises with annual revenue from principal business over RMB20 million; 2) wholesale enterprises and retail enterprises with annual revenue from principal business over RMB20 million and RMB5 million respectively; 3) enterprises of service industry with over 50 staff members or annual revenue from principal business over RMB10 million.



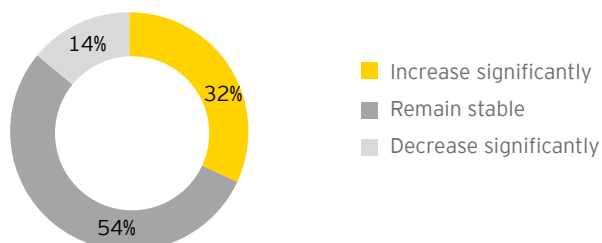
2.1 Enterprises are positive towards investment prospects while their capabilities require improvement

- ▶ 90% of the respondents remain optimistic about the long-term prospects of overseas investment

The survey found that nearly 90% of respondents predict that **the overall overseas investment opportunities will increase or remain stable in the next three years**, while only 14% of respondents believe that **overseas investment opportunities will decrease in the future** (see Q1).

This shows that although the slowdown of globalization process due to the recent uncertainty such as the Sino-US trade dispute, Brexit, and investment review in the European countries and the US, most of the respondents are still optimistic about the long-term prospects of overseas investment.

Q1 How does your company anticipate overseas investment opportunities in the next three years (2019-2021)?

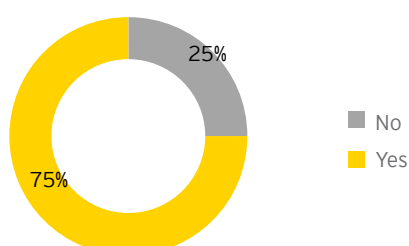


- ▶ "Overseas M&A" is still the preferred method of overseas investment for Chinese enterprises

This optimism is also proven in subsequent questions. Up to 75% of respondents plan to invest overseas in the next three years (see Q2), while **overseas M&A** and **branch establishment** are the main investment approach. (See Q3).

As the preferred choice for investment, overseas M&A was favored by 70% of the respondents, which proves that it is one of the most efficient, fastest and most direct approaches that drives enterprises into international expansion and acceleration. In addition, more than 40% of the respondents chose to set up branches overseas. Considering that global expansion is the main goal of many Chinese companies to "go abroad", through the establishment of overseas branches such as subsidiaries or branch offices, they can access overseas markets faster and more flexibly than conducting M&A. Therefore, such approaches are recognized by many respondents.

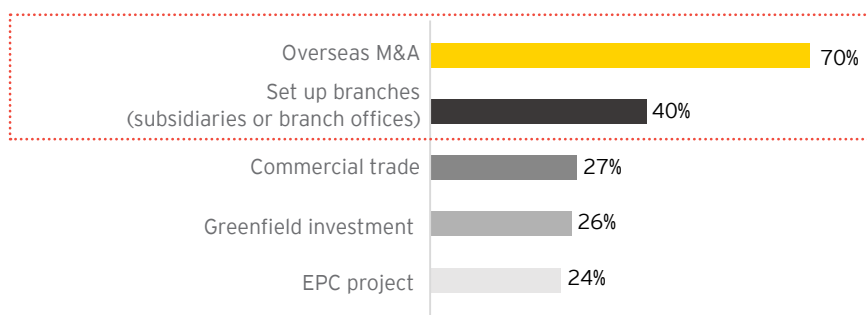
Q2 In the next three years (2019-2021), does your company have plans to invest overseas?



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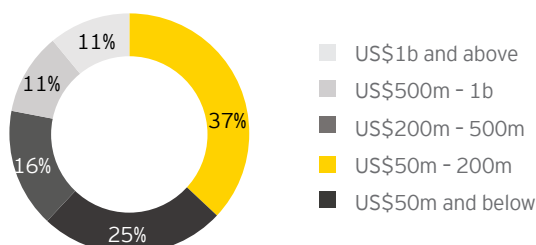
Q3 In the next three years (2019-2021), how will your company invest overseas?



- ▶ Most Chinese companies mainly focus on small and medium-sized investment

In terms of investment scale (see Q4), about 60% of the respondents indicated that the scale of overseas investment in the next three years will be **less than US\$200 million**, among which 37% of the respondents will invest between US\$50 million and US\$200 million in the future. About only 10% of the the respondents said that they would make mega deal (**more than US\$1 billion**) in the future. It seems that most Chinese companies are mainly focusing on small and medium-sized investment in the future.

Q4 In the next three years (2019-2021), what is your company's total amount of investment in overseas business?



Lens on POEs

The result of the POEs respondents shows some differences from the overall finding

- ▶ Regarding Q3, although the POEs respondents also regarded **overseas M&A (72%)** and **set up branches (45%)** as the main investment approaches in the future, only 11% of POEs chose **"EPC projects"**. This reflects that SOE are still the main participants in EPC projects. Most POEs are constrained by various factors such as capital, experience and human resources, so their participation in overseas is relatively limited. Moreover, EPC projects often involve government-level communication. SOEs can take advantage of their own role and participate in large extent.
- ▶ Regarding Q4, 34% of the POEs respondents expect to invest **less than US\$50 million** in the next three years, which is higher than the overall finding (25%), indicating that although POEs are actively participating in overseas investment, most of their investments are still in smaller scale.



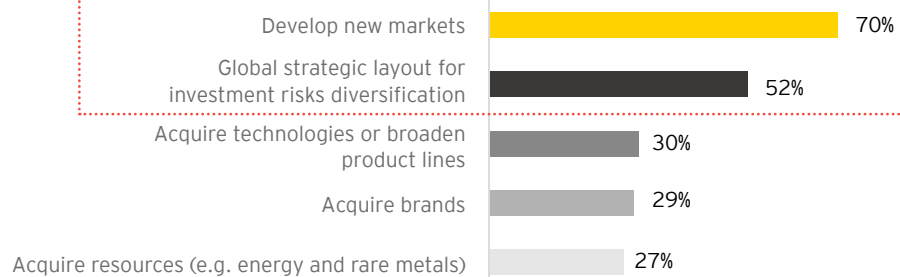
2.2 Future focus on developing new markets, targeting infrastructure and Europe and America

- ▶ In the next three years, most Chinese enterprises hope to develop new markets through overseas investment, realize the strategic layout of globalization, and diversify investment risks

From the survey, **"developing new markets"** and **"global strategic layout for investment risks diversification"** are the main goals that Chinese companies expect to achieve through overseas investment in the future. It found that 70% and 52% of the respondents chose these options, respectively (see Q5). :

- ▶ Promoting the level of globalization of enterprises and developing new markets have always been the most important factors for Chinese companies to "go abroad", and they coexist. In the process of developing overseas markets, enterprises will inevitably accelerate globalization, and the improvement of globalization will also provide incentives for enterprises to further develop overseas markets.
- ▶ In recent years, China is in a special period of industrial restructuring and economic transformation and upgrading. Therefore, Chinese enterprises have paid more and more attention to investing in sectors that contribute to the transformation and upgrading of the real economy, and to reversely feed domestic industries and economies through international development.
- ▶ The uncertainty in the domestic market in recent years have driven companies to diversify risk by allocating resources globally.

Q5 In the next three years (2019-2021), what goals does your company hope to achieve through overseas investment?



2



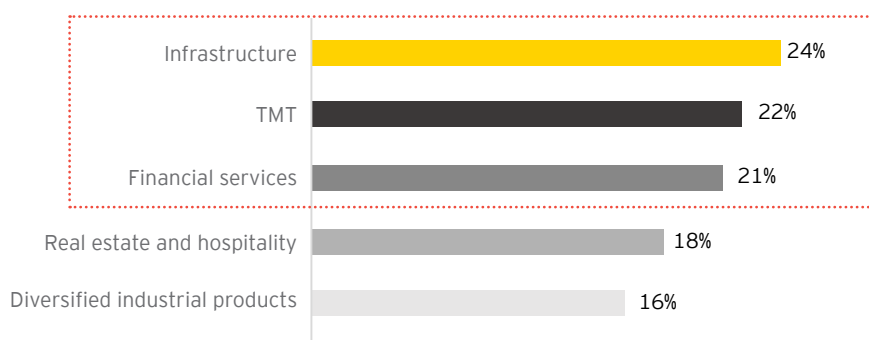
- Infrastructure, TMT and financial services are the three target sectors of Chinese companies' overseas investment in the future. This is essentially in line with the trends of national policies

Infrastructure, TMT and financial services are the three target sectors when Chinese companies invest overseas in the next few years. This is essentially in line with national macro policy trends in related fields (see Q6).

- In order to further promote the BRI, it is necessary to realize infrastructure interconnection and capital financing along the B&R countries. The infrastructure and financial services sectors have therefore become an important direction for Chinese enterprises to invest overseas.
- Expanding the overseas financial sector layout will also provide important support for RMB internationalization and the development of emerging industries such as fintech.
- Investment around the TMT sector is critical to "Made in China 2025", as well as transforming and upgrading China's high-tech industry.

It is noteworthy that, although China has already issued policies that explicitly restrict Chinese companies from investing in overseas **real estate and hotel projects**, this survey finds that the real estate and hotel sector is still the main area of future investment by Chinese enterprises. This probably because some enterprises can still realize limited overseas investment in this sector through offshore capital and financing platforms supported by their previously acquired overseas businesses.

Q6 In the next three years (2019-2021), in which sectors does your company plan to invest overseas?



Lens on POEs

Regarding Q6, the survey shows that **financial services (26%)**, consumer **goods and retail (23%)** and **TMT (21%)** are the main sectors to be invested by POEs in the future. Only about 13% of POEs plan to invest in infrastructure, which reflects the rapid development of Chinese POEs in financial services, consumer products, and high-tech industries in recent years. There is a large demand for market expansion through overseas investment to acquire technology and experience to accelerate international development.



- ▶ Europe and North America are the top two target areas for overseas investment by Chinese companies in the future
- ▶ Southeast Asia is the third largest target area for future Chinese enterprises with huge investment potential

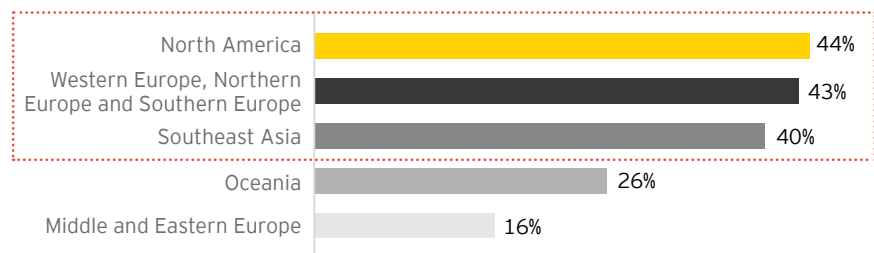
Although there are geopolitical dynamics and uncertainties such as anti-globalization in **Europe** and **North American**, they are still the top two target areas for overseas investment by Chinese enterprises in the future. Regarding Europe, the regions drawing most attention are **Western Europe, Northern Europe and Southern Europe**.

- ▶ As the regions with major developed countries, **Europe** and **North America** have many leading companies, industries, technologies and innovations that will continue to attract Chinese companies to invest in and integrate profoundly into internationalization.

It is noteworthy that **Southeast Asia** has been selected as the third largest target region for Chinese companies' overseas investment in the future, and the votes obtained are very close to those in North America and Europe. It shows that Southeast Asia is one of the fastest growing emerging markets in the world and has been valued by more Chinese companies. There is huge investment potential.

- ▶ Southeast Asia is adjacent to China. The region is rich in natural and human resources. Many countries are deeply influenced by Chinese culture. It has a similar historical and cultural background with China and has become one of the earliest overseas countries for Chinese investors. Also, it is one of the first areas involved in the construction of the BRI by Chinese enterprises. Compared with other regions, Chinese companies have more experience in the Southeast Asia and more comprehensive understanding in the local market.

Q7 In the next three years (2019-2021), what are the target areas for your overseas investment?



Lens on POEs

Regarding Q7, although the survey shows that the above three major regions are also the main target areas for future overseas investment by Chinese POEs, the POEs respondents are obviously more favorable towards **North America (60%)**, and the proportion of POEs that chose North America as the target area for future investment is much higher than the overall . It shows that POEs hope to obtain more market share, advantageous technologies, industry experience and other related resources in the North America.

The survey shows that POEs are mainly planning to invest in the **US**. In the face of the recent escalation of the Sino-US trade dispute, about 60% of the surveyed POEs said that the issue would not affect them. However, POEs focusing foreign exports still need to be alert to the challenges brought by the US additional tariffs on China.

In the face of the Sino-US trade dispute, a small number of the POEs respondents plan to reduce investment in the US and switch to other countries in the future, and mainly chose the **Southeast Asia** as a destination for investment instead, highlighting the increasing attractiveness of Southeast Asian for Chinese companies. The similar cultural background of many Southeast Asian countries, broad market space and fewer barriers to entry, coupled with good economic development momentum, are attracting more Chinese companies to invest there.

2



2.3 Focus on external risks from changes on global economy, foreign policy and geopolitics

▶ Three external risks in the future:

"weak global economy"

"foreign policy adjustment"

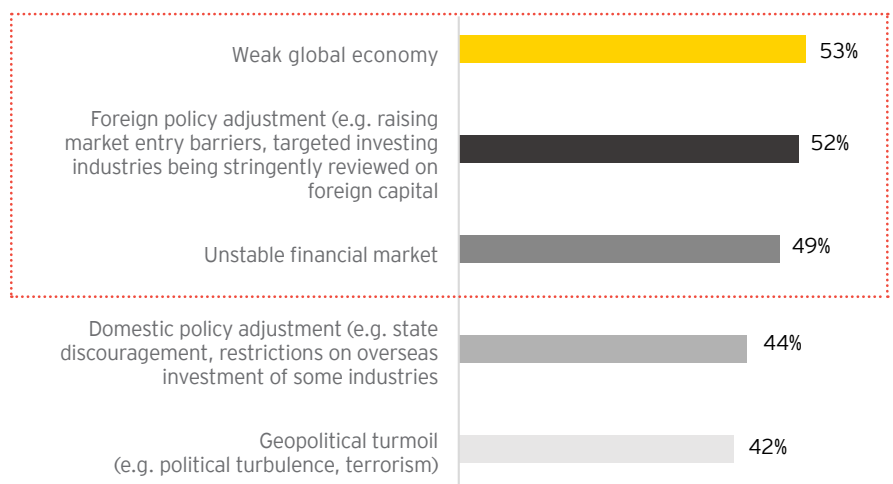
"financial market instability"

According to the survey, around 50% of the respondents chose **weak global economy, foreign policy adjustment** and **financial market instability** as the main external risks of future overseas investment, reflecting the concerns that enterprises have on the external economic and investment environment in the next few years.

- ▶ Since 2018, the Sino-US trade dispute has been escalating. The Trump administration's attitude towards economic and trade issues such as free trade is also uncertain. At the same time, global foreign exchange and stock markets are getting volatile. These factors have increased **the uncertainty of future financial market**, making companies concern about overseas investment at the current stage.
- ▶ In recent years, under the influence of the anti-globalization trend, some western developed countries have considered revising the supervision and review measures on foreign investment. Some measures have affected Chinese enterprises' acquisition activities. For Chinese investors, they also realize that this policy change will have certain impact on their future investment.

In addition, the impact of geopolitical turmoil cannot be ignored. In view of the recent Sino-US trade dispute, Brexit, national regime changes, local protectionism and other anti-globalization events, international geopolitical turmoil will exacerbate the uncertainty of Chinese enterprises in the future, thereby delaying them "going abroad."

Q8 In the next three years (2019-2021), what are the main external risks that your company expects to affect your overseas investment decisions?





- ▶ Political instability is the most possible geopolitical factor that hinders China overseas investment
- ▶ The anti-globalization wave is intensifying and has impact on global goals and corporate interests of Chinese enterprises

Only a prosperous and stable investment environment can attract more investors. However, as global geopolitical risks have been increasing since 2018, many companies' current and future investment plans will be affected as well. According to the survey, most of the respondents believe that political instability, anti-globalization and discriminatory policies against China are the most important geopolitical risks that hinder China overseas investment.

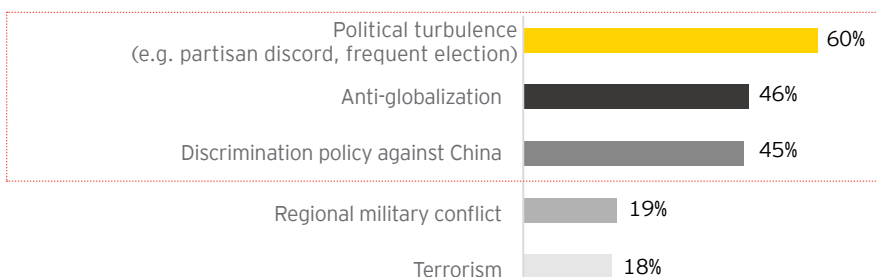
Political instability is considered to be the geopolitical factor most likely to hinder China overseas investment. The proportion of the respondents that chose this is much higher than any other risk factor. In the context of frequent political regime changes, the continuity and stability of policies will be greatly affected. Newly established governments may cancel agreements signed by previous government. After the new Malaysian government came to power in 2018, it immediately cancelled two BRI projects signed by the previous Malaysian government with China.

The **anti-globalization** and **discrimination policy against China** cannot be underestimated as well for the investment of Chinese enterprises:

- ▶ The wave of anti-globalization represented by nativism has recently intensified, and this trend also impact on the global goals and corporate interests of Chinese companies.
- ▶ Some European and American countries are currently implementing more stringent foreign capital regulatory measures. Due to the huge overseas investment of Chinese enterprises in last few years, they are more sensitive to foreign regulators. In recent years, many countries are reviewing the foreign investment policies on the grounds of national security.

Q9

In recent years, the global geopolitical situation has been changing. What are the geopolitical factors that your company believes will hinder the company's overseas investment in the next few years?



2

- ▶ Trade dispute may not be the most critical factor affecting Chinese investment in the US

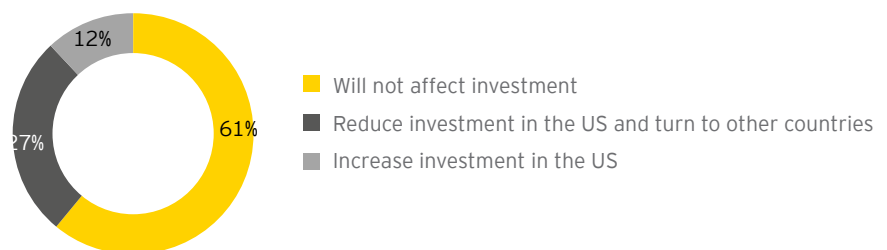
In the context of the escalating Sino-US trade dispute, more than 60% of respondents believe that the issue will not affect their investment in the US, with only less than 30% of respondents said they will reduce their investment in the US (see Q10). This reflects, to a certain extent, that despite the uncertainties of trade dispute, many Chinese companies are still optimistic about investing in the US.

The results of the previous survey showed that foreign policy adjustment is an important external risk for Chinese companies to invest overseas (see Q8). Recently, the US has passed FIRRMA, and will further strengthen the national security review system in the future, focusing on foreign investment in key technology fields such as technology, telecommunications and aerospace.

Despite the challenges of policies and geopolitics, the US is still attractive to Chinese investors. Considering many industries in the US have the technology, market and management experience that appeal to Chinese enterprises' need for transformation and upgrading, coupled with the impact of the US tax reform bill on attracting foreign investment, the effects of the trade dispute on investors are to be observed. In addition to 60% of respondents believing that the Sino-US trade dispute will not affect their US investment, this explains why 12% of respondents even consider increasing investment in the US.

It is also noteworthy that among the respondents who chose to **reduce their investment in the US and switch countries**, many companies regard Europe as the best place for investment instead - and this is also in line with the survey result that Europe will be the most important overseas investment destination for Chinese companies in the future (See Q7).

Q10 With the recent intensifying Sino-US trade dispute, and a tax cut bill proposed by the US, will your company's future investment and operating arrangements in the US be affected?



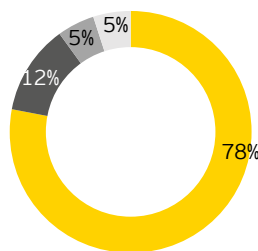


- Chinese enterprises worries about Brexit are gradually degrading, and the UK's dominant industries still have strong investment attractiveness

Coincidentally, this survey also found that the impact of Brexit on Chinese investment in the UK and Europe is smaller than expected. Nearly 80% of the respondents said that **Brexit will not affect their future investment plans** for the UK. It can be explained that since the Brexit referendum in June 2016, the uncertainty caused by Brexit to Chinese investors are gradually waning.

At present, the Sino-British relation is at a good time. In recent years, high-level and diplomatic communication between the two countries are frequent. Chinese enterprises have also maintained positive investment sentiment in the UK. However, after Brexit, UK's situation in Europe and the world may undergo major changes. By increasing the attractiveness of foreign investment, market confidence can be stabilized as soon as possible and a smooth transition can be achieved. Chinese investors also realize that Brexit is both a challenge and an opportunity at the same time when investing in the UK. In the long run, the competitive advantages of UK in finance, technology, innovation industries and infrastructure sectors are still highly competitive and attractive.

Q11 Will Brexit affect your company's future investment and operating arrangements in the UK or Europe?



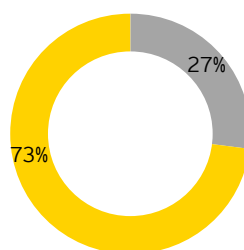
- Will not affect investment
- Reduce investment in the UK and turn to other European countries
- Reduce investment in European countries and turn to other countries globally
- Increase investment in the UK

2.4 Talent and experience shortage represent two biggest challenges for overseas investment

- 30% respondent encountered obstacles to overseas investment in the past year

This survey found that almost 30% of respondents admit that they have overseas investment projects not completed or canceled in the past year (see Q12).

Q12 In the past year did you have overseas investment programs not completed/canceled?



- Yes
- No

2



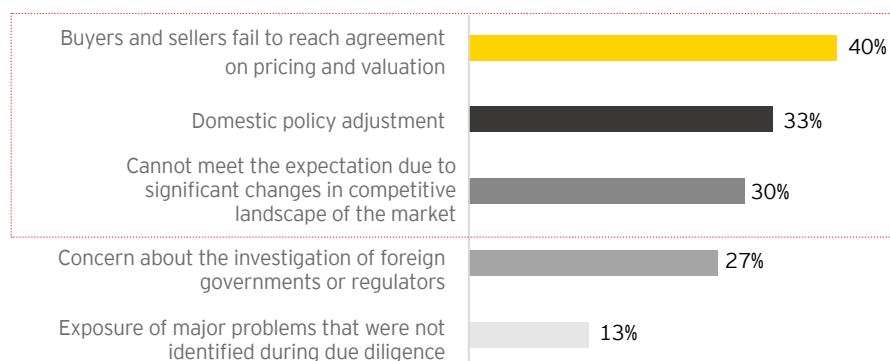
- Buyers and sellers fail to reach agreement on pricing and valuation, reflecting the lack of Chinese enterprises' overseas investment experience and skills

After exploring why Chinese enterprises failed to complete overseas investment (see Q13), we found that respondents consider **buyers and sellers fail to reach agreement on pricing and valuation, domestic policy adjustment and M&A cannot meet the expectation due to significant changes in competitive market landscape** as the most important factors leading to the failure of their investment projects.

- **Buyers and sellers fail to reach agreement on pricing and valuation.** Although there may have many external factors, such as market volatility and third-party competition, but this issue shows that Chinese enterprises may not have adequate knowledge of underlying assets and lack negotiation experience and skills for overseas projects. Therefore, investors fail to make competitive offers, causing disagreement between two parties. From this issue, we can see that although Chinese enterprises have invested many years in international development, some of them still lack talents with overseas investment experience and need to improve the core competencies for "going abroad", such as overseas professional talent pool and overseas projects execution capability.
- **Domestic policy adjustment** reflects the significant influence of national policy guidelines on China overseas investment. In the last two years, policies have been introduced to guide China overseas investment to promote investment structure optimization. In addition, restrictions were imposed on overseas investment in certain industries together with the capital control policy, have caused some companies' overseas projects to stall.
- **M&A cannot meet the expectation due to significant changes in competitive market landscape.** Chinese enterprises "going abroad" usually have some strategic considerations like market expansion and brand promotion. However, in an ever-changing market, their planned investment strategy would be affected once the market landscape becomes different.

Apart from the above three factors, we found that another important reason for overseas investment failure is the **concern about the investigation of foreign governments or regulators**. As mentioned in the former part, the European countries and the US have intensified review of foreign investment in recent years, so many Chinese enterprises' overseas M&A activities were affected.

Q13 In the past year, which factors made you cancel or failed to complete the planned overseas investment projects?





- "Lack of experienced overseas management teams" is considered as the biggest challenge for Chinese enterprises' overseas investment

In fact, the results we got from all the respondents show that(see Q14) **the lack of experienced overseas management teams** is considered as the biggest challenge for Chinese enterprises' overseas investment. Additionally, **strengthened regulatory control on investment sectors and capital outflow on Chinese enterprises and inadequate due diligence capability to identify significant risks** are another two challenges that cannot be ignored.

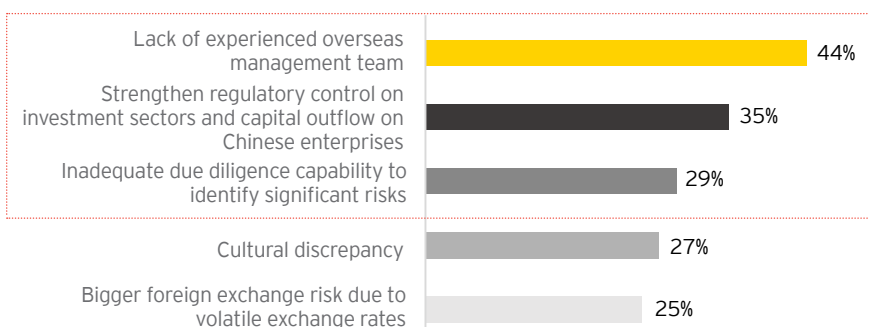
Among the above challenges, **the lack of experienced overseas management teams** is the core problem. An excellent overseas investment team can assist companies from a strategic perspective in linking their global expansion initiatives with the companies' development and providing guidance based on the future development strategies such as the types and locations of investment they should make in order to support their development to avoid cursory decisions or indiscriminate actions on overseas investment.

On the other hand, although companies sometimes have well-planned overseas investment strategies, these could not be properly implemented due to the lack of a good execution team. Sometimes, the later stage of the investment process is affected by deficiencies made at the early stage of due diligence because Chinese enterprises do not have sufficient competent talent for the projects. Besides, an experienced overseas team can quickly analyze policy trends and make best efforts to avoid the losses caused by the conflict between companies' overseas strategies as well as investment directions and national policies.

Generally, this survey shows that **overseas investment talent pool** is a challenge throughout the whole process. In the view of past investment experience and future investment plans, **the lack of professional overseas investment talent and experience** is one of the most severe issues faced by Chinese enterprises "going abroad ". This highlights the fact that talent becomes a core factor influencing Chinese enterprises' overseas investment strategies and investment return.

In the past few years, China overseas investment activities have grown rapidly but their efforts in building a talent pool fell behind and have not yet met the need of Chinese enterprises' "going abroad". Talent development is a long and on-going process which is impossible to complete in a short period of time. However, given the urgent demand of overseas investment talent, some of the enterprises have to assign inexperienced staffs to take charge their overseas investment process. With the current shortage of high-quality investment talent in domestic market, it is recommended that Chinese enterprises look for talent with rich investment experience from other locations (such as Hong Kong) with an open-minded manner in order to better manage the entire overseas investment process. Going forward, Chinese enterprises still have a long way to go in terms of building overseas investment talent pool.

Q14 What was the biggest challenge you encountered in the past overseas investment experience?



2



2.5 Self-cultivation first, Chinese enterprises have a long way to go in the overseas journey

- ▶ Overall competence for overseas investment is still inadequate and international development is a tremendous and long term task to accomplish
- ▶ Chinese enterprises gave the lowest scores to talent pool and overseas operation and governance
- ▶ For Chinese enterprises committed to international development, it is necessary to make "self-cultivation" before "achieving a global presence"

As part of the final self-assessment, the respondents rated themselves on their current statement in different aspect of overseas investment. In general, **the score of each aspect is rated at the intermediate level (5.5-6.7 out of 10)**, showing that the respondents know there are still many improvement opportunities. Even though most Chinese enterprises are optimistic towards future opportunities and plan for overseas investment activities (see Q1-2), they fully recognize that their overall competency for overseas investment is still inadequate and international development is a tremendous and long-term task to accomplish.

Among the self-ratings, companies give the highest score to **"have strong capital funding or financing capability"**. This shows that the Chinese enterprises have already accumulated strong capital base thanks to China's growing economy in the past decades of reform and opening up. They also have established various cross-border investment and financing channels to tackle the overseas financing issues. However, quite a few of enterprises with limited capital are still facing the difficulty of fund raising. **"have clear overseas development strategies"** ranks second. This shows that many Chinese enterprises have not only realized the importance of overseas strategies to company's development but also been working to improve overseas development planning to rationally promote enterprise's internationalization. On the other hand, **"have experienced overseas projects management teams and talent pool"** and **"have efficient overseas operation and management models"** received the lowest scores, proving again that a talent pool and investment experience mentioned earlier are two of the most crucial factors for Chinese enterprises' overseas investment return.

For the Chinese enterprises that are committed to international development, it is necessary to upgrade the inhouse overseas investments talent pool before "achieving global presence". Only after a large number of professional talent and rich investment experience are accumulated, can Chinese enterprises "go abroad" steadily.

Q15 Please rate the current statement assessment in your overseas investment situation (1 point for the worst and 10 for the best)?



Lens on POEs

For Q15, POEs in general have consistent results against the overall trend except that some specific aspects are lower than the overall scores from respondents.

- ▶ POEs gave the highest scores for **"have clear overseas development strategies" (6.54)** and **"have strong capital funding or financing capability" (6.38)** which, however, are still lower than the overall. This tells us these companies are still facing great financing challenge despite the overall improvement in overseas investment financing.
- ▶ POEs gave the lowest scores for **"have experienced overseas projects management teams and talent pool" (5.50)** and **"have efficient overseas operation and management models" (5.32)**, with the latter one having lower score than the overall. This highlights the immaturity of POEs in overseas investment experience and investment capability to a large extent compared to the overall.



Conclusion

Look at both internal and external, Chinese enterprises will keep “going abroad” bravely



Regardless of geopolitical dynamics, highlighted global risks and uncertainties around FDI policies of overseas countries, the driving force of “going abroad” remains unchanged.

1

The inner motivation of Chinese enterprises’ “going abroad” remains unchanged

After 40 years of reform and opening up, Chinese enterprises have entered a key stage of transformation as they have been seeking to upgrade the quality and efficiency and further participating in the global industrial chain to acquire higher quality of resources.

The Chinese government makes effective action in guiding and supervising outbound investment

2

In recent years, the Chinese government has intensively introduced plans and guidelines to promote China outbound investment and cooperation in an orderly and efficient manner. Meanwhile, multi-level framework was established to facilitate overseas investment and related cooperation funds were set up to provide financial and tax support for companies. Additionally, China is dedicated to improve the risk control mechanism for overseas investment to help companies to mitigate the risks. The government also works hard to improve the risk prevention system to enhance risk control. In future, the reform of overseas investment management systems will remain one of the priorities for creating a new open economy regime and the Chinese government will continue to introduce effective guidance and regulation on outbound investment.

3

There remains growth space for China outbound investment

In 2016, the ratios of ODI stocks of the world, developed economies, developing economies and transition economies to their GDP were 34.6%, 44.8%, 19.8% and 22.6%⁵, respectively, while it was 11.4% for China, far below the world average. This shows the great growth potential for China outbound investment.

Chinese enterprises are optimistic towards future outlook and seek to improve their own investment capabilities and talent pools.

4

The survey found that on one hand, over 70% of the respondents are optimistic towards outbound investment and have related plans for future. On the other hand, around 50% of respondents clearly realized that geopolitical and other external risks would pose certain challenges to their future investment and they should improve their investment capabilities and enrich the talent pools. Facing the uncertain factors like international geopolitical volatility, Chinese enterprises should have a clear understanding of the global environment and enhance their competitiveness of “going abroad” steadily.

Therefore, we believe that China outbound investment is likely to keep stable in the next two years. Amid the dynamic and ever-changing international environment, Chinese enterprises should think thoroughly in various aspects e.g. investment direction, capital strategy, decision-making procedure, capital operation and return, and risks and security in their future overseas investment. They should plan prudently, invest wisely and continuously enrich their talent pools to maximize investment return.

China Overseas Investment Network helps Chinese businesses navigate through global markets

The current wave of globalization continues to transform the business landscape and impact companies around the world. With the B&R initiative, China will undoubtedly play an increasingly mature and globalized role in the global economy. The global economic situation is still uncertain and challenges may arise due to cultural differences, language barriers, financing difficulties and regulatory issues. Chinese companies need to respond in a timely manner to these challenges while navigating a complex and dynamic outbound transaction environment.

The China Overseas Investment Network (COIN) links EY professionals around the globe, facilitates collaboration, and provides consistent and coordinated services to our Chinese clients making outbound investments. Building on the existing China Business Group in the Americas, EMEA, Asia-Pacific and Japan areas, COIN has expanded our network into over 70 countries and territories around the world.

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At present, CMAA is collaborating with large-scale financial institutions, renowned state-owned capitals and outstanding enterprises from ACFIC to establish the "Restructuring and development fund for POEs" to help them achieve a stable and healthy growth.



Key Figures in M&A Association's 10-Year Development -- large oil painting

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