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WEAKER YUAN AND TIGHTER CONTROLS HIT ACTIVITY

Outbound investments slow, but domestic picture stays robust and companies adjust their targets from US to Europe and Africa, writes **Wilson Lau**

While China's "Belt and Road Initiative" is progressing, uncertainties have emerged in the merger and acquisition (M&A) market because of the weakening yuan and tightening control of capital outflows.

According to Aron Leung, partner for transaction advisory services at RSM Hong Kong, outbound investments by Chinese companies have seen a slowdown in 2018 and the central government's deleveraging policies and increased protectionism in the world have had an impact. He adds that investments by Chinese companies in the United States have been declining while targets in Europe and Africa have been on the radar of Chinese companies.

Barry Tong, national head of M&A transaction advisory services at Grant Thornton, thinks the weakening yuan will make M&A more expensive in local currency terms for Chinese buyers. This could make them less aggressive when bidding for foreign targets because of the increased cost.

"However, it is not likely that outbound investments made by Chinese companies will slow down just because of the weakening yuan. You will see that many big players have funding reserves in US dollars and euros for foreign takeovers. Their business can grow and become more diverse. As a result, the business risks are diversified."

Chinese-backed buyouts in the US are expected to witness a short-to-medium-term chill

BARRY TONG, GRANT THORNTON

"Some sources say the Chinese government encourages companies to enter into currency hedging agreements when announcing a deal so that they can continue to purchase assets abroad. We believe the weakening currency is one of many factors to be taken into account in the negotiation of an overseas deal, while it is not likely that the outbound M&A activities of the Chinese companies will slow down."

Leung believes the weakening yuan adds to the uncertainty over China inbound investments. "Investors are



Aron Leung

worried the yuan depreciation will hurt the return on their investments, and there is concern over slowing growth.

"Nevertheless, if we compare China's domestic M&A transactions to outbound and inbound investments by Chinese companies, there is less to worry about the negative effects of the trade war and the declining yuan. Domestic M&A transactions in China are still robust, with persistent industry consolidation in sectors such as logistics. Public companies are still looking at acquisition opportunities as part of strategies as they tie in with shorter-term results."

Given the tighter control of capital outflows, as well as the regulatory uncertainties ahead, Tong expects a potential decrease in the number and value of deals in the short run.

"That said, in the long run such measures are not likely to slow down the outbound M&A of Chinese companies, given that Chinese companies have been growing aggressively and tend to look at opening up more opportunities in the international market through outbound M&A."

"The tighter capital control will only lead to more caution being taken when investing in non-core sectors or speculative, overvalued projects. Deals will be more carefully structured to avoid the specific structures targeted by the regulators which will increase uncertainty and cause delay to the transaction approval."

Leung predicts China's outbound M&A activities in the coming year will continue to be affected by capital outflow issues in the trade war's shadow, even though government policies favour related investments in the "Belt and Road Initiative" and the Greater Bay area.

"Innovative technology and biotech sectors are considered key drivers of M&A activity in China for the coming year. Bolstered by the listing reform



Barry Tong

of Hong Kong's stock exchange in April 2018, private equity investors will keep chasing after innovative companies and pre-profit biotech companies in China. We expect a further surge of investments in Chinese companies associated with these sectors in the next year."

Tong says there are some notes of caution attributable to changing economic conditions and continuing turbulence in the global political landscape. "Alongside the regulatory challenges, the emerging trade war tension between the US and China, as well as the collective retaliatory battle of tariffs, may dampen the appetite for Chinese M&A outbound activities, particularly in the US."

"Chinese-backed buyouts in the US are expected to witness a short-to-medium-term chill, with deal appetite leaning towards Europe or the Middle East. Despite uncertainties surrounding the business environment, China is looking to make available more opportunities and access for cross-border enterprises to its market."

"By easing restrictions imposed on foreign investments within its free-trade zone and relaxing curbs on sectors such as automobiles, banking, telecoms, agriculture and heavy industries, we may potentially see more market competition to sustain the inbound deal momentum."

Tong notes that with turbulence likely to continue into the rest of 2018 and 2019, the obvious question is: what will the new trends be?

"Continuing the reported long trend for industrial and chemicals, as well as telecommunications, media and technology in the M&A markets, opportunities could be unlocked by going beyond sub-sectors towards education and health care. This is attributed to rising consumption and fuelled by demand for quality services by the unprecedented expansion of the middle class."