

# Deals & Dealmakers

Part five: China



## Ties that bind

How China became a serious force in global dealmaking

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## CONTENTS

- 2 OVERVIEW**  
China is coming of age as a dealmaker overseas, but it is not all smooth sailing
- 4 FINANCING**  
State banks are fuelling companies' drive for offshore expansion
- 6 PRIVATE EQUITY**  
How firms can ease the way for Chinese companies looking overseas
- 8 CASE STUDY**  
Energy group Sinochem's Brazilian adventure highlights trends in China mergers and acquisitions
- 10 FEES**  
Competition is getting tougher for the growing pool of equity fees
- 11 COMMENT**  
Western companies can either embrace or resent China's investment outside its borders, writes Nomura's Zhizhong Yang

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# China lights a fire in

The country's companies look abroad for opportunities, especially

**On the rise: outbound Chinese dealmaking increased by 37 per cent last year to \$55.4bn**

**T**HE MIGHT OF THE CHINESE buyer has become a recurring talking point in global deal-making circles. Sell-side advisers in the US and Europe point to interest from well-funded Chinese bidders when trying to liven up an auction. Competitors disparage Chinese companies' sophistication and their ability to execute a deal while secretly fretting about what valuation they might put on the table. And regulators, particularly in the US, wrestle with how they should treat Chinese acquirers should the long-predicted flurry of global deals come to pass.

The position of China as an economic power is well established. But its presence as a force in global dealmaking is just becoming clear.

Outbound dealmaking jumped 37 per cent last year to \$55.4bn, or about a third of all mergers and acquisitions by Chinese buyers, according to Thomson Reuters. Moreover, 2011 has got off to a strong start, with about \$14.7bn-worth of deals to March 23. A decade ago, Chinese companies bought barely \$1.5bn overseas each year.

"Today, if you are selling certain types of assets, you have to be able to present them to Chinese companies because they may well be the best buyers," says Jim Lawrence, co-head of global investment banking at Rothschild. "That wasn't the case five years ago."

Mr Lawrence adds: "The activity has shifted from western companies looking to buy in China to Chinese companies actively looking at opportunities globally."

According to Zhang Xiuping, co-head of Asian M&A at Bank of America Merrill Lynch, Chinese outbound dealmaking "has really started to pick up since 2006 and 2007, largely driven by natural resources companies".

"And despite the fluctuations in the oil price," says Ms Zhang, "I'd expect Chinese oil and gas companies to continue this activity in the near future."

In fact, the history of Chinese M&A to date has been dominated by the country's hunger for natural resources. Over the past 10 years, the oil and gas and mining sectors have accounted for more than half of total outbound deal volume.

Already this year, PetroChina has paid \$5.4bn for a 50 per cent stake in a Canadian shale gas project owned by EnCana, the energy group. Last year, Cnooc, the Chinese state-owned oil company, bought a 50 per cent stake in Argentina's Bidas, while Sinochem, the chemicals group, spent \$3.1bn for a stake in Brazilian oil assets.

"About 15 years ago, China's National Development and Reform Commission started publishing the strategies it expected corporations to pursue. Some of those were only possible through M&A, particularly in automotive, steel and iron ore, and oil," says Meyrick Cox, a managing director at Moelis & Company, the independent US investment bank, who advised China's Geely on last year's \$1.8bn deal to buy the Volvo brand from Ford Motor.

The priorities established by the state regulator have, so far, helped direct the flows of Chinese dealmaking – as has an acute sensitivity on the part of corporate China to how its interest will be received in a target's home country.

Marcus Silberman, head of Latin American M&A at Credit Suisse, says both those factors have helped prompt substantial interest by Chinese companies in the region.

"The Chinese are very hungry for natural resources, while Latin America is rich in resources and needs capital to develop its reserves," he says. "The Chinese know they are very welcome in Latin America."

Other markets, in contrast, have been considered no-go areas – most notably the US, where



the high-profile problems of past dealmaking forays and the influence of the Committee on Foreign Investment in the United States has deterred Chinese interest. Cnooc's abortive bid for Unocal, the US oil group, in 2005 has lingered in Chinese memories.

Meanwhile, Huawei, the software and telecoms equipment maker, recently decided to unwind a \$2m patent deal in the US following opposition from the US authorities, providing another reminder that any deal – no matter how small – risks a sceptical reception abroad.

"State-owned companies feel at a disadvantage," notes one adviser. "In recent years, they had an advantage over international competitors in terms of funding and liquidity. But [being state owned] doesn't help them when it comes to a competitive auction process."

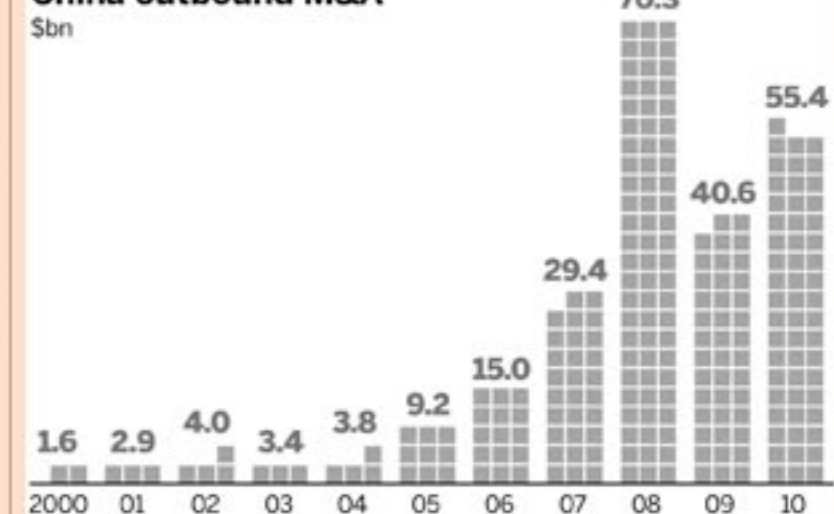
Sellers may shy away from choosing a Chinese buyer, say advisers, wary that the chance of a security review and a protracted approvals process may delay or even derail the deal. Huawei last year was sidelined in two US auctions, despite being the highest bidder, losing 2Wire, a privately owned broadband router maker, to

# global dealmaking

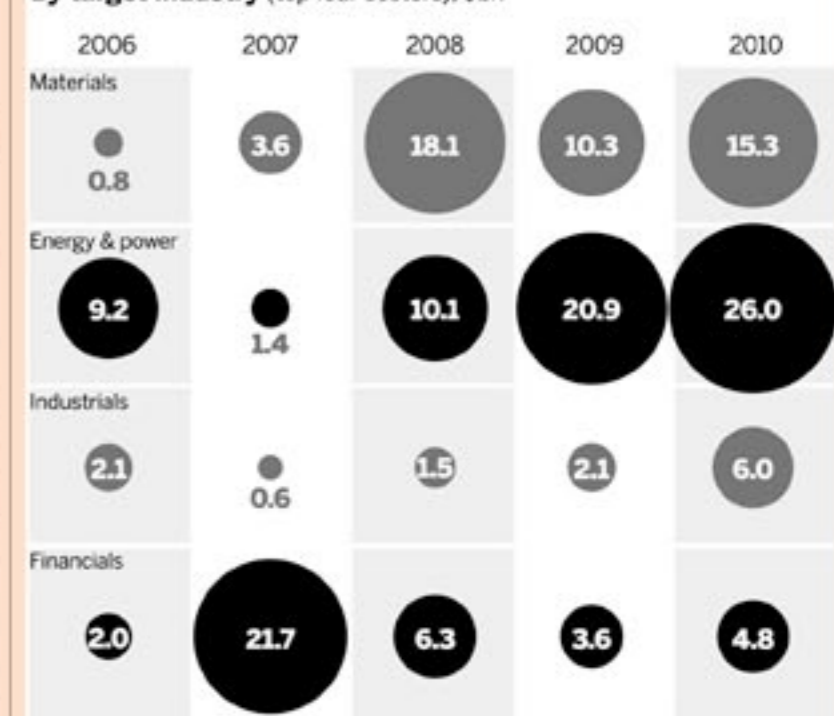
to fuel the hunger for natural resources. By Helen Thomas



## China outbound M&amp;A



## By target industry (top four sectors), \$bn



Source: Thomson Reuters

## 'The activity has shifted to Chinese companies actively looking at opportunities globally'

Pace of the UK, and a unit of Motorola to Nokia Siemens Networks.

However, the scope of Chinese interest in finding opportunities internationally is expanding.

"Most of the companies that are actively looking overseas are doing so either because they can't grow their business any more in China or because they have a need such as upstream resources or technology," adds Ms Zhang of BoA Merrill Lynch.

Meanwhile, a more ambitious approach is also being promoted by the regulator. Moelis & Company's Mr Cox points out that recent rule changes now broadly require international automotive joint ventures by Chinese companies to be Chinese-controlled and to own and develop their key technology.

Meanwhile, bankers point to the increasing activity in the consumer products sector, where Shanghai-based consumer group Bright Food has taken part in several international sales processes and Wahaha, the soft-drinks producer, is said to be scouting for targets abroad, including in the US.

Food security is also an area of focus. Chinese groups, including Cofco, the state-owned agribusiness group that recently bought Château de Viaud, a 49-acre Lalande-de-Pomerol estate in Bordeaux, France, are looking for chances to buy less exotic farmland or for deals that would help secure supplies of food and agricultural commodities.

Of course, the process is not always smooth. Bankers privately admit that most Chinese companies have never been through the M&A process before, arguing that most show particular caution in public company transactions and shy away from anything that smacks of hostility.

Moreover, bankers have expressed disappointment that some would-be buyers have reached the advanced stages of a sales process only for their interest to fade on the home straight.

Bright Food, which is majority-owned by the Shanghai provincial government, has been a

leading bidder in at least three auctions without success. The group last year walked away from talks to buy the UK's United Biscuits and GNC, the US vitamin retailer. Last month, it lost out to General Mills in the auction for a 50 per cent stake in Yoplait, the French yoghurt maker.

Getting the necessary regulatory consent and approvals at home can also be an unfamiliar process – and put the brakes on companies' ambitions abroad.

"In general, the National Development and Reform Commission is very supportive of outbound M&A initiatives by Chinese companies," says Ms Zhang.

But Rothschild's Mr Lawrence adds that dealing with the authorities can prove unpredictable. "The governance process is such that you can have surprises emerge towards the end of a deal," he says. "Those issues are not as straightforward as in the west."

He adds: "Getting deals across the line has been more difficult than anticipated. But I'm quite confident you'll see more Chinese companies buying western assets in the coming years."

# On good terms

Chinese banks fuel 'going global' drive. By *Jamil Anderlini* in Beijing

**T**Hese days, when the governor of China Development Bank travels abroad, he is treated almost like a head of state. Chen Yuan is not only the most senior official at China's biggest "policy" lender, but also a "princeling", the son of a founding leader of the Chinese Communist party, which means he wields enormous political clout in Beijing.

His bank's role as a substantial source of cheap financing for domestic companies looking to invest overseas makes him a very important man outside the country as well as at home.

In recent years, China's government has rapidly ramped up its decade-old policy of encouraging domestic companies to "go global", especially through international mergers and acquisitions. The country's outbound foreign direct investment reached a total of \$220bn in 2006-10, according to government figures. That is close to 10 times the total cumulative \$26bn that Chinese companies had invested in 150 countries at any time up to the end of 2005.

Most of the investments abroad have been made by companies owned or controlled by the state, and almost without exception these deals are at least partially funded by generous, low-interest loans from the country's state banks.

CDB, with Mr Chen at the helm, has been one of the leading providers of loans for companies such as Huawei, PetroChina, Chinalco and many others as they seek to acquire overseas assets.

But China's largest banks, all of which are supposed to have been "commercialised" and have sold shares to public investors in Shanghai and Hong Kong, are also eager to provide financing for offshore expansion on what bankers say are remarkably easy terms.

For example, when Chinalco, the state-owned Chinese aluminium giant, wanted to double its stake in Rio Tinto, the Anglo-Australian miner, it turned to the state banks and received \$21bn in long-term, low-interest loans to pay for its \$19.5bn acquisition plan.

The deal ultimately fell through amid stiff public and political opposition in Australia. Concerns about the aims of the Chinese government, and the level to which Beijing was co-ordinating the Rio Tinto purchase for its own strategic reasons, were heightened by the terms of the loans being offered by CDB, the Export-Import Bank of China, Agricultural Bank of China and Bank of China.

Under the terms of the 15-year loans, Chinalco would have been required to pay just 90 basis points, or less than 1 percentage point, above the benchmark six-month Libor, the London interbank lending rate.

Around the same time, BHP Billiton, another Anglo-Australian miner, with a much bigger balance sheet than Chinalco and a market value at the time of about \$125bn, was only able to secure a 390-basis-point spread over Libor on a 10-year bond.

The extremely favourable loan terms that Chinese state banks can offer state companies to help them with their offshore acquisitions have become a sore point for many of the international companies trying to compete for those deals. State bank financing flows especially freely to companies - particularly state-owned "national champions" - that are buying overseas companies in the high-tech, energy, mining and environmental protection sectors.

In their annual press conference in early March, top officials from China's central bank said the bank was "reinforcing credit policy guidance to support balanced regional economic development and [the] 'going global' strategy of enterprises".

In other words, the country's central bank wields its considerable influence over China's commercial lenders to force them to provide very cheap financing for state companies scouring the world for acquisition targets to expand the Chinese economic empire.

While the bulk of the country's nearly \$3,000bn in foreign

exchange reserves is held in low-yielding US government bonds, Beijing has also been looking at ways of diversifying these reserves and spending more on buying real assets abroad. This could provide a pool of cheap finance far larger than that which the state banks have been able to offer until now.

China Development Bank rarely releases any figures publicly, but some foreign analysts believe it has served as a conduit for some of the foreign exchange reserves to be lent out to state companies expanding abroad.

CDB and the Export-Import Bank of China have, between them, lent more money to developing countries over the past two years than the World Bank, according to Financial Times research. The two "policy" banks signed loans of at least \$110bn to other developing-country governments and companies in 2006-10, compared with the \$100.3bn lent by the equivalent arms of the World Bank from mid-2008 to mid-2010.

Many of the agreements include large loan-for-oil deals with countries such as Russia, Venezuela, Brazil and Kazakhstan, and many of the loans are for overseas companies or governments to buy Chinese equipment and products.

CDB has also made numerous loans similar to the \$30bn it extended to state-owned China National Petroleum Corp to help it with its buying spree of overseas energy resources.

The Chinese government has increased its support for private companies looking for overseas acquisitions as well, and has promoted

## China's largest banks are eager to provide cheap financing for offshore expansion, bankers say

the idea of state enterprises teaming up with them to help overcome political opposition in some countries.

"The number of overseas acquisitions by China's private sector is increasing," Chen Zongsheng, deputy secretary-general of the government of the northern Chinese city of Tianjin, told a conference last November. "Compared with state-owned enterprises, private companies are more likely to succeed in acquiring foreign assets in some politically sensitive areas."

But private Chinese companies still have a much harder time securing bank lending or foreign exchange quotas, and often turn to equity or bond markets in places such as Hong Kong, New York or London to raise the money they need to make offshore acquisitions.

They are increasingly also turning to China's burgeoning private equity industry for funds to help them expand beyond the country's borders.

It just so happens that CDB has already positioned itself to take advantage of this new trend by establishing a fund of private equity funds that is in the process of raising Rmb60bn (\$9bn).

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# Spanning the culture gap

Globally aware private equity firms can carve out a profitable niche in Chinese mergers and acquisitions, reports

*Henny Sender in Hong Kong*



**A**T THE BEGINNING OF March, Providence Equity Partners, one of the large international buy-out firms, sent a note to investors to announce that Sean Tong, one of its Hong Kong-based managing directors, was leaving the firm to launch a China-focused private equity investment platform. Mr Tong is just one of many locals leaving western firms to set up his own shop, adding to competition that was intense even before the defections.

"With the growth of domestic private equity firms in China, the major international firms are losing their competitive edge," says a China lawyer at one of the big US law firms in Hong Kong. So today, if they are to flourish in the Chinese market, private equity firms will have to reinvent themselves once more. Buy-out firms have already had to adapt their model to the reality of the Chinese market several times, because the formula that has worked so successfully in the US does not travel particularly well.

For one thing, there is now a lot of money in the country. Having capital is no longer something unique or differentiating. As the example of Mr Tong shows, there are no barriers to entry on the mainland. In addition, there are virtually no control deals. It is hard to use masses of borrowed money. Aggressive restructuring and cost cutting is difficult. That means many of the deals involve minority stakes in companies that are either about to go public or have already done so.

However, there is still money to be made on such small stakes. Carlyle Group's minority holding in China Pacific Insurance is likely to be among the most profitable deals any buy-out firm

## If they are to flourish in the Chinese market, private equity firms will have to reinvent themselves once more

**Bridging the divide: the 26.4-mile Qingdao Haiwan Bridge in eastern China, opened this year. Private equity firms can help Chinese companies do business overseas**

has done anywhere to date. Similarly, TPG, the US private equity firm, made billions on its stake in Shenzhen Development Bank. It is likely to make even more on its China Grand Auto deal, which gives it a stake in car dealerships all over China but effectively is also a property play, since the dealers sit on land that is increasing in value. Indeed, in 2010, TPG's Asian funds performed far better than its flagship US funds. Its Asian funds were up between 40 per cent and 50 per cent for the year.

But those kinds of returns are likely to fall in the future. "The gravy train of buy low and sell high is over," says the head of Asia for one major private equity firm. "Perhaps the market opportunity is growing, but the money is growing faster."

Now, as the competition for deals becomes more intense, private equity firms are having to adapt again. One sign of that change is their willingness to raise local-currency funds in China in the hope that the country's wealthy entrepreneurs will be the source of both funds and deal flow.

Many also hope that a template that was pioneered when Lenovo, the computer vendor, bought IBM's computer business can be replicated on a bigger scale in the future. Lenovo turned

to TPG and General Atlantic, another private equity firm, for help in running the US technology operation. That should be a natural role for the private equity firms to play, as they can serve as a bridge between two cultures. They can ease political and regulatory concerns, or advise on the practicality of the process as partners rather than paid advisers.

"The value-add is what the private equity firms know outside China," says Joe Gallagher, head of mergers and acquisitions, Asia-Pacific, at Credit Suisse in Hong Kong.

But so far there have not been many such deals. When Haler, the white-goods maker based in Qingdao, was looking to bid for Maytag, the US appliances maker, it teamed up with Bain, the management consultancy, and Blackstone, the private equity group, for help in what was ultimately an unsuccessful bid. Blackstone is also helping China National BlueStar, a consumer company in which it has a stake, make overseas investments.

**A**S CHINESE COMPANIES BECOME more interested in making acquisitions in the developed markets of the west, the private equity firms can potentially do much to help. That is because one of the main fears of domestic companies, even the biggest state-owned enterprises, is about integrating differing cultures. Their lack of experience in the international arena represents an opportunity that does not exist in a market such as India, where executives have far more confidence about their ability to manage multinational companies.

That is one of the principal reasons there have not been more deals, bankers say. Only where deals involve heavy engineering skills or natural

resources do the Chinese have the confidence that they can manage the companies they acquire.

Private equity can also help ease fears of overpaying, a fear that has paralysed many Chinese companies and kept them from closing on deals they desperately want – as was the case when Bank of China tried to buy Bank Internasional Indonesia several years ago.

That reluctance to pay up also helps explain why many China bankers hate domestic deals. "The China advantage should be cheap financing, but because they drip-feed the price, that cheap financing doesn't mean automatic success," says the head of M&A at one large international firm.

There are many other reasons for frustration. Virtually everything in the country is government directed, so when deals come up, a key task for bankers is to figure out who will get Beijing's blessing to bid.

One of Credit Suisse's great success stories was in selling local Wing Lung Bank in Hong Kong to a Chinese bidder in the form of second-tier China Merchants Bank, despite the fact Beijing was backing Industrial and Commercial Bank of China, the largest of the country's state-owned banks. But such upsets are rare.

Meanwhile, there is another template that private equity firms hope does not get repeated.

Last month, China's Wanhua Industrial Group gained full control of Borsodchem, a Hungarian chemicals manufacturer, for €1.2bn (\$1.7bn). Wanhua first bought a stake in the distressed company by acquiring the debt at bargain prices after a poorly timed purchase of Borsodchem by London-based private equity firm Permira in 2006. Chinese companies love such bargains, but private equity firms are not rejoicing when the deals come at their expense.

## Beneath the surface: a fishing trip to China

**I**N JULY 2010, CARLYLE GROUP, a Washington-based private equity firm, put almost \$200m into China Fishery Group, giving the buy-out firm a 13.6 per cent stake in the world's largest fish processor. Except it obviously was not a buy-out at all. But then very little private equity activity in China actually involves true buy-outs. Doing deals in the country is not easy: valuations are high, and most entrepreneurs are still young and have little desire to sell their companies and retire.

Instead, international private equity groups such as Carlyle are reduced to taking minority stakes in companies that are private, about to go public or already listed. Indeed, as many as 70 per cent of all China-related listings and secondary offers involve private equity players, according to data from UBS, the Swiss bank.

That is not to say the upside cannot be as good as – or far better than – the true leveraged buy-out deals that these big investment firms with tens of billions of dollars under management undertake in the US. Indeed, in 2009, after China Pacific Insurance, the country's third-largest insurer, went public in Hong Kong (one of the top 10 listings that year worldwide), Carlyle began to sell down its minority stake. That deal will probably prove to be one of the most profitable private equity transactions to date, and earned the Hong Kong-based Carlyle deal team hundreds of millions of dollars collectively. Thus are fortunes made in China.

Because China Fishery is already public, it will not prove as lucrative as Carlyle's insurance deal. But because the fishery was founded by a Hong Kong entrepreneur and is listed in Singapore, happily the investment is not nearly as risky as deals in China itself. On the mainland, regulators are constantly changing the rules, and concerns about

local protectionism and potential xenophobia are never far from the surface.

Indeed, China Fishery was just what Patrick Siewert, managing director at Carlyle in Hong Kong, was looking for when he joined the group several years ago after running the Asia-Pacific region for Coca-Cola, the US beverages group. He wanted investments in companies that would be plays on the growth of domestic consumption in China, and believed food prices would rise as hundreds of millions of people in Asia became integrated into the world economy.

But, concerned with the reputational risks that are often an issue in the country, Mr Siewert wanted reassurance that the company's practices were appropriate. (Carlyle had already ploughed money into a dairy company after careful due diligence to ensure there was no possibility of another melamine-in-the-milk scandal.) Moreover, he had heard that Ng Joo Siang, managing director of China Fishery, had been talking to UBS about a secondary listing in Oslo (Norwegians understand fish), suggesting the company was looking for additional funds.

Mr Ng, meanwhile, wanted to expand and upgrade. He had arrived in Hong Kong in 1992, a "negative millionaire", he recalls, fleeing creditors from the family business in Singapore. In Hong Kong, he began processing and selling fish. While his competitors were selling to Japan, he ranged further afield to Europe and Russia where the competition was less intense.

Today the company's sales total HK\$11bn (\$1.4bn), Carlyle has helped it comply with best environmental compliance, and the business has operations from China to Chile.

*Henny Sender*

**Food for thought: since Carlyle invested in China Fishery last year, the seafood processor has improved its environmental compliance and started expanding**



# Latin moves in China's rush for oil

Sinochem's stake in an oilfield off Brazil highlights trends in dealmaking, reports *Leslie Hook* in Beijing



## As with any companies doing overseas M&A for the first time, Chinese resources companies have been learning the ropes

Chinese oil companies from bidding against each other for overseas assets, since the regulator would not usually grant approval for two companies to bid for the same thing.

However, that changed in 2007-08 when regulators in Beijing started taking a slightly more hands-off approach. The result is that Chinese companies have started competing for assets overseas with each other, not only with their western peers.

One of the clearest examples of this was the bid contest for the 40 per cent stake in the Peregrino oilfield. The block was contested by no less than three Chinese state-owned oil companies: Sinochem, which grew out of China's state oil trading arm; Sinopec, which historically has run most of China's refineries; and Cnooc, which specialises in offshore oil production.

"[In] the Peregrino auction ... Sinopec and Sinochem were extremely competitive, aggressive,

**Resources play:**  
China's Sinochem now owns a 40 per cent stake of the Peregrino oilfield off the coast of Brazil

Cnooc was there but wasn't quite as aggressive," says one person involved in the deal.

The hot bidding meant the companies' strategic approach to the deal became a key factor in determining who won. According to two people who worked on the deal, Sinopec offered the best financial terms, but insisted on standard conditionality and due diligence. Sinochem, meanwhile, made an unconditional bid, according to one insider – an unusual gamble for the industry but certainly an attractive proposition for the seller.

**S**TATOIL ALSO SEEMS TO HAVE BEEN drawn by the prospect of working with Sinochem in the future. "I am pleased that we also have agreed to sign an MoU [memorandum of understanding] to jointly investigate further opportunities in Brazil and elsewhere," said Helge Lund, chief executive of Statoil, when the deal was announced.

Sinochem is relatively new to China's overseas oil rush. The company's \$3.1bn spend on the Peregrino stake was nearly twice as much as the total amount it had previously spent on overseas oil projects. Although it is a large conglomerate, with roughly \$15bn in assets at the end of 2009, it has traditionally been focused on importing oil and trading oil and chemicals, including fertilisers.

Sinochem made its first overseas energy acquisition just eight years ago, in 2003. But it did not

## Investment shift

**C**HINA'S OVERSEAS INVESTMENTS in oil and gas have become an important driver of the industry. Last year, Chinese energy companies spent more than \$30bn on overseas energy deals, about one-fifth of global deal activity. To give a sense of the pace of the change, consider that in 2008, Chinese energy deals accounted for just 4 per cent of the global dealbook.

While this shift towards overseas investment has been initiated at the highest levels of government as part of the "go out" strategy under which state-owned enterprises are encouraged to venture overseas, it is also driven by commercial considerations.

"In general, the Chinese can take a more long-term view. They are probably on balance less payback-focused [than other oil firms] and more focused on improving the number of barrels produced," one oil and gas banker observes. "This makes them very competitive bidders."

Some industry experts say that Chinese oil companies have a history of overpaying for assets, although a recent report from the International Energy Agency refutes this claim.

The country's large oil companies have a mandate to boost production, and their ownership structures usually make shareholder value a secondary consideration (one exception is Cnooc, which is structured differently from Sinopec or CNPC, China's largest oil and gas producer). This structure allows companies to take longer-term bets on oil than their western peers, because they do not have the pressure to turn around their investments as quickly.

Many state-owned oil companies cut their teeth on assets that were not hotly contested by global oil competitors, sometimes in investments in Africa or the Middle East in countries deemed too risky or unpalatable for most energy firms. This is rapidly changing, though – as the Peregrino oilfield saga shows.

*Leslie Hook*

take long for the company to make a mark in the global oil M&A field. Most recently, it explored the possibility of launching a counterbid for Anglo-Australian mining group BHP Billiton's \$39bn hostile bid for PotashCorp, the potash mining company based in Saskatchewan, Canada. Sinochem eventually decided not to pursue the deal – partly because of opposition from Chinese regulators concerned about overpaying for the assets.

In many ways Sinochem is typical of the Chinese companies making waves in global M&A. They have been extremely fast to move into the sector they are interested in, and those who have worked with them describe Sinochem's M&A team as savvy and sophisticated.

One particular coup was Sinochem's decision to walk away from a potential acquisition of Nufarm, an Australian agricultural company, in 2009. Today, Nufarm shares are trading at a less than half of what Sinochem was offering at the time, before the deal fell through.

That is not to say that there has not been a learning curve. As with any companies doing overseas M&A for the first time, Chinese resources companies have been learning the ropes. Sometimes that has been painful, as with Cnooc's failed bid for Unocal, the US oil group, in 2005, which was derailed by loud political opposition out of the US. But China's state-owned companies have largely been remarkably fast learners.

## An unlikely visionary

How Fu Chengyu helped Cnooc cross borders

**F**U CHENGYU, CHAIRMAN OF CNOOC, China's largest offshore oil and gas producer, is not one to shy away from a deal: he spearheaded one of China's earliest and most aggressive bids in the oil industry, when Cnooc offered to acquire US-based Unocal for \$18.5bn in 2005.

That deal was crucial in testing the waters as China began its relentless march of overseas investments. Not only did it push the limits of US tolerance for Chinese acquisitions on home soil, but, as the biggest Chinese overseas investment at the time, it also signalled a pivotal shift in Beijing's thinking. All large overseas deals by Chinese companies must be approved by state regulators, which was not easy five years ago. "The hardest part of that deal was convincing the government," jokes one Cnooc insider.

The man spearheading the deal was an unlikely visionary. Born in 1951, Mr Fu (below) grew up studying hard and with a natural affinity for sports, playing basketball and football at university as he earned his degree in geology. His bushy eyebrows and forthright demeanour made him something of a rarity among the country's captains of industry when he was eventually appointed as chairman of China National Offshore Oil Corporation in 2003.

If Mr Fu was unusual, so was Cnooc. Created in 1982 by the state, its job was to develop offshore oilfields. At the time, it lacked the experience to manage these fields independently,

## The challenge was to convince the world of Cnooc's uniqueness

Although he belatedly launched a media campaign to accompany the move for Unocal, the bid ran into strong opposition from US politicians and eventually failed. Such public rejection stung, not just for Mr Fu but also for policy chiefs in Beijing and leaders of state-owned enterprises. It was five years before Cnooc ventured to invest in US onshore oil and gas again, even as it snapped up other assets around the world.

Mr Fu is nearing retirement age and has long been rumoured to be preparing for a move into politics. Last year, he stepped down as chief executive of Cnooc but retained his title as chairman – a move that paves the way for a younger generation of Cnooc leaders.

"We learned we need to be more prudent in terms of public relations and political lobbying when dealing with such a big deal," Mr Fu said in an

interview after the Unocal deal failed. That is a lesson that Chinese companies across all industries – from Huawei and Lenovo to Chinalco – are still grappling with today. *Leslie Hook*

## 'We are not really like other Chinese companies'

so joint ventures with foreign partners were necessary from day one.

As a result, Mr Fu and his colleagues gained exposure to working with foreign oil companies from the very start of China's opening-up to the west. The country's other oil majors, Sinopec and CNPC, were much slower to start exploring foreign joint ventures.

For that reason, Cnooc has never quite been a typical Chinese state-owned enterprise, even if the parent company is still majority owned by the state. It has truly independent board members, for example – famously they initially rejected Mr Fu's proposal to bid for Unocal.

The challenge that faced the chairman, however, was convincing the world of Cnooc's uniqueness as he set out to acquire Unocal. "We are not really like other Chinese companies. Our systems, models and processes are more like our western counterparts," he told the FT in an interview in 2005.



# Scraps from the feast

The China fee pool is growing – but so is competition for it. By *Henny Sender* in Hong Kong

**G**OLDMAN SACHS, THE investment bank, began courting the Agricultural Bank of China five years ago in the hope of winning the mandate to help the large state bank go public last July, bringing over senior executives from New York and Hong Kong to woo AgBank officials.

"How much does it cost to bring [Goldman Sachs chief executive] Lloyd Blankfein to Beijing?" asks the head of one of the bank's competitors rhetorically. "That is why you can never quantify the fees versus the costs of doing business in China. So much goes into winning deals that you are never reimbursed for. You can't be too granular about the costs versus the benefits."

Chinese equity fees now account for up to 40-50 per cent of all Asia-Pacific fees. But a growing list of banks competing for the business, Chinese leverage in browbeating banks to cut their prices, and the expense of recruiting and keeping China bankers mean that the profitability of doing business there will remain under pressure.

"Fees are never as good as they are in Europe or the US," says the head of mergers and acquisitions for one international bank in Hong Kong.

Certainly, the data providers offer a positive picture. "China market fees are growing rapidly," notes Thomson Reuters. "They have increased to 7 per cent of the global fee pool in 2010, up from 1 per cent in 2005. Total market fees were \$5.8bn."

However, those fees are being swallowed up by an ever-growing list of banks. While consolidation is the big theme in the financial markets of New York and London, in China the number of banks competing for a role especially in capital markets deals grows ever larger and the competition more intense.

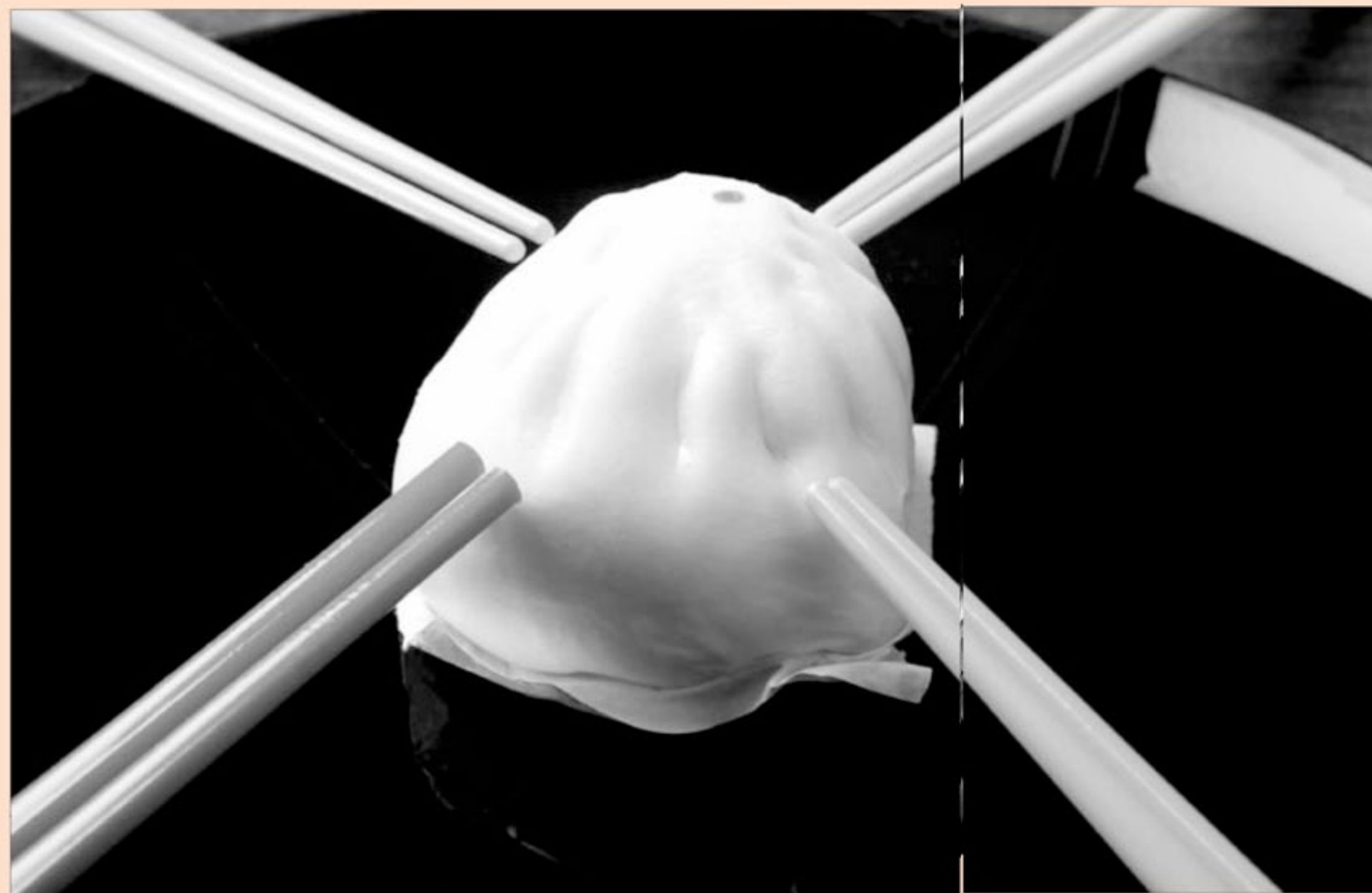
That is true both internationally and locally, and more and more of those fees are going to China. Indeed, the country's banks last year received 66 per cent of the total fees, while 13 of the top 20 banks doing business in the country today are Chinese, according to Thomson Reuters. Some, such as CICC, are experienced players. But others, such as the securities arms of the banks, get deals because of their more powerful parents.

Thus among those whose names appeared in the underwriting group for Agricultural Bank of China's global offer was (of course) ABC International, the securities arm of AgBank, while ICBC International was part of the AIA Group listing. Unsurprisingly, the fees for AIA, the insurer, were far more lucrative than for AgBank, bankers add, precisely because of Chinese browbeating on fees.

Moreover, the cost of the country's bankers remains high, and competition for the best is intense. In the US, an experienced mergers banker has 20 years of experience, compared with about five years in China. But private equity and the growing number of banks doing business in China are all competing for the best talent, leading to the phenomenon of "serial traders" who constantly auction themselves off to the highest bidder.

This year, the volume of capital raising continues to be strong. Core investment banking revenues in China climbed to almost \$1bn for the year to mid-March, which is the highest to date, with two-thirds of that coming from equity capital markets activity.

But bankers say that to generalise about deal fees remains perilous. The entire structure is opaque and the data are often unreliable. Neither the bankers who win the mandates nor their clients disclose the fees, while both those involved and those who lost out have a vested interest in distorting the true figure. Many denounce competitors for allegedly slashing fees, although when a deal is deemed strategic, virtually every firm will reduce the rate.



**The number of banks competing for business, and Chinese leverage in browbeating them to cut prices, put profitability under pressure**

In any case, fees for equity raisings are far more lucrative for the numerous Chinese bankers who have been recruited and cosseted by the big international banks in Hong Kong, Shanghai and Beijing than fees for M&A. Indeed, one banker estimates that if the Chinese bankers were forced to live by M&A fees alone, they would all shrink their teams by 75 per cent.

Chinese cross-border acquisitions are also up this year, although the deals still lag behind 2008, the record year. But while China-related merger deals increase every year, arguably the glass remains more half empty than half full.

"If you have a company to sell and a potential

Chinese buyer, it doesn't always work," says the head of M&A for one big US bank in Hong Kong. "It is disappointing how often the Chinese don't deliver."

Perhaps the most striking thing about M&A in China is how many deals that are expected to happen ultimately do not take place, making the process frustrating and the pay-out at the end questionable.

Take Bright Food, an ambitious Chinese conglomerate whose name has been linked with GNC, the US vitamin and nutritional food maker, the UK's United Biscuits and most recently Yoplait, the yoghurt maker jointly owned by France's PAI and a French co-operative. While the fate of this last potential deal has not yet been resolved, the two former flirtations never led to marriage, leaving many bankers to conclude that this is a nation whose companies "are not ready for prime time", as one China lawyer notes.

The GNC deal made a lot of sense for Bright Food, given Chinese people's predilection for health foods and herbs. Ultimately, though, it fell apart on disagreements including pricing and

funding uncertainties, according to people familiar with the matter. But from the beginning it was never clear whether the deal had the support of Beijing, which is often essential.

Meanwhile, Bright Food's interest in United Biscuits made little sense, according to bankers.

"They were considered the preferred bidders on United Biscuits but it was hard to figure out why they wanted it, apart from ego," says one banker. "It wasn't clear why they wanted to buy a European brand and operations with nothing in Asia. It wasn't clear how they would manage it and whether it would even appeal to the Chinese."

Resistance to paying fees continues to remain strong. "It is only when bankers create a deal or when a deal is outside their comfort zone that they will pay," says one Hong Kong-based lawyer.

International bankers spend much of their time trying to train their Chinese clients to understand the difference between what is value-added advice and what is not. But it is not clear whether the foreign bankers will be the ultimate beneficiaries or if their Chinese counterparts will reap the rewards.

Less to go around: in China, the number of banks competing for a role in dealmaking grows ever larger

**Zhizhong Yang** A real opportunity for the west as China looks abroad



**O**N SATURDAY MARCH 5, ABOUT 3,000 people gathered in Beijing's Great Hall of the People to debate and approve the Chinese government's economic and social plan for the next five years. The topics under discussion were many and varied, but Chinese overseas investment was high on the agenda.

Chinese foreign exchange reserves already amount to nearly \$3,000bn. In five years' time, they could be nearer to \$6,000bn. That is a truly staggering amount, at least some of which has to be deployed over the next decade. And there is a growing belief among the Chinese authorities that investment in western companies is one of the most rewarding ways to use this growing cash pile.

This is not a new trend, but it is gathering momentum. Between 2005 and 2009, the Chinese spent \$145bn on overseas acquisitions. Last year, the figure was more than \$50bn. In 2011, investment outside China is likely to be significantly higher, and over the next five years the figure will almost certainly increase exponentially.

Western companies can respond to this phenomenon in two ways: they can embrace it or ignore it. To date, there has been a bit of both. Governments and corporates have tended to eye Chinese mergers and acquisitions ambitions with suspicion. Acquisition processes can be lengthy, and some countries have stringent rules, limiting the extent of Chinese involvement. Against that, there are notable successes, such as the acquisition of Volvo, the Swedish carmaker, by Chinese automobile manufacturer Geely last year, or the purchase of Cifa, the Italian concrete-pumps maker, by Zoomlion, the Chinese machinery group.

Intriguingly, both acquirers challenge the common perception that Chinese outbound investment is conducted only by the state. Geely is a private sector company; Zoomlion is owned by the Hunan provincial government. This is not a coincidence; rather, it illustrates the way Chinese M&A is evolving. The state will remain important, but it is not the only cash-rich entity in China. Private sector companies are growing in number, wealth and influence, while regional governments are also highly liquid and keen to invest overseas.

Chongqing province, for example, has openly stated it would like to spend \$5bn a year on international acquisitions. Located in south-west China with a population of 30m, Chongqing is just one of 30 provinces in China and has already started investing overseas, spending £20m (\$32m) last year on Precision Technologies, a machine-tools business in Yorkshire, and a considerable amount on farmland in Brazil. Even sovereign wealth funds and other large investors are searching for overseas investments, opting for minority holdings in companies they hope will deliver stable long-term returns.

In other words, companies in the west will face a broad choice of potential Chinese partners, each of which has a slightly different agenda. Some are keen to acquire companies outright, some prefer partnerships and some favour minority investments. Some want to be more involved in daily operations, while

others are happy to delegate. But what unites them all is the desire to spread their wings.

China has made enormous advances over the past decade but is still anxious to develop its knowledge and understanding of the corporate world. Political and business leaders want to refine their management skills, buy technological expertise, improve research and development, acquire brands and learn how to market them.

And, of course, they need to invest in resources to fund the ongoing industrialisation of the country. They have been making progress on this for several years now – primarily in Africa and Latin America. But the most effective way for them to acquire knowledge is to form partnerships with those who possess it – mostly western companies.

Far from being a threat, this should be seen an extraordinary opportunity for the west.

**Western companies can either embrace or ignore China**

Many European and US companies already have a foothold in China. Multinationals, including Procter & Gamble, Coca-Cola and Starbucks, are well established there; numerous others are either selling to the Chinese or helping them construct the country for the 21st century. Still more see China as a new frontier, somewhere they need to be to realise the full potential of their business.

But western companies do not have to make large capital commitments to take advantage of what the country has to offer. They can think more laterally and allow the Chinese to invest in them. Many of the more sophisticated domestic enterprises have learnt to understand cultural nuances, corporate social responsibility and the need to preserve local jobs wherever possible. They also know takeovers or strategic partnerships work best when both sides see the benefit.

They are willing to explore options, ranging from outright acquisitions to joint ventures or minority stakes. Western companies with the foresight to grasp what Chinese investment can offer can derive meaningful benefits. They can leverage their distribution network and reduce costs – tapping into the biggest and fastest-growing market in the world while diversifying their manufacturing and research and development capabilities.

There is a slogan that is common currency in China today: "Zou chu qu". It means walk outside – or look beyond your own backyard for inspiration. The Chinese have started to do just that, creating a real opportunity for the west. Those who turn their backs on it will be forgoing the opportunity to move their business forward into one of the most influential markets of the 21st century. Those who embrace it will be positioning themselves for a stronger, more rewarding future.

*The writer is chairman, Asia ex Japan, of investment banking at Nomura*



# The value of reputation protection. *Or: Our part in your upfall.*

Your reputation is your most valuable asset. But it can also be your most fragile.

Left to its own devices, it is at the mercy of every journalist, competitor, industry commentator, ex-employee or gossipmonger that might choose to bring it into question. And whatever their motive, the effect is the same. A reputation that may have taken a lifetime to build can be destroyed in a moment.

At Mishcon de Reya, we have developed a specialism for reputation protection.

When sensitive information has been picked up by third parties, our timing and tenacity ensures maximum damage limitation.

Where there is the threat of negative information being released, our team always acts with intelligence and speed. Using emergency injunctions and sophisticated negotiation, we have been able to stop whole publications and broadcasts for our clients.

We have also helped them avoid the recurrence of any negative issues by working with our close connections in PR.

And while we will stop at nothing to protect our clients' interests, the value we offer can often lie in our ability to provide calm counsel, avoiding legal proceedings wherever possible yet progressing strategically and with force if they do arise.

Of course, defending your reputation is only one part of the story. A significant element of the true value of your reputation is its unrealised potential. Which is where reputation enhancement comes into play. We have extensive experience in developing strategies that enhance reputations and help build brands. This proactive approach pays dividends which have proved quietly invaluable to many of our clients.

For more on our practices regarding reputation protection, and enhancement go to [mishcon.com/ftreputation](http://mishcon.com/ftreputation)

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