Shopping is fun!

A slew of headline-grabbing cross-border acquisitions are showcasing China’s new deal making skills, writes Kevin Voigt

In February, a quiet financial filing in Singapore caused ripples around the world and threatened one of the largest mergers the world has ever seen.

The bid instrument – filed by the Aluminum Corp. of China (known as Chinalco) and Alcoa Inc. of the U.S. – purchased a 9 percent stake of Rio Tinto PLC for US$14 billion. The move made Chinalco the largest stakeholder of London-based Rio, the target of a US$173 billion hostile takeover by BHP Billiton, the Australian mining giant.

Chinalco’s purchase, the biggest a Chinese company has made abroad, was viewed as a brilliant stroke by China to possibly derail the BHP takeover, which had the potential to hike the price of steel and building costs in the world’s fastest growing economy. Chinalco Chairman Xiao Yaqing was spotted in Melbourne and London, where the mining giants – and the regulators reviewing the merger – are based. Together, Rio Tinto and BHP provide China with 20 percent of its iron ore for steel production. With these two companies controlling a large stake of a resource of national importance, China wanted to make sure it had a seat at the table.

“Really, the timing and execution couldn’t have been done better,” Australian commodities analyst Michael Komesaroff of Urandaline Investments told The Wall Street Journal. “I’m surprised and impressed at the way they’ve gone about it.”

The reaction is a far cry from 2004, when the state-owned oil company China National Offshore Oil Corp., or CNOOC, made a hostile US$18.5 billion bid for the big American oil company Unocal. The deal attracted a firestorm of controversy in the U.S. and was quickly scuttled. It’s clear China Inc. has learned from the Unocal missteps, as shown by the Chinalco’s inclusion of Alcoa as a minority partner – partnering with a U.S. firm to buy a partial stake in the company will help defray fears of a hungry China gobbling up the world’s natural resources, a sentiment which has scotched Chinese deals for mining and petroleum in Western markets.

The Chinalco deal is just one example of Chinese companies eschewing outright takeovers in favour of partial acquisitions in important industries. In April, the Chinese government amassed a 1 percent share in BP PLC, the British energy company, with a stake valued at US$2 billion. The buyer – the Hong Kong-registered State Administration Foreign Exchange Investment Co. – also quietly purchased 1.3 percent of Total SA, the French oil company, valued at US$2.45 billion.

China’s financial might is flowing across the global merger and acquisition terrain in a flood fed by the bursting coffers of its foreign exchange reserves, which brimmed at a record US$1.7 trillion at the end of April (and swelling at an astonishing rate of US$10 million per hour, according to China Business News).

Cross-border acquisitions soar
This rising tide includes the Industrial and Commercial Bank’s announcement in October that it paid US$5.5 billion to purchase a 20 percent stake in The
Standard Bank of South Africa. “This means that China’s largest commercial bank and Africa’s largest commercial bank are joining hands,” ICBC Chairman Jiang Jianqing said in a statement announcing the deal.

Last year, the nation’s newly minted China Investment Corp. reached into its US$200 billion pocket and purchased a US$3 billion stake (about 10 percent) of American private equity firm Blackstone Group. In December, Morgan Stanley – shaken by the U.S. subprime implosion – was handed US$5 billion by the China’s sovereign wealth fund in exchange for a 10 percent piece of the multinational financial services company. The move is encouraging for would-be private equity players in China, who in the past have bemoaned the difficulty in entering the Middle Kingdom.

“By working together with parts of the state, Blackstone may be pioneering a new approach that other (private equity) funds may try to imitate,” a 2008 PricewaterhouseCoopers mergers and acquisitions report said.

Ping An, China’s second largest insurance company, bought a US$2.4 billion piece of Fortis, the European insurance giant, in November.

For the accounting profession, the mergers and acquisitions boom has led to a rising demand for services to help Chinese companies navigate deals. These services include performing due diligence, tax structuring or even “identifying targets abroad that would be good investments,” says Lawrence Chia, head of China M&A for Deloitte Touche Tohmatsu. “We are certainly adding people on the ground in China and in Hong Kong to meet the demand. We go where our clients are going,” Chia says. “The outbound mergers and acquisitions in the first quarter of this year (in China) was US$20 billion, which is equal to all (outbound) mergers and acquisitions activities last year.”

China and the rest of Asia have led the mergers and acquisitions’ growth around the world. Deals of Asian companies (outside Japan) jumped 77 percent to US$751 billion last year, with outbound deals tripling to US$375 billion, according to Thomson Financial.

You can chart the growth of China by its mounting appetite for overseas investment. In the 1990s, the country’s entire foreign investment outflow was US$2.3 billion. In 2004, Shanghai Baosteel Group broke existing foreign investment records with a US$1.4 billion joint venture in a Brazil steel mill. Now that deal doesn’t even crack the top 10 – since 2005, there have been 10 acquisitions and stake grabs that range from just under US$2 billion to more than US$14 billion. Of the US$30 billion Chinese companies have invested in foreign firms from 1996 to 2005, nearly one-third was spent in 2004 and 2005, according to The Associated Press. In 2006, Chinese companies had 103 cross-border deals worth US$20.7 billion, compared to 53 deals worth US$3.8 billion the year before, according to Dealogic.

The outflow of investment is increasing at an exponential pace. Chinese Vice Minister of Commerce Chen Jian said in early May that direct investment overseas by Chinese
companies more than quadrupled in the first quarter of this year to more than US$19 billion, according to Bloomberg.

**China looks out**
The overseas buying spree marks a historic cultural shift in mainland China’s worldview. In his 1983 book, *The Discoverers*, the Pulitzer Prize-winning historian Daniel J. Boorstin posited the question: Why didn’t the Chinese “discover” America? Despite accepting recent claims Chinese admiral Zheng He travelled around the world nearly a century before Columbus, for much of its 5,000-year history, Chinese leaders have been primarily interested in one thing: China.

China was technologically ahead of the West in the 15th Century, notes Jared Diamond in his book, *Guns, Germs and Steel: The Fates of Human Society*, and set sail to seven treasure fleets (including Zheng’s voyages) in the early 1400s. But political infighting in the Chinese court brought an end to this early attempt at globalization, and China dismantled its shipyards and forbade oceangoing shipping. The West was at best a curiosity, or at worst a dangerous distraction with uncivilized barbarians.

The age of insularity is over. Since 2000, the government has aggressively encouraged domestic companies to invest abroad. Financial institutions, commodity and technology companies are prize targets in China’s global buying binge.

“Those industries that have very clear policy direction (for Beijing) – such as energy and transportation – are where Chinese are quickly becoming players,” says William Hess, a Beijing analyst for Global Insight, which studies economic, political and market trends.

Companies have two choices for growth – organic development through slow, steady maturity of management, product, marketing and market share. Or snatching up companies that already possess the objects of your desire. Why build what you can buy?

“For example, Chinese are looking at acquisitions in the aerospace industry so they can build large planes domestically,” Hess says. “If they did everything themselves, it would take a long time.”

Chinalco’s move as a player in the BHP-Rio Tinto merger shows Chinalco has been studying the strategic playbook of Western multinational companies. “At (a multinational company), you look at technology innovation that can help with the company’s major business,” says Duh Jia-Bin, former head of China operations for Microsoft Corp. and Cisco Inc.

“Like at Cisco, we would typically first invest in a company as a minority shareholder role, maybe 12 percent to 15 percent, as well as a seat on the board of directors,” he says. “This gives you time to learn more about the company and take the opportunity to observe key personnel. If it looks like a good company with good technology, then we’d invest more.”

**Regulatory obstacles**
There are some snags for Chinese companies expanding abroad. Government leaders in Europe, Australia and North America are looking harder at state-owned companies – which are often less transparent than private counterparts – for potential national security risks. Huawei Technologies Co., based in Shenzhen, found that out this year with the collapse of a US$2.2 billion deal to buy a stake in 3Com, which was scuttled because of U.S. security concerns (3Com makes anti-hacking software for the U.S. military and Huawei is purported to have close ties with the Chinese military). Huawei may now sell a large stake in its mobile devices division to a foreign investor to help the company grow in the North American market.

More investments are being reviewed by the Committee on Foreign Investment in the United States, or Cfius – a process that causes many would-be buyers to pull out (a U.S. wag quipped the committee’s acronym should stand for “Chinese Foreign Investors Unwelcome Stateside”).

*The Australian* reported that in the past few months at least 10 Chinese companies have withdrawn bids for Australian resource companies. Australia also issued in February new foreign investment rules favouring the most transparent Chinese state-owned enterprises.

“A few (Chinese) institutional investors I’ve talked to lately say the regulatory environment in the U.S. and Europe is pretty unfavourable right now, with new disclosure requirements and... more political rhetoric,” says Hess.

Even back in 2004, a US$5 billion bid by China Minmetals Corp. to purchase Canadian mining giant Noranda Inc. was scorched in a
political firestorm that matched the anti-Unocal merger with CNOOC in the U.S.

Since that failed deal, however, Chinese companies have smartened up, buying instead stakes in Canadian companies that own mining operations outside of North America, such as China Minmetals and Jiangxi Copper’s US$455 million joint purchase of Vancouver’s Northern Peru Copper Corp. in January.

Indeed, Chinese companies are now favouring acquisitions in developing nations in Asia, South America and Africa, which tend to view such investments as a godsend rather than a foreign invasion. The deals often work both-ways – enabling China to secure important commodities and the cash-strapped countries to get money for infrastructure developments.

“I call it a ‘commercial diplomacy’ package,” says Hess. “For the host country, China is building ports, bridges, rail lines, whatever infrastructure is required to acquire the commodity.”

Still, a successful merger does not guarantee business success. In 2004, TCL Corp., a Chinese television-maker purchased France’s Thomson (along with its RCA brand in the U.S.), one of the highest profile Chinese acquisition deals in Europe at the time. But two years following the merger, TCL was drenched in red ink, selling off chunks of its business before returning to profitability last year.

But China’s foreign shopping spree continues apace, largely by smaller companies and smaller deals that don’t garner headlines. “There are thousands of deals happening in the US$10 million to US$30 million (range) that don’t really get much attention, but there are huge numbers of Chinese companies venturing out – and it’s growing all the time,” Hess says. A+

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**China’s top 10 overseas investments**

<table>
<thead>
<tr>
<th>Company</th>
<th>Target</th>
<th>Value of stake (in USD billions)</th>
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</thead>
<tbody>
<tr>
<td>Chinalco-Alcoa</td>
<td>Rio Tinto</td>
<td>$14.32</td>
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<tr>
<td>China Investment Corp.</td>
<td>Morgan Stanley</td>
<td>$5</td>
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<td>CNPC</td>
<td>PetroKazakhstan</td>
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<td>CNOOC</td>
<td>Akpo offshore oil field</td>
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<td>Ping An Insurance</td>
<td>Fortis</td>
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<tr>
<td>CITIC</td>
<td>Kazakh oil and gas</td>
<td>$1.91</td>
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In an aggressive move to become a player in the BHP and Rio Tinto merger talks, the Chinese aluminum giant teamed with the U.S.’s Alcoa in a share-buying spree to purchase 9 percent of Rio’s stock in February. It was the largest cross-border buy to date.

China’s biggest lender bought a 20 percent stake in the South African bank in October 2007 – the biggest acquisition by a Chinese financial institution yet.

China Investment Corp., an investment arm of the Chinese government, bought US$5 billion of securities in Morgan Stanley in December 2007 that will convert to a 9.9 percent stake in the bank by 2010.

China National Petroleum Corp. successfully took over a Canadian-headquartered oil firm with operations in the central Asian republic of Kazakhstan in October 2005.

China Petroleum & Chemical Corp. bought an oil-producing venture in Russia from British Petroleum in June 2006.

China’s sovereign fund purchased slightly less than 10 percent of the New York-based private equity firm Blackstone Group as a passive investor in May 2007.

Purchased a 3.1 percent share of the U.K. bank in July 2007.

In January 2006, China National Offshore Oil Corp. acquired a 45 percent stake in an offshore oil and gas company in Nigeria.

China’s second largest insurance company won a 4.2 percent stake in the Belgian-based insurance giant in November 2007.

The China International Trust & Investment Corp. purchased from a Canadian company fields that produce 50,000 barrels of oil a day in the former Soviet state in October 2006.

**SOURCE:** *The Wall Street Journal, Reuters, Bloomberg and the International Herald Tribune*