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HSBC Global Research

On the New Silk Road V

What Chinese companies are buying overseas

ECONOMICS
CHINA

- China's overseas direct investment is surging despite weak global growth, as Chinese companies continue to internationalise their business
- These investments are diversifying from resources and infrastructure into technology and consumer brands
- Private sector companies are overtaking SOEs as the major outbound investors

It started with raw materials, moved on to infrastructure and manufacturing, and is now starting to focus on big-name consumer brands and high-tech companies. The patterns of China's overseas direct investment (ODI) are changing rapidly as the "new economy" consumer and services sectors gather momentum. Once dominated by large state-owned enterprises (SOEs) in search of iron ore and copper, China's ODI now features private sector giants buying US film studios and European fashion houses, alongside state-backed companies snapping up new technology firms.

This report looks at the changing patterns of China's ODI in terms of size, targets and geography, and the implications for the country's financial sector. It also provides an update on the ambitious One Belt, One Road initiative to create a New Silk Road. We find that:

- China's ODI (non-financial) grew 53.7% in the first nine months of this year to USD134.2bn, exceeding the USD121.4bn for the whole of 2015.
- Private sector companies accounted for 65% of total ODI during the first nine months of this year.
- Europe and the US are now the favourite ODI destinations as Chinese companies seek to invest in technology and brands.
- While infrastructure remains an important theme – One Belt, One Road was the key driver of 2015 ODI flows – manufacturing investment growth has accelerated in the past two years.
- Multilateral financial institutions are playing a bigger role funding infrastructure projects along the New Silk Road. While China's policy banks have long played a supporting role, the country's commercial banks need to grab a larger slice of the pie as Chinese enterprises expand overseas.

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Surging ODI: The top three questions

- What industries are Chinese companies investing in?
- Who is spending more – state-owned or private companies?
- What are the opportunities and challenges?

Rapid growth, new drivers

Since we last wrote about the New Silk Road in April (see *On the New Silk Road IV*, 18 March 2016) China's overseas investment (non-financial) had continued to gain momentum. It has grown 53.7% y-o-y in the first nine months of this year, totalling USD134.2bn, easily surpassing the total for 2015, USD121.4bn.

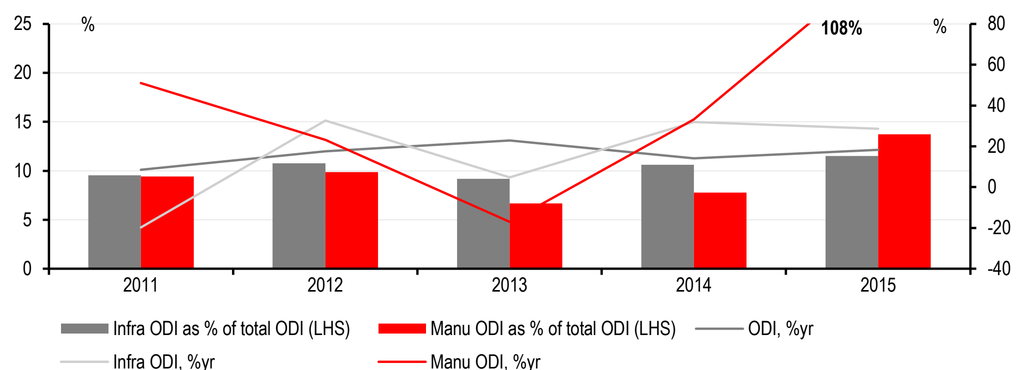
Perhaps surprisingly, this is not being driven by the One Belt, One Road (OBOR, 'Belt and Road') initiative to recreate the ancient Silk Road, the overland and maritime trading route connecting Asia and Europe, which was the key driver of the 2015 ODI flows. So far this year, investment in countries on the OBOR has actually decreased by 7.6% y-o-y to USD11.1bn, accounting for only 8.3% of total China non-financial ODI (13% in 2015).

Before we jump into the details about what has changed over the past six months, which is discussed in the next chapter, we address the three top questions about China's surging ODI based on the latest data available.

1. Is infrastructure still the dominant investment theme?

China is still in the early stages of building the Belt and Road economic network, and infrastructure construction naturally has a leading role to play. Building the physical connections – railways, roads, and ports – to link China to Europe, central Asia and Southeast Asian countries requires steady expansion in infrastructure investment.

Chart 1. Manufacturing ODI has grown strongly in the past year, exceeding infrastructure ODI flows



Source: CEIC, HSBC.
Note: Based on the same national industries classification as National Bureau of Statistics, we group overseas infrastructure investment to include five sub-sectors such as electricity, gas and water production and supply; construction; transport, storage and postal service; information transmission, software and IT service; and water conservancy, environment and public utility management.

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Infrastructure ODI outperformed overall ODI during 2014-15

Hua Capital made the biggest technology M&A in 2015

Infrastructure ODI has grown at a faster rate than overall ODI since the OBOR initiative got underway. It rose 28.6% y-o-y in 2015 and 31.9% y-o-y in 2014, well ahead of overall ODI, including financial, which was up 18.3% in 2015 and 14.2% in 2014.

Infrastructure's percentage share of total ODI flows has remained steady at around 10% during the same period (chart 1). But patterns are changing. By industry, investment related to telecommunications, which is classified as infrastructure, has taken a leading role in the past two years, growing at an average of over 120% y-o-y, more than offsetting the slowdown in transportation related ODI. For example, Hua Capital's acquisition of a 100% share of US Omnivision Technologies was the biggest technology M&A in 2015, topping USD1.9bn.

By region, after initial heavy investment in sub-Saharan African transport networks, the favourite destinations for Chinese ODI are now countries in Asia and developing Asia on the Belt and Road route. Based on the Heritage Foundation's China ODI database, China's investment in transport networks is focused on Europe, West Asia, East Asia and Middle East and North Africa (MENA) countries. For example, HNA Group, the owner of China's fourth-largest airline, bought 100% stakes in airport luggage handler Swissport International for USD2.8bn and Irish aircraft lessor Avolon for USD2.6bn, the biggest deals in the sector in 2015.

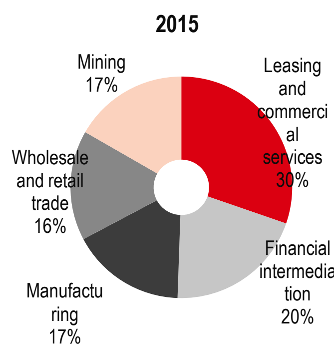
Investment in railway and port infrastructure is mainly in developing Asia countries, especially along the China-Mongolia-Russia Economic Corridor (中蒙俄经济走廊) and China-Pakistan Economic Corridor（中巴经济走廊). China Railway Group (CREC) is building Mongolia's first high-speed road connecting Ulaanbaatar to its new international airport. Transport investment in Pakistan topped USD11.9bn, followed by energy investment (USD26.9bn), all accumulative, by the end of July 2016.

Early this year, China Railway Engineering (CRE) teamed up with IWH, a local developer, to take a combined 60% stake in Bandar Malaysia, an urban development project in Kuala Lumpur, for an estimated USD2bn. This is expected to allow CRE to play a role in building the high-speed railway project from Bandar Malaysia to Singapore.

China Cosco has acquired 51% of Greece's biggest seaport

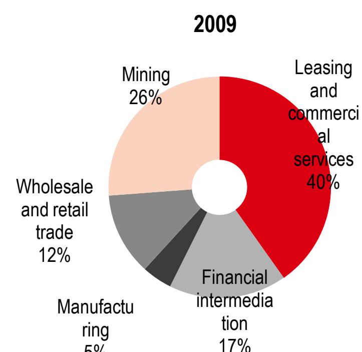
Along the Maritime Silk Road, China Cosco has acquired 51% of Greece's biggest seaport, Port of Piraeus, the major gateway for the China-Europe sea line and trade corridor. Cosco Pacific, a subsidiary, signed an agreement to buy a 35% share of Euromax Terminal Rotterdam in May 2016, making it a strategic partner of Hutchison Port Holdings, the Hong Kong company. Rotterdam has long been the base for Cosco Shipping in north-western Europe. China Communications Construction (CCC) and China Merchants have also been active in purchasing seaports in Asia and Africa in the past few years.

Chart 2. Manufacturing outsourcing…



Source: CEIC, HSBC

Chart 3…and seeking international market access



Source: CEIC, HSBC

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Manufacturing ODI: growing at a strong pace

Manufacturing outsourcing is accelerating

While most investment is channelled into infrastructure, manufacturing outsourcing is expanding rapidly. It was up 108.5% y-o-y in 2015 (Chart 1), with machinery manufacturing increasing 154% y-o-y, which suggests that a significant acceleration in outsourcing of China's manufacturing capacity is taking place.

By region, ASEAN countries and Europe recorded the biggest surge in manufacturing ODI. In the first nine months of this year, manufacturing ODI increased 168.1% y-o-y, totalling USD24.4bn and representing 18.2% of total investment outflows. The equipment industry is an increasingly powerful magnet for manufacturing ODI, attracting 61.7% of the total in the same period and totalling USD15.2bn, up 3.5x compared with January-September last year.

This growing trend is in line with Beijing's policy of promoting international cooperation to boost industrial capacity (国际产能合作), and also part of the Belt and Road strategic framework that encourages domestic enterprises to "go global" and integrate themselves into the international manufacturing network.

Asian and African countries are the focus destinations

In May 2015, the State Council published guidelines on promoting international cooperation with regards to industrial production and equipment manufacturing. The idea is to upgrade the domestic manufacturing industry by internationalizing it. Twelve sectors – steel, ferrous-metal, building materials, railway, electricity generation, chemical, textiles, automobile, telecom, engineering machinery, aerospace, ships and offshore engineering – are identified as industries where China has competitive advantages and there is strong global demand. Neighbouring Asian countries and Africa are the focus destinations. Beijing plans to establish overseas production bases and form a number of China multinationals in the manufacturing sector by 2020.

High-speed trains, railways and nuclear power are China's new global industrial calling cards. Railways in Indonesia, Thailand, Laos and Europe (Hungary-Serbia) are all entering the implementation stage. Nuclear power equipment and technology have been exported to Pakistan, the UK, Argentina and South Africa. Domestic industries suffering from overcapacity, such as steel, non-ferrous metal and construction materials, are outsourcing capacity to industrial parks/economic zones in Malaysia, Indonesia and Ethiopia (Table1).

Table 1. Industrial parks and economic zones

	Name	Chinese investors	Destination	Investment y-t-d, USDm	Chinese share
1	China-Belarus Industrial Park	China National Machinery Group, China Merchants, China International, Harbin Investment Group	Belarus	87.5m	68%
2	Special Economic Zone of Sihanoukville	Jiangsu Taihu-Cambodia international cooperation zone Investment Co.	Cambodia	10m	80%
3	Rayong Industrial Park	Huali Industrial Group	Thailand	196m	55%
4	Malaysia-China Kuantan Industrial Park	Guangxi Beibu Gulf International Port Group	Malaysia	48.4m	49%
5	Vietnam Longjiang Industrial Park	Qianjiang Investment Management	Vietnam	105m	100%
6	Ethiopia Oriental Industrial Park	Jiangsu Yongyuan Investment	Ethiopia	168.6m	100%
7	China - Europe Business Logistics Park	Topshunhe Investment	Hungary	220m	100%
8	Pakistan Haier- Ruba Economic Zone	Haier Group Electric Appliance Industry	Pakistan	42.7m	33%
9	Zambia China Economic and Trade Cooperation Zone	China Nonferrous Metals Mining Group	Zambia	130m	100%
10	Suez Economic and Trade Cooperation Zone	China - Africa TEDA Investment	Egypt	80m	80%
11	Sino-Nigerian Economic and Trade Cooperation Area	Central Africa Lekki Investment	Nigeria	150m	60%
12	Russia Ussuriysk Economic and Trade Cooperation Zone	Kangji International Investment	Russia	166m	100%

Source:MoFCom, Media report

Note: Chinese enterprises have set up 77 economic and trade cooperation zone in 36 countries. Total investment: USD23.4bn as of September 2016.

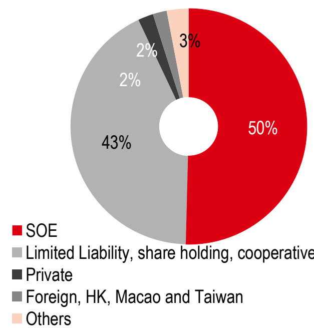
2. Are SOEs still the biggest contributor to ODI?

China's SOEs used to be the dominant contributor to the country's overseas investment, helped by funding from state banks. But this has changed. Their share of ODI has dropped from 69.6% in 2009 to 50% in 2015 (charts 4-5). That's not to say that it is slowing down. Accumulated SOE ODI has more than quadrupled (4.6x) in the past few years, particularly in the areas of mining and infrastructure following the announcement of President Xi Jinping's Belt and Road strategy in late 2014.

Non-SOE investment has expanded at an even faster rate

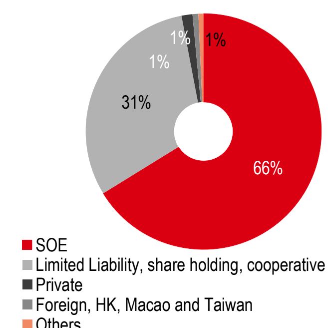
Non-SOE overseas investment has expanded even faster – 10.4x over 2009-15. M&A is a growing trend as 75% of 2015 acquisitions were made by non-SOE enterprises. The total value of M&A in the first nine months of this year reached USD67.4bn, exceeding the 2015 total of USD54.4bn. Manufacturing accounted for 24% and information transmission/software and IT services 23%. Large companies such as Dalian Wanda, Alibaba, Legend, Tencent and Leshi Internet made a number of big deals in Europe, the US and emerging Asian countries.

Chart 4. Private overseas investment…



Source: CEIC, HSBC
Note: Accumulative number

Chart 5. …is picking up pace

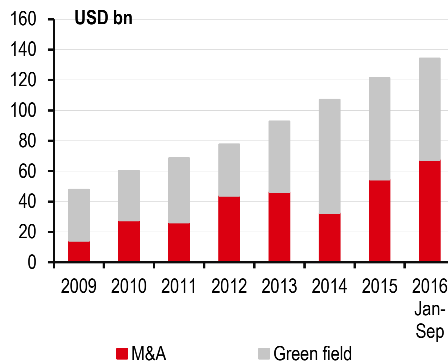


Source: CEIC, HSBC

The acceleration in non-SOE ODI is partly due to structural factors such as growing desire by domestic companies to broaden their marketing channels and acquire advanced technology. The private sector has overcome difficulties in getting financing for overseas projects thanks to easing funding conditions amid an ample supply of liquidity; 68.5% of China's cross border M&A was domestically financed in the first nine months of 2016.

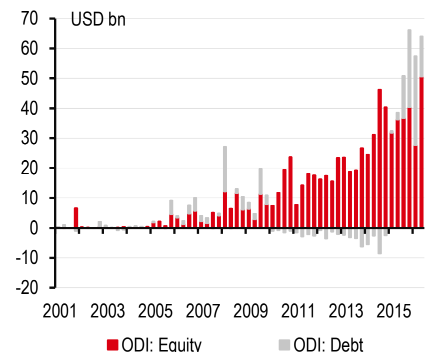
The shift in the preferred industries from upstream mining to downstream entertainment, real estate, services, and technology also reflects efforts to seek a higher return on capital. Developed markets such as the US and Europe are the biggest beneficiaries. The US was the No. 1 destination for China's M&A ODI for Jan-Sep this year.

Chart 6. More ODI going into M&A



Source: CEIC, HSBC

Chart 7. Private sector: rising demand for international assets

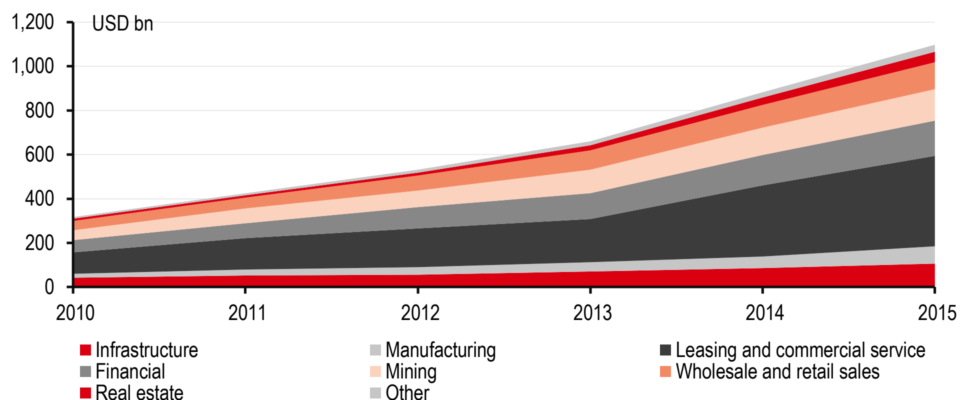


Source: CEIC, HSBC

3. What are the opportunities and challenges for financial institutions?

The rapid expansion of China's ODI provides opportunities and challenges for the financial sector. The financial sector ranks No. 2 in terms of China's accumulative ODI, rising 16% y-o-y y-t-d in 2015 (chart 8). A wide variety of financial institutions in both developed and emerging markets – including banking, insurance, and investment management companies – are common targets for ODI, with M&A being the dominant type of investment. This is not surprising as, lacking international networks, Chinese financial institutions want to follow their corporate and retail clients overseas.

Chart 8. Financial ODI ranks No. 2 (cumulative)



Source: CEIC, HSBC

China's trade with countries on the Belt and Road accounted for 25.6% of China's total trade value between January and September this year, up from 25.2%% in 2015. Exports decreased 1.48% y-o-y, in line with the 1.9% contraction in total exports (RMB-denominated); OBOR imports contracted 21% y-o-y, much more than the 8.2% y-o-y fall in imports as a whole.

China's trade with countries on the Belt and Road are expected to reach a third of total trade value in the next decade as new trade and economic networks take shape. A variety of financial services, including M&A, trade finance, FX business, are cross-border funding and expanding quickly to meet China's overseas investment demand and the related trade flows.

Long-term funding works best

International infrastructure network: policy banks + multilateral financial institutions
For overseas infrastructure projects, relatively low-cost, long-term funding is the best fit. The financing choices range from the multilateral Asia Infrastructure Investment Bank (AIIB), New Development Bank and China's sole proprietor funding Silk Road Fund, to China's policy banks. These include the China Development Bank (CDB), the Export and Import Bank of China (EXIM Bank), Postal Savings Bank (PSB), and China's Agricultural Development Bank, which are already playing a dominant role. CDB and EXIM Bank are also key contributors to the Silk Road Fund. In addition to facilitating central SOEs' "going global" business, the CDB has set up a project database for more than 900 projects in 64 countries on the Belt and Road, with planned investment totalling USD800bn. Outstanding loans for the Belt and Road totalled USD110bn by end-June 2016. China EXIM Bank's outstanding loans for the Belt and Road totalled RMB520bn (USD80bn) by the end of 2015.

Most enterprises are already clients of China's large commercial banks

Commercial banks: facilitating the domestic corporate sector's "going global" efforts
Given that most enterprises, central SOE and private companies alike, are existing clients of domestic commercial banks, facilitating their cross-border business is a natural extension of

their existing business relationship. The only constraint could be the banks' limited international reach (Table 2). This is particularly relevant in countries along the Belt and Road route. They tend to be less developed and have low international credit ratings, suggesting higher risks. This explains why commercial banks often find the Belt and Road projects financially unviable. Financial innovation is needed to deal with the mismatch between the huge investment demand and the lack of private investment/financing.

Table 2. State banks: limited international exposure

	Global		Belt and Road related	
	Country coverage	Branches	Country coverage	Branches
ICBC	42	404	18	123
BOC	46	644	18	21
CCB	25	27	N/A	>10
ABC	N/A	7	N/A	N/A

Source: ICBC Annual report 2015, media report. Data as of end-2015.

Besides bank lending, bond issuance could be a better solution for the Belt and Road infrastructure. In June 2015 the Bank of China (BOC) issued the first "Belt and Road Bond", totalling USD3.55bn, in four currencies: USD, EUR, SGD and CNY. The deal attracted orders of around USD12bn (*Reuters*, 25 June 2016).

Conclusion

The idea is to upgrade the manufacturing industry by internationalizing it

It is well known that infrastructure is the key physical component of the Belt and Road initiative, in addition to trade, investment and financial connections. While China has invested heavily in infrastructure in the past few years, investment in manufacturing, especially equipment manufacturing, has accelerated in the past two years. This reflects Beijing's efforts to promote international cooperation with regards to industrial production and equipment manufacturing. The idea is to upgrade the domestic manufacturing industry by internationalizing it.

This is all part of the evolution of China's ODI. It started with mining and energy and moved on to manufacturing as China becomes deeply integrated into global supply chains as it upgrades its domestic industrial base. M&A is also part of this evolution. High-profile M&A deals by private sector companies this year have made the headlines. Non-SOE enterprises now account for 65% of total ODI (for the first nine months of this year), according to the Ministry of Commerce.

Another trend to watch is the growing role multilateral financial institutions will play in funding infrastructure projects along the New Silk Road. While China's policy banks have long played a supporting role, the commercial banks need to grab a bigger slice of the pie as Chinese enterprises expand overseas. We believe that financial innovation can help them achieve that goal.

Moving from resources to technology and brands

- China's overseas investment outpaced FDI in 2015
- The focus has changed from resources to technology and services branding
- Financing is becoming more broad-based and sophisticated

Emerging as a net capital exporter

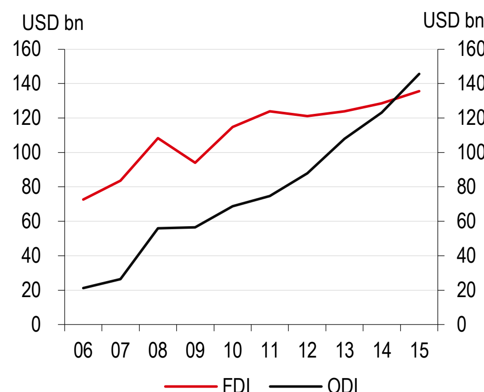
China's Overseas Direct Investment (ODI) exceeded Foreign Direct Investment (FDI) for the first time last year (Chart 1). China also overtook Japan to become the second largest provider of ODI flows in the world. This trend is partly being by the implementation of the One Belt, One Road initiative, also known as the New Silk Road strategy. According to the Ministry of Commerce, China's investment in the New Silk Road region grew by 38.6% y-o-y in 2015, which is more than twice as much as the aggregate growth of China's ODI.

Our estimates of the Belt and Road investment go back to 2003

While there is no official data on ODI in the New Silk Road region before 2014, we have come up our own estimates by adding together the ODI flows of all the 63 countries included in the region. In this way, we can trace the New Silk Road ODI flow back to 2003. Our estimates, which are presented in Chart 2, track the official data (black column).

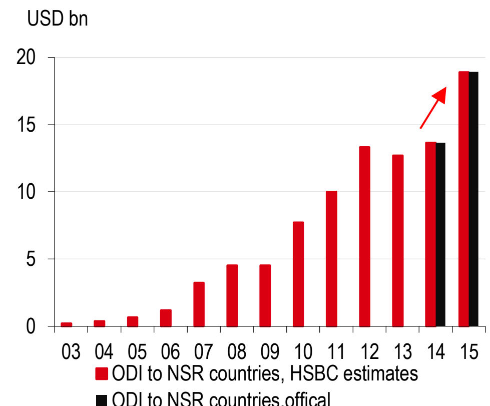
China's ODI to the New Silk Road region started with a relatively low base of around USD0.2bn in 2006. After the financial crisis, as China's ODI became more diversified, investment in the New Silk Road region (mostly developing countries) picked up quickly. In 2015, ODI flowing into the New Silk Road area surged to USD18.9bn, accounting for 13% of overall ODI.

Chart 1: ODI exceeded FDI in 2015



Source: CEIC, HSBC

Chart 2: Partially helped by a surge in investment along the New Silk Road



Source: CEIC, HSBC

In Europe, UK, France and Germany are the favourite destinations for Chinese ODI

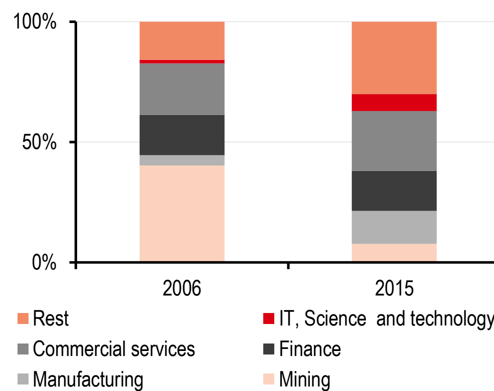
Europe and the US are now the favourite ODI destinations as Chinese companies seek to invest in technology and brands. In 2015, China's ODI to Europe and the US increased by 17.3% and 7.1% y-o-y, respectively. Within Europe, the UK, France and Germany are the top three countries. In the UK, there were 22 M&A deals recorded last year, including:

- Deep sea equipment (Zhuzhou China South Rail acquired Specialist Machine Developments-SMD, a British maritime engineering firm)
- New energy (China Communications Construction Group acquired Swansea Power, a British energy firm)
- Cars and car components (Geely's acquisition of the London Taxi Company)
- Consumer goods (C. Banner's acquisition of British toy store Hamleys)

From resources to technology

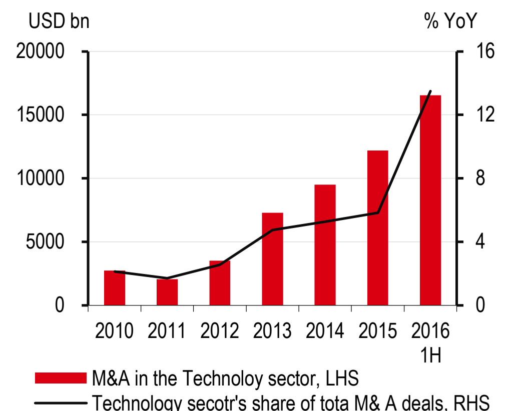
Alongside the pace of growth, the focus of China's ODI has also changed. Chart 3 shows the sector composition of China's ODI in 2006 and 2015. During the past 10 years, mining's share of overall ODI has fallen from over 40% to less than 10%. By contrast, the share of high-end sectors such as commercial service, IT, and science and technology has improved significantly. For example, IT, science and technology investment increased from 1.5% to 7.0%. In absolute value terms, while overall ODI increased by 7x over the past 10 years, investment in IT, science and technology combined rose by over 30x during the same period.

Chart 3: Technology-related investment taking a greater share of China's ODI



Source: CEIC, HSBC

Chart 4: A new wave of M&A to acquire advanced technology



Source: Heritage foundation, HSBC

Industrial firms are seeking opportunities to acquire new technology

This trend is also visible at the company level. In recent years, there's been a new wave of M&A activity aimed at improving the technological intensity of products. Based on data from the Global Investment Tracker provided by the Heritage Foundation, we summarise the amount of M&A in the technology sectors (Chart 4). This covers IT and medical equipment and its share of overall outbound M&A initiated by Chinese firms. It shows that growth in the absolute value of technology investment has been robust in recent years. In the first half of 2016, total M&A in the technology sectors exceeded the amount in full year 2015. The share of the technology sector in overall M&A also increased from 5.8% in full year 2015 to 13.5% in 1H 2016. In addition, officials from the Ministry of Commerce confirmed that in the first three quarters of 2016, the total amount of M&A deals (in value terms) in IT and manufacturing has surpassed that of mining and energy.

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The EU is an attractive market for Chinese investors seeking more advanced technologies. Although the EU's share of total China's ODI was only 3.7% in 2015, the region accounted for 17% of China's scientific research-related outbound investment. Much of the activity centre on Germany. Kai Lucks, the president of German Federal M&A Association, estimated that the total amount of M&A deals initiated by Chinese firms in Germany in 2016 will be 10x in value terms as much as in 2015. In the first half of 2016, Chinese firms initiated seven M&A deals in Germany. Although different sectors were involved, they all had a clear purpose – acquiring new technology (see table 1).

Table 1: Chinese firms are actively buying new technology from Germany in 2016

Chinese entity	Investment value (USDm)	Transaction party	Sector	New technology targeted
ChemChina	1,000	KraussMaffei	Manufacturing	High end chemical manufacturing
Ningbo Joyson	200	TechniSat Digital	Automobile	Automobile related Internet services (Internet of Vehicles)
Beijing Enterprises	1,590	EEW	Energy	Energy production via unitisation of waste
Chengdu Techcent Environment	220	Bilfinger	Utilities	Water technology (water and water waste treatment)
Guangdong Midea	150	Kuka	Technology	Robotics
Fujian Grand Chip	750	Aixtron	Technology	Semiconductor-related equipment manufacturing
Three Gorges	1,540	WindMW	Energy	Wind power

Source: Heritage foundation HSBC

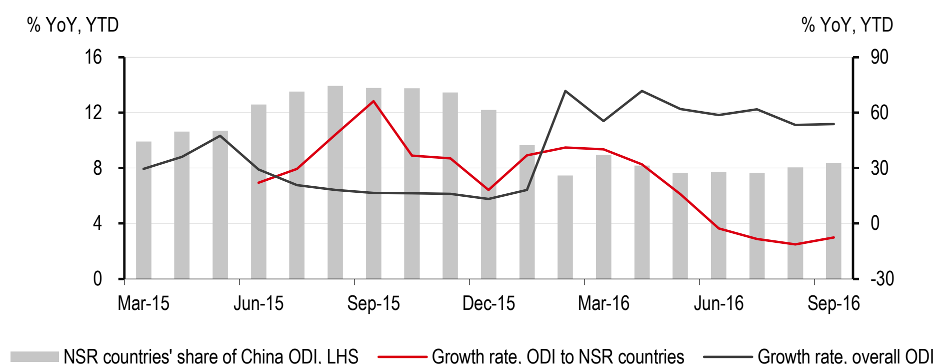
In addition to directly acquiring new technology from more developed countries, some leading Chinese firms have started to establish their own research centres overseas. According to the *Financial Times* (28 September 2016), between January and September 2016, nine Chinese firms opened overseas R&D centres with an investment value up to USD224m. The telecom giant Huawei already has 16 R&D institutes and 36 joint innovation centres around the world. Baidu, the huge Chinese Internet company, also owns two overseas research labs.

It's a similar story in the Belt and Road region

Investment in the Belt and Road region has shown a similar trend. Although data on the distribution of outward investment within the Belt and Road region is not yet available, we can still get a rough idea by looking at the geographical changes. In 2015, the five countries that attracted the most ODI from China were Singapore, Russia, Indonesia, the UAE and Turkey. Together, they accounted for 89% of China's total ODI in the Belt and Road region, with Singapore alone taking up more than half. Back in 2005, Russia received the biggest share (31%) in this region, followed by Kazakhstan, Malaysia, Mongolia and Yemen.

This shift in investment in the last decade mirrors the change in focus in China's outward investment – from resources to technology and services. For instance, 47% of China's investment in Russia, the primary destination in 2005, was in the mining sector. By contrast, China's investment in Singapore, the current biggest investment destination, mostly went into financial services, manufacturing, wholesale and retail services.

Chart 5: ODI flows to New Silk Road area moderated in 2016



Source: Ministry of Commerce , CEIC and HSBC

High-value brands: another driver for China's ODI

In addition to advanced technology, high-value brands are another driving force behind's China's recent outbound investment, especially in the service sector.

Some Chinese technology brands gain more recognition from overseas consumers and generate more revenue from the international market as a result of cross-border M&A. For example, in early 2014, Lenovo and ZTE were generating over half of their revenue from outside China. Lenovo made quite a few overseas purchases in the past decade, from the PC business in IBM to the German computer firm Medion AG. Similarly, ZTE also expanded rapidly overseas, such as the purchase of Cell C, the third-largest wireless operator in South Africa. Rather than developing their own brands by investing heavily in marketing, these companies see acquiring an established one as being a more efficient way to expand.

Finance, real estate, entertainment and tourism

The service sector now contributes 50% of China's GDP, so cross-border M&A holds the key to developing a modern services industry. Service ODI has increased at an average 20% in the past three years (chart 6). High value-added finance, real estate, entertainment, and tourism accounted for 25% of all cross-border M&A deals in 2015 and 2016 y-t-d, according to the global investment tracker. Top deals in value terms so far this year are Tencent's USD8.6bn bid for an 84% share of Finland Supercell's and Anbang's USD6.5bn investment in Blackstone.

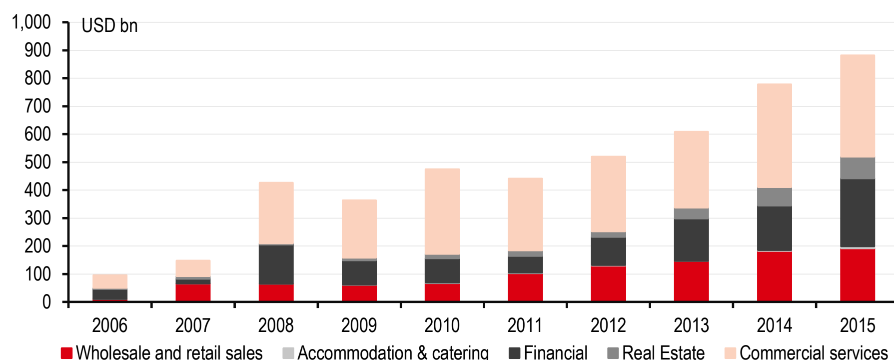
Sports fever amid policy support

Sports and cultural industry the new favourite

Chinese firms are also aggressively buying stakes in famous sports names. Domestic policy measures are promoting the development of the sports industry. Recent deals include:

- Suning acquired a 69% stake in Italian football club Inter Milan for EUR280m (USD310m equivalent) in June.
- Dalian Wanda bought 20% of Atletico Madrid and a 100% stake in the World Triathlon Corporation and its Ironman brand.
- Shanghai's China Media Capital Holdings (CMC), jointly invested by Alibaba, Tencent and Suzhou Oriza Holdings, invested USD400m in City Football Group in April 2016. City Football Group is the Abu Dhabi-based company that owns Manchester City, the top English Premier League team.

Chart 6. Service sector ODI: strong expansion in high-end financial and real estate outflows



Source: CEIC, HSBC

Climbing up the value chain

The HNA group is a good example of this trend. The HNA group is the parent company of Hainan Airlines, famous for its overseas expansion in the past few years. HNA owns the fourth largest airline in China, the No. 2 online travel agency, and also runs the country's biggest aviation leasing business. In the past two years, HNA has spent about USD23.8bn in cross-border acquisitions in order to extend its value chain and strengthen its aviation core business, by buying international airlines such as Virgin Australia (36.6%) and also seeking upstream technology (25.2%) and downstream commercial real estate (38.3%) for higher-value added businesses (the numbers in the bracket refers to percentage of HNA's ODI for each specific sector).

By region, 62.6% of HNA's ODI goes to the US and 35% to Europe. It bought the world's No. 1 airport luggage handler, Swissport International, in July 2015, supported by a state bank, China Construction Bank, which is the main financial supporter behind HNA's international expansion. In order to address market concerns about high leverage and lack of synergies between group businesses, in the past few years, the HNA group has closed down and sold off unprofitable and non-core businesses while deleveraging its balance sheet. The group is now a Fortune 500 company, holding total assets of RMB600bn with revenues of RMB190bn in 2015. Its debt to earnings ratio dropped from 17% in 2012 to 12% in 2015. Its most recent international bid is for a 25% stake in the Hilton Hotel chain for USD6.5bn, made in October (see Table 2).

Table 2: Major M&A deals of services firms acquiring high-value brands

Date	Chinese investor	Transaction party	Deal value (USDm)	Sector
Oct-16	Hainan Airlines	Hilton Hotels	6,500	Tourism
Jun-16	Suning	Inter Milan	301	Entertainment
May-16	Hainan Airlines	Virgin Australia	110	Transportation services
May-16	Shandong Hongda	Jagex	300	Entertainment
Apr-16	Hainan Airlines	Calson Hotels	2,010	Tourism
Apr-16	Huatai Securities	Asset Market Financial	780	Finance
Apr-16	Jijiang Hotels	Accor	280	Tourism
Feb-16	Dalian Wanda	Auchan	1,730	Tourism
Jan-16	Dalian Wanda	Legendary Entertaiment	3,500	Entertainment
Jan-16	Ctrip	MakeMytrip	180	Tourism
Dec-15	Oceanwide Holdings	Ko Olina Resort	190	Tourism
Nov-15	China Media Capital and CITIC Capital	City Football Group	400	Entertainment
Oct-15	Liaoning Fortone	Sinolinks	100	Tourism
Sep-15	Hainan Airlines	Avolon	2,640	Transportation services
Jul-15	Hainan Airlines	Swissport international	2,810	Transportation services
Jul-15	Fosun	Hauck & Aufhaeuser	230	Finance
Jun-15	China Construction Bank	Royal Bank of Scotland (Australia)	1,500	Finance

Source: CEIC, HSBC

What next?

The outlook for the rest of 2016 as we move into 2017 is a little cloudy. Although overall ODI growth remains strong, investment in New Silk Road countries has been moderating in recent months – in the first three quarters ODI fell 7.6% y-o-y, compared with positive growth of 66.2% y-o-y in the same period in 2015 (Chart 5).

One explanation is that global uncertainties are on the rise (e.g. Brexit), so risk-off sentiment means that new investment is more likely to flow into developed rather than emerging markets. Moreover, the base effect from 2015 is quite high, which may also partially explain the low growth rate.

That said, we still see many positive developments supporting future ODI flows in the region. There are a substantial number of new projects being negotiated or announced, which will be translated into stable flow of future outward investment. The China Development Bank lists more than 900 projects linked to the New Silk Road, with an aggregate investment value of USD800bn. Table 3 summarises some of the latest deals announced. As expected, most are concentrated in infrastructure.

In addition, multiple China-Europe railway lines, such as Guangzhou-Europe, Shenzhen-Hamburg, Chengdu-Moscow and Qinghai-Antwerp are (or are expected to be) have been put into operation in 2016. So far, there are 29 China-Europe railways starting in 17 Chinese cities. This should help to increase the region's future trade and investment flows.

Table 3: Belt and Road-related investment projects announced in 2016

Date	Destination	Investing company	Project
Nov-16	Malaysia	Greenland Group	Urban development in Bandar Malaysia and its surrounding expressway construction
Oct-16	Pakistan	Dongfang Electric Corporation	Hydro power equipment provision
Aug-16	Greece	COSCO	Cosco acquired a 51% stake in Greece's Piraeus Port
Aug-16	Belarus	China CAMC Engineering	China Belarus Industrial Park, expected to complete Phase I construction work in 2016.
Jul-16	Bolivia	Power China	Highway construction
Jul-16	Malaysia	China Metallurgical Group Corporation	Steel processing cooperation in Guantan Industrial Park
Jul-16	Papua New Guinea	CSCI	Water treatment project in Port Moresby
Jun-16	Russian	China Railway Corporation	Moscow-Kazan High Speed Railway
Apr-16	Nigeria	SoShare Mobile	Acquired the Nigerian Cell phone operator GiCell
Jan-16	Indonesia	China Railway Corporation	Jakarta-Bandung High-Speed railway

Source: Local media, HSBC

Finally, more financing support is on the way. Two government-led financial institutions – the Silk Road Fund and the Asian Infrastructure Investment Bank (AIIB) – are now fully operational. In table 4, we summarise the projects that have benefited from these two institutions. So far, the AIIB has provided financing support to six infrastructure projects in Asia, with total loan value reaching USD829m. In most cases, the AIIB is working with other leading global financial agencies to make the loans available.

Meanwhile, the Silk Road Fund has originated three investment projects in 2015 and 2016. The fund tends to use a combination of equity and debt investments to provide support in four key areas – infrastructure, energy, industrial and financial co-operation. In addition, other domestic policy banks and commercial banks are also encouraged to participate in the Belt and Road initiatives.

In conclusion, with the global economy showing signs of recovery, more projects are reaching the implementation stage, cross-border connections are becoming more sophisticated, and financing support is gradually strengthening. We expect China's investment in the New Silk Road region to grow at a stable pace in the next couple of years.

Table 4. Projects financed by Silk Road Fund and AIIB

Destination country	Project	Investor	Sector	Investment details
Projects financed by Silk Road Fund				
Pakistan	Karot Dam	China Three Georges Corporation	Infrastructure	Silk Road Fund bought 15% of Three Georges' stake. Joint lending of USD2bn with EXIM Bank, CDB and IFC.
Italy	Pirelli tyres	China Chem	High end manufacturing	Bought 25% stake of the China Chem and support its merger with Pirelli tyres
Russia	Yamal LNG project	China National Petroleum Corp	Energy	Bought 9.9% stake of the LNG project from the Russian company Novatek
Projects financed by AIIB				
Bangladesh	Distribution system, upgrade and expansion	AIIB	Power supply	AIIB loans: USD165m
Pakistan	National Motorway M4 (Shorkot-Khanewal section)	AIIB	Transportation	AIIB loans: USD100m, co-financed with Asia Development Bank (ADB) and UK Department for International Development.
Tajikistan	Dushanbe-Uzbekistan border road improvement project	AIIB	Transportation	AIIB loans: USD27.5m, co-financed with European Bank for Reconstruction and Development
Indonesia	National slum upgrading project	AIIB	Social services, transportation and solid waste management	AIIB loans: USD216.5m, co-financed with World Bank
Pakistan	Tarbela 5 hydropower extension project	AIIB	Hydropower, Energy	AIIB loans: USD300m, co-financed with the World Bank and Pakistan government
Myanmar	Myingyan 225mw combined cycle gas turbine power plant	AIIB	Energy	AIIB loans: USD20m, co-financed with the International Finance Corporation, the ADB and certain commercial lenders

Source: Silk Road Funds, AIIB

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