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China Steps Up Warnings Over Debt-Fueled Overseas Acquisitions

By SUI-LEE WEE AUG. 18, 2017

Anbang Insurance Group was the first big Chinese company to make a splash overseas when it bought the Waldorf Astoria in Manhattan three years ago

BEIJING — China moved on Friday to curb investment overseas by its companies and conglomerates, issuing its strongest signal yet that it wants to rein in runaway debt that could pose a threat to the country's slowing economy.

Beijing has stepped up its efforts in recent months to restrict some of its most acquisitive companies from buying overseas assets, worried that a series of purchases by China's conglomerates around the world has been driven by excessive borrowing.

In the latest move, a statement published by China's cabinet, the State Council, said the authorities would punish companies for violating foreign investment rules, and establish a blacklist of businesses that did so. The statement was attributed to the National Development and Reform Commission, the commerce ministry, the foreign ministry and the central bank.

The statement pointed to acquisitions in sectors ranging from entertainment and sports clubs to hotels, but it was unclear whether or how the government would block deals.

It reiterated a warning issued in December that restrictions on overseas investments were being imposed because of "irrational" investment trends.

That statement said that the kinds of investments overseas it described were "not in accordance with macro-control policies." The government wants to "effectively guard against all sorts of risks," it said. The State Council document said the government nevertheless supported overseas investments in sectors such as oil and gas and in China's "One Belt, One Road" program, which aims to promote infrastructure projects along the historic Silk Road trading route.

"It's the loudest yet of wake-up calls that the government holds the keys to the lockbox of the country's wealth, public and private," Peter Fuhrman, chairman of China First Capital, an investment bank, said in an emailed response to questions. "Bad M&A is all but criminalized."

A surge in overseas acquisitions by Chinese investors in recent years has ignited fears that soaring corporate debt levels could destabilize the country's economy, the world's second largest, and further weaken its currency.

Companies like Anbang Insurance Group, Fosun International, the HNA Group and Dalian Wanda Group have capitalized on cheap loans provided by state banks to snap up trophy assets such as the Waldorf Astoria hotel in New York and AMC Theaters.

Beijing's clampdown on overseas investments shows how the interests of private business can collide with those of the Communist Party government. Beijing has made financial stability a priority this year, with the party's congress scheduled in the fall. Among the party's top concerns: controlling debt, stemming the flow of capital leaving the country, and China's opaque "shadow banking" system.

But while the latest statement from the State Council is likely to have an impact on mergers and deals, a lot of Chinese money is already offshore and thus not easily restricted by the government in Beijing, said Alexander Jarvis, chairman of Blackbridge Cross Borders, which has advised Chinese companies on several soccer acquisitions.

“Deals are still going to happen,” Mr. Jarvis said. “There is plenty of Chinese capital overseas in offshore tax havens, in the U.S., across Europe, Hong Kong. I’m not sure they can fully control that capital.”

In a sign of that deal making, a Chinese businessman, Gao Jisheng, struck a deal to buy an 80 percent stake in Southampton Football Club, a soccer team in the English Premier League, for about $271 million. Mr. Gao obtained the loan from a bank in Hong Kong, a special administrative region of China that is administered under separate laws, [Bloomberg reported] on Thursday.

Geoffrey Sant, a partner at New York-based law firm Dorsey and Whitney, said it is likely that the latest announcement from Beijing will result in a “temporary pause” in overseas acquisitions.

“I think they are thinking there’s a bit of irrational exuberance in the market right now and they just want to cool that off,” said Mr. Sant, who represents Chinese companies. “It doesn’t make sense to permanently ban some of these areas.”

The State Council statement comes amid increased scrutiny of China’s “[gray rhinos]” — threats that are large and obvious but often neglected even so.

In recent months, the government has said it would increase scrutiny of companies’ balance sheets, warning that some of the largest companies could pose a systemic risk to the economy.

Encouraged by the slew of acquisitions made by some of the country’s most powerful tycoons, many smaller Chinese companies started looking overseas, spurred by China’s slowing economic growth to look for new markets.

Many, however, had no experience running the businesses they were targeting. In one such example, Anhui Xinke New Materials, a copper processing company in central China, made a deal to buy Voltage Pictures, an American film financing and production firm, for $350 million. A month later, Anhui Xinke pulled out of the transaction.

In other cases, it was not clear whether many of the big trophy acquisitions were actually good deals.

In 2015, Legendary chalked up a net loss of $540 million, according to a regulatory filing that Wanda Film filed on the Shenzhen Stock Exchange. Fosun International, meanwhile, paid a premium to buy French resort operator Club Med, which was until then an unprofitable company, eventually agreeing to a $1.1 billion price tag in 2015 after a long takeover battle. The firm made a small profit last year, according to Fosun’s filings. And last year, AC Milan, the Italian soccer club that was acquired by a Chinese consortium for about $870 million, [made a net loss] of about $88 million.

“I agree with the Chinese government. A lot of these deals are bad,” said Mr. Jarvis.

Companies have already started feeling the pinch of Beijing's clampdown on overseas investments, which started in earnest in December.

The number of newly announced outbound mergers and acquisitions by Chinese firms fell by 20 percent in the first six months of 2017 compared to the same period in 2016, though it picked up in May and June, according to Rhodium Group, a New York-based research firm.

In March, Dalian Wanda, the Chinese conglomerate that owns AMC Theaters and Legendary Entertainment, was forced to abandon its $1 billion deal to buy Dick Clark Productions, the firm behind the Golden Globes and Miss Universe telecast after Beijing tightened its controls on capital outflows. Months later, Wanda sold a majority stake in 13 theme parks to property firm Sunac China Holdings and handed 77 hotels to R&F Properties, another real estate company based in the southern city of Guangzhou, for $9.5 billion.

https://www.nytimes.com/2017/08/18/business/dealbook/china-companies-deals-debt.html

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" This is the loudest yet of wake-up calls that the government holds the keys to the lockbox of the country's wealth, public and private. It alone will have final say in how much money may leave China, and what it can be spent on.

Along with shutting off the spigot pouring money into recent hot areas of Chinese investment, like New York real estate and British soccer clubs, the government is also paternalistically warning all would-be cross-border investors to do their homework, flee from risk and on no account get fleeced by foreign sellers. Bad M&A is all but criminalized.

It’s a reaffirmation of a message that’s already come through loud and clear in the past months, both through government statements like this as well as practical steps the government has taken to slow the approval process and cast a wary eye on just about all pending offshore deals.

This signals a part-way return to bygone days when China’s overseas investment was mainly then-scarce dollars being spent by SOE giants in less-traveled parts of the globe buying up natural resources. We now know large chunks of money also went astray in places like Angola, for oil wells that never produced a single drop.

The good news for us and those we work with is, if read closely, we now have a clearly-stated rulebook on what kinds of deals can be done. Most favored are deals involving the broad swath of the developing world known as the One Belt One Road countries. But, also, for those who do want to invest in rich countries like the US with established rules of law and vibrant investment targets, China wants more money to flow into high-tech, to buying assets that will help China climb the rungs of the global supply chain. If – and it’s a big if -- the Trump Administration allows it, Chinese will become the most active investor into Silicon Valley and other centers of tech excellence in the US.

The interesting thing from an economic perspective is that China’s government created a private sector that has made hundreds of millions far more well-off than any of them dared dream a generation ago. But, the government still wants to have a say even in how some private wealth is spent. Even with $3 trillion in the bank, they act like they’re down to their last dime. Lots and lots of seriously rich people take a similar approach with their kids. The motivations are identical, not to let affluence lead to waste and ruin.”