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CURBING CAPITAL OUTFLOWS FROM CHINA – WHAT NEXT FOR M&A?

THE CLIFFORD CHANCE PERSPECTIVE

Whilst the implications of the newly-announced restrictions on capital outflows from China remain uncertain, we consider the possible impact on Chinese outbound M&A in 2017 and beyond

- Reports emerged in November 2016 that the Chinese authorities would introduce restrictions on certain outbound investments to curb outflows of capital from China. Reportedly, all outbound mega-deals (US$ 10bn+) and all acquisitions with a value over US$ 1bn which are outside the Chinese bidder's core business areas, will be subject to strict scrutiny by Chinese authorities.
- The underlying rationale is to slow down the depletion of China's foreign exchange reserves, as capital outflows surged in conjunction with the continued weakening of the Renmimbi. Chinese regulators will therefore scrutinise deals to determine whether they are genuinely strategic, or simply a disguised route to move capital out. This gives the Chinese State the option to curb transactions which do not meet its macro-policy objectives.
- What will be the likely impact on overseas M&A in the months and years ahead? We have already seen a number of outbound deals run into difficulties after the news of the restrictions, as uncertainty over the extent and timing of the constraints heightened sellers' concerns with regards to Chinese buyers. We expect this to continue in the early part of 2017, until there is more clarity.
- For the longer term outlook, we expect continued support by the Chinese Government for its 'Going Out' policy and 'One Belt One Road' strategy, for which overseas acquisitions are important. Overzealous investments (e.g football clubs and non-strategic real estate) will likely be reined in, but strategic M&A deals by Chinese state-owned and private enterprises are expected to bounce back in the second half of 2017.
- The risk of Chinese State intervention will lead to changes in market practice. Reverse break fees and deposits are already becoming standard and may increase in size. In some recent deals into the US, break fees have been deposited in escrow with banks in the US or backed by letters of credit. Insurance to protect against these costs is a new development which allows Chinese bidders to table offers with improved pricing and terms. We may also see more deals involving creative offshore financing structures or Chinese bidders teaming up with financial investors with offshore funds.

2017 – LOOKING AHEAD

"Despite the introduction of restrictions on capital outflows in China, we are helping Chinese buyers explore more innovative funding structures and we remain cautiously optimistic about the longer term ability of China to sustain a strong level of outbound M&A activity."

Terence Foo,
M&A Partner, Beijing