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The Belt & Road Initiative

Changing the behaviour and perceptions of Corporate China

Contents

China is in the midst of unprecedented change and its hugely ambitious Belt and Road Initiative (BRI) is the conduit shaping the world's perception of that change.

In this white paper, Commerzbank examines how BRI is influencing trends in Chinese outbound M&A, exports, financing and risk management. In particular, the reputation of Chinese companies is being transformed as a result of BRI, with an increasingly sophisticated requirement for cross-border and financing solutions relating to key BRI corridors.

Introduction

One could argue that BRI is a logical extension of the economic and corporate transformation which began three decades ago in 1978 by former leader Deng Xiaoping.

Since then, the country's GDP per capita has increased 30 fold and many Chinese companies have emerged as global leaders in their respective fields: for example, Huawei and ZTE in telecoms equipment, China Railway for high-speed railways, Alibaba in eCommerce and BYD for electric vehicles.

Unveiled by China's President Xi Jinping in 2013, the objective of BRI is to connect and promote economic cooperation between Eurasian countries, primarily the People's Republic of China (PRC), the land-based Silk Road Economic Belt (SREB) and the ocean-going Maritime Silk Road (MSR).

There are two main drivers pushing companies to focus on BRI investments.

Firstly, China is opening more of its industry and markets to foreign investors, and is looking to push its companies into new markets as the country continues to move away from its reputation as being a low-cost manufacturing centre.

As such, Chinese companies are increasingly leveraging on their own expertise, belying their reputation as acquirers of IP and instead offering high value goods and services.

For example, a huge driver of BRI deals is the need for infrastructure, particularly in emerging and frontier markets, and in this area alone China can draw on almost unrivalled experience. Since 1978, there has been a quantum leap in domestic infrastructure investment in China unmatched in world history, with the country developing strong capabilities in railways, roads, ports, telecoms and technology. China now has 12,000 miles of high-speed rail track, covering a greater distance than the rest of the world's high-speed rails track combined. Considering that China's first high-speed railway was only initiated 11 years ago in 2007, this makes the achievement even more remarkable.

Beyond infrastructure, deals are also being struck in a wide range of sectors, such as technology, real estate, leisure and healthcare across Asia, Middle East, Africa, Central Asia and Europe.

The second driver of companies pursuing BRI deals is the Chinese government's push to reform the country's state-owned corporate giants, reduce corporate lending and debt, and remove implied backing for certain industries that do not perform a national strategic role.

Commerzbank contends that BRI is influencing how Chinese companies talk to governments, woo local investors, regulators and populations, learn about cultural obstacles, raise funds from international investors, attract partners and ultimately improve their global standing.

It is also shaping where deals are being done. While Chinese deal volumes have fallen in the US and Europe in the past couple of years, BRI-related investments have risen considerably. In 2017, China's external trade with BRI countries reached US$1.1 trillion. So far, more than US$87 billion has been spent by China on BRI investment, with US$60 billion of FDI and US$27 billion on infrastructure projects, according to China's Ministry of Commerce.

Some projects encapsulate BRI. For example, there has been an expansion of freight rail links between China and Western Europe, including the building of a route between Zhengzhou in Central China and Hamburg, home to one of the largest ports in Europe. The route passes through Kazakhstan, Russia, Belarus, Poland and – as of the end of 2017 – 1,000 trips have been made since July 2013[1].

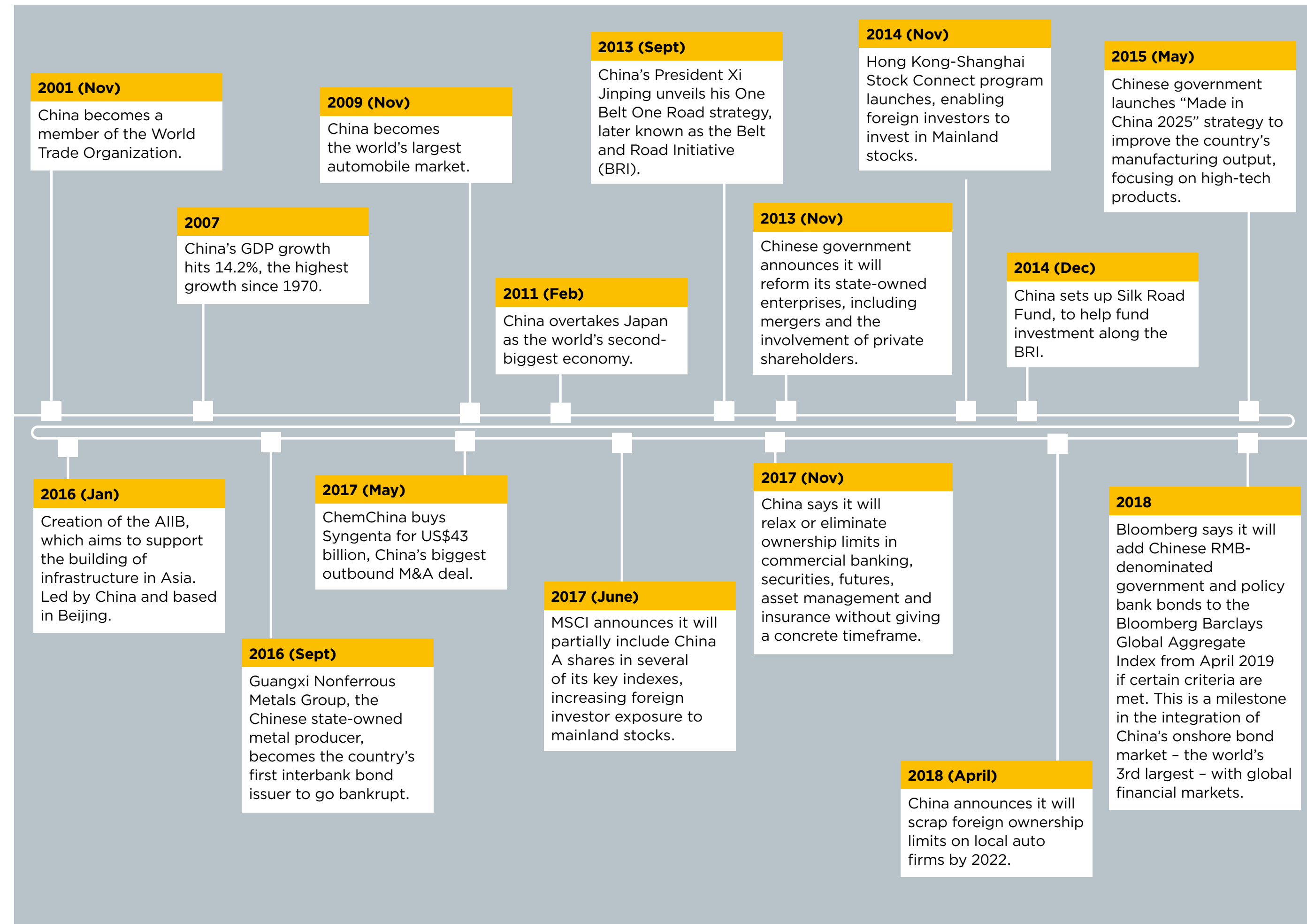
[1] http://www.chinadaily.com.cn/a/201712/26/WS5a41a945a31008cf16da372b.html

Meanwhile, there have been big ticket M&A deals involving Chinese companies that would not have been seen ten years ago, such as ChemChina's US$43 billion purchase of Syngenta.

This white paper outlines how Chinese companies are learning fast how to overcome new challenges. In Europe, for example, Chinese companies are helping to change perceptions of politicians and the general public of their intentions in terms of protecting jobs and safeguarding technology. Meanwhile, in sub-investment grade markets, local regulations can be difficult to navigate and non-payment risks are higher, creating a need for local expertise in order to better understand the environment and the appropriate hedging products to mitigate risks. Companies are now more aware of consolidated hedging at the group level in order to control investment risks overseas.

Perpetuating this is the experience of European companies and financial institutions, which are being increasingly utilised by Chinese companies as they scout projects, negotiate deals and build relationships that are accelerating the technology evolution of Corporate China.

Brief Snapshot of Key Changes in China



Chinese Chinese investments – changing perceptions

BRI-related M&A is on the rise
Commerzbank believes BRI is giving Chinese companies the opportunity to show the world they no longer deserve a reputation as technology and asset hunters, but instead offer high-value products and services.

China is already the largest supplier of mobile phones in many sub-Saharan countries in Africa, for example, but it is also now a serious player globally in terms of higher-end models due to the emergence and expertise of Huawei and Xiaomi.

This growing expertise is increasingly being used to sweeten deals. For example, in January 2017 Chinese group Sirio Pharma's acquisition of Ayanda, a leading European softgel manufacturer, was sold to investors as creating more value for European customers due to the Chinese company's production capability.

As such, this corporate evolution from being a home of low-cost manufacturing making parts and goods for multinationals such as Apple and Nike to being a producer of high value products is shaping BRI M&A, and also being fed by it.

In 2007, China accounted for only 1% of the value of global cross-border M&A but this figure jumped to 14% in 2016 and the nature of deals is also changing drastically, with BRI-related M&A increasingly being favoured.

Commerzbank estimates that there were about 450 Chinese acquisitions into Western Europe in 2016 and 2017, and 300 into the 74 BRI countries[2], valued at US$120 billion and US$60 billion respectively. Tellingly, the number of deals into Western Europe declined 18% in 2017 from 2016 but the number into BRI countries rose 8%.

M&A deals between China and the EU should increase in the next few years, Commerzbank notes, particularly as the US becomes more challenging for Chinese companies and more European companies take advantage of being at one end of the BRI "road".
Germany remains a priority for Chinese acquirers, for example, given its high technology capabilities and the kudos of the "Made in Germany" label. Although the big ticket multi-billion euro China to German deals that hit the headlines (for example, Midea/Kuka and Geely/Daimler) there are many lower profile mid-market transactions undertaken by Chinese buyers wishing to venture into the German Mittelstand in a range of sectors.

Commerzbank also expects there to be more deals in Singapore, Malaysia and Indonesia, while there will also be deals involving German and other European companies as partners with Chinese groups in emerging and frontier markets.

For Chinese corporates, the reason for this trend is not just an increase in expertise, but also the political and business necessity of the BRI.

In China, economic concerns continue to bleed into the corporate sector as the Chinese government continues to control the flow of capital leaving the country while reforming its markets and state-owned companies.

This scrutiny has led Beijing to strongly favour BRI investments, which serve a strategic corporate, political, logistical and cultural purpose, rather than allowing its companies to merely pursue expensive trophy assets.

Commerzbank highlights an emerging distinction between technology-focused acquisitions in Europe (such as ChemChina's €6.8 billion acquisition of Pirelli) and power/infrastructure projects in Central & South East Asia and Africa (such as a Chinese-led consortium's purchase of Kyaukpyu port in Myanmar). Chinese companies are also seeking opportunities in BRI countries that have burgeoning populations but underdeveloped health infrastructure such as India, Vietnam and Thailand.

Understanding the risks of uncharted territories
In less developed countries, local knowledge and advice is increasingly valuable; Commerzbank therefore believes that one of the biggest challenges currently facing Corporate China is not only finding the right targets, but also protecting the investments.

Chinese companies of course use advisors, banks and accountants to scout potential deals, but Commerzbank has found that they are increasingly going on the road to meet competitors and research the local business environment.

Due to the nature of BRI, many of the countries attracting Chinese deals are non-investment grade, or "junk" countries, with laws, regulation and trade protection that can be patchy at best.

Conducting sufficient due diligence is often a challenge in countries with inadequate disclosure requirements, and compliance with local rules can be an issue as Chinese companies grapple with deadlines and timeframes.

For example, shifting political winds and a change in government can quickly tighten foreign ownership rules, such as Indonesia's controversial changes to mining regulation that has caught out even experienced multinationals in the past ten years. Furthermore, in developed, emerging and frontier markets, local labour laws can often be used more aggressively than Chinese corporates are used to, and labour unions hold more agency. This can lead to confrontations that can shut down production and hit revenue, and which cannot be easily remedied.

However, as will be discussed below in Section 2, as Chinese corporates become more experienced, they are increasingly utilising not only their own domestic banks and resources but increasingly using foreign banks to help vet deals.

Likewise, although some European countries are not engaging with BRI and remain wary of Chinese intentions and practices, others are increasingly getting involved.

Germany, France and Italy, for example, are attempting to set up a joint European framework to screen potential Chinese investments, which should improve communication and ultimately trust.

This jockeying for position speaks to the increasing perception of Chinese companies broadly as sophisticated entities and competent dealmakers in their own right, as well as the opportunities the projects offer.

According to a business confidence survey conducted by the German Chamber of Commerce in China, for example, more than one third of German companies in China see a positive effect from the BRI on their future business.

Selected Chinese acquisitions of German SME targets (2016-2018)

Announcement date	Buyer	Target	Sector	Value (€m)
29/05/2018	Ningbo Jifeng Auto Parts	Grammer (remaining 75%)	Automotive components	565
05/02/2018	Hailiang Group	VDM Metals	Metals & Mining	596
02/01/2018	China National Building Material	Singulus Technologies	Electronics	n.a.
14/12/2017	Bohai Automotive Systems	Trimet Automotive Holding (75% Stake)	Automotive components	62
27/09/2017	Zhuzhou Lince Group	mdexx Holding	Electronics	n.a.
12/06/2017	BDstar (Chongqing) Automotive	in-tech	Computer software	80
02/05/2017	Truking Technology	Romaco Pharmatechnik	Industrial automation	100
12/12/2016	Sirio Pharma	Ayanda	Healthcare	n.a.
03/10/2016	Chengdu Techcent Environment	Alba Group (60% of Recycling and services)	Industrial products/services	300
14/08/2016	Shanghai Electric	Tec4aero	Aerospace & defense	174
26/07/2016	IDG Capital Partners; MLS Co; Yiwu State	Ledvance	Consumer	486

2 BRI countries as defined by China's Belt and Road Portal – https://eng.yidaiyilu.gov.cn/index.htm

The keys to the family business
Perhaps the real sea-change in terms of Chinese outbound M&A – and one that could create the largest legacy – is the perception of Chinese companies as managers, of people as well as assets.

As deals become more adventurous and European companies in particular become more open to selling to a Chinese buyer, Commerzbank expects cultural differences will become more apparent as a potential hurdle.

For example, many older European companies have strong family ownership and so a Chinese SOE that wants to buy such a business – where that family is quite important in the local area and is a big employer – will face a large culture gap in terms of management.

However, there have been enough deals to suggest that target companies are seeing a side of corporate China that can be highly beneficial, and that these hurdles can be overcome.

For example, some were sceptical of the €4.4 billion takeover of German robot maker KUKA by China's largest home appliance maker Midea Group, completed last year. Now, the German company is targeting a doubling of business in China by 2020 as a result[3].

Contrary to sensationalist headlines that reflect a minority of cases, there is an increasing track record whereby Chinese companies are putting more investment in companies and safeguarding – if not growing – jobs. Many acquirers target European brands with ambitions to grow them into new markets, the fruits of which are proving valuable to both ends of the deals.

There have been many success stories over the last few years where Chinese companies have understood the need to avoid drastic changes at the acquired company. They have supported local management to continue with their business plans, while patiently building their understanding of the business and learning how to reap the mutual benefits of the combination.

This sensitivity is reflected in Ningbo Jifeng's recent takeover offer for Grammer, the German auto parts supplier[4]. Having initially acquired 25% of the company, Ningbo Jifeng has now agreed to increase its influence while vowing to leave Grammer with a high degree of independence and has safeguarded the workforce. The main driver is on deepening the strategic alliance, broadening market access and cross-selling products to the benefit of both businesses.

3 http://www.scmp.com/business/companies/article/2136197/german-robot-maker-kuka-eyes-eu1b-sales-china-tapping-parents

4 https://www.reuters.com/article/us-grammer-m-a-ningbo-jifeng/ningbo-jifeng-offers-job-guarantees-in-grammer-deal-sources-idUSKCN1IU0QE

5 http://www.ey.com/gl/en/industries/government---public-sector/dynamics---collaborating-for-growth_addressing-africas-infrastructure-deficit

6 http://www.chinadaily.com.cn/beltandroadinitiative/2017-05/19/content_29420197.htm

Financing along the BRI

BRI's great ambitions require great financing
The theme of transformation flows throughout BRI and is redefining how Chinese companies fund their huge patchwork of investment projects, FDI and M&A deals, creating a need for more sophisticated financing solutions.

China's companies are facing pressure at home as the government continues to re-write rules regarding capital flows and debt. Meanwhile, as they enter new markets, there is an increasing need to explore and understand more complex hedging products to offset increased risks, including currency and interest rate fluctuations, political and regulatory uncertainty and project delays.

Furthermore, trade finance offers its own specific challenges in non-investment grade BRI countries – in terms of export contracts – with the profitability of companies at risk of non-payment or non-delivery. Risk mitigation is key but securing it is not always easy.

The challenges vary depending on the particular investment corridor and the issues are not immaterial.

According to Asian Development Bank 2015 estimates, published by Moody's Investors Service, 45 Asian countries – a large component of BRI – will require a total of US$11.7 trillion of funding for power generation projects from 2016-2030, US$7.8 trillion for transport infrastructure and US$2.3 trillion for telecoms infrastructure.

Meanwhile, some estimates put the cost of addressing Africa's infrastructure deficit at about US$90 billion every year for the next decade[5].

Although much of this investment will come from a range of countries, China's BRI ambitions are having a transformative impact.

China obtained US$126 billion of new infrastructure contracts from BRI countries in 2016, representing about 52% of the country's total engineering, procurement and construction contracts globally[6].

Although the total amounts still lags behind the US and Europe, the trend is clear.

Funding sources
So far, funding for BRI-related projects in particular has been largely reliant on Chinese financial institutions, including the Export-Import Bank of China, China Development Bank (CDB), China Export & Credit Insurance Corp (Sinosure) and commercial banks such as ICBC and Bank of China.

By the end of 2016, more than US$110 billion in outstanding loans had been extended to BRI projects by CDB, 35% of the bank's international loans, while the Export-Import Bank of China extended about US$90 billion in loans, constituting 25% of the bank's total loans.

International financial institutions such as the Asia Infrastructure Investment Bank (AIIB), the Silk Road Fund and the Asian Development Bank are also providing sizeable financing for projects.

However, a cocktail of Chinese and overseas factors means there has been an increasing role for international commercial banks to complement mainland Chinese funding channels as BRI progresses – particularly banks that can offer a complete suite of financing options across their international banking networks.

This expertise is particularly important when raising funds privately because there are many companies too small and inexperienced to go down the public finance route successfully, considering investor optics are key to attracting investment.

Furthermore, private funding can often be much quicker, less complicated and help build a stronger investor base by utilising advisors' often extensive network of clients, matching their needs with the needs of the company seeking financing.

Commerzbank expects the theme of private funding for BRI projects to increase significantly in the coming years, particularly as the picture in Mainland China is pushing more companies to raise funds overseas.

For China's companies, the concept of BRI financing dovetails with government efforts to reform the country's biggest companies, reduce corporate debt and stabilize the economy.

According to Bloomberg, China's corporate debt hit 159% of GDP in 2016[7], and defaults are rising, albeit from a low base. As a result, the implicit government support for companies – which previously distorted the onshore bond market and has led to concerns that the true health of companies was being masked – is also changing.

Larger companies considered core to Beijing's strategic goals – including BRI-related projects – will increasingly face fewer restrictions than non-core sectors in terms of raising debt and investing. This will become increasingly important as debt needs to be refinanced.

Ample international investor demand for BRI-related debt

This is forcing more companies to tap the global markets, particularly the USD bond market, further internationalising their debt profiles.

Commerzbank believes this trend will continue for at least the next few years as the Chinese government persists with efforts to control the onshore bond market.

The trend partly explains the unsteady progress of the RMB as a trade currency, although it has recently been included in various international benchmark index trackers, exposing more fund managers to mainland stocks. The currency is still not widely used outside of Mainland China, however, and its internationalisation will largely depend on the pace of the Chinese government's liberalisation of its financial markets.

Commerzbank believes the RMB has the ability to change rapidly and become a key trade currency, depending on how far and fast the government loosens its grip on it being used cross-border. The key message is that companies still need to be RMB-ready.

In the meantime, the internationalisation of Chinese companies' financing profiles will help them to more easily utilise funds for overseas investment[8], with BRI set to be a direct beneficiary.

Trade and FDI risk management – moving towards a globally integrated supply chain

BRI continues to create new trade and investment links between China and a range of other countries along the key BRI corridors.

As such, Commerzbank notes that financial risks for companies are also increasing as BRI-related exports and investments grow to a number of sub-investment grade countries. In this case, trade finance is a key area of focus for many Chinese companies and MNCs in China to facilitate and finance trade, but also to mitigate the various non-payment and performance risks involved.

This can be a material pain point for corporates given the size and frequency of export contracts, as well as the long term and strategic nature of FDI. It is not just the quantum and increasing number of such deals, but also the evolving nature of such transactions. In addition to acting as a facilitator of exports and import transactions, trade finance is increasingly becoming integrated into complex cross-border financial supply chains. Efficient financing, operational efficiency and risk mitigation are all critical to ensuring corporate performance in such an environment.

On both sides of a trade finance deal, non-payment risk is often the difference between profitability and financial losses. For a manufacturer in China, being paid on time (as well as paying suppliers on time) has a material impact on the overall stability, efficiency and cost of financial supply chain. It can take just one event of non-payment to derail the profitability of a company's entire financial year. Especially considering tight margins across several industries, the scope for error for such corporates is very fine indeed.

As with M&A, some governments can quickly change priorities, direction and place restrictions on imports, foreign ownership levels or foreign exchange. As part of this, seeking risk mitigation can be an essential component of venturing into certain markets. It is certainly an operational risk to consider across the BRI markets, considering the number of BRI markets that are sub-investment grade. It is Commerzbank's view that the more difficult it is to secure trade risk mitigation in a particular market, the more important it is to have it.

This is an area where established foreign banks can really add value to Corporates in China (both Chinese corporates and MNCs in China) by offering access to an international network for cross-border solutions, as well as a broader range of integrated hedging solutions – to simultaneously help offset the market related risks in foreign exchange and interest rates.

Beyond risk mitigation, trade also provides an efficient tool to avail of financing to optimise a Corporate's overall working capital, unlocking value by shortening cash conversion cycles.

While documentary trade remains prevalent in dealings with relatively difficult markets, there is also an evolution towards open account trade, where counterparties become familiar and are in domestic or relatively highly rated international jurisdictions.

On the Open Account side, there is an increased uptake of such solutions among Buyers and Suppliers, in terms of Receivables Finance and Payables Finance respectively. Continued adoption in these areas is to be expected, especially with the growth of intricately inter-dependant cross-border supply chains across BRI corridors.

Meanwhile, Commerzbank economists estimate the value of completed Chinese BRI projects increased from US$64.4 billion in 2014 to US$85.5 billion in 2017, while the value of Chinese newly–signed BRI contracts soared to US$144.3 billion in 2017 from US$86.3 billion in 2014.

7 https://www.bloomberg.com/news/videos/2018-02-02/china-s-corporate-debt-hits-159-of-gdp-in-2016-video

8 http://www.scmp.com/business/article/2143163/hna-unit-creating-us15-billion-war-chest-groups-primary-vehicle-shopping

Commerzbank economists expect FDI investment from China to BRI countries to double from 2014 to 2020, to US$25 billion, underscoring its importance. Much of this is of strategic importance to the host governments and long tenor in nature.

Although exports and FDI seldom grab headlines relative to M&A, it is perhaps these areas that will help define the role Chinese companies play in global trade and finance in the coming 10 years.

Changing debt structures

For BRI countries themselves, their financing needs – particularly infrastructure – are already changing their debt structures, particularly the external debt owed to foreign companies and governments.

Pakistan, for example, has seen a significant increase in non-government external debt, from 7% of total external debt in 2010 to 14% in 2016 – mainly due to inbound investment flows as a result of BRI projects, according to Moody's Investors Service.

Meanwhile, The Center for Global Development (CGD) and Nomura claim that 80% of the increase in Tajikistan's external debt from 2007 to 2016 is owed to China – which is likely to increase with BRI – while loans from China Export-Import Bank to Kyrgyzstan are, at US$1.5 billion, equivalent to 40% of the country's entire external debt. They also say that BRI has brought Pakistan US$62 billion of additional debt, and 80% of it is financed by China[9].

This trend is highly likely to increase velocity during the planned course of BRI development, providing an enticing opportunity for Chinese corporates, Chinese banks and their European counterparts.

Commerzbank is confident that the trends dominating financing in the next 5-10 years will play a central role in determining the success of the BRI.

9 https://www.euromoney.com/article/b17t73c8rtfgwd/belt-and-road-the-debt-threat

10 http://www.business.hsbc.com/belt-and-road/ensuring-sustainability-throughout-the-bri

11 https://www.ft.com/content/88d584a2-385e-11e7-821a-6027b8a20f23

Sustainability

The role of ESG along BRI

A compelling question is how will BRI dovetail with both the Made in China 2025 and Paris Agreement (COP 21) targets. Are they mutually exclusive or are there opportunities for the schemes to complement and, perhaps, even define each other?

The question is especially pertinent considering five of the most polluted cities in G20 countries are currently in China[10], which is not surprising considering the country is one of the world's biggest users of fossil fuels and the air is regularly choked with smog.

However, when President Xi labelled BRI the "project of the century" in 2017, he could easily have meant "project for the century" such are the environmental, social and governance (ESG) opportunities – and synergies with domestic policy.

China is in the driving seat when it comes to dealing with environmental issues precisely because the issue is a cornerstone of Xi's tenure as China's president and, as such, the country is an important sandbox for green initiatives that can be rolled out across the BRI.

Corporate China has developed various clean technology solutions to its own pollution problems, such as a west-to-east ultra-high voltage direct current (UHV DC) power transmission system that, during peak summer season, is helping reduce about 85 million tonnes of carbon dioxide emissions[11].

China has the largest installed wind energy capacity[12], nearly three times more than the US and taking its total wind power capacity to about one-third of the global total. Meanwhile, China is also the world's biggest producer of solar power by capacity.

Furthermore, China invested the largest amount of money in renewables last year, at US$126.6 billion[13], a 31% increase compared to 2016, and plans to spend much more.

The adoption of green financing tools and definitions

To help pay for all this, and more, China has found itself at the forefront of embracing green financing tools such as Green Bonds and Climate Bonds, while it has worked at introducing guidelines for its companies to help manage environmental risks of overseas projects.

As befitting such a prominent player in renewable energy, China is a leader in green bond issuances. Still in its infancy, onshore green bond issuances hit US$36 billion in 2016, accounting for nearly 40% of global green bond issuance[14].

Globally, green loans have yet to catch up with the Green bond market, but the product has become established in Europe and is gaining ground among investors in Asia-Pacific. For example, Commerzbank acted as a Mandated Lead Arranger in Asia's first sustainability corporate loan of US$500 million to Singapore-listed Olam International Ltd. Green loans have reached US$14.2 billion this year, compared to US$36.3 billion of Green bonds, according to Thomson Reuters data. The Asia-Pacific tally stands at US$1.2 billion worth of green loans so far this year, compared to US$5.6 billion worth of Green bonds.

There have been many notable deals. In November 2017, Commerzbank acted as joint lead manager and joint bookrunner for the EUR tranche of China Development Bank's inaugural dual-currency, senior unsecured, fixed-rate USD-denominated 5-year and EUR-denominated 4-year green bond.

This was the first green bond from a Chinese policy bank, the first green Silk Road bond and the first EUR bond from a Chinese financial issuer with a 4-year maturity. The investor base was diverse, geographically and by investor type, highlighting the huge demand for such instruments.

Meanwhile, in October 2017, ICBC issued its first Climate Bond, while Bank of China sold a Climate Bond in three currencies in Paris in November.

The evolution of "environmental financing" is particularly important to BRI considering many projects are infrastructure in nature, in under-developed countries and are likely to have a large environmental impact.

Such green instruments can therefore assuage local environmental concerns, attract more western investors to projects and also help satisfy BRI sceptics.

It is Commerzbank's view that a huge challenge facing BRI in terms of ESG, particularly when it comes to the success of green financing, is that not all investors have a single set of principles they all agree defines a green investment.

For example, a clean coal project in Pakistan, which attracts investment from a Chinese company, policy bank or commercial bank, would be considered green by Chinese standards but not under international standards due to coal being labelled a "dirty fuel" outside China.

In such cases, the potential risks may not be understood by companies and investors, leading to further funds being denied during the project's lifecycle[15]. Therefore, different standards and principles being applied in different BRI countries create huge risks for companies seeking investments.

However, Commerzbank believes the issue creates an exciting opportunity for financial institutions and environmental bodies to collaborate, increase awareness and provide investors and companies with more information on which to base decisions, as well as the tools to execute those decisions.

For example, to help harmonise standards, Climate Bonds Initiative (CBI) – a London-based body that sets environmental standards for bonds – is exploring a Green Bond Connect initiative, which would effectively be a link-up between CBI and the Hong Kong Stock Exchange allowing traders and investors to see which bonds are certified green by the CBI, meeting international standards.

Other international bodies are also exploring similar ideas, with China itself (through the NDRC and PBoC) working on a common set of guidelines for green bond issuance, expected to be launched in 2018.

Meanwhile, China's corporates and banks are not waiting around for governments and NGOs to create a level playing field in terms of pricing, risk and standards for green projects and financing.

Guangdong Power Engineering Co. Ltd is building power plants in Bangladesh, China Railway Group is building infrastructure throughout the BRI, including the Ethiopia-Djibouti rail link, while China Three Gorges Corp is building power projects including the Karot Hydropower project in Pakistan.

There are also numerous projects in Europe, such as a tie-up between Ukraine's largest private power producer DTEK and China Machinery Engineering Corp (CMEC), which have a joint project to build one of Europe's largest solar energy generators at a cost of €230 million[16].

As such, various Chinese industry bodies including the Asset Management Association of China and the China Banking Association announced guidelines for controlling the environmental risks of Chinese overseas investments[17].

Behind the data, sustainability is a driving force behind governments, companies and investors embracing BRI, allowing them to sign off on or up to deals that can have an impact beyond the length of the contract.

In the meantime, to really give a boost to ESG, Commerzbank contends that full-service banks and multilateral development banks can bridge the knowledge gap for many Chinese dealmakers by offering tailor-made hedging tools to offset ESG risks.

This can increase the level of comfort for Chinese companies, dealmakers, investors and project staff alike, and further deepen their sophistication and expertise when it comes to financing solutions. This will ultimately determine the success of the BRI.

12 http://iopscience.iop.org/article/10.1088/1748-9326/aaadeb

13 https://www.cnbc.com/2018/04/06/china-becomes-a-driving-power-for-solar-energy-with-86-point-5-billion-invested-last-year.html

14 https://www.globalcapital.com/article/b14xk6w8gd2wxb/belt-and-road-chinas-new-green-finance-laboratory

15 http://greenfinanceinitiative.org/wp-content/uploads/2017/10/Greening-the-Belt-and-Road-English.pdf

16 https://www.reuters.com/article/us-ukraine-dtek-solar/ukraines-dtek-chinas-cmec-to-build-one-of-europes-largest-solar-projects-idUSKCN1HD1ZT

17 https://www.globalcapital.com/article/b14xk6w8gd2wxb/belt-and-road-chinas-new-green-finance-laboratory

Conclusion

Whether Chinese companies need to become more sophisticated as a result of BRI, or BRI needs to happen because Chinese companies are becoming more sophisticated, it is clear that the trend is set.

In Commerzbank's view, not only is BRI redefining the targets and scope of outbound Chinese M&A, it is also helping to transform how deals and investments are being paid for while creating greater hedging opportunities.

Perhaps most importantly, BRI is reshaping perceptions of Chinese corporates in terms of deal making and managing acquisitions, while also creating more opportunities for foreign companies looking towards China.

This is providing new opportunities for European companies to collaborate with their Chinese counterparts, while also allowing them to expand into frontier markets and develop relationships with players in the world's second largest economy.

As politics continue to change globally, with the potential for trade wars between the US and China amid rising interest rates and the spectre of protectionism, BRI looks like not just a political necessity but a very smart business strategy – not just for China but for the whole of Europe and Asia.

There are however numerous challenges, as outlined in this white paper.

It remains unclear how China's economy will perform over the lifespan of BRI, as it is also unclear which areas of the country's markets the government will tighten controls over next.

In its push to create more viable national champions able to better operate globally, Beijing may yet overstep the mark and stymie investment, pushing its biggest companies into a corner.

As Chinese companies invest in other markets, local cultural issues need to be navigated, labour unions placated and intentions clearly communicated. This is no mean feat considering the opaque business climate that exists in China.

Furthermore, the financial risks for Chinese companies that invest in frontier and emerging markets from political uncertainty, currency fluctuations and environmental issues is very real, necessitate a more sophisticated approach to risk and cash management.

China's BRI companies will typically receive the implicit backing of the Chinese government but that does not mean every investment will be a success for the company or any local partner.

It is also unclear how the continued internationalisation of the RMB will play into future deals, in spite of progress being made in terms of the currency's inclusion in global benchmark indices.

Despite these challenges, Commerzbank is confident that, for BRI countries and companies – including those from Europe – as projects increase, so will the opportunities, trust, expectations and rewards.

As BRI enters maturity in the coming years, the global corporate landscape may not be skewed squarely in favour of Chinese companies per se in the way "Made in China 2025" envisages.

However, the playing field will be much more level, with benefits for all sides. China will have a tangible avenue through which to sell its goods and ideas to the world. And it is winning many admirers along the way. Belt and Road is not just about the destination, it's also about the journey.

Commerzbank AG
Frankfurt
DLZ Gebäude 2, Händlerhaus
Mainzer Landstraße 153
60327 Frankfurt am Main
Tel. +49 69 136 44440

CommerzbankBRI@commerzbank.com

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