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FEATURE: Where are the opportunities for Chinese investors in European TMT?

While Chinese investment continues to flood into Europe, interest in the continent's TMT sector – particularly areas such as gaming, media distribution and VR – is on the increase, with a flurry of deals recently announced and deep pocketed Chinese buyers scouting for more opportunities.

Yedda Wang, Reporter, TMT Finance, speaks to a number of key advisers and investors to understand the factors that are driving these investments, as well as which sub-sectors are proving most attractive to Chinese investors – plus exploring any issues which may affect M&A.

Why are Chinese companies investing in Europe?

The Chinese economy has matured significantly over the past 10 years, so the key thing Chinese companies are looking for is bottom line profit growth. When China was still experiencing its boom, Chinese companies could expect growth and profit within the domestic market, however as the economy has matured, it has become far more difficult for these companies to sustain such high growth domestically.

The uniqueness about the Chinese market is the structure of Chinese stock market. The valuation of companies in China is two to three times higher than any other major market in the world. To prove strong and continuous growth in a market where the profit growth is becoming more difficult, the best way is to acquire profitable companies that have potential to help Chinese companies grow. Hence, Europe, where there are a lot of companies that offer leading technology in relevant sectors, has become the ideal place for Chinese companies to shop. Also, within the TMT sector, TMT companies outside China are not valued as high as the ones in same sector/sub-sector in the Chinese market, therefore, these deals are more attractive to Chinese investors.

It is worth noting that unlike some US and European financial investors and private equity firms, as a general rule Chinese investors are less interested in distressed or poor performing companies, as they have less appetite to work with companies to turn them around, sources commented.

Many Chinese companies are not using cash or debt to finance their acquisitions, instead, they prefer to issue shares via equity markets to raise funds. Once the target company is acquired and integrated into the group, it will give an immediate increase to the share price of the acquirer.

By making acquisitions in Europe or US, the primary aim for Chinese companies is to increase their attractiveness to the Chinese market. Assets/targets that will help these companies to gain more market share domestically will be very attractive to these firms. To enhance the share price and valuation can be considered as the key motivation behind a lot of acquisitions by private (non-state-owned) Chinese companies.

Which TMT sub-sectors are most appealing?

●**Sports:** There have been a series of outbound investments from China in entertainment and media, including the acquisition for London-based sports media firm MP&Silva from Everbright Securities and Beijing Baofeng Technology, retailer group Suning's purchase for Italian football club Inter Milan, etc. This trend will continue in 2016-2017, according to sources.

The sports sector (content, data, gaming, TV rights, etc) is currently considered as one of the hottest sub-sectors in entertainment and media, and is now a very mature business in Europe. Chinese audiences' appetite for sports contents is growing substantially, and therefore, Chinese investors are willing to pay robust prices for sport clubs or sports content providers or sports broadcasting rights.

●Movies: Some Chinese real estate companies (like Wanda Group) are showing increasing interest in acquiring film companies, as they have set up necessary infrastructure (cinemas) in many areas in China while developing residential properties. Revenues from movies have been increasing in China over the past couple of years, which has further compelled appetite for movie content and distribution to boost vertical integration offerings.

Companies like Wanda are also likely to invest in UK film production-related companies, such as sound or video production, with the UK viewed as a world leading player in this field.

Apart from real estate groups, Chinese tech firms like Tencent have also shown interest in acquiring media content assets. Tencent's most valuable asset, social media app WeChat, has about 760 million subscribers, which is a powerful platform which can be used to distribute content.

Sources said Tencent's strategy has two major streams: one is to build a platform as big as possible - which they have achieved via WeChat; the other is to acquire content to pump into the platform. That is what's driving the company's acquisitions in the media sector, with more acquisitions of film studio, short movies, etc. predicted, following the company's acquisition of Hollywood film studio STX in August.

Tencent (via WeChat) could prove to be the game changer for the Chinese movie industry, as WeChat can be a digital distribution channel for film, which would also save the film distribution costs which are usually 40-50% of the total film production cost.

●Gaming: In China, as in many other parts of the world, investment in the gaming industry has changed from website gaming to mobile gaming and increasing competition has led the gaming industry to reach to a bottle neck. In China in particular, the concept of virtual reality presents a new opportunity for the industry – and companies are starting to combine mobile gaming with VR technology. According to sources, the VR technology itself is not very complicated, but making the content attractive with VR technology is the key issue. In Europe and US where the gaming industry is more mature and some game companies have the technology to make the content attractive, it is seen that many Chinese gaming companies will want to make acquisitions or are working together and bring those products to the Chinese market.

●VR: Aside from gaming, VR has been applied to many other industries in China, like e-commerce. Big e-commerce companies like Alibaba or JD.com are now starting to reach a saturation point in terms of growth, but VR will bring a new growth element via improving user experience. Apart from e-commerce, video streaming companies are also hoping to enhance their content with VR technology and provide more services to subscribers. Therefore, VR, which will bring revolutionary changes to the TMT industry, is a hot sub-sector for Chinese investors to consider.

●Robotics: China has been a labour intensive market, however, it has lost some of its competitiveness as labour costs increase and many companies have shifted factories to other emerging markets. China wants to keep its dominating its position in manufacturing, therefore

robotics will be a sector that the Chinese government is encouraging academic institutions and companies to develop. Currently, this industry is not commercialised yet, so the next step will be commercialising the technology developed by academic institutions and universities. China may work together with US and Japan on this.

●Semiconductor: Competition in the semiconductor business is quite fierce in Europe and the US. Also, semiconductor manufacturers are facing big financial challenges as the products need upgrading frequently. In China, many companies including Tsinghua Unigroup are likely to expand their business globally through acquiring the semiconductor manufacturers that have financial problems. The aim is to make sure every mobile device – smartphones and tablets – in China will rely on China's manufacturing base, to avoid needing to import chips from overseas.

●Big data analytics: This is predicted to be a big trend in China as it is internally. The machine learning business is more mature in Europe and US, so there will be more partnerships between Chinese companies and European/American firms or academic institutions. However, as time goes by, there will be a China-focused ecosystem based on a China specific market.

What are the issues facing Chinese investment or M&A in Europe?

China doesn't have many multinational companies. Only few can be considered as multinational groups. Many companies are big, but on average 95% of their business is in China according to recent figures. But this is changing and Chinese companies are attempting to grow on a global level. In order to become a true multinational company, M&A is the easiest and quickest route, as opposed to organic growth which would be too time consuming. However, in general, Chinese strategic companies don't have much M&A experience. Very few companies in China have a professionally managed M&A department to identify targets, do due diligence and execute acquisitions. Some of the companies refuse to use professional advisers because they think they can manage it in-house, which according to sources can often cause issues.

The usual way of doing M&A internationally is to decide on a growth area and highlight the target companies following a well-planned development strategy. However, one source said "some Chinese companies will buy first and think later – they lack of a good rationale for a deal, which will eventually make it difficult to measure if the deal is successful or not."

Apart from these, some Chinese investors which are from traditional industries – mining, iron, steel, etc. – are making investment in TMT in Europe to diversify away from their core business areas which have plateaued. However, investment in TMT from these companies is not strategic, as they can't bring strategic help to the acquired firms in Europe and it is unlikely for them to help the acquired firms to grow and develop in China. Their investments are more akin to a financial investment and they are likely to divest the acquired target several years down the track.

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