Valitas Insights: China, Canada, and Capital Controls...The Impact on Cross-Border M&A

Over the past couple of years, Chinese outbound M&A has reached record high levels, hitting a peak of [US$227 billion] in 2016, and more than doubling its 2015 level. In November 2016, China announced that new capital controls would be put in place effective January 2017, to reduce this outflow of currency.

Chinese investment in Canada differs from the global pattern. Canadian deal activity peaked in 2012, when China took first place in the rankings of inbound M&A, but dropped off in subsequent years as commodity prices fell. In 2016, however, Chinese inbound M&A in Canada was back in the top three, ranking by value behind the U.S. and the U.K..

We were curious about whether the new Chinese capital controls were impacting deal activity in Canada, and were fortunate to speak with Chris Flood, counsel at Blakes, who has extensive experience advising Chinese corporate and financial investors on M&A transactions in Canada.

Valitas: How has Chinese inbound investment in Canada changed over the past five years?

CF: Leading up to its peak in 2012, Chinese inbound investment was primarily focused on the resource sector. While investment dropped off with the decline in commodity prices, we have seen steady inbound activity since, but are now seeing much greater diversification. Canada is really finding itself on the map in China as an investment target for diverse industries. We've seen deals in a broad range of sectors including technology, real estate, life sciences and aviation.

Valitas: What about Chinese acquirers? Has there been a shift in the type of buyer investing in Canada?

CF: Definitely. Acquisition activity was previously dominated by large, state-owned entities, but we're now seeing much more interest from non-state-owned companies, like investment funds and Chinese publicly listed companies.

Valitas: The new Chinese capital controls went into effect in January 2017. Have you seen any impact on deal activity in Canada?

CF: It's important to understand that the objective of these capital controls is to prevent "irrational" outbound transactions – that is, transactions that don't create any value – in order to slow the flight of capital. Chinese investment in Canada has been relatively flat, without the spike that the U.S. and E.U. have seen, and transactions in Canada do not typically conflict with the new rules. As a result, Canada has not really felt the brunt of the capital controls. Where we have seen an impact though, is with sellers concerned about whether the new controls will be an impediment to closing a transaction.

Globally, Chinese investors seem to be shaking off worries about the new rules, with outbound investment rebounding, up from 7th position in Q1, to 2nd position in Q2/17. This recovery is consistent with an observation in a recent McKinsey article, that, with respect to outbound M&A, "[China] is still relatively early in a long growth trend". An additional insight was shared by Chris Flood during our chat:

"For the past fifteen years, the Chinese government has been promoting overseas investment, and the fundamentals are definitely still there."