Orient Capital Research

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# China Oceanwide

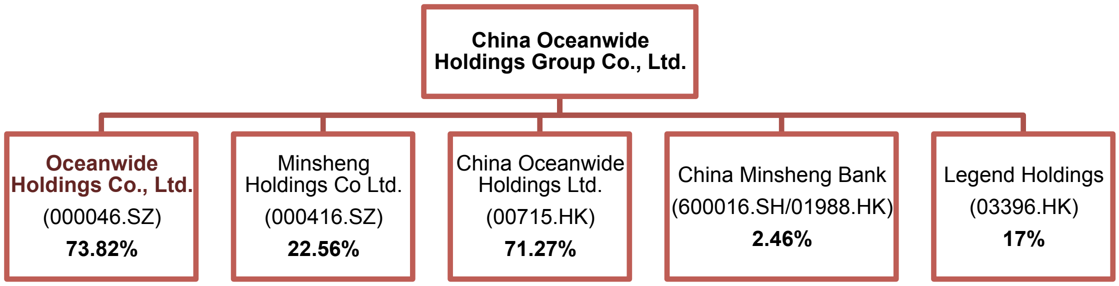
## Synergies in the Acquisition of Genworth

### 1. Summary of Deal

China Oceanwide Holdings Group Co., Ltd. (715 HK) announced in October it plans to acquire 100% of the outstanding shares of Genworth Financial Inc. (GNW NYSE). The purchase will be made through its affiliated company, Asia-Pacific Universe Investment, for US$5.43 per share in cash, 4.2% more than the closing price of the date of announcement, for a total amount of US$2.7bn. In addition, China Oceanwide pledged to provide US$600mn to Genworth to pay down debt maturing in 2018, as well as US$525mn to strengthen its life insurance business. The deal is expected to be completed by the middle of 2017. The direct investment of insurance premiums into overseas financial markets not only lowers the cross-border transfer costs for property companies that want to expand overseas, but also allows them to avoid the pressure of short-term debt given the relatively longer life span of most insurance projects and a steady stream of funding provided.

### 2. Company Profile

**China Oceanwide** is a conglomerate that spans real estate, energy, culture and media, and financial services, employing more than 10,000 employees globally. It was founded in 1985 by a well-connected Chinese businessman, Lu Zhiqiang, who is a senior member of the Communist Party in China and one of the founding shareholders of China Minsheng Banking Corp, as well as a member of the standing committee of the 12th Chinese People's Political Consultative Conference. The company is the controlling shareholder and investor in several China Mainland and Hong Kong listed companies.




**Asia-Pacific Universe Investment** is 40% owned by China Oceanwide Holdings Group and 35% owned by Oceanwide Holdings' wholly-owned subsidiary, China Oceanwide International Capital Management. The remaining 25% is indirectly held by Oceanwide Holdings Co., Ltd. through its subsidiary, Wuhan Wangjiadun Central Business District Construction Investment Limited.


## 3. Motivation behind China Oceanwide's acquisition

a) **To achieve the company's ambition in the insurance industry.** China Oceanwide started in the insurance industry in 1994 when chairman Lu helped to establish China's first private invested insurance company, Minsheng Life Insurance. Although Lu withdrew in 2010 due to a share dispute, he reentered the industry in 2015 by forming China Oceanwide and acquiring a 51% share of Ming An Insurance for Rmb1.785bn, which has been renamed Asia-Pacific Property & Casualty Insurance Co Ltd. In the meantime, Oceanwide Holdings started two new insurance companies, called Asia-Pacific Internet life Insurance and Asia-Pacific Reinsurance, through its subsidiary, Wuhan Central Business District Construction

Investment Limited, the platform to execute and develop its strategy in the insurance industry. Oceanwide Holdings also announced it planned to raise Rmb15bn through a private placement, among which Rmb4bn will be add-on capital for Asia-Pacific Property & Casualty Insurance. Acquiring Genworth will not only enrich the company's business portfolio by adding long-term care insurance (LTCI) and mortgage insurance but will also expand its footprints overseas.

b) **Diversifying business in untapped markets to avoid steep competition.** China's insurance market has become an oligopoly where 60% is controlled by state-owned (SOE) insurance companies and the remaining 30% is held by just two companies: China Pacific Insurance Group and Ping An Insurance Group. The remaining 10% market shares are controlled by a growing number of smaller companies like China Oceanwide. To break through the increasingly difficult competition, China Oceanwide has planned strategic moves into niche sectors such as internet life insurance and reassurance sectors by establishing two new companies. China Oceanwide started late on reinsurance with few entrants and only accounted for ~ 2% of the global reinsurance market in terms of premium income. If the new company is approved by regulators, China Oceanwide will be the first private company in the industry and one of the two companies having all three licenses for property insurance, life insurance, and reinsurance. Similarly, the life insurance business via the internet is a new concept with a short history and lack of national players. The acquisition of Genworth is expected to help the company capture the relatively new Long-Term Care Insurance (LTCI) market, which currently only provides products that distribute cash as the final remedy but do not offer long-term care services. The deal would help China Oceanwide leverage its experience in this area.

c) **To benefit from upcoming favorable policies.** In July 2016, the Chinese Ministry of Human Resources and Social Security started a pilot program for LTCI in 15 cities nationwide, which will cover employees who subscribe to the state-run basic medical insurance scheme. This is the first concrete measure taken by the Chinese government after announcing its plan to encourage LTCI market as a major part of the country's 13$^{th}$ Five-Year Plan. We expect to see similar plans in the future, which will largely benefit the early movers of the industry. If China Oceanwide completes the acquisition, it will enjoy a first mover advantage as well as a shorter learning curve thanks to Genworth's long history and rich experience in

LTCI. Moreover, chairman Lu's close relationship with both central and local governments will be a unique advantage over its competitors given the greater extent of freedom granted to local officials of the pilot cities. For instance, the pilot cities are allowed to decide whom to cover and the extent of coverage as well as the amount of financing to be raised.

## 4. Property company's new ATM: Insurance Company

The marriage between property and insurance companies became popular beginning in 2015. For example, five of the top 10 life insurance companies have property developers as their major shareholders, such as China Ping An Life Insurance and Pacific Life Insurance.

| Insurance Companies | Property Shareholers | % Share |
|---|---|---|
| Ping An Insurance | Shenzhen Investment Holding | 5.3% |
| | Shum Yip Group | 1.4% |
| | Sub-total | 6.7% |
| Pearl River Life Insurance | Pearl River Investment | 30.2% |
| | Zhu Guang Group | 20.0% |
| | Hengyang Hechuang Real Estate | 19.0% |
| | New South | 10.3% |
| | Sub-total | 79.4% |
| Union Life Insurance | Hubei Defan Real Estate | 13.9% |
| | Tian Xin Jie Real Estate | 4.4% |
| | Sub-total | 18.3% |
| Foresea Life Insurance | Baoneng Group | 51.0% |
| Taikang Insurance Group | Jade Investment Group | 23.8% |
| | Beijing Jiuding Real Estate | 1.2% |
| | Sub-total | 25.0% |
| Aeon Life Insruance | Wanda Group | 11.6% |
| | Neoglory | 10.3% |
| | Yifang Group | 10.3% |
| | Hengmao Real Estate | 10.3% |
| | Dalian City Construction Group | 10.3% |
| | China Wall King Holding | 10.3% |
| | Sub-total | 62.9% |

Property developers, which are struggling with high debt ratios, have turned to cash-rich insurance companies for liquidity and low-cost capital. The property business contributed ~62% of total operating revenue, or Rmb8.7bn, for China Oceanwide in 2015.

In general, there are three ways for property developers to align themselves with insurance companies. The first method is through acquisition. The second method is to work with an asset management firm to set up a joint-venture with an insurance licensee, and third is to introduce an insurance company as a strategic investor.

| Acquisition | | | |
|---|---|---|---|
| **Property** | **% Share** | **Insurance** | **Deal Value** |
| **China Oceanwide** | **100%** | **Genworth** | **US$3.8bn** |
| Yango Group | 52% | Phoenix Holdings | Rmb3.4bn |
| Thai Hot Group | 100% | Dah Sing Life | US$1.4bn |
| Evergrande | 50% | Great Eastern | Rmb4bn |
| Fosun International | 80% | Caixa Seguros | US$1.36bn |
| | 85% | Peal Reinsurance | US$468mn |
| | 100% | MIG | US$430mn |
| | 50% | NAGICO | N/A |
| | 100% | Ironshore | US$2.3bn |
| **Joint Venture** | | | |
| **Property** | **% Share** | **Insurance** | **Registered Capital** |
| Future Land | 20% | Guo Feng Life Insurance | Rmb1.5bn |
| Red Star Macalline | 20% | | |
| HOdo Group | 10% | | |
| Changzhou Hualida | 15% | | |
| Xining Weiye | 15% | | |
| Hodo Industrial | 15% | | |
| Sunrain | 5% | | |
| Rongxin Group | 20% | Life Insurance<br>Reinsurance<br>Insruance Agency | Rmb2bn |
| BOE Technology Group | 20% | | |
| Ping Tan Urban Investment Group | 20% | | |
| Ping Tan Investment Group | 20% | | |
| Watertek Information Technology | 20% | | |
| Thai Hot Group | 10% | Haixia Life Insurance | Rmb1.5bn |
| Fujian Energy Group | 20% | | |
| Yango Group | 13% | | |
| Sheng Xing Group | 10% | | |
| Septwolves | 10% | | |
| Fujian Mechanical & Electric Holding | 10% | | |
| PanPan Foods | 9% | | |
| Sanming Caixin Investment | 5% | | |
| CPT Technology | 5% | | |
| Bosheng Healthcare Investment Group | 5% | | |
| Shanghai Haosheng Investment Group | 3% | | |
| Shenzhen Yingde Land Limited | 15% | Funde Sino Life Insurance | Rmb1.02bn |
| Dalian Dongpeng Real Estate | 4% | | |
| Fu Tak Investments Group Limited | 20% | | |
| Houde Financial Holdings | 18% | | |
| Shenzhen Intercontinental Trade Invesment Group | 12% | | |
| Funde Insurance Holdings | 11% | | |
| Dalian Shide Group | 4% | | |
| **Introduction of Strategic Investor** | | | |
| **Property** | **% Share** | **Insurance** | **Share Value** |
| Country Garden | 9.9% | Ping An Life Insurance | HK$6.297bn |

Note: Property companies are highlighted.

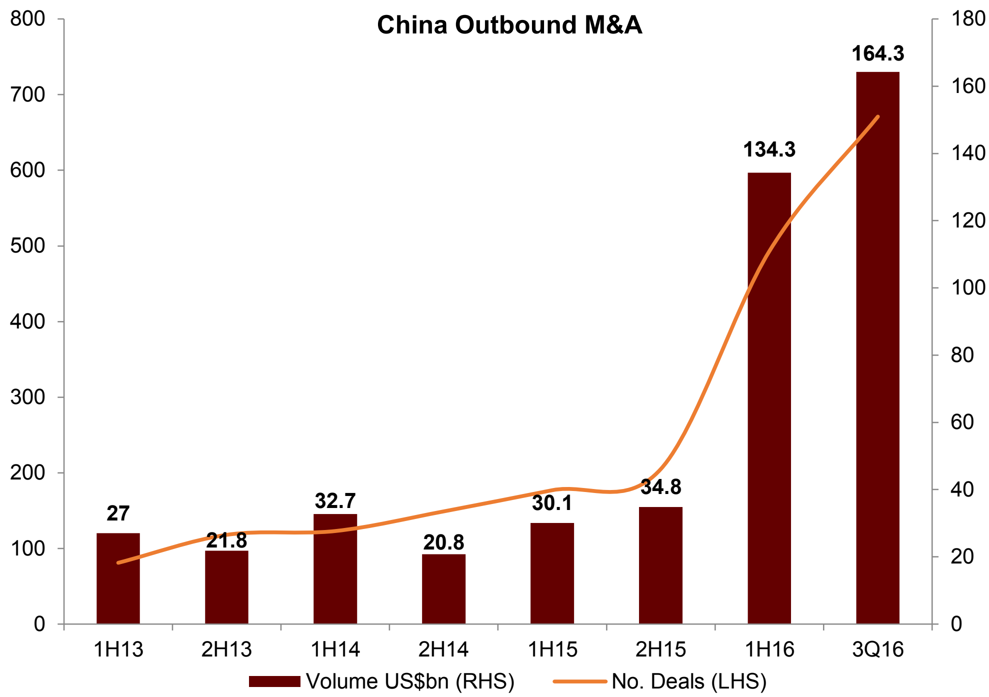
Currently, foreign insurance companies are becoming more popular as takeover targets due to strong competition in the domestic market. There are two major benefits that attract property developers to invest in the overseas insurance industry.

- **Better financing position in the form of lower financing costs:** The direct investment of insurance premiums into overseas financial markets not only lowers the cross-border transfer costs for property companies that want to expand overseas, but also allows them to avoid the pressure of short-term debt given the relatively longer life span of most insurance projects and a steady stream of funding provided. For instance, after acquiring the insurance arm of Portuguese state bank Caixa Seguros, Fosun International invested €1bn in foreign bonds and US$460mn in 14 Portuguese equities and bonds. It also invested in Caixa's property projects in Japan and Australia. In addition, the whole investment process was much faster in the absence of regulatory restrictions in China.
- **Great value at low cost:** The low valuation of foreign insurance companies provides Chinese property companies a good entry point to the market as it is increasingly difficult and costly to get domestic insurance licenses under tightening regulations. For example, Fosun International spent US$3.76bn acquiring U.S. insurer Ironshore, which had total assets of US$6.7bn at the end of December 2014. "Although insurance shares have underperformed the market in the past few months, we give a premium to the cheap long-term insurance float that we could leverage on," said the CFO of a large property developer company. "We could raise five times the market value of an acquired insurance company by issuing new insurance products whereas we could only raise 60%~80% from others by making collateral loans with banks." After they acquire the insurance company, property companies can issue insurance products to raise more capital. The additional capital they raise is also counted in the valuation of acquisition.

In the absence of REITS, an insurance float is the most ideal source of capital for property companies to develop their business in China. In addition, property developers and insurance companies can share customer resources and thus drive customer retention and loyalty.

## 5. Big Picture: A new way for capital flight

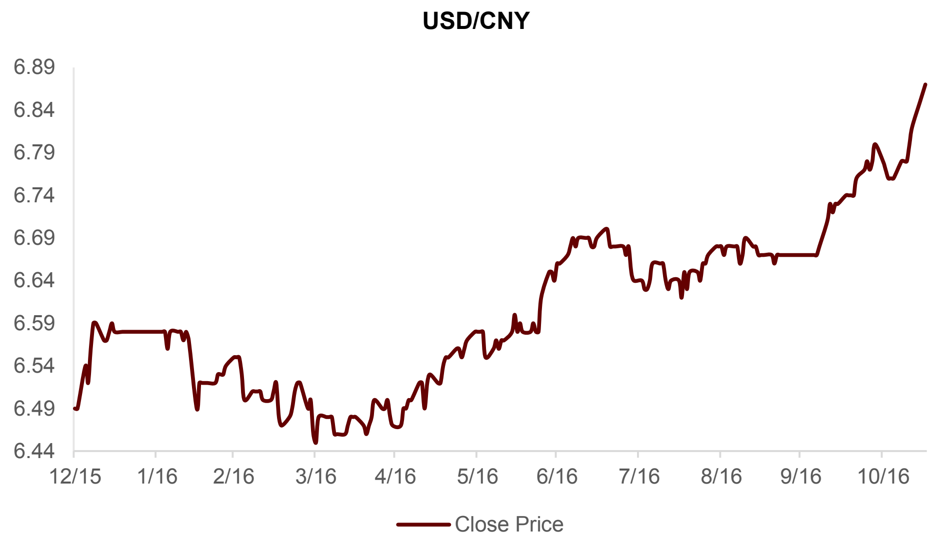
1) **Overview:** Outbound M&A has become one of the new tools for Chinese companies to send their capital abroad. According to PwC, the volume and value of outbound M&A by Chinese companies hit a record high at the end of 3Q16, leading global cross-border M&A acquisitions for the first time on record and up from sixth place in 2015 YTD.




Deal volume nearly doubled that for the whole of 2015 to 671, while deal values reached US$164.3bn, increasing 198.2% YoY. Private companies were still the most active players in terms of transaction volume, clinching 449 M&A deals for the first three quarters, which was nearly five times higher than the number for SOEs. For the first time, private companies surpassed SOEs in transaction value, accounting for half of the total over the first three quarters of 2016.

2) **The Reasons Behind:** The fear of RMB further depreciation is the biggest motivation driving China outbound M&A. Since the beginning of this year, the Rmb has dropped over 4.5% against the US dollar and has touched six-year lows. Conversion of RMB assets into other currencies has become a popular solution among Chinese companies that either experienced

currency translation losses or expect a dramatic decrease of the RMB's value in the near future if the central government halts its support for the RMB's value.




As a result, China's foreign exchange reserve fell the most in nine months in October, and by far more than expected, to the lowest since March 2011. Reserves dropped US$45.7bn to US$3.121 trillion in October, exceeding the previous three months combined – despite the government imposing tighter measure on restricting capital from leaving China, including cracking down on illegal fund remittance services from "show banks", restricting Union Pay overseas transaction limit (mostly purchasing saving-type life insurance products), tightening overseas purchase requirements and other measures.


**Under stricter rules, outbound M&A is a new and effective way for capital flight.** For instance, HNA Group, a conglomerate focus on the airlines business in China, recently spent HK$8.8bn (Rmb$7.7bn) to acquire a residential development project in Hong Kong. The price paid broke the record for similar projects and rendered the market to suspect HNA group wanted to relocate part of their capital outside of China via this vehicle.

| Acquirer | Type | Target | Value | % Share | Status |
|---|---|---|---|---|---|
| Haier Group | Private | General Electric Appliance | US$5.4bn | 100% | Completed |
| ChemChina | SOE | Syngenta | US$44bn | 100% | Expected to complete by 1H17 |
| HNA Group | Private | Ingram Micro | US$6bn | 100% | Expected to complete by 2H16 |
| Caixin Enterprise Group | SOE | Chicago Stock Exchange | US$100mn | 100% | Expected to complete by 1H17 |
| Zoomlion | Private | Terex Corporation | US$3.3.bn | 100% | Suspended |
| Tsinghua Unigroup | SOE | Western Digital Corporation | US$23bn | 15% | Suspended |
| Dalian Wanda | Private | Legendary Entertainment | US$3.5bn | 100% | Expected to complete by 1H17 |
| Fosun | Private | Club Mediterranee | €939mn | 93% | Completed |
| Hua Capital | Private | OmniVision | US$1.9bn | 100% | Completed |
| Shandong Hengyuan Petrochemcial | SOE | Shell's oil refienery in Malaysia | US$480mn | 51% | Expected to complete by 2H16 |
| Ningbo Joyson | Private | KSS | US$920mn | 100% | Completed |
| Canyon Bridge Capital Partners | PE | Lattice Semiconductor | US$1.3bn | 100% | Expected to complete by 1H17 |

In addition, Chinese companies can receive a double benefit from these overseas transactions. The government encourages state banks to make loans in RMB to acquire foreign assets. If the RMB continues to depreciate, the borrowing costs will shrink while the returns from overseas will appreciate**.** For example, China

Oceanwide is believed to be receiving financial support from Minsheng Bank for its acquisition of Genworth given the company's current ownership stake as well as the long history of controlling the bank. According to media reports, China Oceanwide once received approximately 80% of its loans from Minsheng Bank at worth Rmb4.2bn, accounting for ~20% of the bank's net capital, far more than the 10% threshold set by the China Banking Regulatory Commission.

**Conclusion**

As long as the central government continues to implement favorable policies for outbound acquisitions, we expect to see a growing number of China outbound M&A in various industries such as insurance.

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