Outbound foreign direct investment by Chinese energy companies began to gain momentum in the early 2000s when large Chinese state-owned enterprises, or SOEs, stepped up their search for natural resources overseas. As China’s continued economic growth drove increased domestic demand for energy, Chinese energy companies began to look overseas to secure new reserves and long-term energy supplies. This international pursuit was led predominantly by China’s largest energy companies: China National Petroleum Corporation (CNPC), China National Offshore Oil Corporation (CNOOC) and China Petroleum & Chemical Corporation, more commonly known as Sinopec.

While China’s SOEs operate as commercial enterprises similar to their counterparts among international oil companies, their overseas acquisitions do contribute to China’s energy security and the SOEs have benefited from Chinese government policies promoting outbound investment in energy and natural resources as well as from export credit and similar financial support – again not unlike their counterparts among US and other international oil companies. Chinese government leaders have also given support to overseas energy and natural resources investments during visits to energy-producing countries in Africa, South America and elsewhere.

According to data published by the Chinese government, by end of 2012 China’s oil imports reached 57% of its demand. Both Chinese energy demand as well as imports as a proportion of overall supply have continued to increase since that time. Meanwhile imports of natural gas by pipeline and in the form of liquefied natural gas (LNG) have likewise continued to increase. To meet this growing demand, it is expected that Chinese energy companies will continue to seek opportunities to acquire and develop overseas oil and gas assets. Yet the manner in which they go about selecting and acquiring new assets is evolving.

Chinese energy companies now place greater emphasis on efficiency and return on investment whereas in the past they had focused on acquiring overseas reserves and production barrels. There is also a greater focus on improving integration of assets as well as portfolio management. As Chinese energy companies look at new opportunities they are likely to become more selective and strategic in the deals they choose to pursue.

Going out into the world
China’s accession to the World Trade Organization in 2001 spurred the country’s continued economic growth, and with it increased demand for energy and natural resources both as an input for export-oriented, often energy-intensive manufacturing as well as to fuel the new cars and other products for the rising urban middle class.

Early transactions tended to be acquisitions of oil and gas assets from smaller companies, often one-off transactions and relative to the complex transactions of recent years quite small. The sellers and deal counterparties were often smaller, privately-held upstream companies rather than publicly-listed global players of similar size to the Chinese SOEs. In a few instances where SOEs attempted to pursue higher-value M&A activity they were preempted by international oil companies exercising rights of first refusal.

The global economic slowdown that ensued in late 2008 created opportunities for Chinese energy com-
panies with their ready access to cash to pursue larger, more complex deals. With a smaller universe of potential buyers and often under pressure to monetize assets, international oil companies now viewed Chinese energy companies as attractive potential buyers for negotiated deals and as strategic joint venture partners.

In the past six years, Chinese energy companies have completed a series of multibillion dollar, sophisticated transactions with and opposite large independent oil and gas companies and integrated oil majors, including takeovers of publicly-listed companies, large asset acquisitions and complex joint ventures for the development of deep water blocks offshore Brazil, of unconventional shale plays in North America, and of LNG liquefaction and export projects in Australia, Canada and Mozambique. CNOOC’s successful acquisition of Nexen, a publicly-listed Canadian oil and gas company, for US$15.1 billion represents the largest Chinese outbound M&A deal to date in any sector, following Sinopec’s successful acquisition of Addax Petroleum in 2009.

Having completed this series of large acquisitions and joint ventures, the focus has now shifted to integration and operation of acquired assets as well as to the development of experienced management and technical personnel and improving efficiency and return on investment. At the same time, there has been a corresponding slowdown in new acquisition activity. This slowdown is likely to be only a short hiatus, however, and Chinese energy companies are likely to resume new acquisition activity in due course, but now with a view to being more selective and more strategic in the opportunities they elect to pursue.

**What happens next?**

We expect to see large Chinese energy companies continuing to pursue complex acquisitions, strategic partnerships with majors and independent international oil companies and other transactions potentially including partial selldowns and divestitures as they rationalize their portfolios. At the same time, we expect to see more private (non-SOE) companies and private equity funds backed by both private and SOE limited partners becoming active in cross-border energy transactions. Successful integration of assets and operations around the globe and the development of experienced management and technical teams that can bridge cultural and language gaps will be an ongoing task for Chinese energy companies.

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