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Above and beyond: Belt and Road Initiative investment and risk outlook

A study of infrastructure investment trends

February 2019

In cooperation with:

Mergermarket
An Acuris company

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Methodology

In 2018, CMS and Mergermarket, the proprietary M&A intelligence provider, surveyed over 100 senior executives to gauge their views on investing opportunities and risks in the year ahead in countries along the trade corridors of the Belt and Road Initiative (BRI). Of the 100+ respondents, 60 were non-Chinese multinational corporations (MNCs) and 40 were Chinese state-owned enterprises (SOEs) and privately owned corporations. All respondents are either currently active or planning to participate in BRI projects in the near term. In order to ensure confidentiality, identities of all respondents will remain anonymous.

Foreword

Munir Hassan, Partner, CMS UK

Adrian Wong, Partner, CMS Singapore

Welcome to our inaugural edition of the CMS Belt and Road Initiative (BRI) investment and risk outlook, published in association with Mergermarket.

Monumental in its scope and financing requirements, China's BRI is both impressive and a question mark looming over the international community. While some investors remain cautious given geopolitical concerns, few can deny the opportunities and untapped rewards that exist for those that get involved. As attitudes change, so too will the investor mix: to date, Chinese firms have been most active although other participants may soon join the initiative.

In our research, market sentiments are warming to the notion that international investors, including private equity and multinational corporations (MNCs), will more actively participate. Their roles will vary, although market participants say multiple points of entry and opportunities are possible, including both partnerships with Chinese firms and as project leaders. Indeed, as the BRI expands from heavy infrastructure to "soft" infrastructure, opportunities for both Chinese companies and those outside the region will be more prevalent – the same will be true of the risks.

Our survey of senior executives at Chinese and international corporations and investment firms explores the opportunities for these parties in the jurisdictions and industries along the various trade corridors. We also strive to identify the key risks that will be inherent in these transactions, a mix of challenges as diverse as the manifold countries involved in the BRI.

Key findings from our research include:

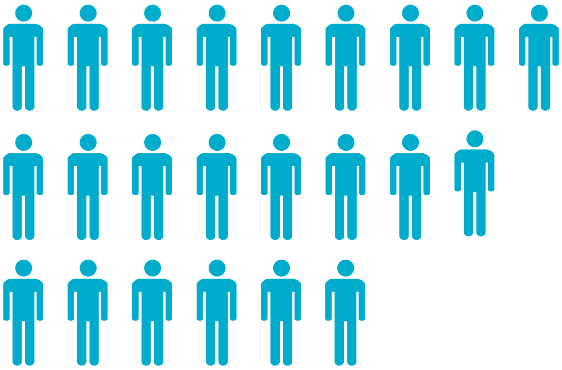
SOURCING DEALS. Identifying opportunities will become less difficult, although still somewhat challenging, especially for international investors, with one in three respondents saying it will be easier to find BRI deals. Likewise, 98% of respondents say international investors will increase their investments into BRI geographies.

KEY GEOGRAPHIES. Respondents identify Southeast Asia, Central Asia and Africa as "hot spot" regions where BRI investment will increase substantially in the near term. This is partly in response to the high infrastructure needs for these locations as well as opportunities that will open in "soft infrastructure" such as IT.

RISKS AND ROADBLOCKS. Political risk stands out for both Chinese (88%) and international (83%) respondents as a top risk. For both groups, legal advisors and risk consultants are included in their investment teams and strategic planning, and both also said more time and resources should have been dedicated to addressing political and legal issues before investing.

Survey findings at a glance

23% expect it to become easier to identify/source BRI investment opportunities in the year ahead

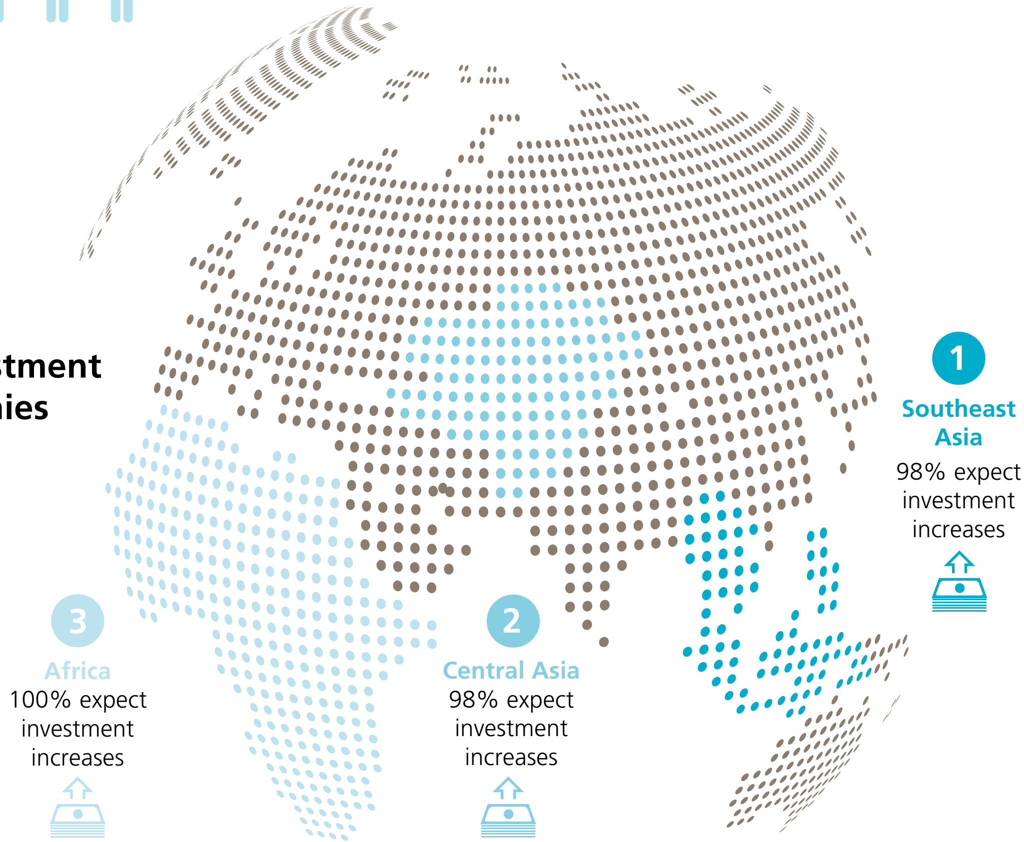


compared to only **5%** at present

98%
think international MNCs will significantly increase their investment in BRI projects over the next 12 months

46%
of investors believe BRI projects no longer require a Chinese partner or Chinese funding

Top investment geographies



Top 3 areas where investors are expected to contribute:

Chinese

- Investment/Project funding
- Lead investor/Project sponsor
- Supplier of advanced equipment and machinery

International

- Professional services/Experts in international project management
- Technology transfers/licensing
- Joint partnerships/Business alliances

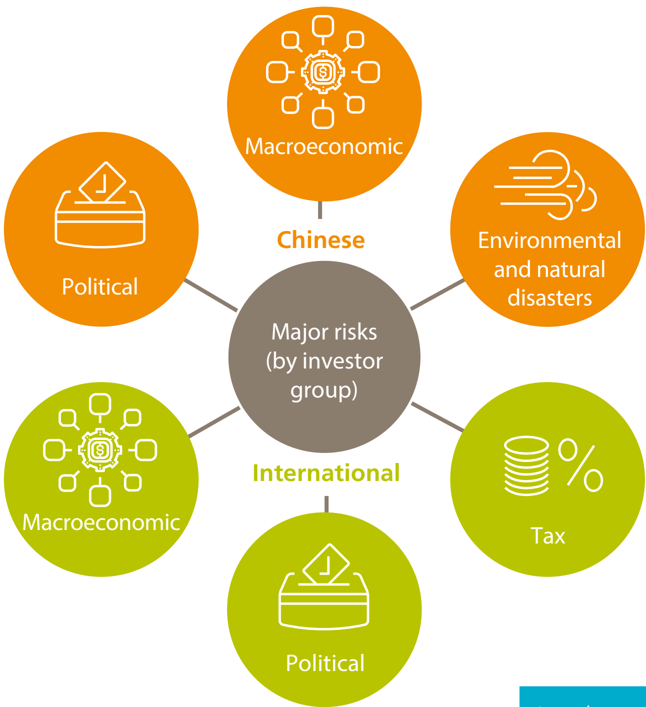
Digital Silk Road

International investors see greater opportunities in:

- **renewables & hydro**
- **telecomms**

while Chinese investors see greater opportunities in:

- **e-commerce & tech**



Top investment sectors

Chinese: Roads, Rail, Ports

International: Ports, Conventional power, Water sector

Investor sentiment and outlook

Our survey results show positivity toward deal sourcing and overall increasing investment in BRI projects, as well as further involvement from international participants.

As the BRI continues to evolve, our survey reveals a growing sense of confidence among Chinese and international investors about their ability to participate. This starts with changing market sentiments toward a definition of which investments can be classified as BRI projects and also which parties must be involved.

While touted by China's President Xi Jinping as an international effort open to all participants, to date the trade and infrastructure initiative has been dominated by Chinese capital or required a Chinese partner to engage in such projects. Likewise, projects have been mostly focused on heavy infrastructure and various megaprojects across Eurasia as opposed to soft infrastructure (such as services, IT and others).

However, 46% of respondents say BRI projects today do not necessarily require a Chinese partner, support or approvals from the Chinese government. Additionally, 50% say these projects can take a variety of forms other than those specific to heavy infrastructure.

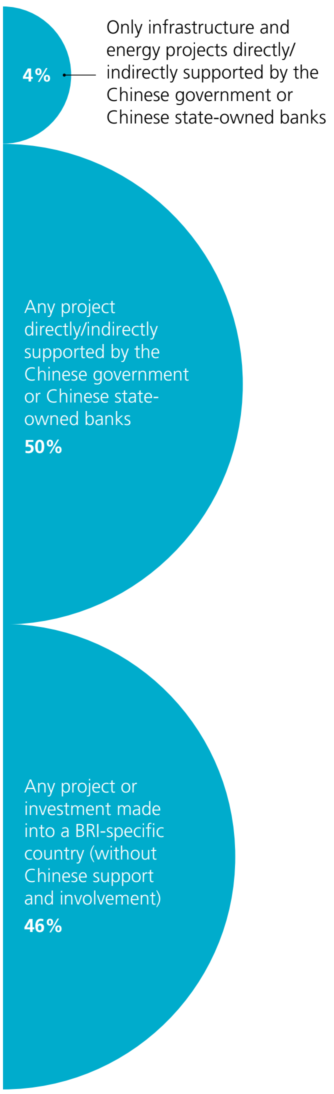
More generally, and with a view to the future, respondents agree that while it is currently a significant challenge to their involvement, identifying and sourcing investable projects will become less difficult in the near term. This is a critical inflection point for interested parties, particularly those who may have assumed exclusion for lack of Chinese support – and, as such, respondents note that various investor groups will increase their involvement in the year ahead.

An international initiative: SOEs, MNCs and private capital

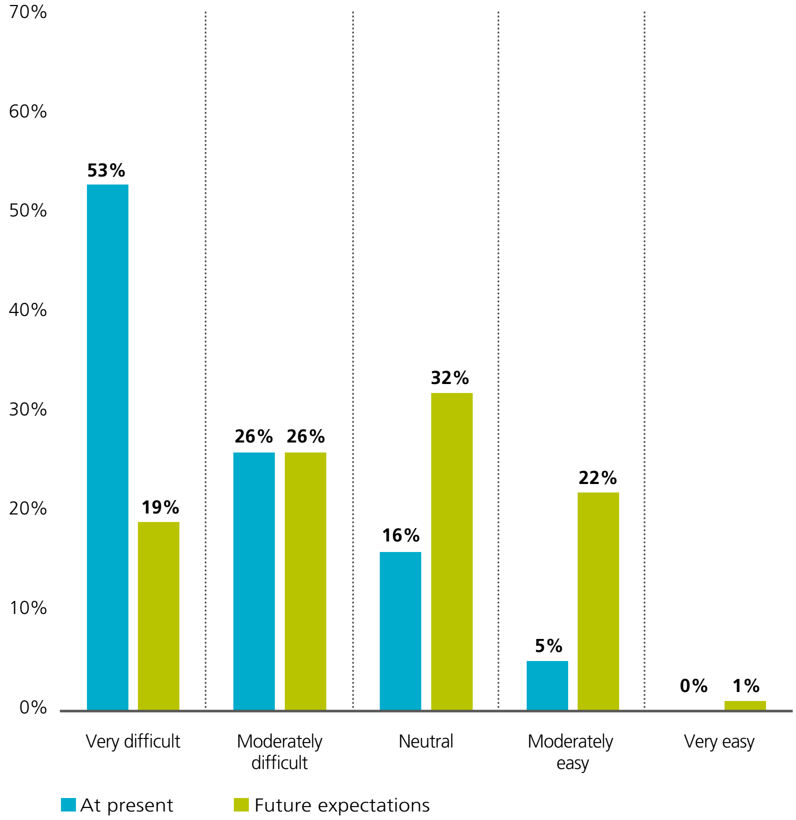
Aside from the obvious expectation that Chinese investors – both state-owned and privately held – will be active project sponsors and leaders, respondents appear hopeful that international participation will be a key theme for the BRI in the year ahead. Indeed, 98% say MNCs will be increasingly active, as they explore opportunities and more aggressively step off the sidelines to assume roles within the diverse patchwork of projects.

What's more encouraging for this investor group are sentiments acknowledging that while the current environment has been particularly challenging (more so than for Chinese investors), the process of identifying and sourcing investment opportunities will become easier. Indeed, Chinese Foreign Minister Wang Yi recently described the BRI as a "sunshine initiative" open to all investors and that China needs to ensure

In your view, what constitutes a Belt and Road project or investment as part of the BRI? (Please pick one)



Please rate the process of identifying/sourcing BRI investment opportunities at present? Over the course of the next 12 months, what are your expectations toward this process?



For international investors, generally speaking, how would you rate the process of identifying/sourcing BRI investment opportunities? Over the course of the next 12 months, what are your expectations toward this process?

> The Belt and Road Initiative will continue to evolve and change over time. It's not one project or even a series of projects, but an idea, and one that encourages creativity and participation from global investors.

Adrian Wong,
Partner,
CMS Singapore

more widespread participation in such projects to manage geopolitical and financial risks.

Many MNCs already view BRI as a once-in-a-generation opportunity to expand the scale and reach of their businesses. For example, General Electric increased its BRI order book from approximately US$400m in 2014 to US$2.3bn in 2016, and this is expected to jump to US$7bn in 2018. Likewise, Caterpillar is reaping revenue rewards by fulfilling demand for construction equipment, while shipping giant Maersk stands to benefit amid rising global trade and construction of new seaports. Financial institutions, such as Citibank and Zurich, are also increasingly involved in relevant projects.

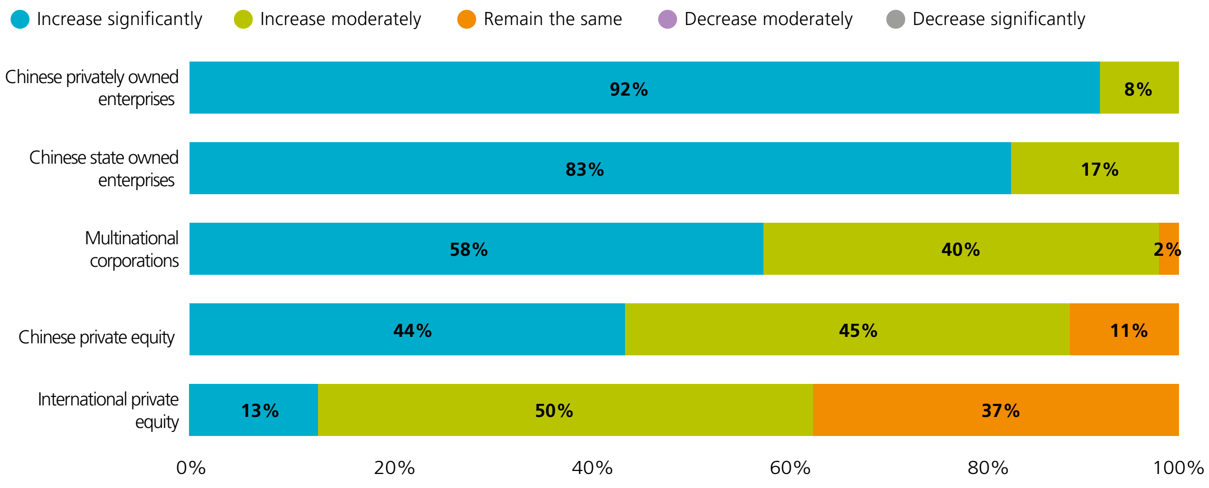
The year ahead could also see another trend develop: increasing activity from private capital. While many respondents say both Chinese and international private equity firms will increase investments into BRI projects, this may be limited, at least in the near term.

The role of MNCs

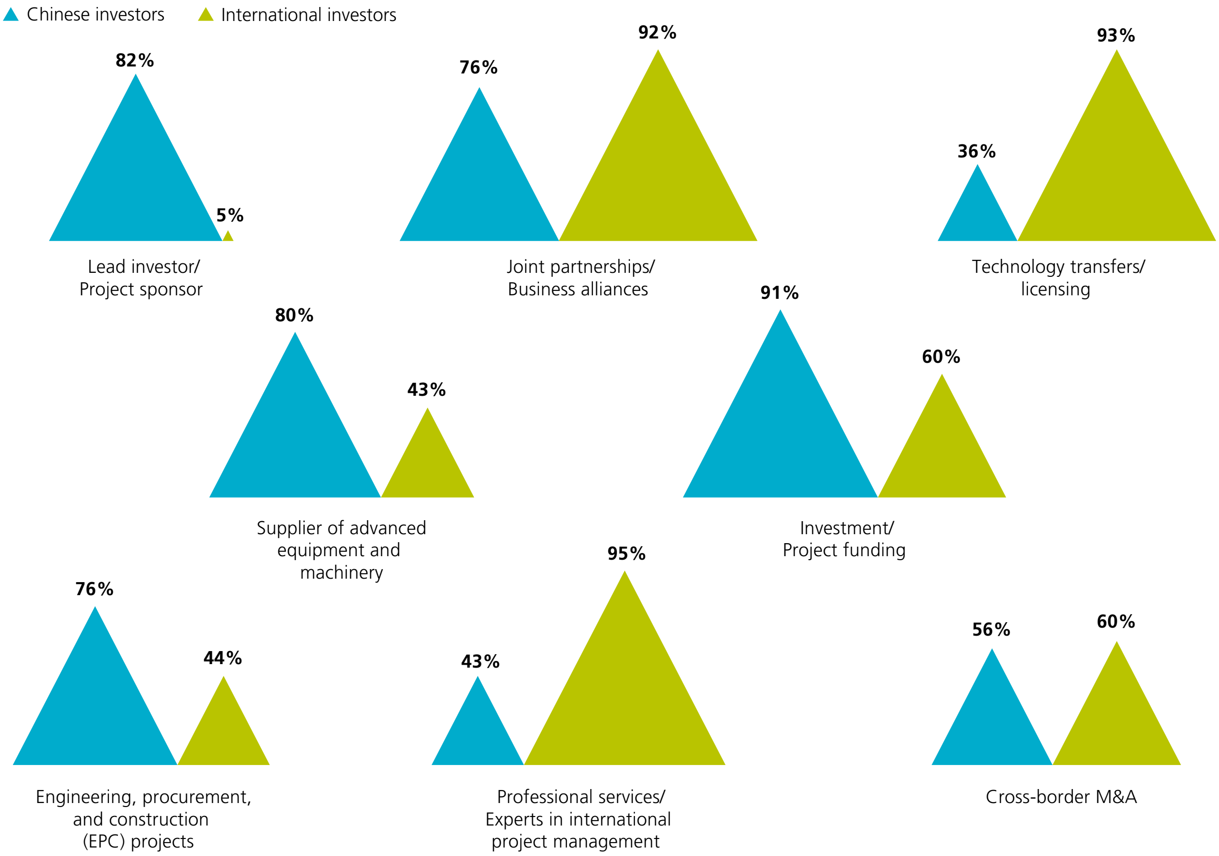
With awareness and enthusiasm rising among MNCs, many are eager to participate. The question is: what role will they play?

Respondents say that international engagement will revolve mostly around joint partnerships and business alliances (according to 92%) as they forge ties with Chinese investors (who will likely take on the role of lead investor or project sponsor). For both groups, this approach will help mitigate risk and bring a diversity of project experience to the table to help navigate the often challenging terrain – in a literal

Over the next 12 months, what do you expect to happen from the following investor groups in terms of their investment in BRI-related projects?



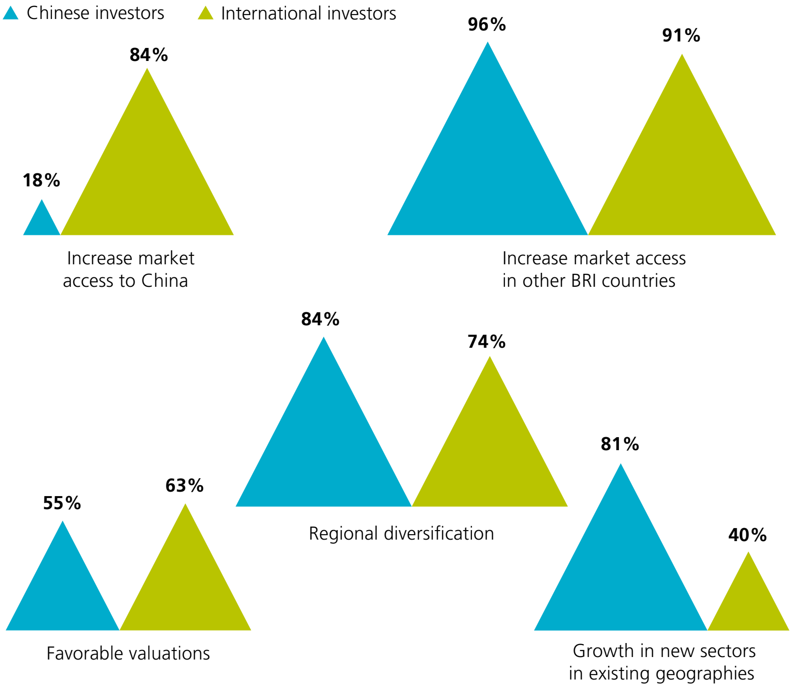
In which of the following ways do you expect the following investor groups to engage in BRI-related projects over the course of the next 12 months? (Please select all that apply)



> There's commentary suggesting that international investors don't need to have a Chinese counterparty to get involved in the BRI, and this is true. However, MNCs should often expect to have a Chinese partner on board, especially in respect of projects in China, if only to provide an extra layer of security for the deal. Chinese partners may know the authorities and the regulatory system, and be able to access key people and capital for the deal more than a potential international partner.

Nick Beckett,
Managing Partner,
CMS Beijing

What do you think will be the top drivers for Chinese and non-Chinese investor groups for engaging in BRI-related projects in the year ahead? (Please select all that apply)



> *The business and investment landscape from East Asia to Europe is very rapidly being defined by BRI projects and policies. For this reason, organizations not currently participating must rethink strategy on how they can get involved if they want to be successful in this part of the world.*

Nicolas Wiegand, Managing Partner, CMS Hong Kong

and figurative sense – of projects in Belt and Road jurisdictions.

An even larger body of respondents point to international investor advantages of technological know-how (93%) and expertise in international project management (95%) as the most significant value-adds they will leverage to seek out participation in these projects.

Deal drivers

Regardless of investor class or domicile, respondents agree that gaining market access to the frontier and emerging economies along the Belt and Road corridors will be the top driver for investment. For international investors, this will also include accessing the Chinese market despite trade uncertainties and market difficulties (lack of transparency, regulatory roadblocks, among others) that MNCs typically face.

For Chinese investors, additional emphasis is being given to growth in new sectors or adjacencies from their main business lines within existing geographies. This has been and will be evident in deals in advanced markets where acquisition opportunities for high-tech know-how and IP will attract Chinese acquirers.

From East to West: Mapping opportunities

Investment in BRI countries will increase in the year ahead, according to our research, with standout jurisdictions in Asia and Africa offering the most opportunities.

Although China's BRI covers 74 countries, there is no official list of Belt and Road projects, participants or countries. This has made it challenging for prospective investors to identify clear points of entry, particularly as many of the projects are still at an early stage of development. However, while this US$900bn roadmap for investment is still in its infancy, a closer examination within each of the geographies shows why respondents have highlighted each as "hot spots" for opportunities.

Southeast Asia

Southeast Asia and the 10 member countries of the Association of Southeast Asian Nations (ASEAN) is a critical hub for trade between China and countries along the sea-bound portion of the BRI. For this reason, the region's burgeoning economies are a key priority in the BRI framework and ranked highest among respondents for project opportunities. Further, 98% of respondents expect these opportunities to increase in the year ahead.

The dynamic ASEAN economy is a top destination for Chinese businesses and corporations, in part due to the region's significant infrastructure deficit. The BRI aims to address this by improving ASEAN's internal connectivity.

Although assets along the BRI maritime "road" route are expected to develop later than the overland "belt", due to China's limited advantage in establishing sea routes, there have already been some notable developments. For example, China Communications Construction Company (CCCC) plans to launch a Singapore-based platform to operate and invest in overseas ports as assets in Southeast Asia attract increasing interest from Chinese SOEs.

Meanwhile, great progress has been made on railway construction in Malaysia, Thailand, Laos and Indonesia as part of China's dream of a trans-Asian railway network link from Kunming, the capital of Yunnan province, to Singapore via Western, Central and Eastern routes.

There are, however, still plenty of BRI-related investment opportunities, with missing links to the proposed trans-Asian railway network in both Cambodia and across the Myanmar-Thailand border. While China's section of the network could be completed in the next five or six years, completion of the entire network is difficult to predict due to the socio-economic development of ASEAN member states and their ability to raise funds.

Central Asia

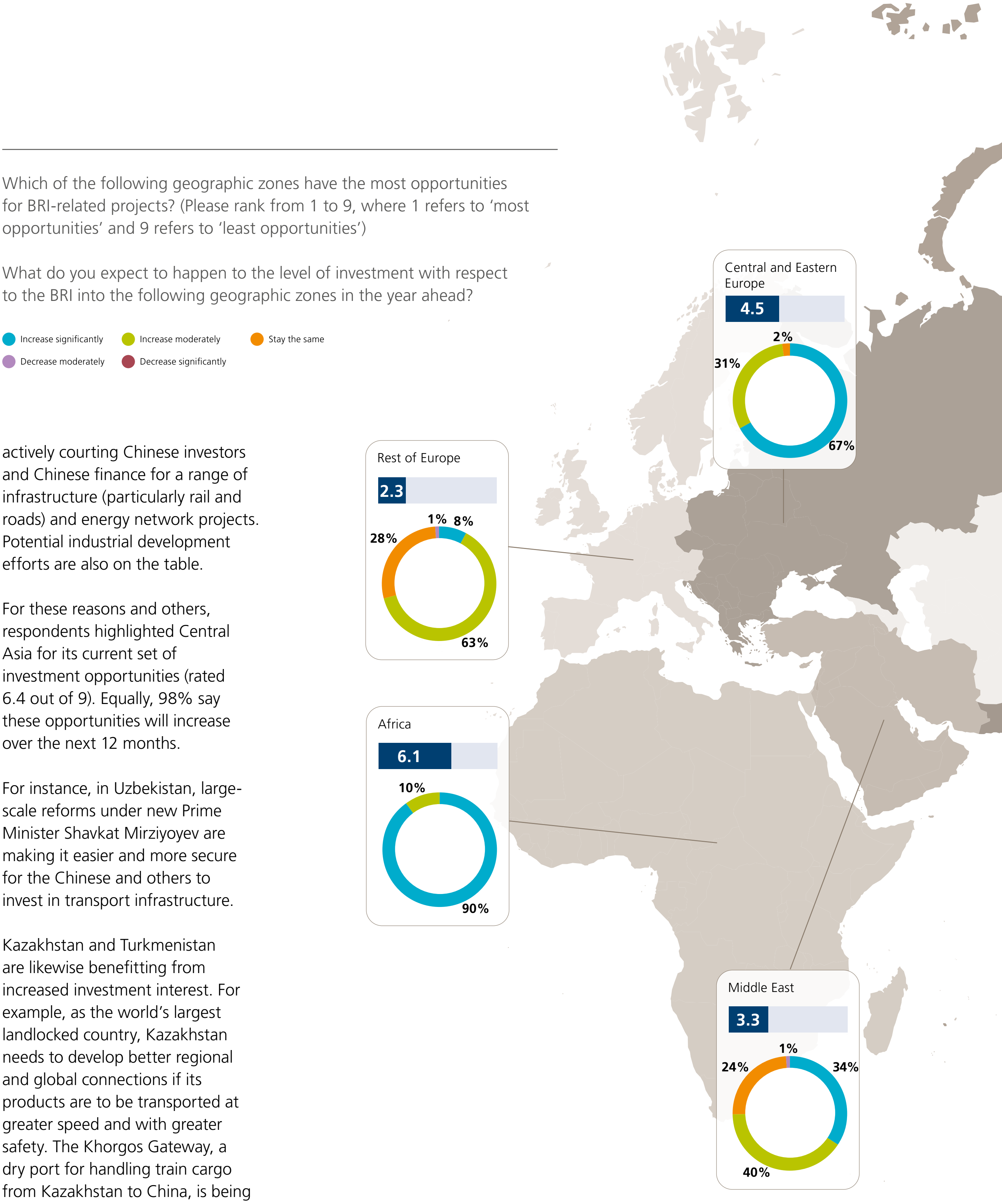
Central Asia was the heart of the Silk Road in ancient times, and today the region is playing an equally important role in the modern day trade network's development. The governments of Azerbaijan, Kazakhstan, Uzbekistan, Turkmenistan and Georgia are

> You can look at BRI investment patterns, especially for the Chinese, like a metaphorical journey. Coming out from China, the closest regions of Southeast Asia and South Asia will particularly benefit, given geographic proximity and relative cultural similarities. These are also the regions heavily in need of infrastructure investment.

Adrian Wong, Partner, CMS Singapore

Which of the following geographic zones have the most opportunities for BRI-related projects? (Please rank from 1 to 9, where 1 refers to 'most opportunities' and 9 refers to 'least opportunities')

What do you expect to happen to the level of investment with respect to the BRI into the following geographic zones in the year ahead?

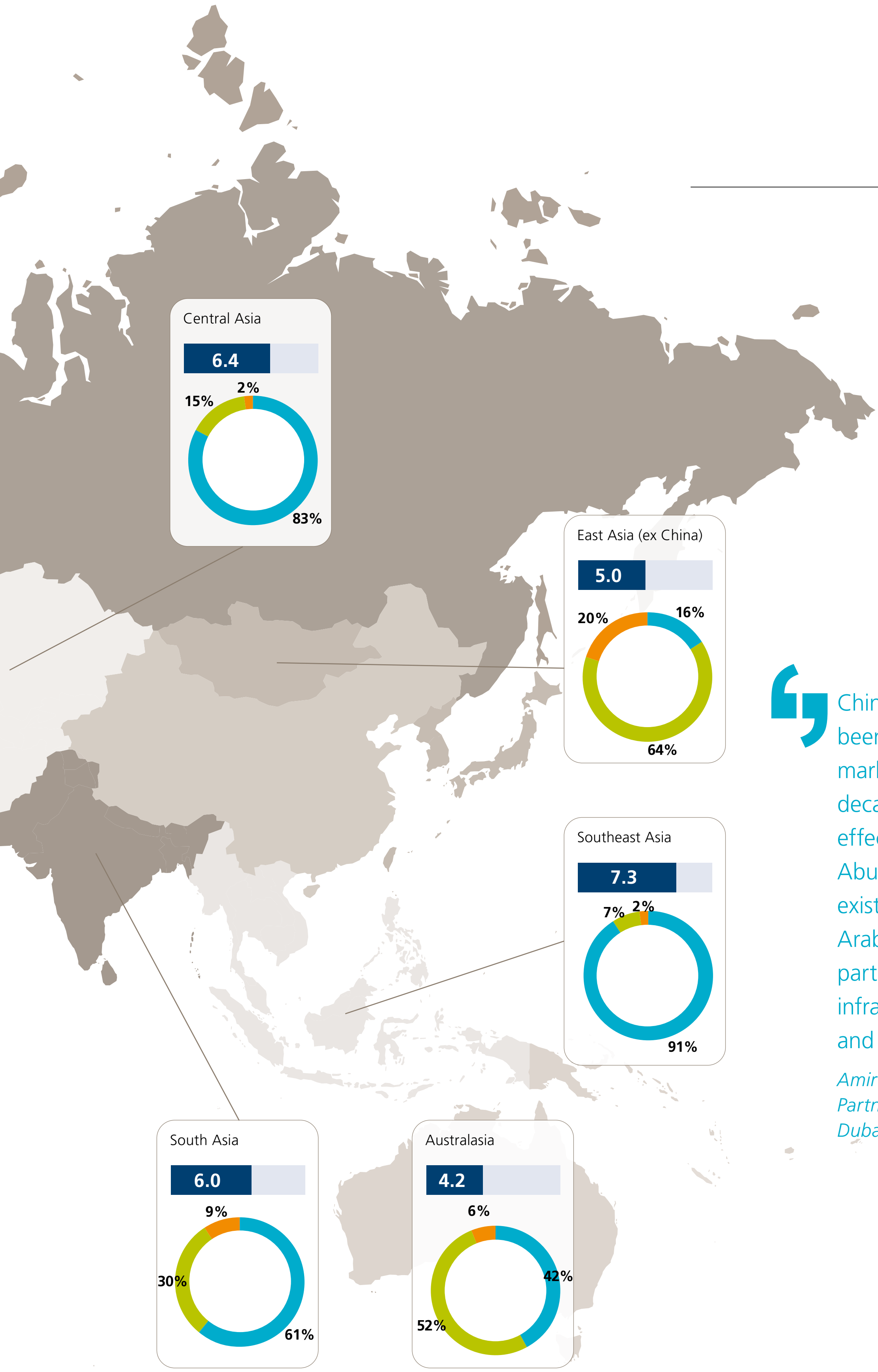


actively courting Chinese investors and Chinese finance for a range of infrastructure (particularly rail and roads) and energy network projects. Potential industrial development efforts are also on the table.

For these reasons and others, respondents highlighted Central Asia for its current set of investment opportunities (rated 6.4 out of 9). Equally, 98% say these opportunities will increase over the next 12 months.

For instance, in Uzbekistan, large-scale reforms under new Prime Minister Shavkat Mirziyoyev are making it easier and more secure for the Chinese and others to invest in transport infrastructure.

Kazakhstan and Turkmenistan are likewise benefitting from increased investment interest. For example, as the world's largest landlocked country, Kazakhstan needs to develop better regional and global connections if its products are to be transported at greater speed and with greater safety. The Khorgos Gateway, a dry port for handling train cargo from Kazakhstan to China, is being



Chinese companies have been present in the Iranian market for more than two decades and are currently effectively unrivalled. Abundant opportunities also exist in the UAE, Saudi Arabia, Iraq and elsewhere, particularly in the infrastructure, energy, and fintech sectors.

Amir Kordvani, Partner, CMS Dubai

TOP SECTORS BY GEOGRAPHY (RESPONDENT SENTIMENT)

JURISDICTION			
South Asia	Transportation: Rail	Renewables & Hydro	Energy networks
China	Transportation: Road	Transportation: Rail	Transportation: Port
Southeast Asia	Transportation: Road	Transportation: Rail	Transportation: Port
Australasia	Transportation: Road	Energy networks	Transportation: Rail
Central Asia	Transportation: Rail	Transportation: Road	Energy networks
Middle East	Energy networks	Transportation: Road	Transportation: Rail
Africa	Transportation: Road	Energy networks	Transportation: Rail
Central and Eastern Europe	Transportation: Road	Transportation: Rail	E-commerce & tech
East Asia (ex China)	Transportation: Road	Energy networks	Transportation: Port

> The UAE's state-of-the-art ports (some of the largest ports outside of Asia), custom services and free trade make it a very strategic point for doing business in the rest of the Middle East and wider region. Dubai, within the UAE, for instance, links with the rest of the world very easily and acts as a great bridge from Asia to Africa and the rest of the world.

Nicholas Kramer, Partner, CMS Dubai

designed to help turn the country into a major Eurasian transport and logistics hub while modernising the country's road and rail networks.

Africa

Respondents unanimously agree that BRI-related investments into Africa will increase going forward. Similar large numbers of participants in our research note the continent for its current opportunities (6.1 out of 9). In particular, investors see project possibilities in road and rail infrastructure as well as energy networks.

A recent example of how Chinese money and ambition can transform a country's rail infrastructure came with May 2017's opening of the Standard Gauge Railway (SGR) in Kenya. The US$3.2bn railway links the capital Nairobi to the port of Mombasa and is Kenya's largest infrastructure project in the country's history. As well as significantly improving Kenya's infrastructure and economy, the country's government hopes that the investment helps the country reposition itself as the strategic gateway to East Africa for trade.

> Chinese entities will need to 'test the waters' when moving into new jurisdictions and new areas of business. Because of this, their ability to assess risks is going to be complicated, however, if they accept that they don't have a full picture of everything on the ground and plan accordingly, with the proper resources and regional experts in place, they can avoid taking on unnecessary risks.
>
> *Munir Hassan, Partner, CMS UK*

There have also been a number of BRI-related investments made in Kenya's ports, consistent with its maritime ambitions. For example, Chinese construction firm CCCC completed the construction of the first of three Phase 1 berths of a huge new port at Lamu in June, while China Merchants Group (CMG) has been involved in the financing of the US$10bn Bagamoyo Port in Tanzania.

Although legal and regulatory risks have previously proved detrimental to encouraging foreign investment into Africa, prospective investors should feel encouraged by such consistent Chinese investment and foreign policy improvements.

South Asia

South Asia falls somewhere in the middle of respondent rankings in terms of BRI project opportunities at present (6.0 out of 9). As far as investment destinations go, Pakistan has arguably benefitted the most from the initiative. For example, the China-Pakistan Economic Corridor (CPEC), launched in 2014, has been described by China as the largest and most effective of its flagship BRI programs. Given Pakistan's lack of infrastructure development, the CPEC is considered to be something of a pilot for the BRI and therefore a priority for China.

The CPEC has attracted approximately US$60bn in Chinese investment so far, highlighted by major energy projects such as the 660MW Thar coal project (the first integrated mining and power project in the corridor) and the Gwadar Port Project. Strategically located on the Arabian Sea, the port will provide China with a shortcut to the Middle East and Africa via Dubai and Oman.

However, whether international investors will follow China's lead in Pakistan as an investable geography remains to be seen. China came to Pakistan's aid when few other countries were willing to invest due to post-9/11 security concerns. And many other nations in South Asia have been in a similar position, with Iran under Western sanctions while extremist violence kept investors away from Afghanistan, Bangladesh and Sri Lanka.

While 91% of respondents believe that BRI investment into South Asia will increase in the year ahead, many international investors may wait this out until further infrastructure developments are made.

Central and Eastern Europe

Ninety-eight percent (98%) of respondents say the level of BRI investment into Central and Eastern Europe (CEE) will increase in the year ahead, however, at present, the CEE zone ranked low in terms of current investment opportunities (4.5 out of 9). Funding is certainly needed for several mega-projects as well as for industrial development, and investors in our survey cite road, rail and e-commerce/technology as the top three sectors where investment opportunities can be found.

Although export trade between China and Russia has grown strongly since the early 2000s, collaboration on large-scale projects outside of the energy sector is still relatively rare. Some recent examples of energy-related collaboration include China's Silk Road Fund stake buy of Sibur, Russia's largest gas processing conglomerate, and Beijing Gas Group's US$1.1bn acquisition of a 20% stake in a subsidiary of Russia's largest oil producer Rosneft.

Transport investments have included projects such as a US$3.8bn rail link connecting Budapest (the Hungarian capital) with Belgrade (the Serbian capital). There is also the refurbishing of Piraeus Port in Greece, which is majority owned by Chinese SOE China Ocean Shipping Company (COSCO).

BRI investment opportunities in Central and Eastern Europe are expected to open up in the e-commerce/technology sector as part of what China has recently referred to as a new "Digital Silk Road". While few details have been revealed, China intends to help BRI countries build their digital infrastructure in areas such as quantum computing, nanotechnology, artificial intelligence, big data and cloud storage, and prospective investors would be wise to watch this space.

East Asia, Australasia and the Middle East

Although there appears to be limited opportunities within China's East Asian neighbours, recent political developments should provide investors with some optimism. For example, the recent easing of tensions between Beijing, Seoul and Pyongyang could see China and South Korea align some of their economic and strategic interests to stabilise the region.

Equally, despite China and Japan having a complicated history, the Japanese government changed its tune on the BRI last year and voiced its support as it could help Japanese MNCs access and expand in BRI markets. However, this has not prevented Japan from talking with Australia, India and the US about establishing a joint regional infrastructure scheme as an alternative to China's BRI.

Although 42% of respondents expect BRI investment in Australasia to increase significantly in the

year ahead, investors may be wise to keep their BRI powder dry until the geopolitical situation becomes clearer. Either way, both Australia and New Zealand stand to benefit from improvements in the overall flow of trade and access to BRI markets.

While barely on the radar for respondents, the Middle East is nonetheless important to the BRI. While the region features many of the challenges and risks (political, legal, regulatory and infrastructure) common in emerging markets, its location will make it critical in linking China and Central Asia with European and African markets.

Investor insights

One of the key barriers Chinese environmental companies have faced when looking at opportunities in ASEAN is that of localisation. They're not very knowledgeable about the regulatory environment and industry standards and practice there, and they often don't have a local team on the ground, so, though a promising market, they've found it difficult to maximise their investments in that region. What we're seeing is Chinese companies searching for and forming teams with local partners to help navigate the local regulatory regimes as well as business opportunities.

Joseph Sun, Asia Pacific energy and environmental investor

Regional focus: The Middle East and North Africa

Amir Kordvani, CMS Partner and Head of Projects (Middle East), and Nicholas Kramer, CMS Partner (Dubai), discuss opportunities and risk mitigation when investing in the Middle East and North Africa (MENA).

Amir Kordvani, CMS Partner and Head of Projects (Middle East)

Nicholas Kramer, CMS Partner Dubai

What are MENA's advantages and opportunity areas compared to other regions along the Belt and Road trade corridors?

Nicholas: When we look at MENA, specifically within the Middle East, the United Arab Emirates (UAE) stands out as one of the main pockets of opportunity. For one, the UAE's state-of-the-art ports (some of the largest ports outside of Asia), customs services and free trade make it a strategic point for doing business. Dubai, in particular, acts as a springboard from Asia to Africa, and for that matter, the rest of the world.

Various free trade zones have been established in the UAE to encourage foreign investment and simplify the process of setting up a business, and the UAE's expertise in Islamic finance is another advantage, providing Chinese developers with access to regional liquidity.

North Africa is the natural geographic link between Asia and the African continent. For example, China Harbour Engineering Company began work in August 2018 on a new terminal in Sokhna Port, near the Suez Canal, which will increase international (including Chinese) shipping traffic.

Amir: While Chinese firms and MNCs have traditionally focused on energy projects – oil and gas and increasingly renewables – other sectors are opening to offshore investment. For instance, in the Middle East, retail and supply chain, leisure (hotels, resorts and anything related to tourism) and fintech are all industries that will receive attention in the years ahead, driven by very positive demographics. In that vein, the region's growing middle class is creating demand for new products and services – and international firms, especially those from China, that are able to meet this demand will be the main beneficiaries of these demographic changes.

Equally important, a large and growing talent pool is making the MENA region more attractive. For instance, we're seeing increases in the workforce in the manufacturing and IT sectors as MENA becomes more competitive and may soon challenge traditional hot spots for these talent groups.

What have been some of the key emerging trends in MENA with respect to the Belt and Road Initiative (BRI)?

Amir: Over the past two years, we've seen Chinese firms take a more aggressive approach toward their investments. This has been happening in sync with policy changes within the region that are supporting this inflow of capital and trying to cultivate further interest.

Generally, the market for investment and projects in these jurisdictions is very much evolving, with several countries pioneering programs to attract further investment. UAE, for example, has implemented pro-investor laws and regulations and is striving to make the project bidding process more transparent. Similarly, Saudi Arabia is keeping pace, introducing new investment legislation and opening various sectors to foreign investment. There's been a massive policy shift toward renewables there, with ambitious goals for clean energy to be a larger contributor to the power generation mix by 2030, which will require investment and participation from offshore capital.

In Africa, China has pledged US$60bn, although no details have been given on specific projects. We have been advising major Chinese companies in relation to energy projects in the Horn of Africa (including a US$4bn gas pipeline project in Djibouti), which appears to have become the gateway for Chinese investment into the continent.

Beyond heavy infrastructure, what will be MENA's role in contributing to the Digital Silk Road?

Nicholas: Outside of the UAE, there are several geographies in the Middle East where technological progress is being made. For example, Bahrain is transforming itself into a hub for innovation to attract Chinese start-ups and tech companies. The Bahrain Economic Development Board entered into two memorandums of understanding in July 2018, the first with China Hi-Tech Transfer Centre to enhance cooperation and the second with Shenzhen Belt Economy & Technology Co-operation Association to promote the exchange of information regarding business and investment projects.

China's digital investment in MENA is already prominent. China's Alibaba has made a US$600 million investment in the port of Jebel Ali, to construct a "tech town" which will house 3,000 firms specializing in developing robotics, AI and new mobile apps. Additionally, Huawei recently opened the first technology company in Qatar, which has 100% foreign ownership, demonstrating Qatar's encouragement of foreign investment. Xiaomi, another of China's largest phone manufacturers, has opened stores in Dubai and Cairo.

What are the main challenges/ risks for investors? How can they manage these risks?

Nicholas: Security risks and country-specific conflicts will be largely out of an investor's control, although staying abreast of geopolitical trends and having eyes on the ground will help investors develop an effective risk mitigation strategy and coordinate with the proper authorities to advance certain projects. For political risk, it is important to conduct thorough due diligence of the political environment and especially any entities you are doing business with, to identify relationships that can both help and hinder investments.

Ultimately, whatever risk assessment or due diligence is being done, it is important to start from a point of zero and work from there. Have advisors on hand who can provide guidance on appropriate set-up options across geographies and industries. When entering into contracts, know the standard forms used and market standard provisions, which can differ significantly from other markets, like Europe.

Amir: Despite the blueprints established by previous Chinese investments, we continue to see companies from China struggle, especially in the Middle East. Their knowledge of the local business culture is still very limited and many continue to apply strategies that they've developed in other emerging markets, which often prove ineffective at best and costly at worst.

The bidding process has been a particular pain point. Many Chinese companies are used to winning contracts through direct negotiation or political connections, as is the case in their home market, so the competitive bidding process commonly used in places like UAE and increasingly in Saudi Arabia (as the two countries become more transparent) has definitely been an obstacle.

Because of this, when Chinese investors do see an opportunity, they may be tempted to jump in without conducting proper due diligence or consulting local advisors. We've seen instances where Chinese companies have found themselves in very hot water because they didn't investigate the asset or assumed contractual obligations without understanding the repercussions, which in turn resulted in project delays and quality of service issues.

In addition to this raising legal issues and lost value, this could cause something of a reputational issue for Chinese firms. Local investors prefer to partner with Chinese firms, which are not known for significant project delays and performance issues.

Spotlight on sectors

Infrastructure continues to be the beating heart of BRI investment, however, new sectors are opening for investment amid increasing digital demands.

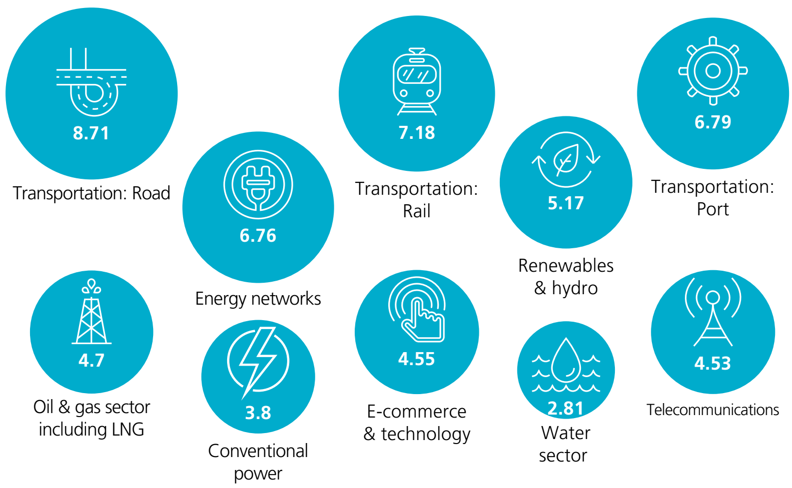
China is financing huge improvements in BRI infrastructure such as IT, ports, rail, roads and telecoms. International investors are likewise getting involved, albeit more cautiously. However, disruptive megatrends, such as rapid urbanisation and technological innovation, are also changing the way that governments and investors think about infrastructure as an asset class.

While governments are conscious of the need to mitigate the chances of traditional infrastructure assets losing relevance, prospective investors have the opportunity to deploy capital during the different phases of the BRI's lifecycle. So far, this has become evident in two phases of project investing and execution: one focusing on infrastructure developments in the transportation, energy and communications sectors; a second that will include, among others, a focus on IT and digital technology, education, financial services, medical care and trade.

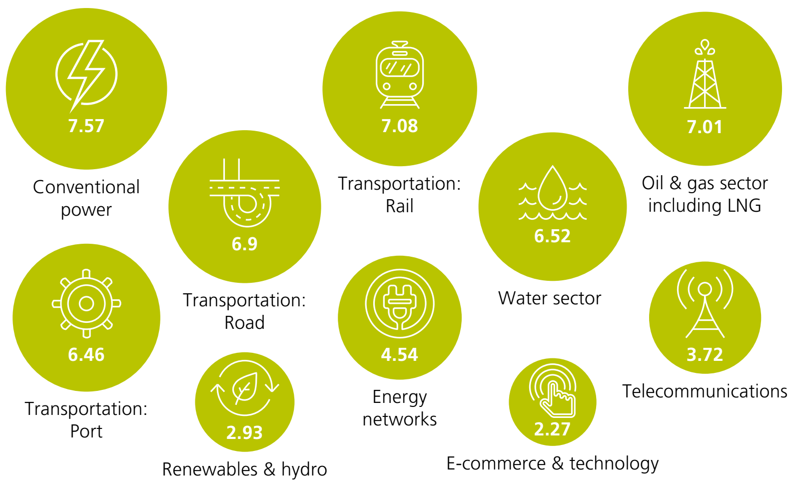
Phase one: Roads and rails, ports and pipes

Some projects under construction in the initial phase include a network of highways, railways, air and sea routes, gas and oil pipelines, power grids and internet connections. This is where respondents see the

Which of the following sectors offer the most investment opportunities for BRI investors? (Please rank from 1 to 10 where 1 refers to 'least opportunities' and 10 refers to 'most opportunities')



Which pose the most challenges/risks from an investment standpoint? (Please rank from 1 to 10 where 1 refers to 'few risks' and 10 refers to 'most risks')



most opportunities, given the need for modern infrastructure in many key economies along the BRI trade corridors. As respondents have mentioned, while construction companies and infrastructure investors may benefit in the short term, these projects will ultimately pave the way for manufacturing and services companies/investors to use these new trade routes to expand into new markets, which respondents noted as one of the top drivers for Chinese and international investor groups.

> The Digital Silk Road – projects specific to IT and tech – will be an important part of the BRI going forward. China is quickly becoming a leader of tech in many fields, and the government wants to see China taking that tech out to the rest of the world. Often they may partner with MNCs who could also benefit from new market opportunities.

Nick Beckett, Managing Partner, CMS Beijing

Respondents also agree that risks in transportation and energy/power are higher given higher capital outlays required to start these projects. Geopolitical uncertainty and various environmental risks are also considerations.

Phase two: Beyond heavy infrastructure

Just as completion of the initial phase will drive secondary phase infrastructure in sectors such as technology, telecoms, logistics and basic services for BRI participants, phase two will in turn lead to the establishment of new distribution channels for a range of consumer goods.

It is predictions for the second phase of BRI investment where certain key differences exist between Chinese respondents and their international counterparts. For instance, Chinese respondents say telecoms will offer more investment opportunities than those in oil and gas. This should not come as a surprise as these opinions are consistent with China's latest 5-Year Plan, which emphasizes the need for Chinese enterprises to seek out tech investments abroad.

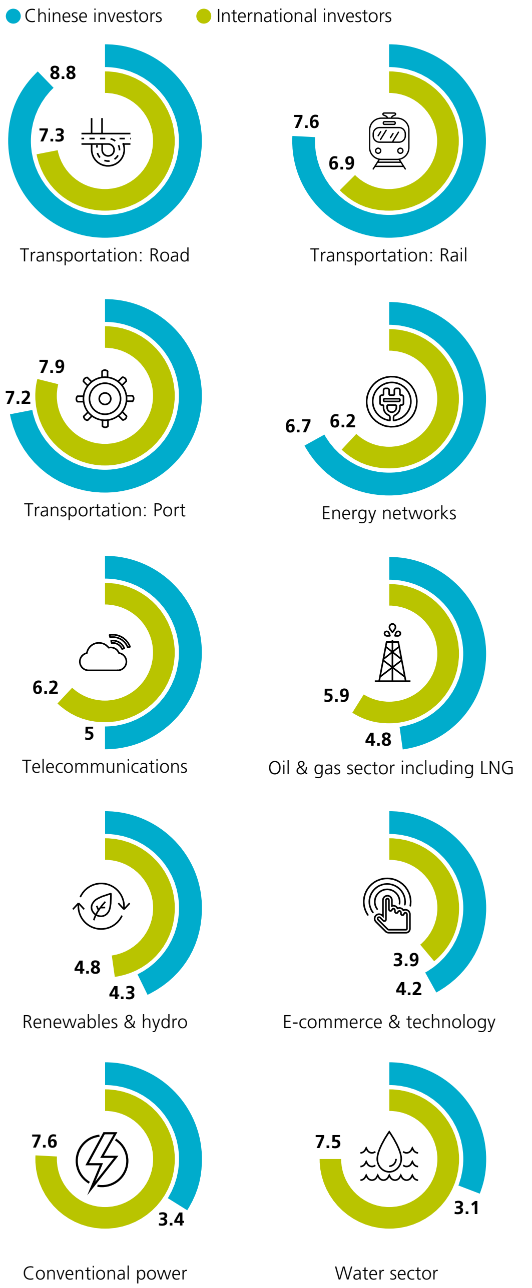
Meanwhile, despite growing global interest in sustainable energy and China's rise as a leader in clean tech, international respondents anticipate greater opportunities in renewable energy and hydropower investment than their Chinese counterparts. As international respondents mentioned, as dependencies on oil and gas decline across BRI countries, demand for sustainable sources of energy and power will be in high demand – the question is, how long will it take this trend to materialize and what are the geographic realities of applying clean tech solutions along the trade corridor?

The Digital Silk Road

Talk of a new "Digital Silk Road" was first mentioned in July 2015. Despite a lack of specifics so far, it involves investments in sectors such as e-commerce and telecoms to scientific cooperation and the smart economy and aims at helping small and medium-sized enterprises further engage in the global supply chain and access international markets.

The digital side of the BRI involves construction of cross-border optical cables and mobile networks, as well as the development of e-commerce between China and BRI countries. Improvements in connectivity will lead to improvements in e-commerce, and a number of China's most high-profile e-commerce players are making significant investments in digital payments, ride-sharing and on-demand transportation. These are not limited strictly to Chinese firms, and investors overall might consider taking note of opportunities in the technology and telecommunications sectors in countries such as Sri Lanka, Cambodia, Afghanistan, Bangladesh, Laos and Yemen, where fewer than 20% of households use the internet.

Which of the following sectors offer the most investment opportunities for Chinese investors and international investors? (Please rank from 1 to 10 where 1 refers to ‘least opportunities’ and 10 refers to ‘most opportunities’)



> When participating in infrastructure projects, significant consideration needs to be centered on making sure the company has the rights it needs to actually build and deploy capital. This can be a complicated process as different investors often enter these projects at different phases.

Munir Hassan, Partner, CMS UK

Investor insights

In my opinion, a critical element of the success of the BRI is its environmental sustainability. Over the past years, the focus of the initiative has been mainly on large projects – like roads, airports and thermal power plants – however, these investments may not have addressed enough on their environmental impact and may not balance for sustainable development in the long term. I believe what we’ll likely see is a gradual shift in project emphasis and capital, from heavy infrastructure investment to more sustainable areas such as distributed renewable energy and the environmental sector.

Joseph Sun, Asia Pacific energy and environmental investor

Belt and roadblocks: Assessing and mitigating risks

Despite market optimism, more than 80% of Chinese and international respondents say political risks weighed heavily on their BRI investments, mentioning that legal frameworks and political uncertainties are the greatest challenges to future projects.

No investment comes without a degree of risk, and this is equally true of BRI investments. Many of the more than 70 BRI countries in Asia, the Middle East, Africa and Europe have vastly different legal and economic systems, with a good number of these judged to be "high risk" by Transparency International's Corruption Perceptions Index (CPI).

A recent study by Washington, DC-based consultancy RWR Advisory Group showed that some 14%, or 234 out of 1,674, Chinese-invested infrastructure projects announced in 66 BRI countries since 2013 have encountered problems such as concerns over national security, objections over labour policies, performance delays and public opposition to projects.

Other categories of risk that need to be managed include foreign investment restrictions, regulatory challenges, political risks (which differ from country to country), commercial and contractual risks against counterparties, litigation in local courts, and language and cultural differences.

Political and macroeconomic concerns were the top risks that more than 80% of those surveyed in both respondent groups say present the greatest threat to BRI investments. Respondents say political volatility in these jurisdictions is a top-of-mind issues, and in that vein, corruption at various levels in these jurisdictions may also come into play. For these reasons and others, legal frameworks (according to more than 90% of both investor groups) and national governments and political issues (according to 90% of Chinese respondents and 80% of international respondents) will be among the most pressing challenges they are likely to face in future BRI investments.

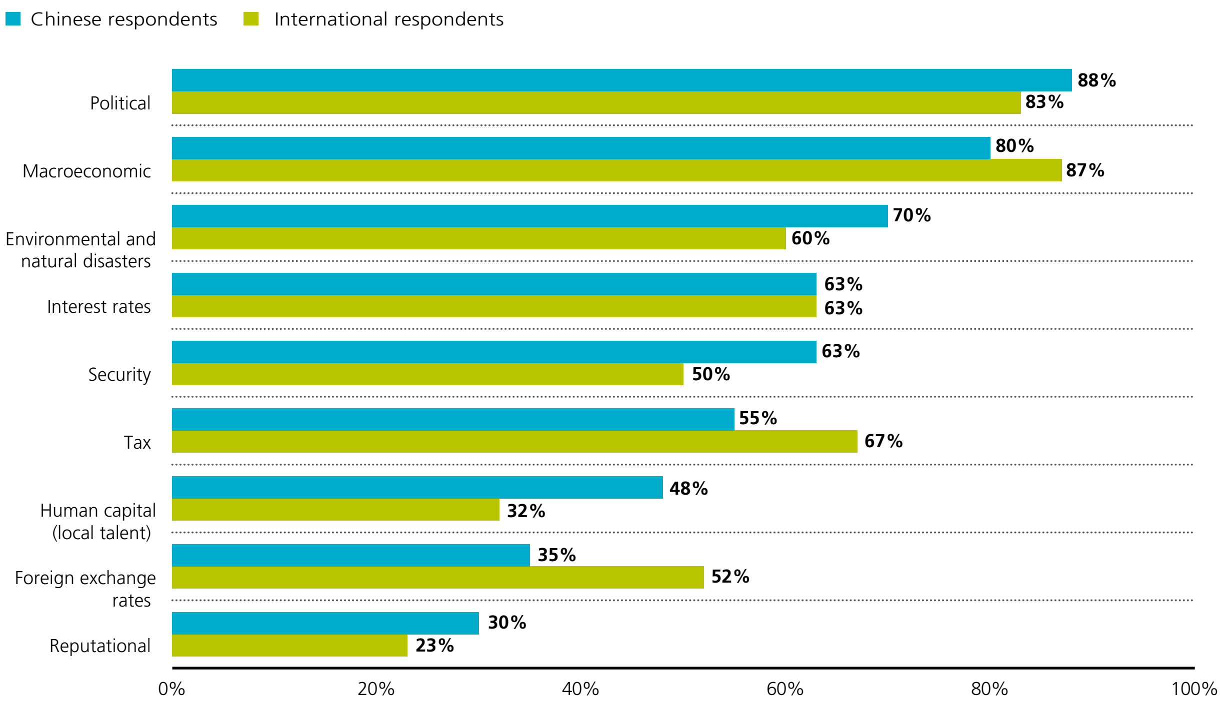
Macroeconomic risk may be even more unpredictable than political issues. As respondents note, economic changes such as recessions are difficult to predict, and given the scale of the BRI and economies involved such uncertainties may be multiplied.

Surprisingly, human capital and reputational risk were not considered to be among the greatest risks to BRI investments, each receiving less than 50% of sentiment from both groups of investors. The complexity and engineering skill required of many of these projects demands experts with not only the know-how but experience in managing and completing these efforts. While certain target jurisdictions may have

China is taking measures to expedite the dispute resolution process, having established a new international commercial court, and is seeking to bring together litigation, mediation and arbitration into one platform. Although as yet untested, it may make the litigation process quicker, easier and more accessible for numerous investors, including multinationals.

Nick Beckett, Managing Partner, CMS Beijing

Which of the following do you think represent the greatest risks to BRI-related investments in your primary target geography/country of focus? (Please select all that apply)



a large pool of potential employees to draw from, others lack this local talent. This human capital deficit explains why respondents rank operational difficulties as the third most difficult challenge.

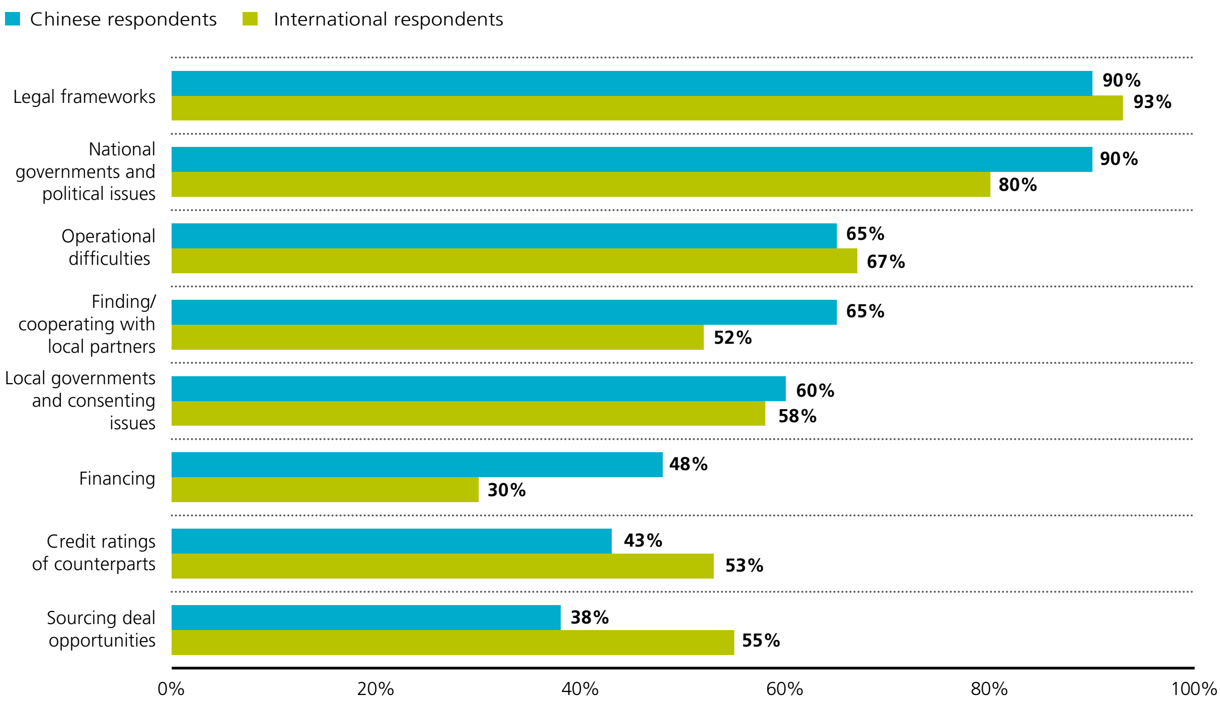
Differing views: Local partners and sourcing deals

While respondents overall agree on many of the top challenges they will face, opinions between Chinese and International respondents diverge in two key areas: finding/cooperating with local partners; and sourcing deal opportunities.

From respondent commentary, international investors have had more success with their local partnerships. Part of this stems from historical trends: many MNCs have much broader experience and operational expertise investing globally and therefore have developed a playbook for forging the local partnerships necessary to succeed in international projects. For them, having a local team and "boots on the ground" is a commonplace tactic that Chinese counterparts may not be adopting.

International investors, however, continue to have more trouble than their Chinese counterparts when it comes to sourcing deal opportunities (a point made earlier in this report). This should not be too surprising given that the initiative for the more than 270 BRI cooperation projects or agreements signed to date has nearly always come from the Chinese side. As China has never published a comprehensive list of BRI projects or deals, it can seem very hard to access the right opportunity. But while it has been suggested that the BRI is a deliberately vague concept so that China can include anything it wants at any given time, ultimately investors will need to be nurturing relationships on the ground in target locations in order to identify suitable openings.

Which of the following present the most challenges to BRI-related investments in the next 12-24 months? (Please select all that apply)



I do not believe the Belt and Road Initiative will materially increase the risk profile of any particular project by nature of it being branded as a "BRI Project". In fact, because of the profile it brings, it may bring new projects to market and increase investment interest in existing projects. Provided they continue to review new opportunities based on project development fundamentals, MNCs really have nothing to lose.

Adrian Wong, Partner, CMS Singapore

A key consideration when contemplating an investment in the BRI is mitigating and controlling the associated risks. It is important to be aware and take advantage of the available protection under the applicable bilateral and multilateral investment treaties. When risks materialise, investment arbitration provides a powerful and effective tool for investors to protect their interests.

Nicolas Wiegand, Managing Partner, CMS Hong Kong

Strategies and lessons from the dealmakers

High-risk investment zones require more than just risk awareness and a plan. Respondents say an expert team with local insights will help reveal hidden challenges and increase the odds of yielding value.

To assess strategies behind BRI investments, we asked Chinese respondents who have engaged in cross-border infrastructure investments (22 respondents) or international firms who have partnered with Chinese sponsors (19 respondents) to elaborate on the process and challenges.

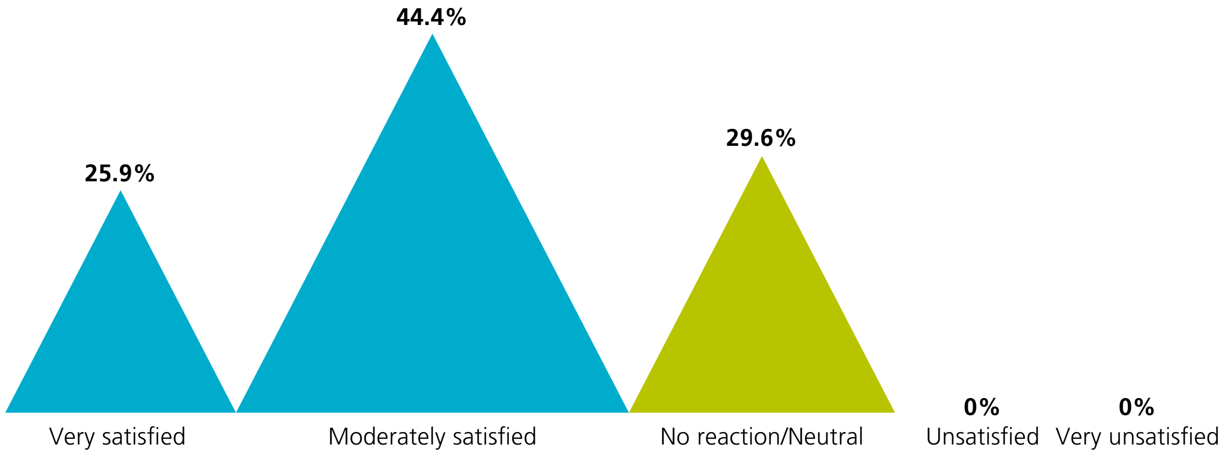
While many of the countries along the BRI are developing nations in economic transition – and therefore high-risk zones for compliance issues – large-scale, debt-financed, long-term infrastructure projects are inherently risky. In the same way a well-executed investment can enhance stability in a recipient country, a poorly executed one can increase those risks.

In our research, however, 70% of respondents who had already completed at least one BRI-related infrastructure investment said the outcomes of their projects yielded satisfactory results. However, a noticeable one in three respondents said results were neutral.

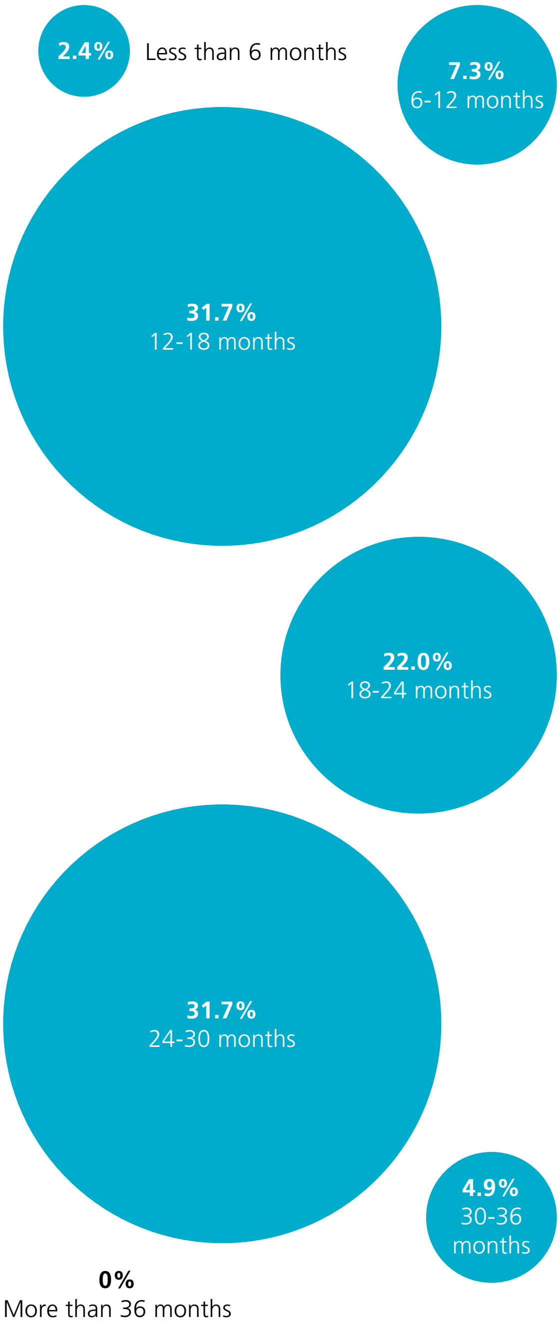
Given the list of challenges, uncertainties and overall risks mentioned in previous chapters, these results seem reasonable. However, there is certainly room for improvement – especially with regard to timing, where 54% of respondents said projects took longer than expected – to maximize results as projects become more complex.

Overcoming challenges
For international investors, the biggest challenge from previous infrastructure investments came from developing an investment/acquisition candidate list (4.3 out of 5.0) followed by rating and ranking these candidates (3.9).

Please rate your level of satisfaction in terms of the process and outcome of your involvement in Chinese outbound infrastructure investment?



How long did it take to complete the most recent Chinese infrastructure investment you have been involved in, from deal sourcing to close?



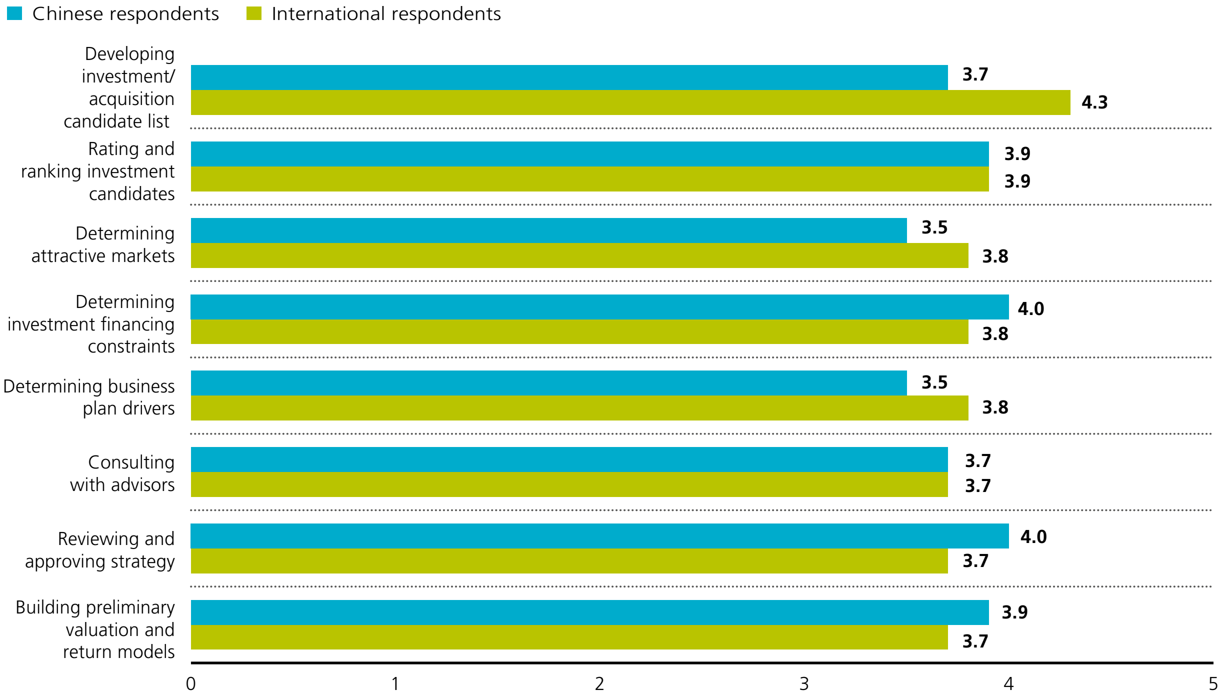
> Having a good contract – one that has a robust arbitration clause – is definitely advisable, however, the greatest consideration should be given to enforcement and whether contractual obligations are enforceable in the jurisdiction where the project will be carried out.

Ulrike Glueck, Managing Partner, CMS Shanghai

> Investment risk is specific to each jurisdiction, but common risks include compulsory acquisition, resource nationalism, ability to repatriate profits, local employment issues, corruption or transparency issues and others. These can all be managed with good due diligence, risk management and engaging the right legal counsel as early as possible.

Marc Rathbone, Partner, CMS Singapore

In your view, which of the following tasks involved in your strategy assessment process do Chinese investors find most challenging? (1 – low challenge, 5 – high challenge)



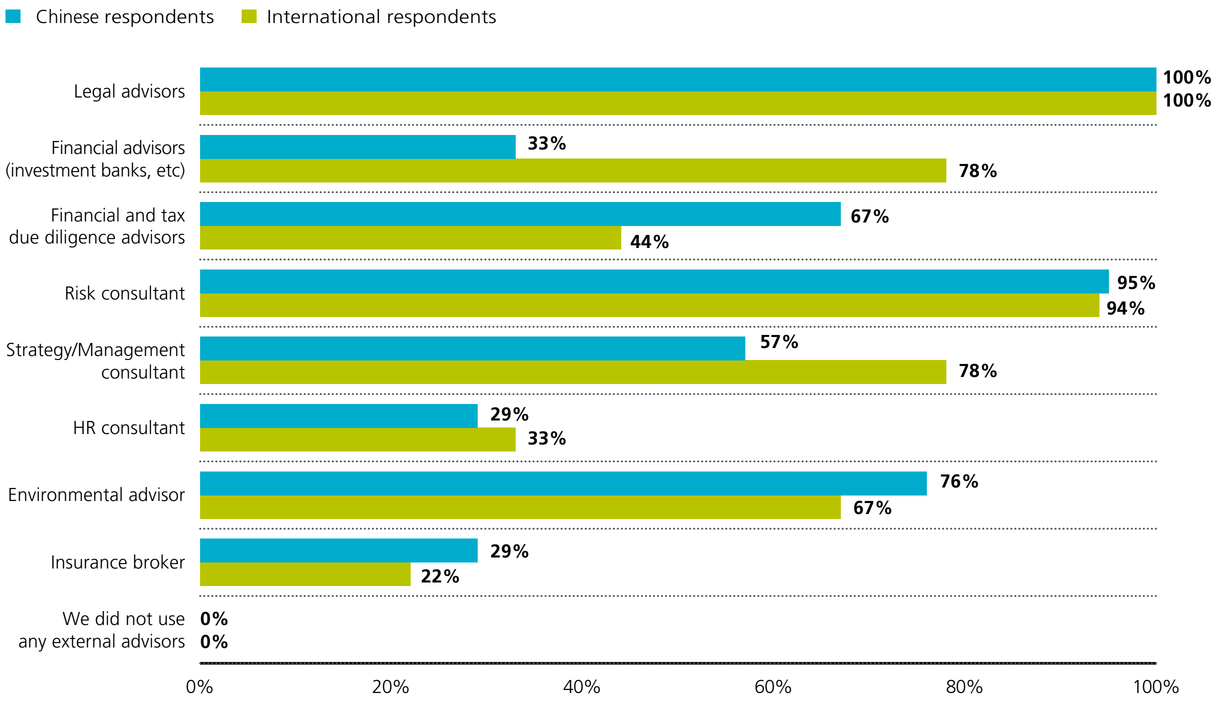
For many, it was a matter of lacking deal experience in certain geographies and with certain partners (in this case, going in with a Chinese counterpart).

For Chinese investors, challenges revolved around reviewing and approving the strategy (4.0) and determining investment financing constraints (4.0). Finding investments/acquisitions targets was much less difficult, perhaps given the head start Chinese investors have had in managing BRI projects in jurisdictions that are much less "foreign" (given closer proximity).

Advisors and third parties

For both investor groups, consulting with advisors ranked relatively low on the list of challenges faced. In both cases, investors made good use of consultants to support a variety of matters, foremost among which were legal concerns addressed in the previous section (page 23). Unsurprisingly, both Chinese and international investors consulted with legal advisors to help navigate the often opaque and complex legal and political environments of Belt and Road countries. And also in both cases, these parties found value in legal

Which of the following external advisors did the Chinese investor consult on your/its most recent Chinese outbound infrastructure investment? (Please select all that apply)



advisors, noting that they were effective in helping capture a positive outcome on their projects.

International investors also found value in financial advisors and strategy/management consultants. Chinese investors shared similar sentiments.

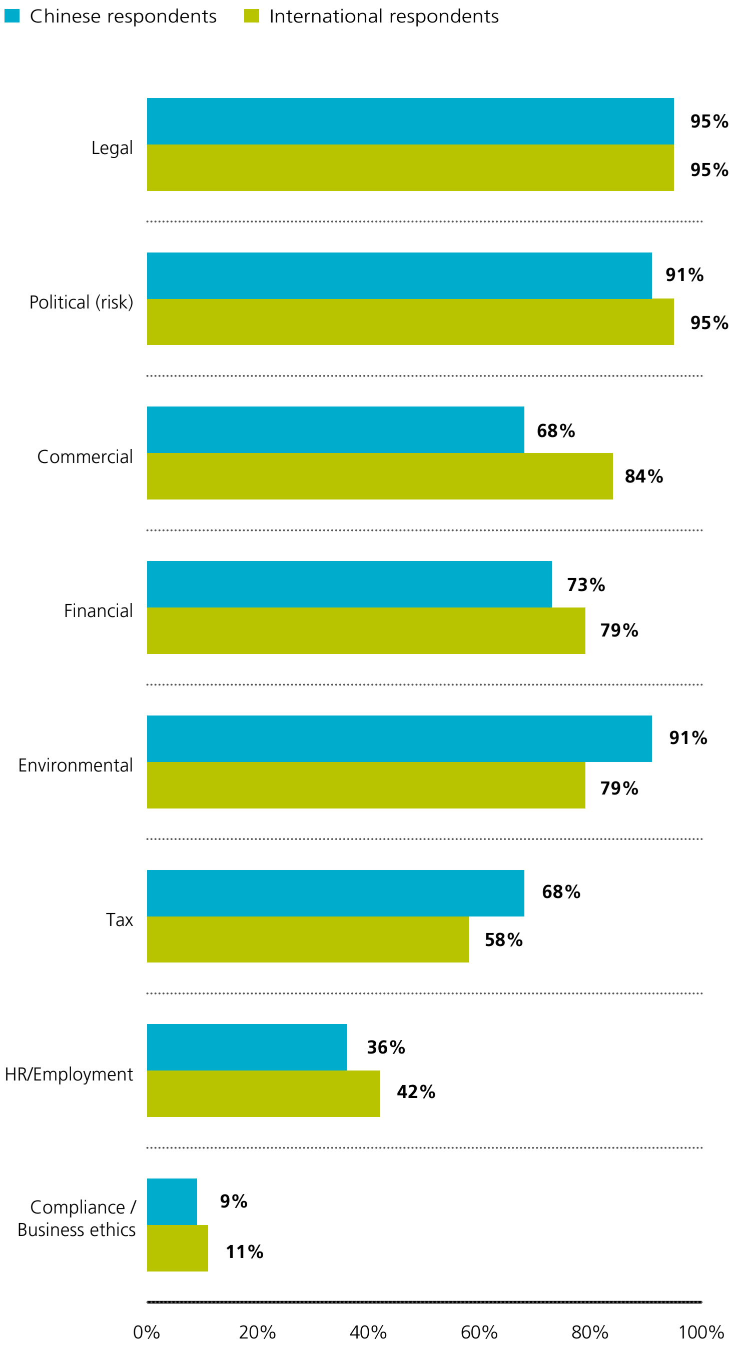
The importance of due diligence
Given legal and political risks, it is unsurprising that investors dedicated the most time and resources to due diligence in these fields. Indeed, 95% of respondents said legal due diligence was a priority in their most recent infrastructure transaction, while 93% said investigating political risk received similar attention. For both fields, respondents also said that additional time/resources would have been useful.

Respondents also highlighted environmental concerns as deserving time/resources, especially given the sometimes unpredictable weather conditions in some countries and the nature of climate change.

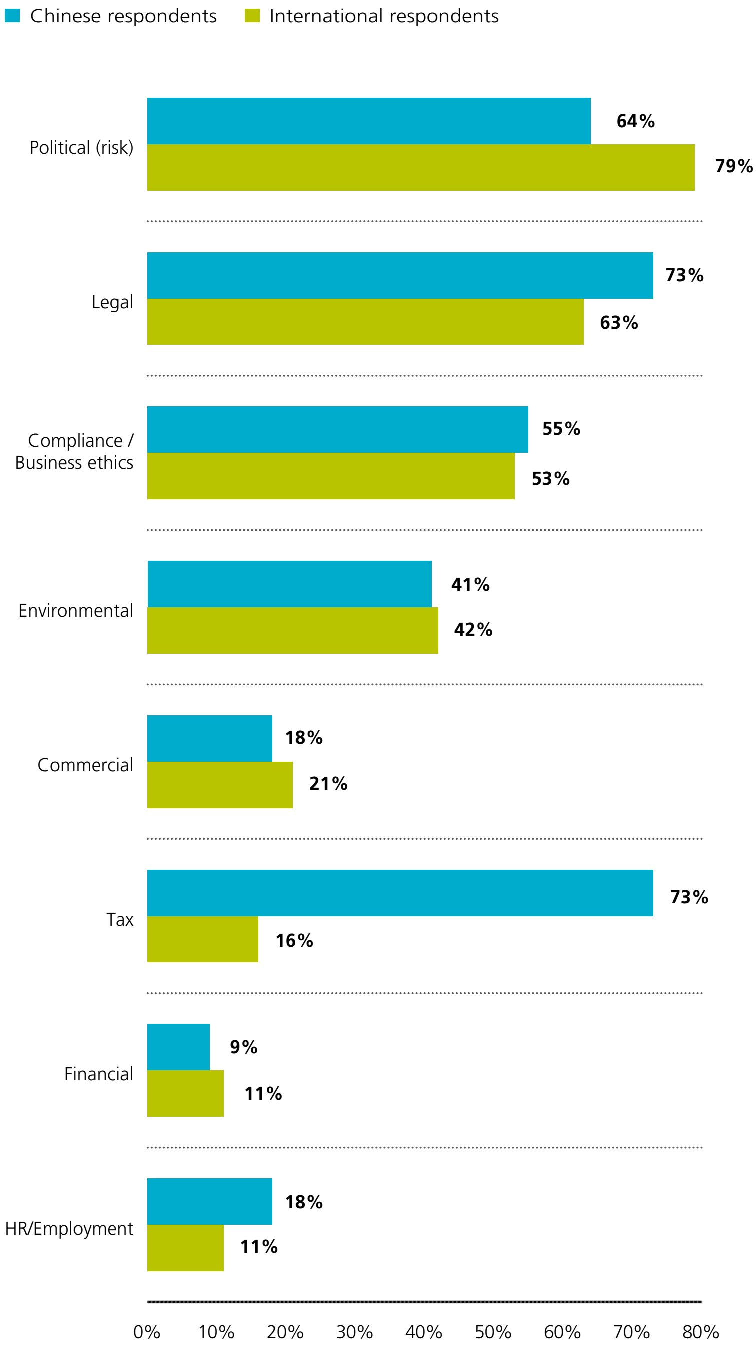
Compliance and business ethics also ranked highly, with both Chinese and International respondents saying it deserved more time and attention. Many respondents noted the changing nature and reach of global enforcement, with anti-corruption enforcement increasing around the world.

Investors should take an ad-hoc approach to risk management. They should also ensure sufficient monitoring, encourage whistleblowing, and follow up on any tip-offs.

What type of due diligence did investors complete in the most recent Chinese infrastructure investment you have been involved in? (Please select all that apply)



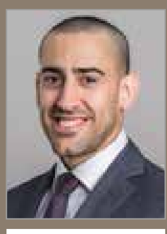
Which areas deserve more time/resources? (Please select all that apply)



Investor insights

Maintaining good relationships with the host government at both the central and provincial level are key to mitigating any political risk. Projects involving more sensitive industries (e.g. energy, mining) need to go the extra mile and ensure they are directly plugged into local communities, employing as much local labour as possible, building critical infrastructure and ensuring they leave behind a positive legacy.

Tim Warren,
Head of Credit Lines,
Zurich Insurance



Paving the way: Siemens AG on Belt and Road investment and risk assessment best practices

Dr. Christian Greissinger, General Counsel for Asia Pacific at Siemens AG in Singapore, discusses the German conglomerate's experience investing in BRI projects and geographies, providing an inside look into the process and playbook for delivering deal success.

Dr. Christian Greissinger, General Counsel for Asia Pacific at Siemens

What have been the most valuable lessons Siemens has learned from its experience and involvement in the BRI so far, as well as from the decades of operating in many of the key economies along the land and sea trade corridors?

Two of the most valuable lessons we've learned in terms of formulating a BRI strategy and operating in these geographies is to be flexible in respect to the potential business models – that is, to not have project parameters that are limited to predefined and traditional ways of doing business – and to be present, by having or developing a strong local presence in China and the BRI countries and understanding of the local cultures where we operate.

Flexibility and the ability to be creative in developing and advancing project ideas is critical given the abstract nature of the BRI. The BRI is much more than just a series of infrastructure projects across multiple geographies; it is an idea, one that lacks specific definition but provides almost limitless possibilities – be it building heavy infrastructure or exploring new digital opportunities – for investors with the right imagination and risk appetite.

Equally important is the corporate and operational presence you have in the geographies where you want to invest. This local presence goes beyond just having a postal address or a permanent establishment for completing a project. It means having a business presence and positive impact where you work, developing deep ties with the local market and having your own infrastructure in place to respond to and capitalise on opportunities as they arise.

For Siemens, we have a long tradition of not only investing in countries on a project-related basis, but in operating sustainable regional footprints and value chains that allow us to develop an understanding of the local market and culture, both the nuances and best practices, in addition to the market-specific risks. We also emphasise building the relationships as a trusted partner that will help you succeed and navigate in these markets.

What are some additional benefits of having a local presence?

Having a local presence, especially when operating in China, is incredibly important in understanding the business requirements and the long-term strategy of the stakeholders in China including the Chinese government. This understanding is crucial when seeking participation in some of the larger flagship projects in China and many BRI countries or when trying to establish what the Chinese offering in these projects will be.

It is always important to create a win-win constellation which benefits all stakeholders. For instance, in one of our recent projects, we were building a power plant. Our Chinese EPC partner contributed the construction materials and building process. That was their offering and contribution. Ours was to contribute products and solutions, the advanced tech equipment. Other investors can expect similar arrangements.

Partnerships and local presence can also help to identify risks in the markets where you operate, is this correct?

Absolutely, particularly as it relates to gauging the local political climate, which in many of the emerging and frontier markets within the BRI can be quite volatile. In some of the countries where projects are located, political stability is far from guaranteed and political risk is simply going to be part of the process of investing in these geographies. It's difficult to completely mitigate or avoid, and investors must be aware of changing licensing or regulatory requirements that often happen because of political changes.

There are, however, ways investors can fortify their strategies and investments against these risks and others. First, local intelligence and ground-level perspective is a must. Sometimes this will take the form of having overall experience operating in the country or consulting external advisors, but knowing the market is much more important than simply being in the market.

Likewise, flexibility comes into play. Many companies will enter these jurisdictions with a one-size-fits-all approach, doing business similarly to how they do business in their home market. This is only going to expose these parties to a litany of risks that could otherwise have been avoided.

From our perspective and based on our experience, you cannot go into these countries without first properly analysing the market from a legal angle, looking at existing regulations and licensing requirements from a historical and forward-looking perspective. Also realise that the legislative and regulatory environment in some of the markets leaves room for interpretation – business practices and even laws can be very gray, and you must be able to determine which risks are paper risks and which may actually impact the business or project.

If you want to participate in the major infrastructure projects, or any project for that matter, you need to do a 360-degree risk assessment and whether you have the risk appetite to see the project through to completion if challenges arise. For Siemens, our greatest advantage is that we've had experience in many of these geographies for decades, but for investors relatively new, having experienced advisors on your investment team is an absolute must.

What are the other major challenges investors face?

Corruption and bribery risk is another area that deserves specific attention and consideration. Across many of the emerging and frontier markets of the BRI – for example, in many parts of ASEAN – these risks are quite prevalent and it's clear you have to have a very robust compliance program in place to root out these problems and remedy them.

Siemens, for example, has a zero tolerance compliance program toward corruption. Our system revolves around three prongs: prevent, detect and respond – and this has so far proven effective in preventing unnecessary risk exposure in certain high-risk geographies. For each business partner we employ, we conduct rigorous due diligence without exception and – if required – detailed compliance training.

Sometimes we must consult external advisors to make sure that certain business partners are complying with the rules. In case of any doubt, we do not cooperate with such partners and look for alternative options. If you want to be successful in these countries, you better make sure that you have a solid compliance process in place.

Due diligence is certainly an important component of any investment strategy, especially in emerging markets. Yet many investors still get this process wrong. Where are investors making the most mistakes?

One thing that investors must realise is that if you want to do business in an emerging market or high-risk geography, you really have to start from zero when you're conducting due diligence. That means that if you're investing in such markets, this process needs to start from a blank slate in terms of the investigative work you do into the legal and regulatory environment, financial capabilities of partners, potential compliance challenges, technical capabilities of various parties involved, among other matters. You have to do everything in a very diligent manner and you have to do it right.

Another thing to realise is that even when you conduct due diligence there will still be surprises. Never underestimate the amount of time it takes, or the amount of capital and other resources, to assess the risks properly and to produce a picture of what is going on, what the risks are, and how you can manage your exposure.

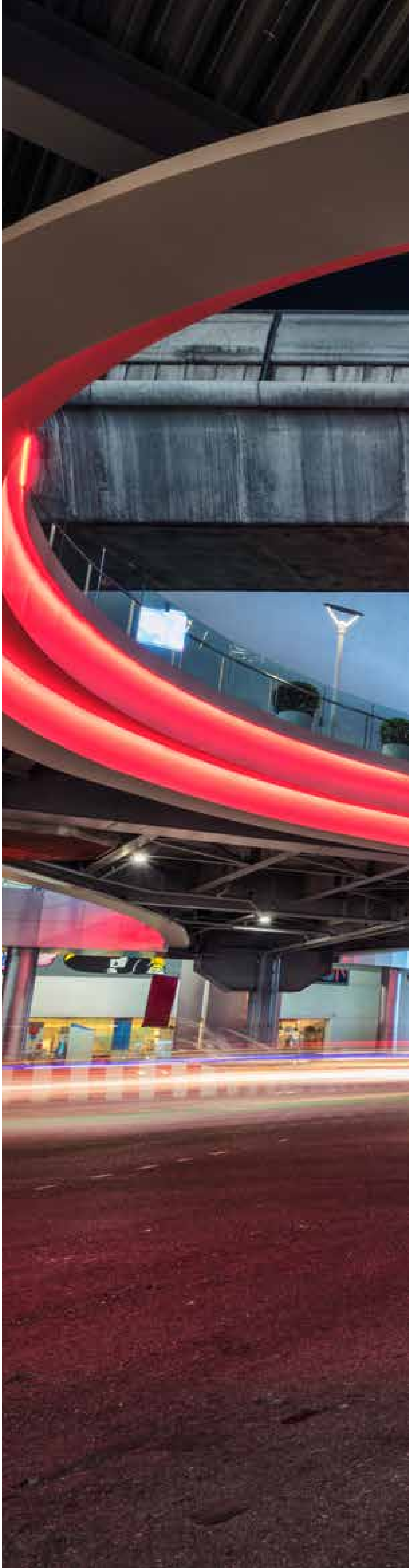
Conclusion

Investment into BRI geographies and relevant industries looks set to remain strong in the short to medium term as both Chinese and international investors are optimistic about unfolding opportunities and their ability to manage risks.

Our survey reveals a growing sense of optimism for BRI investments in markets from Asia to EMEA. There is also rising confidence among international investors that they too will be able to participate, if not en mass, then at least generally and with increasing frequency in the year ahead. If this holds true, the BRI will become a truly international initiative as further international involvement, and increasing commitments from private capital, help expand the Belt and Road's reach, scale and focus.

Nevertheless, just because it is becoming easier to participate doesn't mean it will be any less risky. As our survey illustrates, both Chinese and international investors are keenly aware of the obvious and not-so-obvious risks prevalent in BRI projects, many in emerging markets where lack of transparency and various political, legal and economic uncertainties can raise the spectre for project "hiccups" (at best) and outright failure (at worst). More so, their experience sheds light on key areas where dealmakers wish they had committed more time or resources to identify and mitigate risks. These insights provide invaluable lessons for future investors.

If investors and dealmakers are to translate positive sentiments into positive, value-creating results, they must not let themselves be distracted from the allure of opportunity and give adequate consideration to the risks, challenges and other potential deal breakers. This involves not only forming a plan, but a team to reinforce investment strategy and determine which projects in which geographies are right to pursue.



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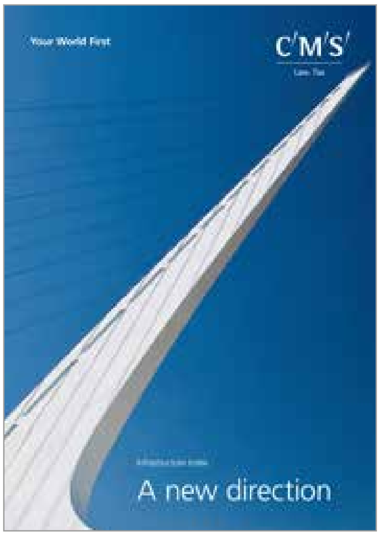

Infrastructure Index: A new direction

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