The Hollywood Reporter

What If China's Money Stream Stops Flowing to Hollywood?

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Illustration by: Kevin Hong

Beijing begins monitoring "irrational" investments in entertainment companies (even while Alibaba pledges $7.2 billion) as one deal falls apart and all eyes focus on Trump.

Chinese companies poured record amounts of capital into Hollywood in 2016 — a trend eagerly embraced by the U.S. film industry. Among the deals: Dalian Wanda Group acquired Legendary Entertainment for $3.5 billion and Dick Clark Productions for $1 billion; Alibaba made a major investment in Steven Spielberg's Amblin Entertainment; and Beijing-based Perfect World Pictures put $500 million into 50 films from Universal.

But tighter regulatory scrutiny and rising protectionism in the U.S. and China now have the industry questioning whether the deal flow could dry up in 2017. Already, there have been casualties.

Indie film player Voltage Entertainment, producer of *The Hurt Locker* and *Dallas Buyers Club*, surprised many in November when plans came to light for a provincial Chinese manufacturing firm to acquire the Los Angeles-based studio for $350 million. But within weeks, the firm, Anhui Xinke New Materials, revealed it was aborting the deal after failing to meet additional documentation requests from local regulators.

The agreement might have squeaked through if it had come a few months earlier. In early December, Beijing announced it was monitoring a pattern of "irrational" overseas investments in several sectors, particularly film, real estate and sports. In an effort to stem capital flight, which was seen as contributing to a devaluation of China's currency, regulators signaled that stricter oversight is on the way. According to a leaked draft of the new rules, Chinese officials said they would scrutinize offshore purchases of more than $1 billion if they were outside the investor's "core business" area. Insiders say deals well below that threshold already are being reviewed as well.

China's concerns are understood to be twofold: that some companies are disguising capital flight as foreign investment, while others are using high-profile entertainment purchases — a trendy sector among Chinese investors — as a short-term strategy to boost stock prices. "This increasing regulatory oversight will make it more difficult for 'concept deals' [Chinese companies acquiring businesses outside of their core business areas] to receive approval in 2017," says Peter Schloss, CEO of CastleHill Partners, a Beijing-based merchant bank focused on the media and entertainment industries.

In light of the new challenges, analysts predict Hollywood sellers will begin to demand larger breakup fees to test Chinese bidders' confidence in their ability to execute deals. But nobody knows how far-reaching the new regulations will be. "Some think that even the well-established entertainment companies may have trouble closing transactions," says Stanley Rosen, a USC professor of political science.

And in the U.S., the deals have caught the attention of Congress and the president-elect. On Nov. 30, incoming Senate minority leader Chuck Schumer said in a letter that the takeover of Hollywood companies by China firms should be examined more closely to determine whether they are being orchestrated to serve Chinese government interests.

At the same time, Donald Trump's appointment of hawkish economist Peter Navarro — author of such books as *Death by China* — to head a new White House National Trade Council inspired Chinese state media to warn of a potential "showdown with the U.S."

Thus far, Hollywood dealmakers have been taking the long view, says Lindsay Conner, an attorney at Manatt with China experience. "People are watching the tweets and responses with interest, but there's no chill yet," he says. "There are protectionist winds blowing on both sides of the Pacific, but there are compelling business reasons for why Hollywood and China have a growing partnership — and those reasons remain."

And China's heavyweight conglomerates have shown little sign of moderating their expansionist ambitions. Alibaba's Jack Ma met Jan. 9 with Trump and pledged to create 1 million U.S. jobs, and Ma's new head of entertainment, Yu Yongfu, said in a memo that he planned to invest $7.2 billion in media during the next three years, with a focus on entertainment content. Yu was named CEO of Alibaba Digital Media and Entertainment Group in October and, he wrote in the memo, "I didn't come to play."

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