Oaklins

VOICE FROM CHINA

QUARTERLY UPDATE ON THE M&A MARKET IN CHINA

2ND EDITION 2018

Oaklins

EXECUTIVE SUMMARY

China's M&A market has become less predictable, as trade tensions between the US and China escalate and the US government steps up its efforts to restrict certain types of foreign investment and the outbound flow of technology.

These developments, which have rapidly accelerated in recent days, are likely to have a lasting impact on China's business growth and economic direction. In response, the Chinese government is placing even greater emphasis on its One Belt, One Road initiative, in an effort to cultivate new markets and more closely align with its European and Asian trading partners.

To fortify its plans and give them even greater momentum, Beijing is undertaking a series of economic reforms. These include greater protections for intellectual property and a push to encourage domestic enterprises in order to reduce the country's dependence on foreign technology.

If you are considering options for your business or would like to discuss more of these trends, please do not hesitate to reach out.

John Zhang
Principal
Shanghai, China
T: +86 21 5012 0990
j.zhang@hfg.oaklins.com

INTRODUCTION

The incipient trade war between the United States and China will have a significant impact on China's economic development and business environment. We are already witnessing the results from the escalating tensions, with a sharp drop in Chinese outbound investments to the US during the first half of 2018.

Former Chairman and President of the Export-Import Bank of China, Li Ruogu, believes the US has fundamentally changed its views on China, and the path that Sino-US relations followed for the past 40 years will no longer continue.

What are the implications of this shift for China's economy and commercial dealings? And what actions will China take to strike a balance between its economic and strategic interests?

According to a report published by Rhodium Group, from January to May 2018, investment by Chinese companies in greenfield projects and acquisitions in the United States fell to US$1.8 billion, a 92% decline from the same period in 2017 and the lowest outflow of investment to the US for any six-month period in seven years. The number of transactions has also markedly declined to the lowest level in six years, from a bi-annual average of 84 since 2014, to 69 in the second half of 2017 and just 39 during the first half of 2018.

The rapid decline in Chinese investments was driven by a "double policy punch", with Beijing cracking down on rapid outbound investment (especially by a few highly leveraged private investors) and Washington's increasing scrutiny on Chinese acquisitions through The Committee on Foreign Investment in the United States (CFIUS). The situation was further aggravated by the US government's increasingly confrontational stance towards economic engagement with China.

Looking ahead, the Rhodium Group report states that the volume and value of newly announced transactions suggest that Chinese investment levels in the US will remain low in coming months. The pipeline of pending M&A transactions remains thinner and the average transaction value far lower than in previous periods.

Among the substantial headwinds to a possible rebound of Chinese investment activity is the Foreign Investment Risk Review Modernization Act (FIRRMA). Passed by Congress at the end of June, the new legislation will expand and increase the powers accorded to CFIUS to scrutinize foreign investment. These will be extended beyond M&A activity resulting in stakes of 10% or more to include other investment modes like venture capital. Further and very importantly, it also requires the US Commerce Department to place stricter controls on outbound transfers of technology.

This greater scrutiny on the transfer of US-developed technology and know-how is likely to discourage Chinese greenfield investments in research and development (R&D) facilities and other innovation-intensive activities – especially in those technologies with potential military applications, such as autonomous driving, machine learning and semiconductors.

Even more ominous are the US$34 billion in tariffs that the Trump administration has imposed on Chinese products, prompting China's government to reciprocate with similar tariffs on US exports. These actions may be the beginning of a trade war between the two countries that has the potential to rapidly escalate. The White House has already said it intends to impose further levies on another US$16 billion of Chinese goods and has threatened to expand the tariffs to cover US$200 billion worth of Chinese products overall. In response, China's Ministry of Commerce issued a statement that by taking these actions, the US "has launched the biggest trade war in economic history so far."

While the direct trade situation with the US has become thoroughly unpredictable, China continues to promote its international economic leadership through its One Belt, One Road initiative. Partly in response to the deteriorating situation with the US, Chinese officials say they are looking to align more closely with other countries, especially those in Europe and Asia. Foreign companies could benefit from China's plans to give them better access to its markets. The State Council, China's cabinet, began lowering the tariffs on imported washing machines, cosmetics and other consumer goods, effective 1 July 2018[1].

The Belt and Road initiative is also expected to open new export markets in Central Asia and the Middle East and provide new channels for direct outbound investment. On 11 April, China's state economic planner released a document to guide the financing and further development of outbound investment, with the aim of generating additional capital for the Belt and Road Initiative and fostering better cooperation with global lenders. The document from the National Development and Reform Commission (NDRC) states that additional funds will be used to help ensure "stable, sustainable and safe capital sources" for Belt and Road projects and to encourage direct industrial investment.

Financing channels will be broadened, the document adds, to include all types of private capital, including sovereign wealth funds. Regulators, including the NDRC and the People's Bank of China, also plan to step up their efforts at risk control to ensure that additional funding takes place on a secure foundation[2].

In another very recent development, a dozen pacific countries, including China, have agreed to move forward with regional coalition aimed at countering US protectionism.

---

[1] https://www.wsj.com/articles/u-s-tariff-threat-could-scuttle-planned-trade-talks-with-china-1527656960

[2] http://www.chinadaily.com.cn/a/201804/11/WS5ace1e7ca3105cdcf6517ab7.html

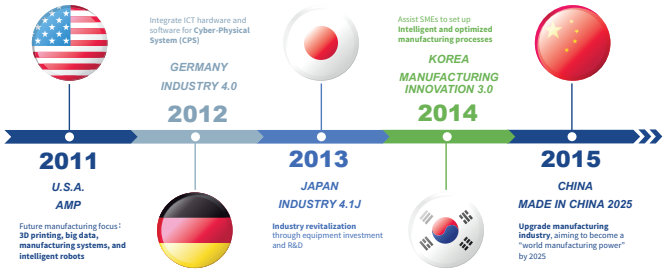
MADE IN CHINA 2025

Many countries have strategic plans to support and subsidize their core industries. These include Germany's Industry 4.0, the United States' Advanced Manufacturing Partnership (AMP) and Japan's Industry 4.1J, all of which are aimed at building agile and predictable cyber-physical systems for smart manufacturing and production. China has also taken steps in this direction with Made in China 2025, an ambitious plan to support the development of Chinese manufacturing by making it greener, more innovative and more efficient.

Made in China 2025 focuses on the following key sectors:

- Advanced medical devices
- Aerospace
- Agricultural equipment
- Automation and robotics
- Energy saving vehicles and power equipment
- Information technology
- Marine engineering and high-tech shipping
- Modernized rail transport
- New materials

To give the plan greater momentum, China's government is introducing a series of institutional reforms and new guidelines concerning intellectual property.



Source: Oaklins HFG China

Enforcement of intellectual property (IP) protection

Intellectual property theft not only harms foreign companies but is a serious problem for Chinese firms as well. Awareness has become widespread that this reflects a shortcoming in the Chinese legal system, and there is general agreement that more legislation to protect commercial information is needed.

The Chinese authorities recognize that domestic innovation is being held back by inadequate IP protection and have resolved to strengthen the country's intellectual property laws. The shift towards greater regulation also serves China's ambition to climb the product value chain, as it looks to develop homegrown brands in films, semi conductors and autos, industries that are currently dominated by the US, Japan and other advanced economies.

President Xi Jinping highlighted the need to improve IP protections in a 2017 speech calling for stricter enforcement and for infringers to pay a "heavy price." Last year, China also began a nationwide campaign to protect foreign firms' international property rights. Allowing that China is a developing country and doesn't have a perfect system to protect IP, the Ministry of Commerce acknowledges that there is much work to do on this front, and Premier Li Keqiang, during a speech in March, promised to protect the rights of foreigners investing in China's economy[3].

This newfound emphasis on IP has been accompanied by a push to grow domestic enterprises and end dependence on foreign technology. An editorial in the People's Daily admitted that China's legacy of dependence on advanced US technology puts it at the mercy of others, but noted that it is also motivating Chinese companies to conduct their own research and development[4].

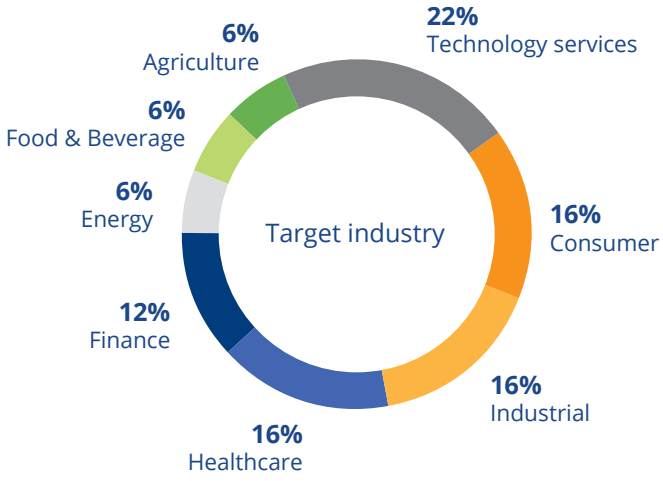
[3] https://www.bloomberg.com/news/articles/2018-03-22/what-s-intellectual-property-and-does-china-steal-it-quicktake

[4] http://industry.caijing.com.cn/20180418/4438704.shtml

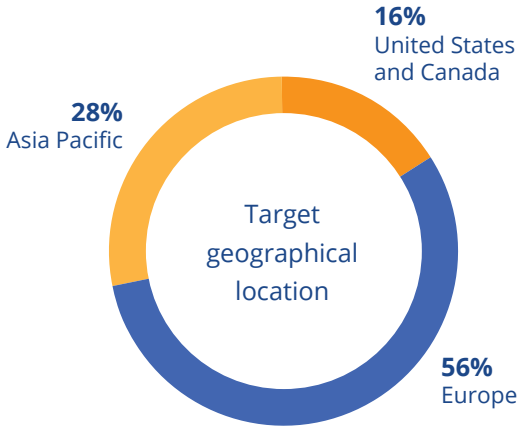
RECENT M&A TRANSACTIONS

Eighteen Chinese outbound transactions were closed in this quarter, compared with 25 the previous quarter, suggesting that the Chinese outbound M&A activities continue to be discouraged by the stricter limitations on foreign investment in previously popular M&A destinations.

- For this quarter, technology services (22%) was the top sector for Chinese foreign investment, followed by consumer services (16%), industrial (16%) and healthcare (16%).



- The top three geographies for Chinese investors were Europe (56%), Asia Pacific (28%) and US and Canada (16%).



- Eleven out of the 18 outbound transactions that closed disclosed the deal's value, with the largest pegged at US$1.8 billion (Guoxin Guotong Fund LLP, China Ningbo International Cooperation Co Ltd., Arbejdsmarkedets Tillaegspension, Universities Superannuation Scheme Ltd. - Redexis Gas SA).

Q2 2018 disclosed transactions by value

Transaction size (US$m)	Number of transactions
< 50	4
50 – 100	2
100 – 250	1
250 – 500	2
500 – 1,000	1
1,000 – 2,000	1
> 2,000	0

Similar to the first quarter of 2018, outbound M&A transactions generally remained small.

Four transactions disclosed the valuation multiples:

Target company	Target country	Target industry	Buyer company	Transaction value (US$m)	Implied EV/ Revenue	Implied EV/ EBITDA
Elliquence LLC		Health Services	Shanghai Xianfeng Investment Management Co. Ltd.	77.15	4.8x	N/A
Gorenje dd		Consumer Durables	Government of China; Hisense Group Co. Ltd.	331.55	0.6x	14.2x
Magex SRL		Industrial Manufacturing	Hangzhou Zhongya Kechuang Investment Co., Ltd.	10.13	24.4x	N/A
Naf-Naf S.A.		Consumer Non-Durables	Shanghai La Chapelle Fashion Co., Ltd.; Shanghai Lacha Enterprise Management Co. Ltd.; Lacha Fashion I Ltd.; Star Platinum Fund LP; Trendy Pioneer Ltd.; LaCha Appanel II Sàrl	64.22	6.84x	N/A

SPOTLIGHT ON: LOW VOLTAGE APPARATUS

Industry overview and M&A dynamic

Low voltage (LV) apparatus primarily consists of two groups of electrical products: power distribution devices, including breakers and switches, and power control products, including contactors, relays and starters. Lighting controls, pilot devices and many other products are also part of this category.

LV apparatus is typically integrated into panels and boards and is widely used for a great range of power distribution and control applications. These include electric utilities, residential and commercial buildings, urban and campus infrastructures and various industrial applications, such as petrochemicals, which may require specialized explosion-proof and anti-corrosion features. Market demand is often stoked by the emergence of new applications, such as the boom in alternative energy, but undercut when established markets, such as real estate, undergo a downturn. Local players have grown by extending their product lines and entering new markets. This is reflected in the M&A strategy of four of the industry's major players:

Selected active players

Delixi

Delixi Group Co. Ltd. operates in the electrical, high-tech, energy, mining, transportation, environmental engineering, real estate and logistics industries. During the past 30 years, Delixi has built up a complete electrical product portfolio, which covers high, medium and low-voltage transmission and distribution, industrial automation and controls. The company established a joint venture with Schneider for low-voltage apparatus in 2006, with each firm holding an equal stake. **Company's future strategy:** Delixi is committed to building advanced electrical manufacturing facilities internationally.

Liangxin (Ticker: 002706)

Shanghai Liangxin Electrical Co., Ltd. engages in the manufacturing and sale of electrical components and equipment. Its products include low-voltage final distribution products, molded case circuit breakers, air circuit breakers and automatic transfer switches. Liangxin attempted to acquire Shanghai Elecon Intelligent Technology, a monitoring and controlling device manufacturer and Shenzhen Sine Electric, an electrical product manufacturer, in 2018. In both cases, they failed to reach an agreement on transaction terms. **Company's future strategy:** Liangxin plans to continue its focus on low-voltage products in 2018.

- Market cap: US$762m
- Revenue: US$214m
- EBITDA: US$35m

Taiyong-Changzheng (Ticker: 002927)

Guizhou Taiyong-Changzheng Technology Co., Ltd. engages in the manufacture, research and development of low-voltage electrical equipment. It offers low-voltage circuit breakers, isolating switches, disconnectors, PLCs, industrial switches and other related electrical equipment. The company was just listed this year, following its successful acquisition of Changzheng. **Company's future strategy:** Both Taiyong and Changzheng are famous brands in low-voltage products, and the combined company plans to further develop these two brands and enhance their market positions in 2018.

- Market cap: US$672m
- Revenue: US$48m
- EBITDA: US$11m

Benefo (Ticker: 600468)

Tianjin Benefo Tejing Electric Co. Ltd. is engaged in the manufacture, design and sale of hydraulic machinery parts. Its products include electrical transmission components, high and low voltage electrical components and other hydraulic equipment. In 2016, Benefo acquired Guanlong Magnet Wire, a Chinese wire producer, to complement its existing product portfolio. **Company's future strategy:** The company aims to extend its product portfolio to high-end applications, such as new material and new energy production through overseas acquisitions.

- Market cap: US$620m
- Revenue: US$179m
- EBITDA: US$16m

LEADING ACQUISITIVE PLAYER'S CASE STUDY

CHINT 正泰

Chint was founded in the 1990s as a small workshop producing low voltage apparatus. As it grew, the company became one of the leading players in China's electrical industry.

Zhejiang Chint Electrics Co., Ltd. engages in the manufacture, sale, research and development of low-voltage electrical products. It operates in the following segments: electrical power distribution, electrical terminals, control electronics, power electronics and electrical & electronic. Chint Solar (Zhejiang) Co., Ltd. engages in the research, development and production of solar modules. It produces thin film, monocrytalline, and polycrystalline photovoltaic (PV) modules, and PV system solution.

Company's future strategy: Looking ahead, the company has plans to explore solar industry and extend its overseas footprint through additional acquisitions.

- Market cap: US$7,065m
- Revenue: US$3,439m
- EBITDA: US$677m

Recent cross-border M&A transactions

On 30 September 2017, Zhejiang Chint Electrics Co., Ltd. acquired Sunlight Electrical Pte Ltd from Sunlight Group Holding Ltd, trading as P5 Capital Holdings Ltd, for SGD17 million (US$12.2 million) in cash.

On 12 December 2013, Chint Solar (Zhejiang) Co., Ltd. acquired Conergy SolarModule GmbH & Co. KG from Conergy AG for an undisclosed amount.

Case Study on the most recent transaction

On 30 September 2017, Chint Electrics Hong Kong Co., Ltd. a wholly-owned subsidiary of Zhejiang Chint Electrics Co., Ltd. (stock no. 601877) acquired a 100% stake in Sunlight Electrical Pte Ltd. Chint plans to use the acquisition to expand its Asia Pacific regional office and grow its LV apparatus business in the Singapore region, making this a good example of how Chinese buyers use outbound investment to acquire overseas sale channels and expand their market reach.

About the target

Sunlight is a leading manufacturer of LV switching gear and a well-known brand in Southeast Asia. Its factories in Singapore, Malaysia and Vietnam serve customers throughout Southeast Asia and the Middle East.

Market trends and transaction drivers

The deal is driven by with China's "One Belt, One Road" national strategy, and in line with Chint's globalization and M&A strategies. Chint hopes the deal can strengthen its business in the Southeast Asian and Middle East region.

Valuation

Sunlight's total equity was US$9m as of 30 September 2016, and Chint paid US$12m for 100% of Sunlight's shares at a P/E multiple of 17 (based on the company's reported net profit of US$0.7m for the 1 April 2015–31 March 2016 reporting period). To justify the valuation premium, Chint cited:

- Sunlight's established sales channel and customer base in the Singapore region
- The opportunity to extend Chint's product portfolio with Sunlight's offerings, positioning the combined company as a complete LV system solution provider
- The use of Sunlight's regional facilities to provide better service to local customers

CONCLUSIONS & OUTLOOK

As the American people bit their nails and held their breath, waiting for the final vote count of the 2016 presidential election, halfway across the globe, the Chinese people slept soundly. As they woke up to the news, it seemed that they will continue to watch Trump's strange campaigns from afar. However, this year, Trump initiated an unprecedented trade war with China.

The increasing tensions will force a future where it is likely, but by no means certain, that M&A and related investments in the US by Chinese companies will diminish. To counteract that, the Chinese government will foster alternative investment opportunities in Europe, other Asian markets, and within China itself to strengthen free trade and cross-border investments.

Future directions in Chinese M&A activity depend on three major factors: the further development and outcome of the current trade frictions between the US and China, further progress with One Belt, One Road, and the other economic reforms and domestic initiatives that have been undertaken by the Chinese government.

Of these, the hardest to forecast is the trade war with the US, since its course is largely dependent on the conflicting attitudes of various US politicians and stakeholders, which are in flux. More predictable are the initiatives backed by China's government, which has every interest in strengthening free trade and cross-border investment.

Appendix: 18 outbound transactions closed between April and June 2018

Date	Buyers/investors	Target/issuer	Country	Primary industry [Target/issuer]	Transaction value (US$m)
29-Jun-2018	Shanghai La Chapelle Fashion Co., Ltd.; Shanghai Lacha Enterprise Management Co. Ltd.; Lacha Fashion I Ltd.; Star Platinum Fund LP; Trendy Pioneer Ltd.; LaCha Appanel II Sàrl	Naf-Naf S.A.		Consumer Non-Durables	64.22
28-Jun-2018	Government of China; Hisense Group Co. Ltd.	Gorenje dd		Consumer Durables	331.55
25-Jun-2018	Evergrande Health Industry Group Ltd.	Season Smart Ltd.		Finance	859.84
20-Jun-2018	Guoxin Guotong Fund LLP and China Ningbo International Cooperation Co Ltd, Arbejdsmarkedets Tillaegspension, Universities Superannuation Scheme Ltd.	Redexis Gas SA		Utilities	1,841.10
13-Jun-2018	Hangzhou Zhongya Kechuang Investment Co., Ltd.	Magex SRL		Industrial Manufacturing	10.13
08-Jun-2018	Zhejiang Starry Pharmaceutical Co., Ltd.	iMax Diagnostic Imaging Holding Ltd.		Health Technology	-
04-Jun-2018	Fu Ya Investments Ltd./ Chunli	Fu Ya Investments Ltd.		Finance	8.92
04-Jun-2018	Shanghai Xianfeng Investment Management Co., Ltd.	Elliquence LLC		Health Services	77.15

Date	Buyers/investors	Target/issuer	Country	Primary industry [Target/issuer]	Transaction value (US$m)
29-May-2018	Dalian Wanda Group Co., Ltd.; World Triathlon Corp.	Titan Experience /Mass Participation Division/		Consumer Services	-
23-May-2018	Jiayi International Education Investment Group Ltd.	Bambinos Ltd.		Education	-
21-May-2018	Trina Solar Ltd.	NClave		Industrial Services	-
16-May-2018	Huitai Investment Group Co., Ltd.	Bröderna Hanssons i Göteborg Export AB		Food & Beverage	-
08-May-2018	Alibaba Group Holding Ltd.	Jade E-Services Pakistan (PVT) Ltd.		Technology Services	200
08-May-2018	SHAREit Technologies Co., Ltd.	Fastfilmz Media India Pvt Ltd.		Technology Services	13
03-May-2018	Best Assistant Education Group Co.; Digital Train Ltd.	Edmodo, Inc.		Technology Services	278.84
17-Apr-2018	Alibaba Group Holding Ltd.; Prenetics Ltd.	DNA fit Ltd.		Health Services	10
12-Apr-2018	Government of China; Syngenta Corp.; Syngenta AG	Abbott & Cobb, Inc.		Agriculture	-
03-Apr-2018	MLS Co., Ltd.	Ledvance GmbH		Industrial Manufacturing	-

MEET OAKLINS, THE WORLD'S MOST EXPERIENCED MID-MARKET M&A ADVISOR

Oaklins International offers the unparalleled resources of **700 merger & acquisition professionals** in **40 countries**. For over **30 years** we have seamlessly advised private shareholders, financial investors and corporate clients on acquisitions, divestitures and financing transactions. In the last five years Oaklins' member firms have closed more than **5,000 transactions**. We combine local market knowledge with our highly talented global industry specialists in **15 sectors**.

700 professionals

60 offices

40 countries

5,000+ transactions

15 sectors

Oaklins

Oaklins – our offices around the world

Oaklins
www.oaklins.com