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Voice from China

Quarterly update on the M&A market in China

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Introduction

WAR, WAR, AND MORE WARS

First, it's a trade war, then it's a tech war, and now the prospect of a currency war, as Trump and the US trade hawks move to weaponize the dollar.

If you ask any economist, he or she will agree that the dollar is the United States' most powerful weapon, and China is preparing for them to deploy it. Just last month, the Chinese government began promoting blockchain technology as a first step towards digitalizing China's currency. Why? Because if the RMB is digitalized like Bitcoin, then China will be very happy to dump SWIFT. Unlike Bitcoin, a digitalized RMB will be neither anonymous nor decentralized from the Chinese central bank, but it creates a sure-fire way for China to avoid the dollar system. In other words, we will be living in a divided world once again, only this time the division will not be due to religion, culture or ideology. It's the Thucydides Trap, as Graham Allison so rightfully put it, and it's human nature that's propelling us there.

How would this decoupling change the dynamics of Chinese M&A activity? We are already seeing different trends and directions compared with one or two years ago. Chief among them, inbound transactions are increasing and we expect this trend to continue.

Since 2014, inbound transactions lagged outbound dealmaking. The main reasons for this were:

1. Inflated price/earnings (P/E) multiples for Chinese companies compared with foreign concerns. For China's public companies, in 2014, this stood at around 56 — considerably higher than that of the rest of the world.

2. Poor internal controls and accounting at small and medium-sized Chinese companies

3. Chinese government restrictions on foreign investment and official policies that impeded investment from abroad.

The situation, however, is becoming more favorable as:

1. In an about-face, the Chinese government has begun instituting policies more conducive to foreign direct investment (see sidebar).

2. The Chinese stock market has become more subdued, and in 2018 the PE multiple for listed companies fell more in line with international averages at around 36.[1]

3. The management of Chinese enterprises is becoming more sophisticated, and a significant number of companies are now led by a new generation of executives who were educated abroad.

4. Small and medium-sized Chinese businesses are actively seeking strategic partners from abroad that can provide them with additional expertise.

5. In recognition of the above, foreign investors are increasingly seeking to enter the Chinese market through mergers or acquisitions, rather than greenfield investments.

[1] The PE ratios for Chinese companies cited here exclude companies with multiples greater than 100. Chinese authorities deem these stock listings to be "extreme cases" and do not include them in market averages.

Outbound transactions, on the other hand, are decreasing as a result of the trade war and Europe's General Data Protection Regulation (GDPR), which inhibits investment from outside the European Union. The slowing global economy is also depressing outbound Chinese M&A, although there is still considerable activity among small and medium-sized companies, especially in regions where protectionist measures have been more muted. While total outbound activity fell during the first three quarters of 2019 by 31% year-on-year, the number of transactions closed during the third quarter exceeded that of the second quarter, possibly hinting at some degree of recovery and geopolitical normalization.

The conflicts between China and the United States are viewed by both countries as a long-term issue. But in the near term, following October's visit to the United States by Liu He and the Chinese trade delegation, we don't see the trade war intensifying further. In the meantime, Chinese outbound M&A activity will continue to increase in Asia under the Chinese government's One Belt One Road initiative.

SHIFTING GEARS ON FOREIGN DIRECT INVESTMENT (FDI): A RECENT TIMELINE OF CHINESE GOVERNMENT POLICY CHANGES

Since 2018, the Chinese government has gradually relaxed international access to the Chinese market by instituting a number of official policies intended to promote foreign investment:

- **28 June 2018:** The National Development and Reform Commission (NDRC) and the Ministry of Commerce issued policies *(Special Management Measures for Admission of Foreign Investment [Negative List] [2018 edition]* and, two days later, *Special Management Measures for Admission of Foreign Investment in Free Trade Pilot Areas [Negative List] [2018 edition])* aimed at easing foreign investor access to a variety of industries, including finance, transportation, trade and commerce, professional services, manufacturing, infrastructure, energy, resources and agriculture. Restrictions on foreign stakes in the banking industry were lifted; limits on foreign stakes in non-banks, such as securities companies, were raised to 51%; 14 previously restricted industries, such as ship design and power grid construction, were opened to international investment, and a timeline was set forth for the further easing of FDI restrictions in specific industries, including dropping all restrictions on foreign investment in commercial vehicle manufacturing and the financial sector by 2020 and 2021, respectively.
- **30 July 2018:** The Ministry of Commerce issued its *Decision on Amending the Administrative Measures for the Strategic Investment of Listed Companies by Foreign Investors (draft for comments)*, which relaxed the criteria and simplified the approval process for foreign investment in A-share listed companies. Among the changes, financial requirements for foreign investors were lowered and the lock-up period was shortened to 12 months.
- **25 December 2018:** The NDRC and the Ministry of Commerce published their *Negative Market Access Negative List (2018 edition).* This divided the Chinese market into two categories, "prohibited entry" and "permitted entry," and gave foreign investors the same legal rights and privileges as Chinese investors for the permitted category.
- **25 December 2018:** *Foreign Investment Law of the People's Republic of China (Draft)* was posted on the Chinese People's Congress website. The document granted equal treatment for foreign-invested enterprises under Chinese law, excepting those market segments on the Ministry of Commerce's negative list. In particular, foreign-invested enterprises were given the right to raise funds through the public issuance of stocks and bonds, and government approvals and various bureaucratic procedures for companies with foreign investors were greatly simplified.
- **1 February 2019:** The NDRC and the Ministry of Commerce requested public commentary on their *Catalogue of Encouraged Foreign Investment Industries (Draft for Soliciting Opinions)*. Part one of the document revises the list of industries nationwide where foreign investment should be encouraged, and part two does the same for China's central and western regions. The stated reasons for the revisions were to expand the scope of foreign investment and promote its growth.
- **30 June 2019:** The NDRC and the Ministry of Commerce released a series of documents, *Special Management Measures for Foreign Investment Access (Negative List) 2019 edition, Special Management Measures for Foreign Investment Access in Free Trade Pilot Areas (Negative List) (2019 Edition) and Encouraging Foreign Businessmen Investment Industry Catalog (2019 edition)*, all aimed at opening China's service sector to global investors and further relaxing their access to the country's agriculture, mining and manufacturing sectors.
- **17 November 2019:** The Ministry of Commerce issued a statement *(Opinions of the State Council on Further Improving the Use of Foreign Capital)* clearing the way for foreign-invested enterprises to participate in setting Chinese national standards for medical devices, foods, drugs and information technology (IT) products.

Recent M&A transactions

OVERVIEW BY SECTOR

During the third quarter of 2019, Chinese companies disclosed the completion of 21 outbound acquisitions, 19% of which were in the packaged software industry, followed by industrial machinery (14%) and metal fabrication (10%).

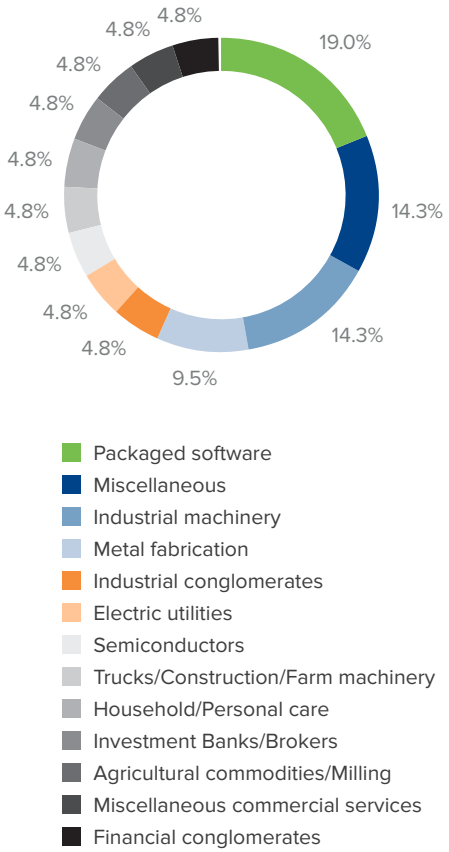
OVERVIEW BY REGION

By region, the greatest share of these outbound deals took place in Europe (43%), followed by Latin America and the Caribbean (24%) and United States and Canada (14%).

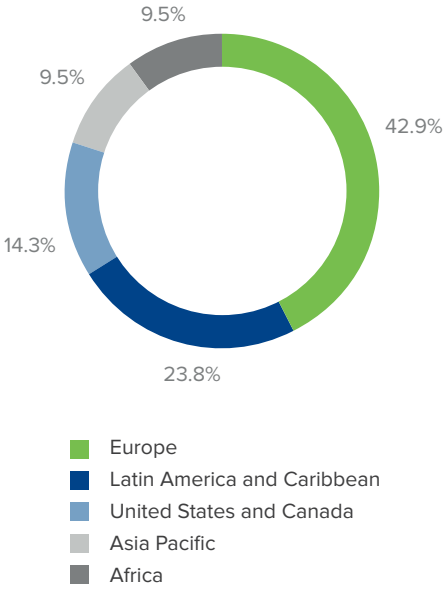
Deal value was disclosed for eight transactions, with the largest pegged at US$144 million for 7Road Holdings Ltd.'s acquisition of Osmanthus Vale Holdings Ltd. from Maple Vale Ltd.

For all eight of transactions, the breakdown was as follows:

Transactions by industry



Transactions by region



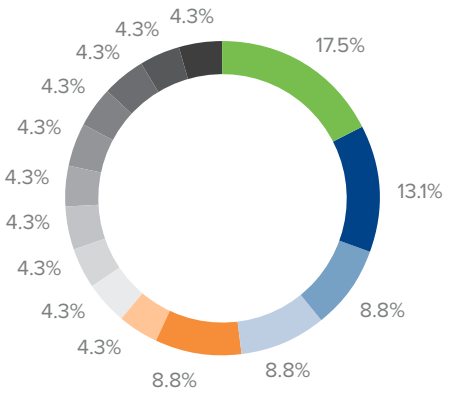
Q3 2019
8 disclosed transactions by value

Transaction size (US$m)	Number of transactions
< 50	6
50–100	0
100–250	2

INBOUND M&A BY SECTOR

For the third quarter, 23 inbound acquisitions of Chinese companies were completed and disclosed, excluding minority deals. Of these, 17% were in the miscellaneous commercial services sector, followed by wholesale distributors (13%).

Inbound by industry

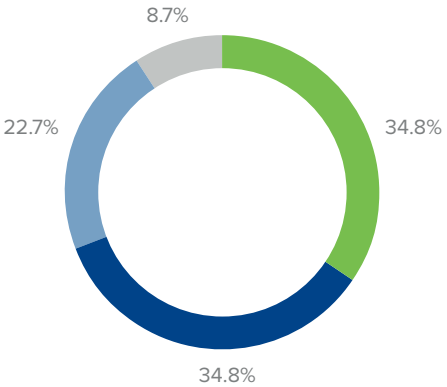


- Miscellaneous commercial services
- Wholesale distributors
- Chemicals: specialty
- Investment managers
- Real estate development
- Industrial machinery
- Environmental services
- Specialty stores
- Other consumer services
- Commercial printing/Forms
- Electrical products
- Advertising/Marketing services
- Information technology services
- Packaged software
- Home furnishings

INBOUND M&A BY REGION

Most of these deals originated in Asia Pacific and Europe (35%, respectively). The United States and Canada were only responsible for a combined 22% of the total.

Inbound by region



- Europe
- Asia Pacific
- United States and Canada
- Latin America and Caribbean

Recent inbound cases of note

- In July 2019, Novena Global Healthcare Group Inc., trading as Novena Global Lifecare, acquired Supercuts Digital Co. Ltd. for US$350 million. The transaction was a continuation of Novena's business expansion into China and the Asia Pacific region. The deal was funded by cash plus shares in the parent company.
- In line with its growth strategy, in February 2019, Royal DSM NV purchased an additional 46% stake in Yantai Andre Pectin Co. Ltd. for RMB1,158.7 million (US$172 million). Upon closing, Royal DSM will own a 75% majority stake in the target company. Founded in 2003, Yantai Andre Pectin is located in Yantai, Shandong, China, and produces and distributes fruit juices.

OVERVIEW OF CROSS-BORDER INVESTMENTS

During the first nine months of 2019, Chinese outbound direct investment stood at US$79 billion, representing year-on-year growth of 3.8%. During the same period, inbound direct investment was US$100.8 billion for year-on-year growth of 2.9%. Over this time period, 30,871 new enterprises were established in China with the help of foreign capital.

Case study: **Alibaba**

This January, Alibaba assumed complete ownership of Data Artisan for a reported US$103 million.

ABOUT THE BUYER

While Alibaba's core business has shifted from the retail to the wholesale market, the online retail platforms Taobao and Tmall are still essential parts of its operation.

ABOUT THE TARGET

Data Artisans was founded in 2014 by the team behind the development of Apache Flink, an open-source, large-scale data-processing technology. Customers for the startup's large-scale data streaming platform include Netflix, ING, Uber and Alibaba itself.

SYNERGY

For the past three years Alibaba has used Data Artisans' platform to support its 11.11 global shopping festival, and the acquisition will allow the two companies to cooperate more closely. Alibaba has already integrated its Blink real-time computing framework into the Flink platform and will support further efforts to enhance Flink by making its in-house development resources available to the open-source community.

> "By leveraging the technology expertise of both teams and [our] shared passion to develop the open-source community, we are confident that this strategic tie-in will further strengthen the growth of the Flink community, accelerate the data-processing technologies and help bolster an open, collaborative and constructive environment for global developers who are passionate about stream processing and enabling real-time applications for modern enterprises."
>
> **JINGREN ZHOU, VICE PRESIDENT OF ALIBABA GROUP**

Spotlight on:
The TMT sector

TMT STANDS FOR TECHNOLOGY, MEDIA, AND TELECOM.

This is a broad sector that includes some of the hottest new technologies, such as semiconductors, smartphones, the cloud, 5G, social media and e-commerce.

Prior to the trade war with the United States, China — leveraging on its large but less-established consumer market and looser policy environment — focused more on the application side of the sector. The resulting boom in e-commerce, mobile payment and the shared economy helped revolutionize daily life for Chinese people. However, it left the underlying core technologies in the hands of other countries, especially the United States, Japan and Korea.

Since it began, the trade war had a profound impact on the TMT sector, probably more so than on any other sector. On one hand, the threat of losing access to vital components and technologies has put enormous pressure on China's biggest technology players, including Huawei and ZTE. On the other hand, these threats have served as a wake-up call for the sector, the Chinese government and Chinese industry overall. In this respect, we believe the trade war will bring real change to China, reshaping TMT's global value chain.

Short term, the US ban on selling key, high-tech components to China will benefit Asian and European suppliers and lead to price increases. Longer term, China's tech giants will take advantage of their vast home market to incubate and nurture local suppliers, especially with regard to semiconductors, high-speed and high-frequency materials, and various types of software.

As this unfolds, M&A will provide a shortcut for Chinese TMT companies seeking to become more self-sufficient, and they will have the backing of the Chinese government, which is largely supportive of startups and M&A activities aimed at providing essential technologies.

Given these imperatives, the TMT sector will look to outbound acquisitions in an attempt to:

1. take advantage of the market opportunity created by the trade war to replace overseas suppliers
2. ensure the supply of core technologies that their current business relies on
3. quickly gain access to the overseas market.

Deals struck earlier this year by three industry leaders are good examples of how these objectives are playing out:

Alibaba

Alibaba, probably the best-known of China's technology behemoths, paid US$103 million to acquire Data Artisans, a Berlin-based startup that provides distributed systems and large-scale data streaming services for enterprises.

Company strategy: For the past three years, Data Artisan has been the secret weapon behind Alibaba's 11.11 global shopping festival, providing real-time data-processing services. With the acquisition, Alibaba takes ownership of one of the core technologies it needs to ensure the smooth operation of its current business model.

- Market cap: US$524bn
- Revenue: US$56bn
- EBITDA: US$14bn

Jingfang Optotelectronics

Jingfang Optotelectronics is a leading supplier of 3DIC and TSV wafer-level, chip-size packaging and testing services. Earlier this year, the company paid over 32 million euros to acquire a 73% equity stake in Anteryon, a Dutch producer and assembler of precision optical components that spun off from Philips Electronics in 2006.

Company strategy: This upstream acquisition gives Jingfang a comprehensive solution for 3D optical sensing chips that can be used for emerging applications like the Internet of Things and artificial intelligence.

- Market cap: US$981m
- Revenue: US$84m
- EBITDA: US$16m

YY Inc.

YY Inc. provides a social media platform for live streaming content. Earlier this year, the company paid US$1.45bn for a 68.3% equity stake in Bigo Technology Pte. Ltd., a Singapore-based social media platform for live broadcasts and short videos. As of 2018, Bigo had 69 million active users worldwide. With the addition of its new stake, YY assumed sole ownership of the target company.

Company strategy: YY's business has been centered on the Chinese market, and the acquisition gives it access to a global audience.

- Market cap: US$5,149m
- Revenue: US$2,382m
- EBITDA: US$407m

21 OUTBOUND ACQUISITIONS BY CHINESE COMPANIES CLOSED BETWEEN JULY AND SEPTEMBER 2019

Date	Acquirer	Target	Target country	Industry	Transaction value (US$m)
27-Sep-2019	Huaxin Cement Co. Ltd.	Maweni Limestone Ltd.		Industrial Machinery	115.2
26-Sep-2019	TICA Thermal Solution Co. Ltd.	Exergy S.p.A.		Electric Utilities	18.08
26-Sep-2019	The Export-Import Bank of China; Gardenica Ltd.	Pasteur - Filiala Filipesti SRL		Agricultural Commodities/ Milling	-
24-Sep-2019	Jilin Chengyang Energy Development Technology Service Co. Ltd.	Mastique Investments Ltd.		Miscellaneous	0.18
24-Sep-2019	Jilin Jinhong Auto Parts Co. Ltd.	ProTec Metalltechnik GmbH		Metal Fabrication	-
11-Sep-2019	Ruibo (United States) Pharmaceutical Co. Ltd.; Zhejiang Raybow Pharmaceutical Co. Ltd.	PharmAgra Labs, Inc.		Miscellaneous Commercial Services	-
11-Sep-2019	Ruibo (United States) Pharmaceutical Co. Ltd.; Zhejiang Raybow Pharmaceutical Co. Ltd.	PHARMAGRA LABS, LLC		Financial Conglomerates	-
9-Sep-2019	Sun Line Precision Ltd. /Yu/	Sun Line Precision Ltd.		Industrial Conglomerates	1.77
2-Sep-2019	Binance Holdings Ltd.	Jex Technology Co. Ltd.		Investment Banks/Brokers	-
2-Sep-2019	Syngenta AG; Government of China	N.S.T New Science Technologies Group		Packaged Software	-

Date	Acquirer	Target	Target country	Industry	Transaction value (US$m)
27-Aug-2019	Babytree Group	Littlelights Holding Ltd.		Packaged Software	-
27-Aug-2019	Babytree Group	Zoetic, Inc.		Industrial Machinery	-
26-Aug-2019	China Renaissance Capital Investment, Inc.; Estun Automation Co. Ltd.; Carl Cloos Schweisstechnik GmbH /Private Group/	Carl Cloos Schweißtechnik GmbH		Industrial Machinery	-
23-Aug-2019	7Road Holdings Ltd.	Osmanthus Vale Holdings Ltd.		Packaged Software	141.12
20-Aug-2019	Dynax Semiconductor, Inc.; Denselight Semiconductors Pte Ltd. / Private Group/	DenseLight Semiconductors Pte Ltd.		Semiconductors	26.00
6-Aug-2019	Huawei Technologies Co. Ltd.	Excelsior LLC (Russia)		Packaged Software	-
17-Jul-2019	IVA Schmetz GmbH; Ningbo Qijing Holdings Co. Ltd.	Tenova S.p.A. / 4 Subsidiaries/		Metal Fabrication	-
15-Jul-2019	Inke Ltd.	Social Network Technology Co. Ltd.		Miscellaneous	33.89
15-Jul-2019	Inke Ltd.	Social Network Technology Co. Ltd.		Miscellaneous	47.59
8-Jul-2019	Zhejiang Yuanzhu Housing Industrialization Co. Ltd.	Aircrete Europe Holding BV		Trucks/ Construction/ Farm Machinery	-
5-Jul-2019	Health & Happiness (H&H) International Holdings Ltd.	Aurelia Skincare Ltd.		Household/ Personal Care	-

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Oaklins brings you opportunities from across the world and we meet you with our expertise wherever you are