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VOICE FROM CHINA

QUARTERLY UPDATE ON THE
M&A MARKET IN CHINA

3RD EDITION 2018



EXECUTIVE SUMMARY



The future of Chinese M&A is unclear but hopeful. Even amidst the escalating Sino-American trade war, China is looking to encourage both inbound and outbound investment via policy changes.

The two new proposed policy objectives, “structural deleveraging” and “leverage stabilization,” may rekindle Chinese buyers’ passion for cross-border M&A. These objectives are aimed at creating financial mobility and debt relief for private firms. Moreover, China has specifically promised more support for M&A transactions.

To further support foreign investment, China has derestricted foreign capital from 22 previously prohibited sectors. Along with China’s market valuation plummeting in recent months, Chinese M&A targets may be considered a hot commodity.

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

A stylized, handwritten signature in blue ink, appearing to read 'John Zhang'.

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INTRODUCTION

Following threats that it would do so for many weeks, on 17 September, the Trump administration finally placed tariffs on US\$200 billion of Chinese imports. Leaving no doubt that a trade war is in the offing, the Chinese government immediately responded with its own tariffs on US\$60 billion of US imports to China.

Currently at 10%, the US tariffs are set to rise to 25% by the end of 2018. This will have the greatest impact on those industries taking part in the Made in China 2025 initiative, which Washington perceives as a threat to US national security, but other, consumer-oriented industries—such as furniture and leather product—will also be adversely affected.

Earlier this year, in March, the US Congress passed the Foreign Investment Risk Review Modernization Act, or FIRRMA for short, which allows the interagency Committee on Foreign Investment in the United States (better known as CFIUS) to discriminate among foreign investors based on their country of origin. To date, only China has been labeled as a country of “special concern,” and this has had a chilling effect on China-US M&A transactions. To wit, compared to the third quarter in 2016, the number of Chinese transactions approved by CFIUS declined from 16 to 7.¹

With the door slammed on the other side of the Pacific, Chinese buyers have been forced to search for new outlets for their deal making. Since European firms are deemed second only to American companies in terms of their technical prowess, the focus of Chinese investors has turned to Europe, and in the third quarter for the past three years running, the number of successful Chinese transactions in Europe has exceeded those in the US.

In spite of this, American protectionism has spilled over into Europe and, in particular, Germany. In July, intervention by the German government derailed the efforts of The State Grid Corporation of China (SGCC) to invest in 50 Hertz, and in August similar interference

blocked the Taihai Group’s overtures to Leifeld. At that time, the German government announced that it is considering lowering the threshold for government transaction review from a 25% to a 15% stake in the target company.

Germany’s concerns that Chinese investment could be detrimental to its national security echo those of the US and are probably due to the similarities between the two nations’ ambitions, as embodied by the Made in China 2025 and Germany’s Industry 4.0 initiative. Given that cross-border M&A can serve as a channel for technology transfer, the German government is seeking to safeguard its technological advantages. As a result, compared with 22 transactions and 26 transactions in the third quarter of 2016 and 2017, respectively, Chinese investors only completed 11 deals in Europe this quarter.

Reflecting all this, in a speech on 5 October, US Vice President Mike Pence claimed that China has weakened and betrayed the United States in the global arena for decades. Pence quoted Trump’s characterization of the current international situation as a “great power competition,” signaling a broad shift towards a more confrontational Sino-US relationship.

In China, Pence’s speech quickly sparked many strong reactions. In a 9 October China Daily article entitled “Does Pence’s speech signal a new ‘Cold War’?,” for instance, the author Fu Mengzi² said, “But in assuming that it can coerce China into concessions with its extreme pressure strategy, the Trump administration is making a serious mistake.” He was joined by hard-line voices in both China and the US in suggesting that a war between the two countries—cold or otherwise—could take place.

¹ These figures only include majority-stake transactions. Source: Factset.

² Vice president of the China Institutes of Contemporary International Relations

Private enterprises benefit from China's structural deleveraging

With a debt to gross domestic product (GDP) ratio of 2.84 in 2017, skyrocketing leverage accompanied by soaring financing costs have scared some Chinese buyers away from outbound M&A deals. But a turnabout is underway, as official Chinese monetary policy has increasingly centered on deleveraging with the introduction of two important concepts: structural deleveraging and leverage stabilization.

As opposed to uniform or across-the-board deleveraging, the policy of structural deleveraging is selectively applied to certain state entities. Specifically, it is aimed at reducing the debt burden at state-owned enterprises and local governments, and in April of this year³ the government announced that this was now a long-term regulatory goal.⁴

Leverage stabilization is a similar policy, abruptly announced in July in response to the US-initiated trade war. Both policies leave privately owned companies free to assume new debt based on their particular circumstances and business requirements.

Moreover, in August, the Chinese government promised to provide more support for M&A transactions and other forms of private debt, including debt-stock swaps, directional add-issuance, IPOs and convertible debts—particularly for certain strategic industries, such as high tech.

Deleveraging: A summary of recent policies and guidelines

Date	Issuing department	Summary
10 August	People's Bank	Guidance that structural deleveraging and a neutral monetary policy will remain in force going forward.
8 August	NDRC	M&A, debt-stock swaps, directional add-issuance, IPOs and convertible debts were singled out as preferred investments and vehicles for raising capital.
23 July	People's Daily	The concept of leverage stabilization was introduced, signaling an intensified effort to reduce China's overall debt to GDP ratio.
21 July	Chinese Academy of Social Sciences	Policy makers argued for more flexible deleveraging policies in order to better balance economic development and debt reduction.
5 April	Finance and Economics Commission	The policy of structural deleveraging was introduced for the first time, singling out local governments and state-owned enterprises for targeted debt reduction.

³ During the first conference of the Finance and Economics Commission in 2018

⁴ "China's Monetary Policy Implementation Report for the 2nd Quarter 2018"

China rolls out the welcome mat for foreign investors

In contrast to the harsh situation faced by Chinese investors overseas, the Chinese government continues to roll out the welcome mat for foreign investors in China.

In June, restraints on foreign capital were lifted for 22 industrial sectors, including automotive, power system development, gas station construction, banking, securities and railroad construction.⁵ The wholly foreign-owned enterprise (WFOE) established by Tesla to manufacture electric cars in China was the first high-profile venture to take advantage of this new latitude.

Moreover, in a striking about-face from previous policies, the idea has been floated to permit investors to take stakes in Chinese state-owned enterprises and to sharply limit the number and types of regulatory approvals such investments must receive.⁶ This would not only lower the threshold for deploying foreign capital in China, but also encourage more outbound as well as inbound M&A activity.

All this takes place at a time when the Chinese stock market is plummeting, due in part to the escalating US-China trade war. Ironically, though, the falling share prices result in bargain-basement valuations, which are likely to make Chinese enterprises more attractive investment targets for overseas investors.⁷

On balance, recent economic events still bode well for Chinese cross-border M&A

As the rest of the world becomes more resistant to Chinese outbound investment, the M&A climate is becoming more favorable within China itself.

The challenges Chinese buyers are facing abroad are largely due to the US-initiated trade war and its ripple effect throughout the Western world. Countries like Germany, which have attracted more Chinese buyers in the wake of growing US hostility, are also beginning to view Chinese investment as a potential threat to their national interests.

Within China, however, overseas investment is increasingly welcome, as the government lifts limitations on foreign capital and openly promotes more M&A activity. And as China's deleveraging policies become more flexible, it will likely be easier for private Chinese enterprises—especially those in sectors deemed strategic—to finance cross-border M&A transactions.

Given the ambitions behind the Made in China 2025 initiative, the escalating trade war and the uncertain prospects for the Chinese economy, China may continue to become more open to the rest of the world.⁸ This in turn may rekindle overseas investors' passion for the Chinese M&A market.

⁵ "Special Management Measures for Foreign Investment Access (Negative List) (2018 Edition)"

⁶ "Measures for Actively and Effectively Utilizing Foreign Capital to Promote the Development of High-Quality Economy"

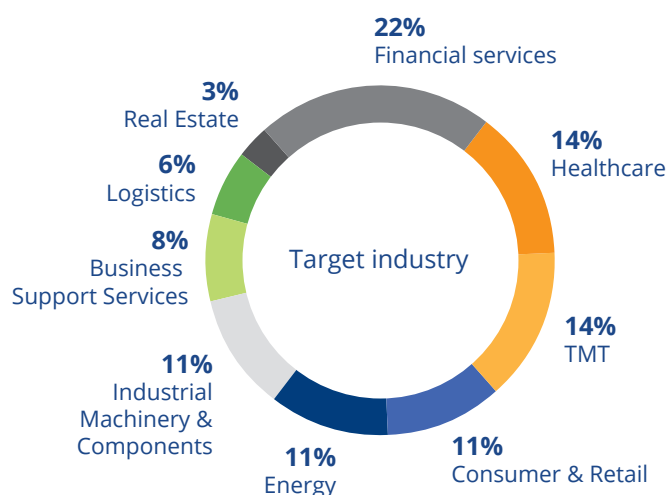
⁷ Sina Finance, "The Increasingly More Evident Impact of Foreign Investment: A 15% Rebound of the Chinese Stock Market by the end of 2018"

⁸ Zeping, Ren. "US-China trade War Might Be China's New Opening Up Opportunity"

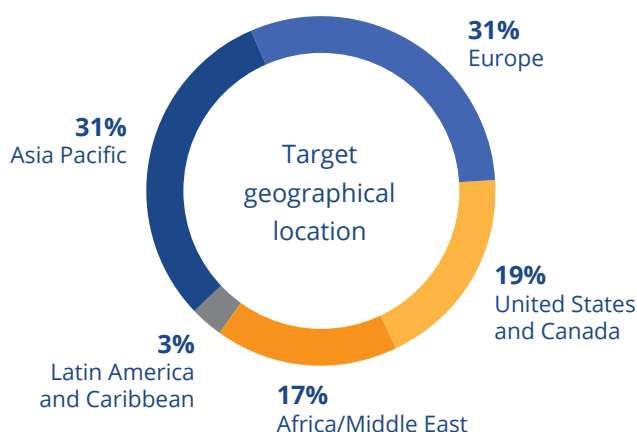
RECENT M&A TRANSACTIONS

A total of 36 Chinese outbound transactions were closed in this quarter, compared with 18 the previous quarter, suggesting that Chinese companies continue to embrace M&A activity, despite a less favorable global environment.

In the third quarter, financial services (22%) was the top sector for Chinese outbound investment, followed by technology, media and telecom (14%) and healthcare (14%).



Most of these deals took place in Asia Pacific (31%), Europe (31%) and US/Canada (19%).








Among these transactions, 25 disclosed the deal's value, with the largest pegged at US\$6.2 billion (Shanghai International Port (Group) Co., Ltd.; COSCO SHIPPING Holdings Co., Ltd.; Orient Overseas (International) Ltd.).

Q3 2018 disclosed transactions by value

Transaction size (US\$m)	Number of transactions
< 50	12
50 – 100	5
100 – 250	3
250 – 500	1
500 – 1,000	1
1,000 – 2,000	2
> 2,000	1

Five transactions disclosed the valuation multiple:

Target company	Target country	Target industry	Buyer company	Transaction value (US\$m)	Implied EV/ Revenue	Implied EV/ EBITDA
Orient Overseas (International) Ltd.		Logistics	Shanghai International Port (Group) Co., Ltd.; COSCO SHIPPING Holdings Co., Ltd.; Orient Overseas (International) Ltd.	6202.55	1.49x	25.99x
Geiger Fertigungs-technologie GmbH		Energy	Zhejiang Tieliu Clutch Co., Ltd.	44.74	0.73x	N/A
AAG Energy Holdings Ltd.		Energy	Sichuan Liming Energy Development Co., Ltd.; Liming Holding Ltd.	615.09	5.95x	11.16x
Prosper Construction Holdings Ltd.		Logistics	Government of China; Qingdao West Coast Holdings (International) Ltd.	68.50	1.88x	12.01x
Sirtex Medical Ltd.		Healthcare	China Grand Pharmaceutical & Healthcare Holdings Ltd.; CDH Investments	1462.64	8.27x	29.84x

SPOTLIGHT ON: MEDICAL DEVICES

Industry overview and M&A dynamic

The medical device market has been one of the fastest growing sectors in China, maintaining double-digit growth for over a decade. During the past three years, its global M&A activity has been notable for three reasons:

- First, more of the industry's leaders are participating in M&A, resulting in corporations of enormous size. From 2015 to 2017, the global CR10 has increased from 35% to 40%.
- Second, the number of transactions among players in different market segments has been increasing.
- Third, all of this is in line with the increase in cross-border M&A worldwide—especially among Chinese companies.

There are two key factors behind the industry's strong interest in M&A. The first is that medical devices are updated frequently, which shortens their product life cycle, and many device makers seek to remain competitive by acquiring the latest technology. The second is the diverse and purpose-built nature of these devices. With a limited market for each device, manufacturers in their quest for growth resort to M&A to quickly enter different market niches. Deals in developing markets also provide new avenues for expansion.

Another reason cross-border deals have become more popular is the overall potential of the Chinese medical device market. Target companies in other countries recognize that by partnering with a Chinese manufacturer, they will benefit from introducing their products into the large but still rapidly growing Chinese market.⁹

⁹ Hengsheng Securities, "Rethinking and Relearning the M&A Paths Taken by Global Medical Device Tycoons"



These trends are reflected in the recent deals struck by these four leading players:

Blue Sail Medical

Blue Sail Medical Co., Ltd. engages in the manufacture of medical PVC gloves. Its business activities include the development, production and sale of disposal PVC gloves, skin care gloves, household gloves, gloves for children, and other rubber and plastic products. In October 2018, Blue Sail acquired 93.37% of the shares of Biosensors International Ltd. for US\$860 million.

Company strategy: Blue Sail aims to become a leader in the global medical industry via M&A transactions.

- Market cap: US\$2,736m
- Revenue: US\$230m
- EBITDA: US\$49m

Weigao

Shangdong Weigao Group Medical Polymer Co., Ltd. engages in the research, development, production and sale of single-use medical devices. Market segments include single-use medical device products and orthopedic products. In January 2018, Weigao acquired Argon Medical Devices Inc. from Roundtable Healthcare Management Inc. for approximately US\$844.2 million in cash.

Company strategy: Weigao intends to expand its foreign business through outbound M&A transactions.

- Market cap: US\$4,517m
- Revenue: US\$931m
- EBITDA: US\$24m

Kinetic Medical

Shanghai Kinetic Medical Co., Ltd. engages in the research, development, manufacture and sale of medical devices designed for minimally invasive orthopedic surgery. Its products include kyphoplasty balloon catheters, puncture needles and kyphoplasty tool kits. In June 2018, Kinetic Medical acquired Elliquence LLC. for US\$77.2 million in cash.

Company strategy: Kinetic Medical plans to remain competitive through M&A transactions.

- Market cap: US\$1,014m
- Revenue: US\$117m
- EBITDA: US\$4m

Salubris Pharmaceuticals

Shenzhen Salubris Pharmaceuticals Co., Ltd. engages in the research, development, manufacture and sale of pharmaceutical and biomedical products. Salubris offers cardiovascular medications and antibiotics, as well as active pharmaceutical ingredients. In August 2018, the company acquired 9.08% of Mercator MedSystems, Inc. for US\$8 million.

Company strategy: Salubris seeks opportunities to improve its research and development (R&D) capabilities through outbound M&A transactions.

- Market cap: US\$4,238m
- Revenue: US\$603m
- EBITDA: US\$261m

MEDICAL DEVICE ACQUISITION: A CASE STUDY

About the buyers

China Grand Pharmaceutical & Healthcare Ltd. engages in the development, manufacture and distribution of pharmaceutical products, which include ophthalmic medicines for anti-bacterial, antibiotic, antipyretic and analgesic use. The company was founded on 18 October 1995 and is headquartered in Hong Kong.

Company strategy: China Grand Pharmaceutical aims to improve its performance through internal R&D and acquisitions that can enrich its product portfolio.

- Market cap: US\$2,418m
- Revenue: US\$696m
- Net Profit: US\$62m



Working together, **CDH Investments** and **China Grand Pharmaceutical** recently acquired a 100% stake in the Australian cancer treatment specialist **Sirtex Medical Ltd.** for US\$1.4 billion, which represented a 78.4% premium to the target's closing stock price on 29 January 2018. The transaction was funded through internal resources and existing debt facilities, including a US\$700 million financing commitment from the Bank of Macau and a US\$355.7 million loan facility from Sun Hung Kai Investment Services. Under the terms of the deal, CDH Investments and China Grand Pharmaceutical took ownership of approximately 51% and 49% of Sirtex Medical, respectively.

During the bidding process, Varian Medical Systems Inc. tendered a competitive offer that was initially favored by the Sirtex board. But on 22 May 2018, the board said it had received a binding offer from CDH capable of acceptance by way of a scheme of arrangement. On 23 May, Varian Medical declined to submit a counterproposal, and on 20 September, 8 days following approval by the Federal Court of Australia, the deal proposed by CDH officially closed.

About the target

Sirtex Medical engages in the research, commercial development, manufacture and distribution of liver cancer treatments. It offers a targeted radiation therapy, known as SIR-Spheres Y-90 resin microspheres, and its clinical programs include SIRFLOX, FOXFIRE/FOXFIRE Global, SARAH, SIRveNIB and SORAMIC. Sirtex operates in Asia Pacific, the Americas, Europe, the Middle East and Africa.

Market trends and transaction drivers

The deal was driven by the growth potential of China's liver cancer treatment market. Both acquirors believe that Sirtex's products represent a revolutionary way to treat liver cancer that will far outperform existing treatments in the Chinese market. In addition, Sirtex will benefit from the additional distribution channels provided by the buyers.

Deal particulars

The transaction price of US\$1.462 billion for Sirtex represented an EV/EBITDA multiple of 29.84 and an EV/Revenue multiple of 8.27, making this the most expensive outbound transaction ever undertaken by a Chinese company in the medical device sector. Seeking to justify the price it paid for the deal, China Grand Pharmaceutical stated that:

- SIR-Spheres Y-90 resin microspheres, the main products of Sirtex, can provide a very effective way to control liver cancer and are already registered in the major countries around the world.
- The acquisition of Sirtex represents a great opportunity for China Grand Pharmaceutical to expand into the oncology market, given that liver cancer has been one of the leading causes of death in China and the effectiveness of current treatments is limited.
- China Grand Pharmaceutical and CDH are able to help Sirtex effectively develop its international distribution channels, especially in the promising Chinese market.

Appendix: 36 outbound transactions closed between July and September 2018

Date	Buyers/investors	Target/issuer	Country	Primary industry [Target/issuer]	Transaction value (US\$m)
28-Sep-2018	CIMB Group Sdn. Bhd.; China Galaxy Securities Co., Ltd.	Jupiter Securities Sdn. Bhd.		Financial Services	12.91
28-Sep-2018	Health & Happiness (H&H) International Holdings Ltd.	BBB SAS		Consumer & Retail	-
26-Sep-2018	Shanghai Pudong Science & Technology Investment Co., Ltd.	Semicon- ductor Technologies & Instruments Pte Ltd.		Industrial Machinery & Components	66.77
26-Sep-2018	EQT Partners AB; GPA Global	Lucas Promotions Ltd.		TMT	-
26-Sep-2018	EQT Partners AB; GPA Global	Lucas Luxury Packaging Ltd.		Business Support Services	-
24-Sep-2018	Swissport International AG; HNA Group Co., Ltd.	APRON GmbH Airline Support Services		Business Support Services	-
20-Sep-2018	China Grand Pharmaceutical & Healthcare Holdings Ltd.; CDH Investments	Sirtex Medical Ltd.		Healthcare	1,462.64
4-Sep-2018	Wecast Network, Inc.	Grapevine Logic, Inc.		TMT	2.40
31-Aug-2018	Morris Holdings Ltd.	Jennifer Convertibles, Inc.		Consumer & Retail	35.00
28-Aug-2018	Nanjing Sanyou Real Estate Co., Ltd.	Bright Triumph Development Ltd.		Real Estate	18.18

Date	Buyers/investors	Target/issuer	Country	Primary industry [Target/issuer]	Transaction value (US\$m)
28-Aug-2018	Modern Crown Shenzhen /Fan/	Modern Crown Ltd.		Financial Services	0.01
24-Aug-2018	NVC Lighting Holding Ltd.	Blue Light (HK) Trading Co., Ltd.		Financial Services	78.49
24-Aug-2018	China Agroforestry Low-Carbon Holdings Ltd.	Today Bridge Ltd.		Financial Services	21.15
20-Aug-2018	Nodechain, Inc. /Shen/	Nodechain, Inc.		TMT	0.45
17-Aug-2018	TPG Capital Asia, Inc.; TPG Capital Advisors LLC	Healthscope Ltd. /Asian Pathology operations/		Healthcare	206.63
17-Aug-2018	China Hengrui Co., Ltd.	Engenuity Ltd.		Healthcare	-
16-Aug-2018	Sichuan Liming Energy Development Co., Ltd.; Liming Holding Ltd.	AAG Energy Holdings Ltd.		Energy	615.09
16-Aug-2018	ENN Energy Holdings Ltd.	Excellence Award Holding Co., Ltd.		Business Support Services	412.17
16-Aug-2018	Government of China; Qingdao West Coast Holdings (International) Ltd.	Prosper Construction Holdings Ltd.		Logistics	68.50
16-Aug-2018	Bibox	Chain Capital AG		Financial Services	-

Appendix: 36 outbound transactions closed between July and September 2018 (continued)

Date	Buyers/investors	Target/issuer	Country	Primary industry [Target/issuer]	Transaction value (US\$m)
3-Aug-2018	Zhejiang Tieliu Clutch Co., Ltd.	Geiger Fertigungs-technologie GmbH		Energy	44.74
2-Aug-2018	Nanjing Xinjiekou Department Store Co., Ltd.	Shiding Shengwu Biotechnology (Hong Kong) Trading Ltd.		Healthcare	1,048.28
2-Aug-2018	Legend Capital Co., Ltd.; Momentum Sports Development (Beijing) Co., Ltd.	Creative Artists Agency LLC		TMT	-
27-Jul-2018	Shanghai International Port (Group) Co., Ltd.; COSCO SHIPPING Holdings Co., Ltd.; Orient Overseas International Ltd. /Private Group/	Orient Overseas (International) Ltd.		Logistics	6,202.55
26-Jul-2018	Syngenta AG; Government of China	Floranova Ltd.		Consumer & Retail	-
20-Jul-2018	Anton Oilfield Services Group	Anton Oilfield Services DMCC		Energy	95.53
20-Jul-2018	Yue Da Group (HK) Co., Ltd.; City of Yancheng	Absolute Apex Ltd. (British Virgin Islands)		Financial Services	21.91
19-Jul-2018	China Infrastructure Construction Corp.	Hippocrates Direct Healthcare, Inc.		Healthcare	-

Date	Buyers/investors	Target/issuer	Country	Primary industry [Target/issuer]	Transaction value (US\$m)
13-Jul-2018	China Nonferrous Metal Industry's Foreign Eng. & Constr.	PT Dairi Prima Mineral		Energy	198.80
13-Jul-2018	Zhejiang Tiancheng Controls Co., Ltd.	Acro Holdings Ltd.		Financial Services	75.61
12-Jul-2018	Ningbo Sanxing Medical Electric Co., Ltd.	Nansen SA		Industrial Machinery & Components	-
10-Jul-2018	Bison Capital Holding Co., Ltd.	Banif Banco de Investimento SA		Financial Services	33.22
4-Jul-2018	Jack Sewing Machine Co., Ltd.	Finver Spa		Industrial Machinery & Components	28.32
3-Jul-2018	China Triumph International Engineering Co., Ltd.	Orda Glass Ltd.		Consumer & Retail	33.96
3-Jul-2018	TPG Capital LLC; Cirque du Soleil, Inc.; Shanghai Fosun Industrial Investment Co., Ltd.	Vstar Entertainment Group LLC		TMT	-
1-Jul-2018	Wolong Electric Group Co., Ltd.	General Electric Co. /Small Industrial Motor Business/		Industrial Machinery & Components	160.00

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