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VOICE FROM CHINA

QUARTERLY UPDATE ON THE
M&A MARKET IN CHINA

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INTRODUCTION

Following the massive shopping sprees by Chinese companies in 2016, Chinese cross-border M&A activity dropped in 2017, declining moderately both in the number of deals and the total value of all transactions. The strength of the market continued to wane through the final quarter of 2017, as the number of closed outbound transactions fell by 24%, compared to the previous quarter¹.

This decline can be interpreted as a turn towards rationality for the Chinese M&A market, induced by a series of government policies to regulate and guide foreign investment. On the bright side, the new rules, released this past quarter by the National Development and Reform Commission (NDRC), eased the reporting requirements

for outbound investments worth over US\$300 million. It is widely believed that this will not only enhance the efficiency of cross-border transactions, but also greatly reduce the uncertainties and risks associated with obtaining regulatory approval from the Chinese government.

Less certain is the impact of the US government's recent tax reform. The reduced tax rates could potentially attract an even greater flow of Chinese investment to the US, but, how the Chinese government would react to that is unclear. Nevertheless, due to the streamlined reporting procedures and reduced costs for US companies, there is reason to believe that China's M&A market will bounce back in 2018, growing in both transaction size and volume.

THE POTENTIAL IMPACT OF NEW CHINESE REGULATIONS AND US TAX REFORM

NDRC eases policy on outbound investment

On 3 November 2017, the NDRC released new rules to streamline administrative procedures and strengthen regulation over outbound investment by domestic firms. Effective as of March 2018, a 2014 provision will be waived that requires companies contemplating bids on overseas projects worth over US\$300 million to request approval beforehand.

Under the new regulations, the NDRC will only require pre-approval for sensitive projects. For non-sensitive investments worth more than US\$300 million, a Chinese investor can provide the NDRC with the relevant information without filing a formal report. For investments worth less than US\$300 million, no preliminary information needs to be provided. Sensitive dealings that still require preliminary reporting include: (1) projects involving sensitive

countries and regions; and (2) projects involving sensitive industries, such as weapons manufacturing, cross-border water resource development and news media, among others².

Other rule changes that should facilitate outbound investment include eliminating the project information reporting system, abolishing local preliminary examinations and extending the project registration period.

As a result of these changes, we expect the average size of China's cross-border M&A transactions to grow in 2018, compared with the previous year. Taken together, the new regulations reflect a gradual easing on outbound investment, and we expect additional rule changes this year to further encourage cross-border M&A activity.

¹ Source: S&P Capital IQ

² Source: <http://www.ndrc.gov.cn/zcfb/zcfbl/201712/W020171226340410103048.pdf>

Recent changes to Chinese government regulations on direct foreign investment

Time	Issuing department	Summary
27-Apr-2017	State Administration of Foreign Exchange ³	Procedures to verify the authenticity of outbound investments, diminish fraudulent investment practices and strengthen regulatory compliance
12-Jun-2017	Ministry of Finance ⁴	Clarifies responsibility for decision-making, financial operations and the supervision of outbound investments; provides guidelines for operating norms, risk management, control and decision-making systems
18-Aug-2017	National Development and Reform Commission; Ministry of Commerce; The People's Bank of China; Ministry of Foreign Affairs ⁵	Classifies outbound investments into three separate categories: encouraged, restricted and prohibited
03-Nov-2017	National Development and Reform Commission ⁶	Revises procedures related to the definition, filing and approval of outbound investments, especially for transactions valued over US\$300 million
24-Nov-2017	National Development and Reform Commission ⁷	Establishes a foreign economic cooperation credit system; sets out disciplinary measures for regulatory violations pertaining to foreign investment, foreign contracted projects, foreign trade and foreign financial cooperation
07-Dec-2017	State Administration of Foreign Exchange ⁸	With regard to onshore guarantees for offshore loans, requires banks to strengthen their auditing processes to include transaction background, debtor qualifications, the loan purpose, sources of repayment and counter-guarantees
18-Dec-2017	National Development and Reform Commission; Ministry of Commerce; The People's Bank of China; Ministry of Foreign Affairs; All-China Federation of Industry and Commerce ⁹	Provides guidance and standardizes private enterprise activities related to business management, compliance, social responsibility, environmental protection and risk control

³ Official from SAFE answers questions regarding Circular of the State Administration of Foreign Exchange on Further Advancing Foreign Exchange Administration Reform to Enhance Authenticity and Compliance Reviews ([2017] No.3)

⁴ Ministry of Finance Circular on issuing the Measures for the Financial Management of Outbound Investments in State-owned Enterprises ([2017] No.24)

⁵ Circular of Opinions on Further Guiding and Standardizing the Orientation of Outbound Investment ([2017] No.74)

⁶ Administrative Measures on Outbound Investment of Enterprises (Draft)

⁷ Circular of Opinions on Strengthening the Construction of the Credit System in Foreign Economic Cooperation; Memorandum of Cooperation on Joint Punishment Against Grave Breaches of Trust in Foreign Economic Cooperation

⁸ Circular on Improving the Foreign Exchange Administration on Banks' Onshore Guarantees for Offshore Loans

⁹ Operating Norms on Outbound Investment of Private Enterprises

US tax reform likely to attract more investment from China

The recent tax reform legislation passed by the US Congress, along with monetary tightening by the US Federal Reserve, are widely expected to lure more foreign capital to US shores, and Chinese companies are likely to step up their investments in the US to take advantage of the lower tax and higher interest rates.

Such an outcome has the potential to undermine the Chinese government's continuing efforts to curtail the country's outbound capital flows, and a recent report by *The Wall Street Journal* suggests that China's government is preparing to respond. Under its contingency plan, the Chinese government would rely on a combination of "higher interest rates,

tighter capital controls and more-frequent currency intervention" to keep money at home and support the Yuan¹⁰. At the same time, China's government may act opportunistically and loosen in-bound capital controls. It also remains uncertain whether the new US tax rates will actually attract more investment from China, and even if they do, increased outbound investment is unlikely to benefit all sectors equally, as Chinese investors are still liable to steer clear of sensitive industries, such as technology, to avoid the restrictions imposed by the US Treasury department's Committee on Foreign Investment in the United States (CFIUS).

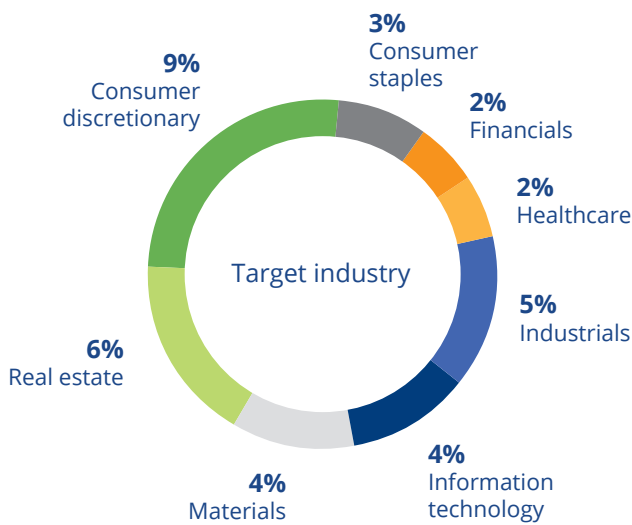
¹⁰ www.wsj.com/articles/beijing-develops-plan-to-counter-trump-tax-overhaul-1513012363



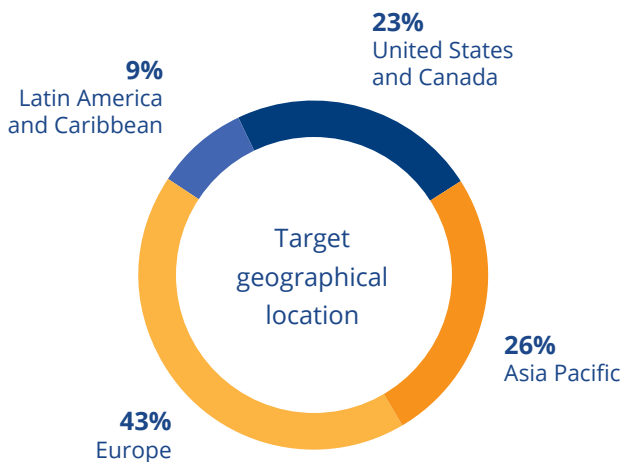
RECENT M&A TRANSACTIONS

Thirty-five Chinese outbound transactions were closed in the final quarter of 2017, compared with 46 closed transactions during the previous quarter, a drop off that may have been due to the government’s ongoing efforts to rationalize and regulate overseas investment activity.

- During the fourth quarter, the consumer discretionary sector drew the lion’s share of M&A activity (26%), followed by real estate (17%) and industrials (14%).



- In terms of regions, Europe drew the most interest (43%), followed by Asia Pacific (26%) and Canada and the US (23%).



- Among the 19 outbound transactions that disclosed the value of the transaction, the largest deal was for US\$13.82 billion (China Investment Corporation - Logicor).



Q4 2017 disclosed transactions by value

Transaction size (US\$m)	Number of transactions
< 50	6
50 – 100	1
100 – 250	4
250 – 500	5
500 – 1,000	2
1,000 – 2,000	0
> 2,000	1

As it did during Q3 2017, the transaction value of Chinese outbound M&A activity remained relatively small overall.

Of the 35 transactions that closed in the last quarter, eight disclosed valuation multiples:

Target company	Target country	Target industry	Buyer company	Transaction value (US\$m)	Implied EV/Revenue	Implied EV/EBITDA
SEG Automotive Germany GmbH	Germany	Automotive	Zhengzhou Coal Mining Machinery Group Company Limited (SEHK:564); Chizhou Zhongan Zhaoshang Equity Investment LLP; China Renaissance Capital Investment	594.26	0.4x	7.6x
Oasis Dragon Limited	Samoa	Baby Care	Goodbaby International Holdings Limited (SEHK:1086)	345.68	1.2x	N/A
Henry Group Holdings Limited (SEHK:859)	Hong Kong	Real Estate	Shanghai Sansheng Hongye Investment (Group) Co., Ltd.	342.84	51.4x	104.7x
On Time Logistics Holdings Limited (SEHK:6123)	Hong Kong	Logistics	YTO Express Group Co., Ltd. (SHSE:600233)	156.68	0.6x	40.6x
Aquascutum Holdings Limited	UK	Apparel	Jining Ruyi Investment Co., Ltd.	117.00	3.3x	N/A
RoadShow Holdings Limited (SEHK:888)	Hong Kong	IT	Bison Capital Holding Company Limited	103.02	1.9x	N/A
Lirtix SA and Rondatel SA	Uruguay	Food	Qiqihar Hengyang Food Processing Co., Ltd.	82.72	1.3x	N/A
LCE HK Limited	Hong Kong	Business Services	Smartac Group China Holdings Limited (SEHK:395)	13.92	7.2x	N/A

SPOTLIGHT ON AN ACQUISITIVE CHINESE BUYER



Huafu Fashion Co., Ltd. (SZSE:002042) is the leading brand and the world's largest manufacturer of mélange yarn, which is used in an array of products including underwear, shirts, business suits, socks, bed linens, towels and decorative fabrics. The company also produces raw-white, dyed, semi-worsted and open-end spinning yarn products for markets in Europe, the US, Japan, Korea, Hong Kong, Macau and Southeast Asia.

Among its numerous domestic acquisitions, in August 2011, Huafu invested US\$24.49 million for a 67% stake in Kuitun Jingye Textile Co., Ltd., which manufactures textiles and agricultural products. Earlier, in December 2010, Huafu purchased a US\$95.75 million minority

stake in Xinjiang Liufu Textile Industrial Park Co., Ltd., which manufactures yarn products.

Now, to support its growth strategy of rapid market penetration worldwide, Huafu is actively looking to acquire US-based companies that are part of the global apparel, textile and home textile supply chains. In addition, it is seeking to buy European companies with expertise in innovative clothing and textile technologies. Huafu is also interested in purchasing stakes in overseas makers of industrial textile machine parts, which the yarn manufacturer can integrate into its existing machinery as part of its ongoing effort to enhance its production efficiencies.

AN OUTBOUND M&A CASE STUDY OF NOTE

In a US\$117 million deal, Ruyi Investment, the investment arm of the Shandong Ruyi Woolen Garment Group, acquired a majority stake in the British clothing brand Aquascutum from YGM Trading Limited.

About the buyer



Jining Ruyi Investment Co. Ltd. is the investment arm of the Shandong Ruyi Woolen Garment Group, which manufactures and sells woolen and cotton textiles and garments in China and internationally. Jining Ruyi Investment provides investment management services for the maker of clothing, footwear, cotton, wool and chemical fiber products. In other recent transactions, Ruyi purchased a majority stake in SMCP S.P.A., which owns the French brands Sandro, Maje and Claudie Perlot, and a 41% stake in the Japanese clothing brand RENOWN. It also bought a minority stake in London-based TM Lewin and an 80% stake in the UK-based worsted fabric specialist Taylor & Lodge in 2014.

About the target



Aquascutum manufactures and sells apparel and related products. As the inventor of a technique for producing waterproof wool, the firm became one of the most popular clothing brands in the UK and has a large roster of celebrity clients.

Market trends and transaction drivers

Although Ruyi is one of China's top 10 woolen textile producers, it has been challenged by the steady depreciation of the British pound and is seeking to transform itself from a production-oriented manufacturer to a brand-oriented apparel company with sway in the global fashion industry. The acquisition of Aquascutum is an attempt to accelerate this process, by giving it entrée into the ready-to-wear business and its higher profit margin.

Appendix: 35 outbound transactions closed between October and December 2017

No.	Date closed	Buyers/investors	Target/issuer	Headquarters - country [Target/issuer]
1	31-Dec-17	China Renaissance Capital Investment; Zhengzhou Coal Mining Machinery Group Company Limited (SEHK:564); Chizhou Zhongan Zhaoshang Equity Investment LLP	SEG Automotive Germany GmbH	Germany
2	29-Dec-17	Shanghai Kangzheng Investment Management Co., Ltd.	Planta Metalurgica Antay Pacha S.A.	Bolivia
3	28-Dec-17	Smartac Group China Holdings Limited (SEHK:395)	LCE HK Limited	Hong Kong
4	22-Dec-17	Hangzhou Jinjiang Group Co., Ltd.	Jinjiang SAM	France
5	21-Dec-17	Eurazeo SE (ENXTPA:RF); Primavera Capital Group	WorldStrides, Inc.	United States
6	21-Dec-17	Shanghai Sansheng Hongye Investment (Group) Co., Ltd.	Henry Group Holdings Limited (SEHK:859)	Hong Kong
7	21-Dec-17	Wanfeng Aviation Industry Co., Ltd.	Diamond Aircraft Industries GmbH	Austria
8	20-Dec-17	Temasek Holdings (Private) Limited; New Hope Group Co., Ltd.; Beijing Hosen Investment Management, LLP; Genbridge Capital	Real Pet Food Company	Australia
9	19-Dec-17	Pacific Media Group Ltd.	Barnsley Football Club 2002 Limited	United Kingdom
10	12-Dec-17	Mercari Communications Group, Ltd. (OTCPK:MCAR)	Mercari Communications Group prior to reverse merger with Chengdu Aixin Zhonghong Biological	United States
11	5-Dec-17	Beijing Ideal China Group Co., LTD	One Newark Center	United States
12	5-Dec-17	Cheung Kei Group	5 Churchill Place	United Kingdom
13	30-Nov-17	China Investment Corporation	Logicor Europe Ltd.	United Kingdom
14	23-Nov-17	Jining Ruyi Investment Co., Ltd.	Aquascutum Holdings Limited	British Virgin Islands
15	20-Nov-17	Qiqihar Hengyang Food Processing Co., Ltd.	Lirtix SA and Rondatel SA	Uruguay
16	17-Nov-17	Boao-Gruppe	Rebo Lighting & Electronics GmbH	Germany
17	13-Nov-17	Kenergy Scientific, Inc. (OTCPK:KNSC)	Parliament Holdings, LLC	United States

Primary industry [Target/issuer]	Total transaction value (US\$m, historical rate)	% Sought	Implied Enterprise Value/Revenues (x)	Implied Enterprise Value/EBITDA (x)
Auto Parts and Equipment	594.26	100.0	0.366	7.56
Copper	2.64	100.0	-	-
Internet Software and Services	13.92	51.0	7.23	-
Aluminum	21.9	100.0	-	-
Education Services	-	-	-	-
Diversified Real Estate Activities	341.86	74.76	51.24	104.42
Aerospace and Defense	-	100.0	-	-
Packaged Foods and Meats	777.73	-	-	-
Movies and Entertainment	26.68	80.0	-	-
Education Services	-	100.0	-	-
Real Estate Operating Companies	-	100.0	-	-
Real Estate Operating Companies	363.09	100.0	-	-
Real Estate Operating Companies	13,815.27	100.0	-	-
Apparel, Accessories and Luxury Goods	117.0	100.0	3.29	-
Packaged Foods and Meats	82.72	100.0	1.35	-
Auto Parts and Equipment	-	100.0	-	-
Hotels, Resorts and Cruise Lines	-	100.0	-	-

Appendix: 35 outbound transactions closed between October and December 2017

No.	Date closed	Buyers/investors	Target/issuer	Headquarters – country [Target/issuer]
18	13-Nov-17	Zhejiang Geely Holding Group Co.,Ltd	Terrafugia, Inc.	United States
19	10-Nov-17	ChaoZhou Three-Circle (Group) Co.,Ltd. (SZSE:300408)	VERMES Microdispensing GmbH	Germany
20	9-Nov-17	Fujian Thaihot Investment Co., Ltd.	Macau Life Insurance Company Limited	Macau
21	8-Nov-17	Bohai Commodity Exchange Co., Ltd.	Public joint-stock company "Ukrainian Bank for Reconstruction and Development"	Ukraine
21	6-Nov-17	GPA Global	MW Creative Ltd	United Kingdom
22	6-Nov-17	Shandong Luxin-Rio Visual Technology Company Limited	Arts Alliance Media Ltd	United Kingdom
23	6-Nov-17	Taihai Manoir Nuclear Equipment Co., Ltd. (SZSE:002366)	Duisburg Tubes Production AG	Germany
25	3-Nov-17	YTO Express Group Co., Ltd. (SHSE:600233)	On Time Logistics Holdings Limited (SEHK:6123)	Hong Kong
26	1-Nov-17	Ctrip.com International, Ltd. (NasdaqGS:CTRP)	Trip.com	United States
27	27-Oct-17	Bison Capital Holding Company Limited	RoadShow Holdings Limited (SEHK:888)	Hong Kong
28	26-Oct-17	Bosch Huayu Steering Systems Co., Ltd.	ASCN	Germany
29	25-Oct-17	Rantum Capital Management GmbH; Cedarlake Capital	Bartholet Maschinenbau AG	Switzerland
30	24-Oct-17	Anhui Shanying Paper Industry Co.,Ltd. (SHSE:600567)	Nordic Paper Holding AB	Sweden
31	23-Oct-17	Goodbaby International Holdings Limited (SEHK:1086)	Oasis Dragon Limited	Samoa
32	20-Oct-17	Logan Property Holdings Company Limited (SEHK:3380)	Florence Regency	Singapore
33	17-Oct-17	WuXi AppTec Co., Ltd.	Cycle Solutions, Inc.	United States
34	13-Oct-17	Bank Of China Group Investment Limited; Ascendent Capital Partners; Ally Bridge Group; GL Trade Investment Limited; Avengers Limited; Boying Investments Limited	SciClone Pharmaceuticals, Inc.	United States
35	11-Oct-17	Kailong Fund	Three Properties in Sheung Wan	Hong Kong

Primary industry [Target/issuer]	Total transaction value (US\$m, historical rate)	% Sought	Implied Enterprise Value/Revenues (x)	Implied Enterprise Value/EBITDA (x)
Aerospace and Defense	-	100.0	-	-
Electronic Equipment and Instruments	-	100.0	-	-
Life and Health Insurance	27.93	100.0	-	-
Regional Banks	3.3	99.9	-	-
Paper Packaging	-	100.0	-	-
Application Software	-	100.0	-	-
Industrial Machinery	-	100.0	-	-
Air Freight and Logistics	156.68	61.87	0.562	40.58
Internet Software and Services	-	100.0	-	-
Advertising	103.02	73.01	1.86	-
Auto Parts and Equipment	-	100.0	-	-
Industrial Machinery	-	-	-	-
Paper Products	291.71	100.0	-	-
Personal Products	345.68	100.0	1.2	-
Real Estate Operating Companies	462.2	100.0	-	-
Life Sciences Tools and Services	-	100.0	-	-
Pharmaceuticals	-	-	-	-
Real Estate Operating Companies	128.11	100.0	-	-

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