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10 years of China Outbound Merger & Acquisitions, trends and lessons learned

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Overall M&A in China (inbound, outbound and domestic) reached a peak in 2010 with US$ 209 Bil of transactions (up 27% over 2009) in 4,251 disclosed transactions. 2010 and 2011 also confirmed the healthy rise of outbound transactions: between 2009 and 2010, outbound transactions grew by as much as **30%**, with 188 transactions and a combined value of US$38 Bil (up from 144 deals and US$ 30 Bil in 2009). In 2011, outbound transactions reached US$ 42.9 Bil, up 12% from 2010 (across 207 deals, +10% over 2010)[1]. Yet, outbound transactions represented a mere **18%** (in value) of the total China M&A market, dominated by domestic transactions. The local market – highly competitive and undergoing consolidation in many areas, grew by 6% to reach 2,947 disclosed deals in 2010 (US$131 Bil in value, up 41% over 2009). Despite a 10% growth in domestic transactions in H1'2011 (reaching 1,616 deals), the overall China M&A market slightly contracted in 2011 to reach US$ 201 Bil in value (-4% from 2010)[2].

To explain the steady growth of China's outbound transactions, one has to look into deeply rooted factors: since the 1990s, China has engaged in a consolidation and restructuring process for strategic industries with the aim of creating national champions with global ambitions. China's State Council selected a batch of business groups to undergo trial reforms in 1991. 57 large groups were selected in key industries. By 1997, there were 120 of these large groups. To help them succeed, Beijing has been providing a set of powerful tools including highly favorable regulations (creating barriers to entry), local credit support and generous export credit and subsidies. For example, early 2009, the five main Chinese commercial banks issued about US$ 22 Bil worth of loans to support 11 different M&A deals[3]. That included the massive US$ 21 Bil loan granted to Chinalco for its (failed) bid to Rio Tinto. The credit terms of this loan were amazing. Chinalco would have paid only 0.945% above 6-month LIBOR, when competing bidder, BHP Billiton, the world's largest mining company then, would have paid 3.45% above 6-month LIBOR for a 5-year bond or 3.9% above 6-month LIBOR for the 10-year bond. The Policies set out in the 12th Five Year Plan ratified in spring 2011 by the Central Committee of the CPC are a logical extension of these "go global" guidelines enacted 20 years earlier. The recent Policies are encouraging consolidations and restructuring, particularly in the Automotive, Steel, Cement, Aluminum, Rare Earth Metals and Chemicals sectors. The 12th Five Year Plan also strengthens

[1] http://www.pwccn.com/home/chi/pr_130112_chi.html
[2] http://companies.caixin.com/2012-01-04/100345521.html
[3] according to CBRC, China Banking Regulatory Commission

and encourages Chinese companies' overseas ambitions in "Seven Strategic Emerging Industries", such as energy efficiency and clean energy, environment protection, advanced materials and next-generation vehicles, IT, manufacturing and biotechnology.

The largest outbound M&As are traditionally happening in the natural resources sector, the most strategic sector for the local manufacturing industry. Most transactions in the sector are beyond US$ 1 Bil, the largest being the acquisition of Addax Petroleum (Canada-based) by Sinopec for US$ 8.1 Bil in 2009 and the acquisition of 40% of Repsol YPF's equity in Brazil by the same Sinopec for US$ 7.1 Bil in 2010. In 2011, there were 16 outbound transactions above US$ 1 Bil in value (compared with 12 in 2010), 14 of these transactions occurring in the natural resources and energy fields. The manufacturing sector comes second: one of the largest transactions of 2010 was the US$ 1.8 Bil acquisition of Volvo by Geely. Smaller transactions (US$ 50-100 Mil) took place in textile, machinery, logistics, transportation, hospitality etc.

Geographically, the US became the main destination for outbound M&As, with 32 deals in 2010 (vs 21 in 2009) followed by Europe (20 deals), Africa (17 deals) and Japan (16 deals). While Asia remained China's second largest outbound M&A destination (33 deals in H1'2011), Europe transactions grew faster in H1'2011 to exceed all 2010 transactions (30 in H1'2011 vs 20 in 2010).

Two very large transactions marked the end of 2011 and confirmed the trend that Chinese SOEs[4] and large private enterprises are taking well advantage of a low euro and US dollar against the Yuan, that they recognize the strong brands and technology developed in the West and that they now have the confidence to go after much prized national assets, for example during a series of privatizations in Europe aimed at reducing budget deficits. In December 2011, China Three Gorges Group, the operator of the Three Gorges Dam (China's largest hydropower developer), announced the acquisition of 21.35% of Energias de Portugal (EDP) for a whopping EUR 2.69 Bil. EDP accounts for 9% of Portugal's GDP and is also the main power generator in Brazil, an attractive destination for the Chinese Group and Chinese SOEs in general. Earlier in December, HNA Group (the parent company of Hainan Airlines, a group claiming US$ 10 Bil revenue in 2010) acquired the world's 5th largest marine container leasing company, GE SeaCo, a transaction estimated at US$ 2.5 Bil.

China's outbound M&A history has been marred by painful failures, reminding us that relationship and partnership building, lobbying and soft skills are critical tools that Chinese companies must acquire when conducting overseas transactions. The failed Chinalco bid on Rio Tinto in 2009 (and elder failed attempt of CNOOC at Unocal in 2005) served as a testimony that Beijing aggressive export-driven policies, via Chinalco and CNOOC, were perceived as "reckless", "unfair" and even "hegemonic", thus frustrating foreign parties' sensitivity and patience. The human aspects of the post-merger integration and local politics in the country were also very much overlooked. Trying to outmaneuver one's own regulator at home could also be fatal, like in the Tengzhong's failed bid at GM's Hummer in 2009-2010. Not only did China's MOFCOM[5] not

[4] SOE: State-Owned Enterprise
[5] MOFCOM: Ministry of Commerce

see a deep connection and synergy between the heavy machinery maker from Sichuan and the luxury vehicle manufacturer, but press releases mishandlings and attempts by Tengzhong to move the deal offshore in hope to save tax liabilities for GM were futile (and totally illegal[6]) as it would have been impossible to build a manufacturing plant onshore for Tengzhong-Hummer without MOFCOM and other authorities' approval.

Learning from some of these historical failures, many Chinese companies have taken a more conservative approach by forming a JV or becoming minority shareholders in a target company before acquiring it entirely. Chinese companies also started to take integration issues seriously and to answer such key questions as: "what is the acquisition for?", "what is the vision of the merger?" or "are there enough synergies between the two companies?". A pattern, mainly related to the economic crisis in the West, also emerged: Chinese companies now tend to target weak or distressed companies with shareholders seeking an exit or companies needing entry into the Chinese market but who do not have the financial means to do so. A few successful deals illustrate these important changes:

- 2004: TCL acquired Alcatel Mobile phone division. Starting with a JV, TCL acquired the remaining part of the JV in 2005 and turned around the company (total cost: EUR 110 Mil). Strong of its experience, TCL then acquired (2011) the main assets of France's Sagem Wireless, which included a 450-people R&D Center in China's Zhejiang province (*disclaimer: Shanghaivest conducted this transaction*).
- 2005: Lenovo bought the laptop division of IBM for US$ 1.25 Bil and took over US$ 500 Mil of IBM's debt. IBM first took 18.9% of Lenovo and signed a 5-year cooperation agreement with Lenovo. Meanwhile, Lenovo took ownership of IBM's R&D centers in Japan, US and the Shenzhen factory (10,000 employees) and for five years, Lenovo products were supported by IBM after-sales organization and maintenance centers.
- 2010: Fosun purchased 7.1% of Club Med (luxury tourism) for an estimated EUR 22 Mil and in 2011 purchased an additional 2.8%. The synergy was strong as China is becoming the first luxury market in the world circa 2015 and Fosun was on paper a good partner to help Club Med localize their concept to the local affluent population. Fosun later acquired 9.5% of Folli Follie, an Athens-listed luxury company for EUR 84.6 Mil. Folli Follie already had hundreds of stores in China, so it was already a local success story.
- 2010: Zhejiang Geely announced they purchased Volvo (from Ford) for US$ 1.8 Bil. To win the deal "emotionally", Geely reiterated that the company would retain its headquarters and manufacturing in Sweden and Belgium, and that the board would remain mainly Swedish, giving much freedom to Volvo's management. In February 2011, Geely and Volvo's CEOs also announced a US$ 11 Bil five-year development plan, including prospective China plants and the hiring of 1,200 engineers in Belgium.

[6] Contravening Circular 601 Guidelines, issued by SAT (State Administration of Taxation) on December 9, 2009 regarding Offshore Beneficial Ownership.