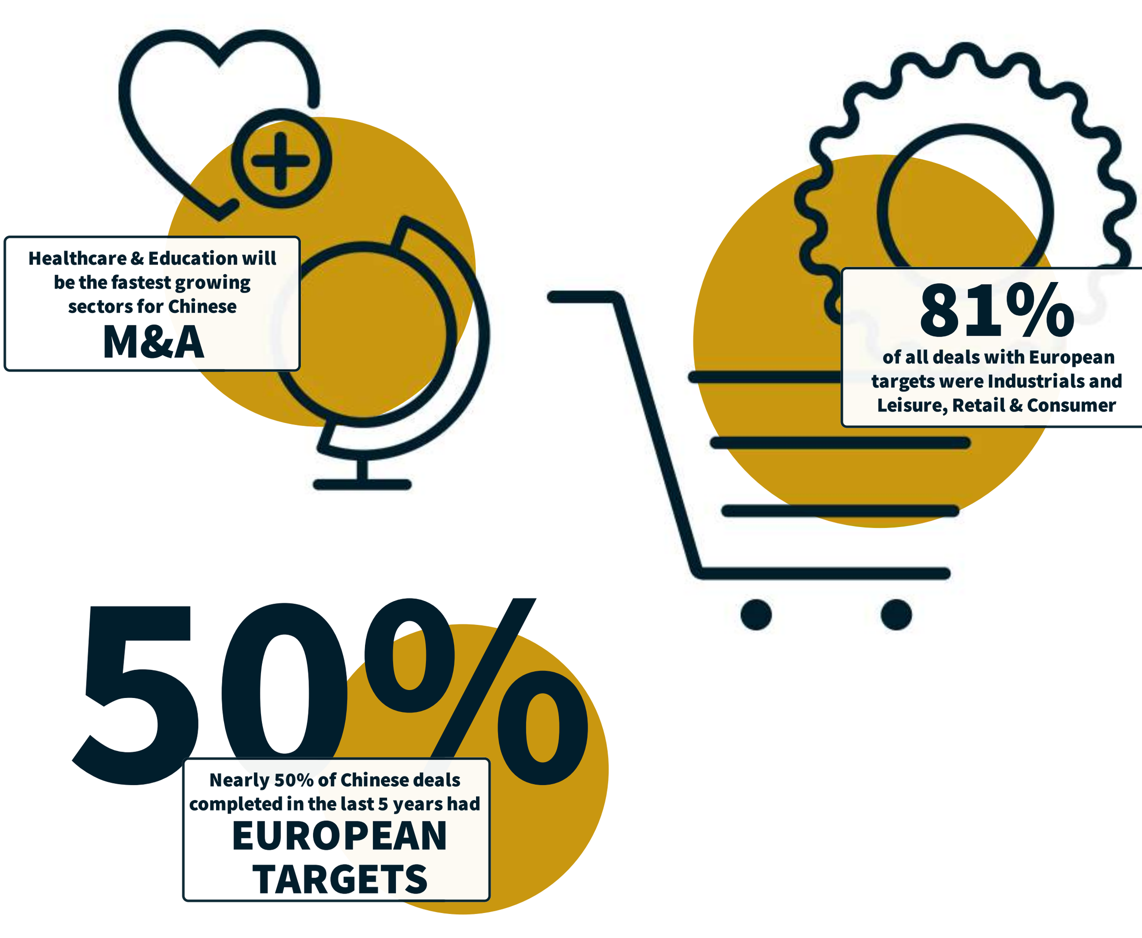
Chinese Buyers: Perception & Reality

What's driving Chinese M&A?

06 December 2016

China's market volatility, high levels of debt and economic slowdown are, by now, familiar headlines. In addition, the government is now to limit overseas acquisitions to prevent further declines in the value of the renminbi. Nevertheless, Chinese interest in acquisitions of companies in Europe and the US has increased sharply. While past acquisitions were often undertaken solely to support the government's plans, recent deals have shown that capital markets and commercial objectives have become more important. The current five-year and 10-year plans are designed to achieve growth and stability within specific areas, such as quality of life goals and the modernisation of China's manufacturing industry. This article will explore China's acquisitions of overseas businesses and the role and characteristics of M&A in the market.



China's five-year plan

China launched its current five-year plan in March 2016. It aims to grow GDP by 6.5% annually and achieve objectives designed to increase quality of life for the population.

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Factors influencing Chinese buyers

China's top down approach in the way it governs its commercial enterprises is unique. Specific areas of mandated focus include green energy, improved healthcare and infrastructure services. At the same time its capital markets industry is growing in influence and domestic companies have a strong appetite for international acquisition. Their buying behaviour is still influenced by long-term, state-led objectives and access to significant capital but commercial interests are increasingly important.

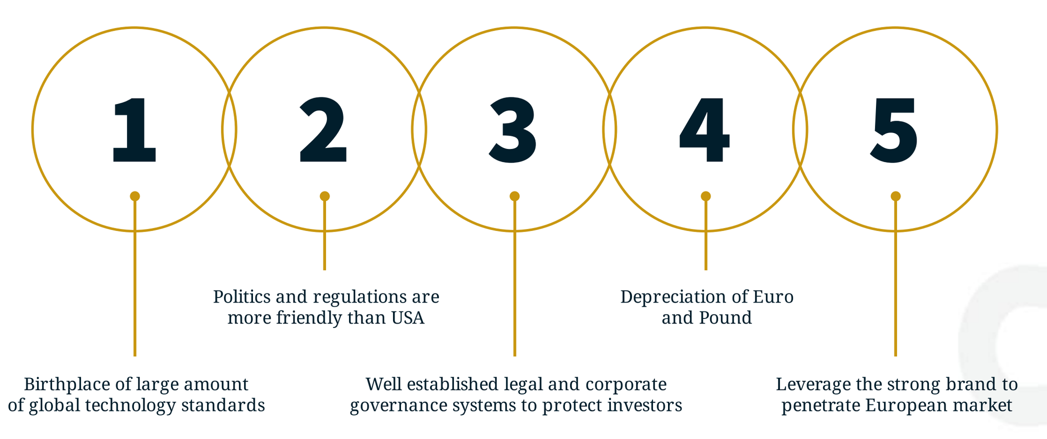
Shift in growth strategy

The headlines around China's recent slowdown are constant. However, in reality the Chinese government has shifted its attitude towards growth; it no longer measures China's advancement with one-dimensional growth rate statistics – today's focus is on the nature and quality of the growth. Chinese buyers are more strategic than before.

China's rules on outbound foreign investment

Recent reports indicate that China's government plans to tighten approvals on outbound foreign investment to restrict capital flight and clampdown on money laundering. If they're implemented, the rules are tied to deals that are worth over USD1BN and specifically cross-sector. It would also mean investments made by wealthy individuals are scrutinised for money laundering abuses. This is less likely to impact deals in the mid-market, deals with strategic rationale and those with strategic importance to China and its broader objectives. Out of the deals completed so far in 2016 with a Chinese acquirer less than 10% would be impacted by these rules. However, this shows how important it is for companies to navigate China's regulatory and business landscape when it comes to cross-border deal processes.

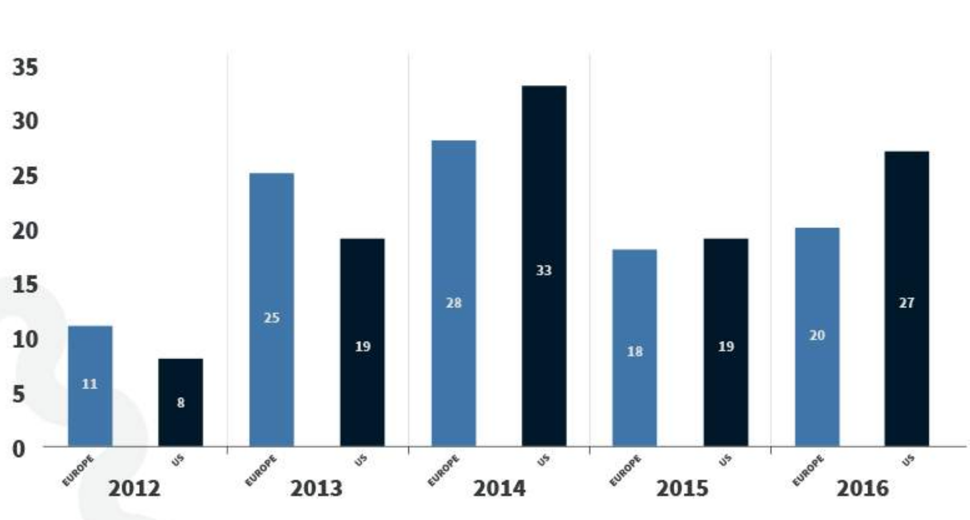
Top 5 reasons Chinese buyers acquire European companies



Where will China buy?

The US may increase trade regulation next year. This would mean M&A with US companies is less appealing to foreign investors. At the same time, we expect a high volume of deals involving overseas targets and Chinese buyers. If the US limits foreign investment, Chinese companies may want to acquire European businesses more than they do their US counterparts. However, there are a number of vendors who are sceptical about the capacity of Chinese companies to complete transactions, driven by a lack of experience and concern around the approval processes required. Nevertheless, it is the experience of our Asia Access team that many of these obstacles can be overcome by careful management.

Deals completed with Chinese buyer & European & US targets 2012-2016



Mid-market deals (valuation GBP50MN-GBP1BN) completed in Europe by Chinese acquirers, 2012-2016. Data source: Mergermarket, analysis: DC Advisory

China's 10-year plan

China announced its inaugural 10-year plan in 2015, Made in China 2025, which has a sector-specific aim. The State Council of China (MIIT) established the plan in order to support domestic advanced manufacturing, inspired by the German Industrie 4.0 concept. The plan is designed to evolve China from being a mass goods manufacturer to a high quality goods manufacturer. It aims to strengthen the capabilities of Chinese corporates through improvements in technology. Chinese companies are also driving international investment through 'technology transfer' plays, that is, acquisitions of technology firms to achieve rapid innovation. New Horizon Capital – a Beijing based private equity firm – recently acquired a stake in Punch Powertrain NV (Punch Powertrain). Punch Powertrain develops and manufactures fuel efficient continuously variable transmissions, hybrid powertrains and electrical drive systems for passenger cars. The deal means that Punch Powertrain can expand in Asia and New Horizon Capital can support growth in cutting edge automotive technologies.

Made in China 2025

Technology acquisition has political & financial support

Chinese companies have demonstrated a strong will to continue acquiring technologies. Additionally, the acquisition of advanced technology makes it easier for buyers to receive both political and financial support. Firms typically maintain the existing operations of the acquired company (generally based in Europe or the US) and develop the offering for local, Chinese consumers.

Since 2012 China-Europe deals completed with

UK 30% | **GERMANY 18%** | **FRANCE 10%**

DC China-Europe Deals

Many recent deals show the trend to drive quality and growth is already influencing buying behaviour. DC has completed four China-Europe deals so far in 2016 alone.

- Sailing Capital's acquisition of Astrum Education: Astrum Education is a collection of independent sixth-form colleges in London which between them educate 750 students. It was acquired by Sailing Capital, a Hong Kong-based investment firm. This acquisition directly supports the state's objective to develop the education sector.

- Midea's acquisition of Clivet: Midea is a listed global manufacturer of consumer appliances and heating, ventilation and air-conditioning (HVAC) systems. Clivet is a leader in the design, manufacture, sale and service of HVAC solutions. Clivet has developed proprietary heat pump technology-based systems which use energy sustainably. Its acquisition is the most recent example of a strategic deal with Chinese and European counterparties. With this deal Midea can expedite its technology development and support the state's objectives around green energy, as well as achieve its own commercial aims.

What this means for M&A

When the plan concludes in 2025 China will have fulfilled several schemes to keep economic growth on track and address quality of life challenges. The government announced investments of USD180BN to upgrade internet infrastructure, USD20BN for public housing and USD40BN for high speed railways. In turn, this will impact M&A activity. In developed countries a majority of economic growth and innovation comes from small and medium-sized enterprises (SMEs). That means understanding how Chinese state-led investments will trickle down to smaller companies is central for overseas companies interested in M&A with a Chinese buyer.

What are Chinese buyers interested in acquiring in the mid-market?

Our research shows that M&A activity in the industrials sector is set to continue. Additionally, Chinese companies continue to acquire **technology, media and telecommunications** (TMT) companies and there is a growing interest in **healthcare**. Chinese buyers are moving away from heavy industrials and towards knowledge-based industries. Recent cross-sector acquisitions show this. For example, Cultural Investment Holdings, a Chinese listed company, acquired Framestore, an Oscar-winning British visual effects company.

1. INDUSTRIALS

2. HEALTHCARE

3. EDUCATION

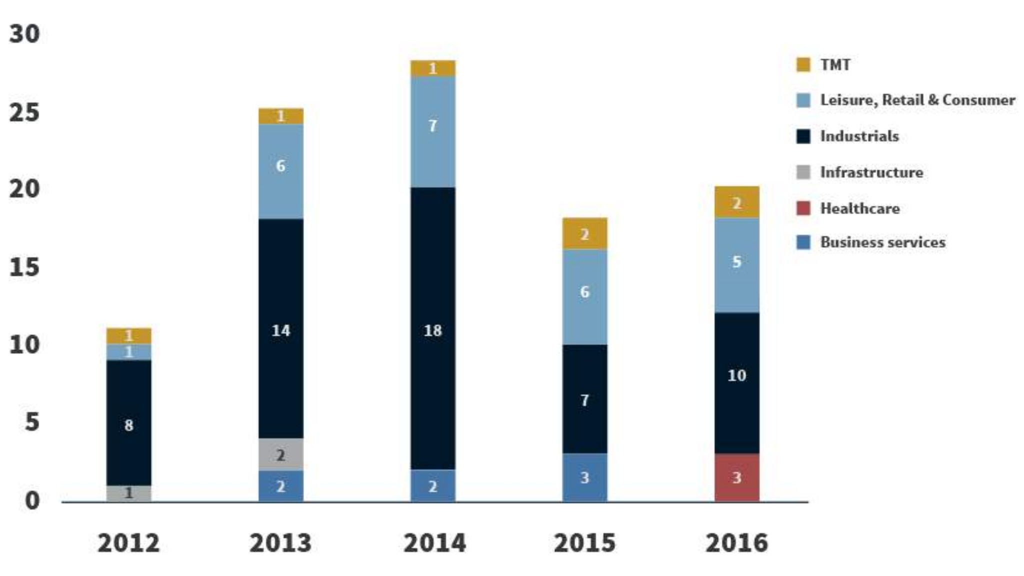
4. TMT

Change is imminent in the West

Change is imminent in the West and today the uncertainty is palpable. The President-Elect of the USA's protectionist views and Brexit in the UK are affecting day-to-day business for Western players and their Chinese counterparts. However, in June Premier Li Keqiang of China told an audience at the World Economic Forum in Tianjin that countries should collaborate to ensure they are well-positioned in the global economic environment. He said China would seek to continue to "dedicate itself to maintaining the good development of Sino-Europe and Sino-British ties". This is in line with China's aim to continue to move west in order to create new opportunities and achieve growth. M&A is one of the most effective strategies China can employ to achieve its growth and quality of life objectives.

Click here to see all deals completed by DC Advisory with China.

European mid-market deals completed by Chinese acquirers 2012-2016



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