



2nd ANNUAL INTERNATIONAL M&A ADVISOR SUMMIT

International Forum - China - M&A Market Report

What risk factors are causing even the most experienced dealmakers to slow down their M&A activities in China? According to a study released by PwC in August 2012, M&A activity in China declined by a third in the first half of the year, as companies held back on deals amid uncertainty over the world's second-largest economy. The biggest drag on M&A activity was a 42 percent fall in the number of inbound deals into China by foreign buyers and a 25 percent decline in domestic deals, compared to the same period a year ago.¹

A number of factors, including economic, governmental and political changes taking place in the U.S. as well as in China have contributed to investors' greater sense of caution. However, many experts still cite China as a top choice for M&A acquisition strategies, provided that investors take the time to identify the most pressing risks and opportunities today.

Several China M&A experts recently shared their insights and advice with attendees at the M&A International Summit held in New York. The Symposium Session faculty members included:

- **Mark Zavadskiy** [Moderator], Asia Bureau Chief, Russia Beyond the Headlines
- **Al Ernest**, Principal and Senior Operations Leader, East West Associates
- **Professor Ann Lee**, Author, "What the U.S. Can Learn From China"
- **Alex Hao**, Partner, Jun He

Moderator Mark Zavadskiy kicked off the session by asking, "What kinds of U.S. companies should be going into China now? And what should they be considering before making the move?" Following are the areas critical importance noted by the panelists.

Cautious But Preparing for Future M&A

Foreign investment into China may have slowed down in the past year, but Al Ernest, Principal & Senior Operations Leader of East West Associates sees many companies making preparations for future M&A activities. "When I talk to American companies, they're preparing business cases and the metrics of understanding what a China play might look like," Ernest said, "They're on hold for the next couple of months, but they're watching to see whether it is a little more favorable to go in or not." In advance of that, he says many companies getting prepared so that they're ready to go when opportunities become available.

Identifying Good Targets for Acquisition

So what makes a company a good target in China? Are there certain kinds of laws that investors should take into consideration? The answers, according to the panelists are not always clear-cut. China's reticence to

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¹ Jean Chua, CNBC, "China M&A Activity Plunges by a Third in First Half: PwC." 8/14/2012.

welcome foreign investment is understandable when it involves sectors where the assets are a matter of national security. But national security concerns are not the only reason the Chinese government may block a potential acquisition.

In the case of Coca Cola's \$2.4 billion bid to acquire Huiyan Juice Group, the government refused to accept the bid with little explanation. In fact, noted Alex Hao, partner of law firm Jun He, there was talk of retaliation for the U.S. government's treatment of Chinese companies trying to do elsewhere in that world, that were blocked on anti-trust grounds, but he pointed to other factors that could have affected the Coca Cola and potential future deals.

Specifically, he urged attendees to remember that the Chinese government has introduced several anti-trust, anti-monopoly and anti-corruption measures in recent years, all of which need to be more carefully understood by foreign investors before they identify a target. In the case of Coca Cola's acquisition of Huiyan Juice Company, the sale of Huiyan would have placed a Chinese company with an estimated 40% market share into a very large foreign company's control. This may have been enough to squelch the deal.

Further, although the Huiyan decision came on the heels of recently passed anti-trust legislation, Alex cautioned attendees from inferring too much about future M&A decisions from this case. "We have not seen a continuation of that and we don't see this is a trend or a precedent setting case by itself. We still need to see more cases to determine whether it is a path in terms of the Chinese government's sentiment to foreign positions in China."

China has also introduced new anti-corruption legislation, a factor that can have significant impact on foreign investors whose countries also have adopted anti-corruption policies. Hao noted that his firm has been helping U.S. companies understand the anti-bribery laws in China, because "an anti-bribery investigation in China could almost invariably trigger an FCPA investigation in the U.S."

Citing several such examples, panelists noted that China has changed significantly in the past few years, in terms of political, governmental and business practices. Rather than jumping to conclusions based on high profile cases or news stories, they urged investors to work with advisors who have a demonstrated knowledge of current M&A risks and opportunities in China before approaching a target.

Understanding Government Involvement in M&A

Are certain industries more protected by the Chinese government than others? In this respect, noted Hao, it may be a little easier for foreign investors to go into China, because the Chinese government publishes an "industry policy" that designates industries and their level of protection. "China has something the U.S. does not – an industry policy or a catalog, that divides all industries into four categories: "Encouraged," "Permitted," "Restricted," and "Prohibited" categories. He recommended that any potential investor first check the industry catalog, early in their research.

However, as the next step beyond this “black & white” categorization, investors also need to gain a sense of the more subtle elements of Chinese M&A market, including the government’s motivating interest in a given industry or company. “The official line out of the Chinese government is that they are very open to M&A activities and want to promote it,” noted Professor Ann Lee, author of “What the U.S. Can Learn From China.” She added, “I suspect that part of this is also to encourage their own SOEs to buy up certain companies.”

In Lee’s view, to get into M&A in China is “a mixed bag, because so many companies there are growing organically that they’re not really focused on M&A – they’re just so busy doing the blocking and tackling to take advantage of the growth that is currently going on. “M&A is typically used by companies as a growth strategy when they don’t have the organic growth themselves,” she said, “This is not the case in China.”

Impact of Culture on Business Negotiations

If understanding government policy is a critical component to success, learning how negotiations are conducted in China is equally as important. “If an opportunity for M&A comes up, the American company has to be well aware of the cultural differences between the U.S. and China,” said Ernest, “You need to take the time to learn about Chinese culture before making an acquisition.” In his opinion, this is the most important factor in determining an M&A transaction’s success or failure. Americans and Chinese, he argued, are very far apart on the continuum of human communications.

“American culture is egalitarian and task-oriented,” he said, “Chinese culture is built on relationships and hierarchy. We represent total opposites of the communication spectrum.” Buyers need to know how these two very different mindsets approach business negotiations if they want a winning deal.

Ernest and Hao also stressed the importance of conducting proper due diligence on any Chinese M&A transaction. “First there has to be trust,” said Ernest, “The Chinese company has to want to work with you and you’ve got to build that relationship. Following that, you need to conduct thorough due diligence, including operational due diligence, because [the U.S. and China] operate under two very different systems, so it’s very important.”

Hao noted that many Chinese companies approach due diligence differently than Western companies do, and they run the risk of their deal falling through due to unforeseen pitfalls. “Many Chinese companies do not pay as much attention to documentation,” he said, “They prefer to rely on relationships with a few specific individuals that they think they know. But in some cases, management has totally changed several weeks after a deal was reached with previous management. However, it was not documented well enough, so when they took what they thought was a done deal to new management team, they found that actually had no deal at all.”



Alex Hao, Partner at Jun He

Preparation and a Long-Term View

Panelists touched on many issues that can make it difficult for foreign investors to successfully navigate the Chinese M&A market. But they also voiced their belief that opportunities are there to be had by investors who

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are willing to take the time to prepare in advance and willing to make a long-term commitment to their investments. They also stressed the importance of having a strategic plan that guides their entire acquisition plan.

“The most successful American company is the one that has an excellent vision, mission and business case, right down to the proforma or P&L,” said Ernest, “They don’t put it in a drawer after the acquisition transition and expect to run the business. They keep it in front of them so they know what their goals are, they have good metrics and they can achieve.”



Al Ernest, Principal and Senior Operations Leader at East West Associates

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Al Ernest is a Principal and Senior Operations Leader at East West Association. Prior to joining East West, Al Ernest had more than 30 years of domestic and international experience in technical, manufacturing and leadership positions with Owens Corning. During his career with Owens Corning, he held numerous position in the US and China. In the US, he held positions as: Scientist, Senior Scientist, Project Scientist, and Lab Director at the Owens Corning Science and Technology Center in Granville, Ohio. In 1986, Mr. Ernest received the prestigious “OC Innovators Award” for his development of the SSLII pipe insulation closure system, still an exclusive product offered by Owens Corning today. In 1995, Mr. Ernest accepted a position as Plant/General Manager of the “Building Materials Asia Pacific” Guangzhou, China plant. From Guangzhou, in 1999, he became the Plant/General Manager of the Second Owens Corning plant in Shanghai China. After setting up the Shanghai plant, Mr. Ernest accepted the Senior Management position “Director of Manufacturing and Engineering”, his responsibilities included: Operations, Manufacturing, Engineering, Capital Sourcing and Science and Technology. He has set up Greenfield plant operations in China and Korea as well as relocated Manufacturing Plants from North America to China. Mr. Ernest built or relocated facilities throughout China and Korea, including Anshan, Tianjin, Wuhan, Nanjing, Beijing, Jiang Yin and Asan. Since 2005, he has been consulting with American and Chinese companies on operations and manufacturing.



Alex Hao is a Partner at Jun He. He has significant experience in M&A, finance, private equity and capital market matters, and is also knowledgeable in various related areas, including antitrust, bankruptcy, dispute resolution, international trade and national security. Alex is familiar with a wide array of sectors, including banking, energy, manufacturing, real estate, telecom and transportation. Prior to joining Jun He, Alex practiced law in New York for eight years at two leading U.S. firms – White & Case and then Vinson & Elkins – and played a leadership role in many international transactions that won “Deal of the Year” awards. Alex also performed legal work in Beijing, Hong Kong and Singapore. Alex is a member of American Bar Association and New York State Bar Association, and is a Registered Foreign Lawyer at The Law Society of Hong Kong. Alex is also an Executive Director of the Professional Services Committee of China General Chamber of Commerce USA, and a co-founder and former director of Chinese Business Lawyers Association. Alex is a frequent speaker at professional conferences, including recent ones at the law and business schools of Harvard and Columbia, and has recently been interviewed by CCTV, China Daily, 21st Century Business Herald, Caixin, China Press, Sinovision and Elle Men. Alex obtained his J.D. from Northwestern University School of Law in Chicago, he also studied finance and accounting at Northwestern’s Kellogg School of Management and obtained his LL.B., summa cum laude, from Peking University.



Professor Ann Lee is an Author of “What The US Can Learn From China”, frequent media commentator on economic issues and a former investment banker and hedge fund partner. In addition to television and radio appearances on MSNBC, Bloomberg, ABC, CBS, CNN, CNBC, Fox Business, and NPR, her op-eds have appeared in such publications as The New York Times, The Financial Times, The Wall Street Journal, Newsweek, Businessweek, Forbes, Harvard Business Review, The American Prospect, and The American Banker. She has been quoted in hundreds of publications and has been an invited speaker at numerous industry and academic conferences. Ann is also an adjunct professor of economics and finance at New York University and a former visiting professor at Peking University where she taught macroeconomics and financial derivatives. While she was teaching at Peking University, she also acted as an economic adviser to Chinese economic officials as well as to several large Chinese asset management firms. She was educated at U.C. Berkeley, Princeton University’s Woodrow Wilson School of International Affairs, and Harvard Business School.



Mark Zavadskiy is the Asia Bureau Chief of Russia Beyond The Headlines (RBTH). His main responsibilities include co-editing Russia and Greater China supplement inside South China Morning Post and overseeing Asian development of the RBTH project. Mark also founded and manages the Hong Kong based Asia To Go Limited company, which specializes in Russia-Asia intellectual, economic and cultural exchanges. His journalist career includes working as senior political correspondent for Ezhenedlly Zhurnal in Russia before moving to Hong Kong in 2004 where he was hired by the Russian Information Agency Novosti to open its Hong Kong Bureau. In 2008, he became Chief Asia Correspondent for the Russian Business Weekly Expert. Mark Zavadskiy appeared several times as expert in Russia and Russia Asia relations at Hong Kong RTHK radio station and Phoenix TV

Channel, Russian Expert-TV, Echo of Moscow radio station, Business FM, Russian service of BBC and others. He has been a keynote speaker at last year's "China Reform Forum" on Hainan island, moderated sessions at Russia Hong Kong Investment Forum in Hong Kong, Asia Business Advisory Council Small and Medium Enterprise Forum in Vladivostok and has covered numerous major international forums including two APEC Summits, WTO ministerial meetings, Chinese Davos Forums in Dalian and Tianjin and multiple high profile Russian visits to Asian countries. Mark holds a Masters Degree in Chinese Studies and Political Economy from Institute for African and Asian Studies at the Moscow State University.

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