Quarterly Review

China Mergers & Acquisitions

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Q1 2019
Volume 1 | Issue 1

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Market Trends

During Q1 2019, the global economy experienced uneven growth across developed and emerging markets. The United States and China both experienced robust economic growth in Q1 2019. Meanwhile, Germany and Japan faced interest rates re-approaching negative territory, reflecting elevated probabilities of diminished economic growth prospects in the two economies.

Emerging markets in Latin America, Africa and Southeast Asia generally observed healthy economic growth in Q1 2019 relative to economic output and productivity levels observed during CY 2018.

In the United States, the economic recovery continued into its tenth year, with robust growth levels observed in Q1 2019 across major macroeconomic indicators.

In Q1 2019, U.S. GDP grew at an annualized rate of 3.2%. U.S. labor markets remained tight with steadily higher wage growth relative to levels observed in Q4 2018. U.S. consumer spending increased. Q1 2019 U.S. exports increased by 3.7%, while imports contracted by 3.7%.[1]

In Q1 2019, China's GDP grew a rate of 1.4%—or 6.4% annualized—compared to a growth rate of 1.5% for Q1 2018.[2] China's Q1 2019 economic growth derived principally from increased manufacturing activity and consumer spending in China. China's Q1 2019 exports totaled approximately $550 billion,[3] while imports totaled approximately $470 billion.[4] Q1 2019 foreign direct investment (FDI) in China totaled approximately $36.2 billion.[5]

China sustained robust economic growth in Q1 2019 despite domestic policy measures aimed at reducing excessive leverage across the country's financial system. These measures have not resulted in material deflationary movement in China.

Elevated asset prices and tighter credit spreads generally sustain mergers and acquisitions activity in China. At the same time, domestic regulatory developments and adverse macro-political dislocations can reduce China's M&A volume, including both intra-China M&A transactions and cross-border M&A transactions possessing a commercial nexus to China.

Heightened volatility in China's financial and capital markets—coupled with ongoing trade tensions between the United States and China—continue to contribute to uncertainty among

[1] Federal Reserve Bank of St. Louis *(Apr. 2019), https://fred.stlouisfed.org/series/A021RL1Q158SBEA*
[2] TradingEconomics *(Apr. 2019), https://tradingeconomics.com/china/gdp-growth-annual*
[3] TradingEconomics *(Apr. 2019), https://tradingeconomics.com/china/exports*
[4] TradingEconomics *(Apr. 2019), https://tradingeconomics.com/china/imports*
[5] TradingEconomics *(Apr. 2019), https://tradingeconomics.com/china/foreign-direct-investment*

North American multi-national companies and private investment firms with respect to consummating cross-border M&A transactions with a nexus to China.

While the contours of ongoing U.S.-China trade negotiations remain in flux, we believe a completed U.S.-China trade deal in Q2 2019 likely would both mitigate near-time downside risks to U.S.-China economic relations and increase appetite among market participants to engage in U.S.-China cross-border M&A deal-making during the remainder of CY 2019.

M&A Recap

China M&A activity decreased significantly in Q1 2019, relative to Q1 2018, in both overall deal volume and aggregate deal value. China M&A activity experienced reductions in intra-China M&A, outbound China M&A and inbound China M&A. The number of private equity investments in China similarly decreased in Q1 2019, relative to Q1 2018 buyout activity in China.

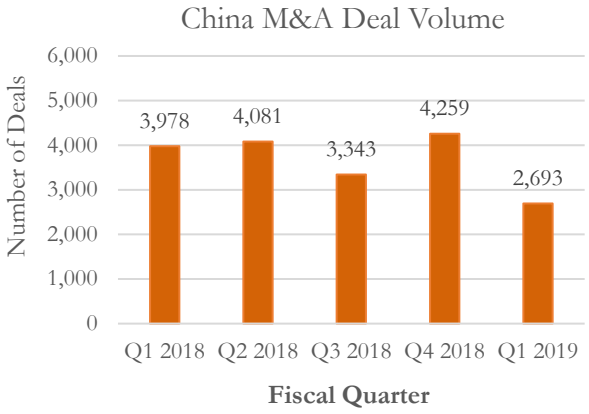
Target EV/EBITDA valuations in China M&A transactions generally decreased in Q1 2019, relative to Q1 2018.[6] In Q1 2019, EV/EBITDA multiples among China M&A targets decreased to their lowest levels in approximately five years.

Q1 2019 China M&A transactions materialized across major industry verticals in the region, particularly within biotechnology, industrials, telecommunications and mining. Those M&A transactions generally reflected buyers' sustained appetite for attractively valued assets and businesses for which fewer regulatory impediments emerge in the China market. Indeed, China's domestic regulatory considerations remain a principal concern among China M&A participants with respect to implementing strategic corporate planning and effectuating M&A deal execution strategies.

In Q1 2019, China rolled out its new Foreign Investment Law (外商投资法, *waiguo touzifa*). The new legislation outlines China's regulatory expectations with respect to foreign investment entities and foreign transactions and related investment activity in the China market. China's Foreign Investment Law will take effect at the beginning of 2020.

Deal Volume

For the China M&A market, overall M&A deal volume and aggregate M&A deal value decreased in Q1 2019, relative to Q1 2018 levels. Q1 2019 China M&A transactions totaled 2,693, representing a decrease of approximately 32% relative to the number of transactions (3,978) in Q1 2018.[7]

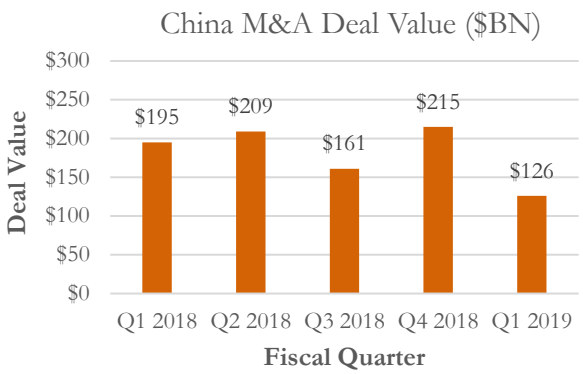


Source: MANDAPORTAL

Aggregate deal value in China M&A in Q1 2019 amounted to $126.6 billion, representing a 35% decrease from Q1 2018 aggregate China M&A deal value of $195 billion.[8] Notably, Q1 2019 deal value decreased in inbound China M&A to $77.8 billion, representing a decrease of 35% relative to Q1 2018 levels.[9]

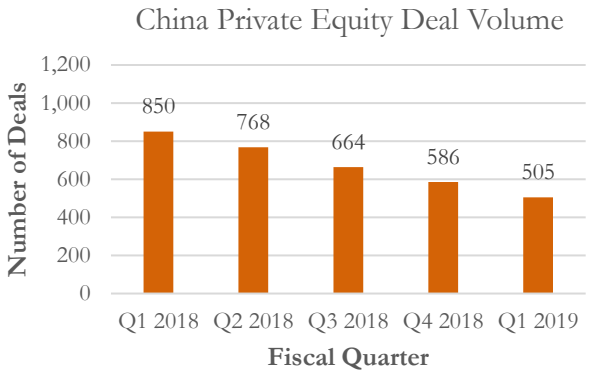
[6] *A common valuation indicator for public and private China M&A transactions derives from trailing and forward-looking EV/EBITDA multiples.*
[7] MANDAPORTAL, *Global M&A Review Q1 2019 (Apr. 2019)*, http://www.mandaportal.com/getattachment/c800cd70-520e-429e-9192-2e46d58f0008/Global-M-A-Review,-Q1-2019
[8] *Ibid.*
[9] L. He, *Global M&A hit hard in first quarter, with trade war and cooling growth taking toll in Asia*, SOUTHCHINAMORNINGPRESS *(Apr. 3, 2019)*, *https://www.scmp.com/business/banking-finance/article/3004474/global-ma-hit-hard-first-quarter-trade-war-and-cooling*

In Q1 2019, outbound M&A from China and Hong Kong decreased to $25.1 billion, with 65 announced deals during the quarter.[10]



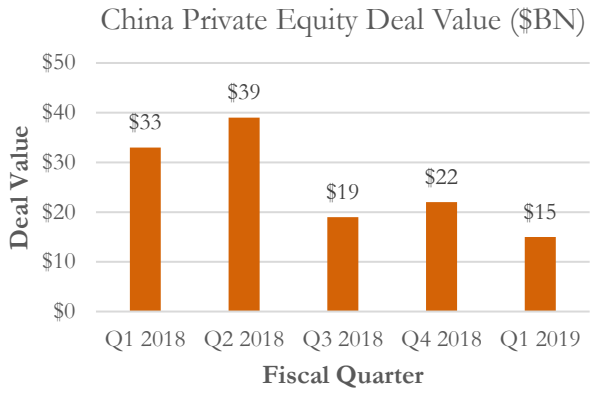
Source: MandaPortal

For private equity in China, both aggregate deal volume and total deal value decreased in Q1 2019, relative to Q1 2018. 505 China private equity investments occurred in Q1 2019, representing a 41% decrease from the total number of China private equity deals observed (850) in Q1 2018.[11]



Source: MandaPortal

Private equity deal value in China totaled $14.6 billion in Q1 2019, representing a decrease of approximately 56% from Q1 2018's total of $33.4 billion.[12]



Source: MandaPortal

Notable Transactions

Q1 2019's notably active verticals within China M&A were industrials and chemicals. These industries remained the busiest in China. Sustained appetite for targets within industrials and chemicals also contributed to significant M&A activity in APAC more generally, with of an aggregate deal value of $21.5 billion in the region.[13]

As part of its ambitious "Made in China 2025" initiative (中国制造 2025 年, *zhongguo zhizao 2025 nian*), the Chinese government has formally implemented a policy of committing resources and personnel in order to boost China's capabilities in 10 important industries: electric cars (电动汽车, *diandong qiche*), information technology (信息技术, *xinxi jishu*), artificial intelligence (人工智能, *rengong jineng*), agricultural technology (农业技术, *nongye jishu*), aerospace engineering (航空航天工程, *hangkong hangtian gongcheng*), new synthetic materials (新型合成材料, *xinxing hecheng cailiao*), biomedicine (生物医药, *shengwu yiyao*), advanced electrical equipment (先进电气设备, *xianjin dianqi shebei*), high-end rail infrastructure (高端铁路基础设施, *gaoduan tielujichu sheshi*) and high-tech maritime engineering (高科技海事工程, *gao keiji haishi gongcheng*).[14] Q1 2019

[10] Z. Yangpeng, *China's outbound investment shows signs of life in first quarter, but analysts are wary*, SouthChinaMorningPost (*Apr. 25, 2019*), *https://www.scmp.com/business/money/markets-investing/article/3007527/chinas-outbound-investment-shows-signs-life-first*

[11] MandaPortal, *Global M&A Review Q1 2019* (*Apr. 2019*), *http://www.mandaportal.com/getattachment/c800cd70-520e-429e-9192-2e46d58/0008/Global-M-A-Review;-Q1-2019*

[12] *Ibid.*

[13] W. Jamshet and W. Boghani, *Chinese semiconductor M&A under pressure in 2019, analysts say*, S&PGlobalMarketIntelligence (*Mar. 11, 2019*), *https://www.spglobal.com/marketintelligence/en/news-insights/trending/yqgC4nizC60FTJMUwAanyQ2*

[14] J. McBride and A. Chatzky, *Is 'Made in China 2026' a Threat to Global Trade?*, CouncilonForeignRelations (*Mar. 17, 2019*), *https://www.cfr.org/backgrounder/made-china-2025-threat-global-trade*

China M&A transactions reflected this policy focus. Deals occurred across a broad range of industry verticals in Q1 2019, reflecting sustained M&A appetite across the Chinese economy, notwithstanding ongoing domestic regulatory risks and sustained volatility in capital markets stemming from continued U.S.-China trade tensions. Key verticals with notable China M&A transactions in Q1 2019 included industrials, biotechnology, telecommunications and mining. The table below sets forth a selection of significant China M&A transactions in Q1 2019.

Value *($ billions)*	Type	Target	Target Country	Acquiror	Acquiror Country
$5.9	Capital increase	Bank of Beijing	China	ING Bank of Netherlands	Netherlands
$5.9	100% acquisition	Henan Luohe Shuanghui Industrial	China	Shuanghui Investment and Development	China
$5.6	100% acquisition	Beijing EasyHome New Retail Chain	China	Wuhan Zhongnan Commercial	China
$4.5	100% acquisition	China State Construction Engineering Corp. Ltd	China	Anbang Life Insurance Co., Ltd	China
$2.7	Acquisition 37% to 100% acting in concert	Hopewell Holdings Ltd	Hong Kong	Petrus HK Co Ltd	Hong Kong
$2.6	87% acquisition	Jiangyin Xingcheng Special Steel Works	China	Daye Special Steel	China
$2.5	100% acquisition	Zinjang Production Construction Corps Eighth Division Tianshan Aluminum Industry Co., Ltd	China	Shimge Pump Industry Group Co., Ltd	China
$2.2	Capital increase 23%	China Merchants Securities Holdings Co., Ltd	China	n/a	n/a
$2.2	100% acquisition	Oceanwide Construction Holdings Co., Ltd	China	Sunan Real Estate Group Co., Ltd	China
$2.0	45% acquisition	Grifols Diagnostic	USA	Shanghai RAAS Blood Products	China
$2.0	100% acquisition	Guangzhou Securities Co, Ltd	China	CITIC Securities Co., Ltd	China
$1.9	Capital increase	CSC Financial Co, Ltd	China	Investors	n/a
$1.5	100% acquisition	Bingo Technology	Singapore	YY Inc	China
$1.1	80% acquisition	Tenke Fungurume Mining	Congo	China Molybdenum	China

Regulatory Considerations

China's new Foreign Investment Law (外商投资法, *waiguo touzifa*) was passed by China's National People's Congress on March 15, 2019. The new law will take effect on January 1, 2020.[15]

The Foreign Investment Law provides new rules and guidance governing the treatment of foreign-owned businesses that operate in China. Importantly, the new legislation will replace three foreign investment laws previously enacted in China between 1979 and 1990: (a) the Wholly Foreign-Owned Enterprise Law (中华人民共和国外资企业法, *zhonghua renmin gongheguo waizi qiyefa*), (b) the Chinese-Foreign Equity Joint Ventures Law (中华人民共和国中外合资经营企业法, *zhonghua renmin gongheguo zhongwai hezijingying qiyefa*), and (c) the Chinese-Foreign Contractual Joint-Ventures Law (中华人民共和国中外合作经营企业法, *zhonghua renmin gongheguo zhongwai hezuo jingying qiyefa*).

The Foreign Investment Law bears several important characteristics with implications for

[15] Foreign Investment Law of the People's Republic of China (2019).

China M&A transactions and foreign investment activity in China.[16]

The Foreign Investment Law defines foreign investment as any foreign investor's direct or indirect investment in mainland China, including foreign-invested enterprises (FIEs), stock ownership and investment in new projects.

The new legislation provides that foreign investment will be treated no different than domestic investment during the *investment access stage*, which is defined as the establishment, acquisition, expansion and such other stages of an enterprise. The Foreign Investment Law does not apply to Hong Kong, Macau or Taiwanese investments.

In addition, the Foreign Investment Law sets forth new policies for promoting foreign investment in China. The new legislation provides that equal treatment will be afforded to foreign and domestic investments regarding business development policies and government procurement. Further, under the new legislation, Chinese regulators will be required to publish foreign investment guidelines and consult FIEs when formulating new rules with respect to foreign investment in China.

The Foreign Investment Law also sets forth various protective measures for foreign investors in China. Importantly, under the new legislation, foreign investments in China will not be subject to expropriation by the government except under *special circumstances* and *for the public interest*, whereby the Chinese government will be required to pursue procedural mechanisms to compensate an aggrieved foreign investor. In addition, the new legislation provides that forced technology transfers will be prohibited by administrative measures.

The Foreign Investment Law also establishes an FIE working mechanism to address complaints made by foreign investors in China.
The Foreign Investment Law also contains provisions that regulate the permitted scope of foreign investment in China. Significantly, the new legislation stipulates that foreign investors may not invest in prohibited industries in China.

In addition, for industries requiring licenses, China's regulators will be required under the new legislation to treat foreign applications the same as domestic applications.

Under the new legislation, China's national security review decisions will remain final, while M&A transactions with mainland Chinese enterprises will be required to file for formal anti-monopoly review with Chinese regulators.

The Foreign Investment Law also outlines legal responsibilities for foreign investors. Foreign investors will remain subject to penalties for investing in prohibited industries and for violating conditions specified by the *negative list* regarding investments in China's restricted industries.

Penalties would include cessation of business investment, restoration of the *status quo ante* (*e.g.*, disposition of shares or assets) and potential forfeiture of illegal proceeds.

The final section of the Foreign Investment Law allows China to take reciprocal action against jurisdictions that discrimination against Chinese investment.

Finally, upon official adoption of the new legislation on January 1, 2020, FIEs will have up to five years to comply with China's general corporation and partnership laws.

Expectations of the Foreign Investment Law remain uncertain. While the new legislation offers the probability of more open markets and less restrictive investment requirements for foreign enterprises in China, the new law likely will attract a significant degree of ongoing interpretation among multi-national M&A participants, Chinese courts and Chinese regulators.

[16] C. Wei, *Summary of China's New Foreign Investment Law*, NPCOBSERVER (*Mar. 15, 2019*), *https://npcobserver.com/2019/03/15/summary-of-chinas-new-foreign-investment-law/*

The 52 Index™

On May 8, 2019, 52 Capital Partners, LLC announced the launch of *The 52 Index*™—the M&A industry's first-ever algorithm-driven proprietary index for assessing analytically the overall strength, transaction activity and industry trends within China's M&A market.

The 52 Index™ consists of a proprietary aggregation of a broad series of macroeconomic data, industry indicators and proprietary quantitative algorithms developed independently at 52 Capital Partners, LLC.

The 52 Index™ score for China M&A activity will be released quarterly by 52 Capital Partners, LLC and made available to the public.

Following the completion of each calendar quarter, 52 Capital Partners, LLC will release *The 52 Index*™ score to assist industry players, including North American multi-national companies and investment firms, in forecasting near-term trends and opportunities in China's M&A market.

With the launch of *The 52 Index*™, 52 Capital Partners, LLC is setting a new standard in the global M&A industry for assisting leading North American businesses and investment firms that deal with China M&A.

52 Capital Partners, LLC's objective is to provide corporations and investment firms with a reliable, data-driven, one-stop metric, with the goal of assisting Boards of Directors and senior management teams in effectuating important strategic decisions with respect to navigating China's M&A market.

The first score generated by *The 52 Index*™ will correspond to Q2 2019 China M&A activity and is anticipated to be released by 52 Capital Partners, LLC in early August 2019.

Looking Ahead

Elevated U.S.-China trade tensions may continue to hamper cross-border M&A activity with China. Given continued concerns around data privacy risk, foreign technology transfers and intellectual property risk in China, M&A activity in software and technology is likely more acutely exposed relative to other verticals for the remainder of CY 2019.

In the current market environment, cross-border M&A deal-making in China generally requires greater levels of patience and innovation with respect to both deal execution strategies and deal structuring.

The appetite to consummate M&A deals in China generally remains strong. Many North American private investment firms remain active in China. Private market valuations in China, particularly in non-technology verticals such as industrials, consumer and manufacturing, remain comparatively attractive.

Against this backdrop of sustained appetite for cross-border M&A with China, concerns among M&A participants linger with respect to heightened regulatory scrutiny of cross-border transactions involving China. Concerns span both China's domestic regulatory environment and U.S. regulatory reviews of cross-border transactions that bear a probability of implicating U.S. national security, necessitating review by the Committee on Foreign Investment in the United States (CFIUS).

We believe Q2 2019 likely will yield comparable levels of Chinese buyers in the North American M&A market relative to levels observed in Q1 2019. Bi-lateral tariffs and other defensive regulatory measures in the United States, as well as domestic capital controls in China, may continue to exert downward pressure on cross-border M&A activity from China-based buyers in the United States.

Notwithstanding near-term risks to cross-border M&A activity with China, an acceleration of market-oriented reforms to China's financial

system and capital markets may yield greater opportunities for North American businesses in China in Q2 2019 and for the remainder of CY 2019.

The current macro environment reflects heightened levels of uncertainty with respect to the near-term prospects for U.S.-China economic relations. An ongoing bi-lateral trade war persists in the wake of new tariffs and other protectionist policy measures. Economic sanctions proliferate.

In addition, investment activity and cross border capital flows proceed with greater caution. Heightened volatility affects financial networks and capital markets in both countries, particularly in the wake of new tariffs levied.

Amidst this amalgam of uncertainties, now is the time for North American senior management teams and Boards of Directors to develop smart strategies in order to compete successfully and thrive in this "new normal" for U.S.-China economic relations and cross-border M&A opportunities with a nexus to China.