IMAP
Focus on China

July 2019

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China Outbound M&A: What Next?
Where is the World Heading in the Coming Decade?
Introducing IMAP China

**IMAP China** is an international team of expert professionals that specialize in mid-market M&A transactions between China and the rest of the world.

China is without a doubt an important market for IMAP. Being able to identify and reach Chinese buyers creates competitive advantages for M&A advisors and adds value to its clients. Due to China’s fragmented economy and dynamic financial market, it has been challenging to find a traditional financial advisor focusing solely on M&A and extensive nationwide coverage that could adequately support IMAP. The increasing demand from IMAP member firms for China coverage triggered the formation of IMAP China, a joint initiative by IMAP Germany and IMAP Netherlands at the start of 2019.

IMAP China is an international team of highly experienced advisors, with years of combined experience in closing transactions in this important market, led by the members of the China Desks at IMAP Germany and IMAP Netherlands. The 2 offices have been involved in Chinese outbound transactions for 9 years and during this time, have built an impressive team with valuable deal experience, diverse sector expertise, cultural understanding of the market, a proven track record and an extensive Chinese network.

The IMAP China team is led by 2 senior partners: Karl Fesenmeyer, President of IMAP Germany and former Chairman of IMAP and Balthazar den Breems, Partner at IMAP Netherlands. Karl and Balthazar travel to China frequently, are very familiar with the Chinese way of doing business and use their experience to support the team whenever required. Jacky Wang, May Wu, Catharina Peters and Zheng Yang form the operating team and all have relevant deal experience and language skills, as well as a crucial understanding of both western and Chinese culture.

IMAP China leverages its Chinese network and experience to help IMAP partners to generate new leads and close transactions with Chinese buyers. Its Chinese speaking dealmakers work closely with IMAP partners and provide seamless assistance throughout their transaction processes. Everyone at IMAP China looks forward to working with you all.

Visit our new Chinese website at: www.imap-china.com
Chinese Outbound M&A: What’s Next?

During its 2019 Spring Conference in Munich, IMAP officially launched IMAP China, an international team that specializes in mid-market Chinese outbound M&A transactions. **May Wu from IMAP China**, talks below about the latest developments in the market and the outlook for outbound Chinese M&A.

**CHANGING TIMES**
After four decades of adopting the Reform and Opening policy, China has become an important influencer on the world stage. The second largest economy in the world, it is active in almost every aspect of the international business community. While the past 10 years have witnessed China as an active participant in the global M&A market, recent political and economic developments have caused a slump in Chinese M&A activity. Will the Chinese global M&A spree pick back up? And where do the opportunities lie ahead?

**WHO, WHAT AND WHERE?**
The Chinese outbound M&A market used to be dominated by state-owned enterprises, but that is no longer the case. In 2018 state-owned enterprises only contributed 10% of total outbound M&A deal value. The recent M&A trend has been characterized by a wider universe of buyers, with (listed) privately-owned companies and financial investors playing a more significant role in driving Chinese outbound acquisitions.

Transaction data from the past 5 years collected from Mergermarket shows that Chinese outbound M&A activity peaked in 2016, highlighted by the acquisition of Syngenta by ChemChina for $43 billion. In 2017 and 2018 the outbound M&A market calmed down slightly, but deal volume and value were still considerably higher than in 2014 and 2015. The top 3 investment destinations are Europe, Asia and the US, with Europe being the most favored continent in 2018 by means of $50 billion in deal value. Asian countries remain popular for Chinese investors thanks to geographic convenience and governmental incentives.

Chinese buyers’ interests lie across a broad range of industries. Although you can find Chinese buyers in almost every sector, the vast majority of transactions take place in sectors such as Technology, Consumer Products and Services, Healthcare and Industrials. There are sectors however, which are national security facing in which acquisitions are strictly prohibited by the Chinese or foreign governments, which include Defense and Military, Telecommunication and Natural Resources.

**SOURCE OF CHINESE OUTBOUND M&A (2018)**

- Financial investors: 42%
- Private enterprises: 48%
- State-owned enterprises: 10%

Deleveraging was probably the most mentioned word in the Chinese financial market in 2018. Chinese companies have a history of using high leverage; this is particularly true for state-owned enterprises and publicly-listed
companies. As economic growth slows down, illiquidity and insolvency problems begin to appear, causing financial authorities to call for the deleveraging of the economy. In the long-term, deleveraging will have a positive impact on the economy as it will force state-owned enterprises to reform and result in a more mature and efficient banking system. In the short-run, however, with companies’ financing capabilities being limited, their willingness to invest abroad becomes hindered.

The political tension between China and the US not only discouraged investors on the stock market, verified by the 24% plunge in stock market value in 2018, but also scared away Chinese buyers from the US M&A market. Transaction value in the US by Chinese buyers reached only $13 billion in 2018, a quarter of the deal value seen in Europe. Investors are instead looking at more friendly destinations, pushing up 2018 deal value by 82% in Europe and 52% in Asia.

Capital controls have been an obstacle for companies that invest in non-core sectors that do not have obvious benefits for the Chinese economy. Since 2015, a vast amount of domestic capital has flown out of China, with monthly capital flight exceeding $100 billion for the last 7 months of 2015. This has spurred governmental actions to pull capital back to China to stimulate domestic economic growth.

A Chinese company has to obtain at least 3 domestic governmental approvals before the purchase price can be paid and if the company is publicly listed or state-owned, an additional layer of scrutiny will apply. The lengthy governmental approval process creates disadvantages for Chinese companies in an organized auction process. In addition, governments from some destination jurisdictions have adopted strict scrutiny on proposed takeovers by foreign investors. In recent years, a number of Chinese takeover attempts in the US were blocked by The Committee on Foreign Investment in the United States (CFIUS). Some European countries such as the United Kingdom and Germany have also started to tighten takeover rules to prevent companies in sensitive industries falling into foreign hands. In fact, the European Union has recently drawn up a framework aiming to tighten its scrutiny of foreign takeovers in strategic sectors including Telecommunication and Artificial Intelligence.

**MARKET OUTLOOK**

With all these developments as a backdrop, what can we expect next from Chinese buyers?

**Trend 1: (Listed) private enterprises and private equities take the lead**

Privately owned companies, as well as financial investors have become the main driving force behind Chinese companies going abroad. Private companies are typically younger, more dynamic and more driven to acquire advanced technologies or premium brands because they are facing fierce domestic competition. Unlike western financial investors, most Chinese private equity funds are currently unable to absorb and manage portfolio companies independently. They often act as co-investors and team up with an industrial player who understands the business well in order to limit investment risks.

**Trend 2: State-owned enterprises shift to OBOR**

The One-Belt, One-Road initiative was first introduced in 2013, as a development and cooperation framework connecting 60 countries alongside the ancient “silk road” and “maritime silk road”. These countries have a total population of 4.4 billion and a total economic output of $21 trillion. Stimulated by the government and headed...
by state-owned enterprises, Chinese investment in these countries has been increasing and will continue to pick up.

**Trend 3: Small is beautiful; less mega deals and more mid-market transactions**

Targets in the mid-market are attracting more attention from Chinese buyers because of their advanced technology, unique products or premium brands. The number of transactions in the mid-market will likely continue to grow supported by the growing desire for M&A from private companies and financial investors.

**Trend 4: Emphasis on Technology, Consumer related, Healthcare and Industrials**

What has been popular in the past will continue. Sectors that are highly favored by Chinese buyers remain Technology, Consumer goods, Healthcare and Industrials. Rising investment is expected in the Energy and Infrastructure sectors along the OBOR region. However, deals in sectors such as Real Estate and Entertainment are considered “irrational” and will see minimum growth.

**Trend 5: Approval is still an issue**

While the Chinese government remains supportive to overseas investment in general, restrictions on capital outflow are having the opposite effect. Furthermore, with the tightening scrutiny of target destinations, the overall approval process is unlikely to be shortened in the near future.

**ADVICE FOR ADVISORS**

As international M&A advisors, how can we best prepare ourselves to deal with Chinese buyers?

- **Study the market.** Not every deal is suitable for Chinese buyers. While already a global leader in some regards, China is still a developing country and behind the western world in some sectors. Chinese companies are looking for technologies, products and services that are scarce, scalable and beneficial for the Chinese economy. Determining whether your client has a competitive advantage compared to Chinese peers is an important step in order to assess the preliminary interest from Chinese buyers.

- **Price or speed, you can’t have both.**

  You have probably heard about the China premium – the lure of higher price offered by a Chinese bidder to compensate for the slower deal execution process. If your client favors the high price proposed by a Chinese buyer, they must be prepared to deal with a lengthy approval process. However, exceptions do exist; when a Chinese buyer already has offshore capital reserves, governmental approval will no longer be the stumbling block of the deal.

- **Be flexible.** A structured auction process might work well with experienced western bidders, but Chinese shoppers could still ignore or delay the well-thought timeline you entailed in your process letter. They may react in contrary to your plan and request a site visit before issuing a bidding letter, or fly in their entire due diligence team before the letter of intent is even agreed. So be strict on the content, but stay flexible on everything else.

- **Be aware of the culture difference.**

  The wide cultural difference between East and West can make negotiation even harsher. Try to unveil the hidden intentions and establish a relationship with the Chinese buyer to help smoothen the transaction process.

For an economy of its size, China’s spending on outbound M&A was merely 0.6% of its GDP last year, less than half of what Japan spent. Chinese appetite will continue to underpin outbound M&A activities. And as Chinese buyers become more active in global M&A, advisors should consider them as legitimate participants when executing sale transactions. Forward thinking advisors with a good understanding of Chinese buyers will be better equipped to create value for the sellers and achieve successful transactions.
Where is the World Heading in the Coming Decade?

During the IMAP 2019 Spring Conference in Munich, IMAP was delighted to present guest speaker **Krisztián Orbán, Founder and Managing Partner of Oriens**, one of Europe’s top performing private equity funds, who previously worked at McKinsey & Company. Orbán shared insights on global macro developments and discussed the current USA-China trade war and what this means for M&A.
THE WESTERN ECONOMIC STRUCTURE AND RULES-BASED SYSTEM ENFORCED BY MILITARY AND ECONOMIC MIGHT, NO LONGER COVERS THE WORLD

According to Orbán, we have taken for granted that the US exerts influence across the whole world and though it does remain the strongest global power, its influence is no longer paramount all the time. Military might and the credible threat of its application underpins the enforcement of global rules in otherwise sovereign countries; therefore, it directly impacts business. The US’s decreased readiness to interfere or enforce rules has changed the global business environment over the last 5-10 years.

The People’s Republic of China (PRC) is a clear challenger to US hegemony, though it is still substantially smaller than the US and Europe in economic terms. The PRC’s economy represents about 13% of the world economy, compared to the US and Europe at 22.5% and 24% respectively. However, for many countries the PRC as a trading partner is now more important than the US, with much of Asia centered around the PRC and certain countries looking towards its development model enabling poorer countries to become rich.

The pushback on the power of the West cannot be ignored. Countries which just 10 years ago would have been under the sphere of the Western and globalized world, such as Turkey, Ukraine, Pakistan and much of South-East Asia, are now in transition and Western control is no longer evident. For many countries, the hard choice of PRC or US rule is becoming a big issue.

SIZE OF LARGEST ECONOMIES
(USD TRILLIONS, % OF GLOBAL TOTAL.
2016 FIGURES)

Source: IMF, Courtiers

LARGEST TRADING PARTNER IN GOODS
(EXPORTS AND IMPORTS COMBINED)

NOTE: Data omitted for some small nations as indicated in gray.
SOURCE: UNCTAD; McKinsey Global Institute analysis.
TROLLING AND FREE-RIDING THE WESTERN SYSTEM
The world is full of trolls and free-riders and until 2018 key decision makers did not seem to be fully aware of what was happening. Orbán cited recent events in the press, including alleged Chinese influence in Australia’s domestic politics and incidents in the US involving so-called institutes for Chinese cultural exchange punishing those speaking out against the PRC. Russia, he says, is rather more obvious in its activities and has been active across the globe, yet it appears that sanctions have been forthcoming only for low-level operatives rather than at the top. Furthermore, in the case of recent alleged trolling activities by North Korea, there have been no ramifications. Of course, when rules are not enforced, it invites more trolling and influencing operations.

THESE ARE ONLY SYMPTOMS – THE FUNDAMENTAL PROBLEM LIES WITH THE US
According to Orbán, so far, the entire global system has been sustained by America’s credo of liberal democracy and open trade, yet its domestic policy no longer supports this. Free trade policies are under scrutiny in the US, key global organizations are underfunded and there is less support for military intervention. Though there have been national outrages following events in Syria, Libya and Ukraine, nothing ever happens and only inertia now maintains order.

Knowing that domestic policy in the US has always trumped strategic considerations, allies are no longer willing to follow American guidance alone. In turn, trolls and free-riders are emboldened.

CURRENCY ACTIVITY SHARE FOR DOMESTIC AND INTERNATIONAL PAYMENTS, %, DEC 2017

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<th>Rank</th>
<th>Currency</th>
<th>Activity Share</th>
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<tr>
<td>1</td>
<td>USD</td>
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<td>2</td>
<td>EUR</td>
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<td>3</td>
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<td>4</td>
<td>JPY</td>
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<td>5</td>
<td>CNY</td>
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<td>CAD</td>
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<td>AUD</td>
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<td>8</td>
<td>CHF</td>
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<tr>
<td>20</td>
<td>TRY</td>
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</table>

Source: SWIFT Watch

FUNDAMENTALS STILL FAVOR THE US
Having the most powerful and most funded military in the world awards the US a significant level of power. They are the largest economy and the dollar is the ultimate source of influence over the world economy. When it comes to foreign trade, we are essentially living in a dollar denominated world. Furthermore, every single dollar transaction, even outside the US has to be cleared by the US who holds jurisdiction over payments. Likewise, the oil and energy trade are denominated in dollars - yet another lever for the US.

THE FATE OF THE WESTERN DOMINATED GLOBAL SYSTEM HINGES ON IF AND WHEN THE US CAN REALIGN ITS DOMESTIC POLICY WITH ITS IMPERIAL DUTY
Orbán believes that the next 10 years is likely to bring about a new governing ideology in the US, along with a new economic model and the emergence of a new wave and generation of politicians with the potential to lead to the reestablishment of foreign commitments. Figures show that with the current urban-rural divide in the US, the Democratic Party is dying out in rural America, which is now going Republican. However, the strategy of focusing on rural voters may work in the short-term but is not a valid long-term strategy as it goes against the mega trend of urbanization throughout the US.
In terms of business and what will have the most direct impact, this will be technology and who controls it. It’s also likely there will be 2 technology worlds; Chinese and Western – with each set of rules making it difficult to transfer technology from one to the other.
IMAP China Credentials

**FOOD & BEVERAGE**

*IMAP China Credentials*

**TECHNOLOGY**

*IMAP China Credentials*

**BUSINESS SERVICES**

*IMAP China Credentials*

**TRANSPORTATION & LOGISTICS**

*IMAP China Credentials*

**REAL ESTATE**

*IMAP China Credentials*

**INDUSTRIALS**

*IMAP China Credentials*

**FINANCIAL SERVICES**

*IMAP China Credentials*
Founded in 1973, IMAP is one of the first and worldwide leading organizations for Mergers & Acquisitions. IMAP is located in 40 countries with more than 450 M&A professionals organized in international sector teams.

IMAP is specialized in the sale and the acquisition of companies, as well as strategic corporate finance advisory. Our customers are primarily family-owned, mid-sized companies, but also include large international corporations, as well as family offices and financial investors.

IMAP advisors successfully execute more than 200 transactions per annum with a transaction volume of approximately $10 billion.

DEALS BY SECTOR 2016-2018

DEALS BY REGION 2016-2018
IMAP Global Presence

40 COUNTRIES | 450+ PROFESSIONALS

Argentina | Belgium | Bosnia & Herzegovina | Brazil | Canada | Chile | China | Colombia | Croatia | Czech Republic | Democratic Republic of Congo | Egypt | Finland | France | Germany | Ghana | Hungary | India | Ireland | Italy | Ivory Coast | Japan | Mauritius | Mexico | Morocco | Netherlands | Norway | Portugal | Peru | Poland | Russia | Senegal | Serbia | Slovenia | South Africa | Spain | Sweden | Turkey | United Kingdom | United States
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IMAP's China Team

The world's leading M&A partnership since 1973

IMAP is an International Mergers and Acquisitions Partnership with more than 450 M&A advisors and a presence in 40 countries. IMAP has closed over 2,100 transactions valued at $90bn in the last 10 years and is consistently ranked in the world's top ten M&A advisors (Thomson Reuters) for mid-market transactions. IMAP advises primarily mid-sized companies and their shareholders on the sales and acquisitions on a global scale, providing clients with entrepreneurial, unbiased advice and successfully helping them achieve their objectives.

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