EXECUTIVE INSIGHTS

VOLUME XIV, ISSUE 6

China on the Acquisition Trail: Increasing Competition for European Company Buyers

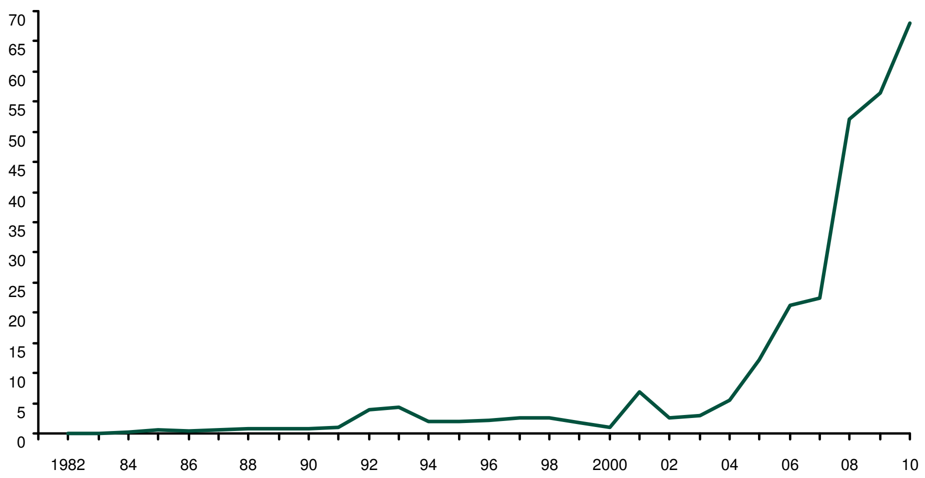
"Too few attractive targets, stiff competition, high prices." This is how leading private equity firms such as Permira, Apax or HIG Capital describe the current situation of the German mergers and acquisitions (M&A) market.

And even worse - Chinese state funds as well as corporate buyers have declared the European and especially the German market as prime targets for their acquisition spree. In addition to the very active state fund CIC and some globally active Corporates two more Chinese state funded vehicles with a war chest of more than $100 billion will start their quest for attractive targets in Europe.

After a rather slow start in the 1980s, Chinese buyers have accelerated their acquisition pace in the years after 2000 after having gained some valuable first hand experience (Figure 1). Supported by leading western legal, financial and strategic advisors, Chinese executives have then started on rather large targets. Especially in Germany, the purchase of PC maker Medion by IT giant Lenovo for an estimated value of €600 million as well as the just announced deal for concrete pump producer Putzmeister by the major competitor Sany Heavy Industries have made major headlines.

Figure 1

China Outward Foreign Direct Investment Stock Annual (1981-2010)



Source: UNSTATS L.E.K. analysis

China on the Acquisition Trail : Increasing Competition for European Company Buyers was written by Karin von Kienlin, Partner and Wolfgang Wagner, Director of L.E.K. Consulting in Munich. Please contact us at a.schrallhammer@lek.com for additional information.

Apart from these high visibility deals the Chinese buyers are mostly interested in industries which have been given top priority by the State through the various 5-year development plans.

Prime example for such strategy is the automotive industry which has been one of the key strategic development areas for the last 20 years and continues to be for the foreseeable future.

The strategy not only calls for satisfying the rapidly growing domestic market for passenger cars and trucks, but also to conquer the world market with state-of-the-art products in the medium term. To achieve this ambitious goal, the Chinese vehicle manufacturers need to strengthen their technical know-how in some areas which they try to find especially in Germany - via acquisitions and cooperations.

It all started with the classical Joint Ventures of Chinese car manufacturers with the German Mercedes (Beijing Benz), Volkswagen (Shanghai Volkswagen) or BMW (BMW Brilliance), but in order to become fully self-sufficient , the Chinese car companies and their suppliers are increasingly going the direct way to acquire know-how and expertise. Prime examples over the last twelve months have been the takeover of sealings specialist Saargummi by Chongqing Light Industry (CQLT), interior company Sellner by Ningbo Huaxiang Electronic, Preh Electronics by Joyson, casting company KSM Castings by CITIC as well as the just announced purchase of world market leader for automotive latches Kiekert by the Norinco group.

Particularly interesting has been the fact that two of these acquisitions were difficult bankruptcy cases and the Chinese purchasers outbid interested private equity firms and corporate buyers. Not only had they offered the highest purchase price, but they also gained the support by the very critical German car manufacturers which are gradually accepting Asian owners for their critical suppliers.

But not only suppliers are on the list of the Chinese company hunters - the publicly stated interest of state fund CIC in a stake holding in industrial giant Mercedes Benz shows of ambitious targets overall.

Looking at Chinese acquisitions in a holistic way, it seems that:

- China is prepared to pay premium prices for strategically important companies
- Companies with a higher risk profile such as bankruptcy, restructuring needs, etc. are not excluded from the list of potential targets
- Initial "ramp up losses" with difficult cases are accepted
- Know-how acquisition and transfer are main purchasing motives

For European asset sellers this development is certainly positive in a rather stagnant market these days - more buyers means higher prices - and also difficult situations find a new home. For those, however, who are on the buying side, the situation will increasingly become difficult with more buyers chasing currently very few attractive targets.

In a detailed study on recently closed transactions involving both western and Asian buyers, strategy and M&A advisory L.E.K. Consulting has identified a number of key success factors for both sides.

For "Western" buyers, it is quintessential to position themselves clearly against their Asian competitors and to react proactively.

Success Factors for European M&A

- Develop a clearly articulated acquisition strategy for all stakeholders - "Why has the company been bought and what will happen to it over the next years? What about the long term perspective?"
- The reputation and track record of the buyer must be immaculate - the acting persons must communicate in a proactive and open way
- "Speed is everything" - swift and to the point negotiations will benefit both seller and buyer as just seen with the purchase of a majority of airline Airberlin by Etihad of Abu Dhabi against the competitor Hainan Airlines
- Development of an extensive "deal package" which not only consists of the purchase price, but of various unique elements e.g. debt financing, guarantees, patent rights, etc.

Apart from these "general" M&A guidelines, Chinese investors should adhere to some additional guidelines giving them an edge in European acquisitions:

Guidelines for Chinese Investors

- Present an even more detailed acquisition plan and communicate it through all possible channels
- Early involvement of local management who subsequently support the new owners whole heartedly
- Active communication of European/German - Chinese success stories as blueprint for how aquisitions can be made successful
- Slow integration as the method of choice which allows for a gradual learning from each other
- Installation of effective supervisory body which bridges the "cultural gap" of the stakeholders

In some instances, however, all academic discussion about do's and dont´s is meaningless as the German energy giant EON just experienced in Portugal. The Chinese Three Gorges group had bid for a stake in Portuguese energy company EDP in competition to EON - and outbid them by €200 Mio. In this case, just the sound of money has been the determining factor and nothing else.

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