

## ► Mergers and Acquisitions in China

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March 2004

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## **I. Introduction – Background to M&A in China**

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## **II. Structuring the Optimum China M&A Deal**

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## II. Structuring the Optimum China M&A Deal (cont'd)

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### i. Direct Acquisition

- purchase all or part of the non-listed equity interest
- subscribing for increased capital of the target company

## II. Structuring the Optimum China M&A Deal (cont'd)

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### ii. Indirect Acquisitions

- acquire or increase control of the target company via purchasing offshore some or all of the shares held by the target company's foreign parent(s)
- available if the PRC target company has foreign investors' equity

## II. Structuring the Optimum China M&A Deal (cont'd)

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### iii. Asset Acquisition

- investor uses a new foreign invested enterprise or an existing foreign invested enterprise as an acquiring vehicle
- allows a foreign investor to select the preferred assets and businesses of the target company

## II. Structuring the Optimum China M&A Deal (cont'd)

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### iv. Acquisition of corporation with State-Owned Interests

- usual process for direct equity and asset acquisition applicable
- certain special regulations governing acquisitions of State-owned interests

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### **III. Current Government Policy**



### III. Current Government Policy (cont'd)

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i. Resolutions of CPC Central Committee

“further strengthen the vitality of public ownership, actively develop a mixed sector of the economy and realize the diversification of investment sources, making the joint-stock system one of the major forms of public ownership”

### **III. Current Government Policy (cont'd)**

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**ii. Support from SASAC**

**iii. Entry into WTO**

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## **IV. Laws and Regulations and the Opportunities Created**

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**1. Provisional Regulations on the Merger and Acquisition of Domestic Enterprises (“M&A Rules”) (12 April 2003)**

## **Provisional Regulations on the Merger and Acquisition of Domestic Enterprises (“M&A Rules”) (12 April 2003) (cont’d)**

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1. First comprehensive regulation aimed at making all types of mergers and acquisitions involving foreign investment subject to consistent standards
2. Represent another step toward the overall modernization and rationalization of China’s foreign investment laws and regulations

# Provisional Regulations on the Merger and Acquisition of Domestic Enterprises (“M&A Rules”) (12 April 2003) (cont’d)

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## A. Scope

### (a) Share Acquisition

- (i) acquisition by agreement of equity in a domestic company and its conversion into a foreign invested enterprise; or
- (ii) subscription of additional registered capital in a domestic company and its conversion into a foreign invested enterprise

## **Provisional Regulations on the Merger and Acquisition of Domestic Enterprises (“M&A Rules”) (12 April 2003) (cont’d)**

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### (b) Asset Acquisition

- (i) establishment of a new foreign invested enterprise and its acquisition by agreement of the assets of a domestic company and operation of the assets; or
- (ii) acquisition of assets in a domestic company by a foreign investor by agreement and injection of those assets as registered capital into a foreign invested enterprise

## **Provisional Regulations on the Merger and Acquisition of Domestic Enterprises (“M&A Rules”) (12 April 2003) (cont’d)**

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### **B. Foreign Investors’ Qualifications**

- (i) all foreign investments must follow the Foreign Investment Industry Guidelines
- (ii) delineate the categories of encouraged, permitted, restricted and prohibited industries for foreign investment



## **Provisional Regulations on the Merger and Acquisition of Domestic Enterprises (“M&A Rules”) (12 April 2003) (cont’d)**

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### C. A New Type of Foreign Invested Enterprise

- (i) foreign investment of less than 25% in a company is permitted for all transactions covered
- (ii) but not able to take advantage of any preferential treatment available to a foreign invested enterprise with 25% or more foreign investment

## **Provisional Regulations on the Merger and Acquisition of Domestic Enterprises (“M&A Rules”) (12 April 2003) (cont’d)**

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### D. Asset Appraisal

- (i) transfer price based on an asset appraisal
- (ii) transactions involving state-owned equity interests or assets must comply with special regulations on the management of state-owned assets

## **Provisional Regulations on the Merger and Acquisition of Domestic Enterprises (“M&A Rules”) (12 April 2003) (cont’d)**

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### E. Creditors’ Rights

- equity transaction does not affect debts and creditors’ rights of a domestic enterprise

## **Provisional Regulations on the Merger and Acquisition of Domestic Enterprises (“M&A Rules”) (12 April 2003) (cont’d)**

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### F. Payment of Consideration

#### (i) general rules

- the seller must pay the consideration within three months after issuance of the business license of the foreign invested enterprise

## **Provisional Regulations on the Merger and Acquisition of Domestic Enterprises (“M&A Rules”) (12 April 2003) (cont’d)**

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- (ii) equity merger or acquisition leading to an increase of the registered capital
- if provide for a one-time payment, then make payment in full within six months
  - if payment in installments is provided, then must pay at least 15% of the full subscription price as the first installment, remainder in full within three months of issue of the new business license

## **Provisional Regulations on the Merger and Acquisition of Domestic Enterprises (“M&A Rules”) (12 April 2003) (cont’d)**

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### G. Registered Capital

- (i) an acquisition of equity interests from existing domestic shareholders, registered capital remains the same
- (ii) subscribing for the increased portion of registered capital
  - registered capital will be the sum of the original registered capital and the newly subscribed capital
  - relative ownership percentages will be negotiated between the parties based on the appraised value of the assets

## **Provisional Regulations on the Merger and Acquisition of Domestic Enterprises (“M&A Rules”) (12 April 2003) (cont’d)**

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### H. Ratios Between Registered Capital And Total Investment

- sets forth the upper limits for total capital based on the registered capital of the resulting foreign invested enterprise

## **Provisional Regulations on the Merger and Acquisition of Domestic Enterprises (“M&A Rules”) (12 April 2003) (cont’d)**

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### I. Application, Examination and Approval Procedures

- similar to those currently required for the conversion of a domestic entity into an FIE
- Documents including:
  - shareholder approval
  - application for conversion
  - joint venture agreement and articles of association of the resulting FIE
  - equity transfer agreement



## Provisional Regulations on the Merger and Acquisition of Domestic Enterprises (“M&A Rules”) (12 April 2003) (cont’d)

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- increase capital or asset transfer
- corporate and creditworthiness documents
- corporate documents of the domestic entity
- plan of disposition of employees
- additional requirements
- timeframe for approval and the requirements for registration with the SAIC are similar to existing rules

## Provisional Regulations on the Merger and Acquisition of Domestic Enterprises (“M&A Rules”) (12 April 2003) (cont’d)

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### J. Anti-Competition

- turnover of a party exceeds RMB1.5 billion in the current year
- foreign investor acquired more than 10 domestic enterprises in related industries within one year
- China market share of a party exceeds 20%
- China market share of a party reaching 25%

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## **2. Provisional Regulations on Reforming State Owned Enterprises with Foreign Investment (“SOE Reforming Regulations”) (1 January 2003)**

# Provisional Regulations on Reforming State Owned Enterprises with Foreign Investment (“SOE Reforming Regulations”) (1 January 2003) (cont’d)

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## Applicability and Scope

- i. Acquiring all or part of the State interest in an SOE
- ii. restructure a “company with state interests” into an FIE by acquiring all or part
- iii. Acquire from domestic creditors debt owed to them by the SOE
- iv. Acquire all or the majority of the assets of a SOE and subsequently establish a FIE
- v. Purchasers of an equity stake become shareholders in an SOE and convert such SOE into an FIE

# Provisional Regulations on Reforming State Owned Enterprises with Foreign Investment (“SOE Reforming Regulations”) (1 January 2003) (cont’d)

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## Required Reorganization Plan

- i. in many respects similar to the “feasibility study report” required for all FIEs
- ii. highlighting information about the foreign investor, its financial status, its business scope and equity structure, and plan for settlement of staff
- iii. introduction of sound corporate governance into the target SOE

# Provisional Regulations on Reforming State Owned Enterprises with Foreign Investment (“SOE Reforming Regulations”) (1 January 2003) (cont’d)

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## Employee Protection

- i. First seek the opinions of the staff and worker’s congress of the SOE
- ii. Reorganizing party of the SOE must formulate a plan for settling the staff, and such plan is subject to the staff’s approval

# Provisional Regulations on Reforming State Owned Enterprises with Foreign Investment (“SOE Reforming Regulations”) (1 January 2003) (cont’d)

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## Approvals

- i. Mirror in many respects existing foreign investment rules
- ii. The same US\$30 million threshold used in establishing an FIE is used

## **Provisional Regulations on Reforming State Owned Enterprises with Foreign Investment (“SOE Reforming Regulations”) (1 January 2003) (cont’d)**

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Several documents are required to be submitted along with the acquisition agreement, including but not limited to

- i. An audit and asset appraisal report of the SOE;
- ii. A staff and worker settlement program;
- iii. An agreement for settling claims and debts;
- iv. A restructuring plan;
- v. Resolutions of the reorganizing party of the SOE; and
- vi. The opinions or resolution of the congress of the staff and workers of the SOE.



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### **3. Provisional Regulations on Administration of the Transfer of State-owned Assets (1 February 2004)**

## **Provisional Regulations on Administration of the Transfer of State-owned Assets (1 February 2004) (cont'd)**

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### 1. Approval Procedures and Documents

- Submitted to State-owned Assets Supervision and Administration Commission

## **Provisional Regulations on Administration of the Transfer of State-owned Assets (1 February 2004) (cont'd)**

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### 2. Procedures on Transfer of State-owned Assets

- Research on Feasibility
- Asset Appraisal
- Announcement
- 2 or More Purchasers – Auctions or Bids
- Payment of Consideration

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## **Qualified Foreign Institutional Investors ("QFII Regulations")**

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## V. Reducing Acquisition Risks – Due Diligence

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Reasons for Conducting Due Diligence Exercises

1. Protection
2. Regulatory Compliance
3. Investigation of the Company
4. Assess the Risks and Understand the Parameters

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## Case Study

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## **Case Study of Acquisition of Steel Plant**

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## Due Diligence

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## Shoreline Issues

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## Valuation Issues

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## Practical Structuring Factors

Sources: Bloomberg, World Federation of Exchanges, Dealogic, World Economic Forum, The Heritage Foundation and Wall Street Journal, Fraser Institute and Economic Freedom Network, Economist Intelligence Unit and Ernst & Young, International Institute for Management Development, The Chinese Academy of Social Sciences (as at end of 2012), IMD World Competitiveness Centre, Dealogic

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## Case Study

Source: Hong Kong Exchanges and Clearing Limited

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## Case Study (cont'd)

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### PRC Listed Cement Plant

- Acquisition by Strategic Investor
- US \$30 million Investment
- Listed shares
- Approximately 25 per cent of issued share capital

Source: WFE, SGX (as at end of 2011), HKEx, Dealogic

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## Case Study (cont'd)

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### Time Frame:

- 2/3 years
- 1 year of intensive professional involvement

Source: Blomberg, WFE, WEF, WSJ

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## Case Study (cont'd)

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### Importance of Understanding:

- the legal/business environment
- the industry

Source: Hong Kong Exchanges and Clearing Limited  
Note: Trading of 35 issuers (including 8 GEM companies) is suspended as of Jan 2010

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## Case Study (cont'd)

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### PRC

- Legal Norms
- Business Practices
- Management Behaviour
- “Neibu” Information

## Case Study (cont'd)

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### Understanding the Cement Industry

- capital intensive
- long-term view required
- long-term finance essential
- title to land/mining/building rights crucial

## Case Study (cont'd)

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### Professionals

- Lawyers (Hong Kong and PRC)
- Technical experts
- Accountants
- Valuers

## Case Study (cont'd)

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### Business Approach

- “Partnership”
- Ensure all legal formalities effected
- Business Planning
- Human Resources Planning
- Capital Investment Planning

## Case Study (cont'd)

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### Regulatory Application

- China Securities Regulatory Commission
- Shanghai Stock Exchange

Source: Hong Kong Exchanges and Clearing Limited

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## Case Study (cont'd)

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Initial Meetings

Site Meetings

Information Gathering

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**Due Diligence Areas**

**Huaxin's Operations**

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## History and Overview

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**Shareholdings and Capitalisation**

**Relationship with Major  
Shareholders and the Municipality**

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**Management Structure**

**Intellectual Property**

**Land Use Rights and Building Ownership Certificate**

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## **Products and Production Arrangements**

### **Particulars of Kiln Project**

### **Raw Materials Supply**

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**Energy Supply**

**Transportation**

**Distribution**

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**Market Position and Competition**

**Financing Arrangements and Indebtedness**

**Insurance**

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**Labour and Welfare Arrangements**

**Taxation**

**Environmental Compliance**

**Miscellaneous**

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## **Legal Due Diligence Report**

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## Major Issues

### Land

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## **Mining Rights**

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## **Asian Development Bank**

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**Tax**

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## Tax (cont'd)

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- A. Subsidiaries and Joint Ventures
- B. Questionnaire
- C. Summary of further information required
- D. List of documents relating to Huaxin's operations supplied and inspected and reviewed
- E. Assumptions and Qualifications
  - Assumptions
  - Qualifications
- F. Summary of Articles of Association
- G. List of assets in excess of RMB • in value
- H. List of International Equipment Purchase Agreements using ADB Loan

I. List of local environmental protection rules and regulations

J. PRC Legal System

- Overview of the PRC Legal System
- PRC Company Law
- Securities Law
- Tax Laws and Regulations
- Foreign Exchange
- The Mineral Resources Law
- PRC Environmental Protection Law

### Further Process

#### Tax Laws and Regulations

- Review
- Negotiation
- Solutions
- **Finalisation**

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## **Importance of Legal Opinions**

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## **The Final Outcome**

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## Q & A

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## Contact us

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