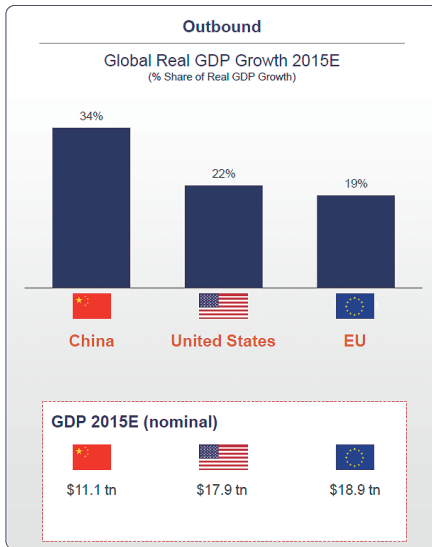


Completing M&A Transactions Successfully with Chinese Companies in a Swiss Context

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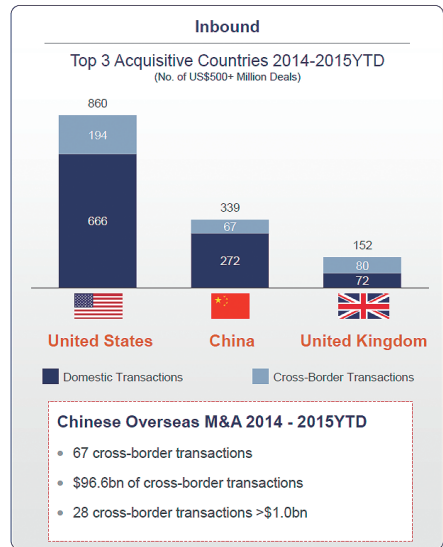
The growing appetite of consumers in China has propelled Chinese companies to the top ranks of the global league tables for mergers and acquisitions (“M&A”). The real Gross Domestic Product

(“GDP”) growth of China in 2015 is expected to be a 34% share of the global real GDP growth. Of the top three acquisitive countries, China has recently taken the second place.



Sources: Provided by Citibank

Chinese companies are acquiring a wide range of assets worldwide, and Swiss companies are a popular target for Chinese buyers. For example Dalian Wanda Group Co., Ltd., one of the leading Chinese conglomerates and China’s largest investor in cultural and entertainment sector, has reached in February 2015 an agreement to acquire Infront Sports & Media AG, the world’s most respected international sports marketing company based in Zug, Switzerland, from the European private equity



firm Bridgepoint. The transaction was valued at approximately EUR 1.05 billion (USD 1.2 billion) and was subject to customary conditions. Other examples of Chinese companies acquiring Swiss companies are the Swiss watchmaker Corum that was recently (in 2013) acquired by Citychamp Watch & Jewellery Group Limited of Hong Kong. Previously, in 2011, the Citychamp Group had already bought the Swiss watch brand Eterna. Also in 2011, two factories, Swissmetal Reconvilier (in

the Canton of Bern) and Dornach (in the Canton of Solothurn), were saved from bankruptcy by the Chinese group Baoshida. Another example is the industrial group OC Oerlikon's sale of its natural fibers business unit to the Chinese Jinsheng Group. In this article, we will address the expansion of Chinese companies into the Swiss, or generally Western, M&A market with a focus on the
























challenges resulting from the different cultural backgrounds. We will also discuss certain key factors to be considered for the successful completion of M&A transactions. Although this article is written from a Swiss seller's perspective, it discusses challenges that Western and Chinese companies commonly encounter in cross-border M&A transactions.

I. Identification of Active Chinese Buyers in M&A Transactions

There are mainly four different types of active Chinese buyers in M&A transactions. The first type is the State Owned Enterprise ("SOE"), which plays an important role due to its relatively large size. Among the well-known Chinese SOEs we find, for example, PetroChina, Bank of China, and China Mobile. The second type is the Privately Owned Enterprise ("POE"), which is becoming increasingly active in cross-border M&A deals.







Gaining access to new technology and increasing market shares are the most common driving forces. Examples of POEs are Lenovo, Hainan Airlines, and Huawei. The third type is the small but growing China-based Private Equity Firm. It recently started to increase its focus on international opportunities. Finally, the Sovereign State-Owned Wealth Funds also use M&A transactions to diversify China's foreign currency reserves. They tend to focus on smaller but high value stakes in large companies. An example of such a Sovereign Wealth Fund is the China Investment Corporation.

Highly Active Chinese Investors in 2012 – 2015YTD

Bidder Company	Type	Target Company	Sector	Country	Stake	Deal Value (US\$mm)
 招商局亚太有限公司 China Merchants Asia Ltd. (CMA)	SOE	Port de Djibouti	Services	Djibouti	24%	185
 东芝株式会社 Toshiba Corp. (TSC)	SOE	Terminal Link SA	Services	France	43%	539
 武汉钢铁(集团)公司 Wuhan Iron and Steel (Group) Co.	SOE	ThyssenKrupp Tailored Blanks	Industry	Germany	100%	334
 科宝恩公司 Koblen Inc.	SOE	WISCO International Resources	Resources	Canada	100%	737
 阿里巴巴集团 Alibaba Group	Private	Koblen Inc.	Services	US	81A	120
 中国亚森传媒集团 China Yason Media Group	Private	China Yason Media Group	Services	Hong Kong	60%	664
 新加坡食品有限公司 Singapore Food Ltd	Private	Singapore Food Ltd	Services	Singapore	100%	269
 东芝食品工业有限公司 Toshiba Food Industries Ltd	Private	Toshiba Food Industries Ltd	Industry	Japan	77%	1,073
 锡格达通信(10%)有限公司 Snigdha Com (10%)	Private	Snigdha Com (10%)	Services	India	10%	560
 欧洲电信联盟 Eutelsat Communications	Private	Eutelsat Communications	Services	France	7%	484
 健康行机场控股有限公司 Healthrow Airport Holdings	Private	Healthrow Airport Holdings	Services	UK	10%	726
 尚迪卡集团 Pty Ltd Shandika Group Pty Ltd	Private	Shandika Group Pty Ltd	Services	South Africa	23%	281
 中国投资有限责任公司 China Investment Corporation	SOE	Thames Water Utilities	Services	UK	9%	779
 世邦魏理仕-购物城市 CBRE-Shopping City	SOE	CBRE-Shopping City	Industry	France	100%	1,445
 米盖尔食品集团 SA Miguel Alimentacion Group SA	SOE	Miguel Alimentacion Group SA	Industry	Spain	100%	143
 德文能源公司(项目) Devon Energy Corporation (projects)	SOE	Devon Energy Corporation (projects)	Resources	US	33%	2,500
 巴西石油有限公司 Petrobras Brasil Ltd	SOE	Petrobras Brasil Ltd	Resources	Brazil	33%	4,600
 塔利曼能源(英国)有限公司 Talisman Energy (UK) Ltd	SOE	Talisman Energy (UK) Ltd	Resources	UK	49%	1,500
 里海内陆资源有限公司 Caspian Inland Resources	SOE	Caspian Inland Resources	Resources	Kazakhstan	NA	1,260
 云布公司(阿美子公司) Yunbu Co (ARAMCO subsidiary)	SOE	Yunbu Co (ARAMCO subsidiary)	Resources	Saudi Arabia	NA	562
 基恩公司 Kion	SOE	Kion	Industry	Germany	25% / 30.1%	431
 林德液压有限公司 Linde Hydraulics	SOE	Linde Hydraulics	Industry	Germany	70%	352
 联想集团 Lenovo	Private	OCÉ	Services	Brazil	100%	149
	Private	Motorola	Mobility	US	100%	2,810

Sources: Provided by Citibank

2015 Activity has Redoubled Interest in Large Sino/Euro Deals

Acquiror	Target	Target Country	Size (US\$ bn)	% Acquired	Sector
China National Chemical Corp	Pirelli & C SpA		7.7	>95% <i>(Acquisition in Process)⁽¹⁾</i>	Tire Manufacturing
GO Scale (GSR) / Nancheng Industrial	Philips-LED Components		2.9	80.1% <i>(Pending)</i>	Lighting
HNA Group	Swissport		2.9	100%	Services
JianGuang Asset Management Co (JAC Capital, state-owned)	NXP Semiconductors' RF Power Business		1.8	100%	Semiconductor Manufacturing
Dalian Wanda Group and Co-Investors	Infront Sports & Media AG		1.2	100%	Marketing Consulting Services
Ping An Insurance	Deutsche Asset & Wealth (Tower Place, London)		0.5	100%	Real Estate

Sources: Provided by Citibank

II. Why Swiss Companies are Targets of Chinese Buyers

The following factors motivate Chinese companies to undertake M&A transactions with Swiss companies:

- Switzerland offers economic and political stability and security;
- the Swiss legal & regulatory framework is favorable for M&A transactions with Chinese buyers (there is a favorable Double Taxation Treaty between China and Switzerland and, so far, the Free Trade Agreement between China and Switzerland is the only such agreement that China has concluded with a continental European country);
- Switzerland is rich in human capital and offers reliable and well educated employees;

- M&A transactions with Swiss companies allow for an efficient inroad to advanced technical know-how;
- the acquisition of companies in Switzerland offers Chinese groups relatively quick and easy access to the Swiss market;
- it is a good way to acquire recognized brands, which may provide legitimacy in the Swiss, European, and even global markets (as Chinese companies sometimes struggle with reputational issues);
- Swiss luxury goods are very popular in the Chinese market. The Chinese are fascinated by Swiss technology and, particularly, by Swiss luxury goods;
- Chinese buyers have the potential to increase the value of the acquired Swiss companies

and brands by their ability to facilitate a better and more direct access to the Chinese market. For example, in 2014 Asia accounted for more than half of Switzerland's watch exports by value (53.2%). China is, after Hong Kong, the second largest Asian market and, notably, third at world level.

III. Challenges Due to Different Cultural Backgrounds: Observations from a Western Party's Perspective

a) Mutual relationship of trust and respect

Generally, the Chinese prefer to deal with people whom they know well and whom they trust. They certainly rely more on personal relationships than their Western counterparts. Western companies are therefore well advised to make themselves known to, and respected by, the Chinese. The relationship needs to be built not only between companies but also between individuals at a very personal level; building such a relationship is an ongoing process.

In meetings, a lot of small talk seems to take place from the Western party's perspective. They may be surprised that the really important part of a meeting is often postponed until the very end of the meeting and that a considerable amount of time is spent on finding common ground and understanding on minor topics. However, this approach is important to develop the relationship of trust that is necessary to do business with the Chinese.

Chinese parties put a lot of emphasis on respectful behavior. They are very careful not to expose anybody to what is commonly known as "losing face". Especially in confronting business situations, aggressive behavior from either party might damage the "face" of the other party. The level of

acceptance of aggressive behavior is much lower if the counterparty is Chinese.

b) Procedural Structure

While Western parties are generally used to working based on a commonly established timeline, which describes the steps to be taken on each working group level until the signing or the closing of the transaction, Chinese parties often pursue a more flexible and less foreseeable approach. One reason is that transactions involving Chinese parties often require internal or external regulatory approval or other procedures. The timing of such approval or procedures is often difficult to predict. Consequently, clearly set timelines are less common in the approach that Chinese companies pursue. Western parties should therefore be prepared for the fact that set timelines may often not be followed.

Also, Chinese parties tend to involve advisors quite late in the process, which can result in delays. A Western party, if time is of the essence, may therefore want to insist (*vis-à-vis* its Chinese counterparty) on the timely involvement of its advisors.

c) Indirect approach

Problematic issues are often not directly addressed by Chinese buyers but rather in a cautious and discreet way. The same approach may be advisable on the part of Western counterparties in order to preserve the relationship of trust and respect. Furthermore, it is essential to be aware not only of what is said in meetings but also of what is not said and which, in fact, should be.

d) Conclusion of negotiation topics

While Western parties often assume that agreed points can be considered as definitively closed, Chinese parties often reopen negotiations on these topics. This

occurs throughout the negotiation process until signing — and sometimes even after signing (eg, in the context of conditions precedent, pre-closing covenants, purchase price adjustments, earn-outs or other deferred payments). Western parties should therefore be prepared for this and remain flexible. With respect to deal items that allow a discussion after signing or even closing, such as earn-outs and other deferred payments, a Western seller should therefore consider seeking adequate security. Also, one should be aware that issues that seem to be “minor” to a Westerner may not be as “minor” to the Chinese counterparty.

e) Negotiation attitude

Chinese parties are typically very firm on their position and expect the same from their counterparts. For that reason, the taking of a firm, clear position and posture from the beginning of the negotiations is essential.

Irrespective of the above, when negotiating a deal with a Chinese party, it is often advisable to keep room for concessions, so that the Chinese counterparty can report to its superiors some “points won” that allow it to keep its “face” while making some concessions on other points.

f) Risk Perception

Based on experience from transactions made in China, Chinese buyers sometimes tend to require additional security on the profitability of the target companies and the existence of the assets on their balance sheets, such as by additional due diligence requests (such as site visits that may go beyond the standards Western parties may be used to), or by requesting guarantees in the transaction documents that go beyond the mere confirmation of compliance with the applicable accounting standards. Western parties should therefore be prepared to spend

additional time on satisfying due diligence requests and, sometimes, lengthy negotiations about the level of contractual guarantees.

g) Escalation to principals

With respect to a great variety of issues, a settlement between the highest level of the principals is necessary and an agreement concluded on the level of the advisors is often not possible. Complex and extended final negotiation rounds that use time and resources of the business principals are often required. Western parties should therefore be prepared to escalate critical issues to the principal level for final conclusion (sometimes involving a key group of senior Chinese advisors).

h) Increased professionalism

Even though Chinese buyers are generally, at least at this point in time, still lacking some experience and, hence, speed in M&A transactions (also due to language barriers, visa requirements, procedural aspects and so on) they tend to get rapidly accustomed to Western processes. Western parties should therefore be prepared for fast processing of multiple work streams with respect to different aspects of the transaction. Chinese buyers, more and more, engage highly professional and internationally experienced advisors early on in the process and keep them involved in all key stages of the transaction.

i) Dimensions of transactions

Deals with Chinese parties often have three different dimensions: business, political and administrative. It is often expected that the complete transaction team is present to make rapid deal progress and to build relationships at all levels. Also, Chinese parties often involve senior political figures as a way to enhance their image. Politicians are often present at the signing ceremony of significant transactions.

j) Post-acquisition phase

Differences in managerial styles and in corporate culture are regarded as the main reasons for past failures of Chinese outbound foreign direct investment. The post-acquisition phase is of great importance in cross-border M&A transactions involving Chinese parties. A fundamental challenge that affects the ultimate success of the integration process of an acquisition is to find the right balance between obtaining the necessary level of organizational integration and minimizing the interferences within the acquired firm's resources and competences. The chosen integration model should consider the cultural effects.

The involvement of professional advisors in cross-border M&A transactions is therefore also advisable after the transactions are closed. Their understanding of local laws and regulations, as well as their professional experience, help Chinese companies to better integrate into the new institutional environment. Moreover, assessment of local risks by professional firms can help the Chinese companies in making informed business decisions.

IV. Selected Legal Aspects in M&A Transactions with Chinese Buyers

a) Approval procedures

For a Western party, the involvement of numerous different national and provincial Chinese bodies in a transaction may be rather unusual. Issues, seemingly to be of a pure administrative nature, may become tripwires. Approvals of Chinese national and provincial bodies require substantial coordination efforts, may be extremely time-consuming and can potentially have a significant impact on the closing timeline of a transaction. Experienced professional local advisors

should be involved, because they best handle approval proceedings before Chinese bodies.

b) Structures of SOEs

There is a significant difference between a Chinese party that is a SOE and other Chinese buyers. SOEs often have:

- a complex organizational structure and sophisticated corporate governance mechanisms;
- a top-down approach;
- little transparency between senior managers and middle managers.

Often only the head of the SOE team is allowed to speak in negotiations, albeit he often may have no English language skills; this can lead to communication difficulties that can make the negotiations even more strenuous.

This complex structure, which in many instances is unfamiliar to Western target companies, often diminishes the motivation of the management of the acquired company to cooperate in not only the transaction process but also in the post-acquisition integration phase. By contrast, privately owned Chinese enterprises are generally more transparent; they show a fast decision-making process and a stronger willingness to learn.

c) Arbitration

China is party to the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards. By contrast, China has not yet entered into many agreements concerning the enforcement of court judgments with other countries (not even with Switzerland). It is therefore advisable to subject the transaction documentation for M&A transactions with Chinese companies to arbitration proceedings in order to best facilitate enforcement.

d) Chops, or corporate seals

In China generally, a chop (corporate seal) is required for a contract to be valid. While it may be unusual for Western parties that the Chinese parties will sign with the company’s

seal, this is an important aspect for the formal validation of the contract and, ultimately, for potential future enforcement of rights under the contract.

V. Issues to Note

Issue	Chinese Party	Western Party
Relationship	Very important not only between companies but also between individuals	Less important; focus is on achieving business interests
Problematic Points	Not addressed directly	Addressed directly
Transaction Details	Discussed on highest level	Discussed at a lower level
Respectful Behavior	Highly important (not exposing someone to “lose face”)	Important (but level of tolerance of aggressive behavior is much higher)
Agreed & Closed Topics	Subject to new discussions until signing and, sometimes, even after closing	Understood to be concluded in a final way
Firm Clear Position from Beginning	Highly important	More flexible
Role of Legal Advisors	Delegation of resolution of adverse positions to advisors not customary; normally, agreements are only concluded between principals	Advisors may play a more central role
Administrative Approvals of Government Bodies	Procedure usually more difficult and less predictable, not transparent, time consuming, and outcome unpredictable	Procedure normally transparent and usually of pure administrative nature
Involvement of Political Figures	Common to enhance image	Not common
Different Legal Structures of Companies Influencing Transactions	Very different legal structures (SOEs, POEs etc.) that have an influence on the transaction	Differences in legal structures less important and without significant influence on the transaction

Post-Acquisition Phase	Challenging due to different cultural backgrounds	Important but often better manageable
Arbitration Clause	Recommended since China is party to the New York Convention and has not yet entered into many agreements concerning the enforcement of court judgments with other countries	Choice between State courts and arbitration proceedings less fundamental
Corporate Seal	Necessary to make legal documents valid	Not frequently used

VI. Typical Clauses in Share Purchase Agreement

Topic	Chinese SPAs	Western SPAs
Deal Structure	Fixed price common Price adjustment clauses may be impracticable for SOE's Price adjustments / earn-outs / deferred payments not uncommon for POEs	Auctions: fixed price / locked box often seen Other transactions: closing accounts also very common Earn-outs: less common
Conditions Precedent	Very limited for SOEs Material Adverse Change (MAC) clause unusual	Generally limited to regulatory and third party consents MAC clause not unusual, often quantified Sometimes accuracy of representations and compliance with covenants added
Regulatory Approvals	No "hell or high water" clauses	"Hell or high water" clauses often seen in auctions
Representations and Warranties	Generally limited; increased level of protection occasionally sought on specific matters	For private equity sellers: generally more limited Strategic sellers: generally broader
Representations and Warranties repeated at Closing	Often not repeated	At least core warranties are repeated at closing

Disclosure	Specific disclosure	Usually entire data room
Financial limitations	Higher, sometimes even no caps	Customarily at 10-25% of purchase price; for title, often at 100% of purchase price
Duration of Representations	Longer, sometimes unlimited	At least one audit cycle, often 18 months

VII. Conclusion

The expansion of Chinese companies into Swiss and other non-Chinese markets brings new challenges for Westerners as well as for the Chinese due to their very different cultural backgrounds. It is important that both parties are aware of such differences and establish a common ground to facilitate doing business. The parties should understand that not only is the M&A transaction challenging, but that the post-acquisition phase is also of significant importance.

The average Western person is not familiar with “Chinese ways”. For that reason, a chosen integration model should also consider cultural effects. However, if the cultural and institutional particularities of the Chinese business partner are taken into account, the Chinese cross-border M&A market offers significant opportunities to Swiss and other Western companies.

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