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Voice from China

Update on the M&A market in China

MAY 2021

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Introduction

China's GDP expanded by double digits during the first quarter of 2021, as the economy strongly rebounded from the global pandemic.

The stellar 18.3% year-on-year (YoY) growth compares favorably against Q1 2020, when COVID-19 was ravaging the economy. But it is also due to a 43.4% YoY surge in exports, as China's early containment of the disease positioned it to play a central role in the global supply chain. Calculations by *The Economist*, which correct for the exceptional decline during the first three months of last year, put this year's first quarter growth at a more realistic 5.15%. Yet this is still far above the world's other major economies.

2021 is the first year of China's 14th five-year plan which, per the most recent People's Congress, centers on four big themes: industrial upgrades, a "dual circulation strategy," regional economic integration and a carbon neutral energy strategy; each of these will have a big impact on China's M&A market.

M&A activity grew by 23.1% YoY, even as the number of outbound cross-border transactions continued to shrink due to travel restrictions and an increasingly frictious geopolitical environment. Still, as the only growing major economy and one of the world's largest markets, China continued to attract inbound investment.

Real GDP growth rate by countries

	2021 First quarter	2020 Annual realized	2021 Annual forecast
	18.3% (realized)	2.3%	8.4%
	5.0% (forecasted)	-3.5%	6.4%
	-	-6.6%	4.4%
	-	-3.3%	6.0%

Source: International Monetary Fund

ENCOURAGING M&A

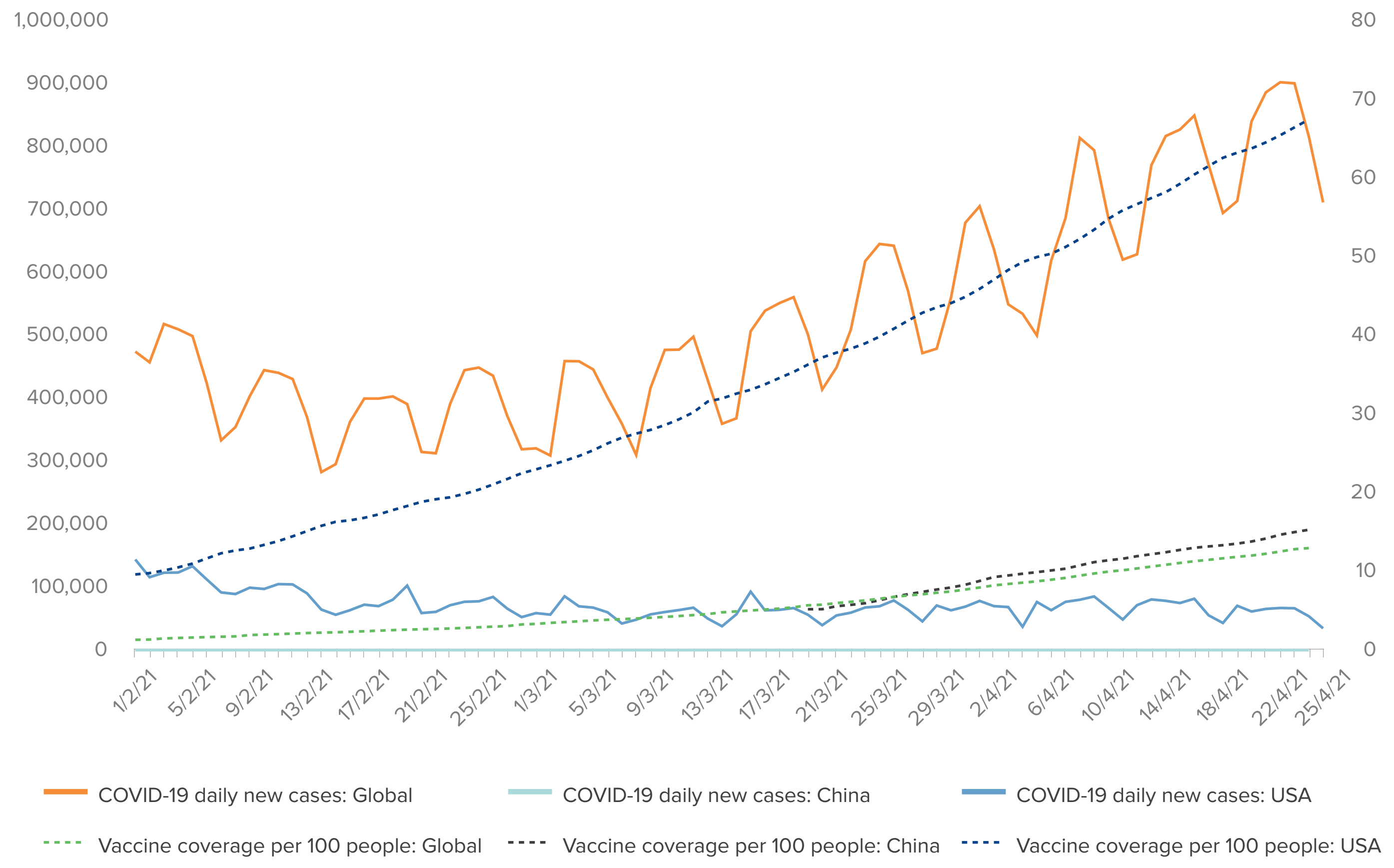
Official policies played a role as well. Using favorable tax treatment and government subsidies, China is encouraging companies to develop their own core technology through a combination of R&D and acquisitions. For example, the government's "Action Plan for the Development of Basic Electronic Components Industry (2021–2023)," announced earlier this year, promotes investment in a variety of technologies including smart terminals, 5G, industrial Internet, data centers and new energy vehicles.

Outbound investment, however, has been impeded by the fallout from an increasingly tense Sino-US relationship. Taking their lead from the USA, the UK and France both passed laws that further restrict direct foreign investment. This led to deals such as China-based Ligeance Aerospace Technology's acquisition of UK-based Northern Aerospace being rejected by the British government.

Despite this, Chinese companies still favor Europe as an investment destination, given its considerable market and less hostile attitude compared with the USA China's regional integration strategy, which includes the country's Belt and Road initiative and RECP agreement (Regional Comprehensive Economic Partnership, a free trade pact with 15 Asia-Pacific nations) is also leading to more Chinese investment in the European Union, as well as East Asia.

As for the impact of COVID-19 on cross-border M&A, this varies country by country. We expect that the more heavily vaccinated countries will begin recovering by summer, which may provide an outlet for the pent-up demand for more outbound investment opportunities among Chinese companies.

COVID-19 daily new cases & vaccine coverage per 100 people



Source: Wind

Chinese president Xi Jinping has repeatedly emphasized the importance of the country's carbon neutral strategy, which calls for reaching peak carbon usage before 2030 and achieving carbon neutrality by 2060. To help achieve these goals, the government is providing extensive support for and actively encouraging direct overseas investment in sustainable technologies such as electric cars, solar and wind energy, and other energy-efficient solutions.

More generally, the Chinese government continues to support inbound M&A and foreign direct investment (FDI) in the hope that foreign companies will introduce new technologies and product techniques, as well as advanced management systems. During Q1, FDI increased 22.2% YoY, with much of it concentrated in the commercial and technology services sectors.

Two of the incentives included in China's Foreign Investment Law

	Clauses
1	For foreign-invested research and development centers, the transfer of technology is exempted from business tax in accordance with domestic research institutions.
2	When foreign-invested enterprises purchase domestic equipment as part of the total investment, if such equipment falls within the scope of the tax-exempt catalog, the domestic equipment value added tax can be refunded in full and the enterprise income tax will be deducted in accordance with relevant regulations.

Recent M&A activity

During the first quarter of 2021, 55 inbound acquisitions of Chinese companies were disclosed, representing a year-on-year increase of 22.2%. A total of 53 outbound acquisitions were also disclosed, a year-on-year decline of 26.4%.

Inbound M&A

	2021 Q1
Number of Deals	55
Change YoY	22.2%
Deal Value (US$m)	5,123.53
Deal Value Change YoY	78.7%

Inbound M&A bounced back from the pandemic-induced lows of Q1 2020, with both the number and value of inbound transactions rising substantially compared with the same period last year.

Outbound M&A

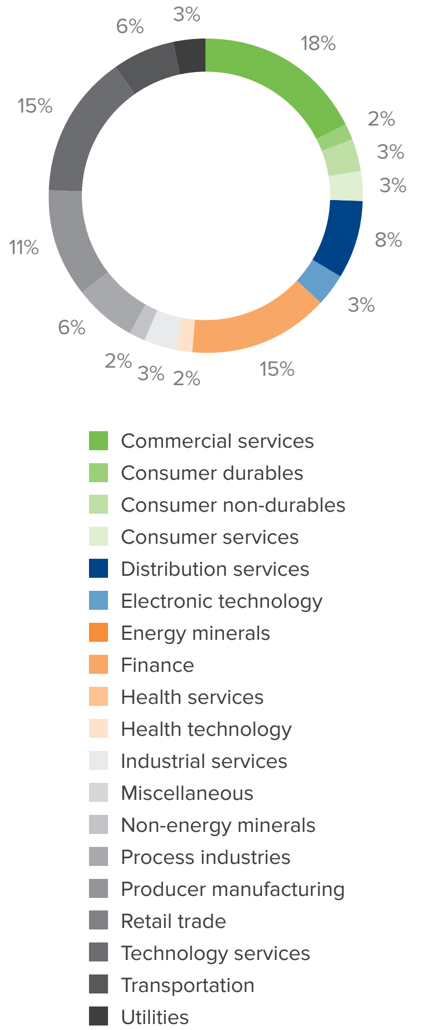
	2021 Q1
Number of Deals	53
Change YoY	-26.4%
Deal Value (US$m)	12,360.50
Deal Value Change YoY	224.6%

The number of outbound deals, on the other hand, fell by 26.4% compared with the same period last year. The value of those deals, however, soared by 224.6% YoY, although this was mainly driven by Hillhouse Capital's acquisition of Philips' home appliance business (deal value around US$4,500 million).

INBOUND M&A BY SECTOR

For the quarter, the most popular destination for foreign investors was the Commercial Services sector (17.74% of transactions), followed by the Finance and Technology Services sector (14.52% of transactions).

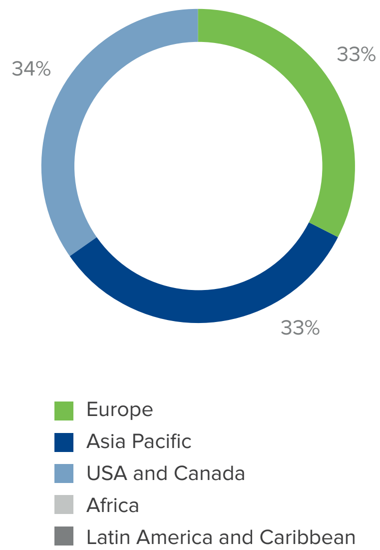
Inbound transactions by sector



INBOUND M&A BY REGION

The source of Q1's inbound investment was nearly evenly split among three regions: USA and Canada (34.55%), Asia Pacific (32.72%) and Europe (32.72%).

Inbound transactions by acquiror region



Transaction values were disclosed for 16 inbound transactions

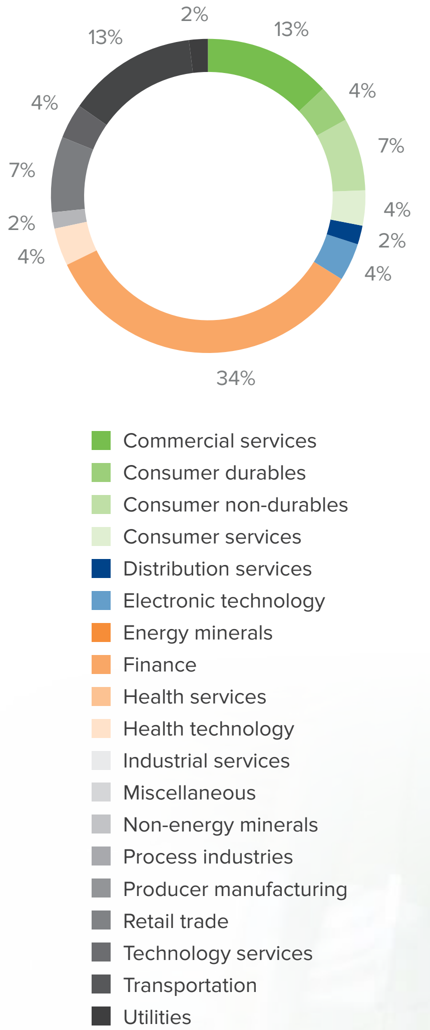
Transaction size (US$m)	Number of transactions
<50	9
50-100	2
>100	5

Source: Factset M&A database

OUTBOUND M&A BY SECTOR

More than a third (34%) of Q1 outbound transactions took place in the Finance sector, followed by the Commercial Services (13.21%) and Technology Services (13.21%) sectors.

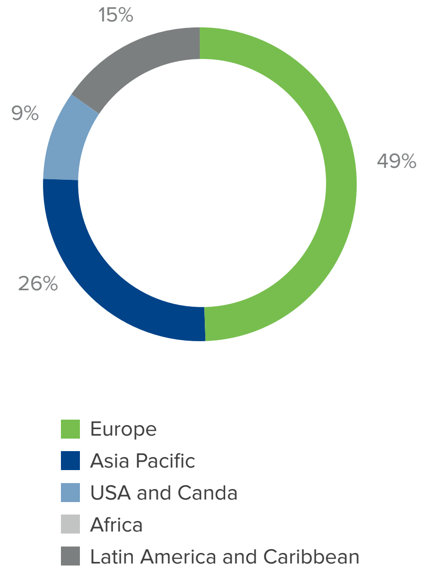
Outbound transactions by sector



OUTBOUND M&A BY REGION

During the quarter, nearly half (49.06%) of Chinese acquirors set their sights on Europe, followed by Asia Pacific (26.42%), and Latin America and the Caribbean (15.09%).

Outbound transactions by target region



Transaction values were disclosed in 31 outbound transactions

Transaction size (US$m)	Number of transactions
<50	15
50-100	2
>100	14

Source: Factset M&A database

Note: All figures for China include mainland China, Hong Kong, Macau and Taiwan; for number of transactions, both completed and pending transactions are counted.

Spotlight on the **low-voltage electrical components sector**

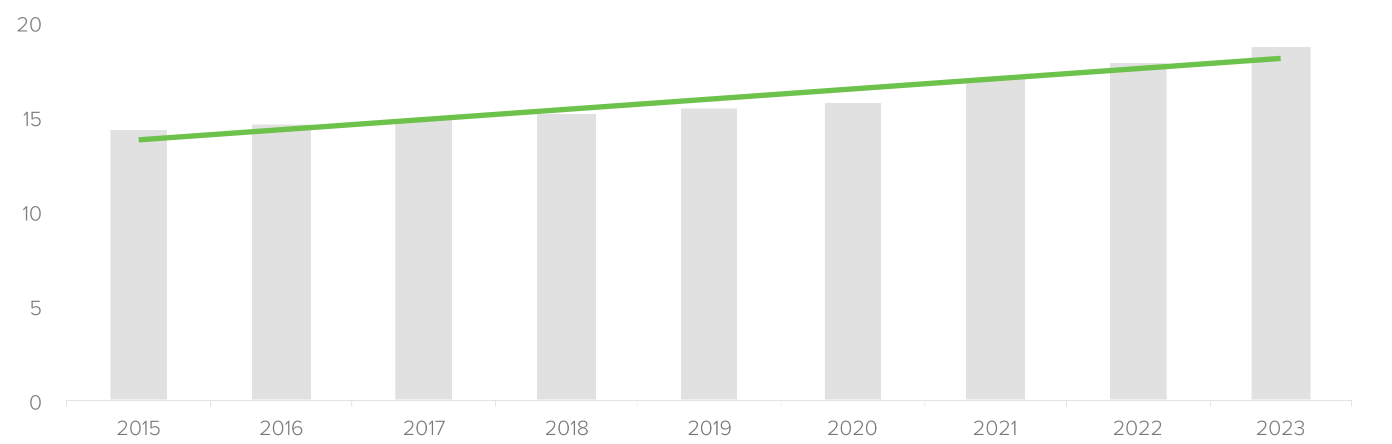
China is one of the world's leading manufacturers of low-voltage (LV) electrical components, with 2,000 companies engaged in their production and sale. Most of these companies are located in Wenzhou, the largest industrial cluster of LV electrical component producers in the world.

This concentration of the LV industry creates a huge competitive advantage for Chinese manufacturers. All the necessary materials can be locally sourced in Wenzhou, which shortens delivery time significantly, and the local workforce is highly skilled in electrical component production.

By leveraging these advantages, several LV component makers in Wenzhou have become OEMs and ODMs for such reputable international brands as Eaton, LS Electric and Honeywell. Some have taken this a step further. Earlier this year, Oaklins HFG China assisted the Wenzhou-based HuanYu group in setting up a joint venture with Eaton.

In 2020, China's LV market exceeded US$15 billion. Given the ongoing developments in 5G, clean energy and power grid transformation technologies, the market is widely projected to continue expanding through 2023.

LV electrical components market size (in US$ billion)



Source: Wind

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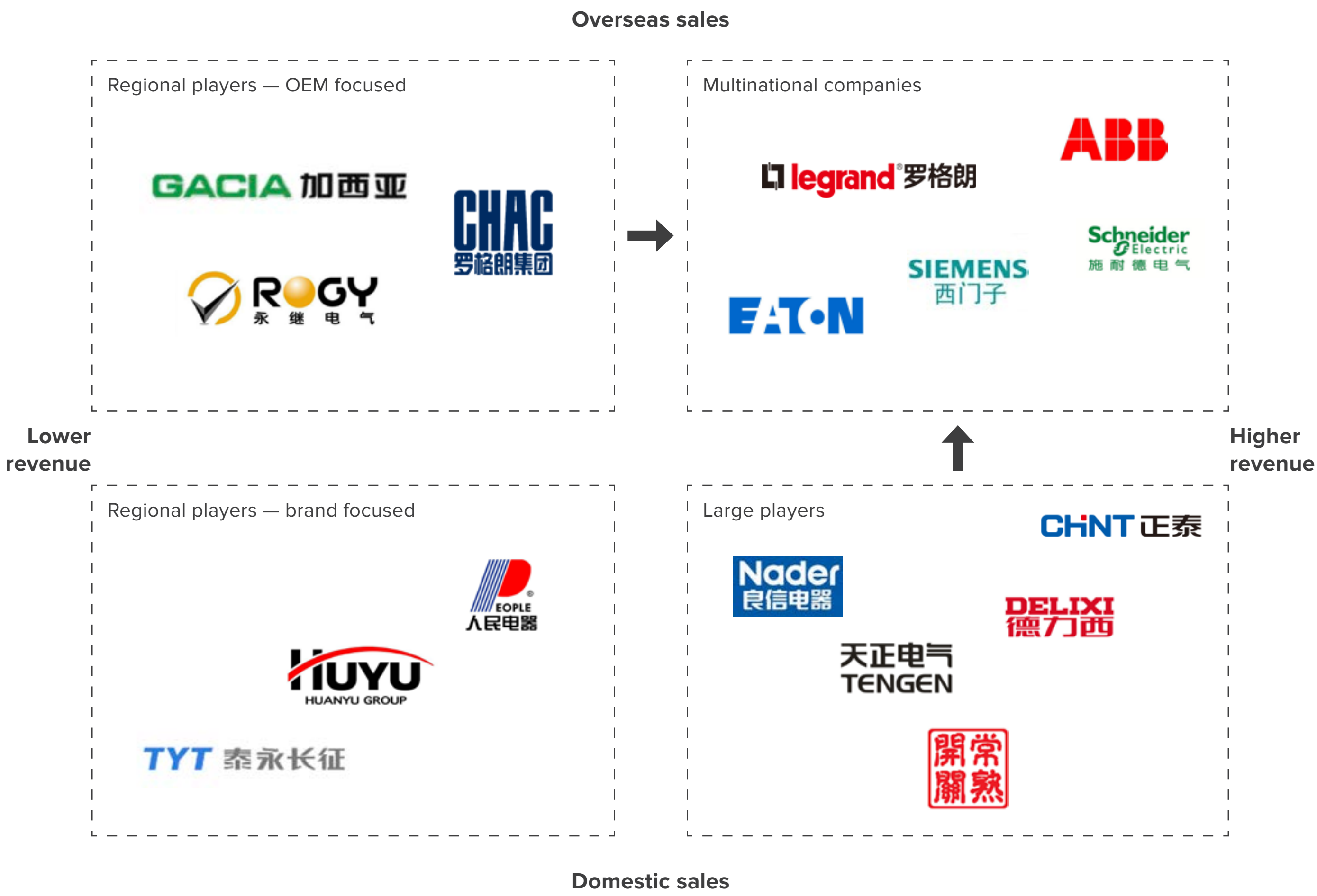
THE COMPETITIVE LANDSCAPE

The LV component market is fragmented and highly competitive, consisting of three groups of players:

Type of player	Competitive advantage	Leading companies
Multinational Corporations	Multinationals frequently have technology and branding advantages. Their customer base typically requires the highest level of product quality.	Schneider, Siemens, ABB, Eaton
National Chinese Manufacturers	China's largest domestic companies benefit from a highly efficient supply chain, strong production capabilities and established sales channels.	Chint, Liangxin, Changshu Switch Factory, Delixi
Regional Chinese Manufacturers	Regional LV component manufacturers are usually smaller companies, with fewer economies of scale and weaker R&D capabilities, although some regional players act as OEMs or ODMs for renowned international brands.	Gacia, People Electric, HuanYu

Low-voltage electrical industry competitive landscape



MARKET TRENDS

Import substitution

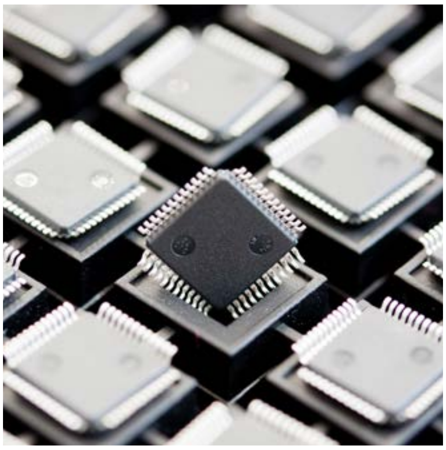
The gap between China's largest domestic manufacturers and foreign multinationals is closing. Through continuous investment in R&D and improved brand recognition, China's domestic players are grabbing market share by offering products that meet the same technical specifications as foreign brands, but at a lower cost. Chinese companies such as Chint and Liangxin have gained share by integrating their supply chains, upgrading their product performance and participating in major government infrastructure projects. These companies pose a growing threat to the multinationals, whom they are seeking to displace.

Consolidation

The larger LV component makers plan to keep their market share by emphasizing R&D and continuously enriching their product lines. Some medium-sized players are focusing on niche markets to differentiate themselves. With product standards rising, some small regional companies with limited technical resources and unsystematic quality control are having trouble keeping up. This has led to increasing concentration within the LV component sector over the last five years. While some multinationals are withdrawing from the Chinese market due to the increasingly fierce competition, others are seeking to strengthen their presence through acquisitions and joint ventures.

Growing demand for high-end products

For the well-known European brands, such as Schneider, ABB and Siemens, the high end of the LV component market accounts for about one-third of their revenue and is where they are most competitive. This positions them to take advantage of China's growing investment in infrastructure projects — including data centers, rail transit, industrial plants and luxury real estate — which will boost demand for LV products at the high end.



Case study: HuanYu Group

THE SELLER

HuanYu Group is a leading Chinese LV electrical equipment manufacturer. Founded in 1989 and headquartered in Wenzhou, China, HuanYu's products are widely used across a variety of industries, including energy, communications, chemicals, metal smelting, manufacturing, medical supplies and pharmaceuticals, transportation and commercial construction.

THE BUYER

Eaton is a diversified power management company that has been in business for over 100 years. Its lines of business include electrical components, electrical systems and services, aerospace, transportation vehicles and, most recently, e-mobility.

DEAL SYNERGY

Eaton benefits from HuanYu's established presence as an LV components manufacturer with sales teams in all of China's major cities. HuanYu reaps the advantages of Eaton's strong brand and technological prowess, positioning it to compete with other international brands and capitalize on the growing demand for high-end LV components. Given Eaton's vast international distribution channel and premium product lines, other opportunities for HuanYu are likely to materialize as well.

HUYU
环宇集团

has agreed on a strategic investment in

HuanYu High Tech Co., Ltd.

from

EATON
Powering Business Worldwide

M&A SELL-SIDE

Industrial Machinery & Components

"We are very pleased to have achieved a strong strategic cooperation with Eaton with the help of the Oaklins' team. This transaction marks a milestone event that promotes the integration of the low-voltage electrical components industry in China. With the local supply chain and resource network in Wenzhou, I believe we will be able to expand our market share, upgrade our technology, products and management, and quickly grow into a more successful enterprise."

WANG KAI

CHAIRMAN, HUANYU HIGH TECH CO., LTD.

20 OUTBOUND ACQUISITIONS BY CHINESE COMPANIES CLOSED BETWEEN JAN AND MAR 2021

Date	Acquiror	Target	Target country	Industry	Transaction value (US$m)
24-Mar-21	TCL Healthcare Equipment Shanghai Co., Ltd.	BEBIG Medical GmbH		Health Technology	-
12-Mar-21	Xeno Holdings Ltd.	EQ Investment Co., Ltd.		Finance	-
11-Mar-21	Ares SSG Capital Management (Hong Kong) Ltd.	Altico Capital India Ltd.		Finance	384
2-Mar-21	WuXi AppTec Co., Ltd.	Oxford Genetics Ltd.		Health Technology	135
1-Mar-21	Comtec Renewable Energy Group Ltd.	Future Energy Capital Group Ltd.		Finance	1.83
28-Feb-21	Acclime Hong Kong Ltd.	Cosec Corporate Services Pty Ltd.		Commercial Services	-
12-Feb-21	Sandbox Industries Ltd.	Tailormade Design Ltd.		Commercial Services	-
8-Feb-21	Ascendum Capital	EndoWays Ltd.		Producer Manufacturing	-
4-Feb-21	Pacific Prime Insurance Brokers Ltd.	CXA Group Pte Ltd. /2 Subsidiaries/		Technology Services	-
2-Feb-21	Vistra Group Ltd.	Jotaerre Digitação e Serviços Ltda.		Technology Services	-

Date	Acquiror	Target	Target country	Industry	Transaction value (US$m)
29-Jan-21	National Arts Entertainment & Culture Group Ltd.	Majestic Bravo Ltd.		Finance	13.06
26-Jan-21	Lightning International Ltd.	Yaddo Ltd.		Technology Services	-
22-Jan-21	Tencent Holdings Ltd.	Klei Entertainment, Inc.		Technology Services	-
21-Jan-21	Qima Ltd.	Normalización y Certificación NYCE SC		Commercial Services	-
14-Jan-21	Yubo International Biotech Ltd.	Platinum International Biotech Co., Ltd.		Finance	380.25
13-Jan-21	Turbo Cash Hong Kong Ltd.	PT Bank Kesejahteraan Ekonomi		Finance	-
12-Jan-21	Clark Orient (BVI) Ltd.	Ecomat, Inc.		Producer Manufacturing	0.32
7-Jan-21	Sequoia Capital China Advisors (Hong Kong) Ltd.	AMI Paris SAS		Consumer Non-Durables	-
5-Jan-21	Vital Materials Co., Ltd.	Ppm Pure Metals GmbH / Langelsheim Ops/		Producer Manufacturing	-
4-Jan-21	Qima Ltd.	Prüfinstitut Hansecontrol GmbH		Commercial Services	-

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Oaklins brings you opportunities from across the world and we meet you with our expertise wherever you are