

► Mergers & Acquisitions in China



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Private & confidential

I. Introduction

– Background to M&A in China

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II. Structuring the Optimum China M&A Deal

1) Direct acquisition

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

2) Indirect acquisition

- ▶ 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

3) 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

4) 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



III. Current Government Policy

1) Resolution 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”

2) Support from SASAC

3) Entry into WTO



IV. Laws and Regulations and the Opportunities Created

1. **Provisional regulations on the merger and acquisition of domestic enterprises (“M&A”) (12 April 2003)**
 - ▶ first comprehensive regulation aimed at making all types of mergers and acquisitions involving foreign investment subject to consistent standards
 - ▶ Represent another step toward the overall modernization and rationalization of China’s foreign investment laws and regulations



IV. Laws and Regulations and the Opportunities Created

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

b) Assets 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 inject of those assets as registered capital into a foreign invested enterprise



IV. Laws and Regulations and the Opportunities Created

B. Foreign investor's 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

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

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 a state-owned assets

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IV. Laws and Regulations and the Opportunities Created

E. Creditor's right

- ▶ Equity transaction does not affect debts and creditors' rights of a domestic enterprise

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

(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 installment, remainder in full within three months of issue of the new business license



IV. Laws and Regulations and the Opportunities Created

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 percentage will be negotiated between the parties based in the appraised value of the assets

H. Ratio 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



IV. Laws and Regulations and the Opportunities Created

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
- ▶ increase capital or asset transfer
- ▶ corporate and creditworthiness documents
- ▶ corporate documents of the domestic entity



IV. Laws and Regulations and the Opportunities Created

I. Application, examination and approval procedures (cont'd)

- ▶ plan of disposition of employees
- ▶ additional requirements
- ▶ timeframe for approval and the requirements for registration with the SAIC are similar to existing rules

J. Anti-competition

- ▶ Turnover of a party exceeds RMB 1.5 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%



IV. Laws and Regulations and the Opportunities Created

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

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

IV. Laws and Regulations and the Opportunities Created

Required reorganisation 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

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

Approvals

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



IV. Laws and Regulations and the Opportunities Created

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

- ▶ an audit and asset appraisal report of the SOE;
- ▶ A staff and worker settlement program;
- ▶ An agreement for settling claims and debts;
- ▶ A restructuring plan;
- ▶ Resolutions of the reorganizing part of the SOE; and
- ▶ The opinions or resolution of the congress of the staff and workers of the SOE.

IV. Laws and Regulations and the Opportunities Created

3. Provisional regulations on administration of the transfer of state-owned assets (1 February 2004)

Approval procedures and documents

- ▶ submitted to state-owned assets supervision and administration commission

Procedures on transfer of state-owned assets

- ▶ Research on feasibility
- ▶ Asset appraisal
- ▶ Announcement
- ▶ 2 or more purchasers – auctions or bids
- ▶ Payment of consideration



Qualified Foreign Institutional Investors ("QFII Regulations")

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V. Reducing Acquisition Risks – Due Diligence

Reasons for conducting due diligence exercises

1. Protection
2. Regulatory compliance
3. Investigation of the company
4. Assess the risks and understand the parameters

Case Study

PRC Listed Cement Plant

- ▶ Acquisition by strategic investor
- ▶ US\$30 million investment
- ▶ Listed shares
- ▶ Approximately 25% of issued share capital

Time frame:

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

Importance of understanding:

- ▶ The legal/business environment
- ▶ The industry

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Case Study (cont'd)

PRC

- ▶ Legal norms
- ▶ Business practices
- ▶ Management behavior
- ▶ “Neibu” information

Understanding the cement industry

- ▶ Capital intensive
- ▶ Long-term view required
- ▶ Long-term finance essential
- ▶ Title to land/mining/building rights crucial

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Case Study (cont'd)

Professionals

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

Business Approach

- ▶ “Partnership”
- ▶ Ensure all legal formalities effected
- ▶ Business planning
- ▶ Human resources planning
- ▶ Capital investment planning

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Case Study (cont'd)

Regulatory application

- ▶ China Securities Regulatory Commission
- ▶ Shanghai Stock Exchange

Initial meetings

- ▶ Site meetings
- ▶ Information gathering

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Case Study (cont'd)

Due diligence areas

Huasin's operations

- ▶ History and overview
- ▶ Shareholdings and capitalisation
- ▶ Relationship with major shareholder and the municipality
- ▶ Management structure
- ▶ Intellectual property
- ▶ Land use rights and building ownership certificate
- ▶ Products and production arrangements
- ▶ Particulars of Kiln project
- ▶ Raw materials supply
- ▶ Energy supply

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Case Study (cont'd)

Due diligence areas

Huasin's operations (cont'd)

- ▶ Transportation
- ▶ Distribution
- ▶ Market position and competition
- ▶ Financing arrangements and indebtedness
- ▶ Insurance
- ▶ Labor and welfare arrangements
- ▶ Taxation
- ▶ Environmental compliance
- ▶ Miscellaneous

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Case Study (cont'd)

Legal due diligence report

Major issues

- ▶ Land
- ▶ Mining rights
- ▶ Asian Development Bank
- ▶ Tax

Case Study (cont'd)

- A. Subsidiaries and joint ventures
- B. Questionnaires
- 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

Case Study (cont'd)

- 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 Exchanges
 - ▶ The Mineral Resources Law
 - ▶ PRC Environmental Protection Law

Case Study (cont'd)

Further process

- ▶ Review
- ▶ Negotiation
- ▶ Solutions
- ▶ Finalization

Importance of Legal Opinions

The Final Outcome

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Contact Us

Hong Kong Office

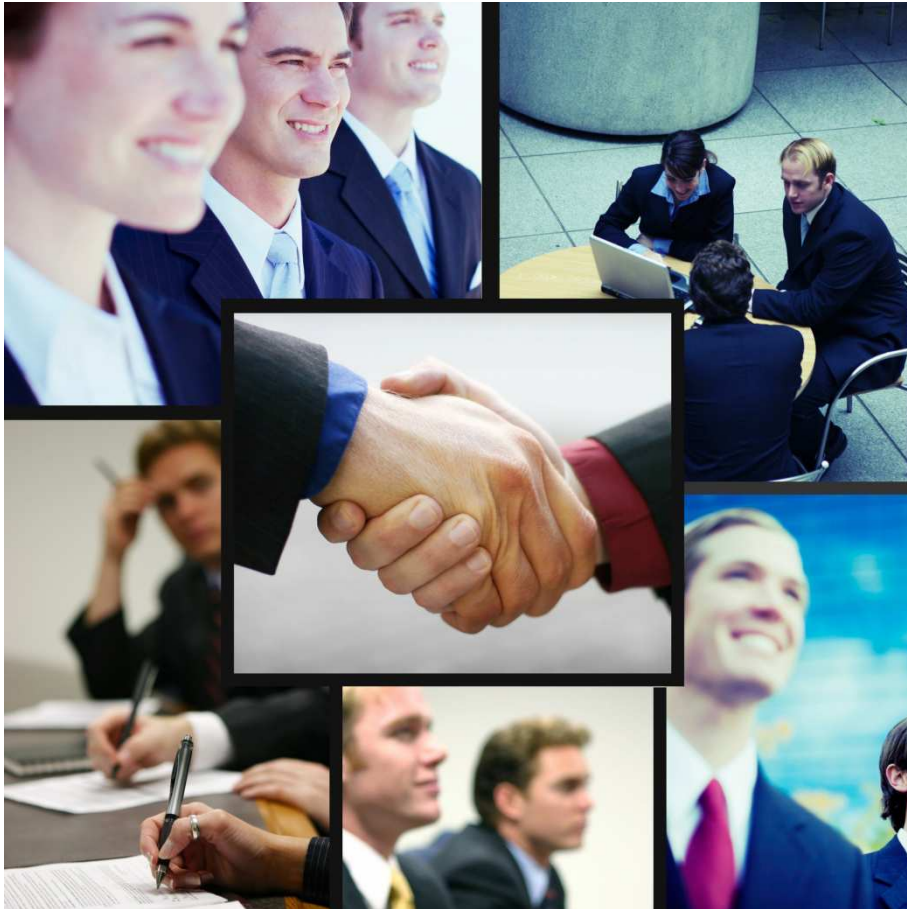
Dominion Centre
12th Floor
43 – 59 Queen's Road East
Hong Kong

Telephone: (852) 2905 7888
Fax: (852) 2854 9596
Email: enquiries@charltonslaw.com
Website: <http://www.charltonslaw.com>

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The End



Hope you enjoyed our presentation...

Julia Charlton

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