MARRYING THE DRAGON

OC&C
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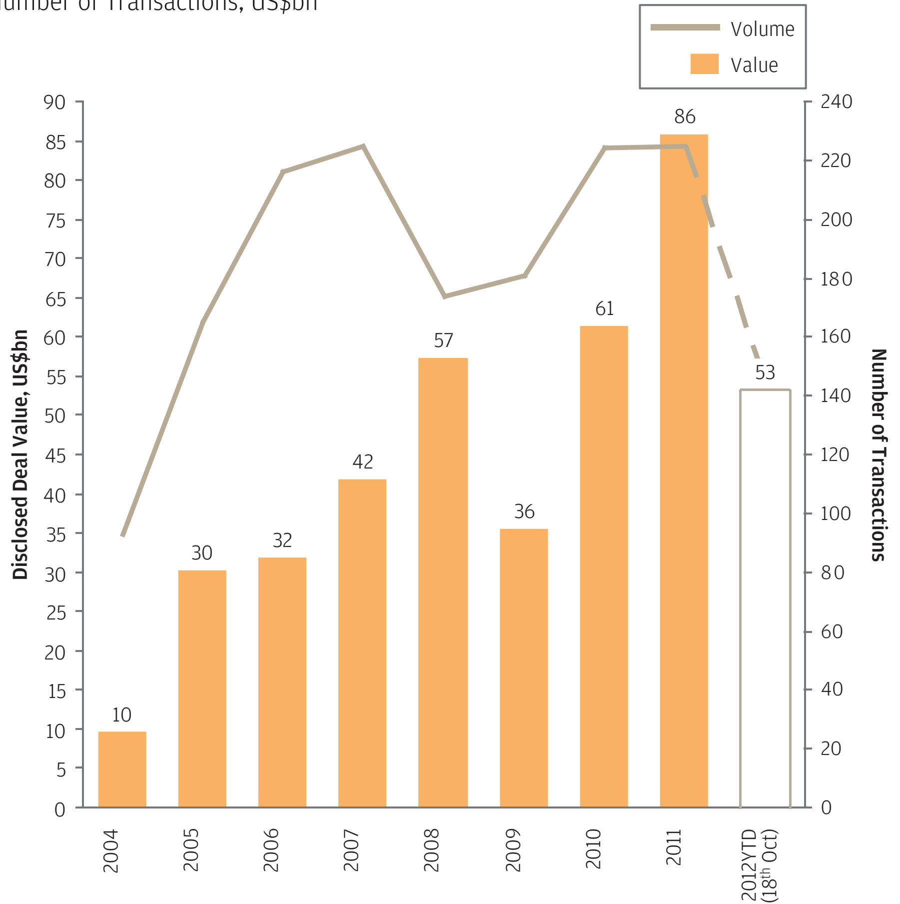
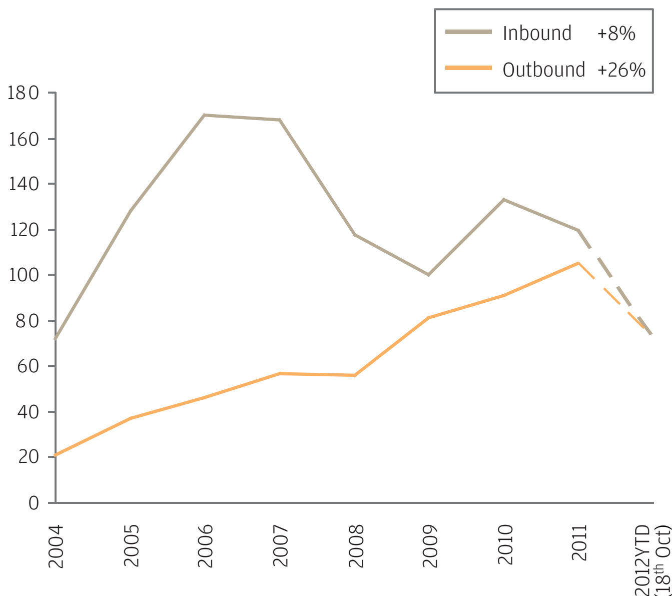
In recent years, China has played a greater and greater role in the cross-border merger and acquisition market. Outbound M&A activities have been accelerating since 2008. By 2011, the value of outbound M&A transactions has exceeded that of inbound by 70%. In particular, outbound deals are getting larger in size. The number of outbound transactions has been growing at 26% CAGR since 2004, and the total value has been growing even faster at 60%. This trend is expected to continue as Chinese companies seek opportunities arising from the debt crisis in Europe and a need for expansion outside a well covered domestic market.

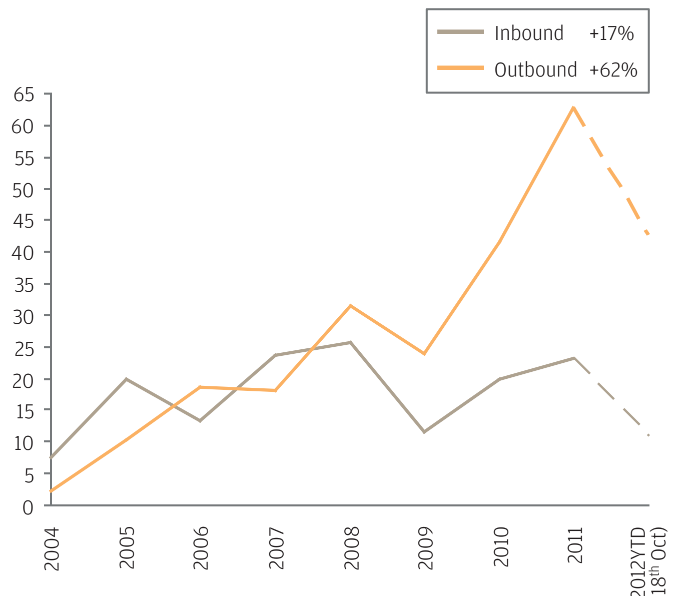
Evolution of Cross-Border M&A Activities[1] in China
Number of Transactions, US$bn



Value of Cross-border Transactions[1], 2004-12YTD
Number of Transactions, CAGR04-11



Value of Cross-border Transactions[1], 2004-12YTD
US$bn, CAGR04-11



[1] Excluding deals with bidders as PE / VC, deals between mainland China and HK / TW, deals with unreleased bidder / value

Changes also happen in the choice of target sectors. For many years in the past, Chinese companies were most enthusiastic in acquisitions around natural resources and advanced technologies overseas. These are still and will remain hot sectors.

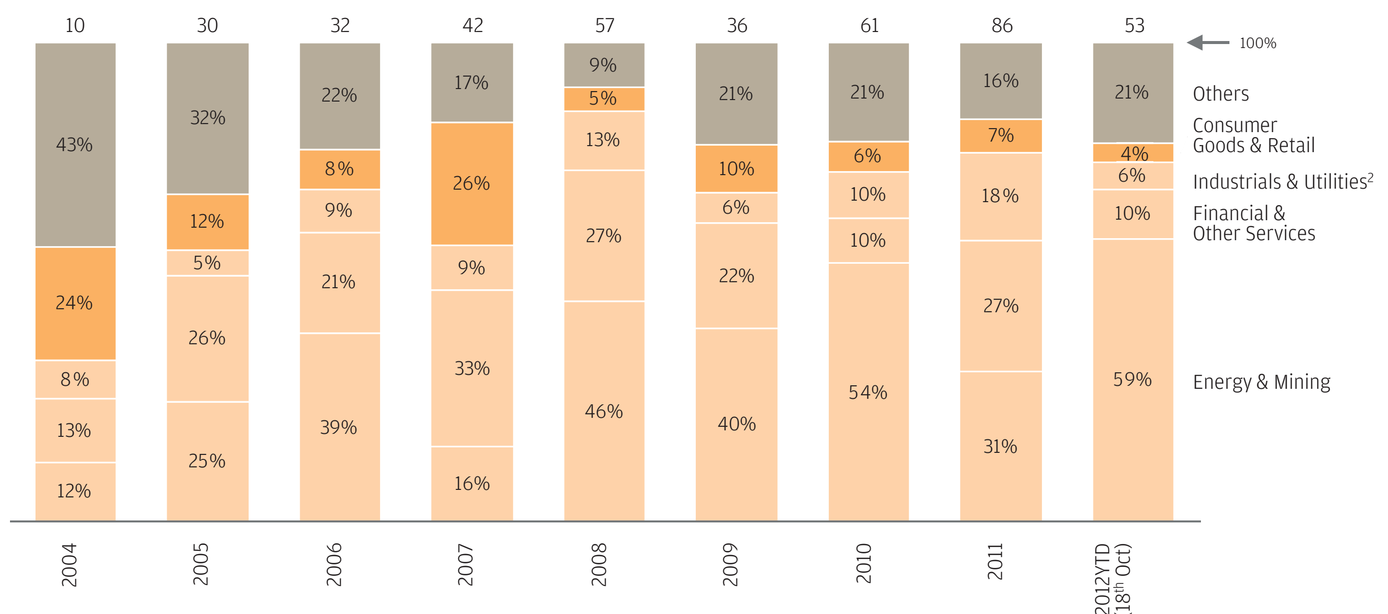
We have also observed the shift in the consumer goods and retail sectors. In the past, the buyers in consumer goods and retail sector were mostly European and American companies who aimed to gain access to the Chinese market. For example, in the 90s, leading international players acquired most leading Chinese brands in the personal care sector.

Year	Target	Acquirer
1991	Maxam (Cosmetics)	S.C Johnson
1994	Panda (Washing Powder)	P&G
1994	Zhonghua (Toothpaste)	Unilever
1994	Maxam (Toothpaste)	Unilever
2003	Mininurse (Cosmetics)	L'Oreal
2004	Yue Sai (Cosmetics)	L'Oreal
2007	C-Bons (Haircare)	Beiersdorf
2007	Dabao (Cosmetics)	Johnson & Johnson
2010	TJoy (Cosmetics)	Coty Inc.

Today, driven by the vast prospects in China, the consumer goods and retail sectors are still a popular target for overseas acquirers. Meanwhile, Chinese companies have also started to actively look for overseas targets of leading brands in the consumer goods and retail sectors. We have seen more and more deals happening in recent years. For example:

- In mid 2011, Chinese electrical retail giant Suning became the majority shareholder of Japanese electric retailer LAOX, a provider of a wide range of categories including household products. Through the deal Suning aims to expand its category offering, get access to store operation skills and strengthen its sourcing capability
- In March 2012, Chinese electrical appliance manufacturer Haier bought the washing machine and refrigerator units of Japanese Sanyo Electric from Panasonic. The acquisition not only enhances Haier's R&D and manufacturing capabilities in white goods, but also provides good opportunities for Haier to enter the South East Asian market where it can continue to use the SANYO brand. In Oct 2012, Haier also completed the New Zealand acquisition of Fisher & Paykel, aiming to gain a bigger footprint in overseas markets and beef up its technology.
- In May 2012, China's state-owned Bright Food Group acquired 60% control of the UK breakfast cereal maker Weetabix, mainly with the ambition to bring Weetabix's business into Asia especially China. The deal, which includes a clause enabling Bright Food to acquire full ownership in two years, values Weetabix at £1.2bn including debt.

Value of Cross-Border Transactions[1] by Sector, 2004-12YTD
US$bn



1 Excluding deals with bidders as PE / VC, deals between mainland China and HK / TW, deals with unreleased bidder / value
2. Including Industrial, utilities and chemical & materials

It is not an easy journey for a cross border merger and acquisition. It involves a vast degree of complexity and challenges. During the M&A process, companies need to build an in-depth understanding of a different market and regulatory barriers. Figuring out what they are really buying often proves harder than expected. Companies also need to handle discussions and negotiations with a group of people who have completely different culture and language backgrounds – not just the verbal language but also their ways of thinking.

Signing the deal is not an end in itself but a start for the real work - new business plans, post-merger integration, and operations under the new corporate governance. In many cases where we have been in the middle of a deal, we witnessed the communication between the two companies come up short in this period. Companies often discovered that the real work behind the plan or sometimes the planning itself should have started far earlier.

These challenges have been well documented for years. Training organizations and chambers of commerce regularly organize classes introducing how to deal with cross culture environment. However, only taking the class is not enough. Through our experience to support numerous merger and acquisition activities, we summarize four key take-aways which we feel especially important for cross-border transactions. For a successful M&A, there are indeed many more topics to think about but these four are the areas we often see where companies have common pitfalls.

1. Develop a clear investment theme upfront not later

Successful M&A starts with a clear investment theme which explains why and how a new investment can strengthen the current business portfolio. This sounds elementary, however in reality we often see companies neglect the importance of having it clearly developed before they seek opportunities. Even those companies with a clear investment theme do not always apply it rigorously and can be easily attracted by every good looking target.

To avoid this, companies should put M&A strategy into consideration when they develop their mid-term corporate strategy and review it every 3-5 years. A company needs to understand how it makes money today and how it will likely make money in the future, then judge whether the M&A can fit in. When developing the investment theme, it should focus on value creation. A first level answer such as “synergy hunting”, “scale enlargement” or enthusiasm to pursue “globalization” is not a good investment theme. Make it concrete and drive to the next level to understand how it might improve the business.

Another Chinese state-owned food conglomerate COFCO is a good example of how to plan M&A around its overall business strategy. COFCO, as the largest food group in China, is seeking opportunities along the value chain focusing on several priority categories to secure raw material supply for its extensive production capacity as well as to build a presence on the retail front. Since announcing its vertical integration plans in early 2009, COFCO has been involved in a series of M&A activities. Those deals are all focused on COFCO’s strategic sectors:

- COFCO acquired 100% of Guangzhou-based Maverick Food in 2009, a meat JV between Smithfield Foods and ARTAL Group in China. The processed meat industry is one of the eight priority industries of COFCO and before the US$284 million deal it had invested in three major projects. The acquisition not only made COFCO the market leader in the South China but, more importantly, gave COFCO access to a strong processed meat brand.

- Wine is another strategic focus of COFCO. In order to develop the wine market in China, the Group is building a global vineyard network aiming at gaining know-how on wine making as well as expanding the breadth of its offerings. In 2010 and 2011 respectively, COFCO acquired Viña Bisquertt of Chile and Chateau de Viaud of France.

- COFCO then acquired Worldbest Biochemicals (Thailand) in March 2012. The acquisition enables COFCO to increase its variety of raw materials as well as expand its business in citric acid.

2. Create a learning process to build internal M&A skills and talents

Companies that are active participants in M&A have a better chance of winning in these deals than those that are not. That is because they have built the skills and teams to handle the complications of a deal process. So for the company who is just starting the journey, it is wise to begin with small deals or even start from organic growth in the new market and only consider M&A after a few years once it has developed an understanding of the market as well as the team capability.

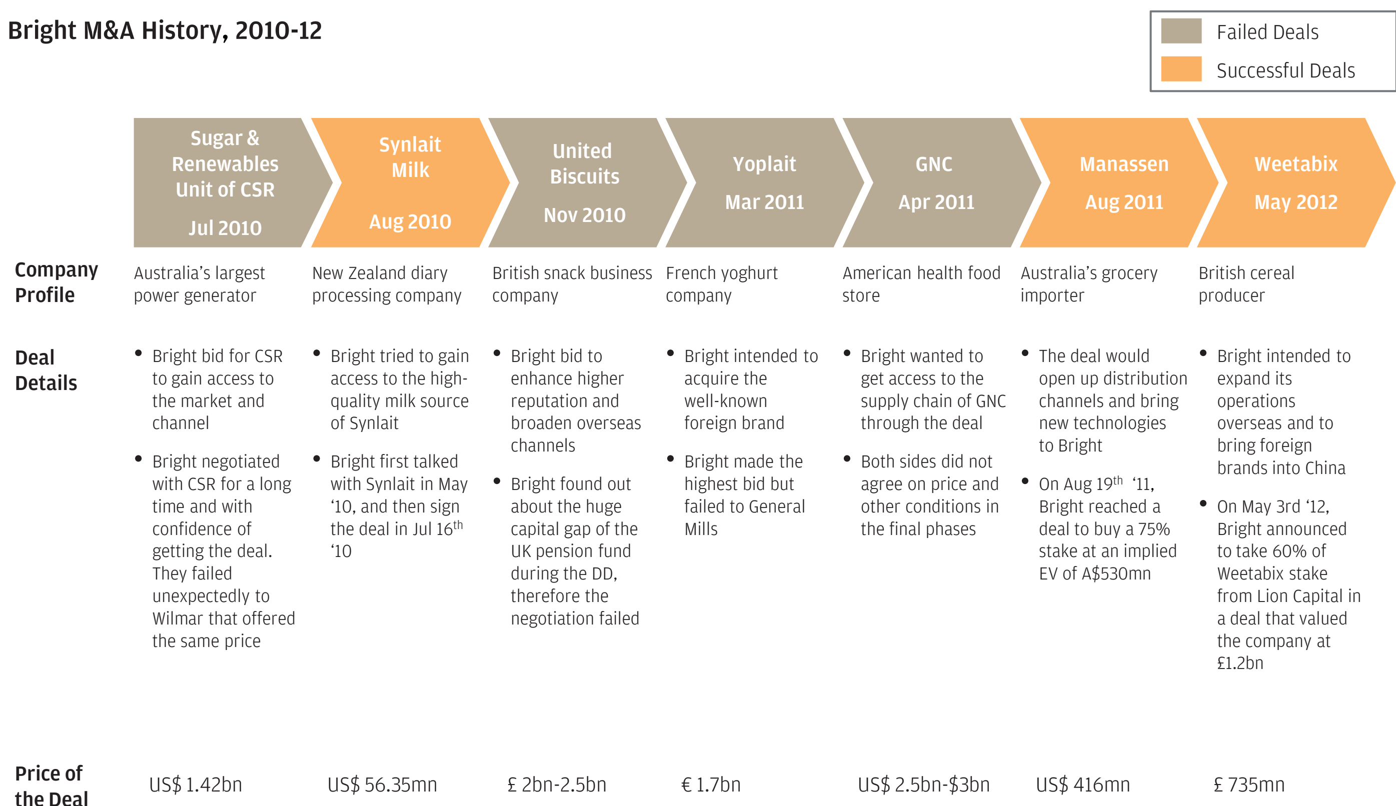
Before Bright Food achieved the recent acquisition of Weetabix, it also accumulated substantial learning from past trials - both successes and setbacks in cross-border M&As.

- Bright's very first attempt was in 2010 for a sugar business, Sucrogen, of Australian group CSR: Singapore's Wilmar surprisingly trumped Bright with an AUD1.75 bn bid - which was exactly the same price Bright offered. Disclosure of Bright's bid throughout the process of negotiation put Bright in a highly disadvantaged place. Due to the lack of experience in cross-border M&A at that time, Bright did not secure an exclusivity agreement with CSR, which was one of the key reasons behind its loss of the bid.

- In 2011, Bright lost out to General Mills in acquiring Yoplait. Recalling the lessons learned from CSR deal, Bright was well prepared for the deal negotiation and made an appealing offer. There were several aspects that Bright could have done better this time: 1) Deliver a convincing business plan for a cross border M&A: In Bright's business plan presented to Yoplait, it made a strong case on one emerging market i.e. China; however, regarding the current core regions for Yoplait - Europe , Bright did not propose a convincing plan. A lack of talent with in-depth understanding of the business in these developed markets was one underlying reason. 2) Build trust and demonstrate oneself as a strong investor: Bright is a state-owned Chinese company. This made Yoplait concerned about the long pending period for government approval and potential threat from Bright to gain too much access to the technology and brand of the French company. During the negotiation, the two concerns were not well addressed by Bright. 3) Identify the potential deal breakers and address them properly in negotiation. In this attempt, the fact that General Mills had the Yoplait license in the USA was also a deal breaker for Bright.

- From 2010 to 2011, 2 small deals among the 7 attempted went through. At the time of the Weetabix deal, Bright Food naturally demonstrated the experience and skills learned. The deal team was disciplined in developing the investment theme upfront and responded well to the questions and concerns during the negotiation. They hired professional firms upfront to lead them through the deal process. They challenged and worked with the agencies to deliver solid due diligence. The top management was closely involved in the deal process and was therefore able to efficiently drive the process forward… And the good news finally came in May 2012!

Bright M&A History, 2010-12



Failed Deals / Successful Deals

	Sugar & Renewables Unit of CSR Jul 2010	Synlait Milk Aug 2010	United Biscuits Nov 2010	Yoplait Mar 2011	GNC Apr 2011	Manassen Aug 2011	Weetabix May 2012
Company Profile	Australia's largest power generator	New Zealand diary processing company	British snack business company	French yoghurt company	American health food store	Australia's grocery importer	British cereal producer
Deal Details	• Bright bid for CSR to gain access to the market and channel • Bright negotiated with CSR for a long time and with confidence of getting the deal. They failed unexpectedly to Wilmar that offered the same price	• Bright tried to gain access to the high-quality milk source of Synlait • Bright first talked with Synlait in May '10, and then sign the deal in Jul 16th '10	• Bright bid to enhance higher reputation and broaden overseas channels • Bright found out about the huge capital gap of the UK pension fund during the DD, therefore the negotiation failed	• Bright intended to acquire the well-known foreign brand • Bright made the highest bid but failed to General Mills	• Bright wanted to get access to the supply chain of GNC through the deal • Both sides did not agree on price and other conditions in the final phases	• The deal would open up distribution channels and bring new technologies to Bright • On Aug 19th '11, Bright reached a deal to buy a 75% stake at an implied EV of A$530mn	• Bright intended to expand its operations overseas and to bring foreign brands into China • On May 3rd '12, Bright announced to take 60% of Weetabix stake from Lion Capital in a deal that valued the company at £1.2bn
Price of the Deal	US$ 1.42bn	US$ 56.35mn	£ 2bn-2.5bn	€ 1.7bn	US$ 2.5bn-$3bn	US$ 416mn	£ 735mn

3. Plan sufficient time to do a proper due diligence

It is not unusual that companies fail to discover critical issues with the target companies due to the time constraint set up by the target companies. These constraints force acquiring companies to rush to a high level assessment of the targets. The corporate practice of conducting due diligence is often sending a team of analysts to download everything from the data room, spend days and nights crunching the data and then synthesize them into memos. These memos often essentially repeat the management presentation with only minor value added e.g. an intelligence firm running reference checks on the core management members.

What bidders should do is to get first-hand information to discover what they don't know and challenge what they already know, ideally from an independent outsider's view. Investment bankers are hired with incentives to close the deal. At the risk of appearing self serving, we believe that consulting firms are usually more apt at conducting the due diligence work. They conduct primary research and build a bottom-up view of the target company and its prospects, picking up the gaps between their views and the rosy pictures the target company's management presents. They assess the value creation opportunities realistically and they are also skillful in building cooperative relationships with target companies without compromise. This ensures a thorough and productive due diligence process.

A complete due diligence exercise should develop clear pictures of at least the areas below which are essential to answer the big question – what is the value of the target company to us?

Diligence Areas	Key Questions (Not Exhaustive)
Market Mapping	• How big is the market? • Who are the competitors and how well do they perform?
Industry Structure	• Along the value chain who is making money? • Does the industry of the target company have pricing power?
Customer Understanding	• How do customers view the target company vs competitors? • What ranges or products drive the profitability and how likely will this change / sustain over time?
Target Company Capability	• How well positioned is the target company in costs vs competitors? • How strong and reliable is the management team?
Synergy Assessment	• Where are the potential synergies and what is their value?

4. Start the post-merger integration planning early

If not planned well in advance, post-merger integration can be a painful process especially when it comes to cross-border deals that involve a much higher level of complexity than domestic deals. Unfortunately, based on our observation, companies do not think seriously about integration until the deal is announced. The moment they realize the real work starts, they rush to develop the integration road map or business plan, which easily misses the critical phase right after deal announcement to motivate the team and demonstrate the value of the M&A to the market.

What they should do is to consider the integration road map or new business plan as early on as the end of due diligence phase: start with a "first 100 days" plan to steer the integration; identify areas for integration and prioritize them based on importance and complexity of the tasks; figure out the quick wins and structure the initial team to work on it.

For example, culture is often a sensitive and difficult issue to handle in the post-merger integration of cross border M&A. Therefore developing a transparent communication platform should be prioritized in the plan. When Lenovo acquired IBM's PC business in 2005, people doubted its future. It was not only an acquisition of a leading brand by a less established one, but also of an American company by a Chinese one. Soon after the deal was closed, Lenovo quickly addressed the market's concern with a well-prepared integration plan which ensured a smooth transition later. Significant HR management actions took place, including stabilizing the current management and employees, and transferring its head office to New York. In 2007, Lenovo announced a successful transition of the Think products from the IBM brand to the Lenovo brand two years earlier than planned.

If you are also considering some M&A activities for your companies, are you equipped to handle all of the above? We would like to help. Get in touch with us and we would be delighted to discuss how we can support you to design a successful M&A strategy and assist you in making cross border deals successful.

Offices

Boston
T +1 617 896 9900

Düsseldorf
T +49 211 86 07 0

Hamburg
T +49 40 40 17 56 0

Hong Kong
T +852 2201 1700

London
T +44 20 7010 8000

Mumbai
T +91 22 6619 1166

New Delhi
T +91 11 4051 6666

Paris
T +33 1 58 56 18 00

Rotterdam
T +31 10 217 5555

Shanghai
T +86 21 6115 0310

Warsaw
T +48 22 826 24 57

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