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M&A China/Germany Update 2017

China Desk

How China is investing in Germany - review of and outlook for an opportunity for international corporations and medium-sized companies alike

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Last year has been marked by various German Chinese transactions that attracted considerable media attention, e.g. the acquisition of the German robot manufacturer Kuka by the Chinese home-appliance maker Midea, the first acquisition of a publicly listed German company. While large acquisitions like EEW, KraussMaffei stand out, they just form the tip of the iceberg with numerous acquisitions targeting medium-sized companies – the so called "German Mittelstand" – like the fork-lift truck manufacturer Kion, which form the backbone of the German economy.

In many cases Chinese companies buy 100 % of the German target. Nevertheless there are several examples where the Chinese investor first acquired a minority or majority share, which was subsequently increased, as in the case of Kuka, for example.

Government intervention as new factor

The acquisition of Kuka and the attempted acquisition of Aixtron, a leading semiconductor manufacturer, was intensively covered by the media and stirred up controversy in the German public. Kuka is part of a constellation of companies that have given Germany a competitive edge in industrial automation, thus raising concerns about the transfer of high-end technology. Some officials in Brussels and Berlin were reported to call for a halt of the Chinese takeovers. However the German government has given the green light for the sale of Kuka, saying that the takeover does not threaten "the security and the public order of Germany". Today Midea holds 94,5 % of the shares. The Aixtron deal on the other hand came to an abrupt halt when the economics ministry withdrew its clearance for the transaction in October. Meanwhile the American president has vetoed against the transaction with regard to Aixtron's U.S. business. Consequently the Chinese conglomerate Fujian Grand Chip Investment retracted its offer as the acquisition of the US subsidiary was a condition of the initial offer.

Fear of capital outflow and new restrictions

In November 2016 the National Development and Reform Commission released a statement saying that outbound direct investments (ODIs) will be more closely monitored. Chinese authorities have become weary of capital flight and reckless spending after ODIs had hit a new record high in 2016. In addition to these new factors already existing challenges remain:

Continuing challenges

The Chinese regulatory framework for ODIs is still cumbersome, however it has been greatly simplified in the last years and it is estimated that cross-border capital flow will be completely relaxed in the near future along with a “managed” capital account convertibility of the RMB.[1]

Record filing primary administrative measure

Prior to these recent reforms investors had to attain a verification from different authorities. Verification is now only required for outbound investments exceeding USD 1 billion - a threshold only few investments breach - or involving sensitive countries or industries. Record filing has thus become the primary administrative measure for Chinese ODI projects.

While the new regulatory framework has encouraged Chinese investors to venture abroad, other challenges to a successful ODI remain – finding a suitable target company or handling differences between Germany and China with regard to economy, legal system and culture being the major ones.

Acquisition process

In addition the acquisition process itself can present a challenge: Acquisitions follow a certain process in Germany that usually is presupposed by the parties and ensures an efficient and professional transaction process. Chinese purchasers often lack experience with this process during their first acquisition in Germany. It is helpful to choose an internationally experienced transaction team to avoid this pitfall.

In a first step of the acquisition process a suitable target company has to be identified and closely analyzed in line with the strategy and goal of the acquisition. Then the acquirer will typically engage the target company and preliminary talks commence, followed by the signing of a confidentiality agreement, letter of intent and a thorough due diligence.

Concerns and cultural differences

Concerns and cultural differences have to be taken into account during this process and in particular during the next

[1] IMF Report: http://www.imf.org/External/spring/2015/imfc/ statement/eng/chn.pdf

steps – the negotiation of the Share Purchase Agreement and the post-merger integration (PMI), e.g.

- German companies are often reluctant to disclose know-how in fear of corporate espionage.
- Negotiations are influenced by different "negotiation cultures".
- German employees fear the relocation of jobs to China.
- The management culture of the Chinese purchaser often is more hierarchical than the management culture of the German target.
- Chinese people communicate in a more indirect form than German people.[2]

The success of Sino-German transactions hinges upon tackling these concerns and cultural differences.

Mastering these challenges

It is essential to be aware of these challenges, to consider them while planning the transaction and especially while communicating with the other party and the German employees and hereby create an atmosphere of mutual trust.

From a legal perspective a two phase due diligence, where sensitive information is only disclosed at a later stage when the likelihood of the transaction taking place is high, can allay concerns of corporate espionage.

When Beijing No. 1 Machine Tool Plant acquired the German machine tool manufacturer Waldrich Coburg in 2005 – one of the pioneer oversees acquisitions – it decided to disrupt the target firm as little as possible by keeping it almost as a completely separate organization with the original management and brand name. This approach ensured a successful PMI.

Conclusion

As Chinese ODIs in Germany are becoming more common, success stories are starting to emerge. Even though the acquisition of German companies in certain technology sectors has come under closer government scrutiny, the future outlook is positive as concerns in

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[2] Bayer, Sonja, Chinesisch/deutsche Transaktionen - Unkalkulierbares Wagnis oder wichtige Chance für den deutschen Mittelstand? in: Kuckertz, Middelberg „Post-Merger-Integration im Mittelstand – Kompendium für Unternehmer“ (2016), p.23-36.

general, in particular concerns of entrepreneurs and employees are being allayed. Whether the Chinese government will tighten restrictions on ODIs again due to fears of capital flight remains to be seen. Overall the recent "Go West" drive poses a great opportunity for both Chinese and German companies, for international corporations as well as for medium-sized companies.

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