

Deals in China: More Local Action Than You Might Think

By Patrick Hurley

Everybody is talking about deals in China, but how do you put it all into perspective and make it work for your company? First, don't bother entering China if you don't have to. Next, if China is part of your picture, get ready to do things a little differently.



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China reopened in 1978 when Deng Xiaoping launched the economic reform era that we see blossoming today. It is impressive

what has been accomplished since our recently departed President Ford's administration when large multi-nationals began seeding the joint ventures that churn out nearly half of what China exports today.

Americans followed Europeans into China as the direction of low cost manufacturing became clear. Expertise gained by big company executives is leading to a wave of private equity and corporate investing by Philadelphia area companies including Aramark, Beijing Med-Pharm, K-Tron, Met-Pro, Technitrol, and many others.

Why do Chinese companies want to do deals? Put yourself in the place of a Chinese owner/manager with a worldview that his or her major customers in China will be the Western-controlled industrial type customers, which have tough standards for key suppliers. The fastest way to comply is to bring in a Western strategic partner to install systems and management techniques that meet those standards.

Companies in China are of two basic types: state-owned or controlled whether public or not, and SME designating small and medium size private enterprises which have no governmental ownership. The biggest businesses and most of the public companies traded in Shanghai, Shenzhen and Hong Kong are effectively government controlled. Their affairs are subject to approval of Beijing or province or city government and state asset bureaus that must bless any M&A deal.

While the 70 million members of the Communist Party is a fraction of the Chinese population, it is a driving force in every aspect of the economy. Capitalism lives in China at the pleasure of the socialist system that values order above all else.

That was evident last summer when the laws changed as China decided that the Cayman Islands was becoming a little too popular for sidestepping government approval for M&A, IPOs

and other exit strategies for investors in Chinese companies. The new regulations essentially require central government approval for non-Chinese buyers using offshore holding companies for liquidity strategies that private equity investors covet.

Non-bank deals in China are almost always smaller than what we've become accustomed to in North America. I'm fascinated by the story behind deals and how smart money moves. Goldman Sachs, Carlyle Group and 3i are perennial powerhouse winners, but how they are connected to small Beijing-based private equity firm CDH China Growth Capital is a beautiful thing.

Carlyle is still trying to salvage what was to be a \$375 million purchase of 85% of \$2 billion revenue heavy construction equipment maker Xugong. Minister of Commerce Bo Xilai is now in the mix as the deal is diluted to a 45% stake with strings attached. It's now almost two and a half years in pursuit of government approval.

On another note, Carlyle stands to profit handsomely in its Focus Media exit and the IPO of China Pacific in which it has a material stake. The exit at nine-fold from Focus Media results from the earlier merger of Carlyle-backed Target Media to 3i-backed Focus Media.

Goldman teamed up with CDH to put over \$100 million into Fuyao Group, the largest maker of automotive glass in China, and to buy Shunghui Group, the largest meat processor in China for over \$250 million. CDH provides local knowledge and investment expertise in China. CDH is backed by limited partners 3i, Zurich Financial and the government of Singapore. Small world.

Three years ago in Hong Kong, a fellow beside me asked a representative from the Ontario Teachers Pension Fund what he considered his most successful China deal. The reply was Ames True Temper near Philadelphia. CEO Rich Dell took what he learned in China from 20 years at Rubbermaid and transformed a garden tool business that made a bundle for Wind Point Partners when sold in a secondary buyout to Castle Harlan.

Chinese companies started making acquisitions of U.S. businesses 20 years ago with the purchase of bankrupt Phoenix Steel also in the Philadelphia area. Remember the hullabaloo about the Chinese businessman cozying up to President Clinton?

He was the boss of CITIC, short for China International Trust and Investment Corp. that took on the union and turned around Claymont Steel that is now a thriving mini-mill produc-

ing carbon steel plate. CITIC sold it in 2005 to private equity group H.I.G. Capital for \$105 million and invested the proceeds to acquire Shijiazhuang Steel in China.

Stories abound about bad numbers and side deals to take Americans to the cleaners in China, but savvy investors protect themselves. Plymouth Meeting based Beijing Med-Pharm partnered in January with U.K. based Allied Boots that put up most of the money to buy into the third largest wholesaler of pharmaceutical products in China with nearly \$1 billion in revenue. The CEO of Beijing Med-Pharm becomes the Chairman of the Guangzhou Pharmaceutical as part of the deal. That may be particularly helpful, as Allied Boots has been put into play for a KKR-backed take private deal.

Technitrol recently announce moving manufacturing operations in Germany and Tunisia to China to boost operating profit. Aramark bought 90% of Bright China Service after grooming through a franchisee relationship. K-Tron sold equipment in China for years before acquiring Wuxi Chenhao Machinery last year.

ACG is co-hosting a major event in Tianjin, China on June 6-8, 2007.

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Selected Recent Transactions



Janney Montgomery Scott is an active M&A advisor to middle market companies and their owners. We work with clients on a highly personalized basis to obtain the most advantageous terms available in the marketplace.

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 has acquired A4Vision <i>Janney Montgomery Scott LLC acted as financial advisor for this transaction.</i>	 has acquired Ontario National Bank <i>Janney Montgomery Scott LLC acted as financial advisor for this transaction.</i>
 \$238,350,000 Follow-On Offering <i>Janney Montgomery Scott LLC acted as co-manager for this transaction.</i>	 \$655,638,000 Common Stock Offering <i>Janney Montgomery Scott LLC acted as co-manager for this transaction.</i>
 \$17,865,000 Debt Offering <i>Janney Montgomery Scott LLC acted as co-agent for this transaction.</i>	 \$118,392,500 Follow-On Offering <i>Janney Montgomery Scott LLC acted as co-manager for this transaction.</i>
 \$14,015,625 Follow-On Offering <i>Janney Montgomery Scott LLC acted as co-manager for this transaction.</i>	 CAN \$24,000,000 Follow-On Offering <i>Janney Montgomery Scott LLC acted as U.S. placement agent for this transaction.</i>
 has been acquired by Radware Ltd. <i>Janney Montgomery Scott LLC acted as financial advisor for this transaction.</i>	