

# MERGERS & ACQUISITIONS

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## Heading East? Set the Clocks Back

Dealmakers understand that execution takes longer in China, although many still underestimate the amount of time it takes to close a transaction

By Jason D. Ramey

For over two decades, multinational companies have been heavily investing in China. Today, there are a significant number of small to middle market companies that are either considering expansion or they have new plans for entering the Chinese market through acquisition. Prior to entering China, there is usually a general understanding that it always takes time for government approval to be able to acquire a mainland enterprise. But for the new entrants into the Chinese market, often there is a misconception of the amount of time it really takes to close a deal. While it is important to set an overall timeline for investing in China and for closing the deal, it may be even more important to understand that the timeline may not be met. The following describes some common time-consuming matters that management of US companies may not fully appreciate when initially investing in China.

Performing due diligence in the US is very different from performing due diligence in China. The investor should expect the timeline to be a few months to even more than a year to conduct due diligence in China, which is generally much more time required than in the US. There are key reasons that due diligence in China is so time-consuming. The acquirer should focus on genuinely getting to know the target and related business partners associated with the deal. This includes building a trusting relationship with the target and it requires investing a signif-



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icant amount of time "on the ground" in China. Further, the financial records may lack transparency and there is a good chance there are undisclosed related parties, tax liabilities, contingencies and other accounting misstatements. It is not uncommon for Chinese companies to have two or more sets of books, one for tax reporting and one or more for other purposes. The acquirer also needs to understand who has title to assets, in particular land and buildings. Contributing to the ambiguity is who actually owns the entity, especially if it has originated from a governmental unit. Finally, there is a need to focus more on operational due diligence as opposed to traditional financial due diligence. This may include reviewing the qual-

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ity of customers/suppliers and relationships; relationships with local officials; quality and reliability of the target's supply chain; employee relations, skills and retention; and business licenses. Often, the Chinese target company's management may not allow access to financial and non-financial information until several meetings have been conducted. This can be particularly frustrating for the acquiring party, but it is necessary to understand and be aware that these issues may exist before the due diligence process

begins.

Also, dealmakers cannot underestimate the importance of knowing China's geography. Having an understanding of the target's location may seem relatively simple in the US. But in China, this can be a deal breaker or cause companies dissonance after the deal is closed. There are many highly regarded Chinese companies with facilities in remote areas in China. However, the location may be difficult to reach due to the lack of transportation infrastructure. China has made progress lately in upgrading its transportation system. Nevertheless, when making trips to certain areas it may take an additional day or two to reach the location from a major city. Moreover, after the deal is closed, the US acquirer may require Western management or more sophisticated management from a larger city in China to oversee the newly acquired operations and carry out the company's mission. The location, however, may prove to be undesirable and unable to attract the quality of management talent needed.

It is important that the top decision makers of the acquirer spend the additional time and visit the key locations with significant operations in order to get the "lay of the land" and have a good understanding of the logistics to the facility. They can also assess the surrounding environment and determine whether they may be able to recruit the necessary resources to the location.

Cultural issues are also important. The acquiring firm is usually aware of the obvious language barriers and cultural differences between the US and China, but the firm may not be aware of the differences in culture across China. There can be vast language and cultural differences

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between the various provinces and regions in China. It may not be necessary or possible to fully understand all the differences between the cultures within China. However, it is particularly important to develop appropriate relationships with business partners that are knowledgeable of the local culture, government relations at all levels, and legal and regulatory compliance. Americans often mistakenly identify a business partner because they are from China and they are very presentable with excellent Mandarin and English skills, but the Chinese business partner may have very little knowledge about the local business environment of the target company or they may not have adequate business or negotiation experience.

Perhaps the most overwhelming challenge that a US company will face in China is negotiating the deal. Prior to making an attempt at

negotiating a transaction, it is imperative to understand the Chinese negotiation approach. Western companies should be prepared to spend significant time courting the Chinese target and should expect to attend several very long meet-

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ings. To many Americans, it may appear that nothing is getting done and these meetings may not be perceived as necessary. But, if the proposed transaction seems to be a favorable deal, the additional time spent is warranted and essential in forging long-term relationships. In addition, once a contract is signed, the US party may believe there is actually an agreement in place and the deal is done. Nothing is agreed until everything is agreed and a common sur-

prise to Americans is that often after an agreement is signed, the Chinese party will want to continue negotiating the deal. This should be expected, whereas nothing is unusual in China.

In summary, US companies that plan to invest in China must be prepared to go the distance and anticipate delays and setbacks. However, a successful Chinese deal is possible and the cultural differences, language barriers, and unfamiliarity with local business laws and practices can be overcome with extreme patience and an appropriate approach to the transaction.

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ic times. Cash is king, and buyers with cash available are in a great position to get deals done.

While it is certainly true that more equity helps in getting the senior lender and seller on board, who it is from matters as well. Much scrutiny by senior lenders is directed towards the buyer's credentials and familiarity with the industry. This will make experienced private equity buyers or strategic buyers with significant synergies especially favorable to senior lenders. Many private equity groups have money to invest and are looking for deals; this seems to keep them in the market, even though their investment returns are lessened by the reduced leverage (share) of senior debt.

Even in these uncertain economic times,

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with the right planning and focus, deals are getting done and capital is available for middle market deals in the Midwest. Financing structures are adapting, with a greater emphasis on seller financing and equity. Limitations on acquisition funding are not so much onerous as prudent. It will be important for both buyers and sellers to work with M&A advisors who understand how to make these structures work for the business and transaction, and who can find and maintain excellent relationships with the best sources of funding. It continues to make good business sense to pursue and accomplish strategic acquisitions and sales whenever synergies will create additional growth and value.

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vestment, sound management expertise and the economies of scale realized through a prudent acquisition, investors can develop a successful and profitable oil field service business in the Canadian market. Companies created with a tactical consolidation plan will create a strong competitor that can gain significant market share within the Canada's profitable oil fields.

As Shell and other top tier producers increase their stake in Canadian tar sands, prospects for long-term high yield investment will continue to grow - particularly in oil field service, technology and infrastructure companies. For American private equity investors seeking profitable middle market business opportunities in the energy industry, look north of the border. Today, Canada is the land of opportunity.

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