

China

2019

## China's Business Environment in 2019

"In China for China".  
Navigating through uncertain  
times.

Exclusive China member of  CLEARWATER  
INTERNATIONAL

1994 – 2019: 25<sup>th</sup> Anniversary

InterChina



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Strategy | Corporate Finance

[www.InterChinaConsulting.com](http://www.InterChinaConsulting.com)

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Sources of this report: Recent set of interviews with over 100 China based senior executives + Our Own pipeline of Investment Banking and Strategy Consulting projects...

25 years

...of InterChina doing business.

50

...dedicated staff members, in Shanghai, Beijing and London.

USD 8.8+ bn.

...the value of the **over 180 transactions** we have been involved in.

*"In 2018 we have conducted +1800 executive level interviews to carry on M&A Transactions and Strategy Consulting engagements"*

6

M&A deals to be closed in 2018.

45

Mandates in our execution pipeline

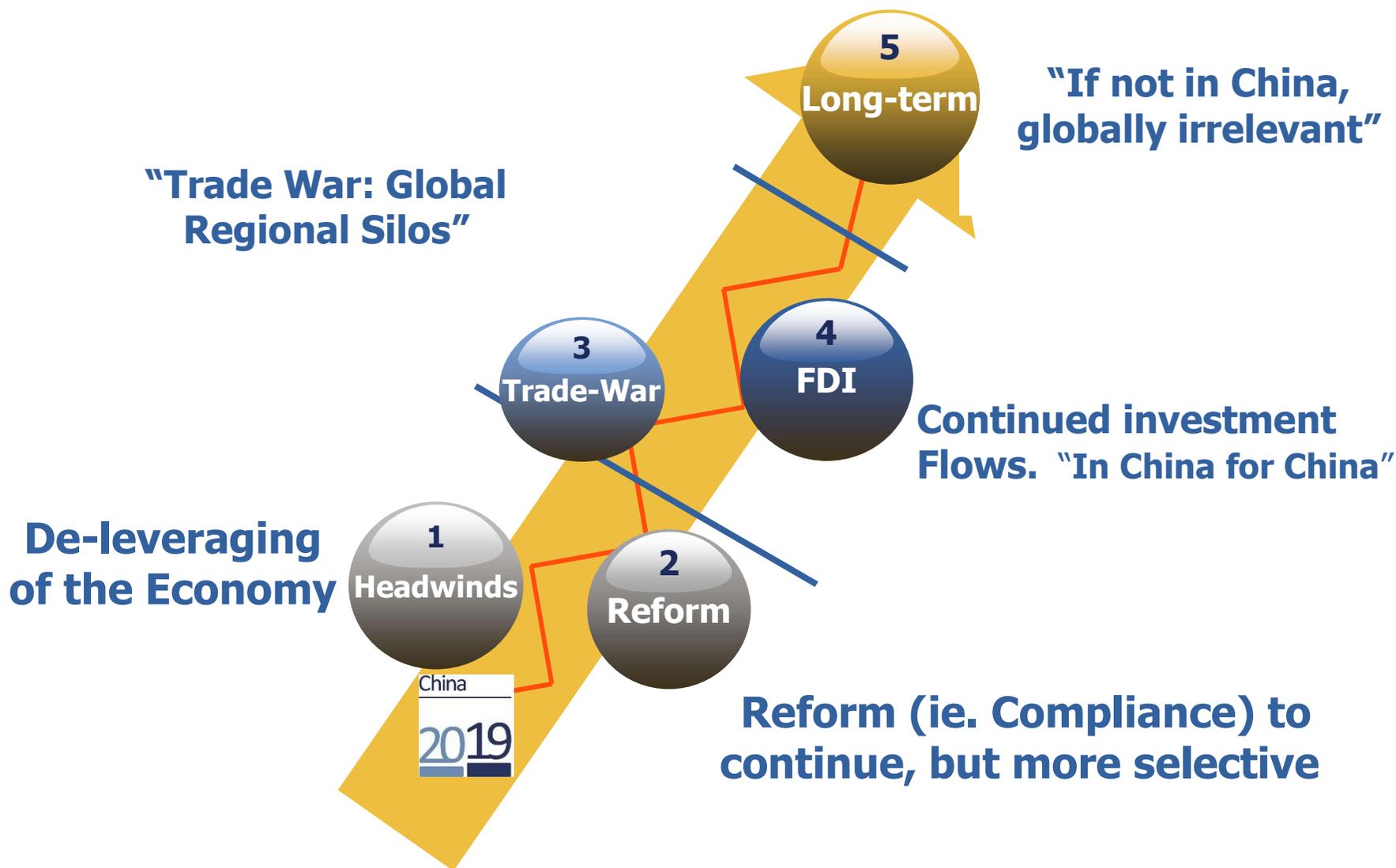
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...strategic Consulting projects on top-line growth in 2018.

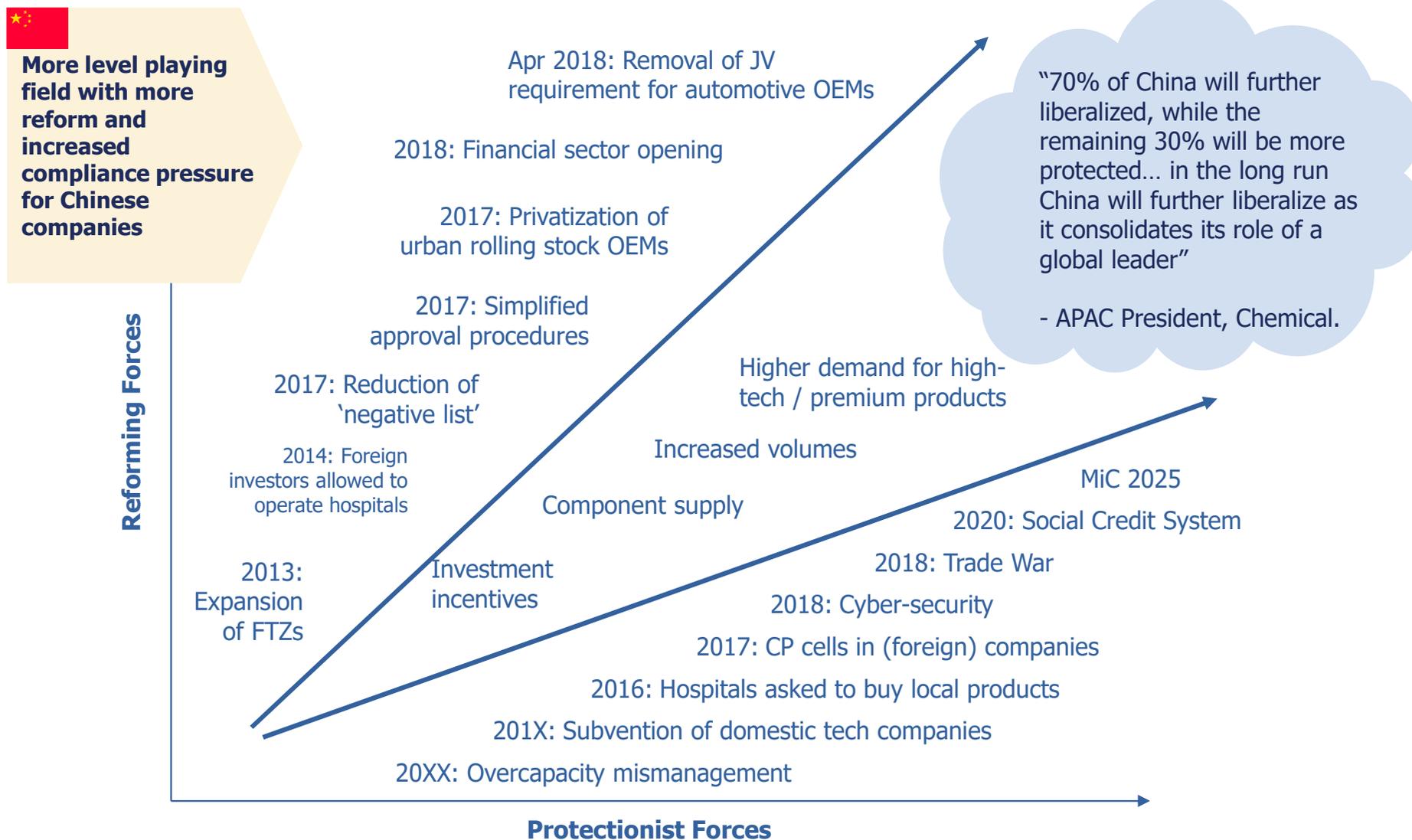
Top 5

...independent advisory firm in China.

**I) Overall Direction:** Still good forecast for 2019, but uncertainty increasing in the short term. Confidence in the medium to long-term future.



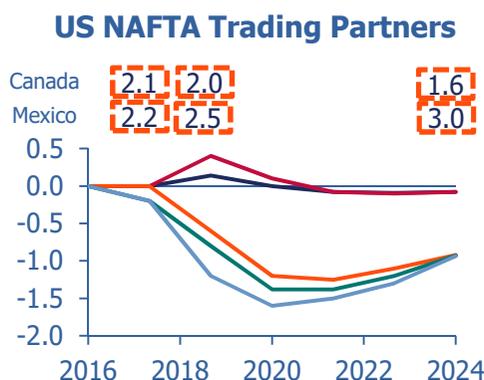
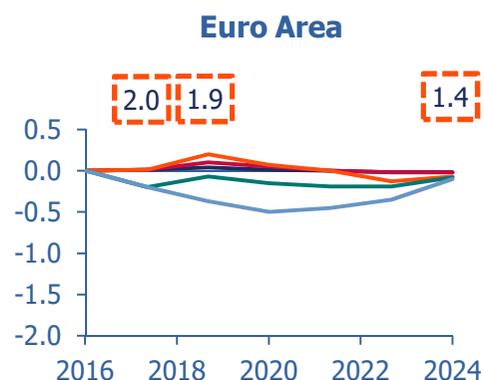
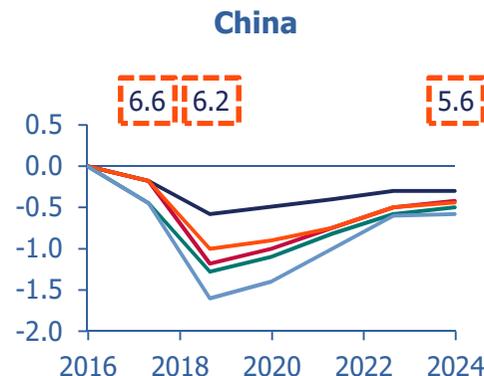
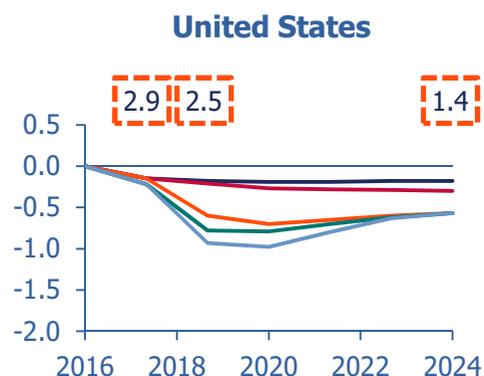
# Impact Of Reforms: The mix of reformist/protectionist forces are creating different opportunities/threats for different companies/sectors





# Limited Impact of Trade War: Reduction of 0.5-1.5+% GDP reduction in short term, and 0.5-1% GDP reduction in the medium term... Government can rebalance easily (stimulus)

## IMF Forecast



- Tariffs in baseline
- Add China (25% on \$267 billion with retaliation)
- Add cars, trucks and parts with retaliation
- Add confidence effect
- Add market reaction

Forecasted GDP growth rate (real) at present year forecasted by IMF, including the impact of "tariffs in baseline".



The underlying, real issue is more serious: Tech Competition with the West.

ZTE中兴

**ZTE's Collapse Reveals China's Huge Dependence On U.S. Technologies**

*Forbes*  
Apr. 22, 2018

HUAWEI

**Huawei has been barred from supplying equipment to Australia..., a move that aligns the Australian government with the United States' sweeping ban against the firm.**

*The Washington Post*  
Aug. 23, 2018

HIKVISION

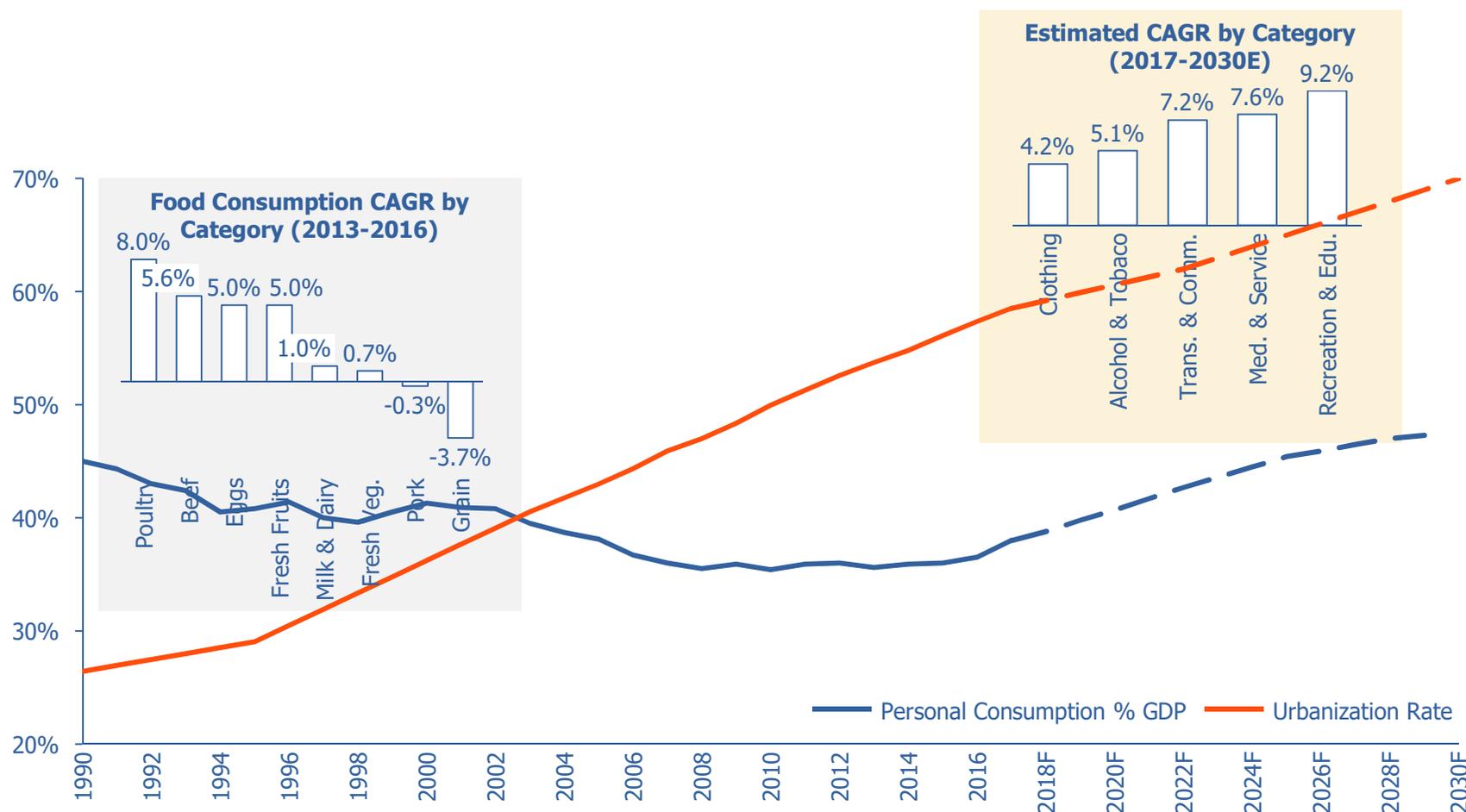
**How tensions with the West are putting the future of China's Skynet mass surveillance system at stake**

*South China Morning Post*  
Sep. 23, 2018

**Commitment to China 2025 will strengthen**

# Is Demand Slowing down?: Consumer Confidence in 2019 might go down (uncertainty), but more a bump in the road. Overall, more consumption contribution to GDP; Driven by quality trade-up and on-going urbanization

**China Personal Consumption % GDP vs. Urbanization Rate (main charts)  
 With Shift From Basic Consumption to Service/Alternative Goods Consumption (two mini charts)**



# A new Playing Field: The End of the Traditional Entrepreneur (and old style distributors).

## A NEW INDUSTRIAL PARADIGM

### NO EASY ACCESS TO FINANCE

**“Financial  
Deleverage  
impact on POE  
and some SOEs”**

**“Network  
Financing down  
and more  
expensive”**

**Stricter  
Environmental  
Protection... Cost  
and Capex**

**Capacity Decrease  
and pressure to close.  
Supply Price  
Increases**

**Tax & Compliance  
Cost**

### WAY TO MARKET HAS CHANGED

**Demand trade up,  
pushing for product  
mix and quality**

**R&D and Product  
Trade Up**

**Need to build real  
Sales & Marketing**

Most industrial leaders (+60 years old) can not adapt...Many 2<sup>nd</sup> generation are not interested to continue the business.



**II) 2019 Macro Forecast:** GDP remains stable, aided by focused public stimulus packages.

### Economic Performance

GDP  
Growth  
**6.2%**

Inflation  
**2.0 –  
2.5%**

RMB Aprec.  
**1 – 4%**

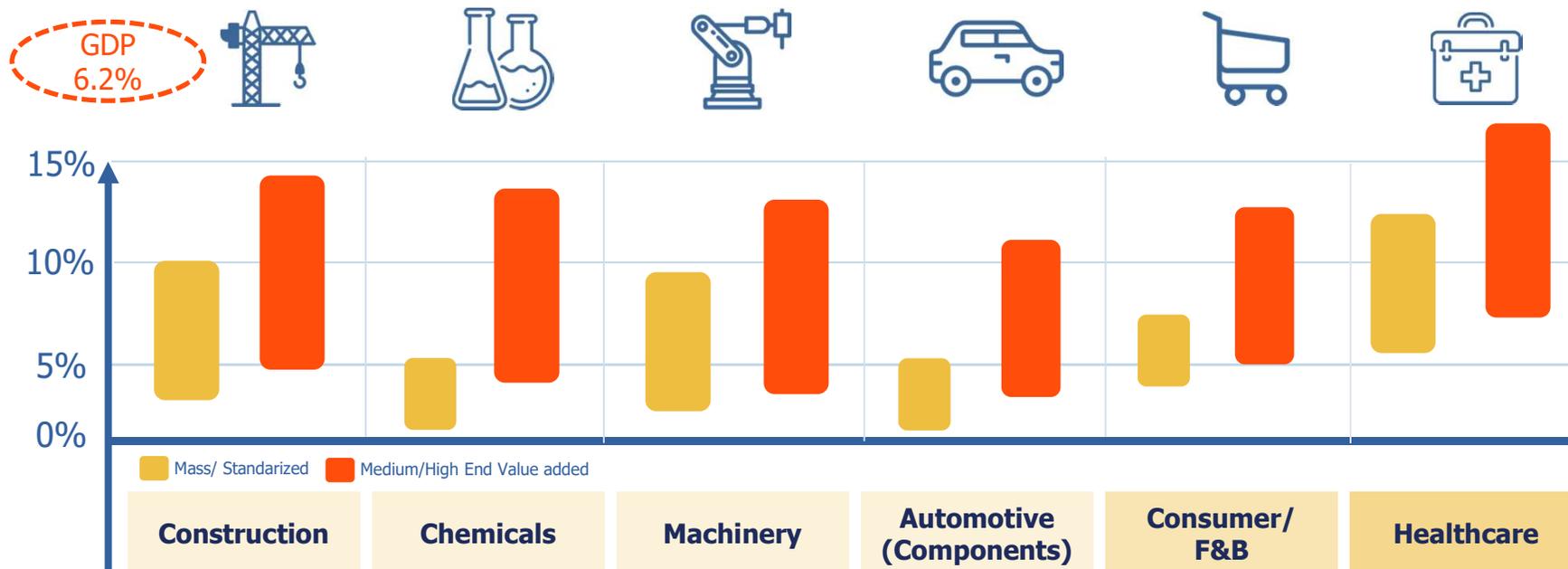
Labor  
Cost  
**4– 6%**

### Rebuilding of Momentum

- **Stimulus** to compensate for Trade War.
- **Consumer confidence bump, but still strong.**
- **Evolving consumption patterns.**
- **Continued consolidation, overcapacity down.**
- **Deregulation in non critical industries.**



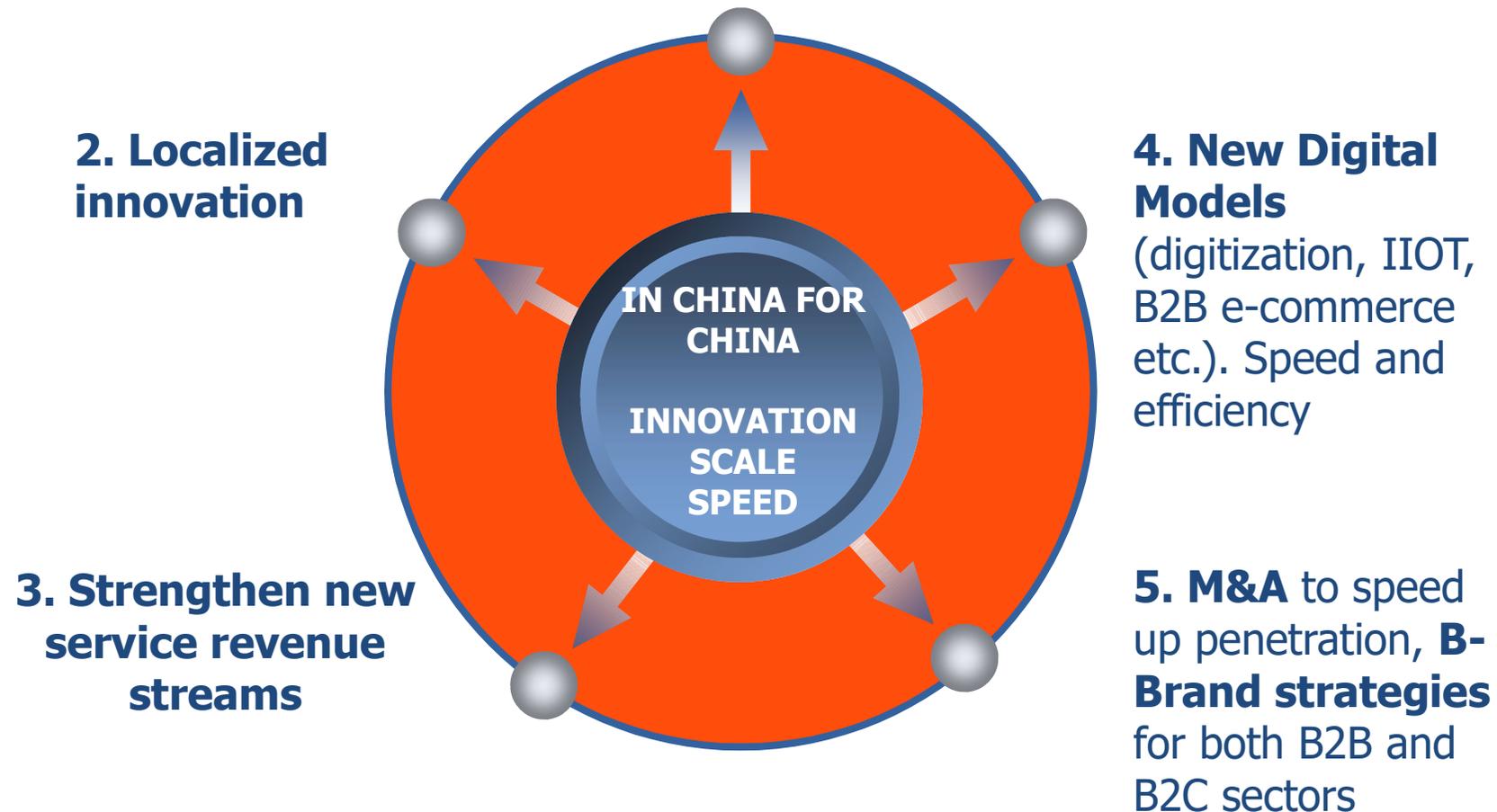
### III) 2019 Sector Forecast: Still growth, but clear gap in growth rates is emerging between commodities and value added products



- |   |   |  |  |  |   |
|---|---|--|--|--|---|
| <ul style="list-style-type: none"> <li>• Tackle domestic Infrastructure.</li> <li>• Value-added.</li> <li>• OBOR.</li> <li>• JV/ M&amp;A outbound.</li> </ul> | <ul style="list-style-type: none"> <li>• Consolidation &amp; Environmental Compliance.</li> <li>• New local Product Launches/ Local R&amp;D.</li> <li>• Digitalization and e-commerce.</li> <li>• JV/ M&amp;A.</li> </ul> | <ul style="list-style-type: none"> <li>• Premium offerings.</li> <li>• Services.</li> <li>• Automation.</li> <li>• Digitization.</li> <li>• Rethink cost base (local manufacturing and R&amp;D)</li> </ul> | <ul style="list-style-type: none"> <li>• Scale vs cost control</li> <li>• Access to Chinese OEM.</li> <li>• Shift to quality of Chinese OEMs</li> <li>• New Segments: EV, AD, light materials.</li> <li>• Aftermarket.</li> <li>• Steady Consolidation (M&amp;A/ JV).</li> </ul> | <ul style="list-style-type: none"> <li>• New products/ formulas.</li> <li>• Revamping Root to Market.</li> <li>• Revamping Regional strategies.</li> <li>• Developing digital capabilities.</li> </ul> | <ul style="list-style-type: none"> <li>• Rigorous compliance.</li> <li>• Focused coverage.</li> <li>• Higher rep productivity.</li> <li>• Localization.</li> <li>• Local partnerships.</li> </ul> |
|---|---|--|--|--|---|

## IV) Business Strategies 2019: In-China-for-China, for real.

### 1. Localization: assets + decision-making

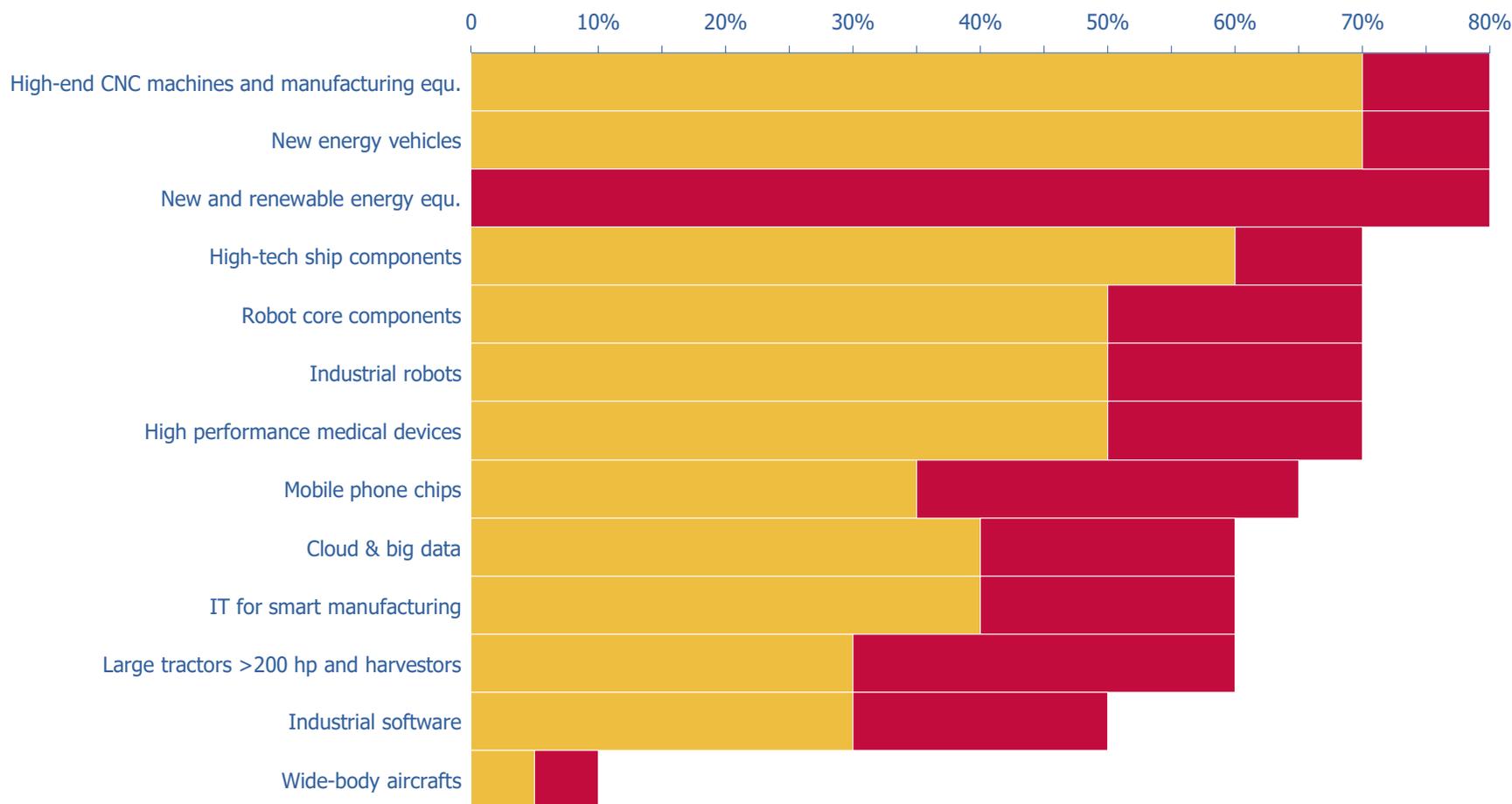


# 1) Second Wave Localization & Revival of Competitive Advantage: Industrial value chains will localize massively... and Multinationals are planning to play an active role (in a China-China technology approach)

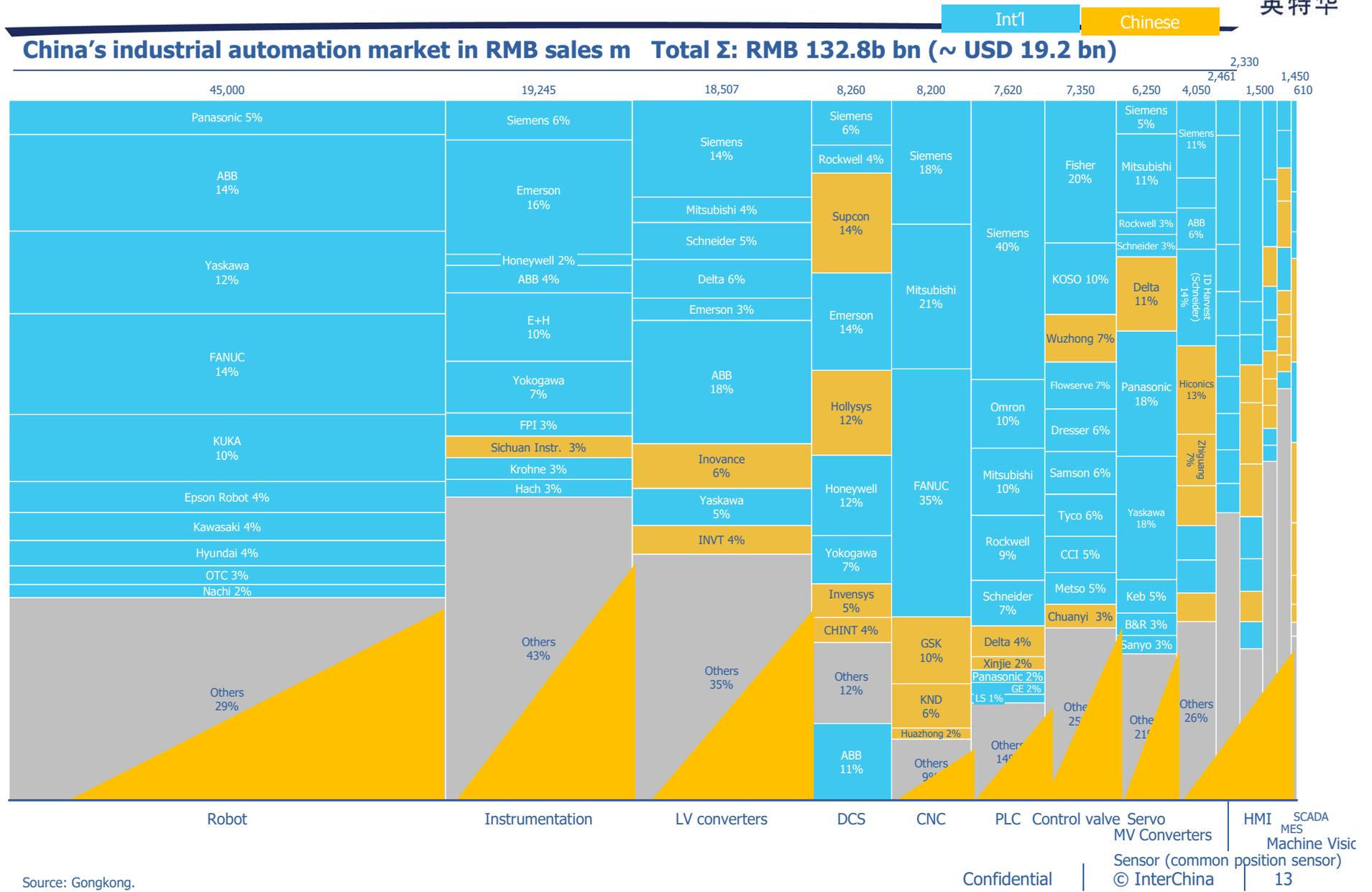
## Made in China China 2025:

Semi-official targets for the domestic market share of Chinese products (in %)

By 2020 By 2025



# MNC Competitive Advantage (1/3): Good Starting point. Example: China's USD 20 bn automation market, Foreign players occupy around 65% of the market



Source: Gongkong.

# MNC Competitive Advantage (2/3): "Easier to adapt than to create".

Examples of Int'l co's R&D centers in China to develop products in China for China...  
The path towards true domestic innovation.

**Siemens- Mammomat Select X-Ray Machine**



**Philips - CT generator**



**CareStream - DRX Nova**



**Emerson – CNG050 Coriolis Flowmeter**



**Schneider – PLC241**



**GE - Optima 3100 Angiography Machine**



**Abbott – Accelerator Experiment Automation**



**Medtronic - TiHot Titanium surgical mesh**



**Thermo Fisher - Finnpiptette F3**

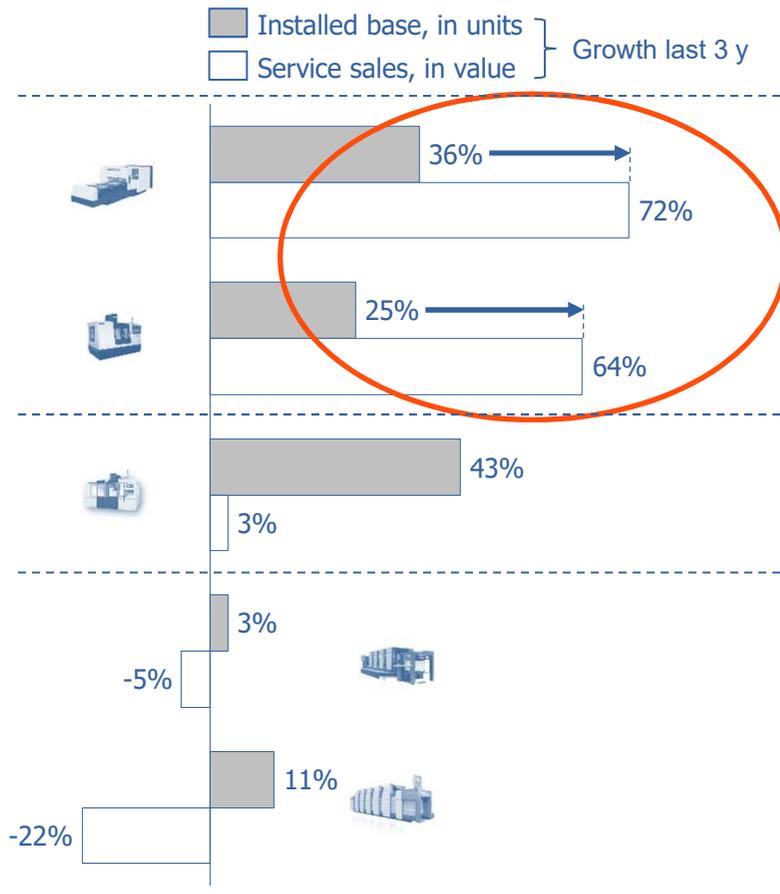


**Honeywell – Video Surveillance**



# MNC Competitive Advantage (3/3): Existing Service Model. Some companies have grown their service business much faster than their installed base in the last 3 years

## Δ in installed base and service sales last 3y



## Commonalities

- Provide credit to service customers, collect bills afterwards.
- Committed investments into resources over the last 3 years (increased team, systems, etc.).
- Consider service as an independent business, or drive transformation towards this goal.
- Services against upfront payment only. Conservative treatment of customers and cash flow.
- Services serves the purpose of customer satisfaction.
- Dropping new unit sales.
- Questionable commitment of brand to service machines.



## 2) Revival of the JV in China. Many new transactions are alliances, many minority.. Why?: New JV Partner Profile

### Traditional JV profile

- Privately owned
- Self Made first generation entrepreneur
- Very early stage of its company's development
- ... nothing to lose, everything to gain.

### The New JV profile

- Listed or to be listed. Cash rich.
- Critical mass, national sales channels.
- Have been playing the Innovation Subsidies for more than 10 years.
- Localized products and brands.
- Still lead by traditional leaders, but run by a second tier of professionalized managers

Long term synergies with few of the traditional IPR ("steal my business") risk

### Which Synergies are new partners looking for?

- Protect its Stock Price
- Quality Technologies and product mix to increase sales channel value
- CAPEX/ Process to face growing China cost and Green compliance
- Investment for growth needs
- Globalization



### 3) More M&A. International companies are seeking synergies that can not easily be achieved organically.

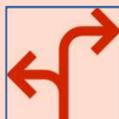
#### General Synergies

##### Need of Scale and New Growth Drivers



- Size is a Key Success factor for profit Protection.
- Search of Adjacent growth segments (double digit)

##### Chinese Client Base



- From traditional client base to new high growth client segments
- Chinese clients (medium sized, listed, SOE)

##### B-brand Buffers



- Accessing the Medium Quality Segment (good enough, at lower costs).
- Preempt incumbent players to move up on the value chain.

##### Acquire Local technologies



- Products 100% adapted to Chinese standards.
- Cost competitive processes that are difficult to replicate to MNC.

#### Specific Synergies

##### Service/ After Sales Revenue Streams



- Local licenses/practices and models that are very difficult to replicate.
- Acquire captured local client basis.

##### Develop Local R&D Teams & Skills



- Access to local talent, processes, subsidies.
- Patents adapted to Chinese standards and needs.

##### Digitalization



- Access to Indigenous innovation (ie. Electric car, Connectivity, E- Commerce)
- JVs between Online and Offline players.

##### Consolidation & Expand Regional Coverage



- Participate in Chinese consolidation process.
- Complement Coastal Regions with Inland and West China presence



## Example 1: Chinese Client Base. Bystronic purchased majority stake of DNE



Bystronic AG is the worldwide leader of sheet metal cutting and bending solutions and is one of the strongest players in the laser cutting applications. Bystronic is active in all economic regions globally. Bystronic entered China in 2002, currently focusing on the premium, high-power market segment.



Shenzhen DNE Laser Equipment Co., Ltd. is a laser cutting machine producer, founded in 2008 in Shenzhen, China. It has quickly become a market leader in the medium end market segment in China with the largest annual sales volume among the peers. DNE is actively moving into medium-to-high end, high-power segment and seeks cooperation with a leading player.

### Transaction

#### Transaction: Acquisition

Bystronic and the shareholders of DNE have agreed on a transfer of a majority stake of DNE to Bystronic, with options for Bystronic to take further stake in the future. Parties all acknowledge that the transaction will create significant synergies both technically and commercially. The joint venture together with Bystronic's existing set-up will likely become the No. 1 market leader in the laser cutting field in China and will actively acquire further market share in other regions such as South East Asia.

### InterChina Partners

InterChina served as Bystronic's advisor and provided comprehensive **transaction advice**.

Advisory included **deal origination, company valuation, due diligence coordination, key terms and definitive agreements, and transaction process management**.

## Example 2: Acquire local Technologies. Faurecia acquires majority stake in Jiangxi Coagent Electronics

### Faurecia

Founded in 1997, Faurecia has grown to become a major player in the global automotive industry. A leader in its three areas of business, the Group is backed by a R&D and production network with sites in 35 countries. It is the preferred partner of the world's largest automakers, which value its operational excellence and technological expertise.



Jiangxi Coagent Electronics is a private Chinese company specialized in infotainment and interior electronic solutions, including the integration of digital displays and HMI technologies. The company employs 1,300 people including more than 300 engineers. Jiangxi Coagent Electronics is based in Foshan for its Research and Development activities and in Jiangxi Province for its industrial production. The company is a supplier to leading Chinese automotive manufacturers and is seeing a strong growth in sales, which reached 148 million euros in 2016 and will rise to 270 million euros by 2019.

### Transaction

**Transaction: majority buyout**

In order to expand its product portfolio and accelerate its expansion in China, Faurecia embarked on an acquisition initiative. Through acquisition of Coagent, Faurecia will be able to penetrate the Chinese OEM market

InterChina served as one of Faurecia's financial advisor in this transaction. Our Role in this transaction was focused on identification of the target and negotiations.



**V) Conclusion...** In a moment of truth for foreign companies in China, many will need to determine the right identity for their China operation ...

**“Should I be perceived as a foreign or a local company?”**

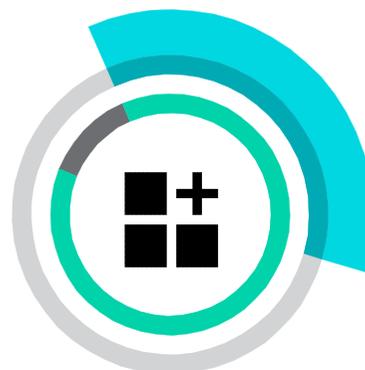
**“I inherited a hybrid structure with a bipolar identity ... Do I need to restructure?”**

**“Should HQ invest more in our own brand, or build a local B-brand, in search of a faster return?”**



### Transformations

- Localization.
- Optimize portfolios.
- Revamp RTM.
- Divest low-performing assets.



### Additions

- New Chinese customer base.
- Introduce B-brands.
- Develop services revenues.
- Digitalize customer relationships.

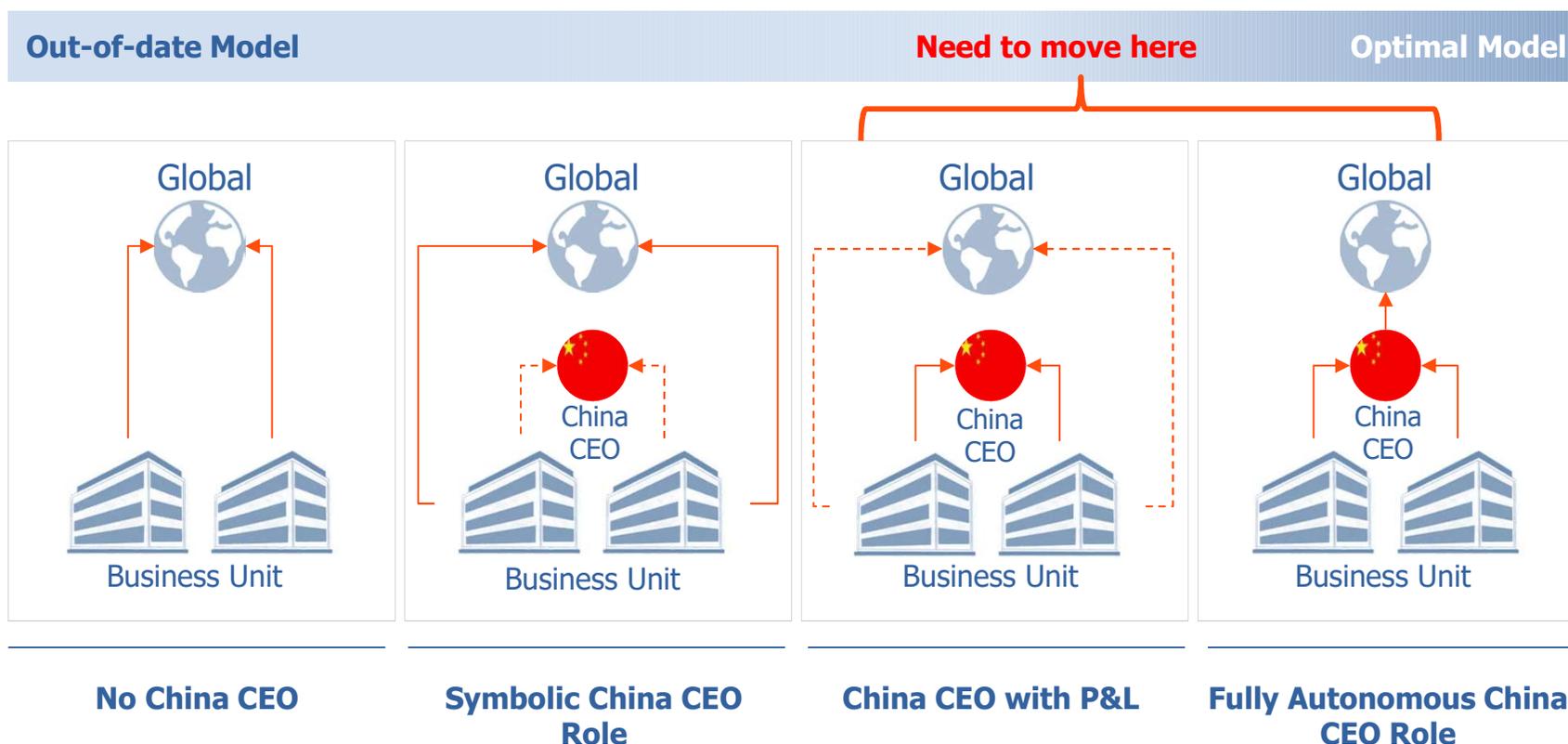


### Accelerations

- JV revamp.
- Acquisitions.

... In this regard, an empowered local structure is critical, giving local autonomy but without losing the company's "DNA" and sound governance

### MNC Structure In China



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25 years of Investment Banking and Strategy Consulting in China

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