

China Mergers & Acquisitions Playbook

Your reference guide to planning and executing deals
2011 edition



Contents

2	Foreword
3	Executive summary
5	1. Deloitte's M&A Lifecycle
8	2. M&A strategy development
8	2.1 M&A strategy planning
	2.1.1 Understanding corporate objectives
	2.1.2 Developing an M&A strategy
	2.1.3 M&A alternatives
	2.1.4 Financing options
	2.1.5 Divestment strategy
	2.1.6 Selecting lead advisors
18	2.2 Preliminary research of potential acquisition candidates
	2.2.1 Developing the acquisition candidate pool
	2.2.2 Sourcing potential acquisition candidates
19	2.3 Financial assessment of the buyer
21	3. Target screening
21	3.1 Target screening process
	3.1.1 Defining screening criteria
	3.1.2 Collecting target data
	3.1.3 Prioritising targets
24	3.2 Initial due diligence
	3.2.1 Synergy opportunities
26	3.3 Valuation
	3.3.1 Valuation of business entity
	3.3.1.1 Financial modeling
	3.3.1.2 Valuation approaches
	3.3.1.3 Purchase price allocation
	3.3.1.4 Valuation challenges
	3.3.2 Valuation of financial instruments
	3.3.2.1 Financial instruments on company's balance sheet
	3.3.2.2 Common valuation requirements for financial instruments
	3.3.2.3 Challenges in valuing financial instruments
36	3.4 Approval process and target approach strategy
	3.4.1 Approval strategy
	3.4.2 Target approach strategy
37	3.5 Initial deal structuring
40	4. Transaction execution
42	4.1 Financial, tax and legal due diligence
	4.1.1 Financial due diligence
	4.1.2 Tax due diligence
	4.1.3 Legal due diligence
46	4.2 Business due diligence
	4.2.1 Integrity due diligence
	4.2.2 Commercial (market) due diligence
	4.2.3 Operational due diligence
	4.2.4 Information Technology due diligence
	4.2.5 Human Resources due diligence
53	4.3 Internal controls due diligence
	4.3.1 Performing an internal controls due diligence
	4.3.2 Other considerations related to internal controls
57	4.4 Negotiations
	4.4.1 Role of the lead advisor
	4.4.2 Forms of negotiations
	4.4.3 Financing structure
	4.4.4 Pricing strategy
	4.4.5 Synergies and post-acquisition issues
	4.4.6 Purchase price adjustment mechanisms

61	4.5 Regulatory considerations
62	4.6 Financing considerations for foreign investors
	4.6.1 Debt-to-equity ratio
	4.6.2 Loans
	4.6.3 Foreign exchange restriction/profit repatriation
	4.6.4 Debt pushdown
64	4.7 Deal structuring
	4.7.1 Overview
	4.7.2 PRC M&A enterprise income tax framework
	4.7.3 Tax structuring
	4.7.4 Exit strategies
76	4.8 Implementation
80	5. Integration and reorganisation
80	5.1 Integration planning and strategy
	5.1.1 The importance of integration
	5.1.2 The overall integration approach
96	5.2 Finance and administration integration
	5.2.1 Redesigning financial management and budgeting processes
	5.2.2 Re-engineering financial, accounting, and tax-related processes
	5.2.3 Financial shared services
	5.2.4 Executing the financial integration plan
	5.2.5 Engaging external service providers
99	5.3 Human resources integration
	5.3.1 Guiding principles for HR merger integration
	5.3.2 Executing HR integration
102	5.4 Information Technology integration
	5.4.1 Guiding principles for IT integration
	5.4.2 IT integration
	5.4.3 Culture and communication in the IT department
105	5.5 Supply chain management
	5.5.1 Key areas of focus for the supply chain integration team
	5.5.2 Executing supply chain integration
106	5.6 Post-acquisition business processes and internal controls integration
	5.6.1 Improving deficiencies in internal controls
	5.6.2 Establishing proper levels of authority
	5.6.3 Integrating business processes and internal controls
	5.6.4 Establishing monitoring controls
112	5.7 Intellectual property rights protection and management
112	5.8 Ongoing compliance
	5.8.1 Tax-related compliance obligations
	5.8.2 Internal controls-related compliance obligations
122	Acronym reference list
124	Appendices
125	1. Administrative Measures on Strategic Investment in Listed Companies by Foreign Investors
132	2. Provision on Merger and Division of Foreign Investment Enterprises
142	3. Rules on Mergers and Acquisitions of Domestic Companies by Foreign Investors
157	4. Measures for the Administration of the Takeover of Listed Companies
183	Contacts

Foreword

The five years since we first launched our M&A Playbook in 2006 have certainly been momentous. Few then, would have been able to forecast both the near-collapse of the global economy and the increasing presence China would come to play on the world-stage. Nonetheless, this is precisely what has occurred and the country's M&A markets have surged as a result, with inbound investments into China over the past four quarters (H2 2010-H1 2011) remaining consistent with deal volumes at the height of the 2007 buyout boom, and outbound acquisitions more than doubling over the same two periods.

This escalation in Chinese M&A activity has meant that buy- and sell-side parties, as well as the government, have become more sophisticated in their approach to deal-making, with the authorities doing much in recent years to formulate clear M&A regulatory and taxation frameworks within their wider remit. Nowhere is this more evident than in the government's recent 12th Five Year Plan policy, which highlights the need for 'high-quality' growth, based on a sustainable, domestic consumer-driven economy driven not only by local capital, but also overseas financing and technical knowledge. At the same time, the plan encourages local businesses to 'go abroad' as it looks to encourage the pace of development at home via expansion overseas.

In order to achieve these goals to the fullest, being prepared and utilising prior deal-making experience remains key. A Chinese proverb suggests that "you dig the well before you are thirsty." If an investor familiarises and prepares themselves on all aspects of deal-making, whether it be on financial due diligence processes or post-merger-integration issues, prior to executing a transaction, they are much more likely to be able to crystallise the benefits of the tie-up quickly, efficiently and completely.

With this in mind, Deloitte hopes that you will continue to find this guide helpful in making your M&A transactions in China a success.



Lawrence Chia
Managing Partner, M&A Services

Executive summary

Deloitte's China Mergers & Acquisitions Playbook will guide the reader in four main chapters through the complexities of implementing an M&A strategy in China. The four major phases of Deloitte's M&A LifecycleSM (Planning, Screening, Execution and Integration) are discussed, thoroughly detailed and illustrated in each of the four main chapters. Each chapter begins by asking a number of salient questions that will be discussed in detail through the course of the chapter and concludes having answered the questions top-of-mind for a potential buyer. Chapters are further illustrated through case studies and lessons learned by Deloitte who have been advising clients in China since 1917.

In the first chapter we take a top level view of Deloitte's four-phase M&A LifecycleSM and consider where within the lifecycle senior management need to be involved in making critical decisions.

In planning an M&A deal, one needs to better understand the corporate and strategic objectives of the company. Whatever the company's growth strategy, the M&A strategy must be consistent with these. The second chapter explores M&A strategy planning and considers the issues which may be relevant in selecting an appropriate M&A advisor in China. The guide goes further to outline the roles and responsibilities of a suitable M&A advisor as well as providing a check-list of issues both on sourcing and assessing a target for the buyer.

The third chapter of the Playbook guides the reader through a three-level approach for screening targets that includes how they may be prioritised. The chapter considers in greater detail how to structure, select and approach both targets and buyers and considers what cost-saving and revenue enhancing synergy opportunities are available; this being a fundamental consideration in a detailed screening of an M&A target. A number of valuation techniques are discussed together with challenges typically faced in China and their possible solutions.

The fourth chapter looks at key considerations in the execution of the M&A deal. Due diligence is discussed with specific focus on Financial and Tax, Business, and Internal Controls and the chapter outlines the areas a thorough due diligence should generally cover. Financing considerations in making an M&A deal are examined in greater detail including both tax structuring issues for foreign investors in China and the major implications of asset acquisitions in China. The chapter also discusses deal structuring in terms of tax implications and exit strategies a buyer may want to consider. The roles and responsibilities of the M&A lead advisor in the execution phase are presented and significant elements from the Sales & Purchase Agreement that may arise on completion of the transaction are discussed.

The fifth and final chapter of the Playbook offers readers an overview of several key considerations for merger integration, outlining critical success factors in integrating acquired organisations. Deloitte's six-tier approach to managing a merger integration is discussed and considerations for re-engineering the Finance & Administration, Human Resources and Information Technology segments of the business are provided. Having planned, screened, executed an M&A strategy and integrated it within the organisation, this reference guide concludes looking at intellectual property management, ongoing tax and internal controls compliance issues such as the Sarbanes-Oxley (SOX) Act of 2002. A SOX readiness approach is presented examining the challenges foreign investors may face in China that must not be overlooked.

Deloitte's M&A LifecycleSM

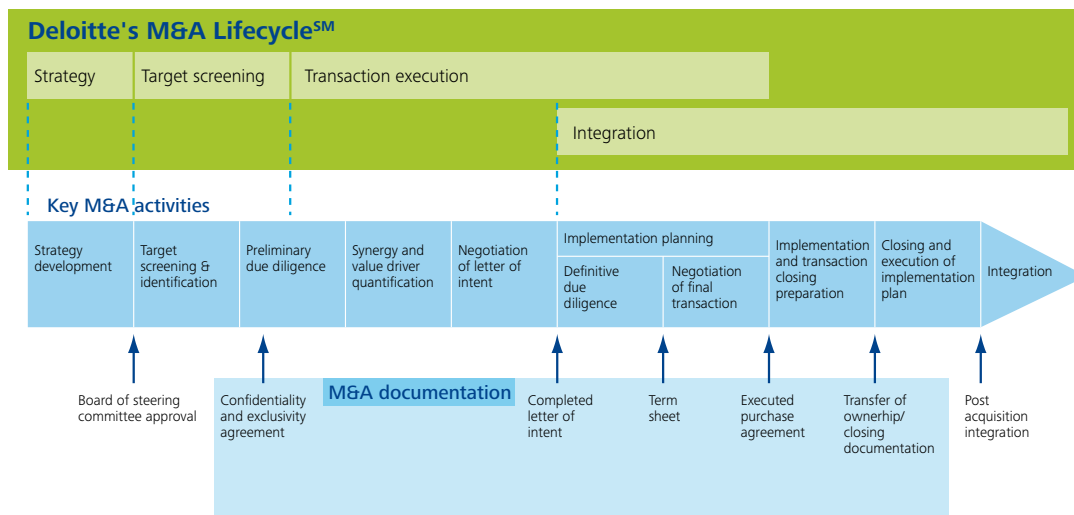
1. Deloitte's M&A LifecycleSM

Deloitte's M&A LifecycleSM has four phases:

1. M&A strategy development
2. Target screening
3. Transaction execution
4. Integration and reorganisation

Each of the four phases requires senior management to make critical decisions and involves activities ranging from reviewing business objectives, performing due diligence, conducting negotiations, and closing a transaction to integrating business units.

Figure 1: Deloitte's M&A LifecycleSM



Questions that will be addressed through the M&A process:

- Is M&A the right approach for a company?
- Why should a company acquire/divest a business organisation?
- Who should participate in the M&A process?
- What may be the most appropriate investment vehicle to defend, grow, fix or exit a business?
- What may be the options to finance the deal?
- What are the activities that may be involved in an M&A transaction?
- When should the acquisition/divestment occur?
- How should an M&A transaction be conducted to improve the probability of success?
- How will the operations of two merged entities be integrated?

When a company considers an acquisition, senior management should develop an M&A strategy that complements the overall corporate strategy and that is consistent with its business model. The strategic objectives should be clearly articulated and understood, at which point focused target screening can begin. Acquisition candidates who meet specific criteria to achieve the M&A strategy can then be identified.

Once a target is approved for pursuit, a multi-functional approach to manage the transaction execution takes place. This phase involves external specialists to conduct in-depth analysis of the target and to facilitate negotiations. An M&A transaction is complete when the Sales & Purchase Agreement is executed and transfer of ownership takes place. However, the process does not end here. Integration efforts to plan and manage the combination process for two merged entities are critical to capture the anticipated value and mitigate risk.

The buyer and target company may "walk away" from a deal any time before the transaction is completed, though there may be certain financial penalties during the later stages of the process. Typically, these terms are negotiated and agreed to in a Term Sheet.

The success of an M&A transaction process will more likely result from engaging a dedicated M&A team comprising internal and external specialists who can oversee the M&A process. The M&A process can be tedious, intensive, time-consuming and complex and having internal resources take part in an M&A exercise whilst still focusing effectively on daily operations may prove to be a challenge. Involving different professionals and expertise at different stages of the M&A LifecycleSM will be necessary to enhance the level of success of the transaction.

M&A strategy development

2. M&A strategy development

Key issues considered in this chapter:

- What is your company's corporate strategy and objectives, both globally and in China?
- Is M&A in line with your corporate strategy and the right option for your company?
- How should your company identify potential acquisition candidates, conduct preliminary assessments and approach targets?
- In the case of a divestment, how should your company identify and approach potential buyers?
- Why is a lead advisor for M&A beneficial? What should a company consider when selecting an advisor?

2.1 M&A strategy planning

2.1.1 Understanding corporate objectives

In considering whether M&A is the appropriate method to improve shareholder value, performance and market competitiveness both in China and globally, a company should first review its corporate strategy. Corporate strategy makes the company greater than the sum of its business units, and sets the organisation's direction and goals, business portfolio, resource allocation and growth plans.

A corporate strategy review is critical for success; however, it is often neglected by executives under pressure to achieve short-term results. One of the primary causes for acquisition failures is often a lack of insight regarding the company's core competencies and limitations as well as changing market conditions.

The rigorous analysis conducted in a strategy review enables a company to understand its internal strengths and external market opportunities at home and in China over the next several years. This analysis helps to develop a set of prioritised options, such as an acquisition or divestment, to achieve the company's objectives.

As challenges and opportunities for growth are defined, options to defend, grow, fix or exit a business can be assessed and prioritised based on company goals, capabilities and financial position. Generally, companies can choose from a myriad of strategic objectives such as:

- **Organic growth** - to increase business breadth or depth through revenue growth, market share capture, margin enhancement or improved asset utilisation;
- **Skill strengthening** - to acquire necessary talent to remain competitive;
- **Portfolio management** - to manage a portfolio of businesses in order to maximise existing and evolving capabilities, reduce risk, or reposition a business;
- **Defensive action** - to ward off potential take-over attempts or fix existing business/operational problems;
- **Opportunistic posture** - to capitalise on a unique market/competitive opportunity or a developing business formula; and
- **Globalisation** - to expand market share and sales in international venues.

Depending on a company's strategy, acquisitions may serve as a way to quickly achieve strategic and financial objectives.

2.1.2 Developing an M&A strategy

Acquiring or divesting a business can be considered as part of a corporate strategy and accordingly, an M&A strategy should be closely linked with corporate and business unit strategic plans. When developing an M&A strategy, a company may wish to consider:

- portfolio management alignment;
- make vs buy considerations;
- regulatory challenges;
- competitive landscape;
- availability of capital;
- barriers to entry; and
- cultural hurdles.

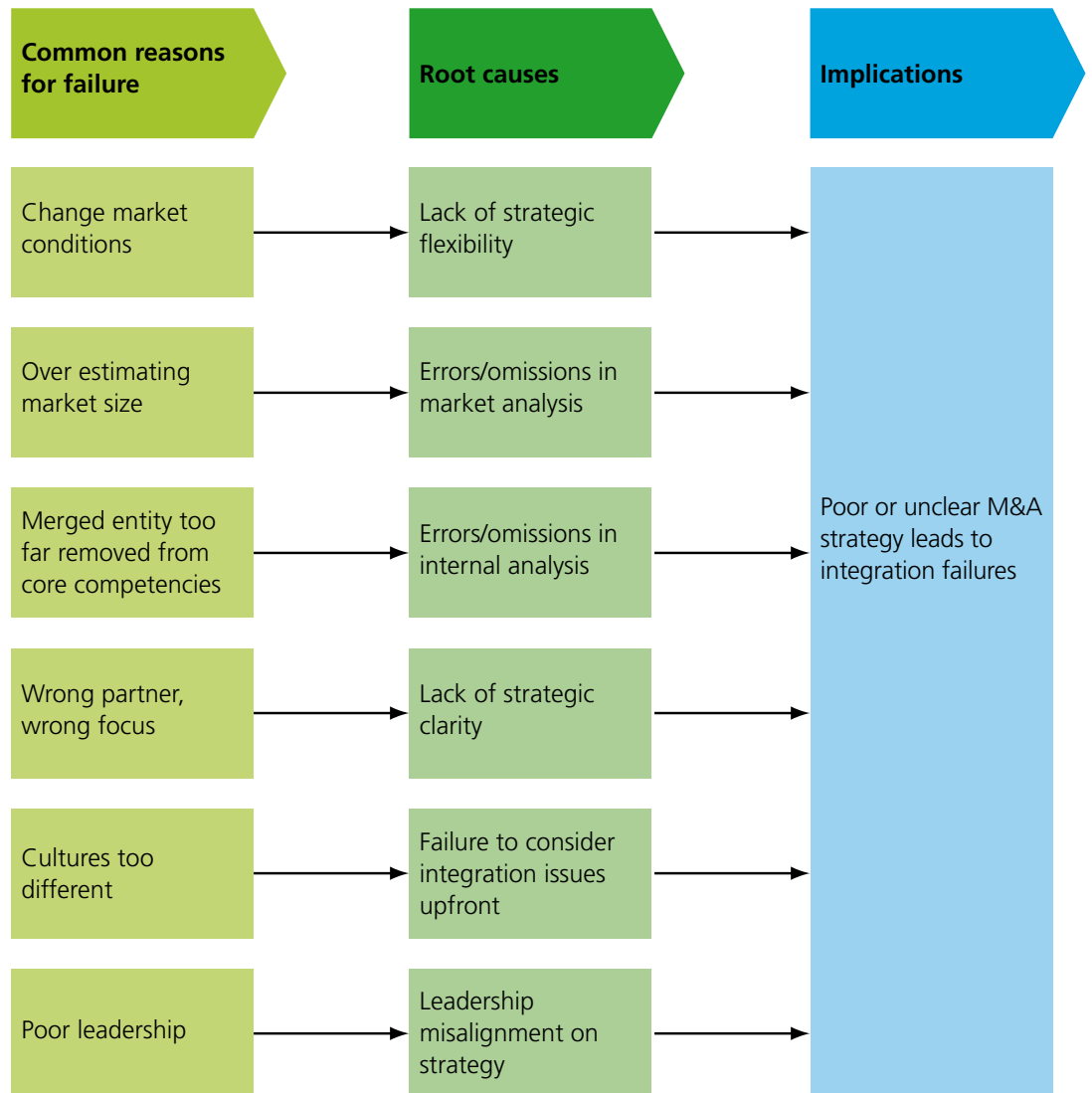
To address these issues, prior to acquiring any new business, all available resources must be identified and their limitations understood. From a financial point of view, companies should estimate working capital and capital investment requirements through cashflow forecasts. This will help to determine if a company has the financial capacity to undertake an acquisition strategy. In addition, a company should also assess the sufficiency and availability of other critical resources, such as human resources, to gauge the level of support available for integration and operating the future business.

Unfortunately, many mergers in China can fail due to poor strategy formulation as a result of:

- changed market conditions;
- overestimating market size;
- selecting the wrong partner or having a wrong focus;
- differences in cultures;
- poor leadership; and
- buying an entity that is too far removed from core competencies.

To facilitate and properly manage an M&A process, a company should consider engaging a dedicated team of professionals early on to manage the alignment of corporate goals with the M&A strategy, provide appropriate skills to analyse markets and the M&A potential, and advise on the availability of capital funding.

Figure 2: Reasons mergers fail



Five cornerstones of a successful M&A strategy in China

- Have an M&A strategy that is consistent with the overall corporate strategy
- Have visible leadership and consistent communications throughout the process
- Create and manage a team skilled in strategy, industry and market analysis, legal and regulatory matters, accounting, tax, finance and valuation, business and IT functions and processes, human resources, negotiations, and project management
- Be willing to embrace open and objective debate about the realities of China's external market forces and the company's internal core competencies
- Implement measurement tools and processes that track the efficacy of the M&A strategy and process

2.1.3 M&A alternatives

There are different ways to achieve strategic and financial goals. After conducting an initial assessment, a company may realise that an M&A transaction may not be the best option to achieve its goal in China and therefore, will need to consider alternative strategies to M&A.

Some alternative strategies may include:

- **Organic growth:** For foreign companies seeking to expand in China, a wholly foreign-owned enterprise (WFOE) is a popular structure, where wholly owned subsidiaries are set up to hold the assets or businesses enabling the company to fully control their own investments. Organic growth allows a company to use its own resources to expand while keeping control of the process. However, planning the requisite financial resources may be a difficult exercise and achieving the desired results may take a long time.
- **Joint venture:** A joint venture is an entity owned, operated and controlled by a small group with the mutual benefit of the shareholders in mind. As China restricts control over important or "strategic" industry sectors, Sino-foreign joint ventures have historically been the most preferred investment vehicle for foreigners investing in China. The entity is usually formed to give access to complementary competencies as well as share risk and expertise, with each party participating in the overall management. Significant decisions commonly require the consent of each shareholder (regardless of ownership percentage) so that no individual shareholder has unilateral control.

The selection of an appropriate Chinese partner is generally the most demanding and important step in forming a joint venture. The following factors should be considered when choosing a joint venture partner:

- a potential partner's political clout;
- its access to domestic financing;
- its ability to provide a domestic market for products;
- the level of skills of its workforce; and
- integrity and strength of its management.

Unlike WFOEs, foreign investors in joint ventures need to spend a lot of time and effort to cultivate relationships with Chinese partners; the success of a joint venture is largely dependent on the degree of cooperation between the parties.

- **Strategic alliances:** Strategic alliances are generally used for research, marketing or distribution purposes. They do not involve equity or debt transactions, but offer the advantage of being an inexpensive way to access new markets. They do, however, limit a company's control, and may result in a loss of intellectual property. Although most of the legal framework in China satisfies international requirements, foreign businesses and governments are sometimes dissatisfied with the enforcement of Intellectual Property Rights regulations.
- **Licensing:** Licensing is a form of strategic alliance that minimises capital investment. A company will receive an up-front payment from an interested party for the right to produce or market one or more of its products. Like strategic alliances, licensing is an inexpensive way to access new markets. The licensor's control can be limited.
- **Franchising:** A franchiser will be compensated by an up-front payment plus a continuous future royalty stream. In certain instances, there will be an agreement where the franchiser will sell materials or supplies to the franchisees. Franchising remains an easy way to expand a business rapidly where other parties invest the capital. However, a franchiser will generally have no control in the franchisee's business and the growth in returns can be limited.

- **Contract processing:** A foreign entity may engage local low cost manufacturers to produce products for an overseas market by supplying the materials, technologies, and supervision required to ensure the quality of the products being produced. This strategy avoids heavy capital investment in China especially when most of the products are sold to an overseas market. However, it may create quality control and intellectual property protection issues, and is often not a preferred long term strategy for companies seeking to penetrate the local market. In addition, manufacturing in China is also becoming more costly than in years past.

When considering the best methodology to grow, companies should align their acquisition strategies to their corporate and business unit strategies.

Table 1: Comparison for market growth alternatives in China

Lever/ transaction type	Description	Benefits	Costs
Mergers, acquisitions, divestitures	Buy or sell a company to achieve corporate goals	<ul style="list-style-type: none"> • Usually quicker than organic growth • Established market position • Easy access to sites/ distribution channels • Local competencies immediately available 	<ul style="list-style-type: none"> • Integration costs • Integration risks • Required discipline, rigor and right skills
Organic growth	Focus on building market share with new or existing products in new or existing markets	<ul style="list-style-type: none"> • Build internal capabilities • No integration risk or costs 	<ul style="list-style-type: none"> • Slow • May be costly (relative to acquisition)
WFOE	Wholly-owned subsidiaries set up to hold assets or businesses of foreign entities in China	<ul style="list-style-type: none"> • Control • Flexible • Common culture 	<ul style="list-style-type: none"> • Significant mobilisation of resources • High regulatory constraints • Higher risk • Lengthy process
Joint ventures/ partnerships	Two or more entities pool resources for cooperation (often in relation to a particular project)	<ul style="list-style-type: none"> • Complementary skills and resources • Risk sharing • Local knowledge • Local culture maintained 	<ul style="list-style-type: none"> • Rewards are split • Increased potential for intellectual property risk • Conflict • Exit costs • Complex legal and commercial structure

Lever/ transaction type	Description	Benifits	Costs
Strategic alliances	Formal cooperation between entities across a broad range of functions	<ul style="list-style-type: none"> • Release capital intensive actitivives and redeploy capital to achieve higher returns 	<ul style="list-style-type: none"> • Complexity of managing third party relationship • Sharing of information can lead to risk exposure (domination by one party)
Contract processing	Utilise lower cost local manufacturers to produce products for overseas markets	<ul style="list-style-type: none"> • Lower capital commitments 	<ul style="list-style-type: none"> • Limited control over quality • Intellectual property protection issues • No local market access

2.1.4 Financing options

Companies will generally use debt or equity to finance an acquisition.

Equity financing consists of a company raising money by issuing additional ordinary or preferred shares to existing or new shareholders. The amount of equity financing will mainly depend on the amount of funds that existing or new shareholders are willing to make available for the proposed transaction. Hence, the amount of equity will depend on the investors' perception of the value brought by the transaction to the business.

The alternative is **debt financing**, where a company borrows money. Debt raised can be either traded in the capital markets (i.e., "bonds") or loaned directly by a bank or via syndication. Bonds and bank debt can be subordinated or senior, straight or structured. Debt financing is attractive because financing costs can be deductible from taxable income if properly structured. There is also the possibility of decreasing financing costs by using assets as collateral. The amount of debt raised may, however, be limited; it will actually depend on the amount of cashflow available to service debt.

The choice between debt and equity or a combination of the two will depend on many factors:

- the macroeconomic situation;
- financial considerations such as cashflow, leverage ratios, credit ratings, and tax;
- management culture such as the inclination to keep flexibility in a business;
- shareholder preferences; and
- whether the company is listed and publicly traded or privately held.

Table 2: Comparison of financing options

	Equity financing	Debt financing
Pros	<ul style="list-style-type: none">• Provides flexibility• A relatively cheaper way to raise money when the share price stands up well in stock markets	<ul style="list-style-type: none">• Interest payments are generally tax deductible• RMB loans from a local bank are generally not restricted, although foreign guaranteed RMB loans may require registration with State Administration of Foreign Exchange (SAFE)• May create tax savings at the foreign investment enterprise (FIE) level
Cons	<ul style="list-style-type: none">• Amount of financing depends on the willingness of existing and new shareholders to provide funding• Dependent on macroeconomic conditions and stock market sentiment• Existing shareholders will suffer from dilution of their equity interest• Potential loss of control	<ul style="list-style-type: none">• Restrictions on maximum foreign currency debt based on debt-to-equity ratio requirements• Interest commitment will increase cash flow burden, especially in a rising interest rate environment• Restrictions on interest deductions arising from inter-company loans based on certain debt-to-equity ratio stipulated under the tax rules (not the above investment rules)

Listed companies should also consider recent price performance and current market sentiment. Questions a buyer should ask when considering fund raising efforts include:

- Are analysts currently upgrading or downgrading the company's shares?
- Are the company's shares under- or over-valued?
- How is the market currently evolving?
- Is it a good time to place new shares?
- Will the current shareholders be disappointed with a new issue of shares, since they will, comparatively, suffer from a dilution of their equity interest?

Privately-held companies may require assistance to approach the right investors and market their projects. While existing shareholders should be approached first, they may not have the desire or capacity to commit new funds. In seeking new investors, the amount of equity raised will, however, most likely require the approval from existing shareholders and depend on their willingness to share management control.

Financing considerations for M&A deals in China

When considering financing options for M&A deals in China, the following should be observed:

- investment regulatory restrictions;
- foreign exchange control issues; and
- potential tax incentives.

2.1.5 Divestment strategy

The process for divesting non-core businesses is very similar to that for acquiring a new business, though managers tend to pay less attention to divestments. However, it is important to pay the same level of attention so that the process is effectively and expeditiously managed.

Proper management of divestments will minimise the impact of rumors on employee morale, customer and supplier uncertainty and overall operations.

Timing is critical for getting an attractive offer when disposing a business. Economic and industry upturns will offer the selling company a better price for its assets compared to downturns. Hence, there may be an optimum period of time to exercise a divestment. With this said, the timing to sell should be balanced against the risks from uncertainty and the urgency to dispose of an asset, all which would affect the selling price of a business.

2.1.6 Selecting lead advisors

M&A is a complicated exercise involving professionals from different areas of expertise. Hence, managing the M&A process requires a systematic approach. As such, it is often beneficial for a company considering M&A activities, whether an acquisition or a divestment, to engage lead advisors during the first three phases of the M&A LifecycleSM (i.e., Strategy, Target Screening, and Transaction Execution) to assist in establishing priorities among opportunities and challenges, to align strategic and financial objectives with corporate missions, and to manage the M&A process.

Table 3: Reasons for engaging lead advisors

Challenges companies face	Strategies taken by lead advisors
<ul style="list-style-type: none">• Unable to find satisfying acquisition targets in the market	<ul style="list-style-type: none">• Review and redefine screening criteria and objectives
<ul style="list-style-type: none">• Selected targets are not accessible or may show no interest to be acquired• Selected targets may consider any investment move as a hostile approach, especially when they are competitors, suppliers or customers	<ul style="list-style-type: none">• Lead advisors can manage conflicting relationships
<ul style="list-style-type: none">• Selected targets are not willing to provide sufficient and reliable information so that a reasonable offer can be made	<ul style="list-style-type: none">• Lead advisors can facilitate the process of developing the right offer by conducting a preliminary, high-level due diligence exercise
<ul style="list-style-type: none">• Owners of selected targets are asking for an unrealistic premium on the market price	<ul style="list-style-type: none">• Lead advisors can assist in the negotiation process bringing in expertise and market knowledge

In managing the M&A process, a lead advisor is generally responsible for helping companies in four major areas:

- defining the appropriate M&A strategy;
- leading the implementation of the strategy;
- closing the deal within an appropriate timeframe; and
- assist in appointing other supporting advisors throughout the process if necessary.

Figure 3: Roles and responsibilities of lead advisors

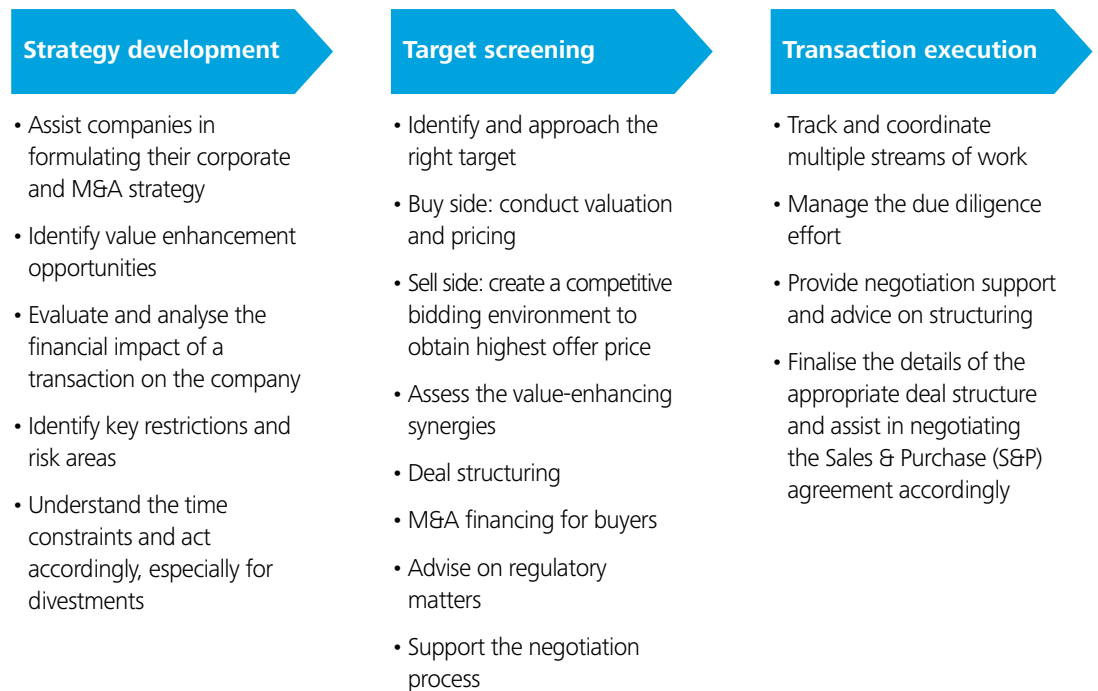


Table 4: Roles and responsibilities of major advisors

Type of advisor	Roles and responsibilities
Legal advisors	<ul style="list-style-type: none">• Draft legal agreements (Letter of Intent, Sales & Purchase Agreement, Shares Subscription Agreement, Shareholder Agreement, etc.)• Review all aspects of legal documentation• Assist in legal procedures including those relating to shareholder meeting (particularly if a listed company is involved)• Perform legal due diligence on the target company• Assist in obtaining regulatory approvals

Type of advisor	Roles and responsibilities
Professional accounting firms	<ul style="list-style-type: none"> • Analyse the quality of earnings • Analyse the quality of assets • Analyse the exposure of debt, liabilities or contingencies • Review relevant contracts and agreements which might have a financial impact on the potential transaction • Analyse target projections in relation to historical performance • Assess the impact on the acquirer's financial statements (cost of acquisition, purchase price allocation, pro forma valuation of intangibles, goodwill, accretion/dilution of earnings per share, etc.) • Assist in formulating purchase price and/or working capital adjustment mechanisms to be included in the Sales & Purchase Agreement • Review tax implications • Evaluate the validity of any tax benefits that the target is currently entitled to and to assess whether such benefits can be carried over post-acquisition • Enquire with the relevant authorities on any unusual tax treatment adopted by the target company and its validity • Assess transactional tax cost • Assist in the drafting of the tax specific warranty and indemnity clauses • Recommend tax-efficient acquisition structures (including financing alternatives, etc.) • Review the existing corporate structure, analyse the impact post-acquisition, and suggest efficient integration or restructuring steps, if necessary
Valuers	<ul style="list-style-type: none"> • Provide valuation of tangible assets such as property and machinery or real estate

Engaging the right lead advisor will firstly, improve the overall management of the M&A process, secondly, provide professional advice and guidance to support senior management decision making, and thirdly, supplement the skills required to conduct a thorough analysis.

Capabilities a company should consider in selecting an advisor:

- the level of deal flow available;
- an advisor's network to source potential targets;
- professionalism;
- ability to access potential targets;
- reputation and M&A expertise; and
- industry experience and track record on both in-bound and cross-border M&A transactions.

2.2 Preliminary research of potential acquisition candidates

In assessing investment opportunities, a company should evaluate the attractiveness of the sector in which it plans to conduct an acquisition by:

- understanding the industry structure and leverage points, where value can be captured;
- appreciating the market scale and growth potentials;
- understanding the key players, both domestic and foreign-owned, along with competitive dynamics;
- envisaging any technological trends; and
- identifying entry barriers.

Once the decision is made to pursue opportunities in a sector, the company can begin preliminary research on potential acquisition candidates.

2.2.1 Developing the acquisition candidate pool

The first step in a target selection process is to develop a strong list of potential acquisition candidates. This involves a high-level search based on criteria including:

- sector/industry;
- competitive position within the industry/product mix;
- revenue/size;
- market capitalisation; and
- location of operations.

Often a search will come up with 100+ potential candidates in the long list. These potential candidates will be further screened and profiled. The way in which these targets may be screened is discussed in Chapter 3.

2.2.2 Sourcing potential acquisition candidates

Finding the right candidate, a buyer or a seller, requires time and patience. A search for a target requires an extensive review of potential candidates before finding one that fits a company's strategic needs while also being fairly priced.

A company could identify potential acquisition targets by using its own network or through:

- examining the financial position of potential companies. Financial problems such as cash shortages or excessive debt may indicate that a sale may be necessary;
- investigating the potential company's shareholding structure and management. Indications of possible future sales include an owner nearing retirement with no heirs in key management positions, absentee owners, or financial investors potentially interested in an exit strategy.

2.3 Financial assessment of the buyer

To prepare for future negotiations, a company should first value itself ahead of an acquisition and develop an acquisition budget.

It is beneficial for the company to understand its financial position by assessing its working capital and capital investment requirements through cashflow forecasts. This will enable the company to assess its own value, its ability to access markets and extend its competitive position, and its capacity to absorb an acquisition and create value - the "2+2 = 5" equation.

Developing an acquisition budget is equally important for the company. Having a budget will help a company to decide whether it should use equity, debt or a combination of both to finance an acquisition. This budget should include costs relating to potential transaction expenses such as due diligence costs, restructuring costs and professional advisor fees.

Before considering debt financing, a company should have a clear idea about its current gearing position and borrowing capacity within the lending sources available. When considering equity financing, investor/shareholder concerns relating to the dilution of ownership and financial measures such as return on investment and earnings per share (EPS) should be understood.

Conversely, if a company is about to divest its non-core businesses, valuing them will provide information on the fair market value and the price a company can ask for from an investor.

The different valuation methodologies available are discussed in detail in Chapter 3: Target Screening.

Summary

- Develop an M&A strategy that is aligned with the strategy and growth objectives of the company
- Consider different financing options when acquiring a company
- Engage a lead advisor to assist with the M&A process
- Divestments should receive the same level of attention as acquisitions
- Leverage external advisors to search for potential targets
- Know the company's value and prepare a suitable budget before conducting M&A activities

Target screening

3. Target screening

Key issues considered in this chapter:

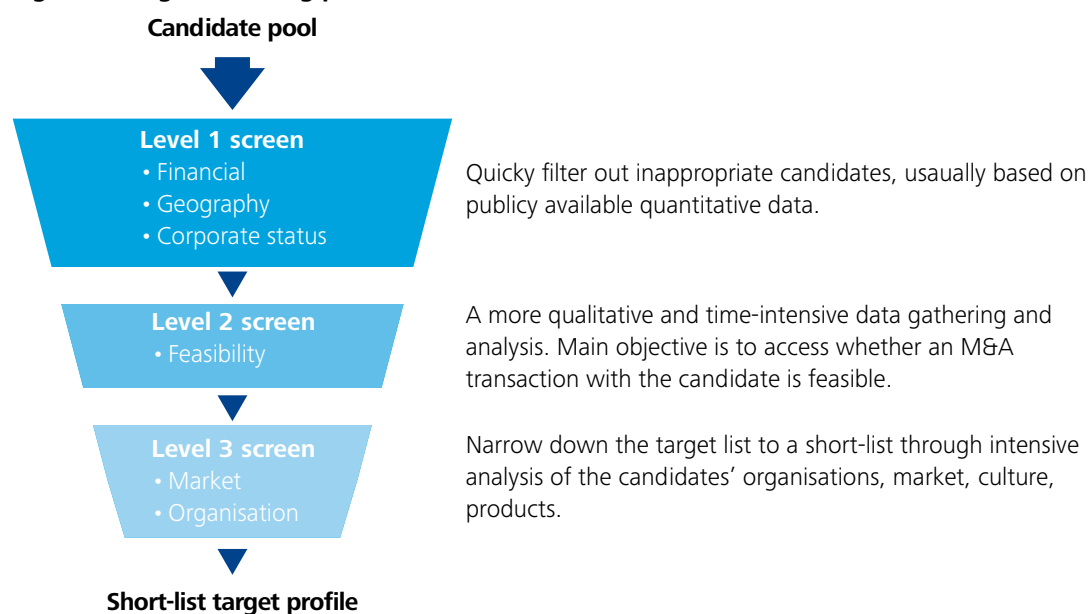
- What criteria should be considered when a company selects acquisition targets?
- How should a company prioritise targets?
- What should a company look for during the initial due diligence and preliminary valuation?
- What is the potential deal structure and financing options for an acquisition/merger?
- What is the strategy to gain approval from all stakeholders of your company?

3.1 Target screening process

After developing a list of potential acquisition candidates, the next step is to conduct research and analyse the profile of the selected targets. The main objective of this process is to narrow your search down to a short list of prioritised targets.

The screening process applies a set of criteria to screen for candidates that will best realise the M&A (and corporate) strategy. It is a systematic approach to identifying the most suitable candidates through an iterative process. Proper target screening lays the foundation for successful deal execution and integration. The figure below illustrates the increasing intensity of analysis to filter down to a short list of suitable targets.

Figure 4: Target screening process



The three levels of screening in this approach are:

- Level 1 Screen - to quickly filter out inappropriate candidates based on pre-established criteria and reduce the candidate pool to a manageable size for qualitative analysis. This screening is usually based on publicly available quantitative information, and can include examining the candidate's financial performance, geographic presence and corporate affiliations and status.
- Level 2 Screen - to conduct a feasibility screening to answer the question "Is an M&A transaction possible?" and to reduce the number of candidates sufficiently to enable a more in-depth qualitative and quantitative analysis. The data gathering and analysis required for this level is more difficult, time consuming, and expensive than for Level 1.
- Level 3 Screen - to arrive at a short list through intensive analysis of the candidates' organisations, markets, culture, products, etc. This is the most time-intensive of all screenings.

Developing target profiles

A target profile is a comprehensive, succinct analysis of each short-listed target remaining after the Level 3 Screen. Customised target profiles should be developed for the transaction at hand, however, the major sections of analysis should most likely include:

- business strategy;
- product summaries/assessment analysis;
- major news announcements;
- customer data (as available);
- consolidated financial data;
- regional/international benchmarked performance data;
- cultural assessment;
- organisational assessment;
- integration options available: absorb, maintain on stand-alone basis, or partially absorb; and
- list of subsidiaries, affiliates, properties, directors and executives.

Target profiles of short-listed candidates will be the basis for prioritising targets - determining which candidates to pursue and in what order.

3.1.1 Defining screening criteria

The criteria used for screening should be developed based on the M&A strategic objectives. As screening criteria are defined, the buyer should spend time prioritising them. By going through such an exercise, a company will establish a clear view of the benefits it plans to achieve through the M&A effort.

Screening criteria should be developed based on the company's strategic plan, financial plan, budget, and resource requirements.

The set of screening criteria can include:

- affordable price range - i.e., determine how much a buyer can afford to spend on an acquisition;
- size range preferences - i.e., determine the desired size of potential acquisition targets in terms of market capitalisation, revenues, net asset values, etc.;
- profitability requirements - i.e., determine EBITDA/EBIT, net margin and free cashflows requirements;

- shareholding preferences - i.e., determine the desired level of control over the target and define separate criteria for a majority or a minority shareholding;
- transaction structure preferences - i.e., acquisition of shares vs assets and acquisition vehicles located in or outside China; and
- management requirements - i.e., take into consideration leadership style, expertise, receptivity to change, compatibility of culture, and modality of management after the completion of the transaction.

In addition, a buyer should define a set of operations-related criteria. This would include establishing:

- marketing criteria in terms of product lines, customer base, brand reputation, geographic presence, distribution channels;
- R&D requirements, such as licences, patents, R&D centres, product pipeline, R&D expenses, etc.; and
- production criteria, such as facilities, labour supply, production techniques and capacity.

Short-listed targets should be further screened to determine:

- their fit into the buyer's current business portfolio;
- their competitive position and future prospects; and
- the value they create for the buyer.

3.1.2 Collecting target data

Collecting information in China is comparatively more difficult than in other developed countries. This is especially the case for privately-held companies. A financial advisor can assist in this process. In addition to using publicly available information, financial advisors can tap into their industry contacts and network of professionals both in China and overseas.

The table below illustrates some typical issues investors face in China and the potential solutions to overcome them.

Table 5: Data collection issues faced by investors in China

Typical issues	Possible solutions
• Lack of sufficient data, especially for targets from the private sector	• Need to develop own projections
• Data integrity (especially the reliability of financial statements)	• Cross-check data acquired from multiple sources for accuracy
• Lack of local equity and industry research	• Need to gather information from company management or industry players

3.1.3 Prioritising targets

Buyers should prioritise potential targets according to the number of screening criteria the target companies fulfill. In performing this exercise, buyers will need to rely on answers to questions such as "How well is the potential target company performing?" and "Do we know management?" At the same time, buyers should consider the reliability of the information supporting the answers to such questions. Taking this all into consideration, buyers will be more equipped to prioritise targets and determine who should be approached first. This approach also serves to establish parameters for deciding under what circumstances would a buyer walk away from one target and move on to pursue the next.

It is advisable that target companies not be approached all at the same time. Not only will this create a substantial amount of work for a buyer's management team and affect daily operations, but it will also increase the likelihood of creating a rumour which would ultimately raise price expectations of targets.

Prior to approaching a target company, additional research and information gathering can be conducted by a financial advisor to provide a more complete picture of the candidate. This would include information on target ownership and management teams as well as subjective elements such as family situations and succession plans (e.g., the willingness of children to take over the business). Very often, negotiation leverages are identified during this process.

An experienced lead advisor can assist in:

- prioritising targets;
- developing appropriate strategies and tactics to approach targets;
- preparing appropriate Confidentiality and Exclusivity Agreements; and
- developing the right time frame for negotiations and due diligence.

3.2 Initial due diligence

When a short-list of potential candidates that match a buyer's growth strategy has been identified, a reassessment should be conducted matching the target's characteristics with the buyer's pre-defined acquisition criteria. In addition, a buyer should perform an initial valuation of its prioritised targets to determine whether an acquisition is a viable option. If the pricing criteria cannot be met, further pursuit of such targets may not be feasible.

As a buyer updates its interest in pursuing a potential target, an initial due diligence should be conducted so that the decision to pursue an acquisition is based on sound information and analysis. Embarking upon such an exercise will also facilitate any eventual acquisition process.

Among others, an initial due diligence should aim to provide reasonable answers to the following questions:

- What are the preliminary issues identified from a preliminary assessment of the target? Are such issues deal breakers?
- What is the financial position of the potential target?
- Has a background check of the potential target's management team and shareholders been conducted?
- What is the reputation of the potential target?
- Are the financial conditions and track record of the potential target consistent with the buyer's risk tolerance?
- What is the impact of regulatory matters on the potential target's future operations?

Commonly encountered issues during initial due diligence in China

Performing an initial due diligence exercise helps to reveal problems investors may face during an M&A process in China. The following list provides examples of issues commonly encountered.

- The process of obtaining relevant government or regulatory approvals for wholly or partially foreign-owned entities and projects may be lengthy and time-consuming.
- Potential targets are often unwilling to cooperate during an initial due diligence review; this is partly due to a lack of M&A transaction experience on the part of target candidates.
- Financial statements may not be transparent and could be questionable in terms of accuracy due to accounting methodologies applied and differences in accounting principles (PRC GAAP vs. IFRS or other forms of GAAP).
- Due diligence information is not always readily available.
- Differences in valuation methodologies; PRC companies tend to use asset-based valuation and may not be familiar with international valuation methodologies.
- Non-transferable assets held by target candidates (e.g., licenses, etc.).
- Complicated tax regimes and potentially unauthorised arrangements with local tax authorities.

It is often useful to address these issues at an early stage so that they can be properly evaluated with respect to their impact on the deal and purchase price.

3.2.1 Synergy opportunities

An important part of initial due diligence is identifying potential synergy opportunities between targets and a buyer. Only targets that bring additional value to a buyer should be considered in an M&A exercise.

A synergy may be defined as the increase in performance of the combined companies over what the two companies are already expected or required to accomplish as independent companies. Put simply, synergy is either an increase in revenue (revenue enhancement) or decrease in expenses (cost savings) achieved as a result of integration.

Revenue enhancing synergies

A revenue enhancing synergy results in additional revenue above and beyond what the two companies are expected to accomplish independently. In identifying revenue enhancing synergies, the following should be considered:

- What are the value drivers and how will each driver create additional revenue?
- On what assumptions are these revenue enhancements based?
- Has the buyer achieved similar revenue enhancements during past acquisitions? Why or why not?

Revenue enhancements promote higher returns and facilitate long-term growth more than cost savings, but they tend to be difficult to quantify. Most initiatives that can enhance revenue can be grouped into:

- **Market expansion:** entering new markets and expanding market share;
- **Margin improvement:** by implementing a better pricing strategy;
- **Asset utilisation:** enhanced performance through better and more efficient use of existing assets;

- **Investments:** better return on investment (ROI) on existing investments. For example, the acquiring company has an extensive IT infrastructure which the target company can also access;
- **Products and services:** increasing product portfolios and service portfolios by creating better product mixes, or removing a potential substitution option.

Cost saving synergies

Cost saving synergies can generally be categorised into:

- **Duplication avoidance:** avoidance of duplicative costs by consolidating functions on a centralised basis (i.e., shared services, or by combining similar expenditures, e.g., licences);
- **Economies of scale:** increase in purchasing power (e.g., improved pricing on contract services);
- **Operational efficiency:** increased control over processes (e.g., maintenance scheduling);
- **Organisational streamlining:** reduction in organisational layers and breadth (e.g., spans of control, substitution of external/internal labour sources); and
- **Performance realignment:** consideration of more efficient structures (e.g., centralisation of certain departments, outsourcing, etc.).

Compared to revenue enhancing synergies, cost saving synergies tend to be more readily identifiable as well as more accurately quantifiable and/or measurable. They can also be more significant in terms of value.

Identifying and reviewing synergy opportunities are critical to determining whether a potential target company should be further considered for an acquisition. Selecting an appropriate target can enhance the performance of the buyer after integrating the deal.

3.3 Valuation

3.3.1 Valuation of Business Entity

3.3.1.1 Financial modeling

Many acquisitions and key decisions are often influenced by the results of the financial models to support important decisions including the first but essential step towards the valuation of the target. The quality of a valuation result is affected by the quality of the financial model along with the data within. A well developed financial model will consider a high-level perspective of the key value drivers and their inter-relationships which may also often form the basis for an ongoing planning model of the target post transaction. While there is growing pressure from investors and stakeholders for businesses to develop forecast models reasonably and deliver to plan, many financial model developers in a transaction however may have received little or no formal training on financial modeling principles and practices.

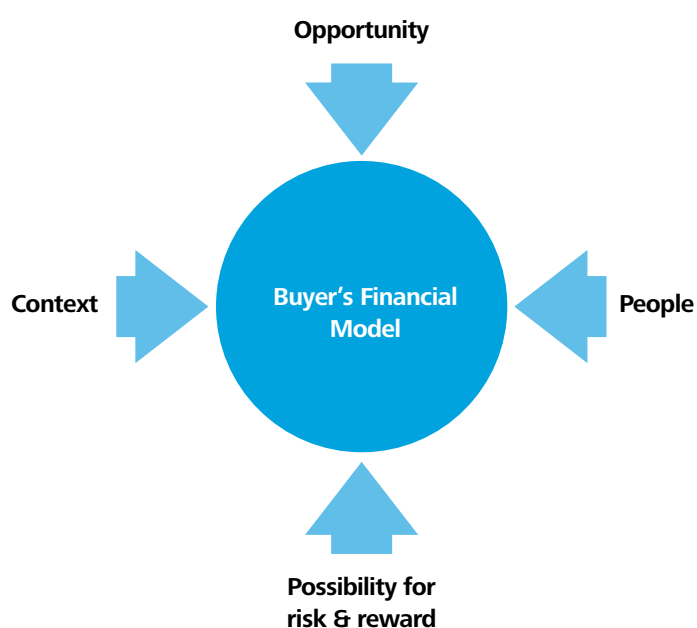
A good financial model should consist of three elements from the target financials: an income statement, a balance sheet and a cashflow statement with historical, current and forecasted figures. The financial model typically should have a forecast period of five years and include three scenarios with different sets of assumptions:

- most likely,
- most pessimistic and;
- most optimistic.

All too often, people take a binary view: either they underestimate uncertainty or they overestimate it and go with their "gut instinct". Building three different models (base, good and bad cases) will help to come up with reasonably satisfying forecasts by spreading the risks and adopting a disciplined method.

It is not easy to compose a robust financial model. This is largely because the focus is often on inputting figures rather than appreciating the underlying business. As seen in the diagram below, buyers have to challenge their financial model in at least four major areas related to factors critical to the success of every new venture: the people, the opportunity, the context, and the possibilities for both risks and rewards.

Figure 5: Four factors to challenge the buyer's financial model

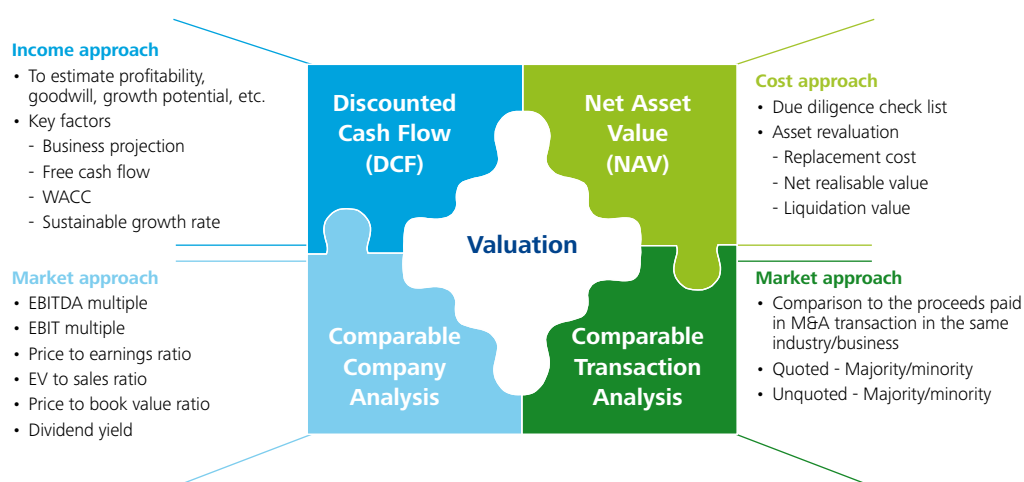


Deriving forecasts when they are not readily available remains a challenging exercise, particularly if the potential target is out of a company's core sector(s). Gathering financial and non-financial data to develop a robust and flexible model that supports a confident assessment of the value of target from buyer, vendor and other bidders perspective requires specialist modeling resources in developing the right transaction model to meet demanding deal timetables.

3.3.1.2 Valuation approaches

Three traditional approaches are commonly used in the valuation of an enterprise. Selection of the appropriate approach or approaches for valuation of the target may depend on available data from the target.

Figure 6: Valuation approaches



• Income approach

The income approach measures the value of an asset or an equity interest in a business by analysing the present worth of the economic benefits it is expected to produce. These benefits may include earnings, cost savings, tax deductions, and disposition proceeds from the asset.

An indication of value may be developed under this approach by discounting expected cash flows to their present value at a rate of return that incorporates the risk-free rate for the use of funds, the expected rate of inflation over the asset's holding period, and the risks associated with realising the cash flows in the amounts and at the times projected. The discount rate selected is typically based on rates of return available from alternative investments of similar type and quality as of the valuation date.

When applied to value the equity interests of a business enterprise, the analysis may include consideration of expected future revenues, expenses, working capital, capital expenditures, debt, business and financial risk, and investment alternatives.

The advantage to the income approach is that future potential earnings becomes the investment criterion and allows incorporation of certain changes to the firm in its revenue stream or expense items. The inherent reliance on future cashflow forecast which requires adoption of multiple assumptions is its biggest disadvantage.

• Market approach

The value of an asset in the market approach (also known as the sales comparison approach) is measured through an analysis of sales and offerings of comparable property. Sales and offering prices for the comparable assets are adjusted to reflect differences between the assets being valued and the comparable assets, such as location, time and terms of sale, utility, and physical characteristics.

When applied to value the equity interests of a business enterprise, the analysis may include consideration of the financial condition and operating performance of the company being valued

relative to those of publicly traded companies or to those of companies acquired in a single transaction that (1) operate in the same or similar lines of business; (2) are potentially subject to corresponding economic, environmental, and political factors; and (3) could be considered reasonable investment alternatives.

The market approach is the easiest to use among the three approaches and is easy to relate to. This method can be used to obtain estimates of targets quickly especially when there are many comparable companies publicly traded on financial markets. However, the ease in using this approach may result in manipulation and misuse. The selection of comparable companies is subject to bias and adjustment to the derived ratios to account for differences between the target and the comparable companies requires certain degree of judgment and experience.

- **Cost approach**

The cost approach (also known as the asset approach) measures the value of an asset by the cost to reproduce or replace it with another asset of like utility. To the extent that the asset being valued provides less utility than a new asset, the new reproduction or replacement cost is adjusted to reflect appropriate physical deterioration and functional and economic obsolescence.

Physical deterioration is the loss in value produced by wear and tear, action of the elements, disintegration, use in service, and all physical factors that reduce the life and serviceability of the asset. Functional obsolescence is the loss in value caused by internal factors, including excess capacity, inadequacy, and technological changes, that impact the asset itself or its relationship with other components of a larger asset. Economic obsolescence is the loss in value initiated by economic forces external to the subject asset itself, including changes in optimum use, legislative enactments, and supply and demand relationships.

When applied to value the equity interests of a business enterprise, the cost approach measures the equity value of the business as the sum of the values of its assets reduced by the sum of the values of its liabilities. The resulting equity reflects a 100 percent ownership interest in the business. This approach is frequently used in valuing holding companies.

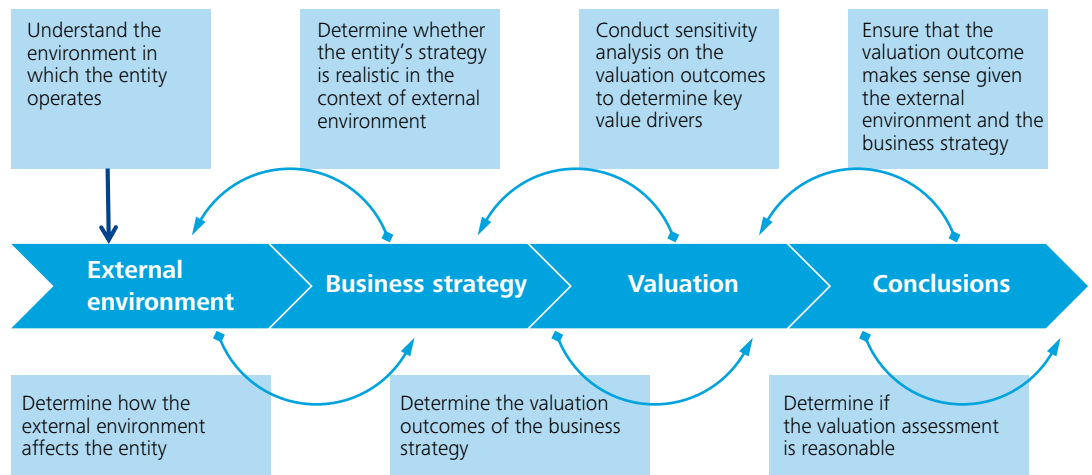
The advantage of the cost approach is that it is relatively objective and does not require adoption of certain subjective judgments and assumptions. Disadvantages of the cost approach are that it does not address economic aspects of ownership and the risks of not receiving the economic benefits.

- **Application of the approaches**

The value of an interest in the equity of a company is dependent on many factors, such as the following:

- The nature and history of the business
- The general and specific economic conditions impacting the company and the outlook for its industry
- Its book value and financial condition
- Its operating history and prospective earnings capacity
- Its dividend-paying history and capacity
- The existence of tangible and intangible asset value within the business
- Prior transactions involving the equity of the business
- The market prices of companies engaged in the same or similar lines of business.

Figure 7: General approach to enterprise valuation



It is important to note that valuation is part art and part science. The use of quantitative methods in a valuation implies exactness while the use of qualitative factors such as the selection of financial metrics and comparable companies requires significant judgment and experience. The above valuation approaches and methodologies aim at determining the fair market value of target although it may not represent the final transaction price. In a transaction, the "deal environment" may influence the final transaction price; factors such as the current market conditions, industry popularity, acquisition structure, tax attributes, and the objectives of the seller or buyer may often have an effect on the final value.

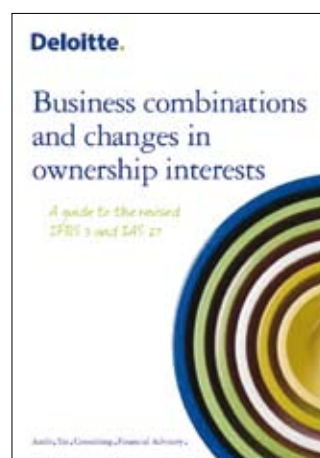
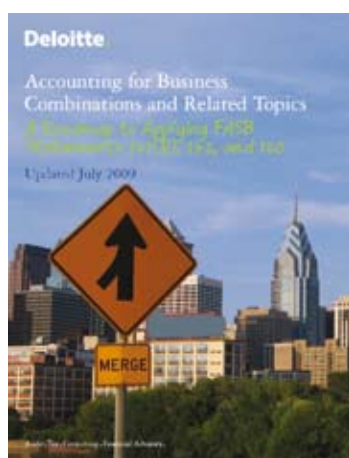
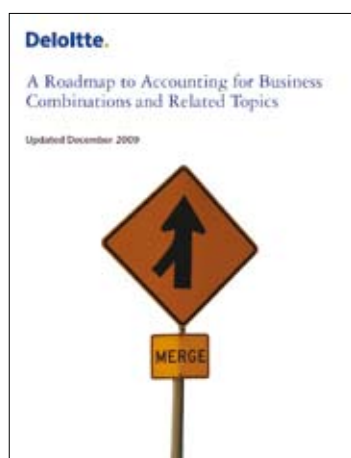
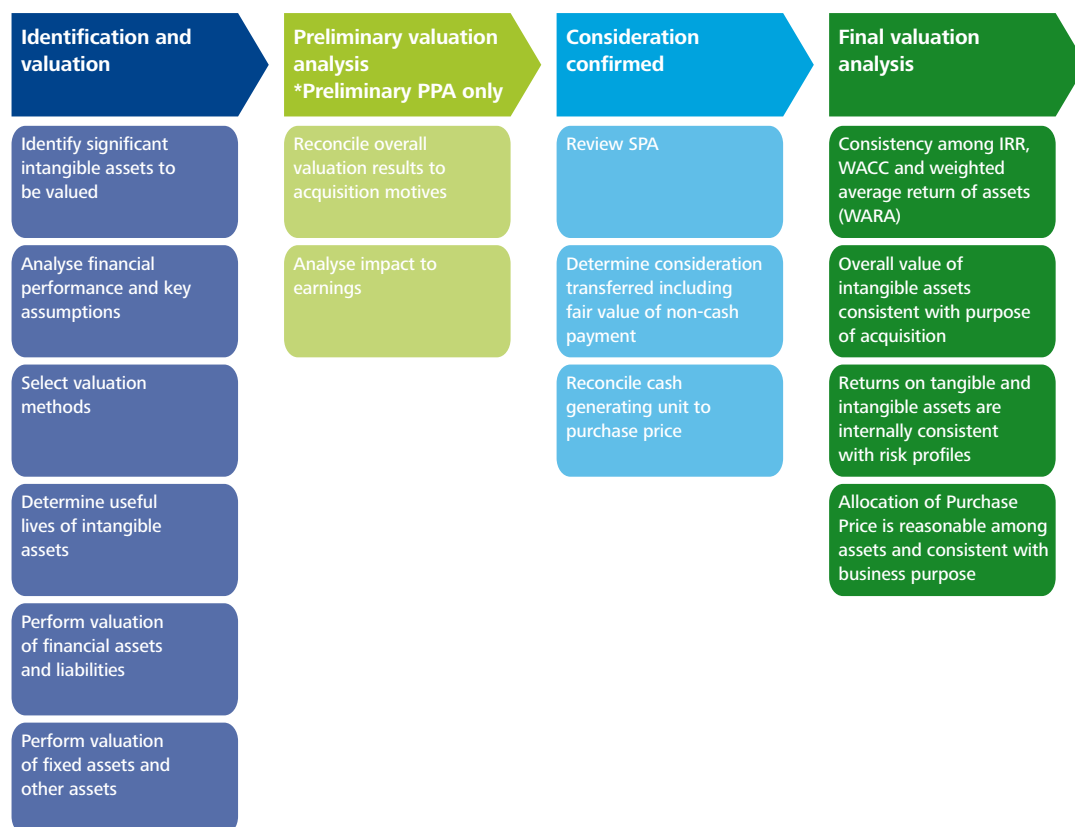
The final transaction price is also influenced by the eagerness of the buyer to buy and the seller to sell, the demand and supply for targets, the form of consideration paid (e.g., shares, cash) and the negotiation skills of the parties.

3.3.1.3 Purchase price allocation

There is a convergence towards fair value measurements for business combinations under US GAAP, International Financial Reporting Standard ("IFRS") and Accounting Standards for Business Enterprises ("ASBE") issued by the Ministry of Finance of the People's Republic of China in February 2006. An acquisition must be accounted for by applying the acquisition method unless it is a combination between entities or businesses under common control. Under the Acquisition Method, an acquirer of a business has to recognise fair values of the identifiable assets and liabilities assumed at the acquisition date with the difference between consideration transferred and net identifiable assets acquired recognised as goodwill.

As part of the overall M&A process, deal team should be aware of the accounting implications of the acquisitions and the impact to acquirer's earnings in terms of depreciation, amortisation and future considerations on impairment.

Figure 8: General framework of PPA analysis



3.3.1.4 Valuation challenges

Performing a valuation on assets in China can be a challenging exercise. Often, buyers attempting to conduct their own valuation on targets may find it difficult to access accurate and reliable information for financial modeling, make appropriate assumptions on operations and market conditions, and comply with statutory requirements. Table 6 summarises common valuation issues in China and provides potential solutions to address these challenges.

Table 6: Valuation challenges in China

Challenges	Potential solutions
<ul style="list-style-type: none"> Difficulties in assessing regulatory and market risks due to rapidly changing market and regulatory environment 	<ul style="list-style-type: none"> Identify relevant risks and assess their impact through research on trends and regulatory updates Engage external experts in the relevant industry with strong research capabilities
<ul style="list-style-type: none"> Unreliable historical financial problems relating to the quality of earnings Collections of trade debts Inappropriate capitalisation of expenses Non arms-length transactions Insufficient provisions on inventories/receivables Hidden costs (e.g. labor benefits) 	<ul style="list-style-type: none"> Identify issues through insightful due diligence carried out by dedicated and experienced M&A professionals Conduct non arms-length transaction resolution Conduct transfer pricing resolution Factor in potential financial issues in valuation Negotiate for a better acquisition price as a result of potential problems
<ul style="list-style-type: none"> Financial projections are not supported by reasonable assumptions Financial model developers received little or no formal training on financial modeling principles and practices 	<ul style="list-style-type: none"> Build a sensible financial model by engaging financial modeling experts, supported by sensitivity analysis of impacting factors
<ul style="list-style-type: none"> Presence of: <ul style="list-style-type: none"> unproductive assets (e.g., investments in non-core business or social facilities) significant contingent liabilities (e.g., tax-related issues, guarantees to third parties, etc.) 	<ul style="list-style-type: none"> Structure the deal to exclude unwanted assets and liabilities Identify accounting and tax issues and resolve them satisfactorily
<ul style="list-style-type: none"> Statutory requirements for valuation to be performed by local valuers, who tend to focus on net assets value in the valuation process 	<ul style="list-style-type: none"> Ascertain reasonable valuation results by nominating a local valuer Review the work performed by the local valuer

For transactions that involve state-owned assets, approval from relevant Chinese authorities is required. In such cases, valuation of the state-owned assets is required to be performed by a licensed local valuer. The valuation report also needs to comply with a special format and layout as stipulated by the authorities.

Valuation of intangible assets is also a challenge in China. The situation is more severe when the Chinese party is represented by a local valuer who tends to adopt an asset approach in valuation and attach little value, if any, to the intangible assets. For some start-up and high-tech companies which own a small amount of fixed assets, the difference between the value concluded by a local valuer and a foreign valuer may be quite significant.

A buyer should also be aware that recent M&A rules in China require domestic-owned (non state-owned) enterprises to perform independent valuation on assets. As a result, when considering an acquisition price and conducting deal negotiations, it is beneficial for the buyer to understand the potential differential in valuation and the issues involved.

3.3.2 Valuation of financial instruments

Corporations are increasingly using financial instruments for their asset and liability management purposes. The values these financial assets and liabilities are increasingly becoming a significant contribution of value to the corporate, and hence there is an increasing demand driving M&A activity to perform procedures around financial instruments that are held on the balance sheet.

3.3.2.1 Financial instruments on company's balance sheet

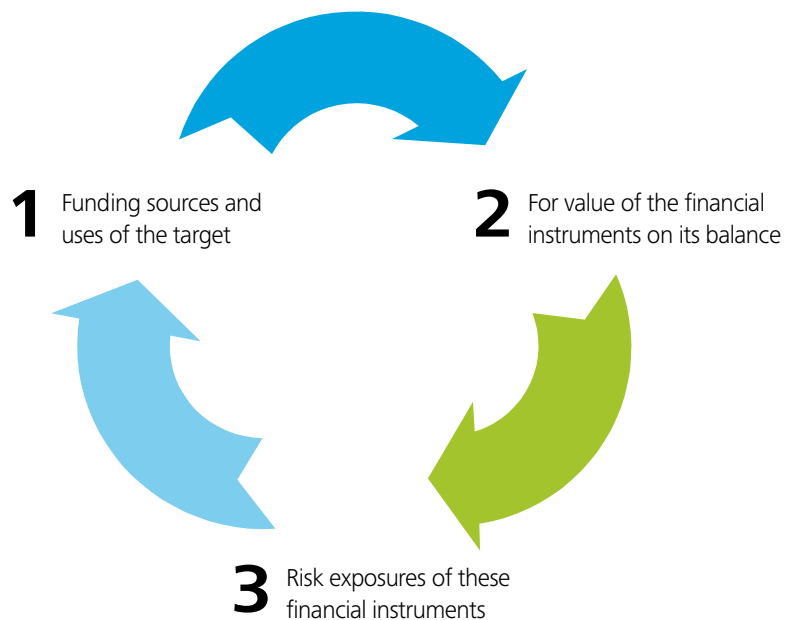
Financial instruments, whether held as financial assets or financial liabilities on the balance sheet, can be in the form of vanilla or derivative products. These are now widely traded or held by financial institutions, fund managers and corporations throughout the world. Table 7 shows some of the actively traded financial instruments in the market:

Table 7: Financial instruments under different asset classes

Interest Rate	Forward Rate Agreements, Interest Rate Swaps, Interest Rate Cap, Interest Rate Floor, Swaption, Bond, Callable Bond, Range Accrual Swaps
Currency	Currency Spot and Forward, Vanilla Call or Put Options, Barrier Options, Digital Options, Target Redemption Forward
Credit	Financial Guarantees, Credit Default Swaps, Credit-Linked Notes
Equity	Equity Call and Put Option, Equity-Linked Notes, Share Options, Warrants, Redeemable Shares
Commodities	Commodities Futures
Indices	Index-Linked Notes
Hybrid	Convertible Bonds

3.3.2.2 Common valuation requirements for financial instruments

When looking at the values of financial instruments on a target company's ("Target") balance sheet, likely questions for an Acquirer would include, "Are these financial assets and liabilities fair valued?", "What are the market risk exposures?", "Will these financial instruments affect the company's cash flow requirement?". It is not an easy task for Acquirers to find the solutions to all these questions themselves. Often, Acquirers may involve valuation specialists to assess the fair values and risks of these complex financial instruments as these could be different from that as recorded on balance sheet. Below are some major areas of concern an Acquirer will address:



- **Funding sources and uses of the Target**

Acquirer should identify the funding sources of the Target and analyse the availability and sustainability of the cash flows. Acquirer should also analyse how the Target uses these funds and whether they are used reasonably and effectively. The timings of these cash flows are vital to the operation of the Target; and it helps the Acquirer to understand how these fit into its own business operation and the accompanying risks.

- **Fair value of the financial instruments on target's balance sheet**

Acquirer would normally engage an external financial instrument valuation specialist to conduct the valuation of the financial instruments on the Target's balance sheet. The general approach adopted by valuation specialists to assess the real value of the financial instruments would involve the following processes:

- Develop an understanding of the terms and backgrounds of the financial instrument transactions
- Build an appropriate valuation model for valuation testing
- Perform sensitivity test
- Determine the fair value of the financial instruments

- **Risk exposure of financial instruments**

Table 8 summarises the Target's market risk exposure that the Acquirer needs to assess before buying the Target:

Table 8: Market risk exposure assessment

Interest Rate Risk	<ul style="list-style-type: none"> • Re-pricing Risk (including financial covenant conditions) • Yield Curve Risk • Basis Risk • Optionality Risk
Foreign Exchange Risk	<ul style="list-style-type: none"> • Market Liquidity Risk • Directional Risk • Event Risk • Settlement date mismatch Risk
Commodity Risk	<ul style="list-style-type: none"> • Directional Price Risk • Basis Risk • Interest Rate Risk • Forward Gap Risk
Other Risks	<ul style="list-style-type: none"> • Equity Risk • Liquidity Risk • Credit Risk (including counterparty risk, credit risk, etc)

3.3.2.3 Challenges in valuing financial instruments

The increasing complexities of financial instruments and the different regulatory environment in major cities of China, such as Hong Kong SAR, Shanghai, Beijing, Shenzhen and Macau, create a challenging environment in assessing the fair value and risk exposures of financial instruments recorded on the balance sheet of the target company. Some examples of challenges that Acquirers will face are illustrated in Table 9 below, and Acquirers are advised to engage the services of well known valuation firms to assist it in its valuation needs:

Table 9: Challenges in valuing financial instruments

Challenges	Potential solutions
<ul style="list-style-type: none">• Different regulations and information disclosure standards may lead to insufficient background information for valuation purposes.	<ul style="list-style-type: none">• A deep understanding of the regulatory environment is required.• In addition, Acquirer should conduct due diligence on the transaction counterparties.
<ul style="list-style-type: none">• The complexities of financial instruments increases the difficulties of building up appropriate models and finding suitable parameters.	<ul style="list-style-type: none">• To have the capability to build financial models to perform the valuation of these financial instruments.
<ul style="list-style-type: none">• Lack of market liquidity and transacted prices of financial instruments may not be fair value.	<ul style="list-style-type: none">• This requires deep financial market experience in order to understand the market pricing mechanism and to conduct in-depth research on the market.
<ul style="list-style-type: none">• Uneven quality of work by inexperienced valuers.	<ul style="list-style-type: none">• To have the capability to perform independent valuations to cross test the recorded values on the balance sheet for accuracy and completeness.

3.4 Approval process and target approach strategy

3.4.1 Approval strategy

Having an approval strategy is critical to the success of a transaction. In closing a deal, the buyer and seller may require approval from various regulatory bodies or entities. This process, however, can be time-consuming. A well-planned approach to obtain approval may facilitate the completion of the transaction. This may involve engaging experts in regulatory regimes to assist with examining regulations related to the contemplated deal structure and to coordinate and liaise with other professionals to obtain the required approvals.

Typically, approval may be required from the following bodies before a deal can be completed.

- **Shareholders** - if the buyer is a publicly-listed company, it may need to obtain shareholder approval before any major or substantial transaction can take place. Particularly, the buyer may be required to seek approval from minority shareholders if the transaction involves a connected party.
- **Governmental entities** - in China, government approval may be required under certain circumstances:
 - most transactions involving a foreign investor will require approval from the relevant regulatory body;
 - the transaction will necessitate the approval of the appropriate authorities if the business operates in certain regulated markets (such as banking, insurance and telecommunications); and

- the transaction will require the approval of the relevant authorities if the business operates in an industry critical to the public's interest, and where the transaction would create a monopoly situation (anti-trust regulations).

3.4.2 Target approach strategy

The strategy for approaching a target can be different based on whether the target is a public or private company. If the target is a public company, it is often possible to conduct an initial due diligence and initial valuation based on publicly available information and data. In such instances, the buyer may be ready to approach a potential target with a preliminary indication of deal/offer.

If the target is a private company, the buyer or its advisor will need to approach the candidate earlier in the process. For example, initial due diligence may not be feasible without access to certain target information, which may only be available after signing a Non-Disclosure Agreement with the target.

A buyer should consider the following questions when approaching the target:

- Who should make the contact?
- How will contact be made?
- What should be communicated to the target?
- Who should be contacted at the target?
- How should any hostile reactions be handled?

An advisor would be able to assist in developing an appropriate strategy to approach a target.

3.5 Initial deal structuring

After initial due diligence, the buyer and the seller will need to have a preliminary idea of how the deal will be structured, taking into account the needs and objectives of both parties. **The main objective: to reach a mutual agreement that is acceptable and feasible for both the buyer and the seller.**

There are various methods to structure and specify the terms for a transaction. In the initial discussion, the seller and buyer would probably have raised a number of critical issues that will need to be addressed. Some of the critical concerns may include:

- Will the seller participate in the post-acquisition organisation as a partner? If so, in which format? As a shareholder, or as part of the key management team?
- Whether to set up a new joint venture entity or a WFOE to take over the business of the target (asset deal) or to have the buyer purchase the equity interest in the target (equity deal)?
- Whether to purchase real estate or fixed assets or to lease from the target?
- What form of consideration is desirable? Cash only, all up-front or with an earn-out provision?
- Which entity will be the seller (onshore transaction or offshore transaction)?
- From the buyer's perspective, whether it needs to consider a special holding vehicle for the target and how to finance the transaction?

From a tax perspective, initial discussion relating to the deal structure is extremely important between the buyer and seller to align their expectations. Depending upon the structure of the transaction, the tax costs for both parties could be significantly different which may impact the economics of the deal. Tax is one of the most critical considerations in evaluating the feasibility of a potential acquisition.

In addition to the tax-related issues, the regulatory approval process should also be considered to determine initially what types of approvals are needed to close the transaction and at what level (provincial or central) to better understand the feasibility of the structure and approximate the timing needed to bridge the expectation gap between both parties.

When structuring a deal, it is common practice to receive indication on whether the owners/shareholders of the target company are interested in continuing the process. Generally, a Letter of Intent (LOI) will be signed to confirm the interests of the two parties and outline the basic terms that have been agreed upon in the initial phases of negotiation. The LOI does not contain all matters upon which an agreement must be reached in order to complete the acquisition, but will draft the key points discussed to date. It will validate and summarise the key terms agreed (for example, stock versus assets purchase, amount and form of consideration) which will be followed by further negotiations.

To some extent, the LOI will also protect a buyer in case the deal drops. As a legally-binding document, the LOI confirms the interest of the two parties in engaging themselves in an M&A transaction. After signing the LOI, both parties should have reasonable opportunities to step back from the deal. Taking this argument further, the target company may include some "drop dead fees" in the LOI to compensate the buyer in case it steps back from the deal for any unreasonable reason.

Summary

- Proper target screening lays the foundation for successful transaction execution and integration
- Develop screening criteria based on internal capabilities in terms of financial, shareholding and management preferences and operational requirements
- Prioritise acquisition candidates based on defined criteria to achieve the M&A strategy
- Conduct initial due diligence to understand short-listed candidates, evaluate potential targets and identify synergy opportunities. Obtaining reliable and accurate information in China can be a challenge - consider engaging experienced professionals to assist with the process
- Develop an approval strategy to facilitate the completion of the transaction early on as obtaining approval can be time-consuming
- Engage in an initial discussion on alternatives for deal structuring to reach mutual agreement on an option that is feasible and acceptable to both parties
- Confirm the interests of both parties and outline the basic terms of the deal with a Letter of Intent

Transaction execution

4. Transaction execution

Key issues considered in this chapter:

- How can a buyer determine that an acquisition target is the "right" choice and the acquisition price is both fair and reasonable?
- What does due diligence involve and what areas should due diligence cover?
- What should a buyer consider during negotiations? How should a buyer deal with issues such as pricing and financing strategy, deal breakers, valuation, regulatory and approval requirements, and post-integration considerations?
- What are the key considerations when structuring a deal?
- What are the deal completion mechanics, transaction documents and key elements of agreements?

Transaction execution generally entails due diligence, valuation, negotiations and deal structuring. These activities occur in parallel and a multi-functional approach helps maintain focus on the most critical elements of the deal on a real-time basis.

Due diligence provides vital information for deal structuring, valuing a target and conducting negotiations. The financial, operational and legal aspects are often considered the three vital components for making the final decision to do a deal. An analysis of the target company in greater depth is necessary to determine whether the disclosed information has been represented properly. This analysis will help the buyer determine whether it indeed wants to buy the target company, and, if so, the appropriate price to pay.

During the execution of a deal, synergy opportunities should be transformed from the value envisioned in the initial due diligence to value captured in the combined companies. The best way to achieve this is for the buyer to have an in-depth and comprehensive picture of the target company. Therefore, in addition to conducting financial, operational and legal due diligence, it is important to conduct due diligence in the areas of tax, internal controls, management integrity, market dynamics, human resources, and information technology. It is also essential that the buyer verify the financial, commercial, operational and strategic assumptions used in the preliminary stages of the deal.

In China, a buyer conducting due diligence on an acquisition target may face many challenges as a result of local culture, business environment and regulatory requirements.

The execution challenges of conducting due diligence in China, if not properly addressed, may expose the buyer to risks which may significantly impact future operations and financial performance. These hurdles and risks can range from expectation gaps and communication issues to internal control and compliance matters. Many companies in China are not accustomed to due diligence activities. While closely examining the operations of a company is common practice in developed economies, cultural sensitivities should be managed so as not to create a feeling of distrust between the buyer and seller. In some instances, a lack of cultural sensitivity could potentially become a deal breaker for the target company.

Figure 9 provides a high-level summary of the common challenges of conducting due diligence in China. Specific areas of concern are further discussed in the various sections of this chapter.

Figure 9: Common due diligence challenges in China

Execution Hurdles	Risks
<ul style="list-style-type: none"> • Expectation Gap between the investor and the target with regards to due diligence scope and the necessary due diligence information • Cultural and Language Barriers between the investor and the target causing miscommunication and delay of the due diligence process • Negotiation Issues between the investor and the target leading to delay of due diligence process and additional due diligence costs • Insufficient Communication between top and local management of the target causing different perception of the transaction • Unavailable and Incomplete Information owing to an unsophisticated information system leading to doubts in reliability of target's financial statements/information • Degree of Centralisation/Decentralisation resulting in different accounting centres and data flow 	<ul style="list-style-type: none"> • Basis of Preparation of Financial Statements: GAAP compliance; GAAP differences between IFRS and PRC standards; disclosures • Fixed Assets: unclear land use rights; legal titles; valuation issues • Related Parties: difficulties in identifying related party relationships and transactions; non-arm's length terms; corporate guarantees given to related parties • Human Resources: funding of social insurance contributions; post-transaction staff continuity issues; quality and capability of staff • Compliance: relating to various local and national laws and regulations, such as safety, health and environmental regulations • Quality of Sales: revenue recognition policy; sales cut-off, receivable collection issues • Internal Controls: management's capability and integrity

For a typical M&A transaction, due diligence usually occurs after target screening is completed. There are two different levels of due diligence: preliminary/initial and detailed due diligence.

Depending on the stage, the focus and the level of depth will be different.

- **Preliminary/initial due diligence** occurs in the initial stages of the M&A process where time is spent collecting and analysing preliminary data and identifying business risks.
- **Detailed due diligence** takes place during transaction execution and is the most rigorous stage. Site visits and interviews are generally conducted with further information collection, and information is fed to the valuation, negotiation and integration planning processes.

External professionals may be engaged to perform due diligence for acquisitions in China. External services are valued for their experience and objectivity, and can act as a second/objective opinion to a company's initial assessment.

Lessons learned in conducting due diligence in China

- Ensure experienced professionals are available locally to put findings in the right context
- Do not under-estimate the importance of cultural due diligence and integration planning, especially if this is your first investment in China
- Language and translation will be a challenge if your team is not bilingual and/or your corporate culture requires all information to be available in English or any other language
- Availability of information may not be as complete and as timely as you like. Prioritise due diligence areas so that efforts can be focused on key areas, especially for time-sensitive transactions

4.1 Financial, tax and legal due diligence

4.1.1 Financial due diligence

The buyer's screening analysis has, up to now, principally been based on limited available information. To proceed with an acquisition, a buyer should conduct an objective in-depth due diligence of the target company to ensure it makes well informed and timely decisions regarding such acquisition.

When evaluating target candidates, the buyer should assess the reliability of the financial figures upon which the pricing/valuation is based. In the case of a leverage buyout (LBO), this will provide a clear picture of the target company's gearing threshold and help to determine its ability to service debt based on future available cashflows.

In a financial due diligence, assets and liabilities are reviewed to assess if assets are recoverable and all liabilities are properly stated. Such an exercise will involve studying the financial statements, account details and supporting documentation provided by the target company.

Given the complexity in the financial, commercial, operational and strategic information involved, it is often helpful to engage local experienced professionals to assist in this process. These professionals can assist to:

- consider the sources of value in the target and focus the deal team during due diligence;
- develop a detailed due diligence question list;
- conduct on-site due diligence and interview management;
- perform detailed financial due diligence, particularly focused on addressing key concerns; and
- execute the due diligence objectively, effectively and expeditiously.

Performing a financial due diligence

Financial due diligence typically includes:

- Obtaining a general understanding of the target company, such as
 - corporate background/legal entity structure;
 - financial reporting and policies;
 - corporate governance and internal controls;
 - management and human resources; and
 - historical external audit findings and opinion.

- Financial statement analysis
 - quality of earnings and pro-forma/normalised income statement;
 - GAAP differences between target company and buyer;
 - working capital required to operate the business;
 - quality of assets;
 - existence of off-balance sheet assets; and
 - exposure with respect to liabilities, commitments, and contingencies.
- Understanding related party transactions

Buyers may work with professional advisors to determine the extent and scope of due diligence. The scope of work is typically tailored and adapted to the nature of the transaction and/or relevant industry, and will depend on variables such as:

- the buyer's concerns regarding the target's financial transparency and reliability of financial information;
- complexity of the transaction;
- deal size;
- percentage of interest to be acquired (minority vs. majority investment); and
- the target's industry.

Lack of supporting documentation in support of general ledger transactions

Financial due diligence in China is often challenging due to a lack of transparency regarding the financial information and uncertainty with respect to the reliability of such information. Some typical issues and suggestions on how to overcome them are listed in section 3.1.2.

Examples of common issues uncovered during financial due diligence in China

- Off-balance sheet bank accounts and/or transactions
- Lack of supporting documentation in support of general ledger transactions
- Inconsistent application of accounting policies
- Presence and/or lack of transparency regarding related party transactions, many on a non-arm's length basis
- Issues relating to the ownership of assets
- Underpayment of statutory employee benefits

4.1.2 Tax due diligence

The tax due diligence exercise is critical and together with the financial due diligence, provides a more complete picture of the financial position of the target. In China's ever changing business environment, especially when tax rules and regulations are still under development and the local authority's interpretation and practical application of the rules may not be consistent, a tax due diligence will help to identify tax exposures of the target.

The statute of limitation is not very clearly defined in China's tax rules and therefore, imposes extreme difficulty in isolating the past tax exposures in an M&A transaction. These exposures may cast significant doubt on the viability or the ability to sustain the financial position of the target. These exposures may also change the acquisition mode from an equity deal transaction to an asset deal in order to avoid any contingent tax liabilities that exist in the target.

In a tax due diligence review, the focus is to review major applicable taxes relating to past operations of the target, such as:

- Enterprise Income Tax (EIT);
- Value-Added Tax (VAT);
- Business Tax (BT);
- Withholding Tax (WHT);
- Individual Income Tax (IIT);
- Land Appreciation Tax (LAT);
- Real Estate Tax (RET);
- Deed Tax (DT);
- Land Use Tax (LUT);
- Stamp Duty (SD); and
- Customs Duty (CD)

In addition to the underpayment of tax liabilities, a tax due diligence will also identify whether the target (taxpayer) failed to pay tax within a set period or whether a withholding agent failed to withhold and remit tax within a set period, as the tax authority will have ordered the taxpayer to pay or remit tax within a given time limit. As of May 2011, there is a daily surcharge for delayed payment or remittance of 0.05 percent of the tax unpaid or not remitted from the date the tax payment or remittance becomes due. If a taxpayer fails to make a declaration of tax, fails to pay or underpays the amount of tax payable, the tax authority will seek the payment of the amount of tax unpaid or underpaid as well as the surcharge for the delayed payment, and concurrently impose a fine exceeding 50 percent of, but not exceeding five times, the amount of tax unpaid or underpaid.

In the event of unpaid taxes or underpayment of taxes due to computing resource errors made by the taxpayer, the tax authority is granted the right to collect the unpaid or underpayment of taxes with surcharge within three years or to five years under special circumstances. If such unpaid taxes or underpayment of taxes are caused by the errors made by the tax authority, the tax authority has the right to collect the unpaid or underpayment of taxes within three years with no surcharge. There is no statute of limitation for tax invasion or similar acts.¹

In addition to assessing major risks and exposures relating to any underpayment of tax liabilities or non-compliance issues, it is equally important to identify any major tax schemes which cannot be rationally supported by the current tax law and regulations. This would impact the projected financial modelling that the buyer would conduct on the target's future business.

During the tax due diligence process, various transaction and business risks associated with the proposed acquisition may be identified. Having identified these risks, both the buyer and the seller may be able to take certain remedial actions to lessen or safeguard against such risks. It is crucial for potential deal breakers and risk areas to be identified and resolved early on in a transaction.

¹ These guidelines are valid as of May 2011.

The following table outlines some of the common issues and risks that can be identified through the tax due diligence process.

Table 10: Common issues and risks identified through tax due diligence in China

Complicated and unofficial ownership structure	Chinese companies often operate under an unofficial legal structure with respect to ownership of the assets used in the business. This can create exposures with respect to the inaccurate recording of revenue/expenses in the respective entities which would impact the tax position of each entity
Related party transactions	<p>Related party transactions in China may sometimes not be very transparent</p> <ul style="list-style-type: none"> • Terms may not be arm's length • Off-balance sheet guarantees of subsidiary/affiliate transactions or other liabilities may be present • Transactions are completed for the benefit of the "Group" rather than commercial reasons • Profits/losses are manipulated to minimise taxes on a group basis, and the related transactions are not supported by reasonable transfer pricing methodologies
Special deals with local tax authorities and unofficial tax concessions	Chinese companies may have special arrangements with local tax authorities for certain tax treatments which are not entirely consistent with current laws and regulations. In addition, tax concessions are often offered to companies without any written documentation or paper trail
Tax compliance	There may be tax compliance issues in Chinese companies. For example, not all required tax adjustments are made to the book for computing income taxes; claiming expenses without official invoices (i.e. the fapiaos); under-reporting of individual income tax liabilities; and under-reporting of VAT and customs duty
Aggressive tax schemes	Chinese companies may have implemented certain aggressive tax schemes to understate revenue and/or overstate expenses with the objective of minimising tax costs

Case study - Necessity of tax due diligence on small-scale subsidiaries

A US-based company acquired a company that has a small operating subsidiary in Northeast China. A due diligence exercise was performed on the US company but did not include a tax review on the Chinese subsidiary because it is relatively small in size.

Two months after the acquisition, the buyer found irregularities in the VAT and EIT reported by the local management in China. After a post-acquisition tax due diligence of the Chinese subsidiary, the buyer discovered that the under-reported tax liabilities, the associated interest and penalties amounted to several million US dollars. The exposure exceeded the expected amount the buyer had set aside in an escrow account.

4.1.3 Legal due diligence

A legal due diligence provides the buyer a view of the legal aspects/compliance of the target. This exercise involves an examination of the legality of asset ownerships such as licences, property rights, titles, and land leases; compliance with relevant laws and regulations; and outstanding legal issues as well as certain other areas. A legal review is especially important for a buyer making an acquisition in China as there may be issues such as:

- a lack of clarity on ownership;
- intellectual property infringement risks;
- expiration on land leases; and
- restrictions on foreign investors holding certain licences.

Legal due diligence is generally conducted by legal advisors. They typically will review all aspects of legal documentation and conduct research and interviews as necessary.

4.2 Business due diligence

Business due diligence provides information relating to a target's operations, commercial environment and business conduct. Generally, it covers integrity due diligence, commercial (market) due diligence, operational due diligence, information technology due diligence and human resources due diligence.

4.2.1 Integrity due diligence

Integrity due diligence provides a buyer key information on the target and its principals, and identifies potential risks related to Foreign Corrupt Practices Act (FCPA) compliance, fraud, reputation, litigation, tax evasion, and financial loss. It is an important exercise as issues identified are often deal breakers.

Generally, an integrity due diligence exercise will focus on:

- the target's business history and reputation;
- the track record of the principals and senior management of the target;
- sources of capital;
- involvement in litigation;
- central, provincial and local government licences, contracts and political connections;
- any conflicts of interest or non-arms length transactions or relationships;
- any side or competing businesses by existing or former employees or stakeholders; and
- where relevant, any links to organised crime or illegal activity.

Information is often gathered and analysed by external professionals through a combination of public record research, enquiries through well-placed and confidential external sources, and technical analysis on transactions and computer systems. Engaging professionals that have domain knowledge and experience is essential to obtaining reliable information and identifying anomalies.

Performing an integrity due diligence

Typically, four areas are covered by an integrity due diligence:

- **Integrity due diligence**

This exercise focuses on the areas previously mentioned, and involves checks of public filings on the target and its legal representatives, extensive searches of public domain open source information, site visits and enquiries with confidential resources.

- **FCPA (or equivalent) compliance review**

This review provides information that can assist in assessing the target's compliance with FCPA and China's local anti-bribery and corruption legislations. Key activities may include:

- collating information on employees, agents and consultants who may interact with government officials on behalf of the company, and departments, agencies, bodies and officials to whom payments were made by employees, agents and consultants;
- engaging analytic and forensic advisors and technology to analyse data to identify suspicious transactions;
- reviewing relationships with contractors, consultants and/or agents, assessing whether proper due diligence was undertaken and verifying that agreements are in writing containing appropriate anti-bribery clauses.

Case study - FCPA infringement in China

A US multinational pharmaceutical company in China engaged external resources to investigate potential FCPA infringement in China. The professionals found that over RMB10 million of product promotion expenses were fabricated and proceeds were used to bribe doctors to meet sales targets. The company was exposed to FCPA compliance, fraud and reputation risk.

The FCPA review resulted in a voluntary disclosure to the US SEC regarding FCPA infringements by the company. The company also implemented remedial actions including a thorough integrity due diligence on distributors, contractors, agents and third parties; improvements to controls, procedures, ethical reporting mechanisms; and development of a fraud response plan.

- **Fraud risk review (FRR)**

FRR provides a buyer with a pre-transaction "health check" on the target entity. The aim is to identify, assess and evaluate fraud and corruption risks associated with the organisation and its key management and employees. It involves a review to understand business operations and processes.

In China, a pre-transaction review enhances a buyer's ability to prevent, deter and detect fraud and illegal acts, thereby helping to avoid costly mistakes, regulatory sanctions and reputation damage post-transaction.

- **Forensic data gathering and analysis**

This entails utilising fraud detection software to extract, interrogate and analyse financial and electronic data to identify and detect anomalies, fraud and malfeasance. Often, data analytic technology is deployed to search for suspicious transactions or dirty data in electronic files and records. Valuable data and digital evidence, even if deleted, may be retrieved in a non-intrusive and evidentially admissible manner.

Case study - Fraud in China

A European food products manufacturer in China was concerned that some expenses related to the promotion of products in retail outlets throughout Guangdong were fraudulent. An investigation by external advisors found forgery of sales vouchers, receipts and chops, and unofficial and unconnected receipts for the tax bureau which were giving a false impression of legitimacy. In addition to financial loss, the company faced potential legal and reputation risk.

To prevent future fraudulent behaviour and mitigate risk, the advisors suggested remedial actions. These included improvements to controls and procedures, implementing training programmes to develop an ethical culture, developing a fraud response plan and "whistle-blowing" reporting

4.2.2 Commercial (market) due diligence

While China promises to be a growing and dynamic market for many businesses, it is also intensely competitive with a rapidly changing macro-environment that impacts not only a company's potential acquisition, but its customers and suppliers.

Commercial due diligence (CDD) focuses on a company's market, industry, competitors, and the likelihood of it achieving (or exceeding) its forecasts in the coming years. Typically, a well developed CDD approach will be based on the demands of financial investors and looks for potential post-transaction gains as well as identifying key risks. When conducting a CDD in China, the approach and output should also be modified where necessary to suit the Chinese market.

By conducting a commercial due diligence, the buyer is able to identify key risks in management plans and opportunities that may have been overlooked. Typically, the buyer will gain first hand insight into customer and supplier relationships and some benchmarking information to assist in the negotiation process. The buyer will also be able to develop potential action steps for post acquisition management.

Scope and approach of a commercial due diligence

The scope of a commercial due diligence is highly customisable to meet the specific needs of a transaction. A typical CDD might include a review on:

- **Market**

A market assessment as part of the commercial due diligence would typically provide an overview of the market in which the target operates and plans to develop. This may include identification of the key demand drivers, market segmentation, volatility drivers, regulatory issues, cost drivers, trends and other industry specific items.

- **Competition**

The evaluation of the competition typically starts with defining the competitive environment in which the target company operates. This may include industry profitability drivers such as the customer buying power, ease of entry, supplier strength, availability of substitutes and competitive intensity. This facilitates the identification of critical success factors and how the target and its competitors benchmark.

- **Company-specific items**

The company review initially focuses on the business model, strategy and its core capabilities. This enables the development of a sensitivity model and identification of potential areas of opportunity and risk. In conducting a commercial due diligence, the approach is highly geared towards primary research conducted in a compressed timeline. Much of the effort is spent on primary data and competitive intelligence gathering; the remainder is spent on analysing company specific information. This helps to overcome the relative absence of detailed market research reports.

Case study - Information accuracy

A manufacturing company was considering an acquisition in a new field. To determine how much manufacturing capacity existed in the target company, the buyer engaged experts that utilised a primary research approach coupled with local agencies and site visits to assist with the assessment.

The nature of information available in China makes it possible to access information that would not typically be available in western markets, but with suspect reliability. Experts with an ability to understand market drivers will provide insights to correct for reliability concerns.

Case study - Brand and distribution

A buyer was evaluating a potential acquisition in the retail sector in China and was concerned about brand and distribution. By utilising a mystery shopping approach, professional experts were able to quickly assess the current distribution channels, product range versus competitors and conduct an 'in-store' customer brand survey to advise the buyer on potential challenges and opportunities it would face post-acquisition.

4.2.3 Operational due diligence

Operational due diligence is part of the evaluation process to determine whether the potential target has the capability to meet a buyer's strategic objectives. It covers every aspect of a target's business operation, including:

- management;
- sales and marketing;
- procurement and supplier management;
- manufacturing;
- service delivery;
- supply chain;
- research & development (R&D);
- finance operations;
- information technology (see section 4.2.4 IT Due Diligence for more details);
- human resources (see section 4.2.5 HR Due Diligence for more details).

For all of the above, a buyer should gain a thorough understanding of the who, what, where, why, how, together with the corresponding costs, quality and time frames. The evaluation should be based on what the target is supposed to do for the acquiring company (for example, the synergy and the added capabilities) and not how it is doing as a standalone business. In other words, a target might be a solid company, but it might not be able to complement the business of the buyer (e.g., unsuitable market positioning and customer base).

The findings of an operational due diligence can be used to:

- validate assumptions of the financial projections (e.g., can the CAPEX investment level and staffing level support the projected growth, any commitments and potential contingent liabilities identified);
- identify gaps and synergy points of acquiring the target; and
- assess the level of difficulty to integrate.

Conducting an operational due diligence

A range of functional teams are involved in an operational due diligence initiative. Members of an operational due diligence team should be objective, and should be subject matter experts for their respective business area. Upon completion of information gathering and analysis, findings will be consolidated into a final report for review. Key due diligence deliverables that may result from an operational due diligence include but are not limited to the following:

- Comprehensive implications worksheet (executive level) - This worksheet is used by the due diligence team and acts as an issues log, tying a summary list of due diligence findings from the functional areas directly to possible implications for negotiation, valuation, deal structure, and integration planning.
- Due diligence output report (detailed level) - This report is a standardised summary of due diligence findings and includes issues by function, the criticality significance or impact issues have on valuation, integration, negotiation and deal structure. The report consolidates critical information for senior management to make final decisions.
- Function due diligence final report - This is a comprehensive report based on a functional perspective. It is written during detailed due diligence and contains assumptions and recommendations for acquiring the target company. The due diligence findings from each function will be used to develop the valuation model and assist with negotiations.
- Function due diligence communications plan - A communications plan should be specifically designed to outline necessary communications from a functional perspective, for example to notify target employees of pre-closing changes.
- Function minimum integration standards - These are guidelines that are defined to expedite the integration planning process, and may include non-negotiable integration requirements. Examples include the migration of financials for reporting, migration or interconnection of the IT systems to a common platform defined by the buyer, and the renegotiation of licenses and maintenance contracts.

Basic project tools that may be used for conducting an operational due diligence

- Cost/Budget worksheet - This worksheet is a project management aid that measures expenditures on due diligence efforts by individual and/or team, especially in efforts requiring significant team scale and international travel.
- Project work plan templates - These are planning tools used to coordinate activities of due diligence teams and to facilitate handoffs.

4.2.4 Information Technology due diligence

Information technology (IT) due diligence is a comprehensive assessment of the IT aspects for issues that affect the valuation, transition, and the overall value of the acquisition. However, IT is often overlooked in the M&A due diligence process. Without completing a proper assessment of the IT infrastructure and capabilities of a target, a buyer may significantly underestimate the magnitude, complexity, and cost of IT-related issues. There have been instances where companies have been forced to incur millions of dollars in additional costs during integration to address IT-related complexities that were not fully comprehended.

In essence, a comprehensive IT due diligence will generally allow a buyer to gain an understanding of:

- issues relating to the IT organisation of the target company that may affect the valuation, transition and the overall value of the acquisition;
- a target's information and telecommunications costs, risks and opportunities that will be important input into the pre-integration, negotiation and valuation processes; and
- areas where the target company can make improvements to increase the probability of success, i.e., to mitigate or avoid risks.

Scope of a typical IT due diligence

Most IT due diligence efforts will cover the following IT aspects of the target company. The exact scope may vary depending on the time and budget allocated to the project.

- In-flight projects - These are IT projects that are still in progress, which have not been completed at the time of the merger.
- IT costs (budget and actual) - This addresses the difference between the planned versus actual IT spending.
- IT approach/strategy - This entails an examination of the overall IT strategy for the organisation, both short- and medium-term.
- IT skill sets - An assessment of the skill sets of the current IT employees will highlight if there are any major differences between the skill sets of the target company and that of the buyer.
- Major application areas - This entails a review of both the hardware and software used in a target company, and includes ERP systems such as SAP, operating systems and databases, and the network architecture or topology.
- IT-related contracts - This involves an examination of the clauses and terms of any contract, long or short-term which may have a negative impact or present a risk to the buyer. An example would be an unfavourable service contract for the next 10 years.

IT due diligence execution

A comprehensive IT due diligence assessment involves developing a well-planned approach and may generally include:

• **Scoping and planning**

In this stage, the IT due diligence team will determine the completion time, framework, desired depth, breadth as well as the focus of the review. The team will also conduct an initial review of the availability of information resources.

• **Understand the business context**

It is important for the buyer to understand the industry trends and pressures, business and project objectives, and what effect these may have on the planned merger.

- **Understand major IT areas**

Part of an IT due diligence is to review the various applications currently in use, and gain an understanding of future IT strategies of both companies.

- **Identify risks and opportunities**

A buyer should understand the technology required to support business operations, the IT budget, and financial data of the target company. It is also important for the buyer to obtain information regarding a target's IT resources, processes and people. Occasionally, a buyer may want to review the financial and technology viability of the target's IT vendors as this could potentially pose a major risk in the long run if applications are no longer supported. Opportunities for cost savings, such as downsizing, outsourcing or establishing shared services, should also be considered.

- **Assess magnitude/impact**

To assess the magnitude of the opportunities or better understand the risks, the due diligence team needs to have a discussion with IT personnel and conduct site visits, and review financial statements and IT documents. Benchmarking a target's IT operations against best practices through consultation with outside consultants and industry experts is also recommended as part of the assessment.

Lessons learned in China

- Appoint senior IT resources to every due diligence effort, to ensure that the output of the due diligence is comprehensive and can be used in the planning stage of the IT integration itself
- Do not shortcut IT due diligence as it can be the source of expensive surprises later
- Check whether there are specific rules requiring that data stored in a target's systems need to be onshore, in particular if your target is in a regulated industry and there are integration plans to share regional/global databases. China has specific requirements on whether certain data can be stored offshore
- Voluntary turnover for IT talent with ERP implementation experience in China is over 20 percent, so be sure to assess the target's IT capabilities, make a retention plan for critical staff early in the process, and assume a higher degree of turnover
- Assess the extent of Chinese font data and reporting in a target's systems, especially if there are plans on centralising/integrating IT platforms post-acquisition. Plan for multi-byte language support and testing post-acquisition early on so that integration efforts can be properly managed

4.2.5 Human Resources due diligence

Human resources (HR) due diligence, although often neglected, is a critical exercise that should be conducted for all acquisitions, and especially in China. The labour laws and rules are complex and may differ depending on locality. Failure to conduct a proper HR due diligence exercise can result in damaging the future operations and integration of the two merged parties. For instance, there could be:

- potential penalties due to non-compliance with government laws or regulations;
- under/over provision of social securities;
- retirement obligation;
- an inappropriate labour cost structure;
- potential severance liabilities;
- potential culture conflicts.

Many successful M&A transactions rely heavily on the comprehensive delivery of the HR due diligence exercise.

Case study

An American electronic appliances company was preparing to engage in a joint venture with a Chinese enterprise and conducted an HR due diligence. In the investigation of the joint venture partner, a number of HR issues were raised, including employee retirement issues, under-provision of social insurance, and noncompliance with local labour regulations. Based on these findings, the US company was able to negotiate a more favourable deal and minimise risk.

Research conducted to measure M&A performance has suggested that HR issues identified and addressed early not only improves the chance of a deal's success, but also enables key issues that may occur during the post-M&A period, such as talent retention, HR policy and process integration, and the development of HR management programs, to be resolved earlier. This is particularly important in the Chinese market as people management can be a challenging task and is often overlooked in businesses.

Some of the main activities covered in an HR due diligence initiatives may include:

- HR management policy and processes review;
- organisation effectiveness assessment;
- corporate culture assessment;
- talent assessment;
- labour cost analysis;
- a review of management practices in regards to compensation and benefits;
- labor law compliance review; and
- HR information system review.

Common issues identified in China through the HR due diligence process

- Unclear HR policies may be in place
- Lack of employment contracts or director service contracts for key management
- Statutory employee welfare requirements may not be fully met
- Possible under-reporting of liable Individual Income Tax

4.3 Internal controls due diligence

Internal controls of some Chinese companies may not be sophisticated. Therefore, an internal controls due diligence may need to be performed to evaluate the target company's control environment, processes and procedures and the internal controls embedded therein for key business areas. This assessment will validate whether a target company has:

- set the right tone at the top in terms of the control environment, e.g., ethical values, integrity, commitment, governance, management philosophies, authority assignment;
- an appropriate governance structure;
- process and procedures to capture business transactions; and
- transaction data that is recorded and reported correctly, completely and timely, and that the recorded transactions are valid.

By conducting an internal controls due diligence, the buyer will be able to understand and make acquisition decisions based on the level of integrity and reliability of the financial information provided by the target company, and the underlying risk attached to the financial figures where adjustments may need to be made to the financial statements. This exercise can also identify potential control weaknesses and risks, and provide insights on the areas for improvement in the target company.

The findings from an internal controls due diligence often are used as points for negotiating deal terms and price. They also provide the buyer the ability to assess the costs and efforts required to improve the deficiencies post-acquisition.

Internal controls due diligence is typically conducted on two levels of controls: entity level controls and process level controls.

- **Entity level controls**

Entity level controls are internal controls relating to the overall management of a company. An entity level control review usually involves interviews and/or questionnaires, and where necessary, a review of selected company documents. Areas for consideration when conducting a review should include:

- Does management commit to character, integrity, and high ethical values when presenting company financial data?
- Does the company have a corporate governance structure that promotes an authorised decision-making process, monitors decision execution and prevents management override?
- Is accountability and control aligned with responsibility and authority assigned?
- For group companies, how does the parent company govern its subsidiaries?
- How well does management understand internal controls requirements?
- Does management commit to competencies?
- Does management have appropriate qualifications and experiences?
- Does the company have a risk assessment mechanism?
- Does the company have effective and efficient communications channels?
- Does the company have an effective monitoring mechanism?

- **Process level controls**

Process level controls relate to control activities in major business processes. Similar to an entity level review, a process level control assessment involves interviews and documentation reviews.

A typical process level control assessment will:

- identify major business activities and group them by business processes. Major business processes may include revenue, procurement, fixed asset management, inventory management, treasury, financial reporting and closing, human resources and payroll, and general computer controls;
- review company processes and procedures to determine the accuracy, reliability, completeness and validity of the data generated from business transactions and processed for financial reporting. The analysis is often conducted for major classes of transactions identified for each business process including routine and non-routine business transactions, and related party and inter-company transactions;
- evaluate controls embedded in processes and procedures to determine if they are effectively designed and operated to address identified risks;

- document identified control deficiencies, potential issues and risks, and recommend solutions to improve internal process controls.

4.3.1 Performing an internal controls due diligence

The Committee of Sponsoring Organisations of the Treadway Commission (COSO) issued an internal control integrated framework in 1992. The COSO internal control framework has since been widely adopted in China by enterprises to better control their business activities to achieve established objectives and goals. The COSO internal control framework consists of five control components - control environment, risk assessment, control activity, information and communication, and monitoring.

An internal controls due diligence review is generally conducted based on the five COSO components covering both entity level controls and process level controls.

• Control environment

The control environment is the control consciousness of an organisation. It is the environment in which people conduct business activities and fulfill their control obligations. The control environment includes both intangible and tangible elements such as integrity and ethical values; board of directors and board committees, commitment to competence; governance and organisation structure; management philosophy and operating style; assignment of authority and responsibility; human resource policies and practices etc.

Management influences the control environment of an organisation by setting the "tone at the top". This involves implementing standards through actions and effectively communicating written policies and procedures, a code of ethics, and standards of conduct.

An effective control environment exists when employees understand their responsibilities, authority, and are committed to acting ethically.

• Risk assessment

One of the most critical challenges management face is to determine how much risk the company is prepared to accept as management strives to achieve business goals and objectives. Risk assessment starts with identifying risks associated with business objectives linked through all levels of the organisation. It requires an evaluation of both external and internal factors. The identified risks should be assessed by understanding their impact on strategies, operations, financial reporting, and compliance, and evaluate the preparedness of the company to respond to those identified risks.

Risks are analysed to determine how they should be managed. Risk responses to avoid, accept, reduce or transfer risk should be selected in line with a company's risk tolerance and risk appetite. Accordingly, policies and procedures should be established to effectively carry out the risk responses.

There are a number of techniques that can be employed in risk assessments. The most common approaches include the Control Self Assessment (CSA) and the COSO Enterprise Risk Management Integrated Framework (COSO ERM framework).

• Control activities

Control activities are policies and procedures that help to ensure identified risks are properly managed and corresponding actions are executed in a timely matter. Control activities focus on the prevention, detection and correction of risks, and should be embedded within the operations of a business so that risks can be managed to reasonable levels.

Control activities may include:

- setting approval, authorisation, and verification levels and requirements, e.g., delegation of authority;
- performing specific functional or activity management activities, e.g., reconciliations;

- reviewing performance indicators, e.g., key performance indications, operational and financial metrics;
- establishing physical controls, e.g., securing physical assets;
- segregation of duties, e.g., custody, authority, recording;
- implementing information systems controls, e.g., security access to data;

In addition, as part of control activities, follow up disciplinary actions should be documented, communicated, and consistently administered for non-compliance.

- **Information and communication**

In a well managed organisation, relevant external and internal information is identified, captured, processed, and communicated throughout the organisation in a timely manner. This includes communicating employee duties and responsibilities and developing open communications channels with customers, suppliers, regulators and other external parties.

Management is responsible for ensuring that communication is fluid upwards, downwards, and laterally throughout the organisation. Different forms of communications are used to effectively distribute information within an organisation, and can include verbal communications (e.g., meetings, feedback), written communications (e.g., policies, procedures, job descriptions), and actions taken by management.

The integrity and quality of information communicated and shared within an organisation is imperative for making business decisions. Hence, internal control mechanisms are required to provide reasonable assurance that the information obtained is appropriate, current, timely, accurate, and easily accessible.

- **Monitoring**

Monitoring activities should be built into normal, recurring operating activities of an organisation. The scope and frequency of monitoring activities depends on the risks identified, and should take into consideration the level of impact they have on operations and the controls established in reducing them.

The performance of internal controls should be assessed through ongoing monitoring of operations over a period of time and by separate evaluations conducted periodically, e.g. periodic reviews conducted by internal audit function.

A well-defined escalation process for reporting deficiencies should be established so that accountabilities are assigned and appropriate corrective actions are conducted to improve internal controls.

A report will generally be compiled for the buyer upon completion of the internal controls due diligence. This report will document deficiencies, corresponding impacts on operations and potential risks, and recommendations for improving internal controls.

4.3.2 Other considerations related to internal controls

A listed company should understand whether there are regulations on internal controls that it must comply with before and after the M&A transaction is completed. Accordingly, the company will need to consider compliance costs and efforts needed during transaction execution. Key questions for consideration include:

- Will the company be able to get ready on time?
- What is the likelihood that the company will fail the compliance? What would be the impact/risk if compliance is not met?
- What are the major challenges and obstacles to achieving compliance?
- Does the company have enough resources and capabilities to achieve compliance?

It is common practice to have an internal controls due diligence performed by external resources. Professionals with the knowledge and experience in internal control, risk assessment and M&A transactions may be engaged to provide the buyer a comprehensive and high quality analysis of the situation.

Case study

A US-listed paper and wood products company that was in the process of acquiring a medium-density-fibre (MDF) manufacturer in China engaged risk and control professionals to execute an internal control due diligence review. The exercise included interviews, observations, review of documents and walk-through tests.

A comprehensive report on the target's overall control environment, significant control deficiencies, and a general process description of all major business cycles provided the US company an understanding of the target's major risks and control weaknesses as well as the potential impact on the target's financials. This became an important consideration for business projections and thus in deal price negotiation.

The due diligence also helped the company in assessing the target's ability to comply with Sarbanes-Oxley Section 404 and helped form the post-acquisition integration plan at an early stage.

4.4 Negotiations

4.4.1 Role of the lead advisor

The lead advisor can play a key role in the negotiation process. In addition to managing the many professional advisors involved, including legal advisors, accountants, tax advisors and valuation specialists, the lead advisor provides negotiation support throughout the deal execution process. In supporting the buyer, an experienced lead advisor will generally help to understand and evaluate risks, advise on deal structuring techniques to gain competitive advantage, consider the maximum purchase price that can be paid for the target, and compare any premium with the expected value creation to maximise shareholder value.

During negotiations, the lead advisor generally should support a buyer by:

- developing the initial strategy to be applied to kick off the negotiation process;
- mapping the sequence of steps to be used in the negotiations;
- advising on the transaction details proposed and counter-proposed; and
- developing responses to counter-offers made by counter-parties.

4.4.2 Forms of negotiations

The objective of negotiations is for the buyer and seller to agree on a price and structure that is acceptable to both parties.

For a **privately-held company**, there are two ways of conducting negotiations:

- **Private negotiation**

This form of negotiation maintains a high level of confidentiality whereby a buyer will request to have exclusive rights to negotiate with the potential target for a defined period of time. The buyer will also be the only bidding party that will have access to confidential company information.

- **Private auction**

A private auction amplifies competition between buyers, and generally contains more restrictions for the seller.

Private auction and state-owned assets

The disposal of state-owned assets in China is mostly carried out through auction. The PRC government maintains a host of restrictions on the underlying selling procedure. The most common restriction is the limiting of representations and warranties. Furthermore, if the number of final bidders for any auction is less than an ideal number and the final offer price is less than a pre-set minimum price, the government will generally have the right to terminate the selling process.

If the target is a **publicly-listed company**, the acquisition can only be conducted through a public offer where special considerations apply.

- **Public company offer**

Regulations require that an offer to acquire a public company be open for a minimum period of time to allow shareholders the opportunity to evaluate the price offered by the bidder. During this time, shareholders often compare the offered price per share to the pre-announcement share prices in their decision-making process. However, very often, rumours on a potential offer may exist prior to the official announcement. Regardless of the nature of the bid (friendly or hostile), such rumours may cause a rise in the share price, and make a bid less attractive when the public announcement is made. Accordingly, a buyer should consider discretion when making an offer for a public company.

Deal breakers

Despite efforts in negotiations, in some instances, a deal may not be carried through completion when agreement cannot be reached between the buyer and seller.

Common reasons that may lead to a termination in negotiations include:

- a gap in price expectations;
- disagreement in the form of payments (e.g., cash versus shares);
- inability to agree on payment terms (e.g., lump-sum or in instalments);
- differing preferences on specific structures (e.g., earn-out payments, put options, etc.);
- demanding representations and warranties in the Sales & Purchase agreement; and
- unresolved issues or irregular findings from the due diligence exercise.

4.4.3 Financing structure

A buyer should determine the appropriate financing structure. With a clear view of the target's financial position and a purchase price determined, a buyer should review its own financial resources and consider if additional funding is required. A buyer should also bear in mind the total funds required for the transaction, which include costs relating to due diligence, restructuring, advisory fees, and integration efforts.

While looking for the most appropriate way to secure financing, a buyer may consider liquidating or selling specific assets of the target business to partially finance the transaction. In such cases, professional advice should be sought to obtain optimal pricing for such assets within a reasonable timeframe.

4.4.4 Pricing strategy

After completing the due diligence process, a buyer may modify a deal structure or the projected financial model to incorporate findings and outstanding issues to achieve an optimal pricing structure.

Some common modifications in pricing strategy that a buyer may undertake include incorporating:

- a **put option** if the target cannot justify financial objectives;
- **drag-along** or **tag-along rights** to include minority shareholders into the negotiation; or
- an **earn-out clause** to attach a portion of the transaction price to company performances in the upcoming years.

However, under the current regulatory framework in China, regulations may limit the utilisation of an earn-out clause in an M&A transaction by requiring all consideration to be paid within a certain timeframe. Therefore, care should be exercised and planning would be necessary to structure the earn-out provision to meet both parties' objective while still in accordance with the existing rules and regulations in China.

By using these tools, a buyer may be able to negotiate concessions into the final transaction price.

4.4.5 Synergies and post-acquisition issues

Upon completion of the due diligence process, it should be possible for the buyer to identify major post-acquisition issues. Operational issues such as HR, IT systems and internal control processes are areas that should generally be planned prior to deal completion. For example, retention of key personnel is usually critical for the integration of the newly-acquired company during the period following the acquisition. Similar kinds of issues should be addressed early in the acquisition process.

Other post-acquisition issues, such as non-transferable assets, service agreements, supplier and vendor arrangements, noncompliance of tax-related issues, to name a few, should also be addressed so that the purchase price, or value of a target, can be adjusted accordingly to take into consideration issues that may arise from the transaction.

4.4.6 Purchase price adjustment mechanisms

When negotiating the terms of an acquisition, a buyer should always consider the need for a purchase price adjustment mechanism. **A purchase price adjustment modifies the price paid to purchase a company based on a comparison of a preliminary, predetermined value with a value calculated at a later time.** For example, an investor finalises a bid price based on (i) a valuation which incorporates a balance sheet value as of the end of December in one year but does not expect to close the transaction until sometime in the following year, or (ii) an expected balance sheet value to be delivered at closing. The investor should have a right to adjust the bid price based on the value of the balance sheet ultimately acquired.

Typically, purchase price adjustment clauses included in a definitive purchase agreement should provide for the preparation of a closing date financial statement (e.g., a closing date balance sheet) from which a financial measure such as working capital or net assets is derived. That closing date measure is compared to the historical or predetermined balance sheet upon which the original bid price was based (the "reference" balance sheet) and the purchase price is adjusted (often, dollar for dollar) based on the increase or decrease between the two measures.

With this in mind, it is important that a buyer establish what would constitute a normal level of working capital during financial due diligence to ensure that the buyer will not need to obtain additional financing post-transaction to fund working capital.

Example of a purchase price adjustment

As a simple example, assume a negotiated purchase price of US\$50 million is based on a multiple of EBITDA and working capital at closing of US\$25 million. However, when the transaction closes several months later, the actual working capital delivered to the buyer is US\$22 million. Under the terms of a plain vanilla purchase price adjustment, the contractual purchase price would be reduced by US\$3 million to a final purchase price of US\$47 million.

Some of the issues generally considered with respect to purchase price adjustment mechanisms include:

- what metric to use - net assets, working capital, etc.;
- what balance sheet accounts to include/exclude;
- how to define net assets or working capital;
- what basis of accounting (i.e., GAAP) to use - IFRS, US GAAP or some other basis;
- consistent application of accounting rules (i.e., conflict between historical practices and pure application of GAAP);
- whether or not to require an audit;
- need to create an escrow account (holdback of purchase price) from which to settle any purchase price adjustment;
- protocol with regard to how to resolve any adjustment dispute(s) between buyer and seller.

The issues that can arise in the design of provisions for a purchase price adjustment are frequently numerous and complex, especially in a cross-border environment. This is also true for the proposed mechanism to resolve any resulting disagreements with respect to a purchase price adjustment (e.g., arbitration).

In summary, purchase price adjustment mechanisms can be extremely tricky but may be an effective means by which to preserve value. When negotiating and structuring purchase price adjustment mechanisms, buyers can seek counsel from their financial advisor, accountants and legal counsel.

Purchase price adjustments may seem to be mere true-up calculations. However, they can also be used as part of an overall M&A strategy. When protected by an effective purchase price adjustment mechanism, a buyer can offer a higher "headline" purchase price with an intention to partially recoup some of these funds after closing.

4.5 Regulatory considerations

As of May 2011, regulations that apply to mergers and acquisitions in China include, but are not limited to:

- Administrative Measures on Strategic Investments in Listed Companies by Foreign Investors (《外国投资者对上市公司战略投资管理办法》) (see Appendix 1 for details);
- Provision on Merger and Division of Foreign Investment Enterprises (《外商投资企业合并与分立的规定》) (see Appendix 2 for details);
- Rules on Merger and Acquisition of Domestic Companies by Foreign Investors (《关于外国投资者并购境内企业的规定》) (see Appendix 3 for details);
- Measures for the Administration of the Takeover of Listed Companies Procedures (《上市公司收购管理办法》) (see Appendix 4 for details).

Consent from the relevant regulatory body is required in some instances for:

- a change in control;
- the acquisition of a minority interest; and
- the disposal or amalgamation of a regulated business.

China has continued to encourage mergers to create large, competitive local conglomerates that can compete with large foreign enterprises. This creates a massive drive for thousands of private and state-owned enterprises to be merged and acquired in the coming years. Foreign investors will likely be invited to participate in this development program. Under PRC regulations for cross-border transactions, a foreign investor may acquire PRC companies either by acquiring the target's equity or assets.

If the buyer wants to acquire the Chinese target's **equity** directly (existing or newly issued shares), the foreign investor will be subject to various registration, validation or approval procedures from different approval authorities, e.g., CSRC, SAFE, MOFCOMM, SAIC, etc. In the case of an **asset acquisition**, certain approval may also be required. When an indirect acquisition is conducted off-shore, the foreign investor may acquire equity in a special purpose vehicle (SPV) which may hold the business in China. Although the transaction is outside the PRC jurisdiction, it may still need to obtain certain relevant government approval as the main assets of the SPV are in China.

Depending upon the size of the investment and the industry the business operates in, approval authorities may be elevated to the Central Government in Beijing, which may lengthen the time required to obtain approval. Therefore, these issues should be considered at a very early stage.

If the transaction involves a state-owned enterprise (a number of SOE's are being made available for restructuring or partnering with foreign firms), then special approvals may be required. When SOE's or state-owned assets are involved, a valuation process by an official valuer may be required to determine the purchase price of the deal. The purchase price cannot be significantly different from the appraised value by the official valuers. In practice, the discrepancy may need to be limited to 10 percent of the appraised value in certain locations.

China is still a foreign exchange controlled country. Therefore, foreign exchange-related regulations must be complied with when structuring and executing an M&A transaction. For example, a government approval and registration process must be completed before a SPV can be set up outside of China by Chinese nationals (including Chinese corporations and individuals) to purchase businesses or operate businesses in China. If such initial approval or registration process is not complied with by the original Chinese owners, a foreign investor's indirect purchase of the SPV (which owns the business in China) may present certain legal validity issues. Legal advice should be sought in this type of situation.

Furthermore, following China's accession to the World Trade Organisation, many industry sectors which were previously restricted for foreign investment have since been opened. However, majority ownership in a few industries is still restricted, including rail freight transportation and telecommunications. Compliance with the Catalogue on Industries for Foreign Investment must be met.

4.6 Financing considerations for foreign investors

An acquisition of a Chinese target can be financed by the foreign investors directly, as a form of direct investment, or indirectly through an intermediate holding company (including the Chinese operating company, a Chinese Holding Company (CHC), or an offshore holding company among others). However, each structure requires careful analysis with respect to its regulatory and operational feasibility and tax efficiency.

4.6.1 Debt-to-equity ratio

In China, certain regulations exist which provide guidelines (limits) as to the ratio between the amount of equity and debt that can be used to finance a business. For most foreign businesses in China (except for joint stock companies, whose capital is represented by shares), capitalisation is represented by the amount of registered capital. The amount of "registered capital" is different from the "total investment", which generally refers to the total amount needed for business operations (including capital expenditure and working capital). **A company's registered capital and its total investment amounts must be registered with the PRC authorities at the time of business formation.**

Generally speaking, the maximum foreign currency borrowing capacity of a company is the difference between the total investment amount and the minimum registered capital. The minimum registered capital for foreign invested enterprises in China are as follows:

Table 11: Investment amount versus minimum registered capital requirements in China (as of May 2011)

Total investment amount (in US\$)	Minimum registered capital (in US\$)
0 - 3 million	70 percent of total investment
3 - 10 million	50 percent of total investment, but no less than 2.1 million
10 - 30 million	40 percent of total investment, but no less than 5 million
> 30 million	33-1/3 percent of total investment, but no less than 12 million

The maximum allowed foreign debt-to-equity ratio can be calculated from the above.

For example, for a company with a total investment amount of US\$2 million, the minimum registered capital requirement would be US\$1.4 million, and the maximum foreign debt-to-equity ratio would be 3:7 (maximum foreign currency borrowings of US\$600,000). For a CHC, the requirements are slightly different. CHCs with a paid-up capital of less than US\$100 million have a debt-to-equity ratio cap of 4:1. For CHCs with a paid-up capital of US\$100 million and above, the ratio should not exceed 6:1.

4.6.2 Loans

Loans are one method of financing an M&A project. The buyer can take out a loan overseas, and then inject the capital into China for the acquisition. A foreign investment enterprise (FIE), whether it be an operating company, a holding company, or any other structure, can also take out loans in either RMB or foreign currency, up to the total amount as allowed under the aforementioned debt-to-equity ratio.

In China, there are generally two kinds of loans - foreign and local. Foreign debt consists of loans denominated in foreign currency, loaned through foreign banks by foreign parties. All foreign currency loans must be registered with and approved by SAFE². It is important to note that whether the maximum amount of foreign loan can be borrowed depends on the percentage of registered capital already contributed, and whether it has been contributed according to the schedule as prescribed by law. If not, the SAFE will not allow the registration of the loan, which means that remittance of the interest and principal repayment would not be allowed. In practice, RMB loans from a local bank are generally not restricted, although foreign guaranteed RMB loans can, in the case of default, require registration with the SAFE as foreign debt.

The interest payment on cross-border loans generally causes the company to incur a 10 percent withholding tax (WHT) on the gross amount, although this may differ slightly in certain countries where its tax treaty with China dictates otherwise. Debt funding may create tax savings at the FIE level, as interest expenses may be tax deductible. For companies whose income tax rate is higher than 10 percent, the difference between the deductible interest expense and the 10 percent withholding tax rate could translate into potential tax savings. For companies enjoying a tax holiday, possibilities exist for interest deferral or stepped interest arrangements in which a higher interest is paid out in the later years of the loan. However, such structures require careful planning that takes into account transfer pricing and related issues, and would generally require clearance from the local tax authorities prior to implementation.

However, interest expenses arising from inter-company loans would be non-deductible if the loans exceed certain debt-to-equity ratios for thin capitalisation, unless that the FIE could provide relevant documents and prove the transaction activities being carried out at arm's length, or the actual tax liability of the FIE is not higher than that of the related party located in China. The debt-to-equity ratio for thin capitalisation is different than the debt-to-equity ratio required in section 4.6.1 which pertains to the legal requirements of the company. The thin capitalisation debt-to-equity ratio is 5:1 for financial institutions and 2:1 for all other companies.

4.6.3 Foreign exchange restriction/profit repatriation

Companies may use the repatriated profit from an FIE to fund the M&A project. However, there are certain PRC laws that regulate foreign exchange and cash repatriation.

Generally speaking, **the repatriation of any and all PRC earnings to a foreign parent is restricted**³. The SAFE and its local branches and designated banks serve as the approval authorities for such remittances. For certain types of trade payments, bank review and approval is sufficient. For non-trade payments, approval requirements differ depending on the amount of the remittance.

The following chart provides a general guideline:

Table 12: Approval requirements (as of May 2011)

Amount of remittance (in US\$)	Requires approval by:
0 - 100,000	The remitting bank
100,000 - 500,000	The local branch of the SAFE
> 500,000	The central SAFE in Beijing

² As of May 2011.

³ As of May 2011.

In general, remittance items that are clearly permitted and regularly processed (e.g., dividends) are usually approved and processed with few obstacles. For other items, especially where potential taxability is an issue, approval and processing may take quite some time, if granted at all.

The probability of a successful approval may rest on the local tax authority, the SAFE, and the individual remitting bank's attitude towards the item at hand.

As mentioned above, dividends distribution is a clearly permitted and regularly processed method of profit/cash repatriation. A 10 percent PRC WHT is generally levied to foreign investors on dividends out of profits which are generated after 1 January 2008. The withholding tax rate may be further reduced under certain tax treaties. Dividends are generally distributed annually; interim dividend distributions are rarely done in practice due to unclear guidelines and difficult implementation, though allowable in theory.

Points to note on debt pushdown

When pursuing a debt pushdown arrangement, it is important to note the related regulations in the countries involved. Also the parent company must consider whether the interest payments from the loan arrangement can be tax exempt at the parent company level. For the Chinese entity, the 10 percent WHT on interest payments generally apply. For debt pushdown schemes, the benefits and applicable regulations depend on the countries and entities involved in the arrangement as well as any applicable treaties between the countries.

4.6.4 Debt pushdown

In instances where the foreign company does not wish to increase its amount of debt or cannot benefit from further interest expense deductibility, debt pushdown, or the "push down" of debt to a local Chinese entity is a potential arrangement. This can be done both directly and indirectly, possibly through holding companies in jurisdictions with favourable tax treaties. However, as stated above, the debt-to-equity ratio restrictions must be observed.

By pushing the debt down to the local Chinese level, the Chinese company may enjoy tax deductions, and the foreign company may get easier access to cash (repatriation of principal and interest payment on debt is much quicker and less restrictive than the foreign exchange remittance process as described above). The increased freedom of repatriation frequency and timing when compared to a dividend distribution is another benefit of debt pushdown arrangements.

4.7 Deal structuring

4.7.1 Overview

A buyer should generally structure the transaction taking into account the needs expressed by the seller as well as its own requirements. There are many ways to structure and specify terms for a transaction. Essential to formulating the optimal transaction structure, the buyer and, in most instances, with the assistance of a financial advisor should:

- conduct a scenario analysis on different possible transactional structures;
- evaluate the financial impact on the company for each scenario; and
- identify and determine the appropriate deal structure.

A buyer can either buy the shares from existing shareholders or directly acquire the assets from the target company. Acquiring shares tends to be more popular than acquiring assets because:

- all shareholders of the acquired entity will share the risks of the merger;
- an asset acquisition may require obtaining consent from third parties not directly involved in the transaction; and
- tax considerations (see section 4.7.3 Tax Structuring for more details).

As of May 2011, PRC laws pose certain restrictions on structuring foreign investments depending on the nature of the investment as well as the industry it operates in. There are also complex laws and regulations on foreign-owned enterprises where foreign ownership exceeds 25 percent, and possible SPV's where the entire transaction is kept offshore.

In addition to the financial structure of the deal, buyers may also consider management, assets, tax and financing issues so that the transaction can be structured to better meet the needs of all parties.

- **Continuity in management**

The continued employment of management is often subject to considerable negotiation. A buyer often considers the management team as a key asset in an acquisition, particularly if the buyer is a financial investor. Under such circumstances, employment agreements are often negotiated with key people, specifying terms, responsibilities, remuneration, and equity participation. Buyers should recognise that retaining existing management would provide continuity in business operations while slowing down cultural integration differences.

- **Real estate**

In China, many owners may structure their business so that the company owns the operating assets (e.g., inventories and receivables) while the owner personally owns the non-operating assets (real estate). Owners would then lease the real estate back to the operating company. Hence, buyers may want to consider the lease terms as part of the negotiation.

- **Consideration**

The consideration a prospective buyer can offer to a seller may be in the form of cash, notes, stocks, shareholders loans, or a combination of the above. Since each form of consideration has different implications and liquidity, the transaction price may be subject to further negotiation depending on the form of consideration offered. The two most common forms of consideration are cash and stock. Table 13 summarises the characteristics of each.

Table 13: Key characteristics of cash and stock considerations

Key characteristics	
Cash	<ul style="list-style-type: none"> • A liquid financial instrument • Simple exit for target shareholders • Increases bid credibility and attractiveness • Can be paid in instalments - but will create a collection risk and a discount for time value of money
Stock	<ul style="list-style-type: none"> • A less liquid financial instrument, particularly if the company's shares are not publicly traded, or is not liquid enough for a small cap stock • Increased complexity as there is a need to determine both the buyer's share value and the target's fair market value • The seller will share benefits and risks of the transaction by: <ul style="list-style-type: none"> - assuming the risk that the buyer's shares are over-valued - taking benefit of future synergies

• **Contingent payouts**

During price negotiations, point of views might diverge on business forecasts. The buyer may believe the growth rate will be lower than what the seller presents. Considering that the price might be based on forecasts provided by management, it is critical to make sure that the figures are as accurate and achievable as possible. One way to break the impasse may be a contingent payment agreement, where additional payments will be made only if the company meets certain pre-defined goals after the transaction is completed.

• **Exit strategy - tax consideration**

Evaluating tax effects can be complicated when exiting an investment or operations in China. An investor not only needs to consider local (China) tax consequences, but also home country tax effects, and the effect on its global tax situation, if any. Good planning will help to reduce the ultimate liabilities upon exit as different structures may yield vastly different tax results.

Before signing any Sales & Purchase Agreement, both parties should understand that there is a chance the deal may not happen for the following types of reasons:

- a potential candidate may receive a better offer after the exclusivity period ends;
- the shareholders of the target company may ask for a higher price; or
- findings from due diligence may reveal issues or may not meet expectations.

There are many reasons which may stop the M&A process. Whether a company will want to search and pursue another target will depend on a number of factors - strategic need, business conditions, morale of the M&A team, and time already spent.

4.7.2 PRC M&A enterprise income tax framework

Effective from 1 January 2008, under the relevant rules and regulations governing the Enterprise Income Tax (EIT) issues on M&A activities in China, a transaction is classified as an ordinary reorganisation or as a special reorganisation:

- **Ordinary reorganisation**

- Any taxable gain/loss for the transferor of assets/equity is recognised at the time of the transaction.
- The amount recognised will be the difference between the fair market value (FMV) and the original tax basis of the equity and assets transferred.
- Tax basis represents the tax value of an asset/equity which is used to calculate the gain or loss when the asset/equity is sold.
- In an ordinary reorganisation, the acquirer's tax basis of the assets/equity received is "stepped up" to post-transaction FMV.
- In general, the net operating losses (NOLs) may not be carried over or utilised in a merger or split.

- **Special reorganisation**

- A transferor may elect to defer recognising gain/loss on transactions for EIT purposes provided that certain criteria have been fulfilled.
- One of the major criteria for qualifying as a special reorganisation is that the transaction should involve a large portion of equity consideration (i.e., stock-for-stock or stock for assets).
- Gain/loss relating to the portion of non-equity consideration should be recognised upon the time of transaction.
- In a special reorganisation, the acquirer's tax basis of the assets/equity received will be the same as that of the transferor immediately before the transfer, i.e. carryover basis, with adjustments from the gain/loss relating to the portion of non-equity consideration.
- NOLs may be carried over to the merging enterprise/split enterprise with a certain limit under different situations.

To qualify as a special reorganisation, the following five conditions must be met:

- i. **Bona fide business purpose**

The reorganisation must have a bona fide business purpose and the primary purpose is not to reduce, avoid or defer tax payments.

- ii. **Amount of equity/assets transferred**

At least 75 percent of the equity interest in the acquired enterprise must be acquired in an equity acquisition or at least 75 percent of the transferring enterprise's assets must be acquired in an asset acquisition.

- iii. **Continuity of business operations**

There must be no change in the original operating activities within 12 months after the reorganisation.

- iv. **Amount of equity consideration**

At least 85 percent of the total consideration received must be in the form of shares. In other words, at most, 15 percent of the total consideration can be non-equity.

v. Continuity of ownership

The equity acquired by the original major shareholders should not be transferred within 12 months after the acquisition.

Additional conditions for cross border reorganisations:

Scenario 1 - Foreign-to-foreign

- A non-resident enterprise transfers the shares of a resident enterprise to its 100 percent directly owned non-resident enterprise;
- Such transfer would not lead to a change in the capital gain withholding tax burden arising from the subsequent transfer of the enterprise's shares; and
- The transferring non-resident enterprise issues a written undertaking to the in-charge PRC tax bureau providing that it will not transfer the shares of the acquiring non-resident enterprise's shares within 3 years.

Scenario 2 - Foreign-to-domestic

- A non-resident enterprise transfers the shares of a resident enterprise to its 100 percent directly owned resident enterprise.

Scenario 3 - Outbound investment

- A resident enterprise invests in its 100 percent directly owned non-resident enterprise in the form of assets or equity.

Scenario 4 - Others

- Other cross-border reorganisations approved by the Ministry of Finance and the State Administration of Taxation.

Treatment of tax incentives under merger and split

In an absorption merger, where the eligibility and conditions of tax incentive entitlement of the surviving enterprise have not been changed, the surviving enterprise can continue to enjoy the pre-merger unused tax incentives carried over after the merger is completed. The amount of tax incentive entitled to by the surviving enterprise is determined based on the taxable profits (zero if loss) of the pre-merger enterprise in the year preceding the merger.

Where there is a merger under ordinary reorganisation, the surviving enterprise is not entitled to the unused tax incentive of the merged enterprise. On the other hand, if a merger is qualified as a special reorganisation, the unused tax incentive entitled by the merging (surviving) enterprise should follow the relevant rules under which all EIT attributes of the merged enterprise would be carried over to the merging (surviving) enterprise.

In the case of a split where the enterprise being split has a tax holiday and it continues to exist post-split, where the eligibility and conditions of tax incentive entitlement of the enterprise being split have not been changed, the enterprise being split can continue to enjoy the pre-split unused tax incentives carried over after the split is completed.

The amount of tax incentive entitled to by the enterprise being split which continues to exist post-split is determined based on the following formula:

$$\frac{\text{Taxable profits (zero if loss) of the enterprise being split in the year preceding the split}}{\text{Total assets of the enterprise being split}} \times \text{Assets being split}$$

When a split is qualified as a special reorganisation, the tax incentive entitled to the split (surviving) enterprise should follow the relevant rules under which all EIT attributes of the enterprise being split would be carried over to the split (surviving) enterprise.

The above descriptions on M&A EIT rules do not cover other tax implications, such as business tax, VAT etc., arising from enterprise reorganisation.

4.7.3 Tax structuring

A foreign investor can acquire a Chinese entity either directly or indirectly by acquiring the shares of the Chinese entity, its overseas intermediate holding company or by acquiring its assets. Various factors should generally be considered in determining whether to acquire the shares (directly or indirectly) or the assets of the Chinese entity. The following is a summary of characteristics typical of a share acquisition and an asset acquisition.

The EIT implications described below are under the assumption that the transactions involved are classified as ordinary reorganisations only.

Table 14: Characteristics of a share acquisition and an asset acquisition under ordinary reorganisations

	Share acquisition	Asset acquisition
Operations	<p>Business operations will continue after acquisition. Various business contracts, licences and employment contracts will remain unchanged.</p> <p>Interruption to the business and additional operational costs that may be incurred due to the acquisition could be minimised.</p>	<p>Various business contracts, licences and employment contracts need to be re-negotiated and re-signed by the buyer of the assets, which may result in business interruption.</p> <p>In addition, the business interruption will be prolonged if a new entity needs to be set up to acquire the assets of the target.</p>
Step up	<p>The buyer's basis in the shares of the target is the purchase price while the inside basis of the assets carries over.</p> <p>The buyer will not be able to achieve any step up in basis in the assets of the target through a share acquisition.</p>	<p>The assets acquired would be stepped up to the FMV which may result in a higher tax deductible depreciation expense.</p> <p>Additionally, the premium paid by the buyer is considered as a goodwill which could be deducted when the entire business of the target is sold or the target is liquidated.</p>
Liabilities	<p>The buyer will inherit any hidden liability of the target which existed at the time of acquisition.</p>	<p>The buyer will not inherit any hidden liability of the target which existed at the time of acquisition other than liabilities assumed pursuant to the acquisition agreement. Additionally, the buyer has the option of not acquiring any undesirable assets.</p>

	Share acquisition	Asset acquisition
Tax	<p>Any tax attributes of the target will carryover and will not be affected by the change of ownership of the target.</p> <p>As of May 2010, there are no provisions under PRC tax laws prohibiting the utilisation of taxable loss already existing in a company following ownership changes. For example, if the target has any unutilised loss carry forward, such loss may be used to offset any postacquisition profit of the target.</p>	<p>In general, an asset acquisition may result in a higher tax cost to the seller which may inevitably affect the purchase price paid by the buyer.</p> <p>No tax attributes of the target will carryover.</p> <p>For a target which is an FIE, any preferential tax treatment already enjoyed by it may be subject to claw-back if all the assets of the target are sold and the conditions previously qualified for the incentive have been changed (e.g. the target ceases operation within 10 years of it being established).</p>
Government approvals	<p>Government approvals are usually required for changes in shareholders. Approval may not be necessary if the foreign investor is acquiring the share of the overseas intermediate holding company, thus effectively gaining ownership of the Chinese operation without any changes in the shareholder of the Chinese operation.</p>	<p>No government approval is required for the asset acquisition of any privately-owned target; however, the incorporation of the new entity requires extensive government approvals.</p> <p>In general, an asset valuation needs to be conducted by a valuer and the consideration paid for these assets needs to be within a certain range of the valuation report.</p>

Tax implications

The tax implications for the buyer and the seller in a direct share acquisition are different from that in an assets acquisition. Generally speaking, **an asset acquisition could result in a higher tax cost to the seller** which may ultimately affect the final purchase price.

The following two tables summarise various tax implications to the buyer and the seller on a direct share acquisition versus an asset acquisition.

Table 15: Major PRC tax implications of a direct share acquisition (as of May 2011)

		Enterprise Income Tax	Stamp Duty
Seller	Non-PRC resident (individual or entity)	10% withholding tax on capital gain (Preferential tax rate may be provided in applicable tax treaties)	0.05% on selling price
	PRC resident (individual or entity)	Capital gain is taxed at the applicable individual or EIT rate	0.05% on selling price
Buyer		N/A	0.05% on purchase price

In an **indirect share deal** where the buyer acquires the equity interest in the overseas intermediate holding company, thereby acquiring control of the Chinese operation, there is no PRC tax effect on the buyer as the entire transaction is carried out offshore. However the buyer still has an obligation to withhold on the purchase price payment as stated in Circular 3. For the overseas seller which actually controls the Chinese target company, if the actual tax burden in the jurisdiction of the overseas intermediate holding company being transferred is less than 12.5 percent, or if the jurisdiction in which the overseas intermediary holding company resides provides an income tax exemption for foreign-source income, the seller will be required to submit all relevant documentation on the equity transfer and the relationship between the seller and the offshore intermediary holding company to the Chinese tax authorities within 30 days after the equity transfer agreement is signed. If the indirect equity deal lacks a bona fide business reason and intentionally avoids EIT liabilities, the Chinese tax authorities may disregard the existence of the intermediary holding company using the "substance-over-form" principle and impose capital gain tax on the indirect sale.

Table 16: Major PRC tax implications of an asset acquisition (as of May 2011)

Assets	Value Added Tax	Business Tax	Enterprise Income Tax	Stamp Duty	Land Appreciation Tax	Deed Tax
Seller						
Accounts receivable	N/A	N/A	Gain/loss subject to income tax (at the applicable income tax rate)	Generally 0.03 percent on selling prices except 0.05% for the transfer of real estate, certain intangibles or other assets registered with government authorities (e.g. cars)	N/A	N/A
Inventory	Collect 17% from the Buyer	N/A			N/A	N/A
Real property & land use rights	N/A	5% on the gross or net (depending upon how the property is acquired)	Certain loss (e.g., loss on disposal of fixed assets and accounts receivable) need to be reported to the tax bureau at year end with supporting documents in order to treat such loss as allowable loss		30-60% on land appreciation	N/A
Fixed assets (include cars but exclude real property)	From 1 January 2009, 17% VAT (collected from the Buyer) if an input credit has been claimed; 2% VAT if no input VAT credit has been claimed.	N/A			N/A	N/A
Intangibles	N/A	5% on selling price			N/A	N/A

Assets	Value Added Tax	Business Tax	Enterprise Income Tax	Stamp Duty	Land Appreciation Tax	Deed Tax
Buyer						
Accounts receivable	N/A	N/A	N/A	Generally 0.03% on selling prices except 0.05% for the transfer of real estate, certain intangibles or other assets registered with government authorities (e.g. cars)	N/A	N/A
Inventory	Pay 17%, which is creditable against future output VAT	N/A	N/A		N/A	N/A
Real property & land use rights	N/A	N/A	N/A		N/A	3-5% on the purchase price
Fixed assets (include cars but exclude real property)	From 1 January 2009, pay 17%, which is creditable against future output VAT (no input VAT credit allowed where 2% VAT applies under the laws.)	N/A	N/A		N/A	N/A
Intangibles	N/A	N/A	N/A		N/A	N/A

In summary, whether a foreign investor should acquire the shares or the assets of a Chinese target depends on various considerations including but not limited to business, operations and costs. In general, a Chinese seller may prefer a share deal for the following reasons:

- to avoid immediate recognition on revaluation gain of the assets;
- to avoid turnover taxes on transfer of assets, such as real property and land use rights (with the exception of transferring the entire business as a whole under which turnover taxes may be avoided);
- to avoid any claw-back on preferential tax treatment enjoyed; and
- to obtain the sales proceeds immediately without going through liquidation of a target.

However, a foreign investor may prefer an asset deal to avoid any historic problems of the target and to obtain the step-up basis in the assets acquired (including intangibles).

Withholding taxes on profit repatriations and use of holding companies

China imposes a 10 percent withholding tax on dividend and capital gains from the disposition of equity interest in a Chinese company by a non-resident equity holder. Other passive income such as royalty and interest income received by foreign companies from Chinese companies are also subject to a 10 percent domestic withholding tax rate.

To mitigate the above withholding taxes on profit repatriations, subject to the investor's home country tax rules and its existing double taxation treaty provisions with China, **it may be tax efficient for a buyer to establish a legal holding structure using an intermediate holding company** located in a jurisdiction that has favorable double taxation treaties with China for an acquisition. Intermediate holding companies can also act as a transaction mechanism for other passive income. By using a holding company, the overall effective tax rate of the transaction may be reduced thereby increasing after-tax investment returns. However, all above intermediate holding company arrangements should be subject to beneficial ownership tests in China before the treaty relief would be granted. Guoshuihan [2009] No. 601 states that the "beneficial owners" means persons who possess ownership and right of control on their proceeds, or rights of properties from which such proceeds generated. The "beneficial owners" generally engage in substantive operation activities and may be individuals, companies or any other associations. An agent or a conduit company shall not be regarded as a "beneficial owner." In general, the following factors are not conducive for the determination of applicants' status as "beneficial owners":

- 1) The applicant is obliged to pay or distribute all or major part (e.g. above 60 percent) of the proceeds within a specified time limit (e.g. within 12 months after receiving) to residents of a third country (region).
- 2) The applicant has no or hardly has any other operation activities except the properties or rights from which the proceeds generate.
- 3) As for a company applicant and the like, the applicant's asset, scale of business and personnel deployment are comparatively small, and not commensurate with the proceeds.
- 4) The applicant has no or hardly has any right to control or dispose, nor does it assume or assumes little risk on the proceeds or the properties or rights from which the proceeds generate.
- 5) The relevant proceeds are nontaxable or tax-exempt in the counterparty county (region) to the tax treaty; or, if being taxable, the effective tax rate is extremely low.
- 6) There exists a loan or deposit contract between the applicant and a third party under which the amount, interest rate and signing dates are similar/close to the loan contract based on which the interest is derived and paid.
- 7) There exists a license or transfer agreement between the applicant and a third party concerning the transfer of ownership to, or right to use of, copyright, patent or technology covered by the agreement based on which the royalty is derived and paid.

Using an intermediary holding company for a transaction may also minimise the time and bureaucratic processes often needed when seeking approval to transfer ownership of a Chinese company.

China has entered into double taxation treaties or agreements with 106 countries and territories of which 96 are in force⁴. The following table summarises the withholding tax rates of several common holding company locations (treaty and non-treaty countries) used for acquisitions of Chinese companies.

- 5 Only if the recipient of the gain, at any time during the 12 months period preceeding such alienation, had participation, directly or indirectly, of less than 25% in the capital of the Chinese company being disposed of, or if the gains derived by the recipient from the alienation of shares deriving less than 50% of their value directly or indirectly from immovable property situated in China.
- 6 No double taxation treaty with China.
- 7 No double taxation treaty with China
- 8 If the beneficial owner is a company which directly holds at least 25% of the capital of the company paying the dividends, the lower tax rate would be applied.
- 9 Only if the seller's equity in the Chinese company that is being disposed of is not more than 25% for the 12 months immediately before the sale and no more than 50% of the property of the company consists of directly or indirectly immovable property situated in China.
- 10 For industrial, commercial and scientific equipment royalties, the 10% tax rate applies to the adjusted amount of the royalties, i.e., 60% of the gross amount. For other cases, the 10% tax rate applies to the gross amount of royalties.
- 11 It does not apply to the disposal of real estate company shares.
- 12 Only if the equity in the Chinese company that is being disposed of is not more than 25% of the company and it does not involve a real estate company share disposal.
- 13 Only applicable to non real estate company shares, and only if the seller's equity in the Chinese company that is being disposed of is not more than 25% for the 12 months immediately before the sale.
- 14 If the interest income is received by a bank or financial institution, the lower tax rate would be applied.

Table 17: Withholding tax rates of common holding company locations (as of May 2011)

Jurisdictions	Dividends	Royalty	Interest	Capital gain
Barbados	5%/10% ⁸	10%	10%	Not taxable in China ⁵
Bermuda ⁶	10%	10%	10%	10%
BVI ⁷	10%	10%	10%	10%
Hong Kong	5%/10% ⁸	7%	7%	Not taxable in China ⁹
Ireland	5%/10% ⁸	10% ¹⁰	10%	Not taxable in China ¹¹
Luxembourg	5%/10% ⁸	10% ¹⁰	10%	Not taxable in China ¹²
Mauritius	5%	10%	10%	Not taxable in China ¹³
Netherlands	10%	10%	10%	10%
Singapore	5%/10% ⁸	10% ¹⁰	7%/10% ¹⁴	Not taxable in China ⁹

4.7.4 Exit strategies

Buyers seeking to invest in a business that may not be integrated into current operations should consider exit strategies before committing to an acquisition. As exit options are formulated, acquisition strategies should be revised according to the best way to sell the acquired business.

For example, a financial investor should consider whether the acquired company or business unit may be of interest to other strategic investors, or whether an exit via listing the company on a stock exchange is preferred. In the case of a public offering, more stringent target selection criteria would be used to assess potential candidates and in turn, more preparation is expected from the target in terms of presentation of financials and management capabilities to address financial market requirements.

Table 18: Exit options and characteristics

	Trade sale	IPO
Price of company shareholding	Higher than an IPO, especially when a premium is required for a controlling interest	Lower than a trade sale; normally will value current shareholding at a minority shareholder level
Timing	Faster, direct process	Longer time involved. Time is needed for: <ul style="list-style-type: none"> • stock exchange vetting and approval • preparing documentation and enlisting underwriters, etc. • waiting for the appropriate market sentiment
Costs	Lower	Higher <ul style="list-style-type: none"> • requires additional professionals (e.g., stock brokers, underwriters, etc. to prepare listing documentation)
Structure	Straightforward sale of minority or majority stake	Less than full exit; listing of new common shares only leads to ownership dilution

Taxation on capital gain

When formulating exit strategies, a buyer should also take into consideration tax implications on capital gain. A direct sale of shares in a Chinese company is subject to tax in China. The statutory rate is 10 percent under Chinese new EIT law and its implementation rules. Double taxation treaties may offer an even lower rate for holding companies located in specific countries (see Section 4.7.3, Table 17 for more details). Hence, a buyer should assess the benefits of various structures and determine the most suitable holding location prior to executing the transaction to minimise future capital gains tax.

In addition to the beneficial ownership issues as stated in section 4.7.3, one must consider the tax reporting requirements and implications of selling your investment at the intermediate holding company level, i.e. an indirect transfer. As discussed earlier, Guoshuihan (2009) 698 states where;

- 1) the foreign investing party indirectly transfers the equity of a Chinese resident enterprise it held; and
- 2) if the country in which the transferred offshore holding company is located levies no taxation on the foreign income of the residents or levies taxation on the foreign income of its residents of a percentage lower than 12.5 percent

then the foreign investing party shall provide the following material to the local tax authorities of the Chinese resident enterprise;

- 1) Equity transfer contract or agreement;
- 2) Relationship between the foreign investing party and the offshore holding company it transferred with respect to the funds, operation, purchase and sale and other required aspects;
- 3) The situation of the production, operation, personnel, finance, assets and other aspects of the offshore holding company transferred by the foreign investing party;
- 4) The relationship between the offshore holding company transferred by the foreign investing party and the Chinese resident enterprise with respect to the funds, operation, purchase and sale and other required aspects;
- 5) The statement of the reasonable commercial purpose for the establishment of the transferred offshore holding company by the foreign investing party; and
- 6) Other relevant materials as required by the taxation authorities.

The local government authorities have the ability under Guoshuihan (2009) 698 to recharacterise the transaction as if the intermediate holding company did not exist. They can do this if it is determined that the use of the intermediate holding company as an abuse to evade the taxation obligation of paying the EIT. If the transaction is reexamined as if the indirect transfer was 'in-substance' a direct transfer, then the gain would be subject to the statutory withholding tax rate of 10 percent under EIT Law.

4.8 Implementation

Role of lead advisors

In general, the role of lead advisors is to coordinate the various professionals and advisors in preparing the closing documentation, assist in obtaining regulatory approvals if required, and make certain that all relevant parties adhere to the closing schedule. In addition, the lead advisor will generally assist in:

- managing coordination of all required documents with the responsible parties before closing;
- determining and revising the completion date according to work progress;
- resolving transaction closing issues;
- arranging financing;
- conducting post-transaction planning;
- finalising settlement arrangements; and
- ensuring the finalisation of the Sales & Purchase (S&P) Agreement.

Role of legal advisors

Legal advisors are generally responsible for drafting and finalising terms sheets and the definitive S&P Agreement based on the agreed terms from the negotiation process. S&P Agreements can be lengthy as they will often include clauses that address all the key issues raised during the due diligence process.

Legal advisors should also advise the buyer on issues concerning the effectiveness of translations of legal terms, the jurisdiction governing agreements, and the impact of the PRC legal system on the deal when finalising the agreements.

Reviewing the Sales & Purchase Agreement

The representations/warranties and indemnifications sections are two of the most important elements of S&P Agreements. It is essential for the buyer (or seller in the case of a divestment) to ensure that sufficient representations/warranties and indemnifications are obtained to minimise unexpected liabilities (financial, tax or otherwise) that may arise upon or after completion of the transaction. In addition, accountants and legal advisors should also be involved in structuring of any purchase price adjustment mechanism; see discussion in 4.4.6 above.

• **Representations and warranties**

The representation and warranties section represents the foundation of the transaction. They make reference to other documents and information such as financial statements, patents, pending litigation or outstanding liabilities. This section lists what the buyer and seller are aware of concerning the business at the time of the transaction. From the buyer's point of view, the representations are clauses to achieve maximum disclosure about the seller's business and operations. If the buyer discovers a material fact that was not represented, he may be relieved from the obligation to close the transaction or claim for indemnification.

From the seller's point of view, providing a full disclosure may be time-consuming and difficult to achieve. The seller will want to minimise the number of representations to limit indemnity exposure. Materiality limits are often established by qualifying representations "to the best of the seller's knowledge".

• **Indemnifications**

The indemnification section specifies the damage and rights the buyer and the seller can claim if the representations and warranties are misrepresented or any terms of the S&P Agreement are breached. It clarifies each party's responsibilities and obligations.

The above provisions can often be a place to resolve differences in opinion on certain contentious potential exposures that may be discovered during the due diligence process. Instead of reducing the purchase price to allow for such potential exposures, if the seller is confident that its view is correct and that certain potential exposures identified will not materialise, the seller may be willing to make a full disclosure of the facts in these provisions and provide the buyer with some recourse in the event such exposures do materialise following the closing of the deal.

In addition, various transaction type taxes may be payable by each party to the S&P Agreement and the amount of some of these taxes may be quite substantial, especially in an asset acquisition with real properties involved. Assistance from professional advisors may be needed to make sure that the seller is responsible for his/her own tax liabilities and that these are not passed on to the buyer because of ambiguous wording in the S&P Agreement.

Required approvals

In a share acquisition, government approvals are usually required for a change in shareholders. The need to obtain approval will not be necessary if the foreign acquirer acquires the shares of an overseas intermediate holding company and thus effectively gains ownership of the Chinese company without changing the shareholders of the Chinese company.

In an asset acquisition, although no government approval is required for the asset acquisition of a privately-owned target, the incorporation of a new company requires extensive government approval by, including but not limited to:

- the local foreign trade and economic committee;
- the local administration of industry and commerce;
- the local security bureau;
- the local technical supervision bureau;
- the local administration of foreign exchange;
- the local tax authorities;
- the local statistics bureau;
- the local finance bureau; and
- the local customs bureau.

For some specific industries, the application for setting up a new company must be approved by the Central Government in Beijing.

Obtaining regulatory approval may be the most challenging condition to complete the deal in a timely manner. If the parties cannot obtain the relevant approval before the prescribed long-stop date (i.e., the deadline), a supplementary agreement to extend the completion time frame may be needed.

Summary

- In addition to ordinary financial, operational and legal due diligence, appropriate tax, internal controls, integrity, market, information technology and human resources due diligence should also be considered. Issues identified should be taken into consideration when negotiating and valuing the target
- Verify assumptions used in the preliminary stages of the deal
- Engage external service providers for conducting due diligence in China; they are valued for their expertise and objectivity
- Determine the form of negotiation, financing structure and pricing strategy to achieve an optimal pricing structure
- Assess the pros and cons of different deal structures - e.g., share acquisition versus asset acquisition and relevant tax implications. Professional advisors can help choose the appropriate structure based on the nature of the acquisition
- Obtain the consent of relevant regulatory bodies before completing the deal - foreign investors in China are subject to various registration and approval procedures from various authorities
- Consider exit strategies before completing the deal to ensure expected financial gains are achievable; bear in mind there may be issues such as tax on capital gains
- Consider a purchase price adjustment mechanism as part of the pricing strategy
- Bear in mind that both parties can "walk out" of a deal anytime before the S&P Agreement is executed

Integration and reorganisation

5. Integration and reorganisation

Key issues considered in this chapter:

- Who will lead the integration effort - who will be the Integration Director?
- What does a merger integration effort involve in terms of resources, planning and activities?
- In what areas within an organisation should integration take place?
- What should a company do to ensure smooth "Day One" operations?
- What compliance requirements need to be addressed?
- How should a company support tax compliance and planning?

5.1 Integration planning and strategy

The integration and reorganisation aspect of the M&A process is often the longest and the most challenging. A poorly managed integration often will not provide the returns and benefits to increase shareholding value.

Studies show that about 85 percent of mergers do not realise value as expected due to integration problems. M&A surveys conducted by Deloitte found the following:

- Synergies are not achieved in 60 percent of cases
- Only 23 percent earn their cost of capital
- 47 percent of executives leave in the first year of integration; 75 percent leave by the third year
- Productivity in the first four to eight months is generally reduced by 50 percent
- When value is not created, poor integration is to blame in 70 percent of cases

Realising the value of an M&A deal will depend on how the buyer addresses and mitigates integration risk factors and how the buyer manages an extremely complex integration project.

5.1.1 The importance of integration

Merger integration and reorganisation is a complex exercise. It entails change in all functions, simultaneously, with interdependencies that have to be managed day-to-day in an environment where people are anxious about their futures. Integration generally involves but is not limited to:

- strategy and organisational consolidation;
- business process standardisation;
- human resources integration; and
- information technology infrastructure integration.

When integrating two business organisations, the merged entity needs to ask a number of organisation and operations related questions:

- What is the best structure for the new entity?
- What can be done to facilitate a fast and successful integration?
- How can a company ensure a successful Day One operation?
- How can a company identify and capture merger benefits?
- How should the changes within the organisation be managed?

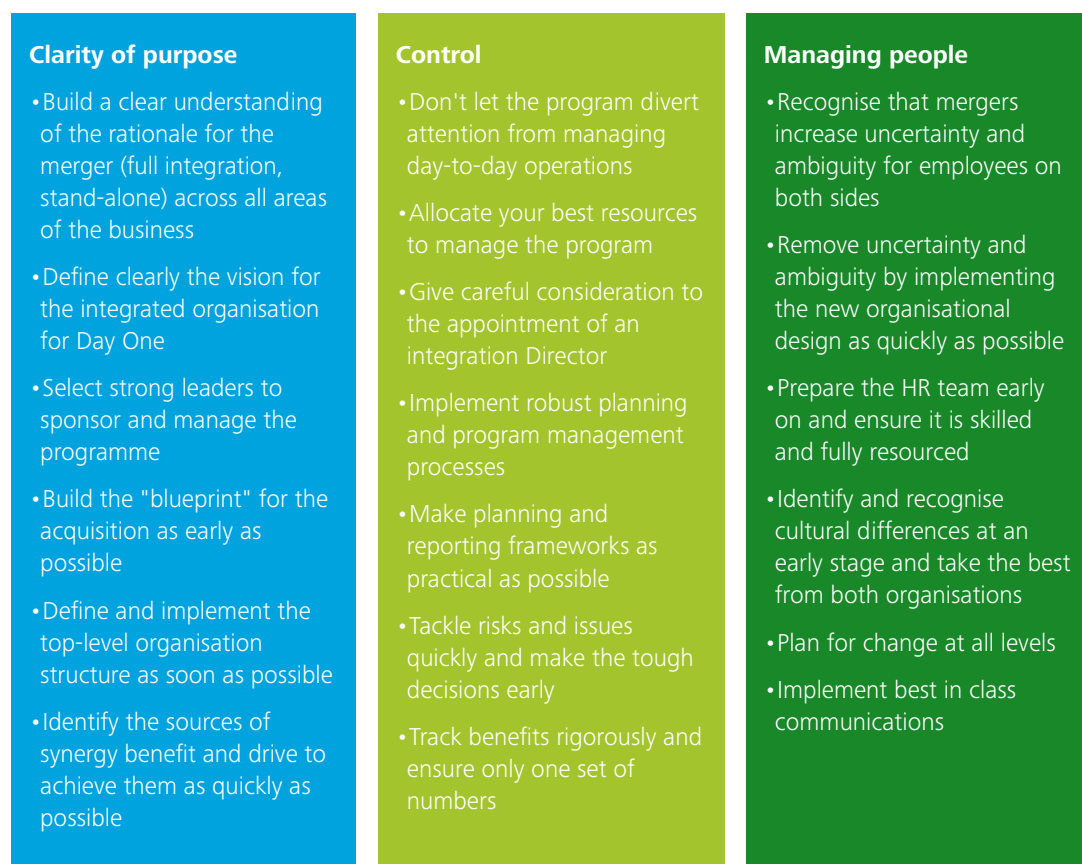
- What can be done to minimise potential conflicts among locations during the integration?
- How should processes be redesigned to capture integration benefits and support IT implementation?
- How will products and infrastructure be integrated?
- Do people have the skills and capabilities required to perform in the new organisation?

An important determinant of merger success is the ability to develop and execute an integration plan that addresses these issues. The principal challenge is how the post-M&A organisation can capture benefits from redesigned processes/shared services while integrating processes, and building a strategic platform of new processes without negatively impacting financial performance. Therefore, while planning, the merged entity should consider options available and select those that will enable the organisation to perform effectively.

Integration is not conceptually difficult, but it requires a ruthless focus on execution, appropriate cadence, and an ability to avoid being overwhelmed by the enormity of the effort.

Critical factors for merger success may be grouped into three categories: clarity of purpose, control, and managing people, as are depicted in the figure below.

Figure 10: Critical success factors for successful merger integration

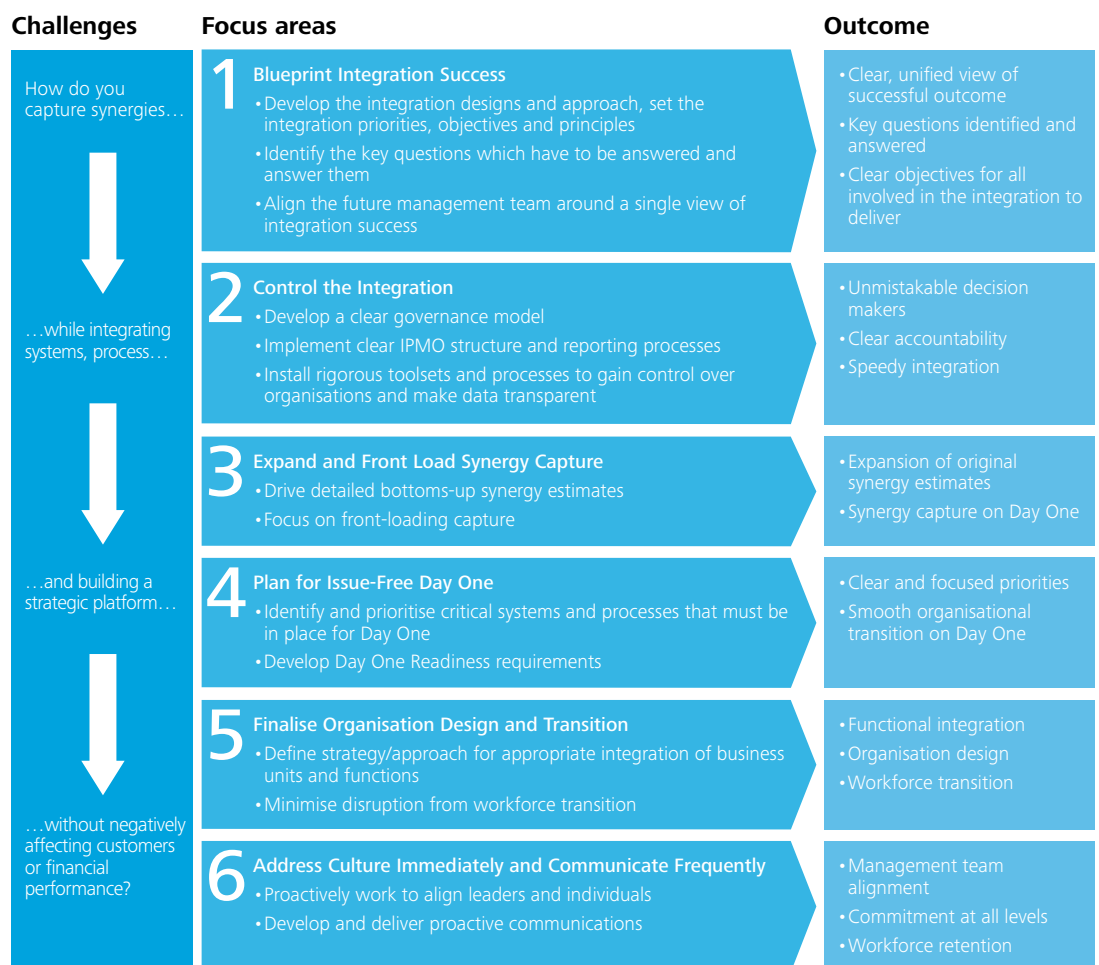


5.1.2 The overall integration approach

The overall integration approach involves pre-close planning and post-merger integration efforts. An integration approach for consideration can be broken down as follows:

- blueprinting success;
- controlling the integration;
- expanding and front loading synergy capture;
- planning for issue-free Day One;
- finalising the organisation design and transition;
- addressing people and culture issues immediately and communicate frequently.

Figure 11: Comments of an integration approach



Phase 1: Blueprint integration success

This phase lays the groundwork for the integration, provides clarity and the maximum amount of direction, which can be set from the small number of people responsible for creating a deal before a much larger number of people become involved in implementing the deal and trying to make it work.

The key is to identify the important questions that will set the direction for the merger and then answer as many as possible, whilst identifying how the balance will be answered.

The questions typically include:

- Why are the companies merging, and what is the vision for the new organisation?
- What will integration success look like and how would it be measured?
- To what degree are the companies merging/staying apart, i.e., status quo versus seeking best of both?
- What are the key milestones that have to be met, either set internally or externally?
- What principles are going to be adopted in order to manage the integration and how will these be communicated?
- What is the integration program structure and who will take the key roles in the integration, i.e., degree of central control versus delegated responsibility?
- What are the "must be" answered questions for the short and medium-term?

Choosing the integration approach

As part of defining the blueprint, it is vital to select a specific integration approach and define how it will apply to your situation. There are three different integration approaches, which are summarised in Table 19 below:

Table 19: Types of integration approaches

Integration approaches	Status quo	Take-over/Reverse take-over	Best of both
Description	Merger or acquisition with minimal integration, perhaps only for financial reporting purposes	Outright acquisition and integration of target into buyer	Merger or acquisition focused on integrating best people, processes, products/services, and technology of both companies
Level of integration	Low	Medium	High
Level of synergy potential	Low	Medium	High
Level of risk to be managed	Medium	High	High

Table 19: Types of integration approaches (Cont'd)

Integration approaches	Status quo	Take-over/Reverse take-over	Best of both
Pros	<ul style="list-style-type: none"> • Fast and limits debate • Strengths of both organisations are retained • Minimal interruption to each business • Limited resources required for integration 	<ul style="list-style-type: none"> • May be able to incorporate a significant portion of the strengths of the acquired • Effective at capturing near term synergies • Effective at gaining upside 	<ul style="list-style-type: none"> • Combined company benefits and supports consensus building • Allows identity of acquired company to remain visible in new company • Generates feeling of worth among acquired employees • Maximises synergy retention
Cons	<ul style="list-style-type: none"> • Limits cost synergy capture • Limits interchange of culture and skills • Requires coordination processes for overlapping, market facing areas • Worst practices of both companies are retained • Limits revenue synergy 	<ul style="list-style-type: none"> • Potential risk in losing acquired capabilities and customers • Potentially alienates acquired employees and reduces productivity 	<ul style="list-style-type: none"> • Time-intensive - must make key integration decisions quickly • Risks in choosing lowest common denominator rather than best practices • Best from both can be hard to define - "Best" accounting system may not work with the "Best" billing system which may not work with the "Best" customer management system

In reality most integrations are a mixture of these, depending on which part of the business and how value will be created. Successful integrations are clear about these from the start.

Executive alignment

One very important and deliberate side effect of going through the process of creating a blueprint is the development of executive alignment around the key elements of the integration.

In creating a deal, the leaders have to move very quickly and let each other focus on their respective roles and responsibilities. For this reason slightly different views get developed. Combining this with the range of views for the new leaders from the target organisation increases the disparity. It is vitally important that, before the number of people involved in the integration process increases, a single common view be developed and documented, for the avoidance of doubt. This then becomes the platform from which all other aspects of the integration will flow and will guide items such as:

- internal and external communications;
- defining the benefits and setting objectives for line managers and integration managers;
- the new organisation design and the composite roles and responsibilities;
- prize tracking;
- transition.

In total, the blueprinting process sets the framework and context for the integration in five main phases. These phases are discussed in more detail below:

- Control;
- Synergy capture;
- Day One;
- Migration to the future organisation structure; and
- Communications and culture.

Phase 2: Control the integration

This phase lays out the mechanisms for controlling and managing the integration, critical to the delivery of a merger integration. The outcome from this phase will generally include a project team and a roadmap.

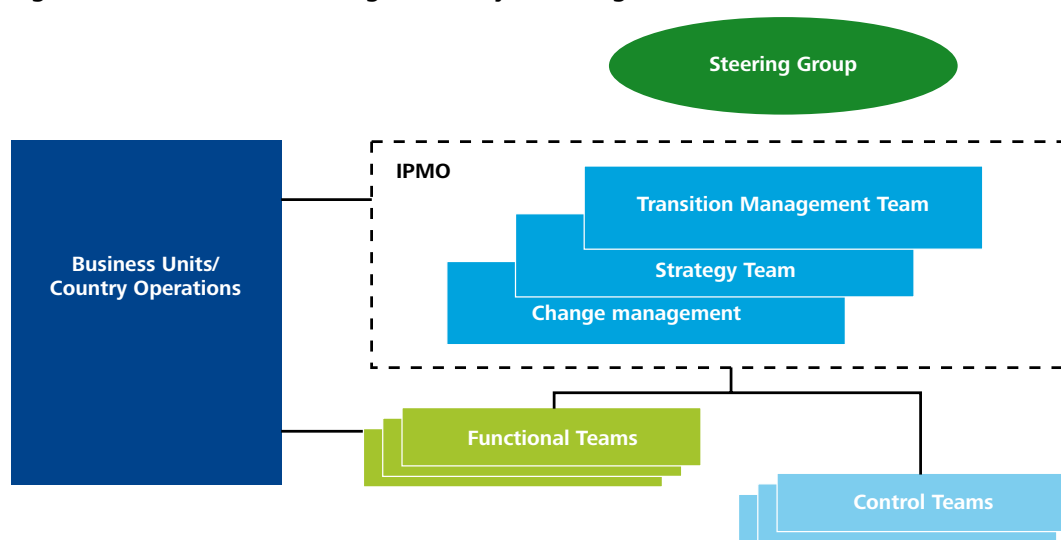
After a company has analysed the options and the needs of the organisation and it has decided upon the integration strategy, management should define a programme management structure to coordinate the entire integration effort.

Effective programme management is a critical success factor for any project, but it is particularly relevant in complex projects such as merger integration initiatives. Project management ensures that the direction and project objectives are met, and that potential deviations from the objectives are identified and resolved at the earliest possible time.

Setting up the Integration Program Management Office (IPMO)

The programme management structure generally includes a steering committee, a full-time Integration Director, an integration project management office, a set of integration project teams, functional teams and control teams. The steering committee sets the overall strategic direction of the project and guides the work of the Integration Director. The Integration Director, supported by the IPMO, is the heart of the project. The IPMO coordinates the work of various project teams. Each project team will be accountable and responsible for a stream of work across the organisation, such as transition management, strategy development, and change management. Functional teams focus on functional related matters and value delivery while the control teams focus on internal controls and compliance issues.

Figure12: Structure of the Integration Project Management Office



Determining the level of governance

After the integration roles and project organisation structure is defined, the new company should determine the level of control each decision-maker who is involved should have and what type of decisions can be made by different levels of staff.

In particular, a company that is in the process of integration should consider the following in determining the level of governance for the project team.

- What are the level of executive sponsorship and the level of authority of the Integration Director?
- Will the organisation comply with IPMO standards (e.g., processes and tools)?
- Who owns the scope of the integration?
- Does the culture support compliance with the defined "integration scope control guidelines"?
- Who is typically accountable for managing the programme budget?
- Who is responsible for tracking benefits and costs of the merger?
- Who is accountable for the realisation of benefits in the merged entity?
- Are decisions typically made rapidly in either/both of the acquirer and target organisations?
- Are decisions frequently revisited in either/both of these organisations?
- Who is responsible for setting the principles that will be applied in the integration and what are these principles?

Case study: M&A integration planning and programme management

A US-based and world leader in medical devices had to prepare both internally and externally for a global merger.

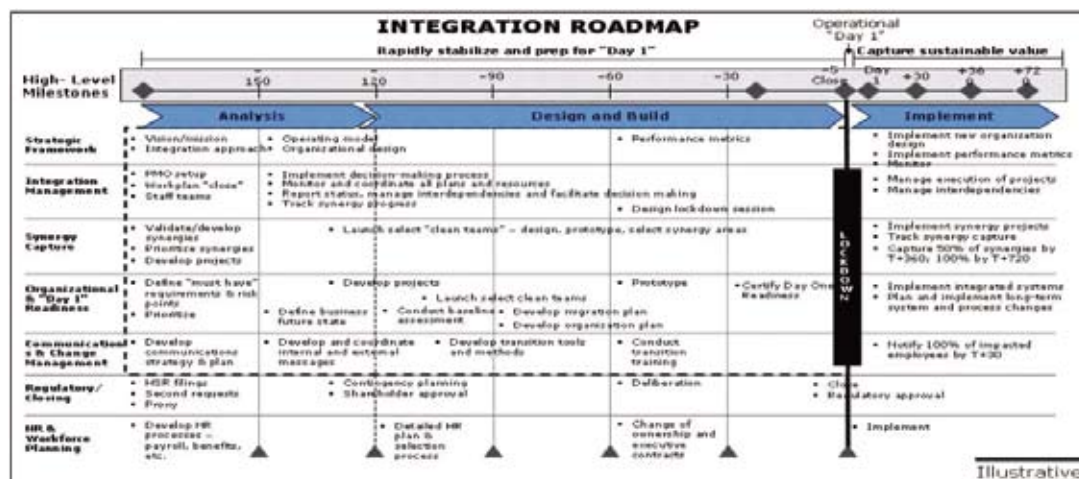
Regional teams were formed to plan and execute tasks to manage internal organisational, processes and systems changes for both companies following global strategies and guidelines. The planned integration date posed a tight schedule for the teams and delays in obtaining official approvals from the US and Europe imposed challenges in managing external events and employee expectations.

To facilitate integration planning and manage challenges, key representatives from the two companies involved in China were brought together for the initial identification of integration tasks. Departments involved included Sales, Marketing, Supply Chain (Customer Service), Finance, Legal, Medical Affairs, Public Relations, Information Management and Human Resources. A dedicated Program Management Office in China was also established to monitor internal and external progress and issues resolution, and to facilitate communication among local parties.

Creating an integration roadmap

With an integration strategy and a project management team in place, the management team of the new organisation should generally be ready to complete a high-level integration roadmap (see Figure 13 for an example). An integration roadmap in essence is a high-level project plan. It has the major milestones defined for each major stream of work and deadlines for each phase of the work. The lockdown date refers to the first day after the integration occurs (Day One). Integration does not only require significant preparation pre-closing, it also requires significant support after the official merger date.

Figure 13: Sample integration roadmap



Lessons learned in China

- Have sufficient governance in place. China has a particular working culture, employees expect specific direction so having the right governance and roles and responsibilities will improve efficiency
- Build a commercial integration plan, then be prepared to review and optimise it from a tax perspective
- Suppliers, customers (and staff) may not be familiar with M&A and integrations - take time and effort to assure and engage them (even though the main initial message may be that they should continue doing exactly the same thing as before)
- Develop and adopt a systematic way of prioritising initiatives
- Responsive decision making enables the integration initiative to keep moving
- It is important to establish small, full-time teams to manage the integration process; clear governance provides fairness and clarity
- Integration teams require a sufficient amount of resources with adequate "cover" for their ongoing responsibilities
- Integration teams must be staffed appropriately; make sure that the right people are represented from both organisations

Phase 3: Expand and front load the synergy capture

The third phase of the project aims to explore and capture key synergy opportunities across the to-be integrated organisation. Synergy capturing should preferably be analysed early in the integration process to build momentum and credibility amongst employees, investors and analysts.

Examples of cost saving synergies

- **Operations materials savings**
Company A's Strategic Sourcing Initiative provided Company B with lower materials costs resulting in US\$11 million in savings over four years
- **Finance headcount reductions**
The combination of two companies resulted in redundancies within the finance department so that multiple positions could be eliminated. Savings realised totalled US\$8.4 million

Identifying synergy opportunities

To identify successful synergy opportunities, the integration team should clearly understand the existing business market of both the target and buyer. The teams may find it helpful to review the due diligence report, and conduct any additional interviews if necessary. With the guidelines presented in the sections above, the team should be able to identify a set of potential revenue enhancing and cost-saving synergy opportunities, and then allocate necessary funding to achieve them.

Synergies can be identified by function or across functions. Good examples of this include supply chain management and customer relationship management (CRM). Table 20 summarises potential synergy opportunities across key functions in an organisation.

Table 20: Synergy opportunities in various organisation functions and areas

Functions	Opportunities
Supply Chain Management	Reduce COGS through scale and consolidation efficiencies
Information Technology	Reduce IT costs by consolidating systems and leveraging them over larger business base
Customer Relationship Management (CRM)	Strengthen customer relationships with breadth of offerings and improved channel positioning
Finance & Administration	Reduce Finance and Administrative costs by leveraging resources over larger business base
Product Development	Create end-to-end product and service solutions
Tax	Tax savings from transaction and resulting enterprise structure
Human Capital	Reduce HR costs by integrating and streamlining HR processes
Valuation	Constantly monitor and adjust valuation
Corporate Real Estate	Realise both quick cost reductions and longer-term optimisation strategies when integrating the corporate real estates of both companies

Capturing synergies

Once synergy opportunities are identified, a "prioritisation exercise" should be performed with the initial focus on the highvalue, quick hit projects because these generate the greatest momentum. For each individual synergy-capturing project, the integration team should develop a plan with detailed tasks, milestones, dates and accountability so that expected results can be monitored and achieved.

Key lessons learned in China

- Overall synergy realisation will be the accountability of the Integration Director
- To be positioned for synergy capture success, each validated synergy must be assigned to a specific owner. It will be the responsibility of each synergy owner to deliver the benefits associated with the synergy opportunity
- The Integration Director is responsible for identifying synergy targets for the overall effort as well as assigning targets for each functional area
- In China, assigning ownership and accountability is particularly important. Identifying the key performance indicators (KPI) and timelines will ensure initiatives stay on track and in budget
- Local managers may not have been targeted on EBITDA, or cash, or efficient use of capital, let alone ROI or ROCE. Education may be required to train managers on what is important to a company, and their role in delivering it

Phase 4: Day One readiness

The fourth phase of the integration process aims for a successful Day One by identifying and managing risk, managing the links and dependencies between projects, and synchronising critical systems and processes.

Day One is the first day that the acquirer has ownership and control of the target, and is the first day that the acquirer and the target officially becomes one organisation. In order to have a Day One transition that is smooth without disruption to business operations, management of the new organisation may consider the following four points:

- **Key risks:** this involves identifying what is legally required, required by the regulator, commercially critical or desirable in order to ensure that plans are put in place to address them and manage risk.
- **Identify key requirements:** this involves defining key requirements for customers, suppliers and employees, and developing the proposed projects that will meet those requirements.
- **Prioritise:** this entails identifying "must haves", "should haves", and "nice to haves".
- **Design & execute:** this involves identifying the project leaders, key activities, and timeline for all Day One projects, planning and agreeing the interdependencies and developing implementation solutions.

In general, the IPMO and/or functional teams will need to prioritise the necessary activities. All "absolutely must have" items and other activities that will result in significant benefits to the merged organisation are given a priority as Day One items. Activities that cannot be completed within the Day One window will be planned as scope for the second milestone date. The third and final milestone date is considered the company's End-state, the stabilising point for the integrated organisation.

It is important to note that the IPMO is responsible to draft the Day One requirements for each of the functional groups for approval by the Steering Committee. Any cross functional Day One requirements will also need to be taken into consideration. Table 21 summarises several "must have" considerations to prepare for Day One operations. These examples are categorised into finance, legal, customers, suppliers, and employees.

The requirements in Table 21 can be further broken down by function. Depending on the line of business, functional teams may include:

- **Information Management** - This function deals with systems integration, data centre and help desk consolidation, targeting both Day One readiness and efficiency improvements;
- **Human Resource** - This function deals with the integration of HR-related processes including organisation design, benefits, salaries, retention, training and recruitment;
- **Finance** - This function deals with the integration of financial-related processes, including accounting, tax, budgeting and planning;
- **Supply Chain** - This function deals with the integration of supply chain related components including procurement, logistics, warehousing, and manufacturing. It ensures that products are delivered to customers;
- **Communications** - This group of professionals should handle all the communication-related activities across all the functional areas. It will also deliver change leadership guidance throughout the entire process.

Table 21: Guidelines to achieve Day One requirements

Functions	Activities
Finance	<ul style="list-style-type: none"> • Corporate insurances in place, including officer insurance • Reporting capability in place, covering management reporting, risk reporting, relevant accounting jurisdiction, treasury, tax and others • Delegation of authorities in place
Legal	<ul style="list-style-type: none"> • Boards resigned and reappointed • Contracts novated/cancelled/replaced • Regulatory approvals received and documented • Confirmation conditions precedent completed
Customers/ Sales	<ul style="list-style-type: none"> • Rationalised customer definition with integrated customer data and teams • Cross-sell playbooks developed for account teams to enhance cross-selling opportunities • Strategy to rationalise and strengthen partner program • Identify specific areas in both companies to improve customer satisfaction and decrease churn • Existing programme terms and pricing policy overlaps/conflicts identified and documented

Table 21: Guidelines to achieve Day One requirements (Cont'd)

Affiliates/ Partners/ Suppliers	<ul style="list-style-type: none">• Completed strategy to address technology migration path issues for affiliates and partners• Redefined Customer Care, Billing and other support arrangements with all affiliates as needed• Branding/marketing strategy and required supporting collateral for use by affiliates• Contract strategy for pending or impaired contracts, e.g., renegotiation, termination, status-quo
Employees/HR	<ul style="list-style-type: none">• Retention of critical employees across all areas• Motivated workforce who individually understand their role in the new company• Workforce transition and relocation programmes determined and completed for affected people

Phase 5: Finalise target integrated organisation design and manage transition

The fifth phase is to finalise the target organisation design and processes, and manage the transition. The challenge in designing a new structure is in adopting best practices and valuable contributions of both organisations combined with a management agreement on how to implement them. The new organisation design will meet the organisation's day-to-day business objectives, as well as position the new integrated organisation for future success. Many elements of this phase are covered as part of the HR and communication functions.

An approach to finalise the target organisation design includes:

- **Define strategy and vision:** entails clearly defining the functions, target culture, leadership roles and responsibilities.
- **Define structure:** involves developing a detailed plan of the new organisation and its functions, including defining a reporting chain and realigning jobs and responsibilities.
- **Develop a detailed design of the new organisation:** involves developing a detailed functional organisation design, making sure that the right people are in place, and establish a transition program to the new organisation.
- **Develop a transition plan:** includes preparing a budget, establishing processes to continuously align systems and processes, and quantifying synergies.
- **Launch implementations.**

Lessons learned

- Reporting lines may not have worked the same way in a local company as in the acquirer. Significant coaching and management development may be required to make the new structure work
- Legacy relationships may have more importance and be harder to change than official reporting lines
- Influence can be exerted by people who have left the business, so exit strategies should incorporate local understanding and sensitivities
- Fundamental changes must be made to processes to reduce real workload
- Develop and apply an "objective" method to evaluate competing business units and systems
- Adopt best practices among merging entities to bring out merger synergies
- Best practice and benchmark data solidifies the need to change and supports the recommendations of integration teams
- Centralisation and standardisation need to be quantitatively justified
- Focus process change efforts on the "biggest bang" for the buck. Align organisation roles and responsibilities
- Develop senior level organisation structure to establish clear ownership of synergy capture
- Establish clear roles and responsibilities for senior management

Phase 6: Address culture issues and communicate

Communications and culture are two intrinsically linked management issues and as such, they need to be planned together. Addressing the communications needs of employees through each phase of the integration from the onset of the official merger announcement can help address potential culture issues and humanise the merger. Poor attention to communications and insufficient focus on addressing culture can be very damaging to the integration.

Table 22: Examples of merger issues

Issue	Merger integration results
Management disagreement over control and differences between culture deemed too difficult to effectively overcome	Deal cancelled
Clash over culture and management control	Divestiture of the acquired company
Stiff imposition of management control over the acquired company and integrating new multinational workforce with distinct cultures	Departure of key managers

Communications is one of the most difficult aspects of merger integration and is especially the case with Chinese companies. Their management styles, culture, priorities and mindsets may differ from companies in developed economies and management decisions may not be communicated across an organisation.

Designing a change management and communications strategy that takes into consideration the culture of the target company and the differences is important in an M&A exercise. A well-developed strategy will help minimise the integration risk while creating an adaptive operating style for the long-term.

Identifying and addressing an organisation culture

There are four steps to gaining an understanding of the culture of the acquired organisation and developing a plan to address it.

- **Understand the target's current operating style.** This can be achieved by administering a culture diagnosis, conducting interviews and analysing results with leadership involvement.
- **Determine the future operating style of the merged organisation.** It is beneficial for senior management in the merged organisation to conduct an end-state workshop to identify the long term strategic organisation culture and business objectives, and conduct an operating gap assessment.
- **Develop a plan to narrow gap.** A change management plan that involves communications and initiatives should be developed to ensure that key objectives and the intended culture can be obtained. The new organisation should select leaders, which may or may not be managers, who are influential within the organisation and obtain their buy-in to start the culture and strategy alignment process.
- **Implement solutions and monitor progress.** Prior to commencing operations integration, it is beneficial to communicate the vision and strategy of the new organisation to all employees according to the change management plan. Broadly communicating the changes taking place will help to alleviate concerns and set appropriate expectations. It also ensures that all levels of the organisation get the same unfiltered message.

The objective is to take an approach where the acquirer gains an understanding of the culture of the target organisation, identifies potential challenges early on, and develop a change management plan for the merged organisation to address the issues and align visions and expectations at the beginning of the integration effort. Proper monitoring of progress will enable management to make adjustments to the integration and address issues detected early on.

Managing stakeholders through effective communications

Different messages are required for different stakeholders of the acquirer and target organisation. By developing separate messages and delivery formats (e.g., open forum meeting, official letter, memo, e-mail, newsletter and media), effective communications can be achieved. Key stakeholders of the acquirer and the target company may include:

- customers;
- internal staff;
- sales prospects;
- alliance partners and service providers;
- business forums and media; and
- regulatory bodies.

Critical success factors should be considered when integrating operations after a merger. The following highlights several related to communications.

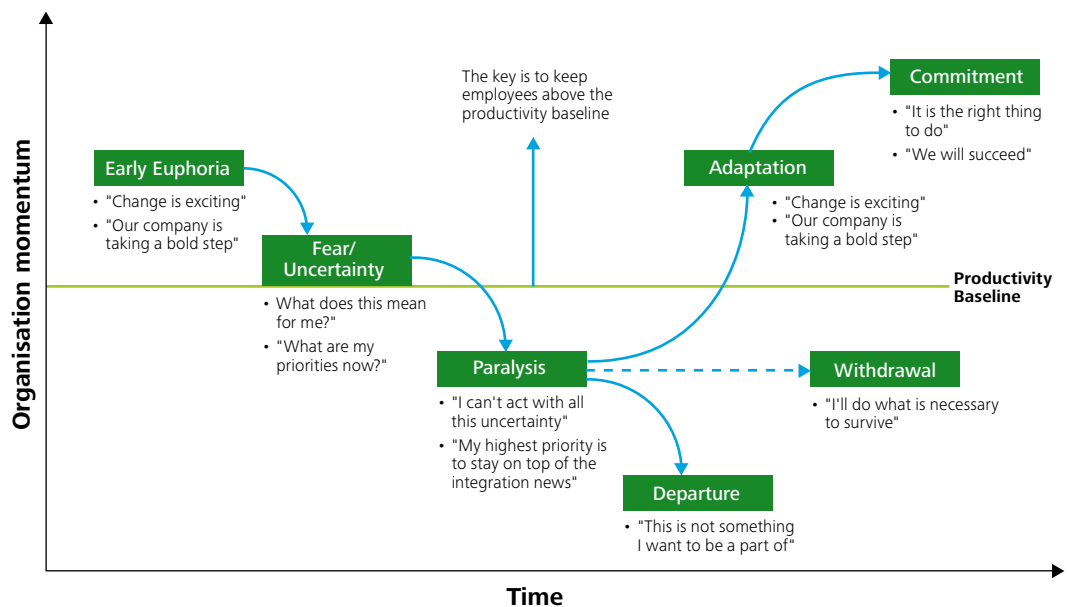
- **Communicate early and often**
It is nearly impossible to over-communicate during a merger or acquisition. Constant communication - even if it is a repetition of the same message - prevents uncertainty.
- **Communicate openly and honestly**
Tell employees as much as possible, even if it means saying, "I don't know" or "We are still looking in to that."

- **Communicate consistently, both internally and externally**
Employees will compare notes. Make sure that everyone is receiving the same message to create trust. Employees will also listen to the media. Public messages should not be different from internal messages. This means delivering the tough messages to the staff at the same time as the "good" messages to shareholders.
- **Communicate proactively**
Telling people that things are not changing is still valuable communication. It is important to deliver the right message to employees.
- **Communicate face-to-face**
Employees are more open and receptive to face-to-face communications. Face-to-face communication provides the opportunity for immediate feedback from employees which can be used to tailor future messages. This also sets the tone for how important the integration is to senior management.

Delivering the message

Understanding the various mental stages that an employee goes through over the course of the merger process will help identify the type and timing of communications. In China, employees often go through a large set of emotions, both productive and unproductive over the course of the integration process. Figure 14 illustrates communication mechanisms for each set of emotions to manage productivity.

Figure14: Various mental stages of employees for different phases of the merger process



Executing a communications plan

Different phases of the merger integration process have different communications needs. A communications plan that is well-developed will outline the key tasks and delivery mechanisms to be performed at each stage. Table 23 provides a summary of the main communication tasks in a communications plan for each phase of integration.

Table 23: Key tasks in a communications plan

Integration phase	Main tasks
Integration kick-off	Charter team and develop plans for communication during integration
Signing day	Announce merger to external and internal audiences through a range of delivery mechanisms Develop talking points for employee, customer and suppliers to ensure the message delivered is consistent
Transition	Update external and internal audiences on the progress of the integration, using appropriate written and face-to-face communications channels and activities
Day One	Announce closing of merger and celebrate the combined company. Key mechanisms may include press releases, a welcome package, "Fast Start" manager workshops, a short-term operating manual and a help desk

Lessons learned for communication and change in China

- Pay particular attention to managing change with core functions in China, specifically sales & marketing, supply chain, and finance & administration
- Identify critical talent employees early in the M&A process. Communicate to them early and often as they will have many other employment opportunities in China throughout the integration process
- Cultural incompatibility can stop a merger - even one with sound economics
- Clear communication and a sound, structured decision-making infrastructure will provide the foundation for every change initiative within the merger integration process
- It is the people in the company who make the integration successful
- If the core elements of leadership, workforce, process, and technology do not adapt and reinforce each other throughout the merger process, the new organisation will not function effectively

Case study

A Korean tire-manufacturing joint venture in China was facing low staff morale due to cultural differences in management styles and inefficiencies in operations. The company engaged external professionals to diagnose people issues via employee surveys, leadership interviews, and employee focus group meetings.

Nine key areas were found as barriers to organisational changes, and five individual task forces were formed to design and implement a change management plan. These areas included performance measurement, leadership, talent management, culture and communication.

The project focused on analysing and managing complexities relating to cultural differences. In implementing the change management plan, different language skills and cultural sensitivities were recognised which provided the local HR function knowledge that was valuable to a foreign company.

5.2 Finance and administration integration

In a merger, the finance function creates value by partnering with an organisation's various business units and provides leadership throughout the process so that the new organisation can realise value. The challenge is in capturing the benefits from integration without negatively impacting financial performance. Integrating finance functions could involve redesigning and/or integrating processes, implementing shared services, and building a strategic platform of new processes.

5.2.1 Redesigning financial management and budgeting processes

One of the key tasks of the finance function is to reorganise the financial management and budgeting processes. A successful M&A transaction should fully integrate and standardise processes to capture performance improvements (e.g., consolidating corporate and overlapping business unit finance and accounting functions) and synergies (e.g., identifying cost reduction opportunities, like reducing finance costs by leveraging resources over a larger business base).

In redesigning or implementing new financial management and budgeting processes to realise integration benefits, the merged organisation should consider conducting a process redesign exercise which entails documenting, analysing and redesigning the current processes. Proper program management, communications planning and change management should be conducted so that the value from improvements and synergies are captured.

Financial planning and budgeting are generally built upon financial accounting information, with few operational and revenue performance indicators. Rarely will planning be tied to non-financial targets. The top-down approach is the most common management style and budgeting method, and integration efforts in these instances are less complex. For companies that have very advanced financial planning and budgeting models or have adopted a bottom-up or mixed mode budgeting approach, the integration effort will be more challenging, especially if the target is not familiar with these methods. In a bottom-up approach, managers, supervisors and front line sales will be required to submit their own plans as they are more familiar with the market and operations. When a target company is to integrate into an organisation using this approach, significant efforts will be required to educate staff.

Having the senior management buy-in from the acquisition target is often required before financial and accounting processes can be reviewed. Once this is achieved, middle management will need to be educated on the integration process and participate in the redesign exercise.

5.2.2 Re-engineering financial, accounting, and tax-related processes

Financial business process re-engineering (BPR) is to re-engineer financial, accounting, and tax-related processes (e.g., sales to accounts receivable cycle, purchases to accounts payable cycle, investment to fixed assets cycle, book-closing cycle, tax compliance process, etc.) for the new company. As mentioned above, the process for re-engineering entails documenting, analysing and redesigning the current processes.

The business benefits resulting from BPR may include:

- re-engineering (automating and/or streamlining) processes for better efficiency;
- re-evaluating control and checking control against the risks being mitigated;
- increasing the authority of staff/officers/managers to match their level of competency;
- identifying and removing overlapped and unclear responsibilities; and
- exploring areas for potential shared services and outsourcing opportunities.

Key considerations for conducting a financial BPR effort in China

Several key considerations should be taken into consideration when integrating the finance function of an acquired organisation. These include but are not limited to the following:

- The financial processes should be able to handle multiple GAAP reporting requirements and tax reporting requirements
- Integrated accounting systems should support multi-byte language, chart of accounts should be consolidated and standardised, and financial systems of the target company should interface with the acquirer's systems. The PRC requires all accounting systems to be certified
- If the target is a small company with simple financial processes, extensive training and change management will be needed
- If significant automation of previously manual processes is expected, there may be a need to re-deploy resources or handle redundancies
- In all BPR projects, proper change management (beyond training) by people who speak the local language and understand the different corporate cultures is essential

5.2.3 Financial shared services

Shared services centres are a popular model adopted in the re-engineering of finance functions to reduce costs. Implementing a finance, accounting and tax shared services centre generally involves:

- formulating a solid business case for a shared services centre;
- designing the integrated finance organisation;
- identifying financial, accounting and tax-related processes and those that could be provided by the shared services centre;
- designing, standardising and improving financial, accounting, and tax-related processes; and
- developing the implementation plan.

The business benefits derived from having a finance, accounting, and tax shared services centre generally include:

- an increase in efficiency and better management controls through process standardisation;
- cost savings through economies of scale in operations;
- the ability to improve and maintain consistent service levels; and
- improved accuracy and timeliness of reporting through centralised information access.

Key considerations for setting up shared finance functions in China

In addition to the considerations for financial BPR, setting up a finance shared services centre in China should include:

- A thorough review of the overall legal and regulatory requirements. Certain practices and conditions taken for granted elsewhere may not be practical in China; for example, there may be limitations on the use of electronic supporting documents and tax implications on cross-entity billing
- Location selection. Conditions vary significantly across China even among large cities. Selecting the most suitable location to host a shared services centre is therefore important to the realisation of benefits. The criteria used to evaluate potential locations should include:
 - the availability of the workforce in terms of affordability and stability of skilled labour (e.g., technical and multi-language capabilities)
 - infrastructure support
 - the cost, availability and quality of suitable real estate
 - the provincial legal and regulatory environment, such as the level of simplicity and transparency, and any local government tax rebate or benefits, and
 - the cost of operations
- An understanding that requirements and tax benefits for each location are not cast in stone. A company should be prepared to negotiate specific arrangements for its operations

5.2.4 Executing the financial integration plan

Integrating the financial organisation of an acquired company will require time. A long-term strategy for the one to two years following the acquisition should be put in place to ensure that the end-state of the merged organisation is world-class. Table 24 is an example of a financial integration roadmap.

Table 24: Sample financial integration roadmap

Strategy	Day One	2 nd Milestone	End-state
People	<ul style="list-style-type: none">• One identified leader with single function accountability	<ul style="list-style-type: none">• One identified leader with single function accountability• Consolidated management team	<ul style="list-style-type: none">• One identified leader with single function accountability• Consolidated organisation
Process	<ul style="list-style-type: none">• Aligned processes, policies and procedures	<ul style="list-style-type: none">• Streamlined processes, policies and procedures in concert with organisational change	<ul style="list-style-type: none">• Integrated best practice processes, policies and procedures in concert with organisation consolidation and system simplification
Technology	<ul style="list-style-type: none">• Parallel transaction and supporting systems• System migration plan in place	<ul style="list-style-type: none">• "Adopt and Go" migration and implementation of selected systems• Rapid progress toward full system integration	<ul style="list-style-type: none">• Common, integrated and simplified systems

Table 24: Sample financial integration roadmap (Cont'd)

Strategy	Day One	2 nd Milestone	End-state
Synergies	<ul style="list-style-type: none"> Synergy targets and required projects identified at the functional accountability level 	<ul style="list-style-type: none"> Synergies targets being aggressively delivered at or before project milestone 	<ul style="list-style-type: none"> Synergies met or exceeded Continuous improvement capability enabled

5.2.5 Engaging external service providers

It is beneficial when implementing shared services to engage external service providers to assist with the initiative. Establishing shared services centres is a complex and time consuming process requiring a significant amount of resources and skills. As the process involves changing the way employees currently perform their duties, external service providers are perceived to bring objectivity to the project. They serve as a temporary resource and their experience in local requirements and culture, proprietary tools and knowledge base are generally valuable.

5.3 Human Resources integration

Addressing human resource issues is critical to the overall success of a merger. People challenges are frequently underemphasised and must be addressed early on in the integration process. Nearly half of unsuccessful M&A deals are unable to achieve the anticipated value due to people issues. As a crucial determinant for the success of integration efforts, it warrants significant attention before, during and after the deal transaction. The HR team is typically one of the first to become overloaded with work if insufficiently resourced from the beginning.

The objectives of the human resources team are to retain and attract the best employees, and ensure cost effectiveness by leveraging business processes, technology and partnerships to manage HR-related costs.

5.3.1 Guiding principles for HR merger integration

A typical HR integration will involve five major areas: organisation design; employee compensation; employee compliance; retention of key talent; and severance and redundancy.

- **Organisational design and development**

The IPMO and HR integration team should work closely to identify the criteria and principles for the merged organisation design, and establish an organisation accordingly. Ideally, the design principles must be identified as soon as possible after completion of due diligence, and the top two levels and divisional Management Committee should be completed within 30 days after the signing of the Sales & Purchase Agreement.

An assessment of the target company culture should be conducted prior to deal closing. Every effort should be made to identify potential cultural integration barriers, and a plan to achieve cultural alignment should be part of the integration process.

- **Employee compensation and selection**

Part of the HR integration effort is to make decisions regarding employee compensation and employee selection for the newly integrated organisation. The new combined organisation should be staffed with the best talent available from either the target organisation or the acquirer. In international integration efforts, local legal employment laws and practices should be reviewed as they may influence the staffing and selection process and selection criteria. In addition, severance payments and lay-off arrangements will need to be considered carefully.

Generally, the target company will convert to the HR policies and practices of the acquirer. This includes benefits, compensation, pensions, employee policies and applying the same Human Resource Information System (HRIS) within 100 days after deal closing. A short-term strategy should be developed to receive and track employee data if the target is using a different HRIS system and if data is not readily available.

- **Employee compliance**

To achieve employee compliance, the HR team should define corporate ethics, security, and anti-trust compliance rules for the new organisation. Intellectual property (IP) protection and compliance will be a major concern for foreign companies investing in China. A communications program should be in place by Day One so that all target employees have a clear understanding of the corporate compliance standards early on.

- **Retaining key talent**

Key talent from the target must be identified in the early stages of the M&A process, preferably during due diligence or as soon as possible after the signing of the Term Sheet. It is customary to request the target to have agreements in place to retain key talent for a defined period, typically for at least six months to one year. A broader use of retention incentives can also be applied, and may take the form of individual incentives based on individual talent and attrition risk, or a group incentive linked to performance to support the integration effort.

- **Redundancy and severance**

With any integration, inevitably there will be redundancies in the organisation. These redundancies need to be handled with care, as it is an extremely sensitive topic. Assessments should be conducted to ensure the right staff is retained, and a program should be in place to provide new opportunities for redundant staff. For staff that is made redundant, appropriate severance packages must be provided in accordance with local regulations. It is often invaluable to compile a headcount baseline on closure of the deal to understand who is in the business and which function is responsible for them, and against which to track changes through the integration.

While performing the HR integration, the work team should bear in mind the key objectives of the exercise is to facilitate a successful merger. This may include:

- minimising the disruption to the workforce;
- supporting the other integration functions on HR issues;
- retaining critical talent;
- maintaining employee morale;
- smoothly transferring all critical HR functions;
- integrating HR policies quickly;
- fully migrating the acquired company into HR enabling systems at the close of the deal; and
- enabling business to continue and grow.

- **Culture and Communication**

In China, the importance of culture and communication must be considered in all the merger integration projects. The major purpose is to help humanise the integration by addressing the needs of all stakeholders and make appropriate decisions on culture assessment, communication plan, and change management activities throughout the whole life cycle. Defining strategy for cultural integration (imposition, separate culture or creation of the 3rd culture) must be addressed beforehand. The communication plan and change management activities that cover every stakeholder should support the cultural integration seamlessly, and periodic assessments need to be made after Day One.

Case study

Properly developed transition plans encompassing HR and financial integration can result in substantial financial rewards. Two major pharmaceutical companies achieved merger headcount and synergy targets while delivering financial commitments with a 60 percent appreciation in share price.

5.3.2 Executing HR integration

A suggested approach to executing an HR integration plan is to involve the right people early in the process, and have the appropriate change management and communication mechanisms in place to support initiatives.

The key steps a buyer should take to address the HR issues in a merger are:

- Define a long-term HR strategy for the new organisation. This includes a talent management strategy and a plan for senior executive integration.
- Define top challenges and categorise these issues into critical/high/medium/low. HR-related areas to consider are:
 - organisation design/governance;
 - culture;
 - total rewards - compensation and benefits;
 - labour relationships;
 - employee terms and conditions alignment;
 - human resources service delivery;
 - recruiting and staffing;
 - training;
 - performance management;
 - redundancy;
 - retention and recruitment;
 - severance policy;
 - HRIS; and
 - pensions and other retiree costs management.
- Address the challenges by taking appropriate action.
- Measure and track progress.
- Always keep employees informed and communicate regularly.

Lessons learned for merger integration and human resources in China

- One of the most formidable and longest lasting obstacles to sustainable M&A success in China is human capital integration
- The increasing M&A activity in China leads to major people issues, including the retention of key staff, development of a new reporting organisation, non-alignment of compensation structures, cost and staff reduction, and culture differences and communication problems
- Accordingly, in an M&A transaction, key barriers and obstacles must be identified, change management plan designed, talent management program implemented, and new organisation and compensation structures created
- Local expertise in these sensitive areas is limited in China, so outsourcing these services is an effective solution many multi-national companies pursue

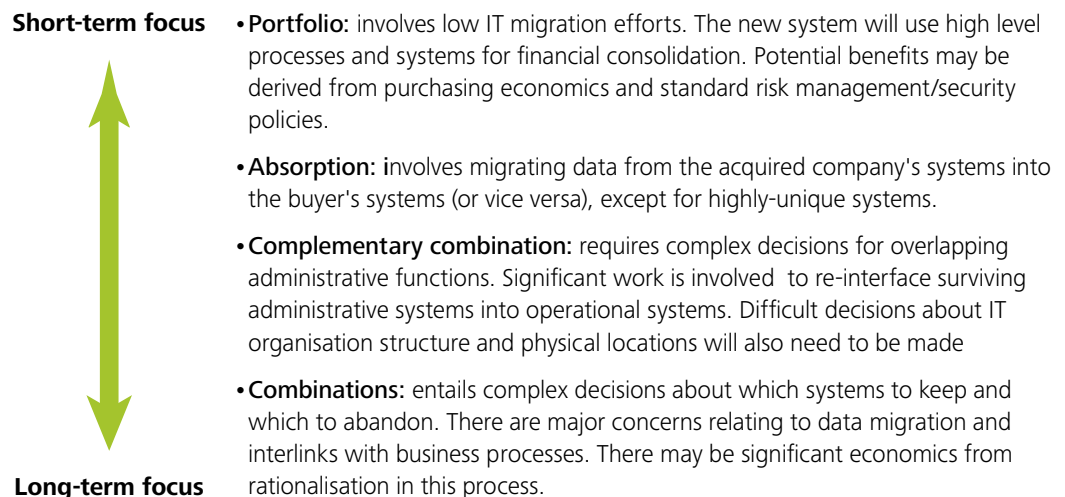
5.4 Information Technology integration

Many companies still place too little emphasis on IT in the early stages of the M&A lifecycle. This lack of early involvement can lead to lower than expected synergies and higher than expected costs to achieve integration benefits.

Information technology is critical to business operations and the vast majority of merger benefits are dependent on changes to IT systems and infrastructure during integration. For example, some process improvements will only be achieved with an enterprise resource planning (ERP) system while customer analysis is only available when the migration of a customer relationship management (CRM) system is completed. Generally, IT integration accounts for about 20 to 30 percent of the total benefits or synergies obtained in a merger. However due to the complexity involved, benefits are often slow to realise.

There are several common approaches to integrating IT systems, ranging in the level of complexity and effort required. Selecting the appropriate approach will depend on the nature of the acquired business operations and the preference of the acquirer.

Figure 15: Common approaches to integrating IT systems



5.4.1 Guiding principles for IT integration

There are several principles an acquiring company should incorporate when planning systems integration. Considering these rules-of-thumb may help to enhance the success of the effort.

- **Accelerate benefit achievement**
 - Perform systems changes that support Day One "must haves" regardless of whether there are concrete business benefits;
 - Optimise efforts based on the magnitude of business benefits gained per unit of effort; significant benefits can be captured through temporary or permanent bridges across systems;
 - For companies with significant operational overlap, full systems consolidation is inevitable; conduct integration deliberately with the goals of cost management, risk management, and speed to synergies in mind;
 - Assess whether hardware can be rationalised and if there are savings in support/maintenance costs.
- **Manage risk and complexity**
 - Maintain the balance between risks and benefits obtained;
 - Consider the new expanded business, geographic, and user scope;
 - Determine the degree of redesign that is necessary;
 - Consider the criticality of the system/application to consumers and the impact on revenue stream;
 - Consider the impact on the accuracy of management information provided internally and externally;
 - Assess the degree of interrelationship a system has with other IT and non-IT projects;
 - Evaluate the level of IT system support required by business operations.
 - Determine the compliance requirements on IT controls (e.g., Sarbanes-Oxley Act).
- **Don't ignore legacy systems**
 - Manage linkages;
 - "Re-interfacing" will happen many times - it is a cost of doing business;
 - Strategic/major decisions can be avoided by thorough and clear front-end planning.
- **Ensure the ability to run legacy systems**
 - Plan for real demands over time;
 - Plan by skill types;
 - Manage total cost by optimising the speed to completion with the cost to achieve;
 - Multiple experienced vendors will be required; plan in advance so they are available as needed;
 - Warn executives of cost and complexity and possible delays to system availability.
- **Consider your applications**
 - Determine what applications are required to support the business process of each business segment and which application is the dominant/preferred system;
 - Determine the implications of a change in the systems on the business application and any additional costs that will be incurred in order to obtain compatibility.

- **Establish an architecture that enables a faster merger/separation**

- Establish a process that enables quick response to "Day One" requirements;
- Utilise middleware architecture to "modularise" applications, thereby reducing time commitment and risk of changing individual applications.

5.4.2 IT integration

IT merger integration is similar to other large-scale IT implementation efforts, except that it may include a rationalisation of two equally critically important applications. Typically the integration will have four phases: plan, design, build, and operate.

To facilitate the management of the project, activities related to each phase can be further categorised into different work streams. Typically, work streams will include IT merger program management, IT strategy and integration execution, and IT organisation and process integration. By detailing the activities involved with each work stream, a better picture of the scope and type of work required can be established.

In cases where two different IT strategies exist, i.e., two different ERP systems, the complexity and the potential risks associated with merging the two systems into one should be carefully assessed. In some instances, maintaining status quo for the first year may be in the best interest of the merged organisation. This will allow time to conduct a thorough analysis to determine if one of the platforms or systems, or a new system is more appropriate and in line with the IT strategy.

If a new system is required as part of the merger integration effort, implementation should occur only after the operations of the new business have stabilised. This will minimise the impact during transition. Generally, it is advisable to consider such enhancements one year after the day integration begins. It is important to consider the short and long term IT strategy of the new organisation, and plan for an approach that will maximise benefits and minimise risks.

5.4.3 Culture and communication in the IT department

The IT department in most organisations has its own cultural and professional characteristics. These features can act as a unifying force between those involved from either side of an M&A as IT people tend to "speak the same language" and approach things in similar ways.

However, when integrating IT departments from companies that use different technologies (the majority of cases), managing cultural differences becomes a challenge. Issues relating to potential job losses and resistance to change are more prevalent in these instances. Business processes and management practices can also affect the integration progress. When organisations from different sectors or different countries are merged, managing cultural gaps is a significant challenge. This is why comprehensive integration planning - especially considering HR integration, change management, and communication plans tailored for China - is vitally important for sustainable success.

Lessons learned in China

- If the integration project involves implementing a new technology or process in China, allow adequate time for retraining. Do not underestimate the change management effort
- Demand for system-skilled workers in China is very high and the turnover rate is in the vicinity of 20-25 percent
- In most cases, the companies that are being acquired in China are relatively small or are start-up operations so they may not have IT strategies. It is often unclear as to where IT fits in terms of the company strategy
- Implement a programme organisation model that encourages a strong working partnership between IT and the business and proactively find out what the business is expecting from IT

- Accelerate IT scoping and planning
- Investigate creative options to complete IT-related integration activities, including migrating to the acquired company's IT solutions, implementing outsource solutions as well as implementing new applications/packages
- Review, prioritise and rationalise all IT projects
- Keep the pressure on - maintain a consistent focus on the integration-related projects until the large majority of synergies are captured

5.5 Supply chain management

Organising and optimising a company's supply chain to continue operations from Day One will be an important part of planning. It is critical that there is an uninterrupted material flow throughout merger activities. In order to integrate quickly and minimise supply chain interruption, a supply chain process, either the one from the acquirer or the target, should be selected as the new process. Typical supply chain components that will be consolidated or rationalised include the following:

- transportation and warehouses networks;
- distribution centres;
- procurement;
- order management; and
- planning systems.

In addition to maintaining business continuity, significant savings can be obtained through the optimisation of supply chain management. A review to optimise or revamp the supply chain process in the merged organisation is generally recommended, but should only be conducted at least 100 days after Day One or closer to the end of the process.

Guiding principles for managing supply chains

- Build a world-class, integrated supply chain organisation with effective processes, operations, tools and technologies
- Drive procurement synergies across the organisation
- Minimise disruptions in the supply chain
- Support the needs of other business functions as supply chain decisions are made
- Proactively communicate the role of supply chain management (SCM) in supporting business objectives and business unit integration
- Maintain technical and operational flexibility and scalability
- Focus on rapid realisation of savings
- When merging operations, support subsidiaries throughout the integration process

5.5.1 Key areas of focus for the supply chain integration team

The supply chain functional team will focus on the following areas as part of the integration effort.

- **Strategic sourcing:** Establish optimal supply and sourcing arrangements to satisfy enterprise-wide requirements. With a China operation, this might be particularly relevant in setting up or re-enforcing a low cost sourcing centre;
- **Procurement:** Implement efficient purchasing policies, procedures and transactions while minimising transaction issues;
- **Logistics and distribution:** Effectively implement and manage processes for logistics support, planning and distribution of raw materials;
- **Supplier management:** Efficiently perform supplier management to:
 - achieve supplier performance standards and contract term compliance;
 - facilitate contract change management; and
 - enhance supplier diversity.

5.5.2 Executing supply chain integration

There are different phases to a supply chain integration work stream. Typically, for Day One operations, the team should generally try to minimise the risk by implementing the necessities to obtain an uninterrupted flow. During this phase, the team should define consistent processes, enable minimal integration, and conduct synergy design and planning for the future. The team may also want to conduct significant communications throughout this process to minimise the effect on employees.

After 100 days of operating as a merged organisation, the team can start implementing improvements to the process, and implement initiatives to realise the synergies planned earlier. Additional planning and design for further improvements should be performed. The objective is to strive for a stable and world-class supply chain management organisation.

In determining whether the supply chain integration was successful, a company should have achieved the following:

- a consolidated world-class supply base that creates innovative solutions, delivers superior results and provides a competitive advantage;
- true and effective integration of organisation, processes, systems and tools;
- exceeding integration synergy targets;
- Day One requirements successfully met on-time;
- effective vendor consolidation and significant savings from sourcing; and
- new contracts and vendor relationships generating cost avoidance/cost savings.

5.6 Post-acquisition business processes and internal controls integration

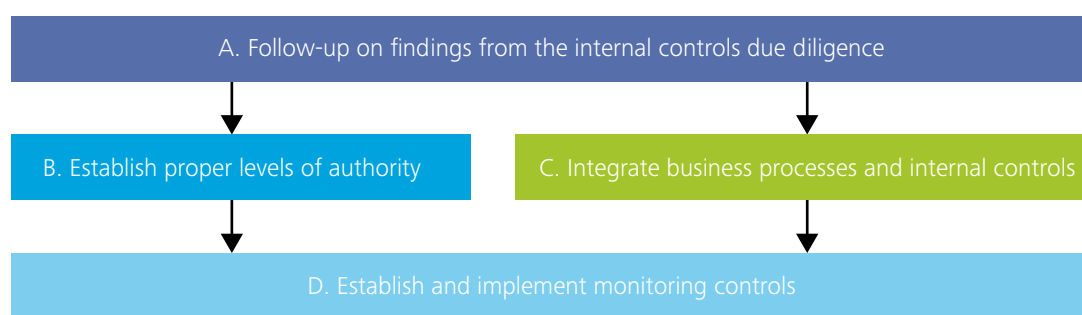
After an acquisition, the merged entity will need to roll out management and financial reporting requirements and consider whether the following three criteria are met:

- the finance and accounting team has the resources and competencies to support these requirements;
- the company has the necessary tools or technology to deliver these reports; and
- the source data fed into the management and financial reports are reliable.

Equipping the company very often involves system implementation, recruitment and training activities, and reviewing business processes and internal controls in key business areas to achieve the desired reporting standards.

A transparent control mechanism is also necessary to facilitate the management of the merged entity. Having a transparent process will enable key decision makers, be it founders/owners of the acquired company or new management, to monitor progress and integration efforts.

Figure 16: Approach to establish monitoring controls



5.6.1 Improving deficiencies in internal controls

The internal controls due diligence conducted in an M&A exercise will often identify deficiencies in controls in a target organisation. During integration, these deficiencies should be addressed and prioritised so that appropriate remedial actions can be implemented in a timely and effective manner.

Issues that should generally be a priority are those that:

- concern the control environment;
- concern fraud;
- have significant impact to the reliability of financial data for management reporting, analysis and decision-making purposes; and
- have a pervasive impact to respective business areas.

Remediation may involve multiple tasks and often involve setting up new or revising existing policies and procedures, performing a business process review and re-engineering exercise, properly segregating duties and authorisation, and conducting training and workshops for employees. It may also involve significant resources and cause disruptions to daily operations. A cost-benefit analysis is therefore helpful before deciding on the corrective actions that need to occur.

Top level support is critical to effective implementation of remedial actions. Senior management involvement will help provide the appropriate messages and motivation to implement the internal control improvements. In addition, action plans should be established early on to systematically manage remedial activities. Regular status updates to all parties involved will facilitate progress monitoring.

It is often beneficial to engage external professionals to assist with remediation planning. These specialists can provide knowledge on internal controls and business practices that may be lacking. As a third party, these experienced professionals may provide a more objective view to the parties involved. Typically in M&A situations, companies will opt to engage the team that performed the internal controls due diligence.

5.6.2 Establishing proper levels of authority

As business operations, processes and policies change during a merger integration, the existing levels of authority in the company should be reviewed to align with business needs and internal control purposes. The review, which is performed from an internal control perspective, should provide recommendations to improve operational efficiency and effectiveness.

Generally, an assessment on the appropriateness of authority levels should consider whether:

- existing management can play a reasonable role to guide and oversee business operations effectively and efficiently;
- the current management structure and corresponding authority is appropriate, and would not be a hindrance to daily operations and implementation of an effective internal control system;
- current levels of authority promote core values within the company. Core values of a company may include, but not be limited to, transparency and fairness, consultation and mentoring, and responsibility and accountability.

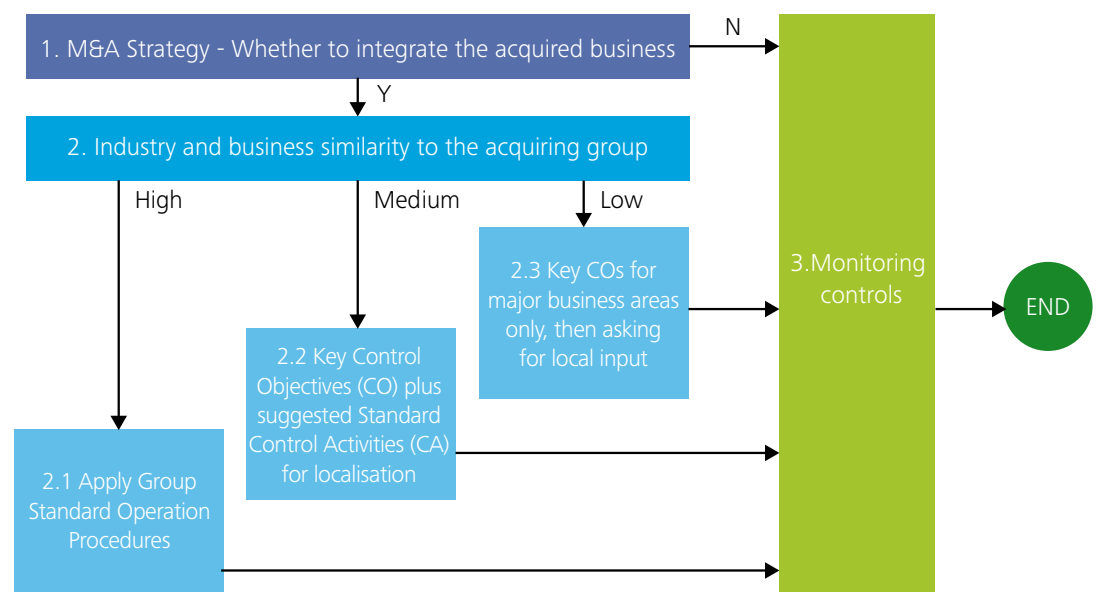
The involvement of an independent third party in conducting such an exercise can mitigate the tension between existing management teams in the target company and the acquirer. Training sessions or workshops and appropriate communications will convey the concept of proper internal control and minimise repercussions that may trickle through the organisation as a result of potential management changes.

5.6.3 Integrating business processes and internal controls

The degree to which an acquirer should integrate the business operations of the acquired company will depend on the acquisition strategy, the industry and business modules of the acquired company.

Figure 17 illustrates a general approach to determine the level of business process and internal controls integration.

Figure 17: Business process integration decision tree



1. M&A strategy - whether to integrate the acquired business

Whether the acquired business operations should be integrated is a decision that is made at the beginning of the M&A transaction. If the acquired company is purely a financial investment that will be sold in the future for capital gains, or there is no intention to get involved in the acquired business in-depth, it is often best to let the acquired entity operate on a standalone basis. However, proper monitoring mechanisms and appropriate controls should be implemented to monitor performance against financial and operational targets, and to enhance the ability to detect errors or fraud.

2. Consider industry and business similarities of the acquired company to the acquirer

When the acquired company is to be integrated into the acquirer, an assessment of the level of similarity between the business operations of both companies will need to be conducted. The degree to which the two are similar can be categorised into high, medium or low, where high represents significant similarities in operations and low represents few commonalities.

- **High:** If the outcome of the analysis is high, then standard operating procedures can be applied to the acquired company.

This includes existing policies and procedures, standard operating procedures, and internal control manuals. However, minimal customisation of these operating procedures may be required to suit different business environments. Input from local staff should be obtained, while training and introduction sessions should be conducted to increase employee awareness and support.

- **Medium:** When the level of similarity in business operations is categorised as medium, the acquirer should:

- compile a list of key Control Objectives (CO) and suggested best practices for Control Activities (CA);
- present the CO and CA list to the acquired company and communicate to its management that the key CO's must be enforced. The best practice CA's are for reference to assist management in developing their own CA's to address the key CO's;
- have the developed CA's reviewed by internal auditors and/or third party resources for effectiveness.

- **Low:** If there are few or no business similarities, it is suggested that the acquirer work closely with the management of the acquired organisation to identify major risks, develop COs to mitigate risks, and identify/establish CA's to address the risks in key business areas. Key business areas, regardless of industries, may include, but not be limited to:

- financial closing and reporting;
- tax reporting;
- treasury and cash management;
- purchase and expenditures, including capital expenditure;
- sales and accounts receivables;
- inventory management, production and costing (for manufacturing only);
- human resource, payroll and employee benefits; and
- general computer control environment and information system.

The developed CA's should also be reviewed by internal auditors and/or third party resources for effectiveness.

3. Monitoring controls

Monitoring controls should be established to facilitate the management of the acquired organisation. Monitoring controls are discussed in detail in the following section.

5.6.4 Establishing monitoring controls

According to the COSO Internal Control - Integrated Framework (COSO framework), there are three components to monitoring controls. They are:

- ongoing monitoring;
- separate evaluations; and
- reporting deficiencies.

All three components should be adopted by the acquiring organisation to achieve efficient and effective monitoring controls. Some monitoring activities may already be embedded into business processes. Others should be in place to comply with corporate requirements.

Ongoing monitoring

Ongoing monitoring occurs in the ordinary course of operations, and includes regular management and supervisory activities, and other actions personnel conduct in performing their duties to assess the performance quality of internal control systems. For a newly-acquired company, functional or departmental leaders in the acquiring organisation may establish direct contact and reporting lines with the same functions/departments in the acquired company. Management may also conduct irregular visits to departments and perform periodical reviews on key documents as part of the monitoring process.

The COSO framework also recommends implementing the following ongoing monitoring controls in an organisation.

- Management should obtain evidence to ensure that the internal control system is operating as management intends;
- Communications from external parties should be reviewed to corroborate internally generated information and to identify problems;
- Data recorded by information systems should be compared with physical assets;
- Training seminars, planning sessions and other meetings should be conducted to solicit important employee feedback to management on whether controls are effective; and
- Periodically ask employees to state explicitly whether they understand and comply with the company's code of conduct.

Separate evaluations

Separate evaluations pertain to periodic checks on the internal control system, focusing on the design of internal controls and their operating effectiveness. The scope and frequency of separate evaluations will depend on an assessment of risks, and how effective the on-going monitoring procedures are. The appropriateness of the separate evaluation methodology and process should also be assessed on a regular basis.

Normally separate evaluations are in the form of control self-assessment (CSA) or internal audits.

CSA is a monitoring control performed by operating staff on their own, led by department or function leaders. Although this approach is less objective than an internal audit, it creates staff ownership to the monitoring process thus achieving buy-in, and is a cost-effective method to collect detailed information. The common tools for self-assessments include questionnaires and workshop discussions. The CSA is a well recognised mechanism in a healthy internal control system and is formally written in the Institute of Internal Auditor (IIA)'s practice manuals.

Conducting internal audits in China

The scope of an internal audit for a newly-acquired entity should be carefully designed so that key concerns are addressed. A well conducted internal audit in China should generally cover:

- an audit plan that takes into consideration the business environment in China
- an audit team that has the Putonghua language capabilities and appropriate knowledge of the local business environment so that source transaction documentation can be reviewed without misinterpretation and practical recommendations can be made to management for improvements
- audit notifications that are fully communicated with local management and line management beforehand
- audit findings that have been communicated to local management before formalising them into a report

After an M&A transaction, the merged organisation should determine how it will align internal audit resources in the most cost-effective and flexible way. Typical internal audit taskforces may include an in-house internal audit team, co-sourcing and outsourcing which are expanded upon further below:

- **In-house internal audit team**

In this instance, the existing internal audit taskforce from the acquiring company will continue to play an important role to monitor the newly-acquired business operations.

- **Co-sourcing**

An internal audit team can have resource restraints or suffer from a temporary workload bottleneck, especially if M&A activities are an on-going concern. One solution is to engage external professionals from a locally-based audit firm, and build a combined team consisting of internal audit staff and external resources to perform audit work. More companies are adopting this model of co-sourcing to staffing their internal audit needs because it provides greater resource flexibility, a reduction in travel costs, removes language barriers, and promotes knowledge sharing internally and knowledge transfer from external professionals.

- **Outsourcing**

It remains challenging in the current dynamic business and legislative environment to maintain enough capacity in an internal audit function to cover global audit needs while keeping auditors up to date in all technical aspects. As a result, some companies outsource the entire or a portion of their internal audit function to external professional firms. This will enable them to quickly accommodate changes in priorities, resource needs, and areas of specialisation.

Reporting deficiencies

Internal control deficiencies should be reported upstream with certain matters reported to top management and the board. In implementing appropriate reporting processes, an assessment of the acquired entity should be conducted for:

- the existence of a mechanism to capture and report identified internal control deficiencies;
- the appropriateness of reporting protocols; and
- the appropriateness of follow-up actions.

5.7 Intellectual property rights protection and management

Intellectual property is recognised as one of the most important challenges of doing business in China. When integrating the operations of an acquired organisation in China, a buyer may consider developing a plan to protect intellectual property (IP) and implement IP practices before transferring technology and business know-how to the acquired entity. Foreign companies are often sharing technological and business secrets with partners in China without considering the potential IP risk exposure. They often fail to factor IP properly into their strategic and operational decisions and think about protecting IP only after it is stolen.

To properly manage intellectual assets, a buyer may need to modify its business model and learn to compete in an environment where IP rights and related assets are uneven or lacking. The buyer should also consider taking strategic and operational action to protect IP. Often, this entails identifying the essential IP required for operations in China, implementing processes or business structures to limit the exposure of valuable IP, and assessing the use of alternative processes and noncritical assets if possible.

Lessons learned in China

- IP issues in China are complex and are rarely straight-forward
- Litigation is no substitute for business strategy
- Careful planning can reduce the risk of losing a company's most valuable IP
- Take strategic, operational and legal action to protect IP before it is stolen. This will likely lower litigation costs and improve the odds that IP will remain safe

5.8 Ongoing compliance

5.8.1 Tax-related compliance obligations

During the tax due diligence process, various tax issues may be identified. Having identified these issues, the buyer may be able to undertake remedial actions to mitigate or safeguard against such issues after the target is acquired and during the integration process.

Table 25: Remedial and corrective opportunities to address common issues identified during the tax diligence process

Issues identified	Initiatives
Special deals with local tax authorities and unofficial tax concessions	<ul style="list-style-type: none">• If the technical position is clearly not in compliance with current PRC rules and regulations, corrective measures may need to be adopted and past exposures may need to be settled with the tax authority• If the technical position is ambiguous, it may be possible to approach the tax authority to discuss the tax issues in detail and obtain a written confirmation or lodge a meeting note. Although there is no guarantee that the target is completely free from any tax exposures from its past, this alternative can give some level of comfort and assurance. In the event that the tax authority wants to re-open the case, there may be a better position to argue for a better settlement, reduced or waived penalties and late payment interest• On a go-forward basis, carefully analyse technical positions and document supporting information if certain tax positions are taken in case positions are challenged

Table 25: Remedial and corrective opportunities to address common issues identified during the tax diligence process (Cont'd)

Issues identified	Initiatives
Tax compliance failure	<ul style="list-style-type: none"> • Review the tax compliance control process and integrate control processes during the merger and integration process • Implement proper procedures to control the tax reporting process to ensure tax compliance
Related party transactions	<ul style="list-style-type: none"> • Analyse the pricing methodologies for inter-company transactions • If not in compliance with PRC transfer pricing regulations and documentation requirements, proper procedures and steps need to be in place to achieve compliance • Proactively conduct transfer pricing planning to minimise tax costs for cross-border transactions and cross-entity transactions within China when the tax attributes of these entities are different (such as different tax rates, different tax incentives, etc.)

Compliance needs

Complying with the tax laws and regulations is a critical component of doing business in China. Therefore, a compliance control review is often recommended for a post-acquisition company. During the compliance control review, the major business activities will be analysed and the respective tax exposures under the existing model will be identified, based on which, potential tax improvement areas and control points from tax efficiency perspectives will be recommended. A compliance control review is different from a tax due diligence review, which aims to improve the control process of the post-acquisition company with a view to improving tax efficiency.

Integration needs

Once the post-acquisition company starts operation, it will be required to file tax returns after obtaining either a revised tax registration certificate in the case of a share acquisition, or a new tax registration certificate in the case of an asset acquisition when a new company is set up. The following are the major taxes an FIE may be subject to:

- Enterprise Income Tax (EIT);
- Value-Added Tax (VAT);
- Business Tax (BT);
- Individual Income Tax (IIT);
- Real Estate Tax (RET);
- Stamp Duty (SD);
- Customs Duty (CD);
- Land Appreciation Tax (LAT);
- Deed Tax (DT);
- Land Use Tax (LUT).

Tax return and payment deadlines for the above taxes are set out in the following table.

Table 26: Tax return and payment deadlines (as of May 2011)

Type of tax returns	Responsible persons	Filing and payment deadline
EIT quarterly return	<ul style="list-style-type: none"> FIEs and foreign enterprises with establishments in China 	<ul style="list-style-type: none"> Within 15 days of the end of each quarter - 15 January, 15 April, 15 July and 15 October
EIT annual settlement return	<ul style="list-style-type: none"> FIEs and foreign enterprises with establishments in China 	<ul style="list-style-type: none"> Within five months after the end of the tax year - accompanied by audited financial statements; final settlement shall be made within five months after the end of a tax year
VAT	<ul style="list-style-type: none"> Seller of taxable goods and services 	<ul style="list-style-type: none"> Within 15 days of the end of the month or taxable period
BT	<ul style="list-style-type: none"> Provider of taxable services; transferor of intangible assets and seller of real properties 	<ul style="list-style-type: none"> Within 15 days of the end of the month or taxable period
IIT	<ul style="list-style-type: none"> Withholding agent/self-reporting taxpayer 	<ul style="list-style-type: none"> Within 15 days after end of the tax month
RET	<ul style="list-style-type: none"> Owners of real properties or mortgagees where the real properties have been mortgaged 	<ul style="list-style-type: none"> May be paid by instalments, quarterly or half-yearly, at the discretion of the local tax authorities
SD	<ul style="list-style-type: none"> Parties to the dutiable documents 	<ul style="list-style-type: none"> When the dutiable documents are drawn up or received
CD	<ul style="list-style-type: none"> Receivers of imported goods and senders of exported goods 	<ul style="list-style-type: none"> Within 15 days after the issuance of CD payment notice
LAT	<ul style="list-style-type: none"> Transferors of land, buildings and associated structures 	<ul style="list-style-type: none"> Within 7 days after the signing of the transfer agreement
DT	<ul style="list-style-type: none"> Transferees of land, buildings ownership rights 	<ul style="list-style-type: none"> Within 10 days after the signing of the transfer agreement
LUT	<ul style="list-style-type: none"> The units and individuals using land within the scope of cities, county seats, towns and industrial and mining zones 	<ul style="list-style-type: none"> Decided by the Government of provinces, autonomous regions or municipalities

After the acquisition, restructuring of the existing company may be required from business as well as tax perspectives. Merger, division and liquidation may be some of the restructuring methods, each of which have very different sets of regulatory and tax considerations.

5.8.2 Internal controls-related compliance obligations

Sarbanes-Oxley compliance

For a listed company, especially one that is an SEC registrant, any newly-acquired business will likely be subject to a compliance obligation on internal controls.

Section 404 of the Sarbanes-Oxley Act of 2002 (SOX) is currently the most comprehensive and rigorous law governing internal controls that has been widely applied. To meet SOX Section 404 compliance requires the management of US-listed companies to state the responsibility for establishing and maintaining an adequate internal control structure and procedures for financial reporting, and to conduct an assessment of the effectiveness of the company's internal controls and procedures for financial reporting. It also requires an external auditor to attest to, and report on, the assessment by the management.

Upon completion of an M&A transaction, the buyer will need to determine whether and when the newly-acquired organisation should be scoped into the management assertion on internal controls over financial reporting.

Lessons learned in China

When the buyer is a US-listed company, to manage the SOX compliance risks arising from new M&A activities in China, the SOX compliance consideration should be taken from the initial stage of the decision making process, and be followed during the due diligence processes to obtain the answers to the following questions as early as possible:

- If the target company is to be financially consolidated with the acquirer after the transaction, how significant an entity would it be in the consolidated financial statements? Is there a possibility the total assets or total revenue of the target company make up five percent or more of the consolidated total assets or revenue?
- How good is the target company's existing internal control system? What are the major gaps compared to those of the SOX requirements?
- Accordingly, what would be the estimated SOX implementation costs in China after the M&A transaction?

Grace period

The SEC provides a buyer with an option to exclude the controls of the acquired business for a period of not more than one year from the date of the acquisition. However, the acquirer's assessment of ICFR should include those controls related to the following considerations in the period in which the acquisition occurs:

- process and controls over the authorisation of the acquisition;
- control objectives and activities related to the valuation and recording of the purchase price, including the preliminary allocation of the purchase price and subsequent revisions of the acquired assets and liabilities;
- appropriate disclosures relating to the acquisition in accordance with generally accepted accounting principles (GAAP) and the SEC Regulation S-X Rules.

In the event the buyer selects to exclude the newly-acquired business from its management assertion over ICFR at the end of the first fiscal year subsequent to the acquisition, external professionals can be engaged to assist with the readiness work and the disclosure, so as not to take up resources needed in the merger integration effort.

The design and operating effectiveness of the company-level controls to the newly-acquired entities should be identified and evaluated. Company-level controls are defined by the Public Company Accounting Oversight Board (PCAOB) auditing standard as controls that would affect multiple locations or entities, thus being more cost-effective and pervasive, and includes:

- controls within the control environment, such as tone at the top, organisational structure, commitment to competence, human resource policies and procedures;
- management's risk assessment process;
- centralised processing and controls, such as shared service environments;
- controls to monitor other controls, including activities of the internal audit function, the audit committee, and self assessment programs;
- period-end financial reporting process.

SOX implementation in China

For companies that are subject to SOX compliance, Figure 18 provides a view of a typical SOX readiness lifecycle project.

Figure 18: SOX readiness lifecycle

Timeline benchmark*	Plan	Identify & document	Identify control design gaps & remediation	Validation of control operating effectiveness	Management assertion
Timeline benchmark*	4 weeks	8 weeks	12 weeks	12 weeks	4 weeks
Major steps	<ul style="list-style-type: none"> • Scope and plan the project • Dedicate resources and define team roles & responsibilities • Conduct training • Present plan to audit committee 	<ul style="list-style-type: none"> • Identify and document entity level controls and company level controls • Identify and document process level controls and map account balances 	<ul style="list-style-type: none"> • Conduct initial internal control gap assessment • Perform walkthrough tests • Update documentation and remediate control design deficiencies 	<ul style="list-style-type: none"> • Set up testing strategy • Prepare the testing programmes • Perform and document tests on key controls • Update documentation and remediate control operating deficiencies 	<ul style="list-style-type: none"> • Conclude and prepare management assertion • Management sign-off

*The timeline benchmark is for reference only and subject to change according to each respective situation

The different phases of the SOX readiness lifecycle involves project planning, identifying controls and gaps, remediation of control deficiencies, validation of control operating effectiveness, and completing a management assertion.

• Phase 1: Plan

A SOX readiness project plan should generally at minimum include a timetable, a team of key team members with defined roles and responsibilities, a project scope, a time and resources estimate, and training plan.

Generally, a team will be comprised of professionals from internal audit teams, process owners and external professionals. One of the challenges of SOX readiness projects in China is to find sufficient resources with appropriate project management skills, SOX expertise and internal control knowledge.

Awareness and support across the organisation should be generated by conducting training sessions and workshops to all levels of management. Engaging external experienced professionals to be involved may facilitate knowledge sharing and knowledge transfer to project team members and ease company resource constraints.

A risk assessment exercise is used to define the scope of SOX projects and take into consideration both quantitative and qualitative factors, such as financial materiality, business complexity and specific identified risks. A well conducted risk assessment exercise should also cover locations where significant operations exist, and identify significant financial accounts and related business processes across the organisation, including the acquirer and the acquired entity.

Once a plan is developed and approved by senior management, it should be submitted for Audit Committee approval.

- **Phase 2: Identify and document**

In most instances, the acquired entities are considered significant in terms of SOX compliance. As a result, a top-down risk-based approach to manage compliance should be applied as recommended by SEC and PCAOB. The identification process should start from entity-level controls and company-level controls, and then focus on the process-level controls.

Ideally, control identification and documentation is performed by experienced employees who fully understand the internal control concepts and have sufficient knowledge in the areas they are working. The documentation can include narratives, flowcharts, or risk-oriented matrixes. The control documentation should comply with SOX and auditing standard #5 issued by the PCAOB. Key control activities should be identified and stated in a clear and concise way, with a logical reference to facilitate management evaluation and testing.

The language of the control documentation must be carefully chosen. Local staff in China needs to understand the document to guide their daily operations; management will use the document to perform ongoing evaluation and testing; and internal and external auditors will need to review the document to perform audits. Therefore, the appropriate language should be selected so that the needs of all parties are met.

- **Phase 3: Identify control design gaps and remediation**

A control design gap analysis involves conducting an initial internal control gap assessment, performing walkthrough tests, and updating documentation and remediate control design deficiencies.

Existing control activities are evaluated over the control objectives and walkthrough tests performed during this stage can confirm that the documented controls are in line with practice. Any control gaps or deficiencies noted will be raised for remedial actions.

- **Phase 4: Validation of control operating effectiveness**

Controls should be tested to prove that they are operating effectively (OE). This requires the development of a testing strategy and testing programs to validate effectiveness.

The next step is to perform and document tests on key controls. In performing this task, it is common practice to engage external resources in China. While selecting the appropriate service provider, it must be noted that the objectivity of the testing performer will affect the reliance strategy of the external auditor, and thus has an impact on audit costs. The more independent and competent the testing performer is, the more reliable the testing results are regarded as, and in turn, the more audit costs saved. However, it should be noted that PCAOB standards require external auditors to perform independent tests on certain key controls regardless of whether such tests have been performed by another party.

Before engaging testing performers, management should understand the different levels of independence offered by different service providers. The most common professionals engaged in descending order of independence are generally:

- external consultants;
- internal audit team;
- operation staff who are not responsible for the areas under tests; and
- operation staff who are responsible for the areas under tests.

In this phase, action plans to improve design and operating deficiencies should also be developed and implemented.

Specific individuals within an organisation should be assigned accountability for the completion of remedial actions within a reasonable timeframe. To improve the effectiveness of the corrective actions, regular tracking and monitoring of the remedial status should be conducted.

• **Phase 5: Management assertion**

The final step to SOX compliance is to conclude the management evaluation on control design and operating effectiveness based on the work that has been done in prior phases. A management assertion should be prepared and issued to the public by the CEO and CFO of the buyer. Within the buyer's organisation, divisional and regional management would usually be asked to provide a sign-off document to the company CEO and CFO and a sign-off would also be required from the newly acquired China entity.

SOX compliance challenges in China

Achieving SOX compliance is not a simple exercise. The following highlights several challenges that are more pervasive in Chinese companies working toward SOX Section 404 compliance.

- Lack of an enterprise-wide, executive-driven internal control management programme.
- Lack of a formal enterprise risk management programme.
- Inadequate controls associated with the recording of non-routine, complex, and unusual transactions.
- Poorly managed post-merger integration due to management culture and language barriers.
- Lack of effective controls over the IT environment.
- Ineffective financial reporting and disclosure preparation processes.
- Lack of formal controls over the financial closing process.
- Inability to evaluate and test controls over outsourced processes.
- Inadequate board and audit committee understanding of risk and control.

In addressing these challenges, it is common practice for many Chinese companies to engage experienced professionals to assist with the SOX readiness efforts. Areas where external resources have facilitated the process include:

- conducting training sessions or interactive workshops for management in the acquired entities;
- project planning, risk assessment, and process and location scoping;
- documenting "As-Is" controls, which is the foundation for management's control evaluation and testing;

- conducting control gap analyses by benchmarking control objectives, best practice control activities and local practices;
- providing recommendations on remedial actions; and
- performing control tests.

Other internal control compliance requirements

In China, in addition to SOX compliance, there are other local internal control compliance requirements that listed companies in the Shanghai, Shenzhen and Hong Kong stock exchanges may need to prepare for.

- In Mainland China, the Ministry of Finance, the China Securities Regulatory Commission, the National Audit Office, the China Banking Regulatory Commission and the China Insurance Regulatory Commission jointly issued the Basic Standard for Enterprise Internal Control, which is effective from July 2009. All listed companies are required to perform self-assessment over the effectiveness of its internal control system and disclose the annual self-assessment result. Listed companies can also appoint qualified professional accounting firms to perform internal audit.
- In Hong Kong, the Hong Kong Stock Exchange (HKSE) has issued the Revised Code on Corporate Governance (Appendix 14) in 2006 . All listed companies should at least annually conduct a review of the effectiveness of internal control system and such review should cover all material controls and risk management functions. According to Corporate Governance Report (Appendix 23 of HKSE listing rule) listed companies are required to prepare a report on corporate governance practices and disclose on a comply or explain basis on the internal control requirements stated in Appendix 14. For initial public offering, according to HKSE listing rule 3A.15(5), sponsors are required to make reasonable due diligence enquiries of the applicant's procedures, systems and controls (including accounting and management systems).

An approach similar to the one for SOX readiness should be established to prepare for compliance.

Lesson learned in China

If the target company is listed in any of the stock exchanges in China, i.e., SSE, SZE, and HKSE, the buyer should consider the relevant internal controls compliance requirements early in the M&A process. It is recommended that lawyers and external control professionals engaged by the buyer assess the impact of these compliance requirements on the transaction and assist with the compliance readiness work as part of the integration process.

Summary

- Merger integration should commence as soon as possible and start with pre-close planning and creation of an integration roadmap
- Establish an effective integration project team with appropriate sponsors, a Programme Management Office and functional and control teams
- Plan for a smooth Day One operations and focus on the "must haves"
- Manage operations transitions - adopt best practices when applicable
- Manage stakeholders through effective communications
- Consider implementing IP protection practices before transferring technology and business know-how to the acquired entity
- Ensure that the post-acquisition company complies with tax laws and regulations as FIEs may be subject to a number of taxes with specific filing and payment deadlines
- Ensure on-going compliance requirements are met - these may include tax compliance obligations, Sarbanes-Oxley compliance and other internal control requirements

Acronym reference list

Acronym reference list

ASBE	Accounting Standards for Business Enterprises
BPR	Business Process Reengineering
BT	Business Tax
CA	Control Activities
CAPEX	Capital Expenditure
CD	Customs Duty
CDD	Commercial Due Diligence
CEO	Chief Executive Officer
CFO	Chief Financial Officer
CHC	China Holding Company
CO	Control Objectives
COSO	Committee of Sponsoring Organisations of the Treadway Commission
CRM	Customer Relationship Management
CSA	Control Self Assessment
CSRC	China Securities Regulatory Commission
DCF	Discounted Cashflow Method
DT	Deed Tax
EBIT	Earnings before interest and taxes
EBITDA	Earnings before interest, taxes, depreciation and amortisation
EIT	Enterprise Income Tax
ERM	Enterprise Risk Management
ERP	Enterprise Resource Planning
FCPA	Foreign Corrupt Practices Act
FRR	Fraud Risk Review
FIE	Foreign-invested Enterprise
GAAP	Generally Accepted Accounting Principles
HKSE	Hong Kong Stock Exchange
HR	Human Resources
HRIS	Human Resources Information System
ICFR	Internal Control for Financial Reporting
IFRS	International Financial Reporting Standards
IIT	Individual Income Tax
IP	Intellectual Property
IPO	Initial Public Offering

IPMO	Integration Programme Management Office
IT	Information Technology
KPI	Key Performance Indicators
LBO	Leverage Buyout
LOI	Letter of Intent
LUT	Land Use Tax
LAT	Land Appreciation Tax
M&A	Mergers and Acquisitions
MOFCOMM	Ministry of Commerce
OE	Operating Effectiveness
PCAOB	Public Company Accounting Oversight Board
PPA	Purchase Price Adjustment
PRC	People's Republic of China
R&D	Research and Development
RET	Real Estate Tax
RMB	Renminbi
ROI	Return on Investment
SAFE	State Administration of Foreign Exchange
SAIC	State Administration for Industry and Commerce
SCM	Supply Chain Management
SD	Stamp Duty
SEC	Securities Exchange Commission
SOE	State-owned Enterprise
SOX	Sarbanes Oxley
SPV	Special Purpose Vehicle
S&P	Sale and Purchase
VAT	Value-added Tax
WFOE	Wholly foreign-owned enterprise
WHT	Withholding Tax
WTO	World Trade Organization

Appendices

Appendix 1

Administrative Measures on Strategic Investment in Listed Companies by Foreign Investors **《外国投资者对上市公司战略投资管理办法》**

Ministry of Commerce, China Securities Regulatory Commission, State Administration of Taxation, State Administration for Industry and Commerce and State Administration of Foreign Exchange Order No. (2005) 28

31 December 2005

Article 1

These Measures are formulated in accordance with the requirements of the *Guidelines on Equity Separation Reform for Listed Companies* and the provisions of State laws and regulations on foreign investment and governance of listed companies and the *Provisional Regulations on Foreign-funded Mergers and Acquisitions of Domestic Enterprises* for the purposes of regulating strategic investment by foreign investors in "A" shares listed companies (hereinafter referred to as the "listed companies") following the equity separation reform, safeguarding the order of the securities market, attracting advanced management expertise, technologies and funds from overseas, improving the governance structure for listed companies and protecting the legitimate rights and interests of listed companies and shareholders.

Article 2

These Measures shall apply to acquisition of "A" shares in listed companies which have undergone equity separation reform and new listed companies after the equity separation reform by foreign investors (hereinafter referred to as the "investors") through medium- and long-term strategic merger and acquisition investment of a certain scale (hereinafter referred to as the "strategic investment").

Article 3

Upon approval of the Ministry of Commerce, the investors may make strategic investment in listed companies in accordance with the provisions of these Measures.

Article 4

Strategic investment shall comply with the following principles:

1. comply with State laws and regulations and the relevant industry policies and shall not endanger national and economic security and public interest;
2. uphold the principles of transparency, fairness and equitableness, safeguard the legitimate rights and interests of listed companies and their shareholders, be subject to the supervision of the government and general public and the jurisdiction of Chinese judicial and arbitration authorities;
3. encourage medium- and long-term investment, safeguard the order of the securities market and speculation shall not be allowed; and
4. shall not obstruct fair competition or cause over-concentration in the relevant product markets in China or exclude or restrict competition.

Article 5

Investors making strategic investment shall satisfy the following requirements:

1. holding of "A" shares in listed companies through negotiated transfer, directed placement of new shares by listed companies and other methods stipulated by State laws and regulations;
2. the investment may be made in phases and the shareholding upon completion of initial investment shall not be lower than 10% of the issued share capital of the company, unless otherwise provided for special industries or approved by the relevant authorities;
3. holding of "A" shares in listed companies shall be subject to a three-year moratorium;

4. investors holding shares in industries where the laws and regulations stipulate foreign investment shareholding ratio shall comply with the relevant provisions in respect of such shareholding ratio for the industry; investors shall not invest in listed companies in industries where the laws and regulations prohibit foreign investment;
5. where the investment involves holding of State-owned shares in listed companies, the relevant provisions on administration of State-owned assets shall be complied with.

Article 6

Investors shall satisfy the following requirements:

1. foreign legal persons or other organisations duly established and operating with sound finance, good creditworthiness and sophisticated management expertise;
2. total overseas assets owned by the investor shall not be less than US\$100 million or the total overseas assets managed by the investor shall not be less than US\$500 million; or the total overseas assets owned by its parent company shall not be less than US\$100 million or the total overseas assets managed by its parent company shall not be less than US\$500 million;
3. it has a proper governance structure and good internal control system and operating norms; and
4. it has not been subject to severe punishment imposed by regulatory authorities in China and overseas during the last three years (including its parent company).

Article 7

Strategic investment by way of directed placement of a listed company shall be handled in accordance with the following procedures:

1. a resolution on directed placement of new shares to the investor and amendment of the articles of association of the company has been passed by the board of directors of the listed company;
2. a resolution on directed placement of new shares and amendment of the articles of association of the company has been passed by a general meeting of the listed company;
3. a contract on directed placement of shares has been concluded between the listed company and the investor;
4. the listed company has submitted the relevant application documents to the Ministry of Commerce in accordance with the provisions of Article 12; where there are specific provisions, such provisions shall be complied with;
5. upon issue of an in-principle approval reply from the Ministry of Commerce to the strategic investment of the investor in the listed company, the listed company shall submit application documents for directed placement to the China Securities Regulatory Commission and the China Securities Regulatory Commission shall verify and approve in accordance with the provisions of the law; and
6. upon completion of the directed placement, the listed company shall collect a Foreign Investment Enterprise Approval Certificate from the Ministry of Commerce and present the Approval Certificate to the industrial and commercial administration authorities for completion of change registration formalities.

Article 8

Strategic investment through negotiated transfer shall be handled in accordance with the following procedures:

1. a resolution on strategic investment by the investor by way of negotiated transfer has been passed by the board of directors of the listed company;

2. a resolution on strategic investment by the investor by way of negotiated transfer has been passed by a general meeting of the listed company;
3. a share transfer agreement has been concluded between the transferor and the investor;
4. the investor has submitted the relevant application documents to the Ministry of Commerce in accordance with the provisions of Article 12; where there are specific provisions, such provisions shall be complied with;
5. investors acquiring shares of listed companies shall, upon obtaining the aforesaid approval, complete share transfer confirmation formalities with the stock exchange, complete registration and transfer of title formalities with the securities registration and clearing organisation, and file records with the China Securities Regulatory Commission; and
6. upon completion of the negotiated transfer, the listed company shall collect a Foreign Investment Enterprise Approval Certificate from the Ministry of Commerce and present the Approval Certificate to the industrial and commercial administration authorities for completion of change registration formalities.

Article 9

An investor proposing to obtain actual control of a listed company through negotiated transfer shall, upon obtaining approval in accordance with the procedures stipulated in Article 8(1), (2), (3), (4), submit a listed company acquisition report and the relevant documents to the China Securities Regulatory Commission; upon passing the examination and verification by the China Securities Regulatory Commission, the investor shall complete share transfer confirmation formalities with the stock exchange, complete registration and transfer of title with the securities registration and clearing organisation. Upon completion of the aforesaid formalities, the matters stated in Article 8(6) shall be handled.

Article 10

Strategic investment by investors in listed companies shall comply with reporting, announcement and other statutory obligations in accordance with the provisions of the *Securities Law* and relevant regulations of the China Securities Regulatory Commission.

Article 11

Investors of listed companies who continue to make strategic investment in such listed companies shall complete the relevant matters and procedures in accordance with the provisions of these Measures.

Article 12

Listed companies or investors shall submit the following documents to the Ministry of Commerce:

1. application form for strategic investment;
2. strategic investment scheme;
3. directed placement contract or share transfer agreement;
4. sponsor opinion (in the case of a directed placement) or legal opinion;
5. investor's letter of undertaking for continuing shareholding;
6. a declaration that the investor has not been subject to severe punishment imposed by regulatory authorities in China and overseas during the past three years and explanation on whether it has been subject to any other non-severe punishment;
7. the certificate of incorporation of the investor and identity document of the legal representative (or authorized representative) duly notarised and certified;
8. audited balance sheets of the investor for the past three years;

9. the documents stipulated in (1) , (2) , (3) , (5) and (6) above shall be signed by the legal representative of the investor or his/her authorised representative, where the documents are signed by an authorised representative, the power of attorney signed by the legal representative and the corresponding notarisation and certification documents shall be provided; and
10. other documents stipulated by the Ministry of Commerce.

The original Chinese copy of all the aforesaid documents shall be submitted, except for documents stated in (7) and (8); the original copies of the documents stated in (7) and (8) shall be submitted together with the Chinese translation. The Ministry of Commerce shall issue an in-principle reply within 30 days from receipt of all the aforesaid documents and the in-principle reply shall be valid for 180 days.

Article 13

Foreign companies (the "parent company") which satisfy the requirements stipulated in Article 6 may make strategic investment through their wholly-owned overseas subsidiaries (the "investors"); the investors shall, in addition to the documents stated in Article 12, submit to the Ministry of Commerce a irrevocable letter of undertaking by their parent company for joint liability towards the investment by the investors.

Article 14

The investors shall open a foreign exchange account in accordance with the relevant provisions on foreign-funded mergers and acquisitions within 15 days from the date of in-principle reply of the Ministry of Commerce. Investors remitting foreign exchange funds into China for use in strategic investment shall open a designated foreign exchange account (M&A category) for foreign investor with the foreign exchange bureau at the place of registration of the listed company in accordance with the relevant provisions on foreign exchange administration; the foreign exchange settlement of funds in the account and closing of account shall be handled in accordance with the relevant provisions on foreign exchange administration.

Article 15

Investors may present the approval document issued by the Ministry of Commerce for strategic investment by the investor in a listed company and their valid identity document to complete the relevant formalities with the securities registration and clearing organisation.

Securities registration and clearing organisations may, based on the application by the investors, open securities accounts for investors holding non-circulating shares prior to the equity separation reform of a listed company or shares held in a listed company prior to its initial public offer.

Securities registration and clearing organisations shall formulate the relevant provisions in accordance with the provisions of these Measures.

Article 16

Investors shall initiate strategic investment within 15 days from foreign exchange settlement of the funds and complete strategic investment within 180 days from the date of in-principle reply.

The in-principle reply of the examination and approval authorities shall become void automatically if an investor is unable to complete strategic investment based on the strategic investment within the stipulated period. The investor shall purchase foreign exchange using the proceeds from foreign exchange settlement and remit the foreign exchange funds overseas within 45 days from the date on which the in-principle reply became invalid.

Article 17

The listed company shall present the following documents to collect the Foreign Investment Enterprise Approval Certificate from the Ministry of Commerce within ten days from completion of strategic investment:

1. application form;
2. in-principle approval letter issued by the Ministry of Commerce;
3. certificate of shareholding issued by the securities registration and clearing organisation;
4. business licence of the listed company and identity document of the legal representative; and
5. articles of association of the listed company.

The Ministry of Commerce shall issue a Foreign Investment Enterprise Approval Certificate stating "foreign-invested shareholding company (acquisition of "A" shares)" within five days from receipt of all the aforesaid documents.

If an investor who holds 25% or more of the shares of a listed company undertakes to hold not less than 25% of shares continuously in the listed company within ten years, the Ministry of Commerce shall issue a Foreign Investment Enterprise Approval Certificate stating "foreign-invested shareholding company (acquisition of 25% or more of "A" shares)".

Article 18

The listed company shall complete change registration formalities with the industrial and commercial administration authorities for change of company type within 30 days from the date of issue of the Foreign Investment Enterprise Approval Certificate and submit the following documents:

1. application form for change signed by the legal representative of the company;
2. the Foreign Investment Enterprise Approval Certificate;
3. certificate of shareholding issued by the securities registration and clearing organisation;
4. valid and duly notarised and certified certificate of business commencement of the investor; and
5. other documents required by the State Administration for Industry and Commerce.

If the change is verified and approved, the industrial and commercial administration authorities shall indicate the wordings "foreign-invested shareholding company (acquisition of "A" shares)" at the column of "Type of enterprise" in the business licence; where the investor holds 25% or more of the shares in the listed company through strategic investment and undertakes to hold not less than 25% of the shares in the listed company continuously within ten years, the wordings "foreign-invested shareholding company (acquisition of 25% or more of "A" shares)" shall be indicated.

Article 19

The listed company shall complete the relevant formalities with the taxation, Customs and foreign exchange administration authorities, etc. within 30 days from the date of issue of the Foreign Investment Enterprise Business Licence. The foreign exchange administration authorities shall issue a foreign exchange registration certificate stating "foreign-invested shareholding company (acquisition of "A" shares)". If the investor holds 25% or more of the shares in the listed company through strategic investment and undertakes to hold not less than 25% of the shares in the listed company continuously within ten years, the wordings "foreign-invested shareholding company (acquisition of 25% or more of "A" shares)" shall be indicated on the foreign exchange registration certificate by the foreign exchange administration authorities.

Article 20

Except for the following circumstances, the investor shall not engage in securities trading (with the exception of "B" shares):

1. the "A" shares held by an investor through strategic investment in a listed company can be sold upon expiry of the period which the investor undertakes to hold the shares;
2. an investor acquiring shares by way of an offer in accordance with the relevant provisions of the Securities Law may acquire shares sold by shareholders of "A" shares of the listed company during the offer period;
3. the non-circulating shares held by an investor prior to the equity separation reform of a listed company can be sold upon completion of the equity separation reform and expiry of the moratorium;
4. the shares held by an investor prior to the initial public offer of a listed company can be sold upon expiry of the moratorium; and
5. where an investor has obtained the approval of the Ministry of Commerce to transfer shares prior to the expiry of the period which the investor undertakes to hold the shares for special reason such as bankruptcy, liquidation, mortgage, etc. which requires the investor to transfer its shares.

Article 21

In the event that the reduction in shareholding of an investor renders the foreign shareholding ratio of a listed company to fall below 25%, the listed company shall file records with the Ministry of Commerce within ten days and complete the relevant formalities for amendment to the Foreign Investment Enterprise Approval Certificate.

In the event that the reduction of shareholding of an investor renders the foreign shareholding ratio of a listed company to fall below 10% and the investor is not the single largest shareholder, the listed company shall file records with the examination and approval authorities within ten days and complete the relevant formalities for cancellation of the Foreign Investment Enterprises Approval Certificate.

Article 22

In the event that the reduction in shareholding of an investor renders the foreign shareholding ratio of a listed company to fall below 25%, the listed company shall complete change registration formalities with the industrial and commercial administration authorities within 30 days from the amendment of the Foreign Investment Enterprise Approval Certificate; the industrial and commercial administration authorities shall amend the "type of enterprise" on the business licence to read as "foreign-invested shareholding company (acquisition of "A" shares)". The listed company shall complete change formalities for foreign exchange with the foreign exchange administration authorities within 30 days from the amendment of the business licence; the foreign exchange administration authorities shall indicate the wordings "foreign-invested shareholding company (acquisition of "A" shares)" on the foreign exchange registration certificate.

In the event that the reduction of shareholding of an investor renders the foreign shareholding ratio of a listed company to fall below 10% and the investor is not the single largest shareholder, the listed company shall complete change registration formalities with the industrial and commercial administration authorities within 30 days from the cancellation of the Foreign Investment Enterprise Approval Certificate and the type of enterprise shall be changed to "company limited by shares". The listed company shall complete cancellation formalities for foreign exchange registration with the foreign exchange administration authorities within 30 days from the date of amendment of the business licence.

Article 23

Parent companies making strategic investment through a wholly-owned overseas subsidiary and having completed the strategic investment in accordance with the schedule shall report to the Ministry of Commerce before transferring the aforesaid overseas subsidiary and submit an application in accordance

with the procedures stipulated in these Measures. The transferee is required to satisfy the requirements stipulated in these Measures and shall enjoy all rights and bear all liabilities of the parent company and its subsidiary in the listed company and report to the China Securities Regulatory Commission, make announcements and perform other statutory obligations in accordance with the law.

Article 24

An investor transferring the shares of a listed company through the "A" shares market may present the following documents to purchase foreign exchange with the foreign exchange bureau at the place of registration of the listed company for overseas remittance:

1. written application;
2. approval letter for foreign exchange settlement issued by the foreign exchange bureau for funds in the designated foreign exchange account (M&A category) for foreign investor for strategic investment purpose; and
3. documentary proof of securities trading issued by a securities brokerage.

Article 25

Where the shareholding ratio of investors in a listed company is less than 25%, the foreign debt of the listed company shall be handled in accordance with the relevant provisions on foreign debt of Chinese-funded enterprises in China.

Article 26

Personnel of the relevant government authorities shall be loyal to their duties and perform their duties in accordance with the law and shall not use their official powers to solicit improper gains and shall keep commercial secrets made known to them confidential.

Article 27

Investors from Hong Kong Special Administrative Region, Macau Special Administrative Region and Taiwan making strategic investment shall refer to the provisions of these Measures.

Article 28

These Measures shall come into effect 30 days after the date of promulgation.

©2006 CCH Asia Pte Limited

All rights reserved.

First published in *China Laws for Foreign Business - Business Regulations*, a comprehensive collection of key PRC business regulations by CCH Asia.

Appendix 2

Provision on Merger and Division of Foreign Investment Enterprises 《外商投资企业合并与分立的规定》

Waijinmaofafa (1999) No 395

Issued 23 September 1999 jointly by the Ministry of Foreign Trade and Economic Cooperation and the State Administration for Industry and Commerce

Revised and re-issued 22 November 2001 in accordance with the Decision of the Ministry of Foreign Trade and Economic Cooperation and the State Administration for Industry and Commerce to Revise the Provisions on Merger and Division of Foreign Investment Enterprises

Article 1

These Provisions are formulated, in accordance with the Company Law of the People's Republic of China and relevant laws and administrative regulations on foreign investment enterprises, in order to regulate activities in relation to merger and division of foreign investment enterprises, and to protect the legitimate rights and interests of investors in and creditors of enterprises.

Article 2

These Provisions apply to the merger and division of Sino-foreign equity joint enterprises, Sino-foreign co-operative enterprises with legal status, wholly foreign-owned enterprises, and foreign investment companies limited by shares (hereinafter referred to as companies), which are established within the territory of China in accordance with Chinese law.

A company merging with a Chinese domestic enterprise shall be handled in reference to relevant laws, regulations and these Provisions.

Article 3

The term "merger", for the purpose of these Provisions, refers to two or more companies that join together and become one company in accordance with relevant provisions of the Company Law and through agreement.

A company merger may proceed either through the absorption method or through the establishment of a new entity.

A merger by absorption refers to a company accepting another company or companies to join itself, where the accepting party continues to exist and the entering party dissolves.

A merger by establishing a new entity refers to two or more companies merging to establish a new company, upon which all merging parties dissolve.

Article 4

The term "division", for the purpose of these Provisions, refers to one company being divided into two or more companies in accordance with relevant provisions of the Company Law and by a resolution of the company's highest power organ.

A company division may proceed either through the continuous existence method or through dissolution.

Division through continuous existence refers to the situation in which one company is divided into two or more companies, whereby the original company continues to exist and one or more new companies are established.

Division by dissolution refers to the situation wherein one company is divided into two or more companies, upon which the original company dissolves and two or more new companies are established.

Article 5

A company merger or division must be carried out in accordance with Chinese law, regulations, the present Provisions and principles of voluntariness, equality and fair competition, and it shall not harm the public interests and the legitimate rights and interests of the creditors.

A company merger or division must comply with provisions of the Provisional Regulations on Foreign Investment Guidelines and the Guideline Catalogue of Foreign Investment Industries. It must not lead to a situation where foreign investors become the sole investor, controlling shareholder or dominant investor of a company in an industry in which sole foreign investment, foreign share-control or foreign domination is not permitted.

Where a company merger or division results in changes in the trade or business scope of the company, such changes must comply with provisions of relevant laws, regulations and state industry policies, and necessary examination and approval procedures must be carried out.

Article 6

A company merger or division shall comply with regulations issued by customs, taxation authorities, foreign exchange administration and other relevant authorities. After merger or division, the continuous company or the newly established company will, upon verification by the examination and approval organ, the customs, taxation administration and other relevant authorities, continue to enjoy the various foreign investment preferential treatments which the original company enjoyed.

Article 7

A company merger or division shall be approved by the original approval organ of the company, and shall carry out relevant procedures for the establishment, alteration or cancellation with registration organs.

If a company intending to merge has two or more original examination and approval organs or registration organs, the examination organ and registration organ shall be the organs authorised by the department in charge of foreign economic relations and trade and the State Administration for Industry and Commerce (referred to as SAIC) in the locality in which the merged company is located.

If the total amount of foreign investment of the companies intending to merge is not within the examination and approval power of the companies' original examination and approval organ or the examination and approval organ in the region in which the merged company is located, it shall be examined and approved by the examination and approval organ with appropriate power.

If one of the companies intending to merge is a company limited by shares, such a merger shall be examined and approved by the Ministry of Foreign Trade and Economic Cooperation of the People's Republic of China (referred to as MOFTEC).

Article 8

Where the original company is dissolved or new companies are established in other regions as a result of a company merger or division, the examination and approval organ in the region in which the company is to be dissolved or established shall be consulted.

Article 9

A company shall not be merged or divided before investors have made their investment in full and met cooperation conditions in accordance with provisions of the contract and Articles of Association of the company, and the company has commenced its production and operation. A company may be merged with a domestic enterprise if investors have made their investment and met cooperation conditions in accordance with provisions of the contract and Articles of Association of the company.

Article 10

Limited liability companies will become a limited liability company after their merger. Companies limited by shares will become a company limited by shares after their merger.

Where a merger occurs between listed companies limited by shares and limited liability companies, it becomes a company limited by shares. A non-listed company limited by shares merging with a limited liability company may become either a company limited by shares or a limited liability company after the merger.

Article 11

Where a merger occurs between companies limited by shares or a company limited by shares is established by merger, the registered capital of the merged company shall be the sum total of the registered capital of the original companies.

Where a limited liability company merges with a company limited by shares and becomes a company limited by shares, the registered capital of the merged company shall be the sum of the value of shares which are converted from the net capital value of the limited liability company on the basis of the value of each share of the company limited by shares, plus the total value of the shares of the original company limited by shares.

Article 12

Where a merger is made in accordance with paragraph 1 of Article 11 of these Provisions, the ratio of share rights of various investing parties in the merged company shall, in accordance with relevant state provisions, and after consultation among the investors or upon the results of valuation of the share rights of individual investors in the original company conducted by an asset valuation organisation, be determined in the contract and the Articles of Association of the merged company, but the ratio of the foreign investors' shares rights must not be less than 25% of the registered capital of the merged company.

Article 13

The amount of registered capital of a divided company shall be determined by the highest power organ of the original company, in accordance with relevant laws and regulations on foreign investment enterprise as well as relevant provisions of the registration organ, but the sum total of registered capital of divided companies must be the amount of the registered capital of the company before the division.

Article 14

The share rights of various investing parties in the company after the division shall be determined by the investors in the company contract and Articles of Association of the divided company, but the ratio of the foreign investors' shares rights shall not be less than 25% of the registered capital of the divided company.

Article 15

Where a company is merged through the absorption method, the date of establishment of the accepting company is the date of the establishment of the merged company. Where a company is merged through the establishment of a new entity, the date on which the registration of the company's establishment is approved and a business licence is issued by the registration organ shall be the date of the establishment of the merged company.

Where new companies are established as a result of company division, the date on which the registration of the companies' establishment is approved and business licences are issued by the registration organ shall be the date of the establishment of the divided companies.

Article 16

Where a merger or division involves listed companies limited by shares, it shall comply with relevant laws and regulations, and provisions of the securities supervision and administration department of the State Council concerning listed companies, and necessary examination and approval procedures shall be completed.

Article 17

A company merging with Chinese domestic enterprises must comply with provisions of Chinese law and regulations on the utilisation of foreign funds as well as industry policies, and must also meet the following conditions:

1. the Chinese domestic enterprise intended to be merged is a limited liability company or a company limited by shares whose establishment accords with provisions of the Company Law of the People's Republic of China;
2. the investors satisfy with qualification requirements for investors to engage in the relevant industry to which the merged company belongs, as provided by the law, regulations and departmental rules;
3. the ratio of foreign investors' share rights shall not be less than 25% of the registered capital of the merged company; and
4. various parties in the merger agreement shall ensure that the existing staff and workers of the company intended to be merged are sufficiently employed or proper arrangements are made for them.

Article 18

Where a foreign investment enterprise is established after a merger between a company and a domestic enterprises, the total investment amount shall be the sum total of the total investment of the original company and the total enterprise assets of the domestic enterprise as stated in the enterprise financial auditing report, and the total registered capital shall be the sum total of the registered capital of the original company and that of the domestic enterprise. The ratio between the registered capital and the total investment of the merged company must conform with the Provisional Regulations on the Ratio between the Registered Capital and Total Investment of Sino-foreign Equity Joint Enterprises issued by the State Administration for Industry and Commerce. In special circumstances where such requirements may not be met, it must be reported to the Ministry for Foreign Trade and Economic Cooperation and the State Administration for Industry and Commerce for approval.

Article 19

Where enterprises established by a domestic enterprise which is merged with a company become enterprises whose shares are held by the merged company, the Interim Provisions on Investment Inside China by Foreign Investment Enterprises and other industry policies on foreign investment must be complied with. The merged company must not hold shares in enterprises in which foreign investment is prohibited.

Article 20

In cases of a company merger through absorption, the accepting company shall be the applicant; and in cases of a company merger through establishment of a new entity, the merging parties shall nominate an applicant through consultation.

An applicant shall submit to the examination and approval organ the following documents:

1. an application statement on the company merger signed by legal representatives of all merging companies and the agreement for a company merger;
2. resolutions of the highest power organs of the merging companies regarding the company merger;

3. contracts and Articles of Association of all merging companies;
4. approval documents and copies of business licences of all merging companies;
5. capital verification reports of all merging companies, produced by statutory capital verification organs of China;
6. balance sheets and property inventories of all merging companies;
7. the past year's audit reports of all merging companies;
8. the lists of names of creditors of all merging companies;
9. the company contract and Articles of Association of the merged company;
10. the name list of members of the highest power organ in the merged company; and
11. other documents required by the examination and approval organ.

Where a company is merged with a domestic enterprise, the applicant shall also submit to the examination and approval organ photocopies of business licences of enterprises established through investment by the domestic enterprise involved in the merger.

Article 21

A company merger agreement must contain the following major items:

1. names, addresses and legal representatives of various parties to the merger agreement;
2. the name, address and legal representative of the merged company;
3. the total amount of investment capital and the registered capital of the merged company;
4. method of merger;
5. plans for absorbing debts receivable and debts payable by various parties into the merger agreement;
6. measures for arrangement of staff and workers;
7. liabilities for breach of agreement;
8. methods for dispute settlement;
9. date and place of the agreement signed; and
10. other matters that various parties to the merger agreement deem necessary to be included.

Article 22

If a company intending to merge has two or more original examination and approval organs, the company intended to be dissolved shall, prior to the submission of relevant documents to the examination and approval organ in accordance with Article 18 of these Provisions, submit an application to its original examination and approval organ for dissolution as a result of the company merger.

The original examination and approval organ shall, within fifteen (15) days of receiving the application for dissolution as provided in the above paragraph, give a response on whether or not the dissolution application is approved. If the original examination and approval organ does not respond within fifteen (15) days, it shall be deemed that the original examination and approval organ has agreed to the dissolution of the company concerned.

Where the original examination and approval organ gives a response disagreeing with the company's dissolution within the time period stipulated in the above paragraph, the company intended to be

dissolved may submit the company dissolution application to the competent department in charge of foreign economic relations and trade at a higher level, which is the next common authority over both the original examination and approval organ of the applicant and the examination and approval organ for the company merger. The competent department shall make its decision within thirty (30) days of receipt of the company's dissolution application.

Where the examination and approval organ disagrees or does not approve the company merger, the response to the company dissolution shall automatically cease its validity.

Article 23

A company intending to make a division shall submit the following documents to the examination and approval organ:

1. application for company division signed by the legal representative of the company;
2. the resolution of the highest power organs of the company on the company division;
3. the company division agreement signed by the continuing company and the companies to be established resulting from the company division (referred to as various parties to the division agreement);
4. the company's contract and Articles of Association;
5. the approval document and a copy of business licence of the company;
6. the capital verification report of the company, produced by a statutory capital verification organ of China;
7. the balance sheet and property inventory of the company;
8. the list of names of creditors of the company;
9. the company contracts and Articles of Association of various companies after the division;
10. lists of names of members of the highest power organs in various companies after the division;
11. other documents required by the examination and approval organ.

Where new companies are to be established in other regions as a result of the company division, the company shall, in addition, submit to the examination and approval organ the opinions on the establishment of new companies as a result of division, signed and issued by the examination and approval organs in the localities where the new companies are intended to be established.

Article 24

A company division agreement must include the following items:

1. names, addresses and legal representatives of various parties to the division agreement;
2. the total amount of investment and the registered capital of the company after the division;
3. method of division;
4. plan for division of company's assets drawn by various parties to the division agreement;
5. plans for absorbing debts receivable and debts payable drawn by various parties to the merger agreement;
6. measures for staff and workers' arrangements;
7. liabilities for breach of agreement;

8. methods for disputes settlement;
9. date and place of the agreement; and
10. other matters that various parties to the division agreement deem necessary to be included.

Article 25

The absorbing company or the newly established company after merger shall fully assume debts receivable and debts payable of the companies being dissolved as a result of merger.

Companies after division shall assume debts receivable and debts payable of the original company according to the division agreement.

Article 26

An examination and approval organ shall, within forty-five (45) days of receiving the relevant documents listed in Article 20 or 23 of these Provisions, make a written preliminary response as to whether it agrees with the merger or division.

Where the examination and approval organ for the a company merger is MOFTEC, and where MOFTEC is of the opinion that the company merger has a potential for industry monopoly or a possibility of forming a market position dominating certain particular commodities or services and thereby obstruct fair competition, it may, after receiving the above mentioned documents, call upon relevant departments and organs to conduct a hearing process over the company intending to merger and carry out investigation on the company as well as on the relevant markets. The time period for examination and approval provided in the previous paragraph may be extended to one hundred and eighty (180) days.

Article 27

A company intending to merge or divide shall, within ten (10) days from the date that the preliminary response agreeing to the company merger or division is made by the examination and approval organ, deliver notices to all its creditors and make a public announcement in a newspaper of a provincial-level or above circulated nationwide for at least three (3) times in thirty (30) days.

The company shall state in the above mentioned notice and public announcement the plan for assuming the debts of the original company.

Article 28

A creditor of the company shall, within thirty (30) days of the receipt of notice mentioned in Article 27 of these Provisions or within ninety (90) days, where the creditors have not received notice of the first announcement, have the right to request the company to revise the plan for assuming debts or to settle a debt or to provide a relevant guarantee.

If creditors of the company fail to exercise the rights provided in the previous paragraph, it will be deemed that the creditors agree to the plan of the company intending to merge or divide for assuming debts receivable and debts payable, and the creditors' claim shall not affect the process of the company merger or division.

Article 29

Ninety (90) days after the company intending to merge or divide makes its first announcement, and the creditors of the company do not raise any objection, the applicant of the company intending to merge or the company intending to divide shall submit to the examination and approval organ the following documents:

1. evidentiary documents showing that the company has placed a company merger or division announcement in the newspaper three times;
2. evidentiary documents showing that the company has notified its creditors;
3. the company's explanations on the settlement of its debts receivable and debts payable; and
4. other documents required to be submitted by the examination and approval organ.

Article 30

An examination and approval organ shall, within thirty (30) days of the receipt of the documents listed in Article 29 of these Provisions, decide whether or not to approve the company merger or division.

Article 31

Where a company merger is carried out through absorption, the accepting company must carry out procedures with the original examination and approval organ for the alteration of its approval certificate of foreign investment enterprise, and complete procedures with the registration organ for the registration of the alteration of the company. The absorbed company must carry out formality with the original examination and approval organ for the cancellation of its approval certificate of foreign investment enterprise and complete procedures with the registration organ for the registration of the cancellation of the company.

Where a company merger is carried out through the method of establishing a new entity, the various parties involved in the merger shall carry out formalities with the original examination and approval organs for the cancellation of their approval certificates of foreign investment enterprise and shall complete procedures with the registration organ for the registration of the cancellation of the companies. The applicant for the newly established company shall obtain an approval certificate of foreign investment enterprise from the examination and approval organ and complete procedures with the registration organ for the registration of the establishment of the company.

Where a company division occurs through the method of continuing existence, the continuing company shall carry out procedures with the original examination and approval organ for the alteration of its approval certificate of foreign investment enterprise, and complete procedures with the registration organ for the registration of the alteration of the company. The newly established companies shall obtain an approval certificate of foreign investment enterprise from the examination and approval organ and complete procedures with the registration organ for the registration of the establishment of the companies.

Where a company is divided through the dissolution method, the original company shall carry out formalities with the original examination and approval organ for the cancellation of its approval certificate of foreign investment enterprise and complete procedures with the registration organ for the registration of the cancellation of the company. The newly established companies shall obtain an approval certificate of foreign investment enterprise from the examination and approval organ and complete procedures with the registration organ for the registration of the establishment of the companies.

Where a company is merged with a domestic enterprise, the company shall carry out formalities to obtain an approval certificate of foreign investment enterprise.

Article 32

An applicant for a company intending to merge or a company intending to divide shall, with regard to matters of dissolution, continuing existence or establishment of new companies as a result of merger or division, carry out relevant procedures for the cancellation, alteration or obtaining of an approval certificate for foreign investment enterprise with appropriate examination and approval organs within thirty (30) days from the date the merger or division is approved by the examination and approval organ.

Article 33

A company shall, from the date of cancellation, alteration or obtaining of an approval certificate for foreign investment enterprises, carry out procedures with the registration organ for the cancellation, alteration or establishment, according to the Administrative Regulations of the People's Republic of China Governing the Registration of Legal Corporations, the Administrative Regulations of the People's Republic of China on the Registration of Companies and other provisions.

Registration of new establishments shall be carried out after the relevant company has completed the registration of the alteration and cancellation.

The plan for settling company assets and the plan for absorbing debts receivable and debts payable stated in the company merger agreement or division agreement, and the company merger or division approval document issued by the examination and approval organ, are regarded as the liquidation reports, which is required to be submitted for a cancellation registration.

Article 34

After a company has completed the registration of cancellation and alteration for its merger or division, concerned parties failing to complete registration of its establishment in accordance with the law shall bear corresponding legal responsibility.

Article 35

A revised company contract and Articles of Association signed by investors in the company merger or division, shall become effective from the date on which the approval certificate of foreign investment enterprise is altered or verified and issued by the examination and approval organ.

Article 36

The continuing company or the newly established company after a merger or division, shall, within thirty (30) days from the date of alteration or obtaining a business licence, notify creditors and debtors of the dissolved company of the alteration of creditors and debtors as a result of the merger or division, and make a public announcement in a newspaper of a provincial level or above circulated nationwide.

Article 37

The continuing company or the newly established company after a merger or division, shall, within thirty (30) days from the date of renewing or obtaining a business licence, carry out relevant registration procedures with taxation administration, customs, land management administration, foreign exchange administration, and other relevant organs.

The continuing company and a new company to be established after the merger between a company and a domestic enterprise shall, in accordance with provisions on foreign investment enterprises, go to such authorities as those in charge of taxation, customs, land management and foreign exchange control to undertake relevant examination and approval procedures.

Article 38

Where a company merger or division involves transfer of ownership of shares, it shall be handled in accordance with relevant laws, regulations and provisions on the change of share ownership of investors in foreign investment enterprises.

During the process of merger between a company and a domestic enterprise, if the foreign investors are to purchase shareholdings held by the domestic enterprises, payment for such purchase shall be carried out in accordance with the Supplementary Provisions to the Certain Regulations on the Subscription of Capital by the Parties to Sino-foreign Equity Joint Enterprises.

Article 39

The merger or division of companies located in other regions of China, established by investors from Hong Kong, Macau and Taiwan, shall be handled in reference to these Provisions.

Article 40

MOFTEC and SAIC are responsible for the interpretation of these Provisions.

Article 41

These Provisions take effect upon promulgation.

©2006 CCH Asia Pte Limited

All rights reserved.

First published in China Laws for Foreign Business – Business Regulations, a comprehensive collection of key PRC business regulations by CCH Asia.

Appendix 3

Rules on Mergers and Acquisitions of Domestic Companies by Foreign Investors **《关于外国投资者并购境内企业的规定》**

Unofficial translation for reference only

The revised version of the *Rules on Mergers and Acquisitions of Domestic Companies by Foreign Investors (the Regulations)* is now circulated and shall be effective from 22 June 2009 and are current as of May 2011.

Order of the PRC Ministry of Commerce No. 6, 2009 on Promulgating the Rules on Merger and Acquisition of Domestic Enterprises by Foreign Investors

Order of Ministry of Commerce [2009] No. 6

22 June 2009

Chapter I: General Provisions

Article 1

For the purposes of promoting and regulating foreign investors' investment in China, introducing foreign advanced technology and management experience, enhancing the level of utilising foreign investment, realising reasonable allocation of resources, ensuring employment, safeguarding fair competition and national economic security, these Rules are hereby formulated in accordance with the laws and administrative regulations on foreign-invested enterprises, the Company Law and other relevant laws and administrative regulations.

Article 2

For the purpose of these Rules, the term "merger and acquisition of domestic enterprises by foreign investors" shall mean a foreign investor purchases the stock right of a shareholder of a non-foreign-invested enterprise in China ("domestic company") or capital increase of a domestic company so as to convert and re-establish a domestic company as a foreign-invested enterprise ("equity M & A"); or, a foreign investor establishes a foreign-invested enterprise and purchases and operates the assets of a domestic enterprise by the agreement of that enterprise, or, a foreign investor purchases the assets of a domestic enterprise by agreement and uses this asset investment to establish a foreign-invested enterprise and operate the assets ("asset M & A").

Article 3

Foreign investors' merger and acquisition of domestic enterprises shall comply with the laws, administrative regulations and rules of China and follow the principles of fairness and reasonableness, consideration for equal value and good faith, shall not result in excessive concentration, exclusion or restriction of competition, shall not mess up social economic order or harm social public interests, and shall not cause state-owned assets to lose.

Article 4

Foreign investors' merger and acquisition of domestic enterprises shall comply with the requirements stipulated by laws, administrative regulations and rules of China, and policies concerning industry, land and environment.

According to the Guiding Catalogue of Foreign Invested Industries, to an industry that is not allowed to be wholly operated by foreign investors, its merger and acquisition shall not result in foreign investors' holding the enterprise's entire equity. To an industry that needs Chinese party to have the holdings or have relative holdings, and the Chinese party shall maintain its holdings or relative holdings in the enterprise after the enterprise in that industry is merged and acquired. To an industry that is forbidden to be operated by foreign investors, the foreign investors shall not merge or acquire any enterprise in that

industry.

The business scope of the original invested enterprise of the merged or acquired domestic enterprise shall satisfy the requirements of the policy concerning foreign-invested industry. Whichever does not meet the requirements shall be readjusted.

Article 5

A foreign investor's merger or acquisition of domestic enterprises involving the transfer of state owned equity and management of state owned equity of listed companies shall abide by relevant provisions on the management of state owned assets.

Article 6

Where a foreign investor establishes a foreign-invested enterprise by merging or acquiring a domestic enterprise, it shall be subject to the approval of the examination and approval authority in accordance with the provisions of these Rules and go through registration with the registration authority for alteration or establishment particulars.

In case the merged enterprise is a domestic listed company, it shall go through relevant formalities with the securities regulatory authority under the State Council in accordance with the Administrative Measures on Foreign Investors' Strategic Investment in Listed Companies.

Article 7

Various parties involved in the foreign investor's merger and acquisition of domestic enterprises shall pay tax and be subject to the supervision of tax authority in accordance with the PRC Tax Law.

Article 8

Various parties involved in the foreign investor's merger and acquisition of domestic enterprises shall abide by the laws and administrative regulations of China on foreign exchange control, go through the formalities of foreign exchange examination and approval, registration, filing and alteration with the foreign exchange authority in a timely manner.

Chapter II: Basic Rules

Article 9

In case the ratio of capital contribution of a foreign investor in the registered capital of the foreign-invested enterprise established after the merger and acquisition (M&A) is more than 25 percent, this enterprise shall enjoy the treatment of a foreign-invested enterprise.

If the ratio of capital contribution of the foreign investor in the registered capital of the foreign-invested enterprise established after merger and acquisition is less than 25%, this enterprise shall not enjoy the treatment of a foreign-invested enterprise except for separate provisions stipulated by laws and administrative regulations. Its borrowing external debts shall be handled according to relevant provisions relating to domestic non-foreign-invested enterprises' borrowing external debts. The examination and approval authority shall issue to it the Approval Certificate of Foreign-invested Enterprises with annotations "ratio of foreign investment less than 25%" (Approval Certificate). The registration administration authority and foreign exchange administration authority shall issue separately to it the Business License for foreign-invested enterprises with annotations "ratio of foreign investment less than 25%" and Foreign Exchange Registration Card.

If domestic companies, enterprises or natural persons merge or acquire the domestic companies that have something to do with them in the name of the companies legally established or controlled by

them in foreign countries, the established foreign-invested enterprises shall not enjoy the treatment of foreign-invested enterprises except that if the company in foreign countries offers to subscribe the capital increase of domestic companies, or increase capital to the enterprises established by this company in foreign country after merger, the sum of capital increase takes more than 25 percent of the enterprise's registered capital. To the foreign-invested enterprise established according to the way as prescribed in this section, except for the actual controller, the foreign investor provide funds more than 25 percent of the enterprise's registered capital, it may enjoy the treatment of foreign-invested enterprises.

The treatment for the foreign-invested enterprises established after foreign investor's merger or acquisition of the domestic listed companies shall be handled in accordance with relevant regulations of the state.

Article 10

For the purpose of these Rules, "examination and approval authority" shall refer to the Ministry of Commerce of the People's Republic of China or provincial commercial authority, "registration authority" shall refer to the State Administration for Industry and Commerce or its authorised local administration for industry and commerce, "foreign exchange administration authority" shall refer to the State Administration of Foreign Exchange and its branches.

In case the foreign-invested enterprises established after merger and acquisition are, according to the provisions of laws, administrative regulations and rules, the foreign-invested enterprises of a special type or industry that shall be approved by the Ministry of Commerce, provincial examination and approval authority shall submit the applications to the Ministry of Commerce for approval, the Ministry of Commerce will make the decision whether to approve or not.

Article 11

The domestic companies, enterprises or natural persons shall, when they merge or acquire domestic companies having something to do with them in the name of the companies in foreign countries legally established or controlled by them, report to the Ministry of Commerce for approval.

The person concerned may not evade from the above requirements by domestic investment of the foreign-invested enterprises or by other means.

Article 12

In case a foreign investor merges or acquires a domestic enterprise and obtains the actual right to control it, and in case it involves major industry, has or may have the influence on the state security or cause the transfer of the actual right of the domestic enterprise owning famous trademark or having a name of long history, the person concerned shall submit a report thereof to the Ministry of Commerce.

If a person concerned fails to submit a report, and its merger or acquisition does cause or may cause serious influence on the state economic security, the Ministry of Commerce may, together with relevant departments, ask the person concerned to stop the deal or transfer corresponding stock ownership, assets or take other effective measures to eliminate the influence of the merger or acquisition on state security.

Article 13

In the case of a foreign investor's equity M & A, the foreign invested enterprise established after the M & A shall inherit the creditor's rights and debt of the merged or acquired company.

In the case of a foreign investor's asset M & A, the domestic enterprise selling the assets shall bear the original creditor's rights and debt.

The foreign investor, the merged or acquired enterprise, creditors and other persons concerned may reach an agreement on the treatment of the creditor's rights and debt of the merged or acquired

domestic enterprise, but they shall not harm the interests of a third party and the public. The agreement on disposing the creditor's rights and debt shall be submitted to the examination and approval authority for approval.

The domestic enterprise selling its assets shall, at least 15 days before the investor submits the applications to the examination and approval authority, send a notice to the creditors and publish an announcement in a nationwide newspaper at the level of province or above.

Article 14

The parties to an M&A shall take the value of the stock right to be transferred and the assessment result of the assets to be sold that are made by the assets evaluation institution as the basis of determining the transaction price. The parties to an M&A may agree on an asset assessment institution lawfully established within China. The international used assessment method shall be adopted for the asset assessment. It is prohibited to divert any capital abroad in any disguised form by transferring any equities or selling assets at a price which is obviously lower than the assessment result.

If a foreign investor's M&A of a domestic enterprise causes the modification of any equity formed by the investments of state-owned assets or transfer of the property right of state-owned assets, it shall satisfy relevant provisions on the administration of state-owned assets.

Article 15

The parties to an M&A shall state clear whether or not there is a connected relationship between the parties concerned. If two parties belong to a same actual controller, the parties concerned shall disclose their actual controller to the examination and approval authority and make an explanation about whether the purpose of M&A and the assessment result are consistent with the sound value of the market. The parties concerned shall not evade the aforesaid requirements by trust, holding shares on behalf of others, or by other means.

Article 16

A foreign investor shall, to establish a foreign-invested enterprise by merging and acquiring a domestic enterprise, pay all the considerations to the shareholders who transfer the equities or to the domestic enterprise which sells the assets within 3 months from the date of issuing the business license to the foreign-invested enterprise. If it needs to extend the time limit due to any case under special circumstances, the foreign investor shall, upon the approval of the examination and approval authority, pay 60 per cent or more of the whole consideration within 6 months as of the date of issuing the business license to the foreign-invested enterprise, and pay off the consideration within one year, and distribute the earnings according to the proportion of the actually contributed investments.

Where a foreign investor offers to subscribe the capital increase of a domestic company, the shareholders of the limited liability company and the domestic joint stock limited company established by the way of initiation shall pay no less than 20% of the newly registered capital when the company applies for a business license for foreign-invested enterprise. The time to pay the rest capital contribution shall be in line with the provisions of the Company Law, the laws relating to foreign investments and the Regulations on the Administration of Company Registration. Provided there are any other provisions stipulated by any other laws or administrative regulations, such provisions shall prevail. Where a limited-liability company issues new stocks for increasing the registered capital, the shareholders shall offer to buy new stocks in accordance with relevant provisions on the share payment for establishing a limited-liability company.

Where a foreign investor conducts an asset M&A, it shall stipulate the time limit for capital contribution in the contract and articles of the foreign-invested enterprise to be established. Where the foreign

investor establishes a foreign-invested enterprise, and through the agreement of this enterprise purchases the assets of a domestic enterprise and operates such assets, it shall make the capital contribution equivalent to the consideration of the asset within the time limit for the payment of consideration as stipulated in Paragraph 1 of this Article. The remaining capital contribution shall satisfy relevant provisions on capital contribution for establishing a foreign-invested enterprise.

Where a foreign investor establishes a foreign-invested enterprise by merging and acquiring a domestic enterprise, if the proportion of its contribution is less than 25 per cent of the enterprise's registered capital and the investors make capital investment in cash, it shall pay in full within 3 months from the day when a business license is issued to the foreign-invested enterprise; if it provides funds in kind or industrial property, it shall pay in full within 6 months from the day when a business license is issued to the foreign-invested enterprise.

Article 17

The means of the consideration payment in an M & A shall comply with the provisions of relevant laws and administrative regulations of the state. Where a foreign investor uses its assets in RMB it lawfully owns as a means of payment, it shall obtain the approval of the foreign exchange administrations. Where a foreign investor uses the shares which are at its disposal as a means of payment, it shall be handled according to Chapter IV hereof.

Article 18

After a foreign investor purchases the equities of a domestic company by agreement, and the domestic company has been converted into a foreign-invested enterprise, the registered capital of this foreign-invested enterprise shall be the registered capital of the original domestic company, and the proportion of the foreign investor's contribution shall be the proportion of its purchased equities in the original registered capital.

Where a foreign investor offers to subscribe the capital increase of a domestic limited-liability company, the registered capital of the foreign-invested enterprise established after the M & A shall be the sum of the amount of the registered capital and the capital increase of the former domestic company. The foreign investor and other former shareholders of the merged or acquired domestic company shall, on the basis of the assets evaluation of the domestic company, determine their respective proportion of capital contributions in the foreign-invested enterprise.

Where a foreign investor offers to subscribe the capital increase of a domestic limited-liability company, the registered capital shall be determined in accordance with the Company Law.

Article 19

As for equity M & A by a foreign investor, the upper limits of the total amount of investments made by the foreign-invested enterprise established after the M & A shall be determined according to the following rates unless it is otherwise stipulated by the state:

1. Where the registered capital is less than USD 2.1 million, the total investments shall not exceed 10/7 of the registered capital;
2. Where the registered capital is more than USD 2.1 million to USD 5 million, the total investments shall not exceed two times of the registered capital;
3. Where the registered capital is more than USD 5 million to USD 12 million, the total investments shall not exceed 2.5 times of the registered capital; and
4. Where the registered capital is more than USD 12 million, the total investments shall not exceed 3 times of the registered capital.

Article 20

As for assets M&A by the foreign investor, the investor shall, according to the transaction price for purchasing the assets and the actual production and operation scale, determine the total investments of the foreign-invested enterprise to be established. The proportion between the registered capital and total investments of the foreign-invested enterprise to be established shall conform to relevant provisions.

Chapter III: Examination, Approval and Registration

Article 21

In the case of an equity M & A by foreign investor, the investor shall, according to the total investments of the foreign-invested enterprise established after the M&A, the type of the enterprise and the industry it engages in, and in accordance with the provisions of laws, administrative regulations and rules on the establishment of foreign-invested enterprises, submit the following documents to the competent examination and approval authority:

1. A resolution of the shareholders of the merged domestic limited-liability company on unanimous agreement with the foreign investor's merger or acquisition of the equity or the resolution of the merged or acquired domestic limited-liability company at the shareholders' conference on agreement with the foreign investor's merger and acquisition of the equity.
2. An application of the merged domestic company for converting into a foreign-invested enterprise;
3. A contract and the articles of the foreign-invested enterprise established after M&A;
4. An agreement on the foreign investor's acquisition of the shareholders' equities of the domestic company or the foreign investor's purchase of the capital increase of the domestic company;
5. The financial audit report of the merged domestic company in the previous financial year;
6. The investor's identity, registration and credit certification that have been notarised and certified according to law;
7. The descriptions about the enterprises invested by the merged domestic enterprise;
8. The (duplicates) of the business licenses of the merged domestic company and its invested enterprises;
9. The plan for the settlement of the employees of the merged domestic enterprise; and
10. The documents to be submitted as required by Articles 13, 14 and 15 of these Rules.

In case the business scope, scale, right of using a land of the foreign-invested enterprise established after M & A are subject to the license of other relevant government departments, the relevant licenses shall be submitted along with the foresaid documents.

Article 22

An equity purchase agreement, or capital increase agreement of the domestic company shall be governed by Chinese laws and contain the following contents:

1. The status of each party reaching the agreement, including the appellation (name) location, name, occupation and nationality of each legal representative;
2. The proportion of price of the purchased equities or subscribed capital increase;
3. The term and method of execution of the agreement;
4. The rights and obligations of each party reaching the agreement;

5. The liabilities for breach of contract, and settlement of disputes; and
6. The time and place of signing the agreement.

Article 23

In the case of an assets M & A by foreign investor, the foreign investor shall, according to the total investments of the foreign-invested enterprise to be established, the type of the enterprise and the industry it engages in, and in accordance with the provisions of the laws, administrative regulations and rules on the establishment of foreign-invested enterprises, submit the following documents to the competent examination and approval authority:

1. A resolution of the property right holders or power mechanism of the domestic enterprise on agreeing with the sale of assets;
2. An application for the establishment of a foreign-invested enterprise;
3. A contract and the articles of the foreign-invested enterprise to be established;
4. An asset purchase agreement signed by the foreign-invested enterprise to be established and the domestic enterprise, or by the foreign investor and the domestic enterprise;
5. The articles of association and business license (duplicate) of the merged or acquired domestic enterprise;
6. The notice of the merged or acquired domestic enterprise, certifications of the announced creditors, and statement about whether the creditors have raised any objections;
7. The investor's identity, or certificate of opening a business, and relevant credit certificates that have been notarised and certified according to law;
8. The plan on the settlement of employees of the merged or acquired domestic enterprise; and
9. The documents as prescribed in Articles 13, 14 and 15 of these Rules.

In case the assets purchased from domestic company and used in accordance with the preceding Paragraph involves in the license of other relevant government departments, the relevant licenses shall be submitted along with the foresaid documents.

Where a foreign investor purchases the assets of a domestic enterprise by agreement and invests such assets in establishing a foreign-invested enterprise, it shall not, prior to the establishment of the foreign-invested enterprise, use such assets to do any business.

Article 24

The assets purchase agreement shall be governed by the Chinese laws and contain the following main contents:

- (1) The status of each party reaching the agreement, including the appellation (name), and location, and the name, occupation and nationality of each legal representative;
- (2) The term and method for the execution of the agreement;
- (3) The rights and obligations of each part reaching the agreements;
- (4) The liabilities for breach of contract, and settlement of disputes; and
- (6) The time and place of signing the agreement.

Article 25

Where a foreign investor establishes a foreign-invested enterprise by taking over a domestic enterprise, unless it is otherwise provided for in these Rules, the examination and approval authority shall, within 30 days upon receipt of all documents as stipulated to be submitted, make a decision of approval or disapproval. Where it decides to make a decision of approval, an approval certificate shall be issued by the examination and approval authority.

Where a foreign investor purchases the equities of a domestic company by agreement, and the examination and approval authority makes a decision of approval, the investor shall simultaneously send a copy of the approval documents separately to the party that transfers the equities, the foreign exchange administrations in the area where the domestic company is located. The foreign exchange administrations in the area where the party that transfers the equities is located shall handle the registration for foreign funds and foreign exchange based on equity-transfer and foreign exchange collection and issue corresponding certificates, which is an effective document proving that the consideration for equity M&A paid by the foreign investor has been in place.

Article 26

In the case of an assets M & A by foreign investor, the investor shall, within 30 days upon receipt of the approval certificate, apply to the registration administrations for registration and get the business license for foreign invested enterprises.

Where a foreign investor merges and acquires equities, the merged or acquired domestic company shall, in accordance with these Rules, apply to the original registration administration for modifying its registration and get the business license for foreign-invested enterprises. If the original registration administration has no authority for registration, it shall, within 10 days upon receipt of the application documents, transfer these application documents to the registration administration with authority and simultaneously enclosed the registration files of the domestic company. When applying for registration modification, the merged or acquired domestic company shall submit the following documents and be responsible for their authenticity and effectiveness:

1. An application for registration modification;
2. An agreement on the foreign investor's purchase of equities of the domestic company or subscription of capital increase of a domestic company ;
3. The revised regulations of the company or the amendment of the original regulations, and the contract of the foreign-invested enterprise which shall be submitted in accordance with law;
4. The approval certificate for foreign-invested enterprises;
5. The certification for the foreign investor's subject qualification or the identity of natural person;
6. The revised name list of the members of the board of directors, the documents with the name and domicile of the new directors, and the appoint documents for the new directors; and
7. Other relevant documents and certificates as stipulated by the State Administration for Industry and Commerce.

The investor shall, within 30 days upon receipt of the business license for foreign-invested enterprises, go through the registration formalities with the tax, customs, land administration and foreign exchange administration authorities.

Chapter IV: Foreign Investors' Merger and Acquisition of Domestic Companies by Payment of Equities

Section 1 - Requirements for Equity M&A

Article 27

"Foreign Investors' Merger and Acquisition of Domestic Companies by Payment of Equities" as mentioned in this Chapter means that the shareholders of an overseas company purchase the equities or increased shares of a domestic company by paying its equities or the increased shares.

Article 28

"Overseas Company" as mentioned in this Chapter shall be established lawfully and there is a perfect system of company law in its registration place, and the company and its management level have no record of punishment made by the supervision administration in recent 3 years. Except for the companies with special-purpose as mentioned in Section 3 of this Chapter, an overseas company shall be a listed company and there shall be a perfect system for dealing in securities in the place where it gets listed.

Article 29

The equities of a domestic or overseas company involved in a foreign investor's equity M&A shall meet the following conditions:

1. Lawfully held by the shareholders and may be transferred in accordance with the law;
2. No dispute over their ownership, no hypothecation and any other restrictions on rights;
3. The equities of an overseas company shall be listed publicly in an overseas open and lawful securities exchange market (excluding the over-counter exchange market); and
4. The transaction price of the equities of the overseas company in recent one year remains stable.

The Items (3) and (4) of the preceding Paragraph is inapplicable to the companies with special-purpose as mentioned in Section 3 of this Chapter.

Article 30

Where a foreign investor merges and acquires a domestic company based on the equities, the domestic company or its shareholders shall engage an intermediary institution registered within China to serve as a consultant (hereinafter referred to as the "M&A consultant"). The M&A consultant shall carry out due diligence investigations on the genuineness of the application documents for M&A, the financial status of the overseas company and whether the M&A meets the requirements of Articles 14, 28 and 29 of these Rules, and provide a M&A consultant report and put forward clear-cut professional comments on each of the aforesaid items.

Article 31

An M&A consultant shall satisfy the following requirements:

1. Having a good reputation and corresponding experiences;
2. No record of serious violation of any law or regulations; and
3. Being capable of investigating and analysing the legal systems of the registration place of the overseas company and the place where the overseas company is get listed, and the financial status of the overseas company.

Section 2 - Application Documents and Procedures

Article 32

An equity M&A of a domestic company by a foreign investor shall be submitted to the Ministry of Commerce for the examination and approval. The domestic company shall not only submit the documents as required in Chapter III of these Rules but also the following documents:

1. A statement of the equity changes and major assets changes of the domestic company in recent one year;
2. An M&A consultant's report;
3. The business opening certifications or identity certification of the domestic and overseas companies involved and their shareholders;
4. Descriptions about the equities held by the shareholders of the overseas company, and the name list of the shareholders holding 5 % or more of the equities of the overseas company;
5. The Regulations of the overseas company and a description about external guaranties; and
6. The financial paper audited in the past annual year and a report on the stock dealings in the past half year of the overseas company.

Article 33

The Ministry of Commerce shall, within 30 days upon receipt of all submitted documents as stipulated, examine the application for M&A. If the application meet the requirements, an approval certificate shall be issued, on which the remark that "A foreign investor's equity M&A of a domestic company" shall be given, and the business license shall be valid for 6 months as of the day when it is issued."

Article 34

A domestic company shall, within 30 days after receiving the foresaid certificate, go through the formalities for alteration particulars with the registration authority and the foreign exchange administration authority. The registration authority and the foreign exchange administration authority shall respectively issue to it a business license for foreign-invested enterprises and a foreign exchange registration card with annotations that "valid for 8 months as of the date of issuance".

When a domestic company goes through the formalities for registration modification with the registration administration, it shall, in advance, submit an application for equity conversion, amendment of the company's regulation, agreement of equity transfer and other documents signed by the legal representative of the domestic company for the purposes of resuming the equity structure.

Article 35

Within 6 months as of the date of issuance of a business license, the domestic company or its shareholders shall, in respect of holding the equities of the overseas company, apply to the Ministry of Commerce and the foreign exchange administrations for going through the formalities of the examination, approval and registration for establishing an enterprise abroad.

In addition to the documents as stipulated in the Rules on the Examination and Approval of Establishing Enterprises Abroad, the parties concerned shall submit to the Ministry of Commerce the approval certificate for foreign-invested enterprises with the said annotation and the business license for foreign-invested enterprises with the said annotation. After the examination and approval of the overseas company's equities held by the domestic company or its shareholders, the Ministry of Commerce shall issue the approval certificate of Chinese enterprise investment overseas and replace the approval certificate of foreign-invested enterprises with no annotation by one with annotation.

After a domestic company obtains the approval certificate of foreign-invested enterprise without annotation, it shall, within 30 days, apply to the registration authority and the foreign exchange administration authority for replacing the business license of foreign-invested enterprise and the foreign exchange registration card without annotation by one with annotation.

Article 36

Within 6 months as of the date of issuance of a business license, in case the domestic and overseas companies fail to go through formalities for equity alteration, the approval certificate with annotation and approval certificate of Chinese enterprise overseas investment shall be invalid automatically. The registration administration shall, pursuant to the application documents for registration of equity alteration submitted by the domestic company in advance, examine and approve the alteration registration and resume the equity structure of the domestic company to the status before the equity M&A.

In case a domestic company fails to increase shares, before the registration administration examines and approves the alteration registration according to the preceding Paragraph, the domestic company shall, in accordance with the provisions of the Company Law, reduce the registered capital correspondingly and make an announcement in a newspaper.

In case a domestic company fails to go through the corresponding registration formalities according to the preceding Paragraph, it shall be punished by the registration administration in accordance with relevant provisions of the Regulations on the Administration of Company Registration.

Article 37

Prior to obtaining the approval certificate of foreign-invested enterprise and a foreign exchange registration certificate without annotation, it shall not distribute its profits to its shareholders, provide a guarantee to any connected company or pay for such capital items as the equity transfer, capital decrease or liquidation.

Article 38

A domestic company or its shareholders shall go through the tax alteration registration with the tax authority on the strength of the approval document and business license without annotation issued by the Ministry of Commerce and the registration administration.

Section 3 - Special Provisions on Company with Special Purpose

Article 39

For the purpose of these Rules, "Company with Special Purpose" refers to an overseas company directly or indirectly controlled by a domestic company or a natural person for the purpose of making the equities of its actual owned domestic company to be listed abroad.

The provisions of this Section shall apply to the company with special purpose that purchases the equities of the shareholders of a domestic company or the additionally issued shares of a domestic company by paying its equities or its additionally issued shares in order to be listed abroad.

In case the parties concerned makes an overseas company holding the equities of a the company with special purpose as a subject to be listed abroad, this overseas company shall satisfy corresponding requirements for the company with special purpose as prescribed in this Section.

Article 40

The listing transaction abroad of the company with special purpose shall be approved by the securities regulatory administration of the State Council.

The country or region where the company with special purpose shall have perfect laws and supervision system and the securities supervision administration of this country or region shall have signed a

memorandum of understanding for supervision and cooperation with the securities supervision administration of the State Council and keep an effective supervision and cooperation relation.

Article 41

A domestic company with its equities listed abroad as mentioned in this Section shall satisfy the following requirements:

1. Its property right is clear. No dispute or potential dispute over its property right;
2. Having a complete business system and good sustainable operation capacity;
3. Having a sound corporate governance structure and internal management system; and
4. The company and its main shareholders have no record of serious violation of any law or regulations in recent three years.

Article 42

Where a domestic company set up a company with special purpose abroad, it shall apply to the Ministry of Commerce for going through the examination and approval formalities. When going through such formalities, the domestic company shall, besides the documents as required in the Rules on the Examination and Approval of Investing in Enterprises Abroad, submit the following documents simultaneously:

1. The identity of the actual controller of the company with special purpose;
2. The business plan on the overseas listing of the company with special purpose; and
3. The assessment report made by the M&A consultant on the issuing price of the stock to be listed abroad in the future.

After obtaining the approval document of the investment abroad for Chinese enterprise, the person who establishes or controls the company shall apply to the foreign exchange administration in the area where the company is located for going through the formalities relating to the registration of foreign exchange for overseas investments.

Article 43

The total value of issuing the stocks listed abroad of the company with special purpose shall not be lower than the value of the equities M&A of the domestic company assessed by the relevant asset assessment institution.

Article 44

Where a company with special purpose merges and acquires a domestic company by equities, the domestic company shall, besides the documents as required in Article 32 of these Rules, submit to the Ministry of Commerce the following documents:

1. The approval documents and certificate for the investment in an enterprise abroad when the company with special purpose is established;
2. Registration Form of foreign exchange for the investments abroad of the company with special purpose;
3. The identity or the business opening certification or regulations of the actual controller of the company with special purpose;
4. The business plan on listing abroad of the company with special purpose; and
5. The assessment report made by the M&A consultant on the issuing price of the stock to be listed abroad in the future.

If the overseas company holding the equities of the company with special purpose serves as a subject to be listed abroad, the domestic company shall also submit the following documents:

1. The business opening certification and the regulations of the overseas company; and
2. The detailed descriptions by the company with special purposes and the overseas company to the equities transaction arrangement and the discount method.

Article 45

Where the Ministry of Commerce approves the documents as required in Article 44 of these Rules upon preliminary examination, it shall issue a letter of principle approval letter. The domestic company shall, on the strength of the principle approval letter, submit the documents for listing application to the securities supervision administration of the State Council. The securities supervision administration of the State Council shall make a decision on approval or disapproval within 20 working days.

After the domestic company obtains the approval, it shall apply for the approval certificate to the Ministry of Commerce. The Ministry of Commerce shall issue to it an approval certificate with the annotation "equities holding by the overseas company with special purpose, and valid for 1 year as of the issuance of a business license".

In case the M&A causes the change of equities of company with special purpose, the domestic company or natural person holding the equities of the company with special purpose shall, by approval certificate for foreign-invested enterprises with annotation, apply to the Ministry of Commerce for going through the examination and approval formalities for the changes of the investment in an enterprise abroad on corresponding items.

Article 46

The domestic company shall, within 30 days upon receipt of the approval certificate with annotation, apply for the alteration registration with the registration authority and the foreign exchange administration authority for modifying the registration. The registration authority and the foreign exchange administration authority shall respectively issue business license and foreign exchange registration card for foreign-invested enterprises with annotation "valid for 14 months as of the date of issuance".

When the domestic company handles the alteration registration with the registration authority, it shall, in advance, submit the equity change application, the amendment of the company's regulations, the equity transfer agreement and other documents signed by the legal representative of the domestic company for the purposes of resuming the equities structure.

Article 47

The domestic company shall, within 30 days after the company with special purpose or its connected overseas company completes the overseas listing, report to the Ministry of Commerce the information about the overseas listing and its plan on the repatriation of financial income, and apply for a the replacement of an approval certificate for foreign-invested enterprises with annotation. At the same time, the domestic company shall, within 30 days after the completion of overseas listing, report to the securities supervision administration of the State Council the information about the overseas listing and provide corresponding documents for the record. It shall also submit its plan on repatriation of financial income to the foreign exchange administration authority and execute this plan under the supervision of the foreign exchange administration authority. It shall, within 30 days after receiving the approval certificate without annotation, apply for the replacement of the business license and foreign exchange registration card to the registration authority and foreign exchange administration authority with annotation.

Where the domestic company fails to report to the Ministry of Commerce within the aforesaid time limit, the approval certificate of the domestic company with annotation shall be invalid automatically, its equities structure will resume to the state before the equity M&A, and it shall go through the formalities for alteration particulars in accordance with Article 36 of these Rules.

Article 48

The financial income from overseas listing of the company with special purpose shall, according to the repatriation plan submitted to the foreign exchange administration for the record, be repatriated according to current regulations for administration of foreign exchange. The financial income may be repatriated by following means:

1. providing commercial loans to the domestic company;
2. setting up a new foreign-invested enterprise within the territory of China; and
3. M & A of a domestic enterprise.

To repatriate the financial income of a company with special purpose under the aforesaid circumstances, the person concerned shall comply with the laws and administrative regulations of China on the administration of foreign investments and foreign debts. In case the repatriation of the overseas financial income of a company with special purpose causes the domestic company and natural person to hold more equities of the company with special purpose or increase the net assets of the company with special purpose, the persons concerned shall disclose the relevant information and report for approval according to the fact, and go through corresponding formalities for the registration of foreign exchange of foreign investments and registration modification of overseas investments.

The foreign exchange income from profit, bonus and capital change obtained by the domestic company or natural person from the company with special purpose shall be repatriated within 6 months after the date of obtainment. The profit or bonus may enter into current account for foreign exchange or be converted into RMB. The foreign exchange income from capital change may, with the examination and approval of the foreign exchange administration, be deposited in the special capital account or be converted into RMB.

Article 49

Within 1 year upon the issuance of a business license, if the domestic company fails to obtain the approval certificate without annotation, the approval certificate with annotation shall be invalid automatically, and alteration registration shall be handled in accordance with Article 36 of these Rules.

Article 50

After the company with special purpose completes the overseas listing and the domestic company obtains the approval certificate and business license without annotation, if the person concerned continues to M&A this domestic company by paying its equities, it shall be governed by the provisions of Sections 1 and 2 of this Chapter.

Chapter VI: Supplementary Provisions

Article 51

In accordance with the provisions of the Anti-monopoly Law, where the merger or acquisition of domestic enterprises by foreign investors satisfy the reporting standards as stipulated in the Rules of the State Council on Standards of Reporting Business Operator Concentration, the foreign investors shall report to the Ministry of Commerce beforehand, and no transaction shall be conducted without reporting.

Article 52

These Rules are applicable to the case that an investment company established by a foreign investor within China merges or acquires a domestic enterprise.

Where a foreign investor purchases the equities of the shareholder of a foreign-invested enterprise in China or offer to subscribe the capital increase of a foreign-invested enterprise in China, it shall be applicable to current laws, administrative regulations on foreign-invested enterprises as well as relevant provision equities changes of the investors of foreign-invested enterprise. If any case is not covered by the aforesaid laws, administrative regulations or provisions, it shall be handled according to these Rules.

Where a foreign investor merges or acquires a domestic enterprise through a foreign-invested enterprise established by it within China, it shall apply to relevant provision the combination and split-up of foreign-invested enterprises and relevant provision domestic investment of foreign-invested enterprise. If any case is not covered by the aforesaid provisions, it shall be handled according to these Rules.

Where a foreign investor merges and acquires a domestic limited liability company and transforms it into a joint stock limited company, or if the domestic company is a joint stock limited company, it shall be applicable to relevant provisions on the establishment of a joint stock limited company; if any case is not covered by the aforesaid provisions, it shall be governed by these Rules.

Article 53

An applicant or declarer shall submit the documents after classifying the documents into different categories and the catalogue is enclosed in accordance with these Rules. All documents required to be submitted shall be written in Chinese.

Article 54

A Chinese natural-person shareholder of a domestic company taken over by equities may, after obtaining the approval, continue to be a Chinese investor of the foreign-invested enterprise established after modification.

Article 55

In case a natural-person shareholder of a domestic company changes his nationality, the nature of the company shall not be changed.

Article 56

The staffs of relevant government authorities shall be devoted to their duties, perform their duties in accordance with the law, and shall not seek any improper benefit by taking advantage of their positions, and shall keep confidential the commercial secrets they have known.

Article 57

Where an investor from Hong Kong Special Administrative Region, Macao Special Administrative Region or Taiwan Region merges and acquires an enterprise in any other region in China, it shall be handled according to these Rules.

Article 58

These Rules shall come into effect on the date of promulgation.

Appendix 4

Measures for the Administration of the Takeover of Listed Companies 《上市公司收购管理办法》

Order of the China Securities Regulatory Commission No.56

27 September 2008

(Adopted by consideration and discussion at the 180th Chairman Meeting of the CSRC since 17 May 2006, and amended in accordance with the Decision of the China Securities Regulatory Commission to Amend Article 63 of the Measures for the Administration of the Takeover of Listed Companies on 27 August 2008.)

Chapter 1: General Provisions

Article 1

For the purposes of promoting and regulating foreign investors' investment in China, introducing foreign advanced technology and management experience, enhancing the level of utilising foreign investment, realising reasonable allocation of resources, ensuring employment, safeguarding fair competition and national economic security, these Rules are hereby formulated in accordance with the laws and administrative regulations on foreign-invested enterprises, the Company Law and other relevant laws and administrative regulations.

Article 2

The activities related to the takeover and changes of the relevant share equities of listed companies shall abide by the provisions of laws, administrative regulations and the China Securities Regulatory Commission (hereinafter referred to as the "CSRC"). The relevant parties shall act in good faith, stick to social moralities and business ethics, voluntarily safeguard the order of the securities market, and accept the oversight of the government and the public.

Article 3

The activities related to the takeover and changes of the relevant share equities of listed companies shall comply with the principles of openness, fairness and equality.

The persons subject to information disclosure in the activities related to the takeover and changes of the relevant share equities of listed companies shall make full disclosure of the their equities and the changes thereof in the listed companies, and strictly perform the reporting and announcing duties and other statutory obligations, and shall keep confidential the relevant information before the disclosure thereof.

The information reported and announced by the persons subject to information disclosure must be true, accurate and complete and shall not contain any false records, misleading statements or material omissions thereof.

Article 4

The activities related to the takeover and changes of the relevant share equities of listed companies shall not endanger the state security or social public interests.

The activities related to the takeover and changes of the relevant share equities of listed companies that involve the national industrial policies, industrial access and transfer of state-owned shares, when required for approval by the relevant state authorities, may be conducted only after having obtained such approval.

Foreign investors that carry out the activities related to the takeover and changes of the relevant share equities of listed companies shall obtain the approval of the relevant state authorities, apply Chinese law and be subject to Chinese judicial and arbitration jurisdiction.

Article 5

The purchaser may become a controlling shareholder of a listed company by way of acquisition of shares, become the actual controller by means of investment relationship, agreements and other arrangements, or acquire the controlling rights of the listed company by a combination of the above-mentioned ways and means.

The purchaser includes investors and their concerted persons.

Article 6

Nobody may damage the lawful rights and interests of the target company and of its shareholders by taking advantage of the takeover of a listed company.

In any of the following cases, a listed company shall not be acquired:

1. if the purchaser has large amount of debts due but not paid, which is in an ongoing situation;
2. if the purchaser had material violations or was suspected of material violations in the past three years;
3. if the purchaser had serious breach of faith in the securities market for the past three years;
4. if the purchaser, as a natural person, falls under any of the circumstances specified by Article 147 of the Company Law; or
5. other circumstances where no listed company may be acquired as provided by laws and administrative regulations and specified by the CSRC.

Article 7

Neither the controlling shareholders nor the actual controllers of a target company may damage the lawful rights and interests of the target company or other shareholders by abuse of their rights of shareholders.

Where the controlling shareholders or actual controllers or any of their affiliates of a target company have damaged the lawful rights and interests of the target company or/and other shareholders, the above-mentioned controlling shareholders and actual controllers shall, prior to the transfer of their controlling rights of the target company, take initiatives to eliminate the damages; and if such damages have not been eliminated, they shall make arrangements where the proceeds from sale of the relevant share shall be used to eliminate such damages, provide sufficiently effective performance bonds or arrangements for the part insufficient to eliminate such damages, and obtain the approval of the general shareholders' meeting of the target company according to its Articles of Association.

Article 8

The directors, supervisors and officers of the target company owe fiduciary and loyal duties to the company they serve and shall treat equal all the purchasers aiming to acquire their company.

The board of directors of the target company shall make decisions and adopt measures concerning the takeover that are conducive to maintaining the interests of the company and its shareholders, and shall not abuse their powers to set up improper obstacles against the takeover, make use of corporate resources to provide the purchaser with any form of financial assistance or damage the lawful rights and interests of the company and its shareholders.

Article 9

The purchaser that carries out takeover of a listed company shall engage a professional agency as its financial advisor that has registered in China with qualifications for undertaking of financial advisory business, and otherwise, the purchaser shall not acquire the listed company.

The financial advisor shall act in due diligence, abide by the professional norms and ethics, and guarantee the truthfulness, accuracy and integrity of the documents it prepares and issues.

The financial advisor who believes that the purchaser damages the lawful rights and interests of the target company and its shareholders by taking advantages of the takeover of the listed company shall refuse to provide the purchaser with any financial advisory service.

Article 10

The CSRC shall supervise and administer the activities related to the takeover and changes of the relevant share equities of listed companies by force of law.

The CSRC may establish a special committee comprised of professionals and the relevant experts to put forward advisory opinions on whether a specific transaction constitutes takeover of a listed company, whether there is any circumstance where a listed company shall not be acquired and other relevant matters at the request of the functional departments of the CSRC. The CSRC shall make corresponding decisions by force of law.

Article 11

The stock exchanges shall formulate business rules by force of law, organise transactions and provide services for the activities related to the takeover and changes of the relevant share equities of listed companies, carry out real-time supervision on the relevant securities transactions, and oversee that the persons subject to information in the activities related to the takeover and changes of the relevant share equities of listed companies practically perform their information disclosure duties.

The securities registration and clearing agency shall formulate business rules by force of law and provide services for such matters as securities registration, custody and management and settlement concerning the activities related to the takeover and changes of the relevant share equities of listed companies.

Chapter 2: Disclosure of Equities

Article 12

The equities of an investor in a listed company include the shares registered in its name and those not registered in its name the voting right of which may be actually controlled by such investor. The equities of a listed company owned by the investor and its concerted persons shall be calculated together.

Article 13

When the shares whose equities are owned by an investor and its concerted persons in a listed company through securities transactions on the stock exchange jointly reach 5% of the shares issued by the listed company, a report shall be prepared on equity changes within 3 days of the occurrence of such fact, and a written report thereof shall be submitted to the CSRC and the stock exchange, with a copy thereof to the CSRC office (hereinafter referred to as the local office) of the place where the listed company is located, and with a notice thereof to the target listed company and a public announcement thereof shall be made. During the term above, the shares of the listed company shall no longer be traded.

After the shares whose equities are owned by the investor and its concerted persons in a listed company jointly reach 5% of the total shares issued by the listed company as mentioned above, each time when the proportion of the shares issued by the listed company whose equities are jointly owned by them increases or decreases by 5% through securities transactions on the stock exchange, reports and public announcements shall be made according to the provisions above. During the report period and within two days of the making of such reports and public announcement, shares of the listed company shall no longer be traded.

Article 14

When the shares whose equities are owned by an investor and its concerted persons in a listed company jointly reach or exceed 5% of the shares issued by the listed company through transfer by agreement, a report shall be prepared on equity changes within 3 days of the occurrence of such fact and a written report thereof shall be submitted to the CSRC and the stock exchange, with a copy thereof to the local office, and with a notice thereof to the target listed company, and a public announcement shall be made.

After the shares whose equities are owned by the investor and its concerted persons in a listed company jointly reach 5% of the total shares issued by the listed company, each time when the proportion of the shares issued by the listed company whose equities are owned by them increases or decreases by 5% or more, the reporting and publicly announcing duties above shall performed.

Neither the investor nor its concerted persons mentioned above may trade the shares of the listed company before having made the required report and public announcement. And the relevant share transfer and transfer registration procedures shall be handled according to the provisions of Chapter IV of these Measures, the stock exchanges and the securities registration and clearing agency.

Article 15

When the shares whose equities are jointly owned by the investor and its concerted persons by administrative transfer or change, or execution of court ruling, inheritance or donation reach the proportion specified in the preceding article, the reporting and announcing duties shall be performed, and the registration procedures for share transfer shall be handled by reference with the provisions specified in the preceding article.

Article 16

If the investor and its concerted persons are not the largest shareholders or actual controllers of a listed companies, when the shares whose equities are owned by them reach or exceed 5% of the shares issued by the listed company but not reach 20% thereof, a short form equity change report containing the following contents shall be prepared:

1. the names and domiciles of the investor and its concerted persons; and the name, registered address and legal representative of the investor and its concerted persons when they are legal persons;
2. purposes for holding of shares, whether or not intend to keep increasing their equities in the listed company in the coming 12 months;
3. name of the listed company, and categories, quantity and proportion of its shares;
4. the time and methods for the shares of the listed companies who equities are owned to reach or exceed 5% of the shares issued by the 5% or for the increase or decrease of the shares whose equities are owned to reach 5%;
5. brief description of the trading of the shares of the company through securities trading on the stock exchange within 6 months before the date of the occurrence of the fact of equity change; and
6. other content as may be required by the CSRC and the stock exchange to disclose.

If the investor and its concerted persons above are the largest shareholders or actual controllers of a listed company, when the shares whose equities are owned by them reach or exceed 5% of the shares issued by the listed company, but not reach 20% thereof, the contents specified by Article 17(1) of these Measures shall be disclosed.

Article 17

Where the shares whose equities are held by the investor and its concerted persons jointly reach or exceed 20% but less than 30% of the shares issued by a listed company, such investor and its concerted persons shall prepare a detailed equities change report, which shall, in addition to the information specified in the preceding paragraph, disclose the following contents:

1. the structure chart of the controlling shareholders and actual controllers of the investor and its concerted persons and their equity controlling relationship;
2. the price for obtaining the relevant shares, funds needed, source of funds or other payment arrangements;
3. whether there is any competition in the same business or potential competition in the same business and whether there is any ongoing associated transaction between the investor, the concerted persons and their controlling shareholders and actual controllers on one side, and the listed company on the other; in case of any competition in the same business or ongoing associated transaction, whether there is any corresponding arrangement that ensures the avoidance of competition in the same business between the investor, the concerted persons and their associated parties on one side and the listed company on the other and the independence of the listed company.
4. the subsequent plan on the adjustment of the assets, business, personnel, organisational structure, articles of association and other relevant matters in the coming 12 months;
5. the substantial transactions in the preceding 24 months between the investor and its concerted persons on one side and the listed company on the other side;
6. where no situation set out in Article 6 of these Measures exist; and
7. being capable for providing the relevant documents according to the provisions of Article 50 of these Measures;

Where the above-mentioned investor or any of its concerted persons is the largest shareholder or the actual controller of the listed company, they shall also engage financial advisor to issue a verification opinion on the content disclosed in the above-mentioned equities change report, except for administrative transfer or change of state-owned shares, transfer of shares between different entities under common control of the same actual controller, and obtaining shares by inheritance. Where the investor and its concerted persons commit not to exercising the voting rights of the relevant shares for at least 3 years, they shall be exempt from engagement of a financial advisor and provision of the documents set out in Item 7 of the preceding paragraph.

Article 18

Within 6 months as of the date of the disclosure, if the investor and its concerted persons who have disclosed the equities change report are required to report and announce the equities change reports again due to the change of shares whose equities are held by them, the report and announcement may be made only on the part different from the previous reports; and 6 months later after the date of the previous disclosure, the investor and its concerted persons shall prepare the equities change report according to the provisions of this Chapter, and perform their reporting and announcing duties.

Article 19

If any change of shares whose equities held by the investor and its concerted persons falls under any of the circumstances specified in Article 14 of these Measures due to the reduction of share capital by the listed company, the investor and its concerted person shall be exempt from performance of the reporting and announcing duties. The listed company shall, within 2 working days from the date of the completion of the alteration registration for the reduction of the share capital, make an announcement on the

change of shares whose equities are held by the shareholders of the company due to such reason; if it is possible that the reduction of the share capital by the company will enable the investor and its concerted persons to become the largest shareholder or the actual controller of the company, such investor and its concerted persons shall, within 3 working days as of the announcement of the relevant resolutions on reduction of the share capital of the company by the board of directors, perform their reporting and announcing duties according to the provisions of Article 17(1) of these Measures.

Article 20

In case the relevant information has been disseminated at the media or something abnormal has been found with the trading of the stocks of the company before a disclosure is made by any person subject to information disclosure in the activities related to the takeover and changes of the relevant share equities of listed companies according to law, the listed company shall immediately inquire the person concerned and such person shall immediately make a written reply thereof, for which the listed company shall make a prompt public announcement.

Article 21

The persons subject to information disclosure in the activities related to the takeover and changes of the relevant share equities of listed companies shall disclose information at least one media designate by the CSRC according to law; the contents of disclosure in other media shall be consistent with those disclosed on the designated media, and the time of disclosure shall not be earlier than that made on the designated media.

Article 22

Where the persons subject to information disclosure are to take concerted actions in the activities related to the takeover and changes of the relevant share equities of listed companies, they may specify one among them as the appointed representative to take charge of the preparation of uniform information disclosure documents in a written form, and agree to authorise the appointed representative to sign and affix the chop on the information disclosure documents.

The persons subject to information disclosure shall be responsible for the information concerning themselves in the information disclosure documents; with respect to the relevant part of the information related to multiple persons subject to information disclosure, each of such persons subject to information disclosure shall bear the relevant several and joint liabilities.

Chapter 3: Tender Offer

Article 23

If the investor, of its own accord, chooses to acquire the shares of a listed company by offer, such investor may make an offer (hereinafter referred to as general offer) to all shareholders of the target company for taking over all the shares held by them, or make an offer (hereinafter referred as partial offer) to all the shareholder of the target company for taking over part of the shares held by them.

Article 24

If the shares held by a purchaser in a listed company through securities trading on a stock exchange reaches 30% of all the shares issued by the listed company and such purchaser continues to increase the holding of such shares, the takeover shall be made by offer, for which a general offer or a partial offer shall be made.

Article 25

In case the purchaser takes over the shares of a listed company by offer according to the provisions of Articles 23, 24, 47 and 56 of these Measures, the proportion of the shares proposed for such takeover shall be no less than 5% of the shares issued by the listed company.

Article 26

In case of takeover of a listed company by offer, the purchaser shall fairly treat all the shareholders of the target company and the shareholders who hold shares of the same class shall be treated equal.

Article 27

If, for the purposes of terminating the listing status of the listed company, the purchaser has made a general offer, or a general offer has been made after an application has been made to the CSRC but an exemption has not been obtained, the purchase price shall be paid in cash; and if the purchase price is paid with the transferable securities (hereinafter referred to as the securities), cash payment shall be optional for the shareholders of the target company.

Article 28

In case of a takeover of the shares of listed company by offer, the purchaser shall prepare a tender offer report, and shall engage a financial advisor to submit a written report to the CSRC and the stock exchange with a copy thereof to its local office and a notice thereof to the target company, and meanwhile an indicative announcement shall be made on the summary of the tender offer report.

Fifteen days after it has filed the tender offer report in line with the provisions of the CSRC according to the provisions of the preceding paragraph as well as the relevant documents specified in Article 50 of these Measures, the purchaser shall announce the tender offer report, professional opinions of the financial advisor and the legal opinions issued by the lawyer. Within fifteen days, if the CSRC has no objection to the content disclosed in the tender offer report, the purchaser may make such announcement; if the CSRC finds that the tender offer report is not in line with laws and administrative regulations and the relevant provisions, the CSRC shall immediately notify the purchaser of the same, and the purchaser shall not announce its tender offer.

Article 29

The tender offer report specified in the preceding article shall indicate the following items:

1. name and domicile of the purchaser; name, registered place and legal representative of the purchaser that is a legal person, and the structure chart of equity controlling relationship chart between it and its controlling shareholders or actual controllers.
2. decisions and purposes of the takeover of the purchaser, and whether it proposes to increase its holding of such shares in the coming 12 months;
3. name of the listed company and the class of the shares to be taken over;
4. quantity and proportion of the shares proposed to acquire;
5. purchase price;
6. amount of the fund needed for takeover, source of fund and the guarantee thereof, or other payment arrangements;
7. conditions stipulated in the tender offer;
8. term of takeover;
9. amount and proportion of the shares of the target company held when reporting and sending the takeover report;
10. analysis on the impacts of the takeover in question on the listed company, including whether there is any competition in the same business or potential competition in the same business and whether there is any ongoing associated transaction between the purchaser and its associated parties on one side, and the listed company on the other; in case of any competition in the same business or

ongoing associated transaction, whether there is any corresponding arrangement that ensures the avoidance of competition in the same business between the purchaser and its associated parties on one side, and the listed company on the other and the independence of the listed company;

11. the subsequent plan on the adjustment of the assets, business, personnel, organisational structure, articles of association and other relevant matters in the coming 12 months;
12. substantial transactions in the previous 24 months between the purchaser and its associated parties on one side and the listed company on the other.
13. the situation concerning the trading of the shares of the target company through the securities trading on the stock exchange in the previous 6 months; and
14. other content to be disclosed as required by the CSRC.

Where the purchaser makes a general offer, it shall make a full disclosure in the tender offer report of the risks of terminating the listing, the time for completing the acts of takeover after termination of the listing and other subsequent arrangements for the sale of the shares held by the shareholders that still hold the shares of the listed company; in making a general offer for the purpose of terminating the listing status of the company, the purchaser is not required to disclose the content as specified in Item 10 of the preceding paragraph.

Article 30

Where the shares of a listed company to be purchased by a purchaser according to Article 47 of these Measures exceed 30% and then the way of the takeover is required to be changed to the way of offer, the purchaser shall, within 3 days after the takeover agreement is concluded or a similar arrangement is made, make an indicative announcement on the summary of the tender offer report, and perform its reporting and announcing duties according to the provisions of Articles 28 and 29 of these Measures, and shall be exempt from the preparation, report and announcement of the takeover report of the listed company; if an approval is required by force of law, a special indication shall be announced that the offer may proceed only if the relevant approval is obtained.

If it fails to obtain an approval, the purchaser shall, within 2 days of receipt of the notice, submit a report on revoking the takeover plan to the CSRC, with a copy thereof simultaneously to the local office of the CSRC and to the stock exchange, and a notice thereof to the target company, and a public announcement thereof shall be made.

Article 31

In case of revoking the takeover plan on its own accord after the tender offer report has been filed to the CSRC but before such tender offer report is announced, the purchaser shall make an application to the CSRC for revoking the takeover plan with the reason(s) thereof, and make an announcement thereof. Within 12 months from the date of the announcement, such purchaser shall not acquire the same listed company once again.

Article 32

The board of directors of the target company shall investigate into the subject qualifications, credit situation and acquisition intention of the purchaser, analyse the conditions of offer, give suggestions on whether its shareholders shall accept the offer, and engage an independent financial advisor to give professional opinions. Within 20 days after the announcement of the tender offer report by the purchaser, the board of directors of the target company shall file the report of the board of directors of the target company and the professional opinions of the independent financial advisor to the CSRC, with a copy simultaneously to the local office of the CSRC and to the stock exchange, and a public announcement thereof shall be made.

Where the purchaser makes any material change to the conditions of the tender offer, the board of directors of the target company shall submit its own or the independent financial advisor's supplementary opinions on the situation of such changes, and shall also make a report and a public announcement thereof.

Article 33

After the purchaser has made the indicative announcement but before the completion of the tender offer, except for conduct of normal business activities or execution of the resolution made by the shareholders' general meeting, the board of directors of the target company shall not exert any material impacts in the assets, debts, equities or operation results of the company by such means as disposal of the assets of the company, external investment, adjustment of the mainline business of the company, provision of guarantee or loan without the approval by the shareholders' general meeting.

Article 34

During the period of the tender offer, no director of the target company may resign from his post.

Article 35

Where a purchaser conducts an tender offer according to the provisions of these Measures, the offer price of the shares of the same class shall not be lower than the highest price for the payment in obtaining such shares by the purchaser within 6 months before the date of the indicative announcement of the tender offer.

If the offer price is lower than the arithmetic mean value of the daily weighted average price of such shares of 30 trading days before the indicative announcement, the financial advisor engaged by the purchaser shall analyse the trading of the shares of the preceding 6 months, and shall make a statement on whether the share price is manipulated, whether the purchaser has any concerted person, whether there is any other payment arrangement with the purchaser for obtaining the shares of the company in the preceding 6 months, the reasonableness of the offer price and other matters.

Article 36

A purchaser may take pay the price for takeover of a listed company by such legal means as in cash, with securities, or a combination of cash and securities. The financial advisor engaged by the purchaser shall state that the purchaser has the capability for tender offer.

Where the purchaser is to pay the purchase price in cash, it shall deposit as the performance bond at least 20% of the total purchase price with the bank designated by the securities registration and clearing agency while making the indicative announcement on the tender offer.

Where the purchaser is to pay the purchase price with securities, it shall provide the audited financial accounting report of the past 3 years of the issuer and the securities valuation report, and assist in the due diligence work of the independent financial advisor engaged by the target company.

The purchaser that is to pay the purchase price with securities listed on a stock exchange for trading shall, while making the indicative announcement of the tender offer, hand over all the securities to be used for the payment to the securities registration and clearing agency for custody, except for the new shares issued by a listed company; where the purchaser is to pay the purchase price with bonds listed on a stock exchange, it is required that the term for the listed trading of such bonds shall be no less than 1 month; The purchaser that is to pay the purchase price with securities not listed and traded on a stock exchange must simultaneously provide the optional way of payment in cash for the shareholders of the target company, and shall disclose the way to and procedure arrangement for the custody and service of the relevant securities to the shareholders of the target company.

Article 37

The term for the takeover stipulated in the tender offer shall be neither less than 30 days nor more than 60 days, unless otherwise specified in a competitive offer.

In the term for acceptance stipulated in the tender offer, the purchaser shall not revoke the tender offer.

Article 38

In case of a takeover by agreement, the purchaser shall, after having made the announcement but before the expiration of the takeover, neither sell the shares of the target company, nor purchase the shares of the target company in any form other than those specified in the offer or beyond the conditions of the offer.

Article 39

Any and all conditions set out in the tender offer shall apply to all the shareholders of the target company.

If case of any change required to the tender offer, the purchaser must submit a written report to the CSRC in advance, with a copy thereof simultaneously to the local office of the CSRC and the stock exchange and the securities registration and clearing agency, and a notice thereof to the target company; and upon approval by the CSRC, a public announcement thereof shall be made.

Article 40

The purchaser shall not change the tender offer within 15 days before the expiration of the term of the tender offer, unless a competitive offer occurs.

In case of the occurrence of a competitive offer, if the time from the change of the tender offer by the purchaser who makes the initial offer to the expiration of the purchase term of the initial offer is less than 15 days, the purchase term shall be extended, and the extended term of the tender offer shall neither be less than 15 days nor exceed the date of the expiration of the last competitive offer, whereby an additional performance bond shall be made at a prescribed proportion; where the takeover payment is made with securities, a corresponding amount of securities shall be added, which shall be handed over to the securities registration and clearing agency for custody.

The purchaser that has made a competitive offer shall make an indicative announcement on the tender offer no later than 15 days before the expiration of the takeover term of the initial offer at least, and shall perform the reporting and announcing duties according to the provisions of Article 28 and Article 29 of these Measures.

Article 41

In case of any material change of the basic facts disclosed in the tender offer report, the purchaser shall, within 2 days after the occurrence of such material change, report the same to the CSRC in writing, with a copy thereof to its local office and to the stock exchange, and a notice thereof to the target company at the same time, and a public announcement thereof shall be made.

Article 42

The shareholders that agree to accept the tender offer (hereinafter referred to as the pre-accepting shareholders) shall entrust a securities firm to handle the relevant formalities for such pre-acceptance. The purchaser shall entrust a securities firm to apply to the securities registration and clearing agency for handling the provisional custody of the shares covered by the pre-accepted offer. The shares covered by the pre-accepted offer under the provisional custody of the securities registration and clearing agency shall not be transferred in the tender offer term.

The pre-acceptance in the preceding paragraph means an initial expression of intention to accept the offer, which doesn't constitute acceptance before the time when it cannot be withdrawn within the tender offer term. The pre-accepting shareholders may entrust a securities firm to handle the formalities for withdrawal of the pre-accepted offer 3 trading days before the expiration of the tender offer term, and the securities registration and clearing agency shall discharge the provisional custody of the securities covered by the pre-accepted offer according to the withdrawal application of the shareholders of the pre-accepted offer. The pre-accepting shareholders shall not revoke its acceptance of the offer within 3 trading days before the expiration of the term of the tender offer. During the tender offer term, the purchaser shall publish the quantity of the shares covered by the pre-accepted tender offer on the site of the stock exchange every day.

In case of occurrence of a competitive offer, in case the pre-accepting shareholders that have accepted the initial offer withdraw all or part of the pre-accepted shares and sell the shares withdrawn to a competitive offeror, a securities firm shall be entrusted to handle the formalities for withdrawal of the pre-accepted initial offer and the pre-accepted competitive offer.

Article 43

Upon the expiration of the term of a takeover, the purchaser that has made a partial offer shall purchase the pre-accepted shares of the shareholders of the target company according to the conditions stipulated in the tender offer; when the quantity of the shares of the pre-accepted offer exceeds that of the proposed quantity of the takeover, the purchaser shall acquire the shares of pre-accepted offer at the equal proportion; for the purposes of terminating the listing status of the target company, the purchaser shall purchase all the pre-accepted shares of the shareholders of the target company according to the conditions stipulated in the tender offer; and the purchaser that makes a general offer without the exemption of the CSRC shall purchase all the pre-accepted shares of the shareholders of the target company.

Within 3 trading days upon the expiration of the term of the takeover, the authorised securities firm shall apply to the securities registration and clearing agency for handling the formalities for the settlement of transfer and the transfer registration of the shares, discharge the provisional custody of the shares exceeded the proposed takeover proportion; and the purchaser shall publish the results of the tender offer in question.

Article 44

If the distribution of the equities of the target company fails to meet the conditions for listing after the expiration of the term of the takeover, the shares of the listed company shall be terminated from listing on the stock exchange according to law. Before the completion of the actions of takeover, the shareholders that still hold the shares of the target company shall have the right to sell their shares to the purchaser at the same conditions as those of the tender offer within a reasonable term provided in the takeover report, and the purchaser shall purchase such shares.

Article 45

Within 15 days after the expiration of the term of the takeover, the purchaser shall submit to the CSRC a written report on the situation of the takeover, which shall be simultaneously copied to the local office of the CSRC, with a copy thereof to the stock exchange, and a notice thereof to the target company.

Article 46

Except for the takeover by means of offer, no investor may publicly solicit for takeover of the shares of a listed company outside the stock exchange.

Chapter 4: Takeover by Agreement

Article 47

When the shares of a listed company whose equities are held by a purchaser by agreement reach or exceed 5% but not more than 30% of the issued shares of the company, the relevant matters shall be handled according to the provisions of Chapter II of these Measures.

A purchaser who continues the takeover after the shares whose equities it holds reach 30% of the issued shares of the company shall make a general offer or partial offer to the shareholders of the listed company. In case of meeting the circumstances as provided in Chapter VI of these Measures, the purchaser may apply to the CSRC for exemption from making of the offer.

If the shares of a listed company a purchaser is to acquire exceed 30%, the part over 30% shall be taken over by means of offer, provided that the purchaser may submit an application to the CSRC for exemption of making the offer in case of compliance with the circumstances specified in Chapter VI of these Measures. The purchaser shall perform the takeover agreement signed by it after having obtained the exemption from the CSRC. If it fails to obtain the exemption from the CSRC and intends to continue performing the takeover agreement, or if it doesn't make an application for exemption, it shall make a general offer before performing the takeover agreement.

Article 48

In case that the shares to be taken over from a listed company by agreement exceeds 30% and the purchaser is to apply for exemption according to the provisions of Chapter VI of these Measures, the purchaser shall, within 3 days of the conclusion of the takeover agreement with the shareholders of the listed company, prepare a report on the takeover of the listed company, submit the application for exemption and the relevant documents set out in Article 50 of these Measures, authorise its financial advisor to submit the written reports to the CSRC and the stock exchange with a copy thereof to the local office and a notice thereof to the target company and publish the summary of the takeover report of the listed company. The local office shall, after receiving the written report, report the same to the people's government at the provincial level where the listed company is located.

The purchaser shall, within 3 days from obtaining the exemption of the CSRC, publicly announce its takeover report, the professional opinion issued by the financial advisor and the legal opinions issued by the lawyer; if it fails to obtain the exemption, the purchaser shall, within 3 days from receipt of the decision of the CSRC, make an announcement thereof, which shall be handled according to the provisions of Article 61(2) of these Measures

In case of finding that takeover report is not in line with the provisions of laws and administrative regulations, the CSRC shall immediately notify the purchaser of the same, and if it fails to make the corrections thereto, the purchaser shall neither publicly announce the takeover report nor perform the takeover agreement before such announcement is made.

Article 49

The takeover report of the listed company prepared according to the provisions of preceding paragraph shall disclose the content specified in Item 1 through Item 6 and Item 9 through Item 14 of Article 29 of these Measures and the conditions of the effectiveness of the takeover agreement as well as the payment arrangement.

If the purchaser that has disclosed the takeover report of the listed company is required to make a report and announcement again due to the change of the equities within 6 months of the disclosure, it may make the report and announcement only on the part(s) that is (are) different from those of the former report, and if beyond 6 months, the purchaser shall fulfill its reporting and announcing duties according to the provisions of the Chapter II of these Measures.

Article 50

In the takeover of a listed company, the purchaser shall submit to the CSRC the following documents:

1. the ID certificate of the Chinese citizen, or the certification document(s) of the legal person or other organisation registered within the territory of China;
2. the description of the feasibility of the subsequent development plan of the listed company based on the strength and business experience of the purchaser, and a supplementary statement that such purchaser has the management capability for operating the listed company in a normal way if the purchaser is to amend the articles of association, re-elect the board of directors of the company, or change or adjust the mainline business of the company;
3. a statement on how to avoid the conflicts of interests such as competition in the same business and how to keep the independence of business of the target company in case there is any competition in the same business or associated transaction between the purchaser and its associated parties on one side and the target company on the other;
4. a statement that no change has happened in its controlling shareholder and its actual controller in the latest 2 years in case the purchaser is a legal person or other organisation;
5. the statement of the core enterprise and the core business thereof of the purchaser and its controlling shareholders or actual controllers, and the affiliated enterprises and their mainline business; as well as the statement on the profiles of any listed company or any financial institutions such as banks, trust companies, securities firms and insurance companies more than 5% shares of which are held by the purchaser or its actual controllers if the purchaser or its actual controllers are the controlling shareholders or actual controllers of two or more listed companies;
6. the verification and examination opinions given by the financial advisor on the fiduciary records of the purchaser, the legitimacy of the source of funding for the takeover, the capability of the purchaser for fulfilling the relevant promises and the truthfulness, accuracy and integrality of the content of the relevant information disclosure; and if the purchaser has been established for less than 3 years, the financial advisor shall also provide the verification and examination opinions on the fiduciary records of the purchaser of its controlling shareholders or actual controllers of the past 3 years.

If an overseas legal person or other overseas organisation is to acquire a listed company, in addition to the documents set out in Item 2 through Item 6 of paragraph 1, the following documents shall also be submitted:

1. the verification and examination opinions given by the financial advisor that the purchaser meets the requirements for conducting strategic investment in the listed company and has the capability for acquiring the listed company; and
2. the declaration that the purchaser will accept the jurisdiction of Chinese judicial and arbitration jurisdiction.

Article 51

In case a director, supervisor, senior officer or employee of a listed company, or a legal person or other organisation controlled or authorised by the listed company proposes to acquire the company or obtain the controlling rights of the company by adopting the measures specified by Chapter V of these Measures (hereinafter referred to as management buyout or MBO), the listed company shall have a sound and well-operating organisation and effective internal control system and the proportion of independent directors to the entire board of directors of the company shall reach or exceed 1/2.

The company shall engage an asset appraisal agency with the qualifications to engage in securities and futures business for providing the assets appraisal report. The takeover in question shall proceed in condition that a resolution has been made by the non-affiliated directors in the board of directors,

2/3 or more of the independent directors have made the consent thereof, and such takeover has been submitted to the general shareholders' meeting for examination and review and approved by more than half of the voting rights of the non-affiliated shareholders present at the general shareholders' meeting. Before issuing opinions, the independent directors shall engage the independent financial advisor to issue professional opinions on the takeover in question and the opinions of the independent directors and of the financial advisor shall be published at the same time.

Any director, supervisor or officer of a listed company that falls under any of the circumstances set out in Article 149 of the Company Law or has any bad fiduciary records in the securities market in the past 3 years shall not acquire the company.

Article 52

With respect to the takeover of a listed company by agreement, the term from the conclusion of the takeover agreement to the completion of the transfer of the relevant shares is the transitional period for the takeover of a listed company (hereinafter referred to as the transitional period). In the transitional period, the purchaser shall not reelect the board of directors of the listed company at the proposal by the controlling shareholder; if the board of directors is to be reelected with justified grounds, the number of directors from the purchaser shall not exceed 1/3 of that of the board of directors; the target company shall not provide guarantee for the purchaser and its associated persons; the target company shall not raise fund by public offering of shares, conduct any material deals, sell assets or carry out any material investment activities, or conduct any other associated transactions with the purchaser and its associated parties, except for the case where the purchaser may save a listed company involved in a crisis or confronted with serious financial difficulties.

Article 53

The controlling shareholder of the listed company that transfers the shares it hold in the listed company to a purchaser by agreement shall make an investigation on the subject qualification, fiduciary standing and intention for the takeover of the purchaser, and shall disclose the relevant situations on the investigation in its equities change report.

Where the controlling shareholder and its associated party fail to pay off their debts to the company, discharge the guarantee provided by the company to them, or has other circumstances that may cause damage to the interests of the company, the board of directors of the target company shall immediately disclose the above-mentioned circumstances and take effective measures for maintaining the interests of the company.

Article 54

The parties involved in the takeover by agreement shall apply to the securities registration and clearing agency for handling the provisional custody formalities for the shares to be transferred, and may deposit the cash used for the payment to the bank designated by the securities registration and clearing agency.

Article 55

After the announcement of the takeover report, the parties involved shall, according to the business rules of the stock exchange and the securities registration and clearance agency and by holding the certification that all the transfer amount has been deposited in the bank account agreed by both parties, apply to the securities registration and clearing agency for discharge the provisional custody of the shares to be transferred by agreement after the stock exchange has made a confirmation on the transfer of the shares, and handle the transfer registration formalities thereof.

If the purchaser fails to fulfill the reporting and announcing duties according to the relevant provisions, or fails to make an application according to the relevant provisions, the stock exchange and the securities registration and clearance agency shall not handle the formalities for share transfer or the transfer registration.

The purchaser that fails to complete the relevant formalities for share transfer within 30 days of the announcement of the takeover report shall immediately make an announcement and describe the reasons thereof. During the period in which the transfer of the relevant shares is not completed, the purchaser shall, every 30 days, publish the progress on the handling of the transfer of the relevant shares.

Chapter 5: Indirect Takeover

Article 56

With respect to the purchaser who is not a shareholder of a listed company where the shares whose equities it holds reach or exceed 5% but less than 30% of the shares issued by a listed company through investment relationship, agreement or other arrangement, the provisions in Chapter II of these Measures shall apply.

If the shares whose equities are held by a purchaser exceed 30% of the shares issued by the company, such purchaser shall make a general offer to all the shareholders of the company; if the purchaser expects it impossible to make a general offer within 30 days from the occurrence of the fact, such purchaser shall urge his controlled shareholders to reduce their shares of the listed company to 30% or less within the aforesaid 30 days, and shall make an announcement within 2 working days from the day of reduction of holdings; thereafter, if the purchaser or any of its controlled shareholders continue increasing their holdings, the way of offers shall be adopted. If an exemption is applied for according to the provisions of Chapter VI of these Measures, the provisions of Article 48 of these Measures shall apply.

Article 57

In case an investor who is not a shareholder of a listed company has acquired the controlling rights over the shareholders of a listed company and the shares held by the shareholders of a listed company under its control reach the proportion prescribed in the preceding paragraph, which has caused material impacts on the assets and profits of such shareholders, the reporting and announcing duties shall be performed according to the provisions of the preceding article.

Article 58

The actual controllers of the listed company and the shareholders under their control shall be obliged to coordinate the listed company in truly, accurately and completely disclosing the information concerning the change of the actual controllers. If the actual controllers of the listed company and the shareholders under their control refuse to undertake the above-mentioned coordination obligation, and hence rendering it impossible for the listed company to perform the statutory information disclosure duties and making the listed company imposed with civil and administrative liabilities, the listed company shall be entitled to initiate a lawsuit against them. In case the actual controllers or the controlling shareholder has directed the listed company and its relevant personnel not to perform their duties for information disclosure, the CSRC shall carry out investigation and punishment(s) according to law.

Article 59

Where the actual controllers of a listed company and the shareholders under their control fail to perform their reporting and announcing duties, the listed company shall immediately make such report and announcement on the day it is aware of such case. If after the listed company has made a public announcement on the change of the actual controllers, the actual controllers have not yet made the disclosure, the board of directors of the listed company shall query with the actual controllers and the shareholders under their control, and may, of necessary, engage a financial advisor to conduct such query, and shall report the information obtained from the query to the CSRC and the stock exchange. The CSRC shall investigate and punish the actual controllers who refuse to perform the reporting and announcing duties according to the law.

If a listed company has actually known that a material change has happened to the actual controllers but failed to report and publicly announce such change, the CSRC shall order them to make corrections thereto, and in case of any serious circumstance, identify the director concerned as suitable candidate.

Article 60

Where the actual controllers of a listed company and the shareholders under their control fail to perform their reporting and announcing duties and refuse to perform the coordinating obligations prescribed in Article 58, or if the actual controllers falls under any of the circumstances whereby no takeover may be made with the listed company, the board of directors of the listed company shall refuse to accept the proposal or provisional proposal submitted by the shareholders under control of the actual shareholders, and shall make report the same to the CSRC or its local office. The CSRC shall order the actual controllers to make corrections thereto, and may identify the director nominated by the actual controllers through the shareholders under their control as suitable candidate. Before the corrections are made, the shareholders under control of the actual controllers shall not exercise the voting rights of the shares they hold. If the board of directors of the listed company has not refused to accept the proposal by the actual controllers and the shareholders under their control, the CSRC shall identify the director concerned as suitable candidate.

Chapter 6

Article 61

An investor and its concerted persons may apply to the CSRC for exemption of the following items in any of the circumstances specified in Article 62 or Article 63 of these Measures:

1. exemption from a tender offer for increase of the holdings of shares;
2. in case of any restrictions on subject qualifications or class of shares, or any special circumstance prescribed by laws, administrative laws and regulations, and by the CSRC, an exemption from making tender offer to all shareholders of the target company may be applied.

If no exemption is obtained, the investor and its concerted persons shall, within 30 days of the receipt of the notice given by the CSRC, reduce the shares held by them or the shareholders under their control in the listed company to 30% or less; if they propose on increasing the holding of shares by means other than an offer, they shall make a general offer.

Article 62

In any of the following circumstances, the purchaser may apply to the CSRC for exemption from making an application for increasing the holding of shares by offer:

1. where the purchaser and the transferor can prove that the transfer in question have not resulted in the change of the actual controllers of the listed company;
2. where the listed company is in serious financial difficulties, the reorganisation scheme proposed by the purchaser have been approved by the general shareholders' meeting of the company, and the purchaser has committed not to transfer the equities it holds in the company in 3 years;
3. where upon approval by the non-affiliated shareholders at the general shareholders' meeting of the listed company, the acquisition of new shares issued by the listed company to the purchaser makes the shares whose equities are held by the purchaser exceed 30% of the shares issued by the company, the purchaser commits not to transfer the shares whose equities are held by it in 3 years, and at the general shareholders' meeting, it is agreed that the purchaser is exempt from making an offer; and

4. other circumstances as may be recognised by the CSRC for the requirements for adapting to the development and changes of the securities market and the protection of the lawful rights and interests of the investors.

Where the application documents submitted by the purchaser meet the requirements and the purchaser has performed the reporting and announcing duties according to the provisions of these Measures, the CSRC shall accept the application, and otherwise, the CSRC shall refuse such application. The CSRC shall, within 20 days of the acceptance of the exemption application, determine whether to grant exemption with respect to specific items applied for by the purchaser; if an exemption is obtained, the purchaser may continue to increase its holding of shares.

Article 63

In any of the following circumstances, the parties concerned may apply to the CSRC for exemption from making an offer by a summary procedure:

1. where the proportion of shares whose equities are held by the investor in a listed company exceeds 30% of the shares issued by the company due to the free transfer, alteration or consolidation of state-owned assets conducted upon the approval by the government or the state-owned assets management department;
2. where, if the shares whose equities are held in a listed company reach or exceed 30% of the shares issued by the company, the increased shares whose equities are held in the company don't exceed 2% of the shares issued by the company within each 12 months 1 year after the occurrence of the above-mentioned fact;
3. where the shares whose equities are held by the parties concerned in a listed company reach or exceed 50% of the shares issued by the company, the continued increase of the equities they hold in the company is of no impact on the listing status of the company;
4. where the shares whose equities are held by the parties concerned in the company exceed 30% of the shares issued by the company due to the reduction of equity capital by repurchase of shares by the listed company from specific shareholders at a fixed price approved by the general shareholders' meeting;
5. where the shares held by a financial institution such as a securities firm or a bank exceed 30% of the shares issued by a listed company by virtue of undertaking of such business as securities underwriting and loans within its business scope according to law without any action or intention of actual control over the company, while a resolution on transfer of the relevant shares to a non-affiliated party has been proposed in a reasonable period;
6. where the shares whose equities are held by the parties concerned in the company succession exceed 30% of the shares issued by the company; or
7. other circumstances as may be recognised by the CSRC for the requirements for adapting to the development and changes of the securities market and the protection of the lawful rights and interests of the investors.

If the application for exemption is submitted in accordance with the provisions of item (1) and Item (3) to Item (7) of the preceding paragraph, and the CSRC raises no objection within ten working days of the receipt of the application documents that meet the relevant requirements, the relevant investors may apply to stock exchange and securities registration and settlement institutions for handling with stock transfer and transfer registration; according to provisions of Item (2) of the preceding paragraph, the relevant investors shall make public announcement concerning the increase of their shareholdings within three days of that increase, and submit an application for exemption with the CSRC. Where the

CSRC does not agree on the application raised by a relevant investor through a summary procedure, the investor shall submit an application in accordance with the provisions of Article 62 of these Measures.

Article 64

In case the purchaser proposes an exemption application, such professional agencies as a law firm shall be engaged to issue professional opinions thereon.

Chapter 7: Financial Advisor

Article 65

The financial advisor engaged by the purchaser shall carry out the following functions:

1. Carrying out due diligence investigations on the relevant circumstances of the purchaser;
2. At the request of the purchaser, providing the purchaser with professional services, fully evaluating the financial and operation conditions of the listed company, helping the purchaser analyse the legal risks, financial risks and operational risks, putting forth countermeasures for and proposals on the purchase prices, purchase methods, payment arrangements involved in the purchase scheme, and guiding the purchaser in preparing the application documents in accordance with the prescribed contents and format;
3. Providing the purchaser with tutorial training on the standard operations of the securities market, enabling the directors, supervisors and officers to be familiar with the relevant laws, administrative regulations and the provisions of the CSRC and to fully understand their obligations and duties and urging them to perform the reporting and announcing duties and other statutory obligations by force of law;
4. Conducting sufficient check and verification on whether the purchaser is in compliance with the provisions of these Measures and whether the contents of the application documents are true, accurate and complete; and issuing professional opinions on the objectiveness and fairness of the takeover event;
5. Accepting the authorisation of the purchaser, submitting the application and declaration documents to the CSRC and organising and coordinating with the purchaser and other professional agencies in providing reply based on the review opinions of the CSRC; and
6. Entering into an agreement with the purchaser, and within 12 months upon the completion of acquisition, continuously supervising and guiding the purchaser in abiding by laws, administrative laws and regulations, provisions of the CSRC and rules of the stock exchange, and the articles of association of the listed company, exercising its shareholder's right according to law and practically performing its commitments or the relevant covenants.

Article 66

The financial advisory report on the takeover in question issued by the financial advisor engaged by the purchaser shall describe and analyse the following matters and issue clear opinions item by item:

1. whether the content disclosed in the takeover report or the tender offer report of the listed company prepared by the purchaser is true, accurate and complete;
2. purposes of the takeover in question;
3. whether the purchaser has provided all the necessary supporting documents, describing whether the purchaser is qualified as an eligible subject, whether it has the economic strength for such takeover, whether it has the management capacity for standard operation of a listed company, whether it

is required to undertake other additional duties and capable for fulfilling the relevant duties, and whether it has any bad faith record based on check and review on the strength of the purchaser and its controlling shareholder and actual controllers, principal business undertaken, ongoing operation status, financial conditions and fiduciary status; faith;

4. with respect to the tutorial training on the standard operations of the securities market with the purchaser, whether its directors, supervisors and officers have been familiar with the relevant laws, administrative regulations and the provisions of the CSRC, fully understood their obligations and duties, and urging them to perform the reporting and announcing duties and other statutory obligations by force of law;
5. the equity controlling structure of the purchaser, and the way for its controlling shareholders and actual controllers to control the purchaser;
6. the source of the funds for takeover and its legitimacy of the purchaser, and whether there is the situation where the shares purchased through the takeover in question are set as pledge with financial institutions including banks for obtaining financing;
7. in case of the situation where the purchaser pays the purchase price with negotiable securities, describing whether the information disclosed by the issuer of the relevant negotiable securities is true, accurate and complete, and the convenience of transaction of the negotiable securities;
8. whether the purchaser has performed necessary authorisation and approval procedures;
9. whether there is any arrangement whereby the stable management of the target company shall be ensured during the transition period, and if any, whether the arrangement conforms to the relevant provisions;
10. analysing the subsequent plan put forth by the purchaser, and analysing the schemes whereby the purchaser solves the conflicts of interests, including competition with the listed company, and the independence of the operation of the listed company is maintained in case the businesses undertaken by the purchaser is in competition with the same business of the listed company, and describing the possible impacts of the takeover in question on the independence of the operations and the sustaining development of the listed company;
11. whether other rights are set up on the subject matter of the takeover and whether there are any other compensation arrangements besides the purchase price;
12. whether there is any business dealings between the purchaser and its affiliated parties on one side and the target company on the other, and whether the purchaser has reached any agreement or tacit understanding on the coming office and post arrangements with the directors, supervisor and officers of the purchases company;
13. whether the former controlling shareholders, actual controllers and their affiliated parties of the listed company have any debts to the company that have not been paid off, where the guarantee provided by the company to them have not been discharged or whether there are other situations whereby the interests of the company have been damaged; and if any, whether there is any practically feasible solutions that have been put forth; and
14. in case the purchaser has put forth the exemption application, indicating whether the takeover in question belongs to the situation whereby exemption is available, and whether the purchaser has made any commitments and whether the purchaser has the strength for performing the relevant commitments.

Article 67

The independent financial advisor engaged by the board of directors or the independent directors of the listed company shall not concurrently act as the financial advisor of the purchaser or have affiliated relationship with the financial advisor of the purchaser. The independent financial advisor shall carry out due diligence investigations according to the authorisation and issue professional opinions on the fairness and legitimacy of the takeover. The report of the independent financial advisor shall cover the explanation and analysis of the following issues and put forward clear opinions:

1. whether the purchaser is qualified as an eligible subject;
2. the analysis on the strength of the purchaser and on the possible influence of the takeover in question on the independence of the operations and the sustaining development of the target company;
3. whether the purchaser uses the assets of the target company or whether the target company provides financial assistance for the takeover in question;
4. in case of tender offer, analysing the financial positions of the target company, describing whether the purchase price has sufficiently reflected the value of the target company, and whether the tender offer is fair and reasonable, and making proposals on the acceptance of the offer by the shareholders of the public shares of the target company;
5. in case of payment by the purchaser of the purchase price with negotiable securities, making valuation analysis on the relevant securities according to the assets, business and profit projections of the issuers of such securities, and providing professional opinions on whether the takeover conditions are fair and reasonable and whether the takeover conditions put forth by the purchaser shall be accepted;
6. in case of MBO, making valuation analysis on the listed company, and carrying out full check and review and issuing clear opinions on the pricing basis of the takeover in question, terms of payment, source of fund for acquisition, financing arrangements, repayment plan and its feasibility, implementation and effectiveness of the internal control system of the listed company, business dealings of the above-mentioned personnel and their direct relatives with the listed company in the recent 24 months and other contents disclosed by the takeover report.

Article 68

The financial advisor that is entrusted to submit the application documents to the CSRC shall make the following commitments in the financial advisory report:

1. having performed the due diligence investigation duties according to the statutory provisions, with sufficient reasons to believe that the professional opinions issued is of no substantial difference with the contents of the application documents of the purchaser;
2. having checked and reviewed the application documents of the purchaser and believing that the application documents conforms to the statutory provisions in content and format;
3. having sufficient reasons to believe that the takeover in question conforms to laws, administrative regulations and the provisions of the CSRC, and having sufficient reasons to believe that the information disclosed by the purchaser is true, accurate and complete, and free from any false records, misleading statements or material omission;
4. having submitted the professional opinions issued for the takeover in question to review by the internal inspection agency, which has passed the examination;

5. during the period of acting as the financial advisor, having adopted strict confidential measures and strictly executed the internal firewall system; and
6. having signed the ongoing supervision and guidance agreement with the purchaser.

Article 69

During the takeover and the ongoing supervision and guidance, the financial advisor shall pay attention to whether there exists the circumstances to the detriment of the interests of the listed company where the target company has provided the purchaser and its affiliated parties with guarantee or loan, and in case of finding any illegal or improper behaviors of the purchaser, prompt reports shall be made to the CSRC, its local office and the stock exchange.

Article 70

In order to implement his functions, the financial advisor may engage other professional agency to assist the purchaser in carrying out the check and review, provided that the financial advisor shall have independent judgment of the materials provided and information disclosed by the purchaser.

Article 71

From the public announcement by the purchaser of the report on the takeover of the listed company to the 12th month after the completion of such takeover, the financial advisor shall pay attention to the operations of the listed company by means of routing communication and regular visit, and perform the ongoing supervision and guidance functions for the purchaser and the target company by combining with the disclosure of the periodic reports and interim reports of the target company:

1. supervise the prompt handling by the purchaser of the transfer procedures and the performance of reporting and announcing duties by force of law;
2. supervise and inspect the standard operations of the purchaser and the target company by force of law;
3. supervise and inspect the performance by the purchaser of public commitments;
4. by combining with the periodic reports of the target company, check to see whether implementation by the purchase of the subsequent plan has reached the expected objectives, whether there is a big difference between the results of the implementation and the contents disclosed previously and whether the relevant profit projections or the objectives expected by the management have been realised;
5. in case of the management buyout, check to see whether the implementation of the relevant repayment plan disclosed in the periodic reports of the target company is consistent with the fact;
6. supervise and examine the performance of other obligations specified in the takeover.

In the ongoing supervision and guidance period, the financial advisor shall issue the ongoing supervision opinions by combining with the quarterly report, interim report and annual report disclosed by the listed company, and report the same to the local office within 15 days after the above-mentioned periodic reports are disclosed.

In the meantime, the financial advisor who discovers the information disclosed by the purchaser in the purchase report of the listed company is not consistent with the fact shall urge the purchaser to truthfully disclose the related information, and promptly report the same to the CSRC, the local office and the stock exchange. In case of discharging the contract of entrustment, the financial advisor shall promptly make a written report to the CSRC and its local office that shall explain the reasons for failure to perform the supervision and guidance functions and make a public announcement thereof.

Chapter 8: Ongoing Regulation

Article 72

Within 12 months upon the completion of the takeover of the listed company, the financial advisor engaged by the purchaser shall within the first three days of each quarter report to the local office the circumstances of big impacts on the listed company including investment, purchase or sale of assets, associated transactions, adjustment of mainline businesses, replacement of directors, supervisors and officers, settlement of employees, and the performance by the purchaser of its commitments.

In case the registered place of the purchaser is different from that of the listed companies, the reports on the above-mentioned circumstances shall also be copied to the local office of the place where the purchaser is located.

Article 73

The local office shall, in the principle of prudential supervision, supervise and examine the purchaser and the listed company upon the completion of the takeover by such means as talks with the certified public accountants firm engaged in auditing of the listed company, inspecting the implementation of ongoing supervision and guidance responsibilities of the financial advisor, or regular or irregular on-site inspection.

If the local office discovers there is any material difference between the actual circumstances and the contents disclosed by the purchaser, it shall pay pointed attention to the purchaser and the listed company, and may order the purchaser to extend the period of ongoing supervision and guidance of the financial advisor, and carry out investigation and prosecution according to law.

In the period of ongoing supervision and guidance, if the financial advisor terminates the contract with the purchaser, the purchaser shall engage another financial advisory agency to fulfill the ongoing supervision and guidance functions.

Article 74

In the takeover of the listed company, the shares of the target company held by the purchaser shall not be transferred within 12 months upon the completion of the takeover

The transfer of the shares of the target company the equities of which are held by the purchaser among different entities controlled by the same actual controller is not subject to the restrictions of 12 months mentioned above, provided that the provisions of Chapter 6 of these Measures shall be observed.

Chapter 9: Regulatory Measures and Legal Liabilities

Article 75

In case the persons subject to information disclosure in the activities relating to the takeover and the changes of the relevant share equities of the listed company fail to perform reporting and announcing duties or other relevant obligations, the CSRC shall issue an order for corrections and adopt regulatory measures including regulatory talks, issuing warning alerts or demanding for suspending or stopping the takeover activities. Prior to corrections thereof, the relevant persons subject to information disclosure shall not exercise the voting rights of the shares he holds or actually controls.

Article 76

In case the persons subject to information disclosure in the activities relating to the takeover and the changes of the relevant share equities of the listed company have false records, misleading statements or material omission in the documents including the reports and the public announcement, false record, misleading statement or significant omission in report, announcement and other documents, the CSRC shall issue orders for corrections and adopt regulatory measures including regulatory talks, issuing warning alerts or demanding for suspending or stopping the takeover activities. Prior to corrections thereof, the purchaser shall not exercise the voting rights of the shares he holds or actually controls.

Article 77

In case the investor and its concerted persons have obtained the controlling rights of the listed company but fail to engage the financial advisor according to the provision of these Measures, hence circumventing the statutory procedures and obligations and carrying out acquisition of the listed company in a disguised form or a foreign investor dodges the jurisdiction, the CSRC shall issue orders for corrections and adopt regulatory measures including issuing warning alerts or demanding for suspending or stopping the takeover activities. Prior to corrections thereof, the purchaser shall not exercise the voting rights of the shares he holds or actually control.

Article 78

The purchaser that has submitted a tender offer but failed to pay the agreed acquisition price or purchase the pre-accepted shares upon expiration of the tender offer shall not acquire the listed company within 3 years of the date of the occurrence of such fact and the CSRC shall not accept any application document submitted by the purchaser or its related party, and with respect to those who are suspected of being involved in disclosing false information or manipulating the securities market, the CSRC shall establish the case for investigation of the purchaser and prosecute the legal liability by force of law.

In case the financial advisor engaged by the purchaser as set forth in the preceding paragraph has no sufficient evidence to show that it has performed its due diligence duties, the CSRC shall prosecute the legal liability by force of law.

Article 79

In case the controlling shareholder and actual controllers of the listed company fail to pay off their debts to the company, discharge the guarantee provided by the company to them, or make corrections with other circumstances that damages the corporate interests in transferring their controlling rights over the company, the CSRC shall order them to make corrections, and suspend or stop the takeover activities.

In case the board of directors of the target company fails to take effective measures according to law for causing the controlling shareholders and actual controllers to make corrections, or fails to urge the purchaser to perform its commitments, arrangements or guarantees after completion of the takeover, the CSRC may identify the directors concerned as suitable candidates.

Article 80

In case any director of the listed company fails to perform his loyal and due diligence duties and seeks for any undue interests by taking advantage of takeover, the CSRC shall adopt regulatory measures including regulatory talks and issuance of warning alerts and may identify such directors as suitable candidates.

In case any clause of the articles of association of the listed company concerning the controlling rights of the company violates any of the provisions of laws, administrative regulations or these Measures, the CSRC shall order for corrections thereof.

Article 81

In case the securities service agencies or securities firms and their professional personnel that issue asset assessment reports, audit reports, legal opinions and financial advisory reports for the takeover of the listed company fail to fulfill their functions according to law, the CSRC shall order them to make corrections and adopt regulatory measures including regulatory talks and presentation of warning alerts.

Article 82

The CSRC shall record in the fiduciary archive the violations and the rectifications and improvements thereof of the parties in the activities relating to the takeover and the changes of the relevant share equities of the listed company.

Those who violate these Measures and constitute a violation of securities laws and regulations shall be investigated for legal liabilities according to law.

Chapter 10: Supplementary Provisions

Article 83

The concerted actions referred to in these Measures mean the behavior or fact that the investor and other investors jointly expand the quantity of voting rights of the shares of a listed company that they may control by agreement or other arrangements.

Investors that have concerted actions in the activities related to the takeover and changes of the relevant share equities of listed companies are concerted persons with each other, and if without contrary evidence, the investors are concerted persons with each other in any of the following circumstances:

1. if there is a share controlling relationship between investors;
2. if investor are under common control by the same entity;
3. if the director, supervisor or the principal member of the officers of an investor acts as the director, supervisor or officer in another investor;
4. if the investor with share participation in another investor has a significant influence over the decision-making of the participated company;
5. if a legal person or organisation other than a bank, and a natural person provides financing arrangement for the investor to obtain the relevant shares;
6. if there are other relations of economic benefits such as partnership, cooperation and joint operations between investors;
7. if any natural person holding 30% or more of the shares of the investor holds the shares of the same listed company with the investor;
8. if the director, supervisor and officer of the investor hold the shares of the same listed company with the investor;
9. where with respect to any natural person who holds 30% or more of the shares of the investor and any director, supervisor and officer of the investor, their relatives such as their parents, their spouse, their children and children's spouse, the parents of their spouse, their brothers and sisters and the spouses of their brothers and sisters, the brothers and sisters of their spouse and their spouses of the latter hold the shares of the same listed company with the investors;
10. where the director, supervisor and officer being in office in the listed company and the above-mentioned relatives simultaneously hold the shares of the company, or hold the shares of the company simultaneously with the enterprise directly or indirectly controlled by himself or the above-mentioned relatives;
11. where the director, supervisor, officer and employees of the listed company hold the shares of the company with the legal persons or other organisations controlled or entrusted by them; and
12. where there are any other relationships between the investors.

The concerted persons shall calculate their holdings of shares by consolidation. When the investor calculates its holding of shares, he shall include both the shares registered in its name and those registered in the name of its concerted persons.

If the investor doesn't believe that it shall be regarded as a concerted person with others, it may provide proof to the contrary to the CSRC.

Article 84

In any of the following cases, it shall be deemed as owning the controlling rights of the listed company:

1. where the investor is the controlling shareholder holding 50% or more shares of the listed company;
2. where the investor can actually control more than 30% of the votes of the shares of the listed company;
3. where the investor can decide the appointment of half or more of the members of the board of directors of the listed company by actually controlling the votes of the shares of the listed company;
4. where the investor can sufficiently exert significant influence over the resolutions of the general shareholders' meeting of the company by reliance on the actual controlling of the votes of shares of the listed company; or
5. other circumstances as may be recognised by the CSRC.

Article 85

In calculating the proportion of shares held by the persons subject to information disclosure, the part that they are entitled to convert between the securities issued by the listed company and held by them that are convertible into corporate stocks and the shares of the same listed company they holds shall be consolidated, and by comparing the proportion of share held by them with the proportion upon consolidated calculation of the shares converted from non-equity securities, the higher shall prevail. Those securities whose options are not exercised upon the expiration of such options or those that still do not meet the conditions for exercise of their options are not required to be consolidated in calculation.

The higher of the above-mentioned two proportions shall be calculated according to the following formula:

1. The quantity of shares held by investors/total number of shares issued by the listed company;
2. $(\text{The quantity of shares held by investors} - \text{the quantity of shares corresponding to the non-equity securities held by the investor that are convertible to corporate stocks}) / (\text{total number of shares issued by the listed company} - \text{total number of shares corresponding to the non-equity securities issued by the listed company that are convertible to corporate stocks})$

Article 86

In case the investor obtains controlling rights of the listed company by administrative transfer or execution of court ruling, inheritance or donation, the reporting and announcing duties specified by Chapter IV of these Measures shall be performed.

Article 87

The contents and forms of documents including the equities change report, the takeover report, the tender offer report, the report of the board of directors of the target company, the exemption application for tender offer shall be separately formulated by the CSRC.

Article 88

In case the target company is listed both at home and abroad, the purchaser shall observe the relevant provisions of the place where the overseas listing is located besides these Measures and the relevant provisions of the CSRC.

Article 89

In case of any takeover by a foreign investor of the listed company and any change of its equities in the listed company, besides the provisions of these Measures, the relevant provisions on the investment of foreign investors in listed companies shall apply.

Article 90

These Measures shall be implemented as of September 1, 2006. The Measures for the Management of the Takeover of Listed Companies (CSRC Order No. 10), the Measures for Management of Information Disclosure Concerning the Changes of Holding of Shares by Shareholders of Listed Company (CSRC Order No. 11), the Notice on the Relevant Issues Concerning the Listing and Trading Conditions of the Shares of the Target Company Involved in Tender Offers (Zheng Jian Gong Si Zi [2003] No. 16) and the Notice on the Relevant Issues on Regulating the Transfer of Actual Controlling Rights of Listed Companies (Zheng Jian Gong Si Zi [2004] No. 1) issued by the CSRC shall be repealed at the same time.

©2011 LexisNexis, a division of Reed Elsevier Inc.
All rights reserved.

Contacts

For more information, please contact one of our specialists below:

Lawrence Chia

Managing Partner, M&A Services

Tel: +86 10 8520 7758

Email: lawchia@deloitte.com.cn

Alan Tsoi

M&A Tax Leader

Tel: +852 2852 6600

Email: atsoi@deloitte.com

Norman Size

Managing Partner, Consulting Services

Tel: +86 21 6141 2388

Email: normansze@deloitte.com

For further information, visit our website at www.deloitte.com/cn

Contact details for Deloitte's China Practice

Beijing

Deloitte Touche Tohmatsu CPA Ltd.

Beijing Branch

8/F Deloitte Tower
The Towers, Oriental Plaza
1 East Chang An Avenue
Beijing 100738, PRC
Tel: +86 10 8520 7788
Fax: +86 10 8518 1218

Chongqing

Deloitte & Touche Financial Advisory Services (China) Limited

Room 10-12
13/F International Trade Center
Chongqing
38 Qing Nian Road
Yu Zhong District
Chongqing 400010, PRC
Tel: +86 23 6310 6206
Fax: +86 23 6310 6170

Dalian

Deloitte Touche Tohmatsu CPA Ltd.

Dalian Branch

Room 1503 Senmao Building
147 Zhongshan Road
Dalian 116011, PRC
Tel: +86 411 8371 2888
Fax: +86 411 8360 3297

Guangzhou

Deloitte Touche Tohmatsu CPA Ltd.

Guangzhou Branch

26/F Teemtower
208 Tianhe Road
Guangzhou 510620, PRC
Tel: +86 20 8396 9228
Fax: +86 20 3888 0119 / 0121

Hangzhou

Deloitte Business Advisory Services (Hangzhou) Company Limited

Room 605, Partition A
EAC Corporate Office
18 Jiaogong Road
Hangzhou 310013, PRC
Tel: +86 571 2811 1900
Fax: +86 571 2811 1904

Hong Kong SAR

Deloitte Touche Tohmatsu

35/F One Pacific Place
88 Queensway
Hong Kong
Tel: +852 2852 1600
Fax: +852 2541 1911

Jinan

Deloitte & Touche Financial Advisory Services Limited

Jinan Liaison Office

Unit 1018, 10/F, Tower A, Citic Plaza
150 Luo Yuan Street
Jinan 250011, PRC
Tel: +86 531 8518 1058
Fax: +86 531 8518 1068

Macau SAR

Deloitte Touche Tohmatsu

19/F The Macau Square Apartment H-N
43-53A Av. do Infante D. Henrique
Macau
Tel: +853 2871 2998
Fax: +853 2871 3033

Nanjing

Deloitte Touche Tohmatsu CPA Ltd.

Nanjing Branch

11/F Golden Eagle Plaza
89 Hanzhong Road
Nanjing 210029, PRC
Tel: +86 25 5790 8880
Fax: +86 25 8691 8776

Shanghai

Deloitte Touche Tohmatsu CPA Ltd.

30/F Bund Center
222 Yan An Road East
Shanghai 200002, PRC
Tel: +86 21 6141 8888
Fax: +86 21 6335 0003

Shenzhen

Deloitte Touche Tohmatsu CPA Ltd.

Shenzhen Branch

13/F China Resources Building
5001 Shennan Road East
Shenzhen 518010, PRC
Tel: +86 755 8246 3255
Fax: +86 755 8246 3186

Suzhou

Deloitte Business Advisory Services (Shanghai) Limited

Suzhou Branch

23/F Building 1
Global Wealth Square
88 Su Hui Road, Industrial Park
Suzhou 215021, PRC
Tel: +86 512 6289 1238
Fax: +86 512 6762 3338 / 3318

Tianjin

Deloitte Touche Tohmatsu CPA Ltd.

Tianjin Branch

30/F The Exchange North Tower
189 Nanjing Road
Heping District
Tianjin 300051, PRC
Tel: +86 22 2320 6688
Fax: +86 22 2320 6699

Wuhan

Deloitte & Touche Financial Advisory Services Limited

Wuhan Liaison Office

Unit 2, 38/F New World International Trade Tower
568 Jianshe Avenue
Wuhan 430022, PRC
Tel: +86 27 8526 6618
Fax: +86 27 8526 7032

Xiamen

Deloitte & Touche Financial Advisory Services Limited

Xiamen Liaison Office

Unit E, 26/F International Plaza
8 Lujiang Road, Siming District
Xiamen 361001, PRC
Tel: +86 592 2107 298
Fax: +86 592 2107 259

About Deloitte

Deloitte refers to one or more of Deloitte Touche Tohmatsu Limited, a UK private company limited by guarantee, and its network of member firms, each of which is a legally separate and independent entity. Please see www.deloitte.com/cn/en/about for a detailed description of the legal structure of Deloitte Touche Tohmatsu Limited and its member firms.

Deloitte provides audit, tax, consulting, and financial advisory services to public and private clients spanning multiple industries. With a globally connected network of member firms in more than 150 countries, Deloitte brings world-class capabilities and high-quality service to clients, delivering the insights they need to address their most complex business challenges. Deloitte's approximately 182,000 professionals are committed to becoming the standard of excellence.

About Deloitte China

In China, services are provided by Deloitte Touche Tohmatsu and Deloitte Touche Tohmatsu CPA Limited and their subsidiaries and affiliates. Deloitte Touche Tohmatsu and Deloitte Touche Tohmatsu CPA Limited are, together, a member firm of Deloitte Touche Tohmatsu Limited.

Deloitte China is one of the leading professional services providers in the Chinese Mainland, Hong Kong SAR and Macau SAR. We have over 8,000 people in 15 offices in Beijing, Chongqing, Dalian, Guangzhou, Hangzhou, Hong Kong, Jinan, Macau, Nanjing, Shanghai, Shenzhen, Suzhou, Tianjin, Wuhan and Xiamen.

As early as 1917, we opened an office in Shanghai. Backed by our global network, we deliver a full range of audit, tax, consulting and financial advisory services to national, multinational and growth enterprise clients in China.

We have considerable experience in China and have been a significant contributor to the development of China's accounting standards, taxation system and local professional accountants. We also provide services to around one-third of all companies listed on the Stock Exchange of Hong Kong.

This publication contains general information only, and none of Deloitte Touche Tohmatsu Limited, its member firms, or their related entities (collectively, the "Deloitte Network") is, by means of this publication, rendering professional advice or services. Before making any decision or taking any action that may affect your finances or your business, you should consult a qualified professional adviser. No entity in the Deloitte Network shall be responsible for any loss whatsoever sustained by any person who relies on this publication.

