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Suggestions on Financing Methods of Cross-border M&A of Private Listed Companies in China

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Abstract

The choice of financing methods not only plays a key role in M&A, but also plays an important role in the subsequent development of enterprises. In recent years, a new way of financing for the cross-border M&A of private enterprises is provided with the development of the capital market. In this paper, we provide suggestions for private listed companies and relevant personnel who are preparing to implement cross-border M&A and are operating cross-border M&A through the selection of financing methods for cross-border M&A of LEDVANCE.

Keywords

Financing method, Cross-border M&A, Private listed company.

1. Literature Review

Ferreira, m Assa and Matos (2010) analyzed the influence of institutional investors on corporate control in the international market. They believed that under the circumstances of weak legal system, underdeveloped capital market, asymmetric information and high private income of control, foreign investment had a greater impact on cross-border M&A.

Sehgal and Banerjee (2012) found that M&A enterprises in emerging markets prefer to retain a large amount of cash for high growth investment opportunities in the future.

Zhang Juan and sun Hailiang (2017) believe that endogenous financing is often difficult to meet their large amount of capital needs. In terms of exogenous financing, domestic listed companies also have a strong preference for equity financing .

Chen Hao (2017) believes that private enterprises meeting certain conditions can use leveraged buyouts to achieve cross-border M&A. At the same time, it is found that a reasonable transaction structure design and financing strategy are the key factors for successful implementation of LBO.

Zheng Mengqi (2018) uses the research method of combining theory and empirical research to sort out the factors that affect the choice of equity financing and debt financing in cross-border M&A of enterprises, focusing on the analysis of the impact of cross-border M&A level factors on the choice of financing methods of listed companies.

2. Case Introduction

2.1. Background of M&A

In 2016, Chinese enterprises announced 438 cross-border investment M&A transactions with available information, an increase of 20.94% over 2015; the accumulated transaction amount was 215794 million US dollars, a significant increase of 147.75% over 2015. According to the report, Chinese enterprises' participation in overseas investment and M&A began after the

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global financial crisis in 2008. In 2008, the global financial crisis had a great impact on the economic development and financial system of the United States and Europe. Many financial service institutions closed down and many industries faced a global shuffle. The impact of China's economy in this crisis is relatively small. It can be said that the financial crisis at that time brought historical opportunities for Chinese enterprises to participate in the competition of global capital market. Many Chinese enterprises are aware of this, so they began to actively seek investment and merger opportunities in overseas markets in 2011-2013. From 2013 to 2015, the number of Chinese capital outbound investment M&A transactions increased significantly, and cross-border M&A of high-quality assets also became a topic of great concern to Chinese entrepreneurs. Under such a historical background, Chinese enterprises' overseas investment and M&A reached a historic high in 2016.

2.2. Subject of Merger and Acquisition

2.2.1. Acquirer - MLS Co.,ltd.

MLS Co.,ltd.is a private listed lighting enterprise located in Zhongshan City, Guangdong Province. It has led packaging and LED application products as one of the leading integrated photoelectric LED new technology industry company. The products mainly involve LED packaging and LED applications. The company has a strong product R & D strength, professional production technology and high-quality management team. It has a wide range of sales channels in China and is the main domestic LED packaging product supplier.

2.2.2. Acquired Party - LEDVANCE

LEDVANCE is a lighting enterprise set up by the divestiture of general lighting business of OSRAM. OSRAM is the world's leading provider of light sources, lamps and lighting solutions, and is tied with GE and Philips in the world's three major lighting plants. In order to adapt to the transformation of strategic positioning from integrated lighting manufacturers to professional lighting service providers, OSRAM decided to divest the general lighting business and set up LEDVANCE to undertake the business. On July 1, 2016, the divestiture was basically completed and LEDVANCE officially operated independently.

2.3. M&A Process

MLS Co.,ltd., together with IDG and Yiwu state owned Capital Operation Co., Ltd., set up a merger and acquisition fund and a subsidiary, Mingxin optoelectronics. Mingxin optoelectronics, a subsidiary, set up SPV company in Luxembourg and completed the acquisition of LEDVANCE with SPV company as the main body.

Step 1: the merger and acquisition fund is managed by harmony excellence, a limited partnership of IDG. The other three LPS are MLS Co.,ltd., harmony haoshu, another enterprise of IDG, and Yiwu state-owned capital operation Co., Ltd. The total amount of M&A fund harmony Mingxin is 40. 01 billion yuan, and the investment structure is as follows: MLS Co.,ltd.: 1 billion 250 million yuan, accounting for 31.242%; Yiwu state-owned capital operation Co., Ltd.: 1 billion 250 million yuan, accounting for 31.242%; IDG's harmony haoshu: 1 billion 500 million yuan, accounting for 37.491%; IDG's limited partnership: 1 million yuan, accounting for 0.025%.

Step 2: after the establishment of M&A fund and harmonious Mingxin, together with the excellent fund manager (GP) Zhuo Rui investment company, the company established Mingxin optoelectronics, a subsidiary, with a registered capital of 4 billion yuan, including 3.996 billion yuan of M&A fund and 4 million yuan of Zhuo Rui investment, holding 0.1%.

Step 3: Mingxin optoelectronics, a subsidiary, set up SPV company in Luxembourg and paid 485.7 million euros (about 3.594 billion yuan) through the company to complete the acquisition of 100% equity of LEDVANCE.

Through the above case introduction, it can be found that the transaction of acquisition of LEDVANCE by MLS Co.,ltd. goes through the following steps: the listed company MLS Co.,ltd.,

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together with IDG and Yiwu state-owned capital operation Co., Ltd. set up a merger and acquisition fund, harmony Mingxin. The M&A fund adopts the mode of "listed company + PE". The limited partnership of IDG, HeXie excellence, serves as GP, HeXie haoshu as LP, and the listed company, MLS Co.,ltd., serves as LP. Subsequently, the merger and acquisition fund and harmony Mingxin set up its subsidiary Mingxin optoelectronics. Mingxin optoelectronics completed the final acquisition of LEDVANCE through the establishment of Luxembourg SPV.

In the process of competing for LEDVANCE, international well-known investment funds IDG and Yiwu national capital played a key role in the final success of MLS Co.,ltd.. This is a typical way of M&A fund financing. The merger and acquisition fund harmony Mingxin purchases the target through Mingxin optoelectronics, a subsidiary, and then sells the target to MLS Co.,ltd. Co., Ltd. The M&A fund acquires the shares of MLS Co.,ltd. Co., Ltd. and becomes the shareholder of MLS Co.,ltd. Co., Ltd.; after reducing the shares of MLS Co.,ltd., the M&A fund distributes the return to the investors.

3. Suggestions on MLS Co.,ltd.'s Acquisition of LEDVANCE

3.1. Reasonable Use of Private Equity M&A Fund

Compared with the state-owned listed companies, the private listed companies have the characteristics of clear property rights, flexible mechanism, strong sense of self-development and competition, but the private listed companies face the obstacles of insufficient capital strength, asymmetric information, lack of experience and talents, and more policy constraints. Through the joint investment of PE, private listed companies can broaden financing channels, reduce their own capital pressure, use PE's extensive relationship and information network to obtain deeper information, and reduce the decision-making risk of acquisition target selection. PE's rich experience in M&A integration and talent reserve can also provide technical and talent support for the integration of private listed companies after M&A. In addition, there are still some domestic policy and legal obstacles for private listed companies to directly carry out equity trading type cross-border M&A, and the establishment of acquisition entities overseas by PE can avoid policy constraints.

3.2. Avoid Single Way Financing

Through the above research, we can find that in the process of cross-border M&A, MLS Co.,ltd. did not use debt financing or equity financing alone. In the process of cross-border M&A, a large amount of funds are needed. It is difficult to raise a large amount of M&A funds in a short period of time by traditional debt financing or equity financing alone, so as to meet the needs of cross-border M&A. in addition, a single financing method has the shortcomings of high cost of capital use and high risk.

3.3. Actively Looking for M&A Partners

From the case analysis, we can see that MLS Co.,ltd. chose Yiwu SASAC as his strategic M&A partner for far-reaching consideration. On the one hand, it participated in the acquisition as a strategic investor, and its state-owned capital background is conducive to help MLS Co.,ltd. complete the process of capital exit approval and overseas investment filing. On the other hand, state-owned capital is relatively reliable and stable, which will not affect the control of Listed Companies in the future. Through cooperation with strategic partners, private listed companies can make up for the lack of capital strength and other related areas, and quickly enhance the comprehensive strength of the company. On the one hand, we can obtain some funds for M&A, on the other hand, we can make use of the advantages of strategic partners in their field of expertise and preferential policies to minimize the cost of M&A and help the company improve the success rate of M&A.

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3.4. Set up Multi-level Transaction Structure

The potential risks can be isolated as much as possible by setting up a multi-level transaction structure to ensure the safety of Chinese enterprises to the greatest extent. Shell companies or SPV companies have independent legal personality in law. If a multi-level transaction structure is built between Chinese enterprises and the target companies of cross-border M&A, the debt risk, operation risk and bankruptcy risk of the target company can be isolated to a certain extent. The risk of cross-border acquisition is huge. In the past, there have been many cases in which the buyer has been implicated due to the failure of integration of the target company after acquisition, so it is necessary to ensure the safety of Chinese enterprises.

In addition, the multi-level transaction structure is more convenient and flexible than direct acquisition. The acquirer can change the control right of the target company and withdraw the financial investors by transferring the equity of SPV company abroad.

3.5. Design the Transaction Structure That Can Enjoy the Preferential Policies of the State

Designing the transaction structure that can enjoy the preferential tax policies of the tax countries can reduce the acquisition costs and future operating costs. We can see from the case of MLS Co.,ltd.'s acquisition of LEDVANCE that MLS Co.,ltd. has set up SPV in Luxembourg to acquire LEDVANCE through SPV. As you all know, Luxembourg is a "tax haven" in Europe. When Chinese enterprises set up offshore companies in Luxembourg or Belgium, they can use the tax differences between these countries and Germany to help Chinese enterprises save the cost of M&A if permitted by law. Because both Germany and Luxembourg are EU member countries, they can enjoy tax treaty and EU tax preferential treatment, and the dividend withholding tax, capital gain withholding tax and royalty withholding tax of enterprise acquisition transaction between the two countries are all zero. Therefore, the design of a reasonable transaction structure can minimize the huge tax expense, reduce the capital needed for M&A, reduce the financing cost, and postpone the financial pressure of the company.

Therefore, in the process of implementing cross-border M&A, private listed companies should actively formulate a tax structure that can enjoy the preferential policies of the state, reduce the amount of financing, save the cost of M&A, and improve the success rate of M&A.

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