

BOOST IN CHINESE BUYERS FOR AUSTRALIAN COMPANIES

[Andrew Lumsden \(Partner\)](#) & [Lizzie Knight \(Partner\)](#)

"If there is a wave, there must be wind"

Chinese proverb

The last three months have seen more Chinese bidders in the Australian public M&A market than for the whole of 2013. While some commentators have attributed this uptick in Chinese buyers to the relaxation of the NDRC approvals, in reality it's more likely a result of Chinese bidders picking what they see as the bottom of the resource cycle and looking to average down their cost of acquisition.

In addition to the formal changes to NDRC's approval process, there seems to be a new willingness to relax the "one-bidder policy". Until this policy is clarified, there is considerable advantage to targets and bidders in designing deal protection mechanisms that address this issue.

Consistent with the reforms highlighted in the Third Plenum (see [Third Plenum Decision - a reform manifesto](#)), on 2 December 2013, the State Council issued its "Catalogue of Investment Projects Approved by Government (2013 edition)" under which it signalled the increase of National Development Reform Commission (NDRC) approval thresholds and changed the current approval-based system to a filing-based system. On 8 April 2014, the NDRC issued the implementing regulations to support this policy announcement – "Measures for Verification and Registration on Overseas Investment Projects". The implementing regulations took effect on 8 May 2014.

The new NDRC approval thresholds are summarised below, having regard to the previous approval thresholds.

Previous thresholds		New thresholds	
Approval	Threshold	Approval	Threshold
Prior reporting/NDRC confirmation letter	All offshore bids and acquisitions	Prior reporting/NDRC confirmation letter	Offshore bids and acquisitions ≥ US\$ 300 million
State Council approval (after NDRC review)	Resource projects ≥ US\$ 200 million Any other projects ≥ US\$ 50 million	NDRC approval	Investment project ≥ US\$1 billion; Investment project in sensitive country, region or sectors*
NDRC Approval + filing with State Council	Resource projects US\$ 30 million – US\$ 200 million; Any other project US\$ 10 million – US\$ 50 million	Filing with NDRC	Investment project (by central SOE) < US\$1 billion; Investment project (by non central SOEs) between US\$300 million and US\$1 billion
Provincial DRC Approval	Resource projects < US\$ 30 million Any other projects < US\$ 10 million	Filing with Provincial DRC	Investment project (by local enterprises) < US\$300 million, not in sensitive country, region or sectors

“Sensitive sectors” are defined in the implementing regulations to include telecommunication, water resources exploitation, large scale land development, power grids and media.

In addition to the recent changes announced by NDRC, the State Administration of Foreign Exchange (**SAFE**) has also relaxed its requirements for the use of funds in overseas investments. In particular in January 2014, a *Circular on Further Improvement and Amendment of Foreign Exchange Policies for Capital Accounts* was issued. As a result of this Circular, Chinese entities:

- can use multiple sources of funds for OFDI including not only self-owned foreign exchange but also foreign exchange borrowed domestically or purchased using RMB, profits from OFDI and retained offshore, and tangible and intangible assets;
- do not need to obtain SAFE verification relating to source of funds but merely need to lodge a statement with SAFE describing the source of funds and to register the source of funds;
- do not need to obtain SAFE approval for remittance of capital overseas but merely need to provide a designated bank with approval or filing documents issued by the NDRC and the MOFCOM and a certificate of foreign exchange registration;
- do not need to obtain SAFE approval for remittance of preliminary transaction costs (such as security and advisors’ fees) associated with proposed OFDI unless such costs are more than US \$3 million or 15% of the total amount of the investment. Even if the preliminary transaction costs exceed either of the thresholds, SAFE approval is still not required; and a Chinese entity engaging in a proposed investment overseas merely needs to fill with the relevant local foreign exchange administrative authority documents verifying that they have indeed engaged in the investment such as bidding documents and proof of application for approval of the proposed investment by foreign regulatory bodies.

Despite the relaxation to the NDRC and SAFE approvals policy, two of the four deals recently announced in Australia, namely the takeover by Landbridge Energy of Westside and the takeover by Guangdong Assets Management Limited (**GRAM**) of PanAust are conditional on PRC regulatory approvals.

The deals so far announced by Chinese bidders in 2014 indicate some changes in the nature of Chinese bids as compared to 2012 and 2013 but also a consolidation of other trends previously identified (see [M&A Review 2012](#) and [M&A Review 2013](#)). Most notable are:

- an apparent shift back from Privately Owned Enterprises (POEs) to State Owned Enterprises (SOEs) from provincial areas;
- an ongoing shift from obtaining target recommendation to making offers directly to shareholders without target recommendation and in some cases a recommendation to reject; and
- a continuing reliance on pre-bid stakes.

In the Corrs’ [M&A Review 2013](#) of public deals, 100% of the public deals in our deal sample involving Chinese bidders were undertaken by POEs. In contrast, three of the four deals announced during the last three months have been SOEs - Norton Gold Fields (whose

majority shareholder is Zijin Mining), Baosteel and GRAM - and in particular SOEs from the provinces rather than central SOEs in Beijing.

Two of three SOE bidders (Baosteel and GRAM) already have significant pre-bid stakes in their targets. These existing stakes were acquired closer to the top than the bottom of the resource cycle. In a continuation of this trend, Cuesta Coal on 21 May announced its major shareholder, state-owned Beijing Guoli Energy Investment Company, would inject \$15 million into the company via two separate share placements to increase its stake from 36% to 54%.

Recent allegations of corruption plaguing senior executives in Chinese SOEs has damaged the reputation of these companies and the questions of accountability may also be responsible for driving SOEs to seek to lower their cost base and book a profit from their overseas investments. This focus on profitability and ultimately accountability is evidenced by this month's report from the State Agency Xinhua that the pace of SOE profit growth increased by 6.5% in January to April 2014 as compared to the same period last year. The profits of SOEs administered by provincial governments increased by 5.1% year on year, a marked turnaround on the 14.7% year on year decline for the same period in 2013.

Irrespective of the causes of the recent spike in PRC investment in Australia, the amendments to the PRC regulatory approvals process are certainly a welcome sign for PRC investment in Australia. That said, questions remain about the impact of the change to the so called "one-bidder" policy.

The recent acquisition battle between two Chinese companies over a Cayman registered semiconductor firm may shed light on China's changing overseas investment approval process. In this case two SOEs - Tsinghua Unigroup of Beijing (Unigroup) and the Shanghai Pudong Science and Technology Investment Company (PSTI) - were bidding separately for Nasdaq listed RDA Microelectronics.

In September 2013, PSTI bid USD15.50 for each of RDA's American depository shares and in October 2013 Unigroup offered USD18.50 per share. PSTI received a confirmation letter from NDRC (which would previously have granted it exclusivity in relation to a deal) in November 2013. However RDA unsurprisingly selected the higher bidder for its shares and executed an agreement with Unigroup. Many media outlets reported at the end of November that Unigroup had received a letter from NDRC advising them that without a confirmation letter, their move to acquire RDA was illegal.

However, in a new twist the Chinese press is now reporting that NDRC has indicated that a confirmation letter is not an exclusive document and that when PSTI obtained its exclusivity letter it had not entered into any binding agreement with RDA and that "such a move to jump the gun in submitting an application before even the most basic conditions of the deal had been agreed might mislead the regulatory departments".

On 20 December 2013, RDA and Unigroup announced the amendment to their merger agreement to reflect the changes to the NDRC approvals process. It now seems the merger agreement is no longer conditional on receipt of NDRC approval with an acquisition price of USD910 million. On 5 May 2014, the parties announced their ongoing commitment to close the transaction and reiterated the long stop date of 8 August 2014 for completion.

Two days later, on 7 May, PSTI issued a press release noting that six months had passed since RDA and Unigroup entered into their merger agreement and stating that PSTI had obtained an extension of its NDRC confirmation letter for an acquisition of RDA through to November 2014.

Understanding the shifting NDRC approvals process is vital for Australian companies keen to realise the opportunities offered by Chinese investment. For PRC bidders, ensuring a target understands the status of confirmation letters and "pre-clearance" will remain important. Target boards will continue to rely on these to assess the certainty of a PRC bid until there is

further clarity on this issue. Until the one bidder policy is clarified, there is considerable advantage to both sides in designing deal protection mechanisms that address this issue.