KURMANNPARTNERS
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Choppy Waters ahead in China

2013 has been an unusually turbulent period for companies in China. Amidst an apparent economic slowdown, the new leadership has pursued an anti-corruption drive, a government frugality campaign, and a strengthened Internet crackdown. Given its current weaknesses and long-term challenges, China has no choice but to restructure and upgrade its economic model. We should expect a gradual and experimental approach, following Deng Xiaoping's "crossing the river by feeling the stones". The environment of uncertainty and volatility is bound to last for a considerable time. We estimate that we could easily be looking at a period of 5 years or longer given the depth and range of reforms required. So, what are the likely perspectives?

Growth will slow: As a maturing economy, growth must slow compared to the past when growth averaged 9.9% per year from 1979-2010 with a peak of 15% in 1984. The size of China's labor force is now contracting, the investment boom has led to declining efficiency of investment, and productivity growth rates have also been falling off. China needs to grow at 7-8% this decade and 5-6% in the next in order to avoid political and social unrest. This trajectory is possible if the new leadership proceeds with productivity boosting reforms, but a significant improvement in the global economy would be needed otherwise.

The economy will upgrade: International experience shows that labor productivity growth is a prerequisite for sustainable growth. We expect China to pursue reforms that will raise productivity, meaning the movement of resources from low-productivity to high-productivity industries; more investment in machinery and automation; more innovation in new technologies, products and ways of working; and more education and training to upgrade workforce skills.

The market will be bolstered: SOE ("state owned enterprises") reform remains fraught with barriers, and thus ambitions to bolster the market will focus on addressing existing distortions and improving competitive conditions. We expect deregulation to relax control over market access; financial reform to increase private sector access to capital; and the liberalization and streamlining of administrative procedures.

Consolidation will accelerate: One of the most severe problems facing the Chinese authorities is over-capacity, caused by the excessively fast growth in investment. And thus one of the major consequences of the shift in growth model will be faster consolidation. Inefficient and uncompetitive companies, increasingly starved of cheap financing, will be pressured to sell out or die slowly. This is already evident in sectors with less government interference, such as consumer goods or automotive components, where we are seeing a marked increase in M&A activity. The

direction is harder to predict in sectors with strong government involvement, as this will depend on the degree to which private capital is allowed to participate in restructuring. As the government will not be able to rely on SOEs alone to achieve its new growth model, we are moderately optimistic that private capital, including foreign capital, will have a role to play.

Consumers will pose new challenges: Despite the common wisdom that the Chinese consume too little

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and save too much, consumption has been growing at a healthy rate of 9% per annum for the past two decades. Over the next few years, we do expect consumption-driven industries to out-pace GDP growth, and investment-driven industries and infrastructure to grow slower. And with the consuming class increasing by several hundred million over the coming decade, consumer-facing companies will need to meet a more heterogeneous and discerning set of needs, with demand dispersed across hundreds of cities and towns.

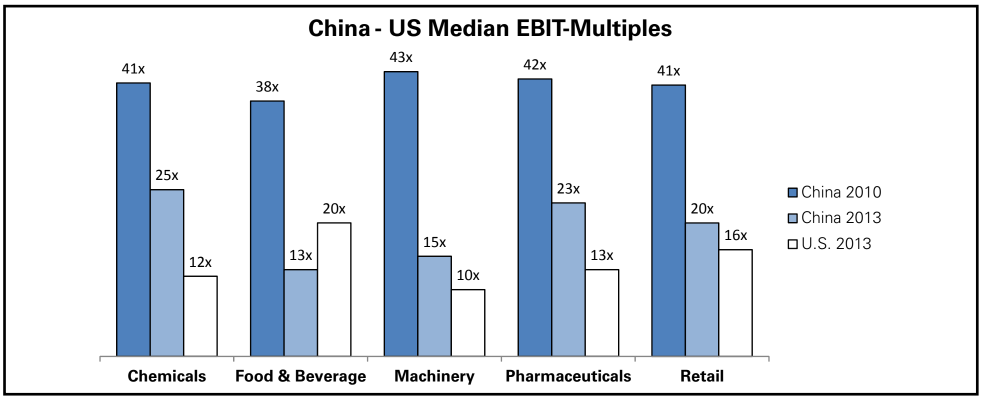
Government will intervene on behalf of consumers: Consumers will become increasingly vocal, especially on the Internet, and the government will increasingly listen and respond. In other words, what is important to the consumer will be important to the government: the cost of living, quality of medical care, safety of food, impact of pollution, access to education etc. It is significant that many price fixing and commercial bribery investigations have been launched in response to media reports. While this may lead to stronger supervision and more order over the long-term, it will mean more arbitrary intervention in the short-term.

Costs will increase further: The upgrading of the economy is inevitably resulting in higher operating costs. We have seen this over the last 3 years, and the trend will continue over the next 5 years. This will put pressure on exporting companies, but also on domestically oriented companies. In the face of revenue growth pressure and rising cost structures, a re-focus on operational efficiency and productivity will be required to maintain profit levels. This will not be easy for companies which for decades have been focusing on top-line growth.

Outbound investment will grow slowly but steadily: We expect a shift to a more natural flow of outbound investment, away from the politically mandated investments by large SOEs, and towards investments by smaller SOEs and private companies. These acquisitions may be smaller and less eye-catching, but more sustainable given their business rather than political foundations. The implication for international companies is a more rational basis to enter into business partnerships with Chinese companies at a global level.

While China has always been considered a complex and dynamic market, the restructuring and upgrading of its economic model will lead to greater uncertainty and volatility over the next 5 years. And while the choppy waters will be navigable, international companies will need to make sure they are ready for them. What worked in the past will no longer be enough. There will be a shake-out in many sectors, and only the better prepared companies will flourish.

Figure: as consequence of slower growth perspectives and increasing competition transaction multiples are likely to come down further but will still be high as compared to "Western standards"



InterChina Consulting

InterChina Consulting is IMAP's exclusive member for China. Founded in 1994 with offices in Beijing and Shanghai, InterChina Consulting is one of the leading advisory firms for strategy and mid-market M&A. The firm employs more than 60 specialized advisors. Its clients are usually global companies. The Swiss national Franc Kaiser, resident in China since 2002, is part of InterChina's multi-ethnic management team and responsible for Business Development. He also leads InterChina's healthcare sector group.

Completed Projects

For the **Grünenthal Group,** Aachen, Kurmann Partners identified **Biogen® Laboratorios**, an established pharmaceutical company, based in Bogota, Colombia, and motivated the owner to sell its entire product portfolio. The product portfolio comprises branded generics that are well-known and established in the Colombian market; some of them holding market leading positions in their segments. The management of Grünenthal was accompanied during the entire acquisition process as well as in the purchase negotiations, which led to the closing of the transaction with the acquisition of the entire product portfolio of Biogen® Laboratorios. With this acquisition Grünenthal strengthened its market position in Latin America and expanded its portfolio with well-known and high quality products.

Comment: It can be generally noted that Latin America remains a key potential growth area for global Pharma companies as the region shows strong economic growth with a strongly growing middle class population.

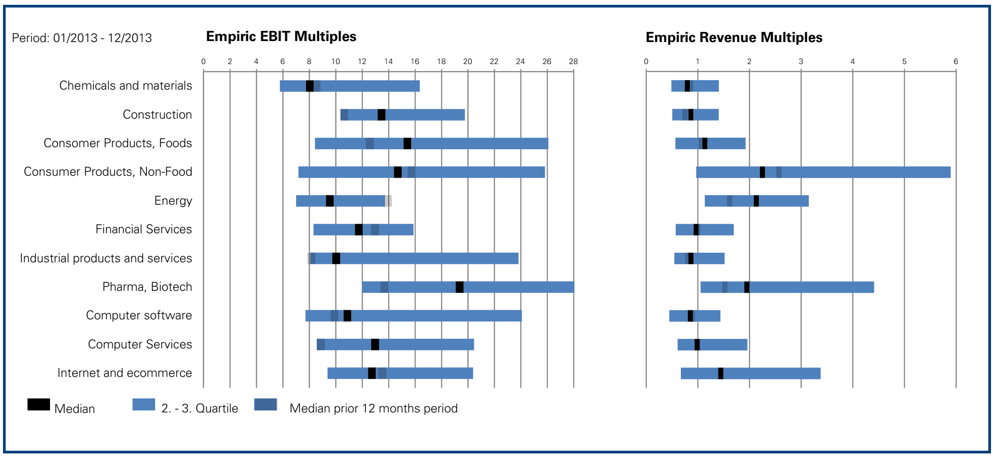
Vital Solutions Swiss AG, headquartered in Tägerwilen, Switzerland, was founded in June 2013 to develop and market innovative plant based ingredients for the food and cosmetics industry. Kurmann Partners helped to shape the business case and based on its contacts in the Healthcare field identified investors who provided growth capital within a transaction structure developed by Kurmann Partners.

Realized Prices

A common method for estimating the value of the company is the use of so-called «multiples». By multiplying a key figure (e.g. revenues or EBIT) of the company of interest with a sector-specific multiple, the pertaining company value («enterprise value», i.e. including debt) is derived. While there are «rules of thumb multiples» for most industries, in practice they show a great variation around the mean and also vary over time.

Even though for many transactions the price details do not become public, there is still a large number of transactions where target financials and transaction prices are known. As a service to the readers of the MergerTalk Kurmann Partners elaborates a statistical analysis of the paid multiples of the last twelve months based on the worldwide realized sales of companies with revenues in the range from $ 10 - 500 million.

In order to present meaningful data, for the calculation of the EBIT multiple we have eliminated in the basis all companies with an EBIT-margin of less than 1%. To eliminate the influence of extreme special situations, we only show in the below graphic the variation over the two middle Quartiles and the Median (i.e. 50% of all transactions in the specific industry have a higher multiple and 50% a lower one). As seen in the graph, the variation of the multiples is high, even within individual industries. The valuation of a company is driven by many individual and subjective factors. The exploitation of such factors in the price realization is strongly influenced by the sequence and the structure of the sales process.



Source of the basis dates: www.mergermarket.com

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We create
and realize value
for our clients.

About us

Kurmann Partners is an independent M&A and strategy consulting firm, specialized in medium-sized companies. We structure and direct the process for the sale of companies, develop and implement growth through acquisitions, and consult on value-enhancing strategies.

Since 1987, we have conducted more than 100 transactions, most of them across borders. As the exclusive Swiss member of IMAP, the largest organization of independent M&A companies globally with over 400 consultants in 30 countries, we have local resources, contacts, and knowledge at our disposal worldwide. All our partners have own executive management experience and for this reason, can develop solutions even in complex situations that prove practical in the implementation and can navigate difficult negotiations with high acceptance of parties involved on the decision makers and operative level.

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