LPA ASIA NEWSLETTER

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M&A in Asia: Some takeaways from recent M&A transactions

Amid an unprecedented global recession and a steep decline in the numbers and value of M&A transactions worldwide, the M&A market in East Asia has remained remarkably resilient, with China snatching from the USA the position of largest FDI recipient in 2020. As new challenges arose (off-site due diligences, online negotiations, weighing of COVID-19-related non-recurring items in company valuation, etc.), our Asian offices reflect on recent M&A transactions to offer key takeaways.

JAPAN

In recent years, Japanese companies have recognized cross-border M&A as a major tool to achieve growth. Cross-border M&A activities have risen especially among middle and large Japanese corporations and, according to data from the Ministry of Economy, Trade and Industry, the total M&A deal volume in Japan in 2019 reached 4,088 transactions. Such eagerness comes as Japanese companies are facing economic globalization and the rapid growth of the emerging Asian countries who are poised as competitors in strategic digital areas that are traditionally Japan's economic strength. Japanese companies' concern over their sustainable growth has further increased in the context of the COVID-19 pandemic, leading many of them to engage in cross-border M&A.

Cross-border M&A transactions are commonly hindered as early as the negotiation stage due to the very specific culture and business practices of Japanese companies, who are moreover usually managed by Japanese-speaking only executives. The decision-making process in Japan is based on the "ringi" (稟議) system, whereby each decision is made collegially after a consensus-building (and time-consuming) process, unique to Japanese culture.

The related difficulties can easily be overcome with the assistance of bicultural advisors who are closely acquainted with both the Japanese language and the Japanese corporate culture and will allow the foreign companies to have a direct access to the Japanese decision-making executives and smoothen the negotiation process by using the proper language and protocol. Doing so, comprehensive agreements will be reached at an early stage, from which the Japanese will seldom depart.

Foreign companies will also appreciate the Japanese legal framework and bureaucracy, which provide clear guidance and comprehensive rules with regards the registration of M&A transactions, allowing for visibility on the time and date when completion of the transaction occurs. However, Japanese authorities generally refuse to register documents which are written in English only and which deviate from Japanese legal practice (such as share purchase agreements made of many pages and drafted only in English); for complex transactions, foreign companies are therefore encouraged to seek assistance from qualified advisors who will draft and submit, for registration purposes, simplified versions of the transaction agreements drafted in Japanese.

CHINA

"在中国没有不可能" "In China, nothing is impossible"

Unfamiliar foreign investors may be daunted by the challenges that cross-border M&A transactions in mainland China seem to pose: heavy bureaucracy, national protectionism, lack of legal framework, etc. Chinese businessmen will soothe their concerns by claiming that "in China, nothing is impossible", and this is generally true. Flexibility and ingenuity, combined with patience, are key ingredients to any successful complex M&A transaction, so long as that the Chinese seller has enough understanding of western practice and standards as to be able to adapt to and accommodate the foreign investor's requirements and concerns.

Language and cultural gaps are a common and major quagmire, but they can be easily overcome by direct high-level communication between the parties and proper assistance from bicultural advisors, and foreign investors will appreciate their Chinese partner's pragmatism and solution-oriented mindset. Unsophistication of the Chinese legal system should also be regarded as a chance rather than a handicap, as it allows for more flexibility in the drafting and implementation of the transaction documents, and foreign investors should be further encouraged by the fact that foreign investments have been strongly promoted by the Chinese government over the past years, to such extent that currently few restrictions still exist.

One must however be aware of the heaviness and versatility of the Chinese bureaucracy, who may at whim refuse to register a document (in particular the SPA and the amended articles of association of the target company) that it deems to be too complex or unusual. This may usually be solved by submitting a simplified version of such document for registration purposes.

The most critical issue commonly faced by foreign investors nowadays remains the remittance in China of funds from overseas, due to cumbersome foreign exchange regulations. Strictly observing such regulations, it is commonly not possible, for instance, to implement earn-out mechanisms or share SWAPs or to secure R&W by depositing part of the purchase price in escrow accounts.

There are nonetheless ways to reach the desired outcome through carefully crafted schemes (e.g. by structuring the transaction through an ad hoc entity, opening joint-signature bank accounts, etc.).

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OUR INVOLVEMENT

- **Ayano Kanezuka**, local partner, represented Global Dining, a Japanese catering group, which the Tokyo Metropolitan Government ordered to reduce its working hours due to Covid-19 situation and which was sanctioned for failing to follow this order.

  Global Dining filed a lawsuit on April against Tokyo Metropolitan Government on the ground of violation of violated Japan's Constitution.

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OUR INVOLVEMENT

- **LPA Shanghai** advised Dentressangle Group with respect to their acquisition of Chinese PPE manufacturer SAFETY-INXS. [Article in French]
- **LPA Shanghai** advised the owners of Chinese Tech company 31TEN with respect to their acquisition by FABERNOVEL. [Article in French]
- **Hubert Bazin** participated as speaker at a conference hosted by Strasbourg University and the *Société de Législation Comparée* to discuss the changes brought by the new Chinese Civil Code that came into effect on 1 January 2021.

HONG KONG

The Hong Kong M&A market has not remained immune to the negative effects of the global Covid-19 pandemic and the US-China trade conflict. Internal political developments have also contributed to uncertainty over the future. As a result, M&A transactions decreased in number and value in 2020. We discuss below two notable takeaways from recent M&A transactions which were impacted by the current crisis elements.

We noticed that M&A parties have greater difficulty finding agreement on the mechanism or formula for valuing an ongoing business, whose revenue has been and will be affected in future by the effects of economic uncertainty. While sellers aim to neutralise the negative impact on the transaction price from the target's reduced revenue during the crisis period, buyers expect and may insist on a lower valuation on the ground of a perceived increased risk when investing at a time when the various crisis issues are still unresolved. Despite these opposite pressures, parties can still be successful provided they are willing to be creative in finding pricing solutions such as a longer valuation period, flexible price adjustment mechanisms and longer earnouts. In addition, they can provide for call and put options with triggers and pricing principles that give both buyer and seller an opportunity to exit or take full control of the target. Further, as sellers are increasingly wary of financing risk, a buyer who is able to give the seller comfort that it has access to a reliable source of funds has a higher chance of getting the deal across the finish line.

Restrictions on international travel have forced parties to rely almost exclusively on online meetings, virtual due diligence investigations and external advisors employed in the location of the target. We experienced that in the case of competitive tenders, offshore bidders with no 'feet on the ground' in the target's area may be at a disadvantage relative to bidders who already had their own staff on site or had pre-existing relationships with local agents or advisors. The ability of a buyer to meet and communicate directly with the target's owners, management and advisors clearly enhances the mutual understanding of the other side's intentions.

This in turn will contribute to each party's level of confidence when negotiating the terms of a deal. Offshore buyers should actively explore ways in which they can improve their communication and understanding with sellers and their advisers. Sending one or more of their staff to the location of the target is an option they should not exclude out of hand despite the onerous travel restrictions and quarantine rules. Forging stronger bonds with its local advisors and having very regular briefings with them is another way of improving a buyer's understanding of the target and seller. The seller on its side should also be aware of the current limitations to which buyers are subject. It should increase the opportunities for buyers to have a dialogue with the management of the target and not impose unnecessary dataroom restrictions on the information provided to potential buyers.

SINGAPORE

Singapore is well-known for placing a strong emphasis on the rule of law. Such emphasis has contributed to Singapore's attractiveness to foreign investors as a top business destination for investment and locating major operations, in particular in ASEAN.

Consequently, Singapore has become a hub for M&A transactions in South East Asia where purchasers will incorporate their investment vehicle to acquire assets or companies located in neighbor countries. We have noted in the course of advising on recent M&A transactions that common concerns for a buyer of such assets or companies are the enforceability of claims against the foreign sellers in their home jurisdictions which may be perceived to be less straightforward than in Singapore, as well as the creditworthiness of the sellers to make good on such claims, especially if they are individuals.

This may result in the M&A parties having difficulty finding an agreement on the price retention mechanism in the SPA, as the buyer may prefer to withhold a portion of the purchase price instead of potentially having to try and recover it from the sellers after paying it out, while the sellers would naturally oppose such a right. Despite these conflicting positions, a deal can still be struck if the parties are willing to compromise and find innovative price retention mechanisms.

Part of the purchase price may be withheld at completion and deposited into an escrow account to secure the sellers' potential liability for warranty or indemnity claims under the SPA (Liability). To reassure the sellers, such arrangement can be tailored to provide for the specific retention amount and period, terms regarding control of the escrow account and entitlement to the accrued interest.

If the buyer has to make deferred payments to the sellers post-completion, the sellers may not agree to these amounts being escrowed. A "middle ground" to secure the sellers' Liability in relation to any claim which has been made (by the buyer against the sellers or by a third party against the target) but is still outstanding when such deferred payment is due may thus be considered. Under such approach, (a) the buyer can notify the sellers of any such claim and withhold a sum from the deferred payment equal to its reasonable estimate of its loss pursuant to such claim (if such loss exceeds a specified threshold) and (b) such withheld sum can be used to set off any subsequent Liability of the sellers to the buyer in relation to such claim once it is decided. However, such withheld sum will be returned with interest to the sellers if the claim is finally decided with the sellers/target not being liable or if the third party does not commence formal proceedings against the target within a specified timeline. This will give the buyer a retention right while ensuring that such right would only be exercised in respect of reasonably estimated loss which is material and that there would be a timeframe for a return of withheld sums (with interest).

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OUR INVOLVEMENT

- **Nicolas Vanderchmitt** participated at the CFO committee of the French Chamber of Commerce in Hong Kong in March 2021 to present the firm.
- **Hong Kong office** strengthens its Tax and Corporate/M&A teams with the arrival of Stéphanie Dodin and Camilla Venanzi.

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OUR INVOLVEMENT

- **LPA Singapore**, as foreign counsel, advised Havas with respect to their acquisition of the Singapore-based marketing agency BLKJ. [Article in English]
- **LPA Singapore** advised Visionairs in Art Pte. Ltd. on all commercial aspects in relation to the touring of the exhibition "Once upon a time on the Orient Express", which initially started in 2014 in Paris at the Arab World Institute. The attraction has been successfully launched in Singapore despite COVID's restrictions.