

# ***Analysis of Domestic Acquisitions and Cross-Border Leveraged Buyouts of Companies***

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**Abstract:** With the development of economy, Chinese companies have started to use M&A to expand their business, and more and more core acquisition funds are investing in LBOs. Meanwhile, the pace of China's economic opening to the outside world is gradually accelerating, and many companies are making cross-border M&A to enter the international market, and leveraged buyout, as a special form of M&A for multinational companies, has also attracted attention and spread widely. This paper first analyzes the basic principles, processes, and characteristics of leveraged buyouts. Based on the current situation in China and combined with specific cases, it points out the necessity and problems of applying leveraged buyouts in China. By analyzing and studying two domestic acquisition cases and two overseas acquisition cases, the paper draws some conclusions. Leveraged buyouts are to some extent applicable to M&A activities of Chinese companies. Despite the challenges they pose, leveraged buyouts will remain an important form of M&A for Chinese firms as long as China continues to improve its legal and financial environment and standardize its operational processes. Through an analysis of China's domestic economic situation and current policies on theories related to cross-border investment in overseas M&A, the advantages and risks of cross-border leveraged buyouts are explored and countermeasures for firms to learn from are proposed.

**Keywords:** China economy, corporate M&A, leveraged buyouts

## **1. Introduction**

With the development of China's economy, many companies have started to use M&A to expand their business. The current M&A financing methods in China can be divided into cash acquisition, securities stock, bond acquisition, bank credit, etc. However, as the number and scale of M&A increases, the existing financing methods can no longer meet the complexity and capital requirements of large M&A, and how to expand new channels is one of the important issues to promote further development of companies [1]. In this context, leveraged buyouts have become a financing method that needs to be explored and developed in the Chinese M&A market.

Meanwhile, with the development of economic globalization, the pace of China's economic opening to the outside world is gradually accelerating, competition in the international market is becoming increasingly fierce, and the wave of cross-border mergers and acquisitions is rising [2]. Many companies are engaging in cross-border M&A to enter the international market and find new

growth opportunities for their business by acquiring overseas companies. Although companies can "make a big deal out of a small one" through leveraged cross-border acquisitions, they are also exposed to many risks. Therefore, it is important to identify the risks of cross-border leveraged acquisitions and establish a system to prevent and control them.

Based on this, this paper takes domestic acquisitions and cross-border leveraged buyouts as the research objects. Based on the review of relevant research results, one applies the theory and characteristics of corporate acquisitions and use the research methods of normative analysis and case study analysis to select a total of two domestic and two overseas acquisition cases, with a focus on leveraged buyout cases. The domestic cases of Alibaba's acquisition of DAMAC and Microsoft's acquisition of Activision Blizzard are used as examples to analyze the motivation and risks of the acquisitions, to interpret the motivation of Microsoft's acquisition of Activision Blizzard with a huge amount of money, and to analyze the risks of M&A activities in order to find the experience of implementing M&A for companies in emerging industries from this unprecedented scale of M&A cases, so as to provide valuable lessons for other companies interested in implementing M&A in related fields [3]. Overseas, the leveraged acquisition of Chilean mining and chemical company (SQM) by Tianqi Lithium is used as an example to analyze the acquisition background and post-acquisition financial performance of the acquisition of SQM's equity, so as to determine the pros and cons of the acquisition [4, 5]. Taking the cross-border acquisition of Kerr Corporation by Xi-wang Food using leveraged buyout as an example, one can analyze its M&A process and make recommendations: first, to make a reasonable valuation of the acquisition target; second, to optimize the leveraged financing structure and method; third, to choose an appropriate acquisition payment method; and fourth, to pay attention to the post-acquisition resource integration [2, 6].

As the pace of overall restructuring of SOEs accelerates dramatically, more and more core acquisition funds are investing in LBOs. at the same time, LBOs will also provide new business opportunities for Chinese companies. Therefore, LBO and its financing model will have a significant impact on China's capital market. Therefore, it is very important to understand LBOs and their financing models as early as possible, which is the purpose and significance of this research paper.

## 2. Acquisition Model

The main modes of business acquisitions are public and leveraged buyouts. A public takeover is a takeover offer made to, or negotiated with, all shareholders of the target company. Leveraged Buyout (or LBO), also known as financing M&A and debt to operate acquisition, is a corporate finance tool [7-10]. It is an acquisition in which the acquirer takes on a high percentage of debt by pledging the present value of the target company's future cash flows or the realizable value of all its assets and operations based on a relatively small amount of its own capital, i.e., by raising a large amount of debt to purchase the target company's shareholders' equity. Usually, the acquirer needs only 10% of its own funds to complete the acquisition, and only a very small portion of the overall acquisition funds, while most of the rest is raised by investment banks issuing junk bonds and loans from commercial banks on behalf of the acquirer [11, 12]. In a leveraged buyout of a target company, each acquisition option has its own characteristics, but most acquisitions also have the same pattern. The basic operational process of a leveraged buyout is shown in Fig. 1.

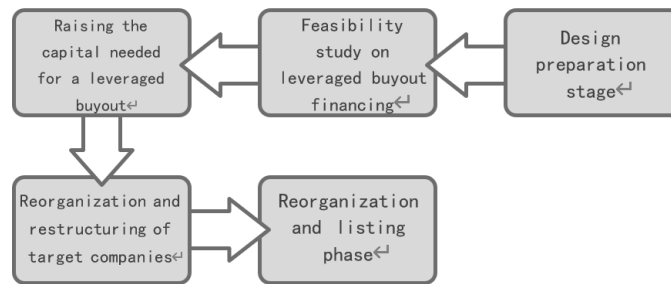


Figure 1: Basic operation flow chart of leveraged buyout.

One of the key features that distinguishes leveraged buyouts from other M&A models is their unique financing model, which is ingenious in that they are acquired with a high percentage of debt secured by the target company's assets or cash flow. The characteristic of a leveraged buyout is that it is not only a transfer of capital but also changes the capital structure of the target company.

In a way, a leveraged buyout leverages big capital at low cost. By choosing the right acquisition target and making a sound leveraged buyout, you can effectively reduce costs and increase the value of your business. The unique leveraged buyout model can provide leverage to a company, but at the same time it is a high-risk behavior for the company. While leveraged buyouts provide a boost to China's capital market and the development of state-owned enterprises, they also face difficult financing problems. In a leveraged buyout, the financing problem of SMEs will be alleviated if the financing channels are expanded to some extent.

There is a need for leveraged buyout to be applied in China, and LBO has a great prospect in China for the following reasons: 1. There are a large number of enterprises to be acquired in China, but due to poor operation and other problems, they urgently need to be restructured in order to find a way out for their future development. 2. Most SOEs in China are highly leveraged at present, and need sufficient financing to bridge the capital gap in their investment and operation. Leveraged buyouts are an effective way to solve this problem. 3. China's financial institutions have a large deposit base, and leveraged buyouts are an effective investment channel for banks and other financial institutions to increase the value of idle assets.

### 3. Domestic Acquisition Cases

#### 3.1. Alibaba Acquires DAMAC

Alibaba is the world's leading B2B e-commerce brand and is currently the world's largest online marketplace and business exchange community. It is the preferred website for global businessmen to promote their business online and is rated as the "most popular B2B website" by businessmen.

Founded in 2004, Barmai Group (Beijing Red Horse Media Culture Development Co., Ltd.) is a comprehensive live entertainment ticket marketing platform in China. After years of development, DAMAC.com has become the No. 1 ticketing website in the global Chinese language category, and has acquired an excellent marketing management team and exclusive ticketing system. As the core business unit of DAMAC Group, DAMAC.com is the world's leading Chinese-language ranked and well-known ticketing company brand and is the leading enterprise in the domestic Internet e-ticketing industry.

Alibaba's M&A of DAMAC did not happen overnight, as early as 2014 Ali became the majority shareholder of DAMAC by virtue of holding 32.44% of its shares, and it took up to three years for DAMAC to become a significant part of participating Ali Entertainment in 2017. Alibaba's acquisition of DAMAC effectively confirms the trend of M&A in today's Internet companies. Alibaba Group acquired DAMAC in a wholly-owned manner and focused on leveraging and leveraging

DAMAC's ticketing portal advantage based on its own operational strengths. The technology owned by Ali and DAMAC can be shared after the merger and acquisition, giving full play to the technological advantages and enhancing the competitiveness of the enterprise. DAMAC has an accurate and scientific ticketing system, a high-end brand service system of the whole industry chain with high-tech system terminals, a professional team with strong operational capability for online ticketing technology, and a large amount of marketing data. Ali will integrate these technologies into the large cultural entertainment, can tap its potential consumers, but also enrich the Internet era under the combination of online and offline ticketing model, improve the layout of the industry chain. As far as the market is concerned, competition among Internet companies is mainly about capturing market share, and M&A can monopolize all the markets of the acquired party and thus greatly increase the market share of the company. Alibaba's acquisition of DAMAC will help transfer these consumer markets to Ali Dafendian.

### **3.2. Microsoft's Acquisition of Activision Blizzard**

Microsoft is an American multinational technology company that develops, manufactures, licenses and provides a wide range of computer software services. The most famous and best-selling products are Windows operating system and Office series software. Activision Blizzard is a video game company based in California, USA, renamed from the merger of the American video game publisher Activision with Vivendi's game division, Blizzard Entertainment, founded in 2008, and one of the largest game developers and publishers in the world.

With the development of Internet technology and the popularity of smartphones, the new game industry is in a golden stage of development due to the influence of the Internet consumer environment. Microsoft acquired Activision Blizzard for \$95 per share in a cash deal worth \$68.7 billion, which is the largest acquisition in the gaming industry.

Microsoft's acquisition of Activision Blizzard is a testament to the Internet's ability to integrate and innovate. For the gaming industry in particular, games are acquiring a higher industrial value than their own entertainment properties. Games reflect the importance in technological innovation and progress as well as in cultural export capabilities. It is important to seize the opportunity and take the lead in planning to take the lead in technology and increase the global cultural output discourse. The acquisition not only promotes the long-term development of the company, but its impact on the cultural communication aspect of society.

## **4. LBO Overseas Acquisition Case**

### **4.1. Tianqi Lithium's Cross-border Leveraged Buyout of SQM**

Tianqi Lithium is a lithium new energy core material supplier integrating upstream lithium resources reserve and development and midstream lithium products processing. It was founded in 1995, and after decades of development, the company has become an important player in the global lithium mining industry and is a leading enterprise in the domestic lithium mining industry. Prior to the acquisition, Tianqi Lithium's operating conditions had been relatively stable, and its revenue and profit had maintained a high growth rate, with all financial operating indicators at the forefront of the industry. Some of Tianqi Lithium's financial data before the acquisition are shown in Table 1.

Table 1: Selected financial data of Tianqi Lithium before the acquisition.

Year	2017	2016	2015	2014
Net sales margin (%)	47.74	45.76	22.81	17.79
Return on Net Assets (%)	31.40	39.46	8.22	6.83
Gearing ratio (%)	40.39	38.29	45.82	22.58
Current Ratio	3.11	1.32	104	1.25
Quick Ratio	2.92	1.16	0.80	0.80
Inventory Turnover Ratio	3.45	2.58	2.17	12.31
Total Assets Turnover Ratio	0.38	0.42	0.27	0.36

Chilean mining and chemical company (SQM) was founded in 1968, SQM was initially engaged in the production of iodine and sodium nitrate, before the company chose to enter the lithium industry in order to complete its industrial footprint. After more than 50 years of development, the company has become the world's largest producer of iodine and potassium nitrate in 2018, as well as a significant producer of lithium carbonate and lithium hydroxide.

As SQM is involved in a wide range of businesses and has a high level of maturity, the company as a whole has entered a period of stable development after decades of development. As a result, its financial indicators were relatively stable prior to the acquisition and did not show significant fluctuations due to the lithium mining business. Although the enterprise's net sales margin is at a low level, the enterprise's return on net assets has shown a year-on-year increase, which indicates its strong profitability in utilizing its assets. Therefore, from an investment perspective, SQM remains an excellent investment target for the lithium mining industry. an overview of SQM's financial data is shown in Table 2.

Table 2: Overview of SQM financial data.

Year	2018	2017	2016	2015	2014
Net sales margin (%)	12.13	12.99	14.54	19.86	19.51
Return on Net Assets (%)	13.13	20.58	19.29	12.14	9.64
Gearing ratio (%)	49.91	47.60	45.31	48.31	50.84
Current Ratio	4.32	3.30	4.02	3.84	4.73
Quick Ratio	2.19	2.67	2.09	2.31	2.41
Inventory Turnover Ratio	1.63	1.47	1.33	1.23	1.53
Total Assets Turnover Ratio	0.53	0.51	0.44	0.37	0.43

The scale of this acquisition is huge, which is an unprecedented challenge for Tianqi Lithium, because the cash paid for the acquisition of the target company is 1.46 times of the company's total assets, which is equivalent to "small fish-eating big fish". In the current environment of sustained international economic growth, M&A can help companies expand into overseas markets, develop their businesses and open up new growth opportunities. However, the case of Tianqi Lithium's leveraged buyout shows that Tianqi Lithium's aggressive leveraged buyout strategy did not produce the expected positive results, instead, the company was burdened with heavy debt, which affected production and normal operations and led to a significant decline in the company's performance. The leveraged buyout increased operational risk, and Tianqi Lithium thus suffered significant losses due

to a sharp decline in the price of lithium carbonate and other raw materials and major changes in the industry. As a result of the acquisition, Tianqi Lithium's financial position deteriorated significantly. This paper hopes that the results of this case will serve as a guide and reminder for Chinese private companies' cross-border leveraged acquisition activities.

## 4.2. A S

Acquisition of Kerr Corporation by Xiwang Food

### 4.2.1. Basic Information of the Acquirer Xiwang Food

It is the largest corn germ oil production base in China and has been named "China Corn Oil City" by the China Food Industry Association, making it the leading enterprise in China's corn oil industry. Ltd., a wholly-owned subsidiary of Xiwang Group, was founded in 1986 as a private enterprise specializing in the production and sales of edible oil products such as germ corn oil.

Due to the non-cyclical nature of the edible oil market and the small changes in market demand, Xi Wang Food's market share in China's edible oil industry is currently stabilizing. The situation will not be optimistic if new competitors join the industry market competition. Therefore, the company needs to find new profit growth points. Moreover, Xi Wang Food has been upholding the three-step development strategy goal of building China's No. 1 corn oil, building China's high-end edible oil and building China's health food, which provides an opportunity for Xi Wang Food's cross-border leveraged acquisition of Kerr.

### 4.2.2. Basic Information of Kerr, the Acquiree

Kerr Investment Holding Corp. ("Kerr"), founded in Canada in 1998, is a company focused on the development, production and marketing of health food products for sports and weight management. Founded in 1998, Kerr is one of the world's largest sports nutrition companies, with a focus on sports nutrition and weight management products.

As the world's largest sports nutrition company, Kerr's main sales market is currently in North America, but the company is now promoting its products in many regions and countries around the world, thus expanding its product sales coverage. Based on publicly available financial data, as shown in Table 3, Kerr's operating income and net profit have been growing in recent years, mainly due to the company's continuous development of new products to meet the needs of different customers and its focus on expanding international markets and the promotion of its Internet e-commerce platform, the company's future operating results will continue to grow.

Table 3: Key indicators of Kerr's audited consolidated profit before the acquisition Amount unit: RMB yuan.

Amount unit: RMB yuan			
	2014	2015	For the period from January 1 to May 31, 2016
Operating income	2,420,766,177.26	2,567,727,544.66	1,285,289,177.59
Net Profit	216,628,565.47	318,981,650.99	166,017,870.88

On September 22, 2016, Xi Wang Foods acquired 100% of Kerr Corporation for US\$730 million in cash. This acquisition by Xi Wang Food was done in cash and at a premium of 969.82%. As a newcomer in the M&A field, Xi Wang Foods beat out many experienced M&A experts to attract

the Canadian sports and health care giant with 55 times leverage and ultimately achieved this cross-border acquisition as a big success. This deal has important implications for the development of M&A leveraged buyouts in the Chinese market, and provides some tips for Chinese companies on how to prevent and control risks in future cross-border leveraged buyouts.

## 5. Suggestions and Insights

The four sets of case studies show that the conditions for large-scale leveraged buyouts in Chinese M&A are not yet mature and the related leveraged buyout mechanism is not perfect. For this reason, efforts are needed to improve the situation from various aspects. It is necessary to accelerate the improvement of corresponding laws and regulations to create better conditions and environment for normal and orderly leveraged buyouts in China's M&A market. The reform of the economic system needs to be deepened so that enterprises can really become the main carrier of M&A. Actively promote the reform of the financial system to truly establish a leveraged buyout financing market and promote leveraged buyouts to be able to develop on a large scale. China's capital market should be vigorously developed to ensure that leveraged buyouts have sufficient sources of capital. Moreover, when conducting leveraged buyouts, aggressive leveraged buyout strategies should be used with caution. The acquirer should fully understand the current situation of the Company and the target company as well as the current market situation, plan well, assess the risks in all aspects, and prepare response strategies in advance.

## 6. Conclusion

In summary, this paper examines the application of leveraged buyouts in both countries, both domestically and overseas, and provides a preliminary study of the prospects for leveraged buyouts in China, as well as some recommendations. The paper argues that leveraged buyouts are an effective way to finance corporate acquisitions. Despite the significant financial constraints in China, the "localization" of leveraged buyouts should be achieved within the existing legal framework in the short term, and attention should be paid to the financing of leveraged buyouts to make leveraged buyouts an important form of M&A in China. LBOs have broad prospects for development in China, and as long as China continues to improve its legal and financial environment and as long as China continues to improve its legal and financial environment and standardize its operating procedures, LBOs will remain an important form of M&A for Chinese companies.

In a cross-border acquisition, the acquirer must not only have a good understanding of itself and the target company, the current situation and future development of the market, and formulate a good strategic plan, but also assess the risks in various aspects and prepare a response strategy in advance. In addition, acquirers need to understand global development trends in advance and grasp future market opportunities in order to accurately analyze the pros and cons of cross-border leveraged buyouts, be prepared to take corresponding risks, and adopt appropriate countermeasures.

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