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Welcome to the September issue of The Global Corporate Advisor.

In this issue, we take a closer look at the challenges connected with identifying and realizing synergies in transactions. Data shows that over 50% of mergers are unsuccessful, which underscores the relevance of this article.

From our Paris office, we have an insightful data-driven article analyzing the valuation methods used during public takeover bids. The studies carried out by the authors examine the relevance, foundation, scope and limits of each valuation method.

Finally, this newsletter has a special focus on the merger and acquisition activity in China in the first half of this year. The M&A market is volatile but volumes are growing, particularly in the IT and clean tech sectors. Inbound cross-border M&A has also grown in volumes and ratio.

Peter Varley
Chairman of GCA
+44(0) 207 842 7353
peter.varley@crowecw.co.uk

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The GCA team is here to respond to your needs relating to M&A transaction support, valuations and advisory services. If there is a topic you would like us to cover in future issues of the GCA newsletter, don’t hesitate to contact Peter Varley, Chairman of GCA, at *peter.varley@crowecw.co.uk.* Alternatively, please contact your local GCA team member to discuss your ideas.

Synergies in Middle-Market Transactions – Tough to Identify and Harder to Realize

By John A. Grivetti and Chris Nemeth, Chicago

Senior leaders at middle-market companies increasingly are saying, "I do": With 2014 marking the strongest year for global deal making since 2007,[1] middle-market companies seem committed to mergers and acquisitions to drive corporate growth. Nearly half of larger middle-market firms were involved in a purchase at the start of 2015, up from 30% a year earlier.[2]

Mergers are fraught with potential pitfalls, and industry experts find that anywhere from 50 to 70% of mergers are unsuccessful. Middle-market companies – many of which lack experience with acquisitions and the financial firepower of their larger counterparts – face enormous challenges when it comes to making an acquisition successful.

Furthermore, mergers and acquisitions participants note that recent purchase prices are at historically high levels in the middle market. To successfully bid for high-quality companies, acquirers are being forced to pay a premium to win competitive bidding processes. This dynamic intensifies the pressure on management to identify accurately and realize quickly the full value of a deal.

Identifying synergies

One of the first steps for any middle-market company contemplating a transaction is to collect and analyze information about the synergies that could result from a deal. Following are the areas where middle-market companies typically find the greatest potential:

- Revenue enhancement opportunities. The ability to enter a new market is one of the most common reasons for a middle-market transaction. These commercial benefits can involve expanding into something new – a product, service, set of relationships, or geography. Revenue expansion depends on many people-driven variables, such as a sales team's ability to understand a new product or to quickly learn new sales processes, as well as on a variety of external market conditions. Given the uncertainty surrounding commercial benefits, middle-market transaction participants should take a conservative approach to quantifying them.

- Cost-related improvements. Although a growing number of middle-market deals are driven by strategic reasons, transactions almost always have a cost-savings component, such as eliminating duplication of personnel or optimizing a company's physical plants or offices. Spending reductions must be approached prudently to make certain that cost cuts do not undermine the commercial or strategic agenda for the transaction.

- Working capital improvements. Regardless of the rationale for a deal, most transactions also present the opportunity to enhance working capital. For example, although companies might be able to better manage their accounts receivable processes, employees might need enhanced training to work differently than they have in the past. As a result, acquirers should develop a strong understanding of the internal cultural shift that will be required as well as of the resultant costs that could drive changes in working capital needs.

- Additional balance sheet opportunities. Putting together two middle-market companies can create significant potential to reduce inventories, heighten efficiency and upgrade margins. These efforts might have associated costs, but management should consider the long-term benefits of making an upfront investment in the combined company.

  Consider a recent transaction in which a middle-market company had more than 10,000 product stock keeping units (SKUs), or distinct products, for sale. Approximately 75 SKUs represented 95% of the company's sales, but the company historically was reluctant to decrease the number of choices it delivered to customers. In this transaction, the acquirer was able to quickly identify and realize the efficiency opportunities inherent in reducing the number of offered products.

- Tax-structuring potential. The structure of an acquisition can provide significant tax savings or minimize future tax costs. Missteps in this area can open the acquirer to additional federal or state tax liabilities. In addition, local and state tax incentives also can be available for funding growth opportunities that often are considerations in acquisition plans.

Build a detailed action plan

When companies start to work on an acquisition, the management is often occupied with tasks necessary to get a deal across the finish line. However, closing the transaction is only the first step. Middle-market companies need a thoughtful, well-documented plan for realizing the value that they originally set out to create.

Consider a middle-market acquisition in which the acquirer approached the transaction with roughly the same plan it used to purchase all capital items, such as photocopiers. The company's leadership soon realized the hard way that the deal process requires its own carefully considered playbook to navigate the unique challenges that inevitably arise during a transaction.

The most successful middle-market transactions have a plan that addresses not only the activities necessary prior to close but also an operational strategy for the post-close period, including day one, the first 100 days and the first year after a transaction. Following are critical steps that help make a middle-market transaction a success.

- Set priorities. Many middle-market companies make the mistake of casting too wide a net when attempting to extract the value of a deal. Chasing down every area of potential opportunity can lead to deal fatigue and a lack of focus. Narrowing down the opportunity creates a higher potential for success.
- Create a culture of accountability. Successful transactions often have an element in common: their leaders define what success looks like from the outset. Any detailed plan should include identifying synergies, assigning responsibility for realizing them and designating milestones. These efforts go a long way in transforming nebulous ideas into measurable, value-added enhancements.
- Work quickly to achieve results. Middle-market transaction veterans note that the longer it takes to implement synergies, the more variability and risk are introduced, the worse a deal will ultimately perform. Quickly analyzing a situation and taking decisive action can mitigate some risks for acquirers and speed the delivery of a transaction's benefits. In addition, foot-dragging can become culturally disruptive, especially in middle-market companies where every employee is crucial in achieving corporate goals. For example, following the acquisition of a competitor, one middle-market company initially planned head count reductions over a two-year period. Although management intended to retain important personnel to help with the transition, it immediately became apparent that working in a culture of uncertainty distracted employees and made them unproductive and unsupportive of business goals.
- Tap the right internal resources. Resource availability is an enormous hurdle for many middle-market companies because employees often have little capacity to take on additional responsibility. From strategy to diligence to integration, the execution of a middle-market transaction requires participation from departments throughout the company. Operations, human resource, IT, sales and marketing and communications departments, all will need to weigh in and execute the plan for a successful transaction. Leadership should select a small team of employees that represent a broad set of departments to serve as the core group that can carry out existing daily responsibilities while simultaneously working on the transaction and subsequent integration.
- Bring in outside experience where it's needed. Understandably, middle-market companies often do not have all of the internal resources necessary to plan and accomplish a successful transaction. Outside experts specializing in the execution of middle-market transactions can offer critical assistance to support the acquirer's team in completing a transaction from the outset through the post-close integration period.

Prepare for potential opportunity

With the increased interest in – and growing volume of – middle-market transactions, savvy acquirers have found the best time to develop a thoughtful, robust approach and playbook is when the company is not engaged in a live deal. Building an effective methodology, toolkit, and decision-making process and then training a core team in advance allows middle-market companies to embark on acquisitions from a position of strength. Then, when a transaction does arise, the team is ready to take swift and successful action.

1 Thomson Reuters, "The Knowledge Effect, Mergers & Acquisitions Review – Full Year," Jan. 9, 2015, http://blog.thomsonreuters.com/index.php/mergers¬acquisition-review-full-year/
2 Leela Parker Deo, Reuters, "TRLPC: US Mid-market Buyers More Decisive in 2015 – Citizens Report," Jan. 13, 2015, http://www. reuters.com/article/2015/01/13/midmart-outlook¬idUSL1N0US1FE20150113

For more information:
John Grivetti is a partner with Crowe Horwath LLP's office in Chicago.
He can be reached at +1 630 586 5340 or john.grivetti@crowehorwath.com.

Chris Nemeth is a director at the Crowe Horwath LLP office in Chicago.
He can be reached at +1 312 899 8405 or chris.nemeth@crowehorwath.com.

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Analysis of Valuation Methods Used During a Public Takeover Bid

By Olivier Grivillers and Aurore Launay, Paris

Evaluation punctuates the main stages in the life of a firm; it's used during takeover bids, asset valuation, impairment tests, restructuring plans, mergers and acquisitions, spin-offs and disposals. Many techniques and financial models enable valuation experts to manage the diversity and complexity of each situation. Hence, it's important to examine the relevance, foundation, scope and limits of each valuation method.

The French financial markets authority, the AMF (Autorités des Marchés Financiers, the French equivalent of the American SEC), requires companies subject to a takeover bid to appoint an independent appraiser when the takeover bid is a squeeze-out offer, or when the takeover bid is likely to cause a conflict of interest, or when it may undermine equality among shareholders. The independent appraiser is in charge of assessing the fairness of the financial conditions of the public takeover bid, including the offered price.

This article discusses two studies carried out by Olivier Grivillers and Aurore Launay, which analyze the valuation methods used by valuators (such as investment banks) and independent appraisers, within the framework of takeover bids. The selected transaction data were extracted from the AMF website.

The studies were performed on the basis of two samples. The first sample comprises 40 transactions (squeeze-outs and takeover bids) between 2013 and 2014. The second sample is composed of 150 transactions between 2001 and 2006.

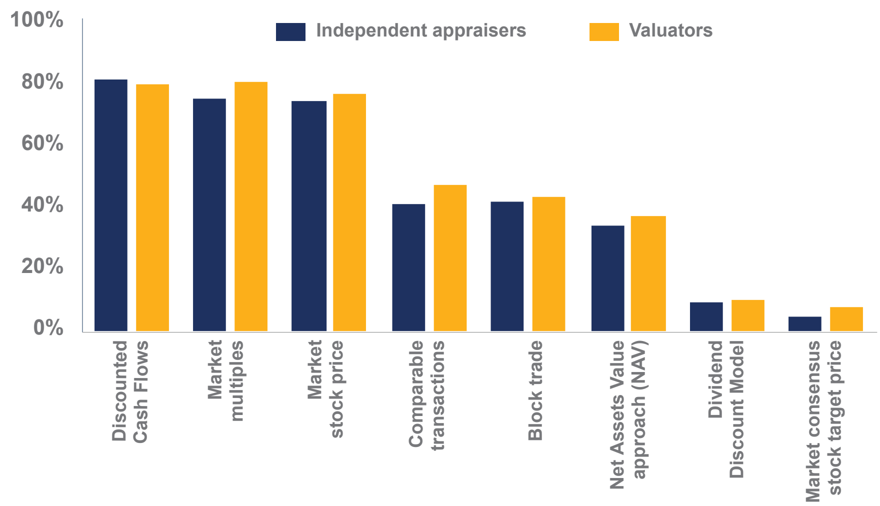
A quantitative analysis of the applied methods

Based on the study performed, there are eight valuation methods used by valuators and independent appraisers to assess the price of a takeover bid. These are:

Figure 1. Number of times a valuation method was used among the 190 analyzed transactions

Applied methods	Independent appraisers		Valuators	
	Number	%		%
Discounted Cash Flows	153	81%	150	79%
Market multiples	141	74%	151	79%
Market stock price	139	73%	144	76%
Comparable transactions	77	41%	88	46%
Block trade	78	41%	81	43%
Net Assets Value approach (NAV)	64	34%	69	36%
Dividend discount model	18	9%	19	10%
Market consensus stock target price	8	4%	14	7%
Total	**678**		**716**	

Figure 2. Percentage of appearance of each valuation method in the analyzed transactions



- Discounted cash flows (DCF)
- Market multiples
- Comparable transactions
- Block trade
- Net Assets Value approach (NAV)
- Dividends Discount Model (DDM)
- Market stock price
- Market consensus stock target price

Among the selected 190 transactions, 678 valuation methods have been used by independent appraisers, that is to say an average of 3.6 methods for each transaction. Among those same deals, 716 valuation methods have been used by valuators, which means an average of 3.8 methods for each transaction.

In the selected sample, the main methods applied by the independent appraisers are:

- Discounted Cash Flows (used in 80% of the transactions)

Discounted Cash Flows

- Market multiples (77%)
- Market stock price method (74%)
- Comparable transactions (43%)
- Reference to a block trade method (42%)
- Net Asset Value (35%)
- Dividend Discount Model (10%)
- Market consensus target share price (6%)

A comparison of the applied valuation methods used in takeover bids over time

Figure 3. A comparison of the applied valuation methods used in takeover bids

Applied methods	2013-2014 40 transactions		2001-2006 150 transactions	
	Av. nb	%	Av. nb	%
Discounted Cash Flows	34	85%	118	78%
Market multiples	34	85%	112	75%
Market stock price	38	94%	104	69%
Comparable transactions	14	35%	69	46%
Block trade	22	54%	58	39%
Net Assets Value approach (NAV)	14	34%	53	35%
Dividend discount model	1	3%	18	12%
Market consensus stock target price	11	28%	n.a	n.a
Total	**167**		**531**	

n.a: not applicable

- The DCF method was applied in 85% of the cases for deals between 2013 and 2014, compared to 78% for the period between 2001 and 2006. This increase can be explained by the fact that this is the only intrinsic method which takes into account the company's business outlook. Nowadays, this method cannot be ignored as its implementation has increased with the application of IFRS and growth in equity research. It is also, the only method which is based on the long term projections of the company.

- The market comparables method was selected in 85% of cases against 75% during the period between 2001 and 2006. Overall, analogical methods (market comparable and comparable transactions) are being used more often. This is due to the development of information and communication tools and globalization of the markets, which has made the search for listed comparables easier, enabling appraisers' quicker access to reliable financial information.

- The market stock prices valuation method has been currently used in 94% of the deals, in comparison to 69% during 2001-2006. This change can be explained by the fact that the companies analyzed in the 2013-2014 transactions sample have a higher liquidity than the ones analyzed in the 2001-2006 sample. During the earlier years, the exclusion of this method can be justified by a lack of liquidity in the stock price of the target companies. Furthermore, the General Regulations of the AMF specify that the market stock prices valuation method is a mandatory criterion within the framework of valuation of listed companies. The regulations also point out that the offer price in a takeover bid cannot be below the average stock price of the last 60 trading days before the announcement of the takeover bid.

  Hence, even though stocks have limited liquidity, it is difficult for valuators and independent appraisers to ignore stock prices in the analysis. This result highlights a reference value observable by the entire market.

- The comparable transactions method was used in 35% of the cases during 2013/2014, against 46% in 2001-2006. This method, like the market comparable method, is an analogical method. Recently, this method has been used less frequently in comparison to the market comparables method, as it is harder to find comparable transactions that can actually be used as a direct reference with regard to the target company.

- The block trade method is used in 54% of the analyzed transactions versus 39% for the period between 2001 and 2006. Nonetheless, one cannot speak of a methodological choice, as might be the case for the other methods displayed in this article, since this method depends on the existence of a block trade in the framework of the takeover bid. Article 234-6 of the new General Regulations of the AMF, which implemented the European directive 2004/25/EC into French law, stating: "where a draft offer is filed..., the proposed price must be at least equivalent to the highest price paid by the offer or... over a period of 12 months preceding the filing of the offer" has made this reference unavoidable.

- The NAV method has been used in our sample in 30% of the cases, against 35% during 2001-2006. This slight decrease is explained partly by the nature of the companies to be assessed (the NAV method is particularly suitable for holding companies and real estate companies). Nevertheless, in the framework of a squeeze-out, the net asset value constitutes the rock bottom price that the bidding company needs to take into consideration in its bid price.

- The Dividend Discount Model (DDM) was rarely applied (3% in the current statistical study versus 11% in the sample covering the period 2001-2006) and seems to have fallen into disuse. This is explained by the fact that this method is redundant with the use of the DCF method. Another reason is that DDM is dependent on the majority shareholder's decisions regarding dividend policy and does not meet the criteria of objectivity required by French law.

Figure 4. Average premium between the calculated share price using each valuation methods and offered price in the transaction

Average premium offered according to the applied methods	2013/2014 (40 transactions)			2001/2006 (150 transactions)		
		Independent appraisers	Valuators		Independent appraisers	Valuators
	population	Average premium	Average premium	population	Average premium	Average premium
Discounted Cash Flows	35	18%	26%	115	16%	18%
Market multiples	29	30%	54%	104	34%	38%
Market stock prices	36	40%	38%	99	27%	30%
Comparable transactions	9	32%	32%	56	25%	31%
Block trade	18	6%	9%	55	4%	4%
NAV	7	2%	2%	46	20%	25%
Dividend Discount Model	1	17%	29%	12	24%	24%
Target share price	5	13%	15%	n.a	n.a	n.a
Total	**140**	**20%**	**26%**	**487**	**21%**	**24%**

n.a: not applicable

- The market consensus stock target price method is currently used in 28% of the deals. Formerly, this method was not considered a method in itself. The growing application of this method is due to the importance given by investors to financial research notes following the valuation of companies, which might be the subject of the transaction. Strictly speaking, this method is often presented as an indication rather than a valuation method. The target stock price is sometimes mentioned in the framework of the market stock price analysis.

Figure 5. Valuation method resulting in a price closest to the offered price

Applied methods	Independent appraiser		Valuators	
	Nb of time	%	Nb of time	%
Block trade	64	34%	63	33%
Discounted Cash Flows	53	28%	49	26%
NAV	30	16%	24	13%
Market stock prices	14	7%	20	11%
Market multiples	16	8%	14	7%
Comparable transactions	7	4%	14	7%
Dividend Discount Model	3	2%	2	1%
Target share price	3	2%	4	2%
Total	**190**		**190**	

What is the average premium offered to the minority shareholders?

Figure 4 summarizes, method by method for the 190 analyzed transactions, the average premiums the offer price presented, in comparison to the values yielded from the valuation methods.

The derived average premium in the 140 implemented methods from 2013-2014 amounts to 20% according to independent appraisers and 26% according to valuators. The derived average premium in the 487 implemented methods from 2001-2006 amounts to 21% for independent appraisers and 24% for valuators.

The premiums calculated by independent appraisers are mostly lower than those calculated by valuators across valuation methods.

The highest premiums calculated by independent appraisers result when utilizing analogical methods (trading multiples and comparable transactions) and the share price method.

The premiums are lower for the intrinsic valuation methods (DCF, RNA, dividends), the target share price method and for reference to block trade. The premium is very low for the block trade method because for many operations the offer price is equal to the block trade price.

Which valuation method stands as a reference?

This analysis is aimed at showing which valuation methods is able to determine the bid price, against those which are used only as means to control or to crosscheck.

In a large number of the 190 analyzed transactions, the bid price has been determined according to the block trade method (34% of cases based on the values calculated by the independent appraisers). This is due to the method’s use in accordance with regulations, as explained above. In some cases, it has

Figure 6. Summary

	2013-2014					2001-2006					Accumulated				
	Applied		Used as reference		(B)/(A)	Applied		Used as reference		(B)/(A)	Applied		Used as reference		(B)/(A)
	(A)	En %	(B)	En %		(A)	En %	(B)	En %		(A)	En %	(B)	En %	
Block trade	19	48%	14	35%	74%	59	39%	50	33%	85%	78	41%	64	34%	82%
Discounted Cash Flows	34	85%	9	23%	26%	119	79%	44	29%	37%	153	81%	53	28%	35%
NAV	12	30%	6	15%	50%	52	35%	24	16%	46%	64	34%	30	16%	47%
Market stock prices	36	90%	4	10%	11%	103	69%	10	7%	10%	139	73%	14	7%	10%
Markets multiples	36	90%	4	10%	11%	105	70%	12	8%	11%	141	74%	16	8%	11%
Comparable transactions	17	43%	0	0%	0%	60	40%	7	5%	12%	77	41%	7	4%	9%
Dividend Discount Model	1	3%	0	0%	0%	17	11%	3	2%	18%	18	9%	3	2%	17%
Target share price	8	20%	3	8%	38%	0	0%	0	0%	na	8	4%	3	2%	38%
Total	**163**		**40**			**515**		**150**			**678**		**190**		

also been determined according to the discounted cash flow method (28% of cases, according to independent appraisers), which is the only method that takes into account long-term projections of the company being evaluated. These two methods are indispensible today. A total of 16% of transactions have had their bid price determined according to the revalued net assets (NAV) method. Together, these three methods are responsible for approximately 75% of the bid prices and constitute the main valuation methods.

The trading multiples, market stock prices, comparable transactions and dividends methods are used in only 25% of the cases to determine the bid price and therefore remain methods of secondary importance.

Transactions for which valuation is higher than the bid price

In 24 operations, at least one of the methods applied by the independent appraiser led to a value higher than the offered price.

In most of these cases, the discounts concern the DCF method and are very slight. For 18 operations out of 24, the discount is lower than 10%.

However, this sample does not include all the projected offers where one or several values were higher than the bid price. In practice, in case of disagreement on the offer price (judged not high enough by the latter) between the company initiating the transaction and the independent appraiser, the projected offer is reviewed or withdrawn, the operation possibly cancelled and the independent appraiser's report not published.

Conclusion

The schedule below summarizes the analysis developed in the previous paragraphs.

The block trade method was retained as a reference criterion by the independent appraisers and valuators in approximately 34% of the cases for an implementation rate of 41%. When applicable, the block trade price is used as a reference value to determine the offer price in 82% of the cases.

The DCF and NAV methods were retained in respectively 81% and 34% of the cases. These two methods were used as a reference value on respectively 28% and 16% of the cases, which means, that when applied, the DCF and NAV methods are used as a reference value in respectively 35% and 47% of the cases.

Conversely, the trading multiples, the market stock prices and the comparable transactions methods have a weak utilization rate as reference methods, notwithstanding their implementation rate.

As explained in this article, the NAV method and the average value of the last 60 trading days of the stock price of the target company, both constitute a reference in terms of the minimum bid price that the bidding company needs to offer.

Thus, two groups of valuation methods can be distinguished:

- The intrinsic methods (discounted cash flows and net assets value) and the block trade reference have high utilization rates as reference methods. These methods can be considered as reference methods to determine the offer price.
- The analogical methods (trading multiples, comparable transactions), the market stock prices method and the dividend discount method have weak utilization rates as reference methods. These methods are thus used as a way of control but rarely contribute to the offer price setting.

For more information:
Olivier Grivillers is a partner at Crowe Horwath - HAF Audit & Conseil, based in Paris, France.
He can be contacted at + 33 (0) 1 41 05 98 40 or ogrivillers@horwath.fr

Aurore Launay is an analyst at Crowe Horwath - HAF Audit & Conseil, based in Paris, France.
She can be contacted at + 33 (0) 1 41 05 98 40 or alaunay@horwath.fr

Summary of Chinese Listed Companies' M&A Activities over H1 2015

By Jason Zha and Dr. Jingxin Zhang, Beijing

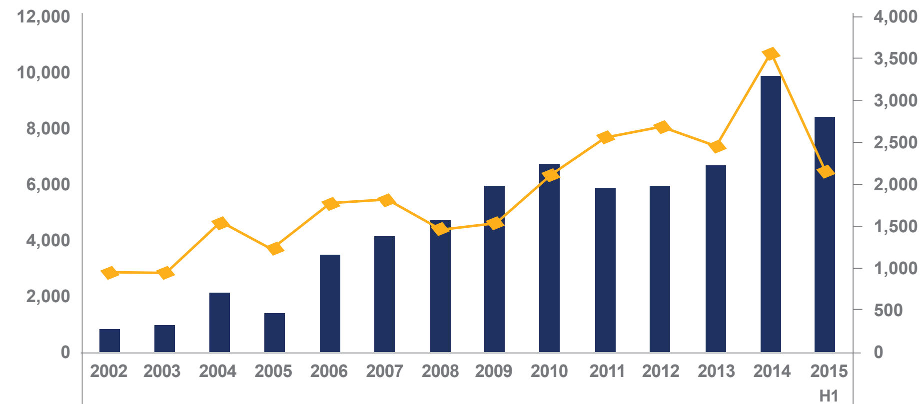
M&A transactions volume and value

From the statistics of 2002 to H1 2015, the China M&A market has been relatively active due to the country's fast-growing economy. The M&A market is volatile but continually increasing in volume. In H1 2015, 2160 deals were announced in the China M&A market, with a cumulative worth of CNY835.8 billion. While the government continues its efforts in deepening reform, a series of industrial policies and preferential tax policies have been carried out, which have improved and boosted the M&A market.

Figure 2 shows the semi-annual data from 2012 to H1 2015, from which we can see that M&A volume during H1 2015 has increased. The total number of deals has increased 33.50% compared to the same period in 2014 and the cumulative worth of these deals shows a 97.83% growth from the same period last year. There are two primary reasons for the good performance of M&A market in 2014 and H1 2015. First, the government policy works in pushing forward market development. Second, with fierce competition in the market, companies use M&A as important strategic tool to enhance competitiveness.

Taking transaction volume as the sole parameter, the information technology (IT) industry ranks number one with 655 deals, which account for approximately 30% of the total volume. Machinery and equipment industry ranks number two with 353 deals, which is approximately 16% of the total. The newly emerging clean-tech industry has 165 deals, accounting for 7.6% of the total volume.

Figure1. M&A transaction volume and value of publicly-listed enterprises from 2002 to first-half 2015

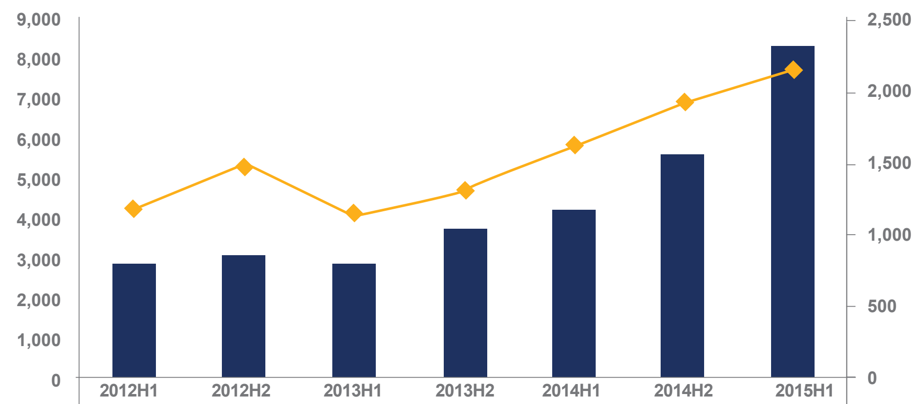


	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015 H1
Transaction value	778	923	2,117	1,323	3,490	4,119	4,693	5,911	6,760	5,875	5,906	6,652	9,874	8,358
Transaction volume	951	934	1541	1219	1765	1823	1462	1526	2103	2545	2670	2457	3546	2160

Transaction value — Transaction volume

Source: ChinaMerger - Chinese Merger & Acquisition Database, developed by Center for Chinese Merger & Acquisition Research, Beijing Jiaotong University; iFinD Database

Figure 2. M&A transaction volume and value of publicly-listed enterprises from H1 2012 to H1 2015 M&A distribution by industry



	2012H1	2012H2	2013H1	2013H2	2014H1	2014H2	2015H1
Transaction value	2,843.44	3,062.6	2,886.91	3,764.88	4,224.87	5,648.78	8,358
Transaction volume	1,178	1,492	1,148	1,309	1,618	1,928	2,160

Transaction value — Transaction volume

Source: ChinaMerger - Chinese Merger & Acquisition Database, developed by Center for Chinese Merger & Acquisition Research, Beijing Jiaotong University; iFinD Database

During H1 2015, the government has been promoting development of the IT industry. As a result, the transaction volume and ratio of the IT and clean energy industries have significantly increased, although the scale of the target companies tends to be smaller. This reflects the fact that across sectors the government is encouraging technical development and entrepreneurship, which has resulted in private enterprises and non-listed companies playing more important roles in the M&A market.

Cross-border M&A

For H1 2015, inbound M&A transaction value and ratio have both largely improved. From January to June 2015, 641 foreign-invested enterprises have been established by M&A, an increase of 21.2% compared to the same period in 2014. The total contracted foreign capital is $14.46 billion, resulting in a 182.1% growth from a year earlier. The actual use of foreign capital is $13.19 billion, which has improved 336.5% over the same period in 2014. The M&A portion of the total actual use of foreign capital increased from 4.8% in H1 2014 to 19.3% in H1 2015.

The total transaction value of outbound deals in 2015 has bettered the record: amounting to $32.5 billion, which has increased 56.0% compared to the same period last year. Among these deals, the total transaction value of the industrial sector is $11.3 billion, resulting in a 321.5% growth compared to H1 2014.

For H1 2015, Chinese outbound M&A activities in Europe resulted in a total transaction value of $16.7 billion, which is a record high; compared to $7.5 billion in the same period of 2014, it has increased by 123%.

For more information:
Jason Zha is the Head of International Liaison Department at Ruihua Certified Public Accountants, the sole China member firm of Crowe Horwath International.
He can be reached at +86 010 8821 9191 x4218 or jianqiu.zha@rhcncpa.com.

Regional GCA Leadership

China
Antony Lam
antony.lam@horwathcapital.com.cn

Indian Subcontinent / Middle East
Vijay Thacker
vijay.thacker@crowehorwath.in

Southeast Asia
Alfred Cheong
alfred.cheong@crowehorwath.com.sg

East Asia
Mok Yuen Lok
yuenlok.mok@crowehorwath.net

Latin America
Francisco D’Orto Neto
francisco.dorto@crowehorwath.com.br

USA / Canada
Marc Shaffer
marc.shaffer@crowehorwath.com

Central and Eastern Europe
Igor Mesenský
igor.mesensky@tpa-horwath.cz

Oceania
Andrew Fressl
andrew.fressl@crowehorwath.com.au

Western Europe
Peter Varley
peter.varley@crowecw.co.uk