NOMURA
Connecting Markets East & West

East meets West: How China's Geely connected with Volvo Trucks

The acquisition of 8.2% of truck maker AB Volvo (and 15.6% of its voting rights) by fast-growing Chinese auto group, Geely, for more than $3.2 billion in December 2017 required strong relationships, strategic thinking and equity structuring expertise to manage tricky regulatory challenges.

Cevian Capital

Founded in **2002**
Based in **Stockholm**
AUM **$16 billon**

GEELY

Founded in **1986**
Based in **Hangzhou**
Market Cap. **$22 billon**

China's Zhejiang Geely Holding Group has become – in a relatively short time – one of China's largest automotive original equipment manufacturer and a global powerhouse in the auto sector. As well as growing its eponymous brand, Geely took ownership of Volvo Cars in 2010 and has successfully transformed the brand with a series of stylish models, especially in the SUV segment. Geely also owns the London Electric Vehicle Company, which makes the iconic London taxi, is the majority shareholder in sports car brand Lotus and a key shareholder in Malaysia's Proton. It even has a stake in US flying car start-up Terrafugia.

Geely has global operations spanning the automotive value chain, from research, development and design to production, sales and servicing. But its reach in the truck and industrial plant sector was limited. Given the rapid expansion of China's infrastructure and logistics markets, some industry observers believed that it was only a matter of time before Geely sought to add truck, bus and construction equipment assets to its portfolio, as part of its stated objective of becoming a top 10 world-leading automotive group.

AB Volvo seemed a perfect fit. The company is one of the world's largest manufacturers of trucks, buses, construction equipment and marine engines, and the largest company by revenue in Sweden. Crucially, AB Volvo owns 45% of Dongfeng Commercial Vehicles, one of China's largest truck makers, and also has a significant construction equipment business in China. Despite sharing a name with Volvo Cars there is no longer a link between the two companies: the car operations were separated from AB Volvo in 1999 and sold to Ford, which subsequently sold the company to Geely.

The only question was how Geely could acquire a stake in Stockholm-listed AB Volvo: more than a fifth of its voting rights are held by Sweden's Industrivärden, a long-term and active owner of a number of high profile Nordic companies such as Handelsbanken, Skanska and Ericsson (though it only holds 7% of AB Volvo's capital given an A/B share structure). A number of other investment firms, including Europe's largest activist fund manager Cevian Capital and Norges Bank Investment management, also held significant stakes.

If Geely wanted to consider buying part of AB Volvo it needed to find a willing seller and a way to make a connection with them.

Getting in touch with Cevian

Cevian Capital, which has around $16 billion in assets under management, was founded in Stockholm in 2002 by Christer Gardell and Lars Förberg. While it is often described as an activist investor, it's the antithesis of many US firms that also share that moniker. It usually holds its investments for five to seven years and, in some cases, for much longer.

Cevian first became involved with AB Volvo in 2006. It fitted the criteria of Cevian's other investments, which have primarily been in large European industrial firms that may benefit from greater shareholder value. Its other major holdings include industrial technology firm ABB, networking and broadband equipment company Ericsson, industrial services firm Metso, supply chain solution provider Panalpina, industrial conglomerate ThyssenKrupp, IT services firm TietoEnator and engineering company Vesuvius.

During Cevian's ownership, AB Volvo had been transformed into a more competitive and valuable company through strengthened governance, improved efficiency and increased focus on its core business, according to co-founder and managing partner Gardell. Volvo AB, which includes the Mack, Renault Trucks and UD brands, is significantly more structurally profitable and has a higher market value than when Cevian acquired its initial stake.

Cevian's investment in AB Volvo hasn't all been plain sailing, however. While AB Volvo shares have delivered an annualized total return of 11% since July 2006, much of that performance has come since 2016: following the appointment of a new chief executive its share price doubled. Moreover, many calls by Cevian for the company to divest assets went unheeded, although the company did explore a strategic review around certain business lines.

Mikael Dahl, Head of Nordic Investment Banking at Nomura, has known both of the co-founders and managing partners Gardell and Förberg for more than 25 years; he first met them when they worked at the leading private equity investor Nordic Capital. "I've covered Cevian Capital and AB Volvo for many years," he explains, "and we had had active discussions about their investment in Volvo during this time."

Dahl's long relationship with Cevian, Nomura's committed presence in the Nordic region and respected global industrials franchise, ultimately led to an M&A mandate to find a buyer for the stake, which represented 8.2% of AB Volvo's capital and 15.6% of the company's voting rights.

Nomura set about sounding out interest from likely buyers. "Financial sponsors were not the primary target given the size of the stake," says Mikael Dahl.

"Ordinarily, such buyers want to take control of an asset and that isn't an option at AB Volvo given that it is closely held by a number of long-term committed investors. Instead, the focus was on structuring a sale process that catered to strategic players, especially in Asia."

In late 2017, having enjoyed recent share price gains and dividends, Cevian received an unsolicited approach by Geely for its stake in AB Volvo. "We understood Geely's interest in AB Volvo given their ambitious plans and recent spate of acquisitions, including Lotus and Proton and Terrafugia. A key priority was to assess Geely's degree of interest, perspectives on valuation and to what extent they had thought through the complexity of such an investment," says Marcel Kus, Head of Automotive at Nomura. "Cevian, although intrigued by Geely's initial approach, was keen to test broader interest in their stake in AB Volvo in order to create price tension and facilitate the best possible deal.

The size of the stake that Cevian was interested in disposing of made it an attractive proposition to a strategic player. As such, we were confident of getting a good hearing with a number of potential buyers."

> *"The focus was on structuring a sale process that catered to strategic players, especially in Asia."*
>
> Mikael Dahl
> *Head of Nordic Investment Banking*
> *Nomura*

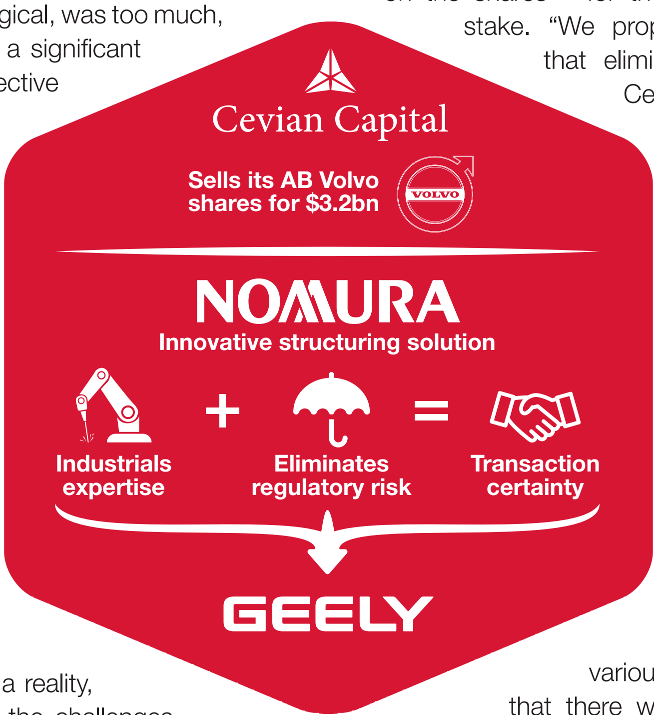
Managing regulatory challenges

Geely, which was founded in 1986 and only began making cars in 1997, was an obvious suitor for a number of reasons. The Hangzhou-headquartered company, which has a Hong Kong-listed subsidiary with a market capitalization of around $22 billion, has, like many other Chinese auto firms – sought to create a global name for itself. However, Geely, which has been a Fortune 500 company for five consecutive years, has been more audacious, and more successful, than most.

Having entered the Chinese auto market at the crucial moment when cars became a viable purchase for many domestic consumers in the 2000s, the company's founder and chairman, Li Shufu, is seen as something of a sage in the industry. His decision to take Geely upmarket as tastes began to change in China at the beginning of this decade reinforced that reputation. And Geely's success in turning Volvo Cars around, something that eluded its previous owner Ford, showed that the company understood the global car market better than some long-established marques. AB Volvo, with its strong international brand, appeared a natural fit.

But while Geely's deal making prowess is undisputed there was a fly in the ointment. Since 2017, China regulators have severely restricted approvals for outbound M&A as part of efforts to stem the outflow of capital from the country and stabilize its currency. The restrictions have curtailed the international expansion of many companies and prompted concerns about the reliability of Chinese bidders in M&A processes.

Regulators have mainly restricted speculative acquisitions, transactions seemingly designed to shift cash outside China, and deals involving assets unrelated to the main business of the company. But the scale of Geely's planned purchase meant it would need several Chinese regulatory approvals (including from the National Development and Reform Commission). Moreover, Geely had only recently made a series of international acquisitions (Lotus, Proton and Terrafugia); there were some concerns that the AB Volvo deal, while strategically logical, was too much, too soon. "We knew this was a significant hurdle," says Dahl. "Our objective was to find a structure that would eliminate this regulatory risk and address Cevian's request for simultaneous signing and completion."



Making the deal a reality

Geely was committed to the acquisition of the 88.47 million A-shares and 78.77 million B shares from Cevian Capital: it agreed to pay an undisclosed premium above the market value of $3.2 billion.

But in order to make the deal a reality, Nomura needed to overcome the challenges associated with approvals from the Chinese regulators, German anti-trust authorities and the Swedish Financial Supervisory Authority – most importantly avoiding the potential delay such scrutiny could entail, which was unacceptable to Cevian. Nomura also needed to produce a simple sales and purchase agreement (SPA) that could be provided to the Chinese regulators.

Nomura called in its renowned Equity Solutions team, part of the Solutions group that structures bespoke transactions to meet Nomura's client objectives. "From an equity perspective, we can help clients to acquire stakes in listed companies, provide financing, overcome regulatory challenges and mitigate the risks associated with acquiring or disposing of equity stakes, including regulatory risks, using our structuring capabilities," says Giles Gleave, Head of Europe, Middle East and Africa Equity Solutions at Nomura, which acted as exclusive financial advisor to Cevian Capital on the transaction. With teams in London, Japan, Hong Kong and the US, the Equity Solutions group has repeatedly demonstrated that it can manage complex cross-border transactions seamlessly.

"For this deal, we had the relationships on the ground in Sweden and China, with an experienced team supporting in London, Japan, Hong Kong and the US. The Equity Solutions Group has repeatedly demonstrated that it can manage complex cross-border transactions seamlessly." stated Mikael Dahl.

Without regulatory certainty, Geely was unwilling and unable to commit funds – even using a margin loan secured on the shares – for the acquisition of the AB Volvo stake. "We proposed an alternative solution that eliminated the regulatory risk for Cevian, thus providing certainty of proceeds (and completion)," says Gleave. Working with Barclays Capital as a syndicate partner, Nomura agreed to acquire Cevian's Volvo stake and committed, using a contingent forward sale agreement, to sell the shares to Geely once the necessary approvals were in place. The deal was the first time such a structure was used to address China-related regulatory issues. Nomura's structuring apportioned risk between the various counterparties while ensuring that there was a simple SPA contract to present to the Chinese regulators.

"Cevian Capital was able to sell its entire stake in AB Volvo to Geely at the agreed price," adds Gleave. "What's more, Geely did not have to commit any funds to the deal immediately. Indeed, given the sensitivity of the deal it was impossible for the company to approach its banks in advance so that was an important goal of the solution." In the event, Geely had plenty of time before regulatory approval was granted to source financing for the transaction, giving it much greater flexibility than is usually the case in an acquisition scenario.

A new era for AB Volvo

The deal was a triumph for all the parties involved. Cevian Capital made a full exit from AB Volvo after 11 successful years of ownership, an unusually long period even for the activist investor, and achieved the largest public exit ever by an activist investor. And Geely

acquired a strategic stake in a company that will further its ambitions in the auto sector.

"We are proud to have played a role in this positive development," explains Gardell at Cevian, who adds that AB Volvo is now leading the industry into a new era. "The agreement will not only give AB Volvo a new large and committed shareholder, but one with significant expertise in strategically important areas for future value-creation," he notes.

What does the future hold for AB Volvo? Beyond the shared names, there are clear synergies between Volvo Cars and AB Volvo, not least the growing importance of electric drivetrains and self-driving technology. In November 2017, Volvo Cars agreed to supply Uber with up to 24,000 self-driving cars, the biggest sale so far. Such expertise could prove invaluable as the technology enters the haulage sector.

"We recognize and value the proud Scandinavian history and culture, leading market positions, breakthrough technologies and environmental capabilities of AB Volvo," explains Li Shufu, Chairman of Geely. Industry observers have speculated that AB Volvo, which has 95,000 employees globally and production facilities in 18 countries, could benefit from Geely's scale when negotiating with suppliers.

Daniel Donghui Li, Chief Financial Officer and Executive Vice President of Geely Holding, says that Geely's intentions are strategic and long term. "We aim to contribute positively to the long-term development of AB Volvo," he notes.

"Geely Holding will be able to contribute its global knowledge, Chinese market expertise and leading research and development capabilities especially in the fields of electrification, autonomous driving and connectivity, to AB Volvo to further its global development, and strengthen the Volvo brand."

Joint marketing is also a possibility.

However, it is important to note that Geely remains a minority investor: AB Volvo has said Geely will be treated like any other shareholder. And despite speculation, Geely has clearly stated that there are no plans to merge the brands, which are both headquartered in Gothenburg in Sweden. Perhaps to reinforce this point, Li says that he will support the board and management of AB Volvo in their continued execution of the current strategy, indicating that there are unlikely to be imminent changes to how the company operates.

Contributors

Mikael Dahl
Managing Director,
Head of Nordic Investment Banking, Nomura
mikael.dahl@nomura.com

Giles Gleave
Managing Director,
Equity Solutions, Nomura
giles.gleave@nomura.com

Marcel Kus
Executive Director,
Head of Automotive, Nomura
marcel.kus@nomura.com