Geely challenges the world automotive leader and cunningly acquires 9% of the German gem Daimler AG

Daimler AG (ETR: DAI) – Market Cap €72.05 bn
Geely Automobiles Holding Ltd.(HKG: 0175) – Market Cap HKD 222.96bn (€23 bn)

Introduction

On 23rd of February, the Chinese car manufacturer Geely announced that it had gathered a 9.7% stake of the German automotive colossus Daimler. This came as a surprise in Germany, as regulation imposes to declare when an owner surpasses either 3% or 5%. But Geely managed, through a complex operation of shell companies and derivatives, to silently weaving the web to become the biggest shareholder. The overall size of the purchase stands at around €7.3 bn.

About Daimler AG

Daimler AG is probably one of the most important multinational automotive corporations in the market. This German gem is headquartered in Stuttgard and listed on the Frankfurt Stock Exchange with a market cap of €72.05 bn. It is well-known thanks to its prominent brands, such as Mercedes-Benz and Smart, acknowledged for the quality and the technology of their products. Apart from cars, Daimler operates in another fundamental division: Daimler Trucks. The latter accounts for almost a quarter of total revenues, it is at the forefront of technology in its sector, and still has a huge potential of growth in the future. In the last FY, the company reported an EBIT of € 14.7bn with an YoY growth of 14% and an overall solid performance. It is mainly positioned in a premium segment of the market, hence it has a profit margin around 9% which is fairly high compared to the industry average.

About Geely Automobile Holdings Ltd

It was founded in 1986 as a refrigerator-building company and it has since experienced an exponential growth, led by its founder and now billionaire Li Shufu. Through the purchase of a failed state-run car manufacturer, it entered the automotive industry and it was among the first players in China. In 2004 Geely was listed on the Hong Kong stock exchange and in 2010 it pulled off a historical takeover of Volvo from Ford. Other relevant acquisitions regard Proton, the biggest car manufacturer in Malaysia, whose rationale was to consolidate its presence in ASEAN; London EV, the producer of black cabs, and Lotus, acquired in 2017. Its market Cap, converted into euros is about €23bn, with EBIT corresponding to about € 800m in the last FY and growth of almost 80% from 2015 to 2016 to give an idea of the potential. The headquarters are in Hangzhou, Zheijian, the same region who gave birth to Alibaba and other industrial powerhouses of China.

Industry Overview

Globally the automotive industry has recovered from the economic crisis, experienced a stable growth and it is likely that the progress will continue with global profits expected to reach €79bn by 2020. The automotive industry is one of the businesses which is going to be affected the most by the technological innovations of recent years. The increasing influence of technology has a direct effect on the companies' acquisition strategies, which are more and more focused on high-tech firms that own the expertise they need to adapt to this changing environment. The main focus of M&A activity in the sector is around suppliers who are trying to adapt to new challenges and acquire the necessary expertise by growing externally, thus performing a significant number of acquisitions of high tech companies.

Deal Structure

Geely has acquired a 9.7% stake in Daimler AG, worth roughly €7.3bn ($9bn), becoming its largest shareholder. The deal involves complex financing structure, so-called funded equity collar, which allowed Mr. Li to fund the deal without the need for a large amount of external funding and to build a large equity holding while limiting the risks. This type of trade, which is used in a hedging strategy that requires puts and call options of the same size and with the same expiration, lets Geely to build up the stake fast and, at the same time, it avoids breaking German rules that require shareholders to disclose holdings that exceed 3 percent.

Deal Rationale

During 2017, Chinese investors have spent around 11.6 billion Euros for the purchase of German companies, twenty times the amount that had been invested in previous years. This year, the machine tool manufacturer KraussMaffei, the energy and environmental technology enterprise EEW, as well as Bilfinger Water Technology were bought by Chinese investors. The weakening Chinese economic growth did not lower merger and acquisition activities of Chinese companies – instead, they increased. The era of huge economic jumps and cheap labor are over and China is aiming for sustainable economic growth. Following the initiative "Made in China 2015" which aims at making Chinese company worldwide leaders in manufacturing and production until 2025, more and more Chinese corporates are switching focus from production volume to automation and digitization of production.

Now, they are using M&A as a strategic tool to strengthen their global competitiveness, and Geely is one of them. To combat the threat posed by developing electric and self-driving vehicles and companies like Tesla, Uber and Google, Geely looks forward to forging an alliance with Daimler. After the announcement, Li Shufu declared that Geely's investment in Daimler reflects its strategic plan towards future Chinese electronic car market. In fact, by 2021, passenger electronic cars will make up 4 percent of China's new car sales, reaching more than 1 million units. He aims at achieving and asserting technological leadership and, in order to reach this goal, he deem fundamental to adapt a new way of thinking in terms of sharing and combining strength. Following the investment, Li and other Geely executives will visit Daimler and meet with German government officials. The discussions is therefore expected to be mainly focused on electric and self-driving technology.

Geely sees potential in Daimler because it is developing high-speed connectivity for autonomous cars at a time when Li believes satellite-based internet connections could become more important. Moreover, among other car makers, Daimler is the only German's one not to be controlled by a family. Volkswagen is majority-owned by the Porsche-Piech clan, while BMW is 47 percent owned by Susanne Klatten, Germany's richest woman, and her brother Stefan Quandt. Daimler, whose shares are majority held by institutional investors, becomes the perfect target for Geely.

It is important to mention that as other Chinese companies like Wanda, HNA, and Anbang are in varying degrees of hot water for excessive overseas spending, Geely has faced no such constraints from the Chinese government even with spending billions on M&A and investments, since they aims at supporting the growth of the Chinese auto industry and the greater national strategies through the growth of Geely.

Market Reaction

Daimler's share price dropped 4% following the announcement made by Geely, as Minister Brigitte Zypries said, the deal will not be blocked but Germany will "keep an especially watchful eye" on it.

Swedish truck maker AB Volvo, one of Geely's other investments, has objected to the Chinese firm's stake-building in Daimler, citing anti-trust concerns. As of result, AB Volvo dropped the chief executive of Volvo Cars from its board.

Advisors

Sources from Reuters said that former Morgan Stanley Germany CEO Dirk Notheis was the architect of amassing the Daimler stake, working with former Morgan Stanley China executive Yi Bao.