

ENTERTAINMENT, ADVERTISING AND DIGITAL MEDIA

U.S.–China M&A and Investment Outlook

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Foreword

Manatt, Phelps & Phillips, LLP, is pleased to present a special report titled Entertainment, Advertising and Digital Media: U.S.–China M&A and Investment Outlook, published in association with Mergermarket. Based on a series of interviews with prominent American and Chinese business executives, investors, bankers and analysts, this report highlights the respondents’ expectations and concerns regarding cross-border transactions between the U.S. and China in the constantly evolving entertainment, advertising and digital media space.

What emerges are the often-competing sentiments, from both American and Chinese respondents, of enthusiasm for continued transactional exposure and cooperation, and significant concerns and trepidation, especially with regard to the “lightning rod” themes of government intervention and transparency of information.

The aggregate value of U.S.-Chinese transactions

shows little sign of contracting, even in this challenging environment. In 2012, Chinese acquirers purchased U.S. assets and companies worth over US\$11.1bn. During the same period, U.S. investors poured nearly US\$10bn into Chinese targets.

Business leaders in both the U.S. and China believe that government regulation and intervention—which can appear at times arbitrary if not viewed with an appropriate cultural appreciation—present the most significant obstacles to sustained and robust M&A and investment activity. In fact, slightly more than 40% of respondents in both the U.S. and China identified regulatory approval as the most significant obstacle facing cross-border transactions. The second-biggest obstacle is information—but the two sides view this from opposite perspectives. Nearly 35% of Chinese respondents identified strict disclosure requirements as a significant hurdle to investment in the U.S., while 40% of U.S. respondents

indicated that the challenges of gaining enough information through due diligence would continue to be a barrier to consummating Chinese-sourced transactions.

The central themes that emerge from this special report, as well as recent U.S.–China transactional activity (and setbacks), are (1) the necessity for both American and Chinese parties to have an appreciation and acceptance of the myriad cultural and regulatory distinctions between the two nations, and (2) the need for a firm commitment by counterparties to work through unanticipated challenges and a transactional timeline that may necessitate significant flexibility.

To be successful in future China-based transactions, U.S. investors and participants will need to be culturally sensitive, willing to make Chinese counterparties aware of certain U.S. business fundamentals (e.g., the ability to review a business's audited financial statements and to be provided with satisfactory information

rights), committed to a sustainable long-term growth strategy in China and, above all, patient. Patience and flexibility will ultimately reward the U.S. investors who are committed to expanding their businesses in China and who are willing, for example, to accept joint ventures and other transactional structures that fall short of outright acquisitions and who can successfully navigate both Chinese and U.S. regulatory hurdles and laws, including the Foreign Corrupt Practices Act.

Chinese investors, on the other hand, can optimistically look to the success of transactions such as the Dalian Wanda/AMC Entertainment acquisition and Galloping Horse's acquisition of a majority stake in Digital Domain but must also appreciate the American security concerns and vigorous oversight and regulatory systems.

As both U.S. and Chinese investors continue to make significant inroads in cross-border transactions in the

entertainment, advertising and digital media sectors, counterparties would be well counseled to foster open and honest communication with one another and to have candid conversations about the potential obstacles a particular transaction may face. Alternative transactional structures, cultural sensitivity and education, flexible timing, and contingency planning are the business tools that will serve investors well and contribute to more successful U.S.–China transactions.

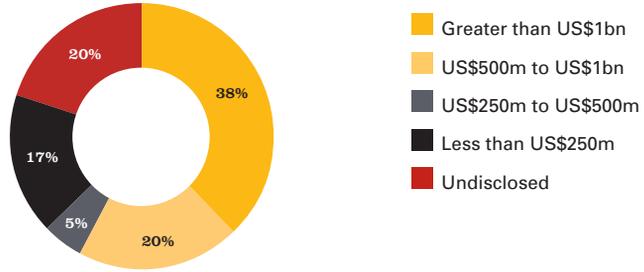
Methodology

Manatt, Phelps & Phillips, LLP, commissioned Mergermarket to conduct a study of mergers and acquisitions (M&A) and investment activity between the U.S. and China in the entertainment, advertising and digital media sectors. Mergermarket interviewed 100 corporate executives, investment bankers and private equity practitioners based in the U.S. and China with operations or experience with M&A transactions in

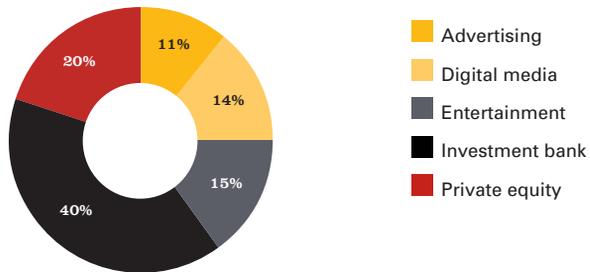
entertainment, advertising and digital media. Respondents offered their insights on current and potential emerging trends in U.S.–China entertainment, advertising and digital media M&A and investment activity over the next 12 months. For this study, China includes Mainland China, Hong Kong, Macao and Taiwan. All respondents are anonymous, and results are presented in aggregate.

Respondent Breakdown

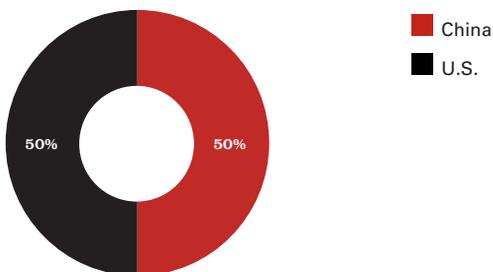
Corporate respondents by company valuation



Respondents by industry subsector



Respondents by region



Historical Data Overview

After a decline in overall M&A activity between the U.S. and China in all sectors after the financial crisis, cross-border dealmaking has stabilized over the past few years. The total value of China-based acquirers purchasing assets and companies in the U.S. peaked in 2012 at US\$11.1bn over 17 deals. Similarly, U.S.-based bidders paid a four-year high of US\$9.6bn over 64 deals for Chinese targets during the same period.

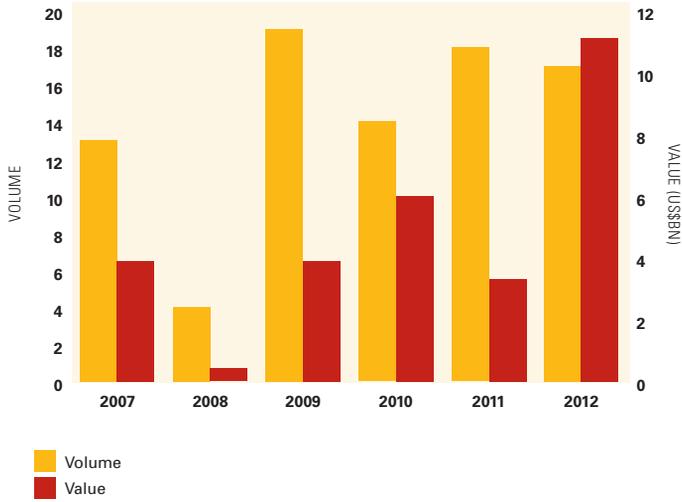
Outbound acquisitions coming from China have typically targeted resource-rich areas, and as a result, Chinese companies and investors showed strong preference for the energy sector when acquiring in the U.S. When Chinese cross-border M&A into the U.S. rebounded following the financial crisis, commodity-based sectors flourished alongside rapid economic growth. As the middle-class wealth and consumer demand spread throughout China, other sectors became more active.

Prior to the January 2010 acquisition of U.S.-based online gaming advertising network Mochi Media Inc. by Shanda Games Limited, entertainment, advertising and digital media dealmaking between the U.S. and China mostly went in one direction—American companies buying in China. Shanda, one of the top online game developers in China, acquired the American company for US\$80m as part of a long-term strategy of becoming a global player in the online gaming subsector, an increasingly common goal shared by Chinese entertainment, advertising and digital media companies over subsequent years. In 2012, a Chinese outbound to U.S. entertainment deal would be among the top deals for the first time in recent history: Dalian Wanda's US\$2.6bn purchase of AMC Entertainment.

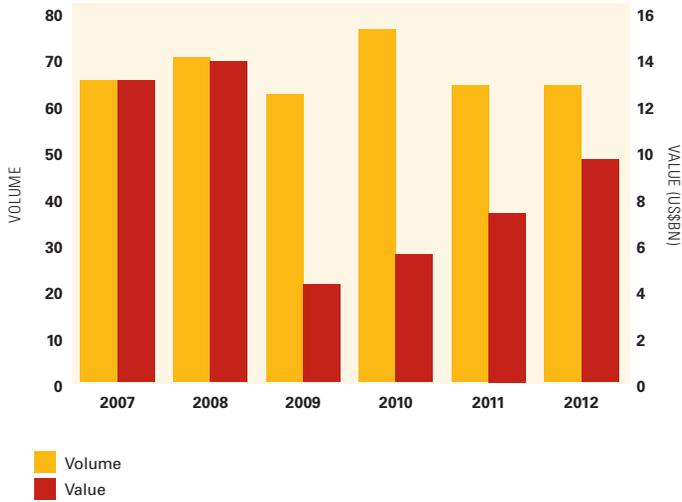
Since 2010, entertainment, advertising and digital media M&A activity between the U.S. and China has increased in value each consecutive year. The overall volume of transactions fluctuated in those sectors during the same period, though the number of outbound China to U.S. deals grew to four acquisitions, more than in any previous year.

Overall Cross-Border M&A Activity

China into the U.S.



U.S. into China



Timeline of Entertainment, Advertising and Digital Media M&A Transactions

2009 **2010** **2011** **2012**

China into the U.S.

US\$100m
OVER THREE
ACQUISITIONS
(ONE UNDISCLOSED)

January 12, 2010—
Shanda Games agreed to purchase U.S.-based online game developer Mochi Media for US\$80m

US\$50m
OVER TWO
ACQUISITIONS (ONE UNDISCLOSED)

US\$2.7bn
OVER FOUR
ACQUISITIONS

May 5, 2012—Dalian Wanda Group purchases American movie theater chain AMC Entertainment for US\$2.6bn

U.S. into China

US\$92m
OVER FOUR
ACQUISITIONS
(ONE UNDISCLOSED)

US\$346m
OVER 12 ACQUISITIONS
(FOUR UNDISCLOSED)

July 30, 2010—Silver Lake Partners purchased a 62% stake in Allyes AdNetwork for US\$124m

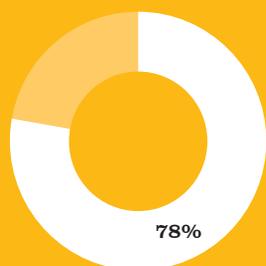
US\$329m
OVER 12 ACQUISITIONS
(FOUR UNDISCLOSED)

August 17, 2011—Warburg Pincus agrees to pay US\$100m for an undisclosed stake in Xiu.com, a China-based online fashion retailer

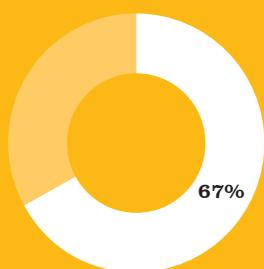
US\$243m
OVER SEVEN
ACQUISITIONS

M&A and Investment Outlook

Survey findings:



of overall respondents expect investments from the U.S. into Chinese entertainment, advertising and digital media to increase



of overall respondents expect investments from China into American entertainment, advertising and digital media to increase

Expectations high for U.S.–China cross-border activity

Investment and M&A activity between the U.S. and China in the entertainment, advertising and digital media sectors will increase over the next 12 months, according to over two-thirds of respondents based in both countries. For U.S.-based investors and companies, China provides access to the world's largest media consumer market by volume. In the U.S., Chinese companies and investors look to gain access to technology and mature markets to expand China's homegrown entertainment and media.

Chinese spending on acquisition of American targets reached a high of US\$11.1bn in 2012, more than triple the value from the previous year, according to Mergermarket research. Other Chinese investment into the U.S. also reached a new high in 2012, with a 12% increase over the previous year up to US\$6.5bn, according to a report published by the global investment research firm Rhodium Group.

Total acquisitions in China by American bidders in 2012 increased by 30% over 2011, according to Mergermarket.

U.S. more optimistic than China

Dealmaking and investment activity between the U.S. and China will be significantly impacted by the two countries' political relationship, of which the future is uncertain.

The results show that majorities on both sides of the Pacific

expect U.S.–China relations to have an effect on investment and M&A activity, but predictions for the relationship itself are less clear. In each country, a narrow plurality of all respondents believes no material change will occur over the next 12 months, but there the similarity ends. Among those who envision material change, most U.S.-based respondents expect improvements to the relationship (by a 40% to 18% margin), while more China-based counterparts expect a decline in the relationship (by a 34% to 30% margin).

The managing director of a China-based boutique investment bank says domestic initiatives will potentially cause a decline. "The [American] government's focus on reviving American manufacturing and bringing job growth involves putting further pressure on the renminbi's value against the dollar." Other respondents

point to a number of issues holding back the development of the U.S.–China partnership, including currency measures, resource nationalization, national security and other international issues such as Iran’s nuclear program.

Respondents based in the U.S. are optimistic with respect to increasing cooperation between the reelected Obama administration and China’s new leadership under Xi Jinping. A U.S.-based investment banker

explains: “The trade disputes are being taken seriously [by American and Chinese leadership] and measures are being taken to improve the relationship and facilitate trade.” In December 2012, Chinese officials agreed to address concerns about enforcing American intellectual property rights, while the Obama administration said it would attempt a comprehensive reform of high-tech exports restrictions, a longtime issue for China.

Associated results:

What do you expect will happen to the political relationship between the U.S. and China over the next 12 months?

RESPONDENTS

	China	U.S.
Improve	30%	40%
Remain the same	36%	42%
Decline	34%	18%

Will this have a significant impact on U.S.–China investment and M&A activity?

Yes	68%	60%
No	32%	40%

Different Goals in Dealmaking

Survey results:
U.S. acquirers will target Chinese entertainment, advertising and digital media:

55%

companies valued less than US\$250m

58%

family-owned/small businesses

Driven by:

58%

size of Chinese markets

50%

gaining foothold in China

U.S. companies focused on smaller deals

As companies and investors target entertainment, advertising and digital media opportunities in China, over half of U.S.-based respondents say they will most likely consider companies and assets valued at US\$250m or less. In 2012, 89% of overall entertainment, advertising and digital media acquisitions by American companies and private equity were for deals valued at US\$250m or less, according to Mergermarket research.

Family-owned and small businesses within the entertainment, advertising and digital media industries in China will be most commonly targeted by American bidders, according to over half of U.S.-based respondents. These businesses are noted to be difficult partners in dealmaking, but with the industry majors being state-owned and thus off the table for M&A, many smaller companies are attractive for their influence within the respective sectors. The concentration of small to midsize businesses is high in these sectors, and regulatory obstacles can be avoided through forming joint ventures and strategic partnerships, according to U.S.-based respondents.

Such small deals are often a part of an overall expansion strategy into China and globally. In Q4 2012, AutoTrader.com, a U.S.-based digital automotive marketplace and marketing and software provider, acquired a 24% stake

in the Beijing-based Internet content provider BitAuto Holdings for US\$65m. In another minority deal, a stake in Chinese daily deal site Tianpin.com was purchased by the U.S.-based venture capital firm BlueRun Ventures. Both deals illustrate M&A driven by a strategy aimed at gaining a foothold in China.

In the Chinese entertainment industry, U.S.-based respondents identify theaters as most attractive to investors, while the advertising and branding subsectors topped the list in the advertising and digital media space. Many note the rise of the Chinese middle class and overall disposable income but lack of premium modern theaters. A 2011 statement from the Motion Picture Association of America said it expects the number of cinema screens in China to double by 2015 as Chinese box office revenue grows to US\$5bn from US\$1.5bn. U.S.-based investors and owners of multiplex chains hope to meet the growing demand.

U.S. entertainment targets in China (ranked in order)

1. Cinemas/theaters
2. Multimedia distribution
3. Multimedia production
4. Television

Chinese entertainment targets in the U.S. (ranked in order)

1. Cinemas/theaters
2. Multimedia distribution
3. Multimedia production
4. Merchandising and licensing

U.S. advertising and digital media targets in China (ranked in order)

1. Advertising and branding
2. Social media
3. Video games
4. Mobile media

Chinese advertising and digital media targets in the U.S. (ranked in order)

1. Social media
2. Service providers
3. Mobile media
4. Advertising and branding

Similarly, the Chinese advertising industry is gaining prominence. U.S.-based firms have a financial advantage and will benefit from the low cost of content development, according to a U.S.-based media VP. In a Q4 2011 deal, the global advertising and public relations firm Ogilvy & Mather Worldwide acquired a 49% stake in the China-based marketing agency Nanjing Yindu for an undisclosed sum. Since the deal, other Chinese content acquisitions involved assets owned by China National Radio (by QVC, Inc.) and Digital Entertainment International (by Wizzard Software Corp.).

Chinese companies targeting wider audience, more open to larger deals

Respondents based in China place social media and multimedia distribution among the top American subsectors for investment and M&A over the next 12 months. In reciprocating the U.S.'s interest in addressing growing consumer buying power, theaters made the top of the list for the entertainment sector, with a 44% plurality of respondents.

When looking to acquire assets and companies in American entertainment, advertising and digital media, Chinese bidders

are less focused than their American counterparts on the smaller deals. While the under-US\$250m companies are still top priority, respondents are more closely distributed, with 37% expecting the US\$250m to US\$500m range to be most active.

While China-based Dalian Wanda Group's recent US\$2.6bn acquisition of the U.S. movie theater chain AMC Entertainment does not represent a common transaction size, the deal illustrates China's acquisition strategy to meet consumer growth. The alliance formed with the American company

**Survey findings:
China will target
U.S. entertainment,
advertising and
digital media:**

45%

companies valued at less than US\$250m

37%

companies valued US\$250m to US\$500m

40%

publicly traded companies

Driven by:

56%

technology

28%

gaining foothold in the U.S.

also allows Chinese media to expand its homegrown media and entertainment into the U.S. and globally.

Investing in and acquiring U.S.-based social media and media distribution houses will allow Chinese companies to fulfill goals of expanding their global audience, according to a senior-level strategist with a top New York City-based advertising and marketing agency. A China-based investment banker adds that Chinese investors have already taken large stakes in film production, and expansion into distribution will raise the ceiling on potential returns. One example is the partnership between Sun Media Group and Harvest Management Fund Co. announced in February 2012. Harvest Seven Stars Media Private Equity created a US\$800m fund that will invest in distribution and individual filmmakers.

Chinese looking to fully acquire; Americans have to settle for joint ventures

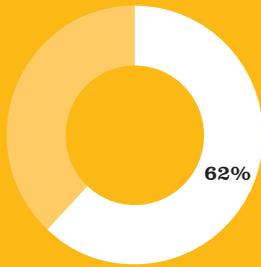
With companies rich with cash, respondents based in both regions overwhelmingly expect Chinese bidders to take on controlling stakes of American entertainment, advertising and digital media targets over the next 12 months, government

permitting. By contrast, and limited by Chinese regulation, American dealmakers looking to China for targets are mostly expected to consider joint ventures, strategic alliances or minority-stake acquisitions.

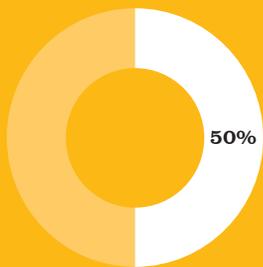
“There are no financial goals behind the acquisitions of American companies,” according to a private equity partner based in China regarding the intentions of Chinese companies. “[They] want to get strategic gains like technology and production standards. For them, the right target is one they can get full control over and eventually bring new content or technology back to China.”

Some potential Chinese bidders express trepidation with the U.S. federal government. The Committee on Foreign Investment in the U.S. (CFIUS), the interagency group reviewing acquisitions resulting in foreign control, notably made the recommendation that led to the presidential order blocking, for national security concerns, an acquisition of an Oregon wind farm, Ralls Corp., by a Chinese consortium. The decision, respondents say, has made many potential acquirers hesitant across other sectors. In digital media, for example, where social media

Survey findings:



of overall respondents say Chinese bidders will seek acquisitions



of overall respondents say American bidders will seek joint ventures; 46% strategic alliance

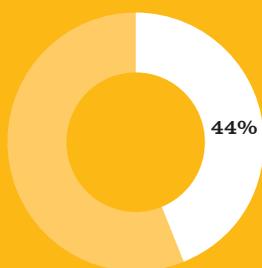
products are built around sophisticated data collection, data technology and privacy can be considered issues of national security.

China's own security review, conducted by the Ministry of Commerce (MOFCOM), and regulations requiring local partners, will force the bulk of M&A activity from the U.S. into China to exclude controlling-stake acquisitions. A U.S.-based media executive comments, "U.S. companies prefer minority stakes, fearing regulatory hurdles." Since 2012, more than half of Chinese entertainment, advertising and digital media acquisitions by American companies were for minority stakes. Notable deals include AutoTrader.com's deal for 24% of BitAuto and News Corporation's purchase of 20% of Bona Film Group.

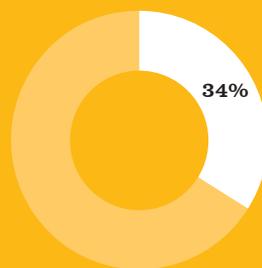
Dealmaking Risks and Obstacles

Survey findings:

Most significant obstacles for Chinese bidders in the U.S.:



U.S. regulatory approval



strict disclosure requirements

U.S. regulation, disclosure requirements are roadblocks for Chinese companies

When asked about issues in the U.S. that present challenges to Chinese bidders looking to gain a foothold in the American entertainment, advertising and digital media industries, respondents pointed to regulatory approval (44%) and disclosure requirements (34%). The presence of CFIUS and due diligence standards in the U.S. creates a compliance risk for Chinese dealmakers.

Many China-based respondents refer to the U.S. government's recent interference in the deal for Ralls Corp. and its proposal that any investment by Chinese telecom manufacturers Huawei and ZTE be blocked as significant challenges. Some suggest an attitude within Congress is forming that is creating major roadblocks for Chinese acquirers. An executive with a popular Chinese digital media site comments, "Chinese companies will wait for more suitable conditions."

A partner based in the Shanghai office of a U.S. private equity firm attributes Chinese companies' difficulty in entering the U.S. to the business nature of keeping information confidential. "Disclosure requirements in the U.S. are not acceptable for Chinese companies," the

partner says, "and the standards seem unnecessarily high. Sources of financing and long-term strategies are very confidential, and when this information is sought, deals tend to fail."

Due diligence: Chinese legal system presents problems for American companies

Performing effective due diligence is the most significant obstacle for American companies and investors acquiring companies in the Chinese advertising, entertainment and digital media industries.

Communication is mentioned as a big hurdle for U.S. acquirers, and accessing the required information to enter the intermediate stage of negotiations is often made difficult by unwilling Chinese companies.

Areas requiring most attention during due diligence

U.S. to China (ranked in order)

1. Legal/environmental
2. Macro-environmental
3. Financial

China to U.S. (ranked in order)

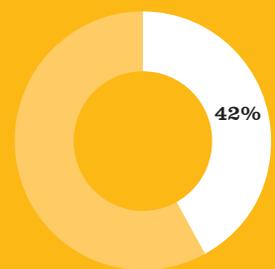
1. Legal/environmental
2. Macro-environmental
3. Production

The degree of disclosure that is standard to U.S. dealmakers is unfamiliar to most Chinese companies, respondents say, especially with family-owned businesses. As business has boomed, standardization and regulation have lagged,

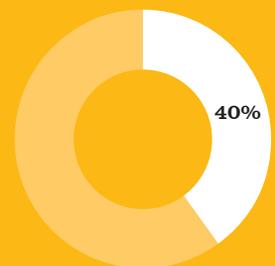
according to comments from a U.S.-based communications executive. As a result, the importance of a trustworthy local partner with sufficient knowledge of the Chinese markets and companies is extremely valuable.

Survey findings:

Most significant obstacles for American bidders in China:



Chinese regulatory approval



challenges to conduct due diligence

Concluding Remarks

Manatt Phelps & Phillips commissioned Mergermarket to conduct this study in order to illuminate perceptions and realities on both sides of the Pacific Ocean. M&A and investment activity in the entertainment, advertising and digital media sectors, by Chinese companies into the U.S. and by American companies into China, is growing steadily and seems poised to continue its expansion.

A critical question for investors and governments in both countries is how to foster this activity, as both a driver of company and industry growth and a pathway to new capital and new markets. An array of challenges—economic, cultural and governmental—will face U.S.–China cross-border dealmakers. As our respondents have shown us, the most important resources for meeting these challenges may well be patience and perseverance, creativity in structuring deals and partnerships, and sensitivity to the differences between countries and the ways to create bridges between them.

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