Comments from our industry leaders

Dominic Nixon
Financial Services Leader
Asia

Financial Services

The outlook for financial services M&A in Asia is one of great caution. With the number of large global banks collapsing or being rescued at unprecedented levels in late 2008, 2009 is expected to be a period of uncertainty for financial institutions in Asia. Senior management in the industry is grappling with issues including managing asset quality, ensuring liquidity/capital soundness, and implementing cost control measures. Although caution appears to be the main policy, many institutions are also carefully watching the market so as not to miss potential bargains or other opportunities arising from the turmoil.

But even when opportunities become available, financial institutions are navigating potential acquisitions very carefully. They are acutely aware of their capital constraints, as well as the probable additional demands on capital as more assets are expected to be written down. In addition, there does not appear to be relaxation on the timetable for implementing new capital rules in Asia (such as risk-based capital rules for insurers). Financial and other institutions which fund their acquisitions via inter-bank funding are also finding their cost of funds escalating significantly. Fraud and mismanagement, best represented by the Madoff incident, further erode confidence when evaluating targets.

The lack of cash is causing many financial institutions to walk away from potentially attractive deals. Many are also evaluating divestments as a way to generate cash or save capital. In 2009, we expect to continue seeing increased sales of non-core assets including properties, minority equity stakes, and ancillary businesses. Restructuring of balance sheets via sale of non-performing assets may also increase. We expect Asia to see a fair share of such divestments, as non-Asian multinationals consolidate and focus on their core European and American businesses. Interestingly, as some of these institutions reduce their exposure to the region, others are increasing it. The narrowing of the quality gap between Asian and non-Asian assets, combined with Asia's greater growth potential, is leading some previously more conservative financial institutions to reassess their ambitions in the region. We therefore expect some of these players to pursue M&A in Asia.

We also anticipate cash-rich Asian conglomerates seizing the opportunity to increase their exposure to the financial services sector; they are expected to partner financial institutions in joint ventures to look at M&A opportunities.

Finally, current market conditions are leading to uncertainty in the deal process – non-completion risk is expected to be high in 2009. It also remains to be seen if governments and regulators in emerging markets will continue to value the transfer of technical expertise from Western financial institutions, which has been a key justification for deals, given the perceived failures of these organisations in their home markets. However, the pricing on certain assets, some of which are now at levels not seen since the Asian financial crisis, may prove too tempting for institutions to ignore. Many have expressed interest and will look at targets but few will have the stomach and nerve to commit and close deals. ■

Comments from our industry leaders *(continued)*

Ken Su
Transactions Partner
Oil & Gas
Asia Pacific

Oil & Gas

While 2008 may not have seen as much reported activity as other recent years for M&A in the oil and gas sector, companies across Asia were still active in seeking investment opportunities, and a number of Asian companies or assets were targeted for acquisition.

Chinese state owned oil and gas companies demonstrated continued interest in overseas investment in upstream assets, along with interest in midstream operations. Notable announced transactions in 2008 were Sinopec's US$2 billion tender offer to acquire the shares of Canadian listed Tanganyika (assets in Syria), Sinochem's acquisition of Australia's SOCO Yemen (assets in Yemen), and PetroChina's refining joint venture with Nippon Oil in Japan. Reported outbound activity in Malaysia and Singapore included entities acquiring an interest in Cairn India Limited.

Indonesia saw a number of significant domestic deals, including the multi-billion dollar acquisition and disposal of Bumi Resources' interests and Bakrie & Brothers' investment in Energi Mega Persada.

China reported inbound interest with Husky of Canada announcing plans for a significant gas pipeline and storage system on the Chinese mainland. Singapore and the Philippines also reported significant inward investment with over US$1 billion being invested into Pearl Energy and PACC Offshore Services of Singapore, and UK companies investing over US$2.7 billion in Petron of the Philippines.

While oil and gas prices remain volatile, the long term outlook for most players is bullish, and activity in 2009 is expected to be at, or higher than, that observed in 2008. There should be continued interest from Asian companies in assets outside of Asia, and, despite the economic conditions around the world, there will still be interest from outside in exploration, production, and services companies and/or assets based in Asia. ■

Comments from our industry leaders *(continued)*

Carrie Yu
Global Retail
& Consumer Leader

Retail & Consumer

According to a recent PricewaterhouseCoopers survey, CEOs of global retail and consumer companies currently consider penetrating existing markets as their main growth driver – as might be expected in a year of financial upheaval. M&A is seen by only 7% of retail CEOs, and 16% of consumer goods CEOs, as a growth strategy in 2009. In the Asia Pacific region however, the outlook is somewhat more optimistic.

Even though the survey revealed that acquisition is not the major strategy right now, acquisitions remain an effective means of entering and penetrating the high profile Chinese market. In the short term, the financial crisis has had a significant impact on the financing ability of investors, and some of them may postpone their investment plans. Private equity investors are still looking for good targets with growth potential and the ability to consolidate a particular market segment. However, most PE funds are being conservative in concluding deals, mainly due to the uncertainty in capital markets. There are some good domestic acquisition targets available in the market, and the financial crisis should bring down vendors' valuation expectations. We still see a reasonable amount of M&A activity in the consumer goods market, especially in the food and beverage segment, e.g. the Coke/Huiyuan deal. Overall, we expect M&A discussions and initiatives to continue, but the number of deals closed in the next 12 months may decrease.

India's retail and consumer M&A outlook remains interesting given its robust GDP growth and recent declines in valuations. We feel there may be some consolidation among retailers and increased transactions in the consumer sector. Retail deals in 2009 are off to a promising start with recent transactions/announcements from India-based groups such as Bennett Coleman and Company Ltd., Fabindia, and Aditya Birla Group. On the consumer goods side, India remains a market where penetration levels and per capita consumption in most product categories are low. 2009 is likely to see moderate transaction activity in this area. Hidden opportunities exist in the current economic climate – valuations are more realistic, and, consequently, we expect to witness increased inbound investment as foreign players look to enter India and develop a presence.

Despite the challenging market environment, the M&A outlook in Australia for 2009 is moderately optimistic. Sector consolidation, a plethora of potential acquisition targets (particularly distressed businesses), and attractive valuations will be the main catalysts for activity in the year ahead. That said, innovative funding structures will be necessary to overcome constrained liquidity in the debt markets. In particular, many of the larger deals executed in 2009 are likely to be structured on a scrip-for-scrip basis. Two sizable deals set to dominate the retail and consumer headlines in 2009 include Lion Nathan's AUD$7.5 billion bid for Coca-Cola Amatil, and Asahi's AUD$1.2 billion bid for the Australian Cadbury Schweppes business. ■

Comments from our industry leaders *(continued)*

Marcel Fenez
Joint Global
Entertainment
& Media Leader

Technology, InfoComm and Entertainment

The overall outlook for M&A in the Technology, InfoComm and Entertainment (TICE) sector in the near term can best be described as difficult and uncertain, with poor sentiment and a lack of debt funding likely to dominate the next six months. Against that background it is however highly likely that we will see deals that are opportunistic or tactical in nature. Smaller-sized deals – under US$10 million – will still happen, particularly in the digital space, as the downturn is likely to accelerate the shift of traditional media to digital platforms, which offer greater targeting and interactivity. Collaboration is replacing outright M&A as the preferred approach across the TICE eco-system. This enables companies to grow revenues by taking advantage of growth opportunities, exploiting new technologies, and offering new value to customers, while at the same time sharing risk.

The tight credit markets will start biting telecommunication companies with heavy debt loads, and we could see some merger activity among the second, third, and fourth placed operators in any market. It goes without saying that balance sheet strength is the spring-board for being able to take advantage of the declining asset values that we are currently experiencing.

In the technology space, the large software companies, which are in large part ‘cashed up’, will hold back their acquisition activity for the better part of the year as they wait for bargains. Expect them to move aggressively though when the time is right as they likely already have their targets firmly in mind. Hardware companies are most likely to hunker down in the current environment, focusing on cost reduction while they ride out the storm. IT services and consulting companies will struggle over the next year as finalising large contracts becomes more difficult and competitive. This may drive consolidation – notably in India.

Equity market capitalisations of media companies have been very badly hit, but it is unlikely that media assets will actually sell at ‘bargain-basement’ prices as most have intrinsic values far higher than what the risk adverse investor is currently willing to pay. We are anticipating some ‘fire-sales’ of distressed assets and it is worth checking the financing structures of deals done in the past two years to identify potential targets. The deal activity in the short term is likely to centre on smaller companies which provide the opportunities for digital extension and for getting closer to the consumer – particularly the digital natives. ■