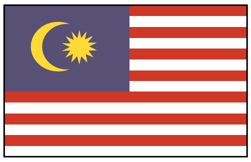


Malaysia

While overall M&A activity has declined sharply with slower cross-border deals, domestic M&A continues at a moderate pace.

Paran Puvanesan
Corporate Finance Leader
Malaysia

Current Environment

Malaysia's economy softened in the first half of 2009 as the full effect of the global economic downturn took its toll on employment, income and consumption around the world.

GDP growth in the first quarter of 2009 shrank 6.2% compared to 0.1% growth in the fourth quarter of 2008. Growth in the services sector was flat with a marginal decline of 0.1% in the first quarter of 2009. Manufacturing contraction was much steeper with a drop of 17.6% led by contraction in the export-oriented industries, in particular electrical and electronics.

With mixed signals on global economic recovery and weaker external demand, the Malaysian government has revised down this year's economic performance to a contraction of 4% to 5%.

In an effort to spur domestic demand and private consumption, the government announced a second stimulus package amounting to US$16.4 billion in March 2009 on top of the US$2 billion fiscal stimulus announced in November last year.

The central bank, Bank Negara Malaysia, continues to maintain a loose monetary policy, holding the overnight policy rate at 2% to support domestic demand and investments. Inflation risk remains low with the Consumer Price Index decreasing for the eighth consecutive month in April to 3%.

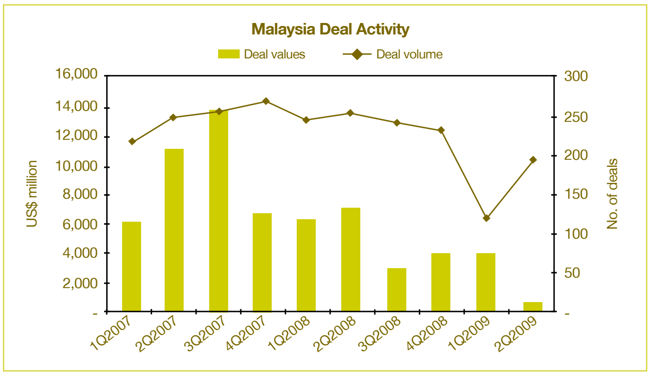
The performance of the Malaysian ringgit in the first half of the year was weighed down by a strong US dollar, weak quarterly economic results and a concern over the high public finance deficit as the government boosted spending. The ringgit started the year at RM3.45 against the US dollar but fell to a low of RM3.73 in March. It has since recovered to RM3.51 in June 2009.

The performance of the local stock exchange, Bursa Malaysia, trails regional bourses. The leading KLCI Index for the first quarter was comparatively weak, dropping to a low of 838 points in March from 894 points at the beginning the year. The market began to rebound in the second quarter reaching a high of 1,091 points in June in anticipation that the US and local economy had bottomed out due to the moderating pace of declines in production and exports in April and May 2009.

Approved investments in the first quarter of 2009 were just RM7.5 billion, which is one eighth of the approved investments in 2008 (RM62.8 billion). Out of the RM7.5 billion, 56% came from domestic investments and the remaining 44% from foreign investments.

In the political arena, in April 2009 Malaysia swore in its sixth Prime Minister, Datuk Seri Najib Tun Razak, who took over from Tun Abdullah Ahmad Badawi.

Deal activity



Source: Thomson Reuters, based on total domestic, inbound and outbound deals announced as of 30 June 2009.

Malaysia's M&A market weakened in the first half of 2009 compared to the same period in 2008.

Total value of announced M&A deals dropped 65% year-over-year to US$4.7 billion, with bulk of the decrease attributed to lower cross-border transactions. Domestic deal activity, however, increased significantly in the first half of 2009, growing 74% year-on-year owing to the privatisation of water assets.

Over the first six months in 2009, the decline in M&A volume is less steep (37% year-on-year) compared to the decline in M&A value, reflecting the underlying market which mainly comprised small and medium-sized deals.

There was no specific sector that was active, other than water privatisation related transactions. The first half of 2009 saw three multi-billion water privatisation deals:

- The Selangor state government's takeover of the water assets and operations of Puncak Niaga Holdings Bhd and Syarikat Pengeluar Air Sungai Selangor Sdn Bhd (Splash) for US$1.5 billion. Negotiations for this transaction are still ongoing, as both parties are assessing alternative plans.
- The federal government's acquisition of Johor state water assets from concessionaire SAJ Holdings Bhd (a subsidiary of Ranhill Utilities Bhd) for US$1.1 billion. The deal involves the federal government assuming the concessionaire's liabilities of US$0.9 billion.
- The federal government's acquisition of Negri Sembilan state water assets for US$344 million from the state government.

The government was also involved in other acquisitions besides water, including:

- The federal government acquiring Sabah Medical Centre for US$70 million.
- The Ministry of Finance (MOF) Inc.'s acquisition of Malaysia Airport Holdings Bhd's convention centre and F1 racing circuit units (NECC Sdn Bhd and Sepang International Circuit Sdn Bhd) for US$45 million.

There were also a number of notable cross-border M&A transactions, involving Malaysian companies acquiring overseas assets. The leisure and casino group Genting, for example, was featured in a number of M&A deals. They include:

- The Lim family, which owns Genting Bhd, sold about 9% of shares in its Singapore unit, Genting Singapore Ltd, to institutional investors for US$421 million.
- Genting Bhd paid US$100 million for a 3.2% stake in US casino operator MGM Mirage.
- Genting Bhd and its subsidiary Resorts World Bhd also subscribed to a combined US$100 million worth of notes issued by MGM Mirage.

Both Genting and MGM Mirage have started talks to consider possible marketing relationships, strategic ventures and partnerships globally. An alliance may provide Genting access to Macau, the world's largest gambling hub, and offer MGM Mirage openings in other parts of Asia.

Besides Genting-related transactions, other significant cross-border deals include:

- Retail group, Parkson Holdings Bhd (via its Hong Kong-listed subsidiary), has acquired the Suntrans Building, a shopping complex in Beijing, China for US$169 million.
- KT Freetel Co, the South Korean wireless service provider is to sell a 16.5% stake in local budget mobile operator U Mobile Sdn Bhd for at least US$100 million.
- Malaysian tycoon Quek Leng Chan (via Hong Leong Group Malaysia) took a 3% stake in InterContinental Hotels Group Plc for US$74 million.

In the domestic M&A market, there were a number of privatisations of listed companies during the period that resulted from companies taking advantage of their surplus cash flow, cheap funding and attractive market valuations. Two prominent deals include:

- IOI Corporation Bhd privatised its property development arm, IOI Property Bhd in a deal worth US$148 million.
- Pahang Agriculture Development Board has offered to make private the plantation operator, Kurnia Setia Bhd, for about US$77 million.

Besides privatisation, there were some outright acquisitions and disposals:

- To reduce its debts, Time dotCom Bhd sold a stake in the country's third largest telecommunications company DiGi.Com Bhd for US$132 million.
- Ramunia Holdings Bhd is to sell its oil and gas fabrication business to Sime Darby Bhd for US$66 million.

Outlook

Despite the global financial crisis, Malaysia's economic fundamentals remain sound with a strong and highly capitalised banking sector, a liquid financial market, a low loan default and a stable property sector, all of which provide a firm base for investments. Further, the softening pace of the global crisis in the second half of 2009 is expected to stabilise the Malaysian economy and encourage businesses to make strategic and value investments.

The Malaysian government is also looking to encourage investments in Malaysia through a number of new and bold measures, which present significant M&A opportunities. They include:

- The deregulation of FIC Guidelines such that the Foreign Investment Committee will no longer fundamentally review any transactions or impose equity conditions on transactions covering acquisition of equity stakes, mergers and takeovers. An exception is being made for strategic sectors such as power, telecommunications, water and transport.

- The liberalisation of 27 services sub-sectors, whereby no equity condition will be imposed. This covered sub-sectors such as health and social services, tourism services, transport services, business services and computer and related technology services.

- The liberalisation of financial services whereby from now through 2012, seven new banking licenses will be issued to foreign participants (five conventional and two Islamic licenses) together with two family Takaful (insurance based on Islamic principles) licenses. Foreigners will also be allowed to acquire up to 70% or more in the equity of investment banks, insurance companies, Takaful operators, stockbroking and fund management companies.

Going forward, Malaysia's M&A market is expected to see a return to fundamental sectors such as consumer products which include fast moving consumer goods, healthcare and pharmaceuticals. Commodity sectors such as palm oil, and oil and gas support services will also feature strongly due to firm underlying demand.

Demand for outbound deals still remains, as Malaysian companies continue to seek attractive investments abroad, building on the recent trend for Malaysian corporates to invest overseas.

The ongoing economic slowdown will also bring about corporate restructuring deals as companies dispose of non-core and non-performing assets. This is especially prevalent for government-linked companies, where they are required to focus more on core activities and divest non-core operations.

We anticipate a number of M&A opportunities in Malaysia due to newly implemented market liberalisation measures, continued strong global demand for its commodity sectors, combined with a demand for both domestic and overseas synergistic investments. ■

Malaysia: Market liberalisation measures introduced

Datuk Anwar Yahya
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The second quarter of 2009 represented a significant milestone in Malaysia's economic landscape. It was during this period that Malaysia's Prime Minister, Datuk Seri Najib Tun Razak, announced a slew of bold market liberalisation measures to help further develop the country's economy and capital markets. Having become a successful middle-income economy with an average annual GDP growth rate of 6.4% and with the poverty rate decreasing from 49% in 1970 to a present rate of below 4%, the government has recognised the need to shift to a high-income economy to maintain the country's growth momentum and market vibrancy.

The government's commitment to make this transition to a high-income economy is part of its efforts towards developing a new economic model based on innovation, creativity and high value to lift the country to the ranks of a high-income nation by 2020. The new economic model is intended to shift Malaysia's reliance on a manufacturing base to a high technology services sector dependent upon skilled and knowledge workers.

Under this new economic model, Malaysia will encourage competition in all sectors of the economy and create a conducive investor-friendly environment that will promote inbound foreign direct investment (FDI). The government intends to systematically foster innovation as a key driver of high value sources of growth such as private education, health tourism, Islamic finance, ICT, creative industries and biotechnology.

In light of Malaysia's shift to its new economic model, significant liberalisation measures in three key areas were announced by the Prime Minister during the second quarter of 2009.

1. Deregulation of Foreign Investment Committee (FIC) Guidelines

Malaysia's existing investment guidelines, administered by the Foreign Investment Committee (FIC), were designed to ensure that foreign investment would fulfill the objectives of Malaysia's New Economic Policy (NEP). The NEP was launched in 1971 and was part of a social engineering programme to raise the Bumiputra's (ethnic Malays and other indigenous people) share of national equity to 30% of the economy from the 2.4% share that existed in 1970. To accomplish this objective, the FIC developed existing guidelines to govern acquisition of assets, mergers and takeovers of firms and businesses in Malaysia.

Acquisition of equity stakes, mergers and takeovers

Under the previous regime, foreign acquirers were restricted in the amount of equity in a company that they could acquire and were required to comply with a minimum Bumiputra shareholding threshold of 30% in a company. With the deregulation, the equity conditions for such transactions will no longer be imposed.

Selected strategic sectors (e.g. power, telecommunications, water and transport, and financial services) will, however, continue to have foreign ownership restrictions. National interest in these strategic sectors will continue to be regulated through the respective industry regulators such as the Energy Commission, Malaysian Communications and Multimedia Commission, National Water Services Commission and the Commercial Vehicles Licensing Board.

Fund-raising by listed companies

Previously, companies seeking to list on the Malaysian stock exchange, Bursa Malaysia, were subjected to a rule whereby a minimum 30% of the shares being placed/issued had to go to Bumiputra shareholders. Following the Prime Minister's announcement, this requirement has been lifted for future initial public offerings, with the exception of initial public offerings in select strategic sectors.

However, in place of the 30% minimum Bumiputra shareholding requirement, 50% of the existing public shareholding spread must be offered to Bumiputra investors. As listed companies are still required to sell at least 25% of their shares to the public, this implies that at least 12.5% of their shares must be offered to Bumiputra investors.

In addition, post-listing fund-raising exercises will no longer be subject to any equity conditions except in the case of reverse takeovers and 'backdoor' listings.

Acquisition of properties

Apart from easing regulatory restrictions pertaining to equity ownership in local enterprises, the government also introduced legislation to eliminate approval relating to any property transactions involving the sale by non-Bumiputra investors or foreign majority interest investors, and transactions between non-Bumiputras and foreign entities. This also applies to a Bumiputra-owned company acquiring property from another Bumiputra-owned company. FIC approval for property transactions will only be required where it involves a dilution of Bumiputra or government interests for property transactions valued at more than RM20 million (US$5.7 million).

Establishment of a government-backed private equity fund, Ekuinas

In line with the new economic model, a new investment institution, Ekuiti Nasional Berhad (Ekuinas) will be established. Ekuinas will be set up as a private equity fund to further promote Bumiputra involvement in the economy, with an initial capital base of RM500 million. The Ekuinas's ultimate fund size is targeted at RM10 billion.

Ekuinas will focus its investments in sectors with high growth potential, in order to support the new economic model. At the same time, Ekuinas will invest jointly with private sector funds to promote genuine partnerships with a commercial focus.

2. Liberalisation of Financial Services Sector

To ensure healthy competition in the domestic financial services sector, the country's central bank, Bank Negara Malaysia proposed issuing seven new banking licences and two new insurance licences to selected foreign participants that can bring a combination of capital and skills to the domestic market in the following areas:

- Two licences for mega Islamic banks with paid-up capital of at least US$1 billion to be issued this year.

- Two commercial banking licences to bring in specialised expertise are to be issued this year. Licences will be issued to banks that bring in the requisite expertise, knowledge and technology to develop business areas that are currently underserved in the financial sector, and which are earmarked to be the new growth areas.
- Up to three commercial banking licences will be offered to world-class banks that can offer a significant value proposition to Malaysia in 2011, i.e. contribute towards enhancing global relationships and facilitate international trade and investment flows between Malaysia and the rest of the world in areas such as international Islamic finance, shared services and outsourcing centres.

In addition to the banking licences, two family Takaful (insurance based on Islamic principles) licences will be offered this year to foreign players. With the liberalisation of the banking and insurance sector in Malaysia, foreign investors will also be allowed to take up to 70% equity in Islamic banks, investment banks, insurance companies, Takaful firms, stockbrokers and unit trust management companies. In addition, fund management companies will be allowed 100% foreign ownership. However, foreign ownership of domestic commercial banks will remain capped at 30%.

These liberalisation measures are accompanied by the removal of several operational restrictions and tax incentives to further spur development in the financial services sector.

3. Liberalisation of 27 Services Sub-Sectors

The services sector contributed 55% to Malaysia's GDP in 2008, of which 48% came from non-government services. This sector also accounts for 57% of total employment in Malaysia. Recognising the growth potential in this sector and with the aim of increasing its GDP contribution to 60%, the government has decided to immediately liberalise 27 services sub-sectors, with no equity conditions imposed, i.e. 100% foreign equity ownership will be allowed. These sub-sectors were previously subject to a 30% Bumiputra equity requirement.

The 27 sub-sectors are broadly grouped into the following:

- Computer and related services
- Health and social services
- Tourism services
- Transport services
- Sporting and other recreational services
- Business services
- Rental / leasing service without operators
- Supporting and other auxiliary services

The overall impact of the liberalisation measures will ensure that Malaysia is well-positioned to receive an inflow of foreign investment capital. Corporates and investors may shift their strategic focus towards Malaysia as a springboard for regional expansion into Association of South East Asian Nations (ASEAN) as well as to capitalise on domestic investment opportunities in the Malaysian economy.

The new legislation will also encourage the entry of foreign players, including those with intentions to set up a regional base in ASEAN, due to Malaysia's strong international links in trade and emerging areas such as Islamic finance. Acquirers and investors can look at investing in export-oriented Malaysian corporates and develop them as regional providers of products and services into ASEAN, as well as Asia at large.

The deregulation of equity rules removes restrictive barriers on ownership and this will attract foreign corporate and private equity investors into the Malaysian capital markets. Private equity players will find that Malaysia's liberalised environment provides additional exit options if they decide to list their investments. Furthermore, the removal of restrictions on ownership will also see increased domestic transactions as locals can now acquire Bumiputra interests.

Despite challenging global economic conditions, Malaysia's bold and significant market liberalisation measures are expected to boost the inflow of foreign capital and help revitalise its economy and capital markets. ■