

Advisory

Asia Pacific M&A Bulletin

The Asia story

Mid-year 2010



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M&A advisor of choice

Number 2 Advisor by Volume in Asia Pacific (ex.Japan)
for 2009 by Mergermarket

Number 1 Advisor for Completed Deals by Volume in Asia Pacific (ex.Japan)
for 2009 by Thomson Reuters

A selection of recent M&A Lead Advisory Transactions in Asia Pacific

Kowa Spinning Co., Ltd
Management buyout
through Kowabo
Company Ltd by raising
its interest in Kowa
Spinning Co., Ltd to
97.19% for **JPY20.6
billion (US\$225 million)**

Financial Advisor:
PwC Advisory Co Ltd
Corporate Finance
Japan

2010

UMC Japan
Sale of 38.68% interest
to Alpha Wisdom Ltd for
**JPY5.0 billion
(US\$55 million)**

Financial Advisor:
PwC Advisory Co Ltd
Corporate Finance
Japan

2009

**Korea Asset
Investment Trust Co
Ltd**
Sale of 50% plus 1 share
interest to Daishin MSB
PEF for **KRW72.1 billion
(US\$64 million)**

Financial Advisor:
Samil PricewaterhouseCoopers
Corporate Finance
Korea

2010

Actis Private Equity
Consolidation of the
distribution businesses
of KS Energy Services
Limited. Total value of
Distribution business is
**S\$320 million
(US\$230 million)**

Financial Advisor:
 PricewaterhouseCoopers
Corporate Finance
Singapore

2009

**Alliance Cosmetics
Sdn Bhd**
Sale of 80% interest to
Navis Capital for
**RM160 million
(US\$50 million)**

Financial Advisor:
 PricewaterhouseCoopers
Corporate Finance
Malaysia

2010

**Resource Holdings
Limited**
Acquired by Keller
Holdings Ltd for a
maximum potential
consideration of
**S\$118 million
(US\$85 million)**

Financial Advisor:
 PricewaterhouseCoopers
Corporate Finance
Singapore

2009

**Simply Squeezed
Limited**
Sale to Frucor
Beverages Limited, a
subsidiary of Suntory
(price undisclosed)

Financial Advisor:
 PricewaterhouseCoopers
Corporate Finance
New Zealand

2009

Agria Corporation
Acquired a 19% interest
in PGG Wrightson
Limited for
**NZ\$69 million
(US\$50 million)**

Financial Advisor:
 PricewaterhouseCoopers
Corporate Finance
New Zealand

2009

**Chinfon Commercial
Bank Co Ltd**
Sale of 19 Taiwan
Branch Operations to
Far Eastern International
Bank for **NT\$19.1billion
(US\$596 million)**

Financial Advisor:
 PricewaterhouseCoopers
Corporate Finance
Taiwan

2009

**Chinfon Commercial
Bank Co Ltd**
Sale of 18 Taiwan
Branch Operations to
Yuanta Bank for
**NT\$19.3billion (US\$602
million)**

Financial Advisor:
 PricewaterhouseCoopers
Corporate Finance
Taiwan

2009

K S Oil Limited
Equity fund-raising
through Private
Placement of Equity
Shares, Warrants &
GDRs for **US\$90 million**

Financial Advisor:
 PricewaterhouseCoopers
Corporate Finance
India

2009

**Gwalior Chemical
Industries Limited**
Sale of chemical
business to Lanxess
India Pvt Ltd for **INR 5.4
billion (US\$113 million)**

Financial Advisor:
 PricewaterhouseCoopers
Corporate Finance
India

2009

Foreword



Chao Choon Ong
Transactions Leader
Asia Pacific

The Asia story

Twelve months after hitting the trough in the worst global recession since the Great Depression, the world economy is recovering steadily on the back of unprecedented fiscal and monetary policy support by governments and central banks. However, unexpected dark clouds, in the form of the European sovereign debt crisis, falling stock markets and stubborn US unemployment, have gathered on the horizon. At the same time, the potential downside risks to the world economy of poorly timed unwinding of stimulus policies, over-regulation and asset bubbles have not abated. Are these mere passing showers or ominous signs of a world spinning headlong into the dreaded double-dip recessionary storm?

World economy recovering stronger than previously forecasted

Following a better than expected first quarter growth, the International Monetary Fund (IMF) revised its 2010 world economic growth forecast to 4.6% in July 2010, up from its 4.1% projection three months earlier. The IMF's forecast for 2011 remained unchanged at 4.3%. The revision was on the account of robust growth in Asia, and an overly pessimistic view of the US, Japan and German economies in April. Based on the encouraging signs of growth in private demand and strong global indicators of real economic activity stabilising in May at a high level, the IMF confirmed expectations of a modest but steady recovery in most advanced economies and strong growth in many emerging and developing economies.

Economic Growth from 2008 to 2011 (Percentage)	Actual		Forecast	
	2008	2009	2010	2011
World Output	3.0	(0.6)	4.6	4.3
United States	0.4	(2.4)	3.3	2.9
European Union	0.6	(4.1)	1.0	1.3
Germany	1.2	(4.9)	1.4	1.6
France	0.1	(2.5)	1.4	1.6
Italy	(1.3)	(5.0)	0.9	1.1
Spain	0.9	(3.6)	(0.4)	0.6
United Kingdom	0.5	(4.9)	1.2	2.1
Japan	(1.2)	(5.2)	2.4	1.8
Australia	2.1	1.3	3.0	3.5
New Zealand	0.3	(1.5)	3.0	3.2
Newly Industrialised Asian Economies	1.8	(0.9)	6.7	4.7
Hong Kong	2.5	(2.8)	6.0	4.4
Korea	2.2	0.2	5.7	5.0
Singapore	1.1	(1.3)	9.9	4.9
Taiwan	0.1	(1.9)	7.7	4.3
Developing Asia	7.7	6.9	9.2	8.5
China	9.6	9.1	10.5	9.6
India	6.4	5.7	9.4	8.4
ASEAN 5	4.7	1.7	6.4	5.5
Indonesia	6.1	4.5	6.0	6.2
Malaysia	4.6	(1.7)	6.7	5.3
Philippines	4.6	1.1	6.0	4.0
Thailand	2.6	(2.2)	7.0	4.5
Vietnam	6.2	5.3	6.5	6.8

Source: IMF World Economic Outlook, April 2010

Developing Asia leads with strong growth, but US is still bulwark for world economy

The Asia Pacific economy is expected to grow at 7.5% this year, compared to 3.3% for US and 1% for European Union. Underpinning Asia Pacific's robust growth are developing Asia's 9.2% and newly industrialised Asian economies' 6.7%. The twin engines of Asia, China and India, are at the front of the pack with 10.5% (2009: 9.1%) and 9.4% (2009: 5.7%) growth respectively. These figures are even more impressive considering the fact that these two economies did not experience any contraction in the preceding year. On the other hand, the advanced economies in Asia Pacific, Japan and Australia, are expected to show modest but steady growth of 2.4% and 3% respectively.

While these impressive figures confirm the Asia growth story, one should not lose sight of the fact that the US accounts for 25% of the world economy. The world economic growth is thus still very much dependant on US growth. Moreover, as the world's largest consumer market, the fortunes of Asia's export-dependent economies cannot be completely decoupled from the state of US economic health. It will be years before Asia is able to generate enough consumption power to rebalance its economy and reduce its dependence on US consumers.

With the rise of emerging markets and the lacklustre growth of developed economies, developing Asia will increasingly become part of private equity funds' core portfolios. At the same time, corporations in the West emerging from the global financial crisis with strong balance sheets will also be looking at investing in developing Asia to tap its growing pool of the newly affluent.

A double-dip recession in the making?

Global stock markets, which raced ahead of the real economy and profits in 2009, are reeling back in the first half of 2010. Asia Pacific bourses fell a weighted average of almost 13% in the last six months. The market may be factoring in the uncertain macros and the possibility of a double-dip recession. Just how real is the risk of a double-dip recession?

The stellar recovery in 2010 has been attributed to businesses rebuilding their inventory after emerging from the global financial crisis, and the pump-priming effect of the massive stimulus policies of 2008/9. The world economic growth, including that of developing Asia, is expected to moderate as we approach 2011. Some leading indicators are already suggesting that this is happening. June's manufacturing purchasing managers index fell to 56.2 from 59.7 in the preceding month, implying slowing expansion. US home sales and housing starts fell in May

after the expiry of a federal home buyer tax credit. The IMF recently noted that the "backlog of foreclosures and high levels of negative equity, combined with elevated unemployment, pose risks of a double dip in housing".

There is also the danger that new financial shocks could potentially derail the nascent recovery. The global financial crisis started as a banking crisis but transformed into a brewing sovereign debt storm by the end of 2009. Iceland, Ireland and Dubai were the first sovereigns to be hit. Greece followed in early 2010, and with it came shocking revelations of disingenuous financial engineering to mask its €300 billion public debts for years. Rating agency Standard & Poor's downgraded Greek sovereign debt to "junk", sparking fears that a Greek sovereign default may have a contagion effect on Portugal, Spain and the crisis-battered banks, and spread to the real economy. It finally took an unprecedented €110 billion bailout from the European Union and the IMF to avert the immediate crisis. To reduce public debt, Greece and other high debt nations will have to swallow the bitter pill of fiscal-tightening in the years to come.

Greece and other EU nations like Portugal, Spain, Ireland, Italy and the UK will have to rein in public spending and raise tax revenue to repair public finances damaged by years of deficit spending and bailing-out of financial institutions during the global financial crisis. Outside of Europe, the US and Japan also face the same medium- to long-term fiscal challenges. All in, it will take a long time for the developed world to fully recover from this crisis. With the US, EU and Japan together accounting for over 40% of developing Asia's exports, this will cast a pall over Asia's recovery in the short run.

In the US, unemployment still hovered at 9.5%, near its record high, as the private sector continued to add meagre jobs to the economy despite the predicted robust 3.3% growth in output this year. On the other side of the Pacific, Japan started the year with rising unemployment and falling domestic consumption even as the world's second largest economy recorded 32.1% growth in exports in the first five months of 2010. On a brighter note, some analysts believe that, with strong reported US corporate profits, it would be a matter of time before employment catches up as corporations reinvest or distribute their profits, creating a multiplier effect on the economy.

While a double-dip recession may not appear to be imminent, the fragile post-crisis environment is more vulnerable to negative events and government policies. Much will depend on how the governments of developed economies manage public debt, unwind stimulus policies and resist populist calls for excessive regulation and protectionism.

China's growth will moderate but long term outlook remains bright

China has defied sceptics and produced spectacular GDP growth of well over 9% despite the global financial crisis. After surpassing Germany in 2007 as the third largest economy in the world, China overtook Japan to become the second largest world economy in the second quarter of this year. Analysts have predicted that the world's most populous nation is expected to reach its economic peak this year before growth slows down to more sustainable levels. Specifically, government consumption and fixed investment will slow down from 2010, compensated by recovery in exports and increase in private consumption.

In a bid to save its economy from overheating, China's Vice Finance Minister Li Yong announced in May that "no new major government spending projects will be approved" this year and the residual amount of the 4 trillion Yuan (US\$ 598 billion) fiscal stimulus announced at end 2008 will be restricted to projects already approved.

After doubling its new loans and lending a record 9.6 trillion Yuan in 2009, the Chinese government began to tighten growth in money supply and credit by raising interest rates, bank reserve requirements and tightening regulations on loan-to-value ratios at Chinese banks. Chinese authorities set a loan target of 7.5 trillion Yuan for 2010, of which 4.6 trillion was recorded by mid-year. This excluded another 1.3 trillion Yuan estimated by Fitch Ratings to have been booked off balance sheet via "informal securitisation" in 2010 to circumvent the lending caps. China's banking regulator, concerned about the rapid growth of such informal securitisation, issued a temporary ban on all such transactions and ordered lenders to put the accumulated total of 2.3 trillion Yuan of such loans back onto their balance sheets by the end of 2011. This will strain capitalisation and loan-to-deposit ratios and could force some banks to seek fresh capital.

Property prices in over 70 Chinese cities soared by 11.7% to hit record levels in March. The country's ballooning property prices triggered the state to rein in speculative investments. The policies imposed include curbs on

bank-lending to developers and higher down payment and mortgage rates for second homes. While these measures quickly took effect, they prompted fear among investors that sudden tightening measures could trigger widespread property devaluations that impact not only homeowners but also construction, finance, steel, furniture and other sectors tied to the real estate market. This led to a sharp plunge in the Shanghai Composite, sinking to a 15-month low by mid-year.

Another significant development was the recent labour unrest at manufacturers Foxconn, Honda and other MNCs. With workers demanding better pay and conditions, the incidents sparked upward revisions of workers' minimum wages in 30 provinces and municipalities by as much as a third this year. These increases could hit the Chinese manufacturing sector hard and some observers predicted a negative effect on the country's short-term growth. On the other hand, widespread reporting of labour unrest by the state media and the swift labour policy response suggest that this could be a deliberate structural shift towards higher value manufacturing and narrowing of the wage gap. In a circular published in June, China's State Council said that it would prioritise raising employees' incomes on its policy agenda for the year, pledging to "optimise national income distribution and improve the proportion of residents' income in the economy". Personal income share of GDP is currently less than 40%, compared to US' 57% and Japan's 51%. Higher wages for China's 468 million industrial and services workers will help generate domestic demand, especially given the poor's higher marginal propensity to spend. In addition, in an earlier speech in May, Vice Minister Li said "we will encourage Chinese companies to decide their own investment overseas". Calling this the "go-out" policy, he also cited examples of Chinese companies that had begun to manufacture products in African countries rather than export them from China.

Despite tell-tale signs of asset bubbles and slowing short term growth, investors have yet to lose faith in this \$5 trillion economy. Indeed, if the world-record \$22 billion IPO by Agricultural Bank of China on 6 July tells us anything at all, it will be that investors' appetite for Chinese assets has yet to wane.

Overview of Asia Pacific M&A transactions in 1H2010

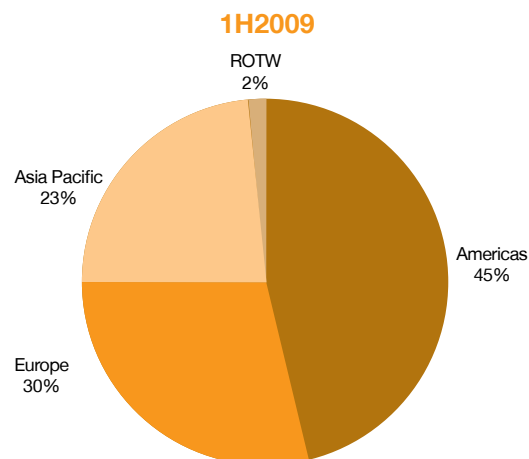
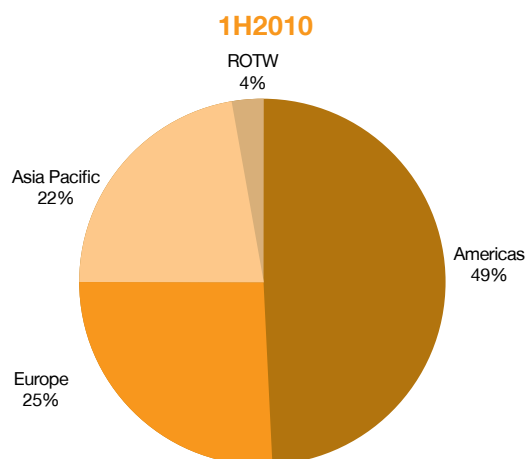
Global Announced M&A by Target Region

	Deal Value				Deal Volume			
	1H2010 US\$ Million	1H2009 US\$ Million	Change US\$ Million	Change %	1H2010 No. of Deals	1H2009 No. of Deals	Change No. of Deals	Change %
Americas	523,399	442,706	80,694	18%	5,595	5,505	90	2%
Europe	268,579	293,275	(24,696)	-8%	6,939	6,705	234	3%
Asia Pacific	231,481	221,429	10,052	5%	6,121	5,922	199	3%
Australasia	54,495	89,725	(35,230)	-39%	919	962	(43)	-4%
South East Asia	25,321	16,544	8,777	53%	1,168	977	191	20%
North Asia	90,597	69,254	21,343	31%	2,285	2,082	203	10%
South Asia	28,299	8,923	19,376	217%	614	614	-	0%
Central Asia	1,234	3,353	(2,120)	-63%	21	32	(11)	-34%
Japan	31,535	33,630	(2,095)	-6%	1,114	1,255	(141)	-11%
ROTW	41,586	16,426	25,160	153%	574	389	185	48%
World-wide	1,065,045	973,836	91,210	9%	19,229	18,521	708	4%

Source: Thomson Reuters M&A Review 1H2010

	Deal Value				Deal Volume			
	1H2010 US\$ Million	1H2009 US\$ Million	Change US\$ Million	Change %	1H2010 No. of Deals	1H2009 No. of Deals	Change No. of Deals	Change %
Developing Asia	81,243	56,273	24,969	44%	2,886	2,299	587	26%
China	50,852	39,918	10,934	27%	1,498	1,086	412	38%
India	16,298	8,797	7,502	85%	560	557	3	1%
Indonesia	5,715	3,445	2,269	66%	249	167	82	49%
Malaysia	4,010	2,089	1,920	92%	346	319	27	8%
Philippines	3,849	1,771	2,078	117%	67	57	10	18%
Vietnam	518	253	266	105%	166	113	53	47%
Newly Industrialised Asia	42,956	29,665	13,291	45%	965	1,123	(158)	-14%
Hong Kong	20,689	11,665	9,025	77%	356	544	(188)	-35%
South Korea	11,170	8,446	2,724	32%	332	347	(15)	-4%
Singapore	7,362	6,033	1,329	22%	192	165	27	16%
Taiwan	3,735	3,522	213	6%	85	67	18	27%

Source: Thomson Reuters



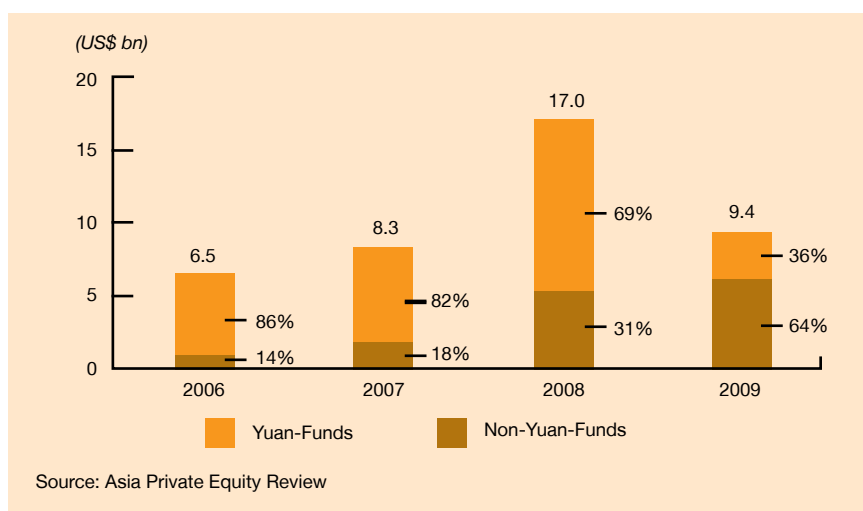
Source: Thomson Reuters

Global M&A deal value for first half 2010 rose 9% over the same period last year, with Asia Pacific (including Central Asia and Middle East) deals increasing by a more modest 5% due to reduction in Australia and Japan deals. Australia fell a whopping 40% or US\$35 billion due mainly to the inclusion of the US\$58 billion Rio Tinto-BHP deal in first half 2009. On the other hand, more than half of Japan's M&A in the first half of 2009 related to outbound investments by Japanese corporations, predominantly in the financial services, energy, resources and food & beverage sectors. These transactions were driven by the overall distressed

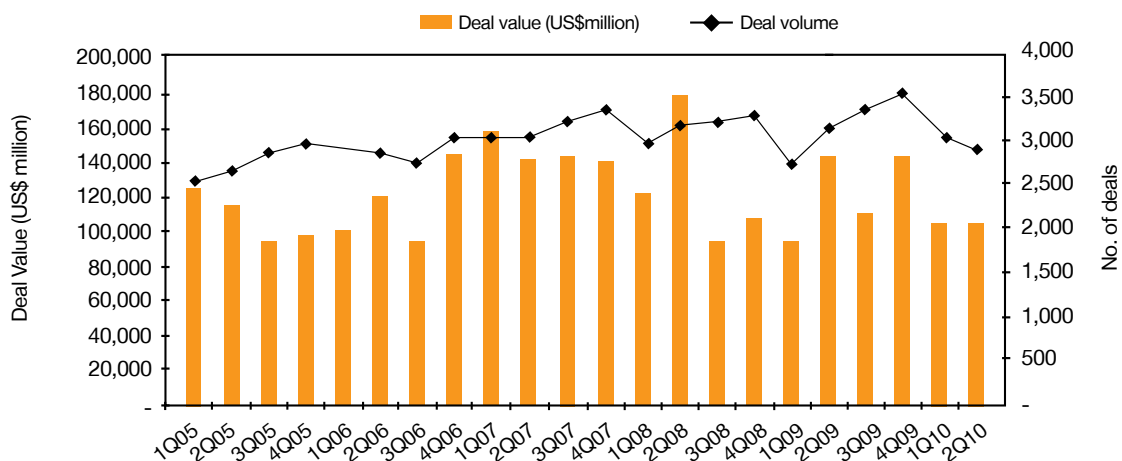
state of the markets then, resource security and expansion beyond the saturated domestic food and beverage market.

Reflecting robust underlying economic growth and strong corporate balance sheets, developing and newly industrialised Asia countries' reported deal value surging by about 45% year-on-year. Deals in China and Hong Kong have also benefited from the growth of both Yuan and non-Yuan foreign China-focused funds in the past two years. This trend has continued into 2010, with China accounting for 84% of the US\$4 billion Asian funds raised in the first quarter.

Growth of the Yuan and non-Yuan Funds (2006 - 2009)

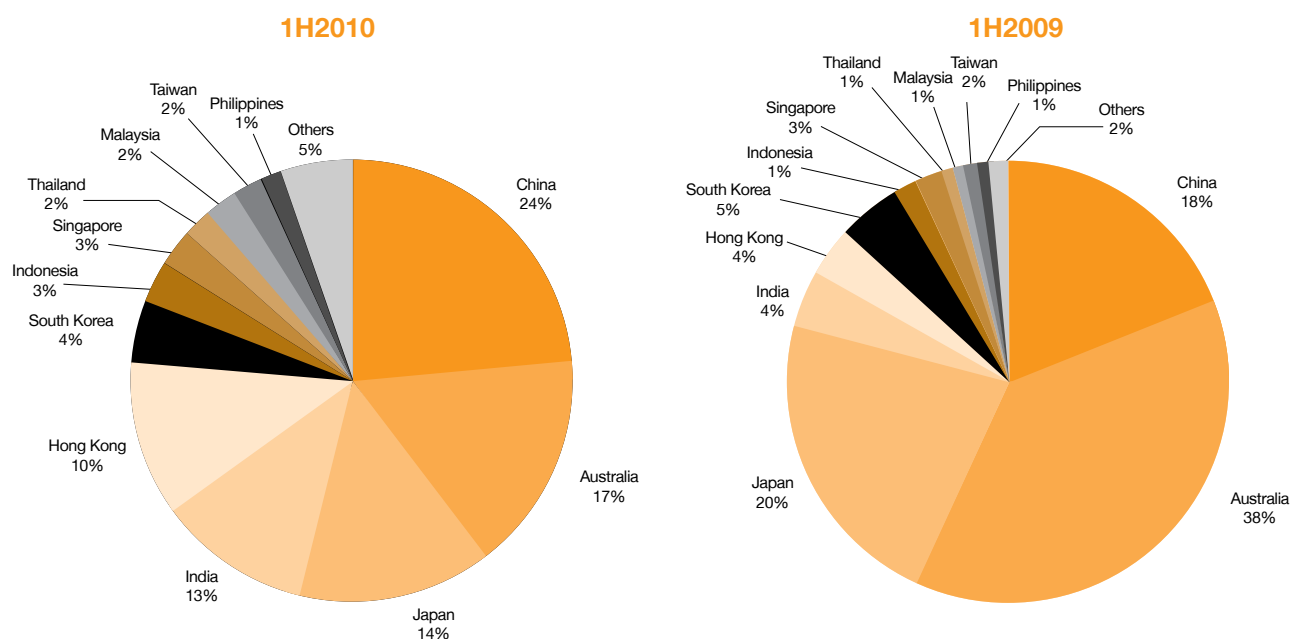


Asia Pacific quarterly M&A value and volume (2005 - 1H2010)



Source: Thomson Reuters

Asia Pacific Announced M&A Value by Country



Source: Thomson Reuters

China reclaimed its lead in Asia Pacific M&A in terms of deal value in the first half of 2010, followed by Australia, Japan and India. Australia's unusually large share of M&A deal value in first half 2009 was due to the Rio Tinto-BHP deal, which if excluded, would have brought its share of Asia Pacific deals in first half 2009 down to 15%.

China M&A activities continue to be dominated by domestic deals, especially in the materials, industrials and real estate sectors, as state-owned and other local companies seek to expand or consolidate. Key deals include China Mobile Group Guangdong's US\$5.8 billion acquisition of 20% interest in Shanghai Pudong Development Bank; Hebei Iron & Steel's US\$2.3 billion acquisition of Hangang Hanbao Iron & Steel and Nanjing Xinwang's US\$2 billion acquisition of coal mine assets from Yima Coal Industry Group.

China outbound investments have burgeoned to US\$22 billion or 30% of its total M&A deal value in the first half of 2010, up from 12% and 15% in the first half of the two preceding years. Almost half of these are in the energy & power sector, and another one-third in materials sector. The key outbound deals in the first half 2010 are Sinopec International's US\$4.6 billion purchase of a 9.03% stake in Syncrude Canada Ltd; CNOOC Ltd's US\$3.1 billion purchase of 50% stake in Bidas Corp; Sinochem Corp's US\$3.1 billion 40% stake in Peregrino Project and Zhejiang Geely Hldg Grp Co Ltd's US\$1.5 billion purchase of Volvo. With the strengthening Yuan, strong balance sheets and growing confidence, we expect to see increasing outbound

M&A from China, as they strive for resource security, know-how and overseas market access. Larger outbound investments may run into nationalistic backlash and regulatory roadblocks, especially in iconic national brands or sensitive sectors affecting national security, public services or financial services. Past failed deals, fairly or unfairly attributed to such causes, included, in Australia, the widely reported Chinalco's rejected investment into Rio Tinto and China Nonferrous Metal Mining's failed bid for Lynas Corp in 2009; in Canada, China Minmetals' unsuccessful bid for Noranda; in the US, Haier's rejected bid for Maytag and China National Offshore Oil Corporation's bid for Unocal in 2005, Northwest Non Ferrous International Investment's failure to buy Firstgold Corp in 2009, Huawei Technology's failed bid to buy 3Com in 2008 and the recent unconfirmed report of its failure to buy 2Wire Inc and Motorola Inc's wireless equipment unit on sellers' fear that Huawei will not win the US government's approval for these deals.

Australia's deal activity in first half 2010 was dominated by the materials sector, notable transactions being National Broadband Network's US\$7.9 billion acquisition of Telstra's wholesale fixed line business, and the US\$3.1 billion planned acquisition of Arrow Energy by a 50:50 joint venture between Shell Energy Holdings Australia Ltd and PetroChina International Investment Co. With the Australian government's recent compromise on the proposed Resources Super Profits Tax, mining deals previously put on hold may be reactivated over the next few months.

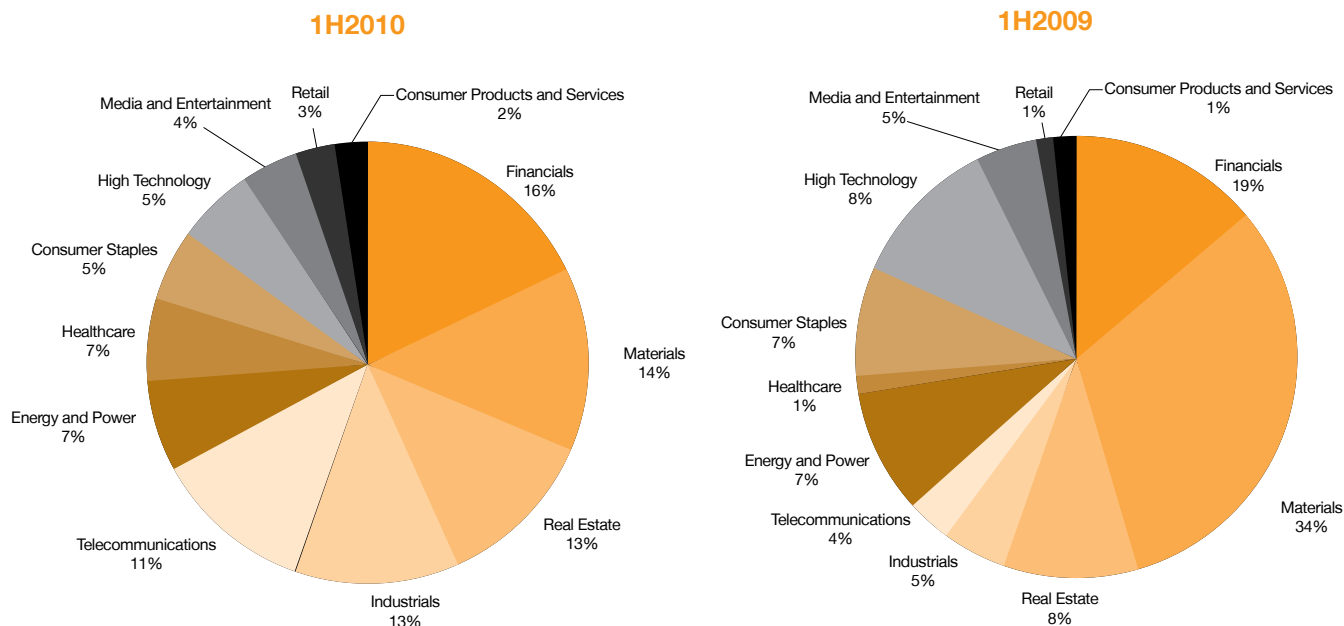
M&A activity in Japan in the first half of 2010 was largely domestic, particularly in the high technology sector, followed by the industrials and real estate sectors. The major domestic deals were United Urban Investment Corp's US\$1.5 billion merger with Nippon Commercial Investment Corp and Sumitomo Corp's US\$1.4 billion acquisition of 40% interest in Jupiter Telecommunications

There was a significant increase in deal activity in India, primarily driven by the four large (over US\$1 billion each)

transactions which accounted for 64% of deal value. These included GTL Infrastructure's US\$10.9 billion acquisition of the telecom tower assets of Reliance Infratel and US\$1.8 billion acquisition of the mobile tower operations of Aircel, as well as Abbott Laboratories' US\$3.7 billion acquisition of the healthcare solutions business of Piramal Healthcare.

Lastly, Newcrest Mining's US\$8.3 billion acquisition of Lihir Gold in Papua New Guinea gave a significant boost to deals categorised under Other Countries.

Asia Pacific Announced M&A Value by Industry



Source: Thomson Reuters

Materials sector's 34% share of Asia Pacific M&A in first half 2009 was due to the Rio Tinto-BHP deal, which if excluded, would have brought it down to 25%. Deals in materials and financial services sectors fell in first half 2010, whereas those in real estate, industrials and telecommunications sectors rose.

Major materials deals in first half 2010 were Newcrest Mining's US\$8.6 billion acquisition of Lihir Gold Ltd, a gold mining company based in Papua New Guinea; and Hebei Iron & Steel's US\$2.3 billion acquisition of 100% interest in Hangang Hanbao Iron & Steel Co Ltd, a state-owned steel manufacturer.

The major financial services transactions announced in the last six months were China Mobile Group Guangdong Co Ltd's US\$5.8 billion acquisition of 20% interest in Shanghai Pudong Development Bank, and PetroChina Co Ltd's US\$1.4 billion acquisition of an additional 41.5% interest in China Petroleum Finance Co Ltd, a provider of financial services.

Real estate deals were dominated by CapitaLand China's US\$2.2 billion acquisition of 100% interest in Orient Overseas Development Ltd; United Urban Investment Corp's US\$1.5 billion merger with Nippon Commercial Investment Corp in Japan; and Mori Trust Sogo Reit's US\$1.2 billion acquisition of the Tokyo Shiodome Building from Mori Trust Holdings.

In the industrials sector, key deals included Enterprise Turnaround Initiative Corporation of Japan's US\$7 billion acquisition of the entire assets of Japan Airlines; and China Lounge Investment's US\$3 billion acquisition of the remaining 62% interest in Denway Motors Ltd, a manufacturer of motor vehicles.

In telecommunications, GTL Infrastructure's US\$10.9 billion acquisition of the telecom tower assets of Reliance Infratel, and US\$1.8 billion acquisition of the mobile tower operations of Aircel; and National Broadband Network's US\$7.9 billion acquisition of Telstra's wholesale fixed line business were the major transactions in the last six months.

The Asia growth story

The Asia growth story continues to unfold even as the economies of the West are bogged down by their free-spending excesses. With a third of humanity in economies growing at high single-digits, millions are emerging from poverty each year, and even greater numbers are ascending the economic ladder into middle class and moving into urban centres. Their growing affluence will fuel consumption, resources, food, energy, water, healthcare, financial services and infrastructure investments. The rebalancing of export-oriented Asian economies with domestic consumption is well on its way, although it will be years before the proverbial tipping point and decoupling from the West.

Editor's note: The format of our half-yearly Asia Pacific M&A Bulletin has been changed with effect from this issue. The mid-year edition will now report on M&A by industries. The year-end edition will continue to report on a country-by-country basis.

Politics and the M&A Environment in Asia



David Kiu
Eurasia Group

Introduction

The global financial crisis has prompted unprecedented state intervention in domestic economies to prop up financial systems and avert a deeper economic downturn. One of the lasting legacies of the crisis is the growing role of politics and political decision-makers in shaping economic outcomes. This trend will shape M&A activity in coming years and pose unprecedented risks to investors. The paradigm of deregulation, privatisation, and free markets that has dominated the global economy since the early 1990s now faces a significant test.

At the same time, the centres of economic and geopolitical influence are shifting toward emerging markets (EMs), particularly in Asia. For two generations, the US, Canada, western Europe, and Japan—the G7—dominated the global economic landscape. But this grouping has emerged weakened from the crisis, while China, India, and other EMs are driving the global recovery and earning seats at the top of the international economy. One of the most important implications of this change has been a rise in capital flows between EMs and from EMs to developed countries.

The rise of state capitalism—not least in China, where the government-corporate nexus is particularly strong—will augment political risk to investors. The state is becoming more influential in determining access to markets, capital allocation, labour trends, consumer opportunities, and the extraction and development of raw materials. National champions, state-owned enterprises, and sovereign wealth funds, benefitting from home advantage, will play an important role in the business environment, whether as market participants, competitors, or partners.

Financial institutions, investors, and companies in Asia that understand this changing relationship between political and economic risk will be best positioned to respond, adapt, and seize business opportunities. For the M&A environment, these changes mean that markets for capital, labour, raw materials, and consumers will become less efficient and open, reversing the trend of recent years. More M&A activity involving state-owned companies or national champions, as well as more activity in increasingly regulated sectors, will raise the importance of political risks over purely financial or economic risks. Ultimately, investors and companies will have to put additional resources into understanding political risks to successfully navigate this complex environment.

The rise of state capitalism and the statist economy

At the heart of this geopolitical shift are some fundamental incompatibilities between the free market and the champions of state capitalism. China is perhaps the most prominent practitioner of this emerging model. Even before the crisis, Beijing relied heavily on state-owned enterprises and government-affiliated firms to secure long-term access to the resources China needs to feed growth and generate sufficient employment in decades to come. China has also relied on select privately-owned companies to shape the development of certain sectors. The leadership relies on policy tools, not simply market tools, to manage the pace of growth and the distribution of economic benefits. It uses sovereign wealth funds, created from the country's enormous foreign currency reserves, to direct flows of investment both within China and outward. Ultimately, the Chinese Communist Party is using markets to create wealth for political ends. In the aftermath of the crisis, China's confidence in this strategy has grown. Officials argue that the country's resilience in the face of the US economic meltdown vindicates their approach to development.

Strikingly, even free market economies that do not subscribe to such principles have seen greater state intervention in the market. In the G7 economies, there are efforts to tighten regulation in the financial services and banking sectors. This regulatory impulse is likely to spread to other sectors, such as telecommunications, airlines, and energy. Changes to taxes, tariffs, non-tariff barriers, and currency policies are also probable as governments become more assertive in managing their domestic economies. This will likely yield new regulatory requirements, some of which overreach politically, or are so stringent that they stifle market activity, thus imposing both political and economic costs. At this point, early indications demonstrated by the passage of the Dodd-Frank bill by the US Senate in July 2010 support this. Historically, the record in the US has been poor. In 2001, lawmakers introduced the Sarbanes-Oxley Act in response to the Enron scandal, but that legislation is widely considered by market players to have increased auditing requirements unfairly. This scenario is likely to be repeated on a larger scale. Governments are considering a further overhaul of financial regulatory institutions, accounting rules, health and safety standards, and climate change legislation. Not all interventions will have negative outcomes for the market, but in each case, corporations will need to anticipate government interventions and the likely impact on their operating environments in order to minimise risks or seize opportunities.

Meanwhile, the economic interdependence that came to characterise the global economy of the last two decades has become a source of considerable risk. No Berlin Wall separates the US and China, but trade, exchange rates, and industrial policy have become intensely politicised, and, as a result, trade tension is rising. In 2009, Washington imposed tariffs on Chinese tyres and steel, prompting retaliatory responses from Beijing. Such disputes have had minimal financial impact on the trade relationship. But as in the case of steel pipes, the US has increasingly applied such tariffs to goods of higher value and greater strategic importance. This pattern may be mirrored in Europe and elsewhere. Indeed, as joblessness and the slow pace of recovery become political and electoral issues in transatlantic democracies, pressure for further action will mount. One risk to trade arises from China's currency peg to the dollar. Another risk arises from barriers to market access in such an environment. Industrial and technology indigenisation policies pose a third risk. Taken together, a substantial rise in trade-related tension is likely, and both China and its major trading partners will find it more difficult to insulate their political and diplomatic relationships.

Risks and opportunities for M&A in Asia

Even as trade risks grow, the shift of global economic gravity to Asia has three main implications for M&A activity in the Asia-Pacific region over the next few years: It will buttress the regionalisation of capital flows, alter the incentives of global multinationals, and heighten political risks as the state exercises a heavier hand in the economy.

Increasing regionalisation of capital flows

Manufacturing and commodity export-led growth are turning key EM countries such as China, India, and the Persian Gulf states into exporters of capital. South-South capital flows are likely to accelerate—and to radically reshape global capital markets and the business opportunities and risks associated with EM countries.

Four primary factors will drive capital transactions between developing countries: New capital increasingly originates in EM countries; EM states continue to offer investors attractive rates of return compared to developed markets; EM states have strengthened their financial market infrastructure and grown more sophisticated; and as a whole, large EM countries are waking up to their newly-found economic power and using it to further their political interests.

As a result, more M&A activity will take place between EM corporations, and they will have a significant competitive edge in their own regions. As more EM corporations seek investments abroad, corporations from developed countries will face greater competition. Most of this competition will probably come from companies within the region, such as the rapidly growing Asian banks and telecommunications companies. Foreign entities from developed states will need to establish an active regional presence in order to effectively compete with EM firms, and must devote resources and time to understanding how to operate in different cultural, social, and political environments. Many EM governments are ramping up spending to prop up their respective economies and ensuring that key domestic enterprises are able to survive and compete.

Nevertheless, EM states will still look to companies from developed countries in certain sectors, particularly where advanced technology and more sophisticated skills are required. This edge will persist for at least the next five years but will come under stress as EM states attempt to lock technology and skills transfers into investments from developed-market companies.

Resurgence of China+1 strategy

China's focus on supporting the growth of its own companies is likely to lead to the resurgence of a China+1 strategy among multinational corporations (MNCs) investing in Asia. China+1 strategies once involved placing manufacturing facilities in different locations outside China to spread risk; now they are about seeking alternative growth opportunities. As companies realise that their earlier medium- and long-term projections for growth are threatened by an overreliance on unrealistic plans to expand in an increasingly protected Chinese market, these companies will seek growth opportunities elsewhere in Asia.

Beyond China, they will be faced with a stark choice: They can compete against, or else partner with, Chinese firms seeking to expand abroad. In pursuing overseas investments, Chinese companies are predominantly motivated by their desire to expand international market share and enhance technical and managerial know-how. The regulatory, diplomatic, and financial support of the Chinese government and state-run banks makes these firms uniquely competitive abroad and affords them important leverage in many host countries.

In the longer term, however, foreign investors may need to seek markets outside China that are not dominated by Chinese companies in order to hedge effectively. Non-Chinese market players may find that they face more intense competition from Chinese companies in countries whose governments have warmly embraced Beijing's expanding influence, as has been the case in several African states. Companies from other countries whose governments choose not to lean toward China may find themselves shut out from participating in both Chinese growth and growth in countries that have gravitated toward China.

Growing political risks

As state actors become more influential in determining economic and business outcomes, political risks facing financial institutions, investors, and companies in the Asia Pacific will grow. Three dimensions of political risk are particularly important for M&A activity: regulatory, policy, and macro-stability. The risks of political instability are potentially the most significant in the long term. In some countries, such as Thailand and Pakistan, there are serious challenges to maintaining government cohesion and stability. While the market may be willing to accept a level of uncertainty for now, ongoing political turmoil or periodic severe instability is certain to reduce the attractiveness of these countries as destinations for new capital investment, as well as these governments' ability to navigate a recovery from the global recession.

Elsewhere in the Asia Pacific, regulatory and policy risks will take centre stage. Governments that had heavily stimulated their economies during the crisis will have to carefully balance the trimming of their higher budgets with ensuring that growth remains on track. Government macroeconomic policy will be a strong driver of future growth and competitiveness. Australia and Vietnam, for instance, will need to continue balancing pro-growth policies with those aimed at containing inflation. Other countries, such as Malaysia and the Philippines, will need to push through tough and politically unpopular economic reforms to secure longer-term competitiveness.

In some cases, the government's approach to regulating sectors that are politically sensitive, such as energy or natural resources, will be a key driver of M&A activity. In Indonesia and China, for instance, where governments are trying to favour local companies, stricter regulation of FDI could increase barriers to entry for foreign companies in sectors that compete with big domestic players, from retail to telecommunications.

Conclusion

Over the next few years, politics and government intervention will shape economies, capital flows, and the M&A environment in unprecedented ways. Companies will find themselves increasingly vulnerable to political risks in their businesses. Successful performance will require an M&A strategy that takes into account the threat from state champions, greater regulation, protectionism, and shifting regional political stability. Key elements of the strategy should include:

- anticipating and preparing for changes in key geopolitical drivers, such as the US-China relationship, that could affect the operating environment, including: cross-border trade, legislation over intellectual property rights, and import tariffs;
- for regional engagement and market entry, ensuring that an M&A strategy takes into account the political stability and volatility of key labour, supply, and consumer markets;
- examining the domestic pressure on governments to support state champions and subsidise local companies to the detriment of foreign players;
- ensuring adequate due diligence is carried out regarding the risk of government interference and arbitrary regulatory interference, particularly in strategic or sensitive sectors.

The evolving M&A environment, while complex, can present opportunities. Companies that understand and can adapt to overcome the relevant challenges will be able to seize new opportunities for expansion in this changing landscape.

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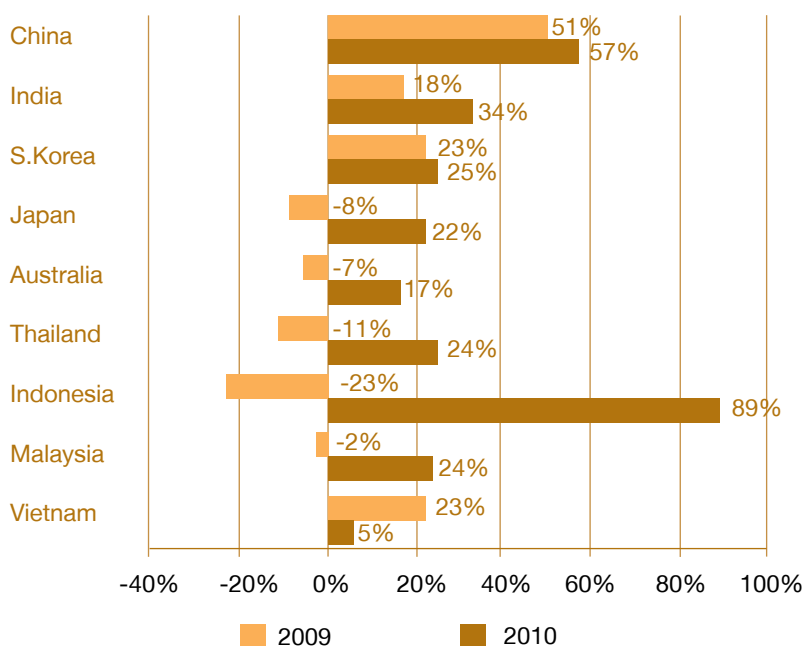


Jeff Herrmann
Asia Pacific
Automotive Deals Leader


From an industry perspective, the second half of 2009 and first half of 2010 have been a boom for the Asian developing countries (China, India, ASEAN) while the developed countries (Japan, Korea, Australia) have stabilised and began to recover during 2010. China continued to drive growth in the Asia region during this period, ending the year with 51% year-on-year growth and went on to surpass the US market to become the number one automotive market globally. This result was truly staggering when taken in the context that developed countries were still working through the structural and market issues that led to a 30% decline in 2008. India's 18% growth would have been considered outstanding if not taken in context with China's growth. As we have progressed through the early part of 2010, the growth in developing markets has continued to progress, with very high year-on-year growth rates due to the slow start in 2009.

In the developed markets, the overall environment has begun to stabilise and recover. Overall, assembly volumes in Korea, Japan and Australia were down in 2009 (Japan down 8%). This trend is expected to continue and stagnation to moderate growth will occur after the initial recovery surge. This is expected to generate over capacity, leading to a shifting of production volume and capacity to other global locations. The good news with the Korean and Japanese OEMs is that they have outperformed their industry peers in North America and Europe as they have gained market share.

Passenger Vehicle Growth Perspective in Major Asian Countries 2009 vs 2010YTD



* Australia data is 2010 June YTD data



From an M&A perspective, the majority of transactions within the industry in Asia over the last year were related to China; Chinese manufacturers are not only consolidating locally, but more importantly are implementing strategies to become truly global players. From an acquisition perspective, these developing entities are utilising their accumulated wealth to acquire either market share (Chang'an buys AVIC) or key technology know-how and intellectual property (Beijing Western buys Delphi suspension, Tempo Group buys Nexteer). Initial indications in mid-2009 were that we potentially were going to see a number of large (over \$500 million) transactions involving Chinese players purchasing troubled Western companies. There were a couple of noteworthy transaction in the past year that demonstrate the globalisation aspirations of Chinese companies through the purchase of Western brands (yet to be completed Geely's acquisition of Volvo, along with Beijing Auto's purchase of the SAAB assets), but the majority were under \$100 million.

Indian automotive companies had undertaken a major buying spree of Western companies in 2007 and 2008, with most notably Tata Motor's acquisition of Jaguar Land Rover and numerous acquisitions by component manufacturers, such as Bharat Forge, Mahindra & Mahindra, Ruia Group, Minda Group and Amtek Auto. Following this spending spree, Indian acquirers have been cautious in their approach to acquisition opportunities in 2009 and in the year-to-date in 2010.

They have in particular been on the lookout for distressed assets which offer the opportunity to acquire both technology and market positions at attractive prices. Notable examples were the acquisitions of VisiCorp in Germany by Motherson Sumi, Vredestein Banden BV in the Netherlands by Apollo Tyres and Henniges in Germany by the Ruia Group.

In summary, both Chinese and Indian companies have used a selective and cautious approach to overseas acquisitions. They have sought to acquire technology to take advantage of the growth that is occurring within their home markets and secure market positions with the global automotive manufacturers, both in their home markets and overseas.

Another driver for this activity is the buoyant demand in their domestic markets and the generally depressed state of overseas markets during the period. In addition, both Chinese and Indian companies often lack the scale and experience to make major acquisitions.

Organic expansion has also taken off in this period as both Indian and Chinese companies have entered into the globalisation phase of their development. Chinese companies are looking to develop sales and distribution capability, and in limited cases, production capacity in countries like Brazil, Mexico, Turkey, Egypt, South Africa and ASEAN. Indian companies are also looking to expand outside India, but have been more focused on the ASEAN countries and Africa. We are also beginning to see enquiries by Chinese and Indian companies into potential targets within each others' markets.

As we look out over the next several years, we expect to see further consolidation activity within China and India as automotive manufacturers and component suppliers look for economies of scale and further collaborations/acquisitions with foreign partners, as both markets continue to expand.



With respect to Western companies in the region, a more conservative approach was taken in 2009 as non-performing entities in challenged countries were paired-back, while both product and capacity were added in China and India. As we enter 2010, we are seeing a revitalisation of inquiry and investigation into strategic and focus acquisitions. Many of these Western companies are relooking at traditional relationships, and rethinking their respective Asia strategies with the global shift that has occurred in the last five years. Within the heavy commercial vehicle sector, there is a realignment of partners in progress in both China, India and across the region. The better performing Western automotive components companies have also reengaged in the region and are looking to further expand their advantage.

A new sub-segment where there is currently solid activity surrounds the trend of green energy. OEMs and suppliers within the Asian region are looking to develop and acquire both battery and alternative fuel vehicle technology. There is high demand for battery technology, along with the advanced transmission and electrical systems needed to produce a full scale electric power train. The recent SAIC JV with battery maker A123 (51% SAIC/49% A123) is an example of how companies are looking to structure relationships to exploit the new technology in a market very open and supportive of electric and hybrid vehicles. Mahindra & Mahindra also recently acquired Reva, the leading Indian manufacturer of electric vehicles. Western automotive component suppliers are also looking for deals that will allow them access to both passenger vehicle and bus fleet strategies within China, Japan and Korea.

As we look ahead to 2011, a number of challenges are on the horizon. The single biggest concern that deal makers have is whether there will be a slowdown in growth in the region. There are a number of signs (namely inflation and fluctuating currencies) that indicate that a moderate slowdown may be on the horizon, and this could affect both the frequency and pace of deals. Some of the challenges to getting deals done and making them successful include the lack of understanding on how to successfully do business in the more developed Western markets and a lack of Western-trained talent to actively manage the complexities of global operations.

Entertainment & Media



Marcel Fenez
Global
Entertainment & Media Leader

The first six months of 2010 has seen advertising spend rebound in the majority of markets in the region from the perilously low levels of 2009. Against that backdrop, the hope would have been for a recovery in M&A activity within the Entertainment & Media (E&M) sector. However, while there are signs of renewed interest in certain areas, this has yet to reflect in terms of completed transactions. In fact the number of completed transactions in the first half of 2010 were significantly (22%) lower than in the comparable period of 2009 – and this trend would have looked even worse had it not been for an unusually robust level of transactions in the Hotels and Lodging sector, reflecting increased attractiveness of reduced asset prices.

With high-profile acquisitions over the past several years, as well as middle-market investments, private equity's influence in the E&M landscape has expanded. As private equity investors continue to assess the cyclical and structural issues within certain E&M subsectors, we expect that such interest will permeate even further via bolt-on acquisitions as well as new platform company investments. Well capitalised conglomerates are also interested in M&A activity as the market stabilises. 'Pay TV' ventures continue to attract interest across the region but specifically in Taiwan and Indonesia.

The recently published PricewaterhouseCoopers Global Entertainment & Media Outlook 2010-2014 highlights that the E&M industry in the Asia Pacific region will grow at a compound annual growth rate (CAGR) of 6.4% over that period, compared with the global sector growth rate of 5.2%. Despite being the slowest growing country in terms of value, Japan remains the largest overall E&M market measured in terms of aggregate advertising and end-user/consumer spend. If Japan were excluded from the regional analysis, then the remainder of the Asia Pacific E&M market is forecast to grow at 9.2% CAGR; led by China (12% CAGR), India (11.8% CAGR) and from much smaller bases, Pakistan (25% CAGR) and Vietnam (17.2% CAGR).

The subsectors driving such growth will be Video Games with a 16.3% CAGR, 'Pay TV' with a 10% CAGR and of course Internet access at 6.2% CAGR. Within the advertising arena, overall advertising spend will grow by an annual compound rate of 6.6%, of which Internet advertising (both wired and wireless) will grow at 14.3% CAGR.

These growth rates are likely indicators of where most interest lies, but it is still likely that there will be few major deals as companies within the E&M sector continue to look at other forms of collaboration with other players in the ever changing digital value chain. These collaborations will seek to create value either through exploiting new revenue streams or through exploiting savings through sharing cost bases which in the long run do not represent any significant competitive advantage.

Financial Services



Matthew Phillips
Asia Pacific
Financial Services Deals Leader

After reaching a low in the first half of 2009, financial services deal activity staged a recovery in the second half of 2009 with US\$37 billion of announced deals and this level of activity has been sustained into 2010 with US\$28.1 billion in the first five months (according to data from Thompson Financial). Our recently launched survey of financial services deal activity in Asia “The Outlook for Financial Services M&A in Asia”¹ published in June 2010 confirms the return of confidence with 54% of those surveyed indicating they intend to undertake or evaluate a deal in the coming year, up from 42% in the same survey last year. However, the landscape for deal activity has changed, with new players, new rules and new opportunities emerging.

2009 saw a marked reduction in financial services deal activity as the effects of the sub-prime mortgage crisis began to be felt. Amid the crisis Asian institutions focused on their core activities and took advantage of lending opportunities arising from stimulus measures. The region escaped much of the direct fallout of the crisis and in our survey 70% of respondents expect healthy growth of more than 10% in 2010. However, what is now becoming clear is that the crisis caused a significant deferral of deal activity, which is beginning to unwind as confidence returns.

China has been the most active market in the first half of 2010 with over US\$10 billion of deals; mainly due to the ongoing capital replenishment by regional banks following the lending increase in 2009 amid the stimulus measures. The largest of these to date was the US\$5.3 billion placement by Shanghai Pudong Development Bank to China Mobile. Other large deals to be announced in the region include the long-planned disposal of state stakes including Siam City Bank acquisition by Thanachart (itself backed by Bank of Nova Scotia) for US\$2.1 billion. The deals figures were also swelled by a number of smaller regulatory backed takeovers and mergers in Japan and India albeit at lower levels than in the previous year. The number of distress bank takeovers appears to be waning as the crisis subsides and now the focus is turning to strategic deals to generate growth. However, the crisis has changed the landscape for those now looking to do deals.

New players

As forecast in the PricewaterhouseCoopers’ report last year “Fortune Favouring the Brave”, Asian financial institutions have seized unprecedented growth opportunities to emerge as winners in the crisis. Such “super-regional players” refer to those who are building regional franchises in close proximity to their headquarters or clustered in part of the region. Leading institutions from Australia, Japan, Malaysia and Singapore have all been making significant cross border moves. In 2010, ANZ, CIMB and UOB all increased their stakes in existing cross border investments. These have increasingly been built around regional trade flows and a desire to exploit synergies in product offerings and operations. Following earlier forays, Chinese institutions have been noticeably absent from regional deals; discouraged by regulators fearful that the institutions may not be ready and keen to see them recapitalised following the recent lending spree. This is unlikely to change in the short term until the recapitalisation is complete and the Chinese institutions have built the management bench strength to manage significant overseas acquisitions.

¹ PricewaterhouseCoopers survey “The Outlook for Financial Services M&A in Asia (June 2010), entitled What lies on the horizon – New Players – New Rules – New Opportunities”.



New Rules

In the near term there will be changes in the rules of competition in the financial services industry with several jurisdictions introducing new financial sector master plans. Thailand and Malaysia are publishing new plans in 2010; while Taiwan, Vietnam and India are introducing changes to existing regulations governing competition in the financial services sector. These plans aim to increase efficiency and competitiveness and in many cases promote consolidation and the opening up of certain sectors to new entrants; in some cases creating opportunities for foreign players. However the political spectre of protectionism increasingly threatens the much needed opening up of the sector across the region.

In the post crisis environment, institutions are inclined to hold on to capital and the credit issues in the West have brought home to the region how vulnerable it remains to a liquidity shock particularly in those markets dependent on wholesale funding. New Basel III capital and liquidity management requirements which are to come into effect in 2012 will also impact deal doers. Acquirers will need to carefully assess not only the impact of these changes on their businesses but also carefully sensitise the impact an acquisition might have on their overall capital and liquidity. Many acquirers appear to be favouring targets which generate substantial liquidity and are looking beyond the numbers to assess businesses that can reduce overall risk by bringing an entrenched market position and brand loyalty; in addition to an experienced management team.

New Opportunities

Recent indications are that confidence has returned to the region's institutions remarkably quickly. In our recent survey, 54% of respondents expected to undertake or evaluate a deal in the coming year. Size in a given market was seen by 90% as a core factor in providing companies with a competitive edge. Interestingly, as we emerge from the crisis, strategies appear to focus more on growing scale in existing geographical markets, with 82% indicating that their deal flow will focus on growing market share and existing businesses, and fewer (56%) focusing on geographical expansion or expanding their footprint. This suggests we are likely to see continued focus on domestic consolidation.

Retail banking continues to be the main focus of interest, followed by private banking and insurance. We are also seeing considerable focus on investment banking and asset/investment management sectors as Asian markets, China specifically, continues to be the home to the majority of larger IPOs.

Looking forward we would expect the main theme for banking deal activity to be capital replenishment with institutions needing to increase capital and liquidity to meet new capital requirements. Regulators emboldened by the crisis will be placing increasing pressure on weaker institutions to increase capital which may create opportunities. At the same time acquirers will be increasingly wary of the capital needs of businesses they acquire. However, with only 21% of institutions indicating an intention to divest businesses in the coming year it will be increasingly difficult to find attractive deals at the right price.

Western institutions will continue to seek opportunities in the key growth markets in the region. While a number have chosen to exit selected businesses in the last few years, a wave of new investors is now emerging. Stronger players from mature markets in the West as well as Japan who may have limited growth opportunities at home are stepping forward in a changing of the guard. Particular focus remains on China, but I would also expect to see continued interest for deals in India, Indonesia, Malaysia and Thailand in the coming year.



Andrew Parker
Asia Pacific
Infocomm Leader

The first half of 2010 continued to be a difficult environment for deals in the industry with just 133 deals announced, down from the 214 deals announced in the second half of 2009 and the 235 deals that were announced in the first half of 2009. Total deal values were US\$23.5 billion, significantly up from the total in the second half of 2009 of US\$16.9 billion. A key driver of this increase in value was the US\$10.7 billion acquisition of wireless communications provider Zain Africa by Bharti Airtel of India, which was completed in June 2010. This was a significant deal for Bharti Airtel following the disappointment of a failed bid for South Africa's MTN just over a year ago.

Whilst the current economic environment and level of industry deal flow is likely to persist for the next six to twelve months, we see the following key themes that are likely to both influence M&A activity and also drive the wider industry landscape:


Separation of Passive Infrastructure

During the first half of 2010, we have continued to see telecom companies segregating their passive infrastructure assets from other elements of their business. There are two distinct drivers: balance sheet efficiency considerations and increasingly, government policies and intervention.

In a capital constrained world there continues to be an increased focus on balance sheet and capital efficiency. The explosive growth in mobile traffic as penetration rates increase, as well as the sheer volume of wireless data traffic being driven by devices such as the iPhone and iPad, is requiring ever increasing investments in infrastructure. At the same time, there is also growing community concern about the environmental and aesthetic impact of infrastructure such as mobile towers. In this environment, telecom companies are looking for ways to reduce debt levels and to free up cash to pursue high growth opportunities in their core business. An example of this is Aircel Ltd's disposal of its mobile tower operations to GTL Infrastructure Ltd. in India for around US\$1.8 billion in January 2010.

In some cases though, such separation has not been a matter of choice but has rather been driven by government regulations. Governments have been increasingly active in taking decisive steps to ensure a level competitive landscape as they seek to accelerate the building of ultra-fast broadband networks that will drive their economies into the digital age.

After announcing a US\$37 billion investment in building a National Broadband Network in 2009, the Australian government introduced legislation that would, if implemented, have resulted in the separation of the wholesale and retail arms of Telstra's business. This effectively gave the incumbent telco the option of voluntarily implementing separation, or having legislation brought into force that would impose a structural separation of its wholesale arm, prevent Telstra's participation in upcoming 4G wireless spectrum auctions and force the divestment of their cable TV assets. In an industry transforming announcement, the National Broadband Network Company (NBN Co.) announced in June 2010 that they had entered into a non-binding Financial Heads of Agreement worth US\$9.5 billion with Telstar on a post-tax net present value basis. The transaction, if completed, will see Telstra decommission its copper network and cable broadband service, provide NBN Co. with access to its infrastructure including ducts, pits and backhaul fibre and avoid certain Universal Service Obligation (USO) costs. Under the deal, the Australian government has confirmed that Telstra will be allowed to bid for Long Term Evolution (LTE) wireless spectrum and keep its cable TV assets if the transaction is completed.



A similar situation has arisen in Japan. A Japanese government taskforce set up to study whether Nippon Telegraph and Telephone Corp (NTT) should be forced to spin-off its fibre-optic network, announced in May 2010 that it was considering a number of options for the incumbent telco. These include forming a separate division or company within NTT to manage the network or to completely spin-off the network into a different entity with no capital ties to NTT. A final decision on the task force's recommendations is expected to be made later in 2010 or in the first half of 2011.

In New Zealand, the government announced the formation of Crown Fibre Holdings (CFH) in September 2009. CFH is responsible for investing the government's US\$1 billion in local fibre companies in order to achieve the government's 75% ultra-fast broadband target as quickly and efficiently as possible. A number of providers, including the incumbent, Telecom New Zealand (TNZ) and utility companies have applied for funding of fibre-to-the-premises (FTTP) projects by CFH. TNZ has indicated that it is considering a de-merger of its local access network unit, Chorus, in order to win support for CFH funding.

In a clear sign that high speed broadband is not only on the agenda of wealthier nations, the Malaysian government announced in March 2010 that it had formed a public-private partnership with Telekom Malaysia to roll out a High Speed Broadband (HSBB) network costing more than US\$3 billion. The network will deliver speeds of at least 10 Mbps using a mixture of FTTP, VDSL2+ and ADSL2+ technologies. Whilst separation has not been contemplated, it is envisaged that the network will be open access. The HSBB is estimated to add 1% to GDP and create 130,000 jobs.

Wireless continues its relentless growth

Mobile and wireless telecommunications have continued to be a source of focus within Asia during the course of the first half of 2010. Subscriber numbers have exceeded 780 million in China and 600 million in India, representing penetration rates of 59% and 51% respectively, leaving significant growth potential.

Consumers are routinely using smart phones to view digital content such as music, games and the Internet. This capability, coupled with the dramatic rise of social networking, is fundamentally changing mobile communications providing anytime, anywhere access to digital content. At the same time, operators' core voice products are suffering from intensifying competition and increasingly, market saturation. Both factors are driving revenues and margins downwards.

These pressures have caused operators to look outside their home markets for growth opportunities, seek access to additional spectrum in order to offer the digital content consumers want, and to consider consolidation as a means of growing scale and lowering costs.

Whilst consolidation has been slow to start following the Vodafone/Hutchison merger in Australia in early 2009, Bharti Airtel completed a US\$10.7 billion acquisition of Zain in June 2010.

India's third generation mobile telephony bandwidth auction concluded in May 2010 with companies including Bharti, Reliance Communications, Vodafone Essar and Idea Cellular among nine operators who emerged as provisional winners. None of the nine operators won rights to bandwidth in all of India's 22 service areas. The government said it will receive nearly US\$15 billion from the auctions, almost twice the estimates included in its budget.



After a number of delays and regulatory discussions, the National Telecommunications Commission (NTC) of Thailand has received approval from the Council of State to go ahead with plans to allocate 3G licenses in the 2.1 Ghz spectrum band this year. The NTC is finalising a licensing plan and expects to auction three licenses before the end of 2010. The NTC has also said that it will auction licenses for WiMax services using the 2.3 Ghz and 2.5 Ghz spectrum bands in September 2010, although a number of commentators have suggested that delays can be expected, pushing the process into 2011 or possibly even 2012.

Vietnam is set to become one of Asia's biggest mobile phone markets in the coming years with some analysts predicting 120 million subscribers by 2014. Although six years have passed since the Vietnamese government first announced plans to part-privatise MobiFone (a subsidiary of the state-owned VNPT), reports have emerged again suggesting that the government may sell a stake in the company this year as part of the country's efforts to restructure the state sector. Analysts have valued MobiFone at around US\$2 billion.

In June 2010, the Australian government announced that it would auction 126 MHz of contiguous UHF spectrum in the 700 MHz band in the second half of 2012. The spectrum will be freed up when the switch-off of analog television signals is completed at the end of 2013. It is expected to be used by mobile operators to provide 4G services.

Realising the synergies from mergers and acquisitions

Whilst industry players look to add scale to their operations in the form of mergers, acquisitions and joint ventures, many are finding the synergy benefits originally expected at the time of the transaction harder and more time consuming to realise than first thought. The Chief Executive Officer of the US\$2.5 billion joint venture between Vodafone and Hutchison in Australia recently commented that whilst back-office cost savings had been achieved as a result of the integration, synergies expected from network rationalisation were taking far longer to realise than originally envisaged.

Infrastructure



Clara Cutajar
Asia Pacific
Infrastructure Deals Leader

The majority of infrastructure transactions across the Asia Pacific region have been focused on greenfield opportunities with the continuing effects of various governments' stimulus packages still resonating, as seen in the strong real GDP growth forecast for the Asia Pacific region. A number of brownfield opportunities have arisen in Australia largely through various ongoing state governments' privatisation programmes.

In the first quarter of 2010, project financing in the Asia Pacific region grew significantly as compared to the same period in the previous year, which is a sign that the banks are open for business again after the global financial crisis. The largest refinancing projects include a US\$12 billion syndicated loan facility for the financially troubled Taiwan High-Speed Rail Corp and financing of a few other power, transportation and telecommunications projects in India; e.g. Jindal Power Ltd (US\$2.2 billion), Jaypee Infratech Ltd (US\$1.3 billion) and Chennai Infrastructure Network (US\$1.1 billion).

China and India, with the highest real GDP forecast of 10% and 8.8% respectively, led economic growth in the Asia Pacific region. Both of these countries are expected to continue to invest heavily in the energy (including renewable energy) and transportation sector to support their domestic economic growth. Indonesia has fared better than most of its neighbours in the South East Asian region during the global financial crisis as it relies less on exports and consumer confidence has been buoyed by a relatively stable political climate. The government proposes to spend approximately US\$12 billion in 2010 and US\$140 billion over the next five years on infrastructure. However, the government still needs to address land acquisition issues and conflicting regulations to attract private sector investors to these projects.

Some specific infrastructure projects in China, India and Indonesia include the following:


- **China:** In December 2009, construction commenced on the proposed RMB73 billion (approximately US\$10.7 billion) Hong Kong–Zhuhai–Macau Bridge. This project, comprising 50km of bridges and tunnels, is aimed to connect the West side of Hong Kong to Macau and the mainland Chinese city of Zhuhai, located on the West side of the Pearl River Delta. This project is expected to be completed in 2015/16. The Chinese government is expected to spend US\$50 billion on high speed rail in 2010 alone and it plans to spend an additional US\$250 billion over the next decade. The plan involves converting existing rail tracks to electric railways. These include the lines between Beijing and Guangzhou, Harbin and Dalian, and Chengdu and Kunming in the Southwest.
- **India:** Various power projects include Jindal Power's expansion of the Tamnar power stations (US\$2.9 billion), where project financing was completed in March 2010; India's state-owned power company National Thermal Power Corporation (NTPC) announced in March 2010 that it would add 4,100MW of coal-based thermal power to its total capacity during the next financial year and four Indian state-run power firms are considering setting up hydro power plants in Bhutan with a view to supplying the bulk of the generated power to India.

- Indonesia: The Cirebon project involves the financing of a greenfield 660MW coal-fired steam power generation plant in West Java, Indonesia, and its related transmission facilities for inter-connection to the relevant grid system and coal jetty facilities. The project is expected to cost approximately US\$416 million and is scheduled to be completed in the fourth quarter of 2011. This project marks the first large-scale, internationally tendered greenfield IPP project in Indonesia since the Asian financial crisis in 1997.

Generally, the greenfield infrastructure projects in the Asia Pacific region are funded by a combination of government and external funds. Infrastructure entities looked to IPOs as a source of funding but uncertainty in the equity market has led to a number of IPOs being shelved recently. In June 2010, China's second-largest wind turbine maker, Xinjiang Goldwind Science & Technology Co, pulled its US\$1.2 billion Hong Kong initial public offering.

Australia, being a developed nation, has a relatively mature infrastructure sector. Whilst transaction activity is still low, there have been signs of improvement with significant state government privatisations of infrastructure assets continuing. In addition, there has been a number of public-to-private transactions that are underway in the various states. Significant transactions in the last 12 months include:

- Privatisation of government assets: The Queensland government programme continues with the sale of the Port of Brisbane underway and the IPO of Queensland Rail expected to be finalised later this year. The NSW government on-again-off-again privatisation of AUD\$8 billion in power assets seems to be back on again with the process expected to be underway in early July 2010.
- Restructuring of infrastructure funds - The completion of the restructuring of Macquarie Infrastructure Group (MIG) resulted in the split into Macquarie Atlas Roads and Intoll Group. In November 2009, Prime Infrastructure (previously known as Babcock & Brown Infrastructure) completed its recapitalisation by accepting Brookfield Asset Management's offer as its new cornerstone investor and selling certain assets to reduce its over-gearred position.
- A number of infrastructure funds undertook deeply discounted equity raises to repay debt and fund required capital spending. This included Asciano (AUD\$2 billion), SP Ausnet (AUD\$520 million) and Epic Energy (AUD\$1 billion).
- Public Private Partnership (PPP) projects saw the completion of project financing for a few infrastructure projects, including the new Ararat Prison (AUD\$350 million), Victoria Desalination plant (AUD\$3.8 billion), 6 super schools in South Australia (AUD\$323 million), and Edith Cowan University Accommodation (AUD\$65 million). PPP projects in the pipeline include Sunshine Coast University Hospital (AUD\$1.9 billion) and New Royal Adelaide Hospital Project (AUD\$1.5 billion to AUD\$2 billion).
- In the hype surrounding the Australian minerals boom, the necessary investment in infrastructure, particularly ports and rail to export to the Asia Pacific market, has been neglected. The country is now playing infrastructure catch-up with more than AUD\$10 billion worth of port projects and expansions in the market, especially in Western Australia and Queensland.



On April 2010, the Australian government announced plans to delay its Carbon Pollution Reduction Scheme (CPRS) until at least 2013. The uncertainty around the implementation of the scheme will continue to impact the refinancing of coal fired power stations and also to a certain extent, investments in the renewable energy. In addition, the government has also proposed to implement the new Minerals Resource Rent Tax, replacing the earlier announced Resource Super Profits Tax. This bill, applicable to iron ore and coal resources, is currently planned to start on 1 July, 2012 and has a significant indirect impact on the infrastructure sector.

The outlook for the next six months in the Asia Pacific region will continue to be led by the development of the social and infrastructure spending required to support the economic growth in the region. The Chinese government is also keen to improve its infrastructure investment vehicle's performance which may present opportunities in asset acquisitions. For the infrastructure entities that have successfully refinanced debt, it will be time for these entities to focus on the future and long term growth. There are still a number of infrastructure entities that have significant refinancing commitments coming up in the next 12 months to two years, limiting their ability to take part in growth opportunities. The liquidity in debt markets and its pricing, which had improved significantly in the last 12 months, is now seen to be stabilising as uncertainties surrounding the European sovereign debt crisis become more stable. It is also worth noting that bank capital treatments under the new BASEL II regulations have a more favourable treatment for infrastructure financing than on comparable corporate financing and there is anecdotal evidence of this being translated into favourable relative pricing outcomes for infrastructure borrowers. Any transaction activity in the sector will be closely linked to the performance of the equity markets, the liquidity in the credit market, the uncertainty surrounding the Euro zone debt crisis and US economic data. If privatisation transactions that are underway in Australia are successfully undertaken, this may have a positive impact on the M&A market for infrastructure deals across the region.



Sam Kok Weng
Asia Pacific
Insurance Deals Leader



Liu Shu-Yen
Partner
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What a year 2010 has been for insurance deals, never a dull moment! Prudential's aborted acquisition of AIA could have been the M&A event of the year. Interestingly, it was not just the size of the deal, nor its complexity that captured onlookers' attention. It was also the story of Asia and insurance in Asia. Many insurers have been looking at Asia to grow their franchise and revenue for the last 20 years. Demographics and economic growth in Asia, as well as low insurance penetration are the main drivers underpinning this strategy. Yes, there were insurance deals in Asia in the last decade, but few came even close to the Pru-AIA deal in terms of geographic reach and the strength of AIA in the markets it operates in.

Even though the deal is not going through, the effect that the proposed transaction has had is likely to remain. CEOs have re-assessed market segments and have re-strategised their plans to grow. Many have now adopted a combination approach and have decided to grow organically in certain market segments but to grow through strategic alliance with banks/distributors and through M&A activities for other market segments. The fact that the deal is not happening will not change the course that other insurers have now charted for themselves.

Last year, we explained why in our opinion Asia remains an attractive market, with its low insurance penetration rate and rapidly growing per capita disposable income levels in many of the large and growing emerging Asian economies, particularly in comparison to markets like the US and Europe. Recently McKinsey & Co. has estimated Asia will deliver around 40% of global life insurance premium growth over the next five years.

Given this background, the outlook for the next 12 months remains strong for insurance M&A. Here are some selected themes for transactions in the insurance space:

China: Insurance needs in retirement and health insurance remain exceptionally strong. The possibility of having a financial holding company equivalent investing in insurance assets will create new shareholders in both the life and general insurance space. In addition, several foreign joint-venture life insurance companies have announced a reduction in their joint-venture shareholding to expedite the expansion plan in China, consequently, opportunities for additional domestic shareholders have also surfaced. Interestingly, some banks in China are interested in the opportunities arising from the planned reduced foreign shareholdings in foreign joint venture life companies. Newly established domestic insurance companies in the last five years are looking for foreign investors with extensive insurance experience to help to move the company to the next phase of growth. Foreign insurers are also seeking access to large state-owned entities for product distribution where insurance product needs are significant.

India: An estimated 11-12% of the 400 million working class in India is insured - providing coverage for the remaining population creates immense potential for the insurance business to flourish. Bancassurance is expected to be a key growth enabler given that both the Insurance Regulatory and Development Authority (IRDA) and the Reserve Bank of India (RBI) have been encouraging banks to enter into the Insurance sector. Whilst many foreign owned operations have struggled to be profitable, many are continuing with their India strategy and are seeking innovative ways to expand their distribution channels.

Indonesia: Between 2001 and 2009, the number of insurance companies has dropped by around 20%. This is largely attributable to the increase in minimum capital requirements under the Risk Based Capital (RBC) regime. Given the

general economic recovery in Indonesia, and the fact that management control is permissible, there continues to be a high level of interest in doing acquisitions. Whilst the organic route is possible, more companies are seeking acquisitions as a means to access distribution channels and management resources.

Thailand: The new RBC requirements post 2011 is expected to increase capital needs for both life and general insurers. We believe that there are opportunities for consolidation and for new entrants to enter the sector.

Malaysia: Bank Negara Malaysia (the central bank) is encouraging further consolidation in the insurance sector by allowing foreign ownership of 70% compared to the previous 49% limit. Malaysia is expected to remain as a key Takaful market as the industry continues its steady growth this year, in line with the expansion of the industry globally (which has seen an annual growth rate of 25% in the past few years).

Regulation: Changes to capital and ownership rules discussed above are expected to accelerate M&A activity in the Insurance sector as insurance companies consolidate to meet stricter capital requirements. For a snapshot of key highlights, refer to Table 1 below.

Country	Ownership Allowed/Trends	Capital Rules/Highlights
China	<ul style="list-style-type: none"> Trend for foreign life companies to reduce their 50% share holding in the 50:50 JV structure to a domestic company with maximum of 25% foreign share. 	<ul style="list-style-type: none"> Four percent of reserves and 0.3% of the sum at risk.
India	<ul style="list-style-type: none"> Foreign partners can hold up to 26% of the equity in the JV company having one or more Indian SCBs or other corporates to participate in Insurance business. 	<ul style="list-style-type: none"> High Capital Requirement: Currently, most private insurance companies are making losses resulting in pressure on efficiencies. Capital requirements are very high due to high distribution costs, agency costs, new product launches, etc.
Indonesia	<ul style="list-style-type: none"> Foreign ownership in the Indonesian insurance companies is limited to a maximum of 80%. 	<ul style="list-style-type: none"> Current regulation requires insurance companies to maintain solvency ratio of 120%. Minimum capital requirement for existing insurance companies to be IDR 40 billion by 2010 to IDR 70 billion by 2012 and IDR 100 billion by 2014.
Malaysia	<ul style="list-style-type: none"> From April 2009, foreign players are allowed to take up to 70% equity in Malaysia insurance companies and Takaful operators, up from the previous limit of 49%. 	<ul style="list-style-type: none"> Minimum paid-up capital; RM 100 million. Minimum solvency; 130% of Risk based Capital. Internal target capital level 180% (ICAR) level to be maintained.
Thailand	<ul style="list-style-type: none"> The OIC currently allow automatic foreign ownership up to 25% with additional shareholdings up to 49% with OIC approval (which has been granted for other insurers). 	<ul style="list-style-type: none"> Current solvency requirement is two percent of the net premium valuation reserve (which uses historical assumptions) but no less than a nominal amount of Baht 50 million. However in 2011 a Risk Based Capital (RBC) regime will be introduced by the Office of Insurance Commission (OIC). Whilst the final framework is still in the process of being finalised, it will undoubtedly result in a higher capital requirement.
Vietnam	<ul style="list-style-type: none"> Current at 49% (as a general rule for all companies). 	<ul style="list-style-type: none"> Current minimum capital requirement for life insurers is VND 600 billion. The above requirement allows a maximum of 20 branches and representative offices. VND 10 billion is required for each additional branch or rep-office in excess of the above limit.



After the global economic crisis, the investment community has recognised that 'insurance companies are not banks'. Insurance regulators are also working on strengthening the Insurance sector in many Asian countries. This, together with the unprecedented opportunity in Asia, is creating the impetus for transactions to be done. As a consequence, there is going to be an increased demand for insurance skills-run-off skills, restructuring knowledge, and making alliances work.

Not only is 2010 and the years ahead looking good for insurance M&A activity, they are likely to be lucrative years for experienced human capital in the insurance sector.

Mining & Resources



Jock O'Callaghan
Asia Pacific
Mining & Resources Deals Leader

There has been a noticeable recovery in M&A activity in the mining sector in the first half of 2010. As is the case following most economic downturns, the recovery in M&A activity has lagged behind the recovery in equity markets. We are only now seeing signs of a turnaround in mining transaction activity in Asia Pacific. Total deal values in the sector in the first half of 2010 (US\$27.9 billion) increased 50% from the second half of 2009 (US\$18.2 billion). This increase occurred despite a reduction in the number of deals from 365 deals in the second half of 2009 to 251 deals in the first half of 2010.

Most of the deal activity in the Asia Pacific region during the first half of 2010 emanated from Australia and China (approximately 72%). There has been a shift, however, in the focus of Chinese investment. Chinese companies have directed a much larger proportion of their investments domestically, whereas in previous periods Australian mining assets were the primary investment targets as China looked to secure mineral supplies for its burgeoning steel mills. However, given the circa 10% decrease in the value of the Australian dollar and a surge in Chinese foreign reserves, Australian acquisitions may be back on China's agenda in the second half of 2010. Moreover, China has recently announced it intends to become more flexible when it comes to the Yuan's peg to the US dollar, which will likely lead to the continued appreciation in the Yuan. This would further enhance the attractiveness of Australian assets.

The gold industry is expected to be a key sector over the next 18 months stemming from its long-term performance credentials. The most significant deal in the first half of 2010 was Newcrest's planned US\$8.4 billion takeover of Lihir Gold. Newcrest completed its due diligence investigations in June 2010 and expects to announce the successful completion of the transaction by September, thereby creating the fourth largest listed gold miner in the world. There has also been significant activity and interest in the coal seam gas industry. Shell-Petro China's US\$3 billion offer for Arrow Energy's coal seam gas assets was unanimously recommended by Arrow's directors and is now subject to approval from shareholders. Elsewhere in the region, there were no deals of comparable size, but Indonesian-based company Alam Tri Abadi PT expanded its growing coal resources via a minority 25% stake in BHP's Maruwai coal mine bordering South and Central Kalimantan in Indonesia. Japan's Toho Zinc Co. Ltd. has launched a tender offer to acquire the remaining 50.1% interest it does not already own in CBH Resources, a Sydney-based zinc, lead and silver mining company for US\$120.3 million.

The most significant development in the regulatory environment in the Asia Pacific region has been the Australian government's proposed introduction of a Minerals Resources Rent Tax (MRRT), which is expected to become operational on 1 July, 2012. The MRRT is a revised version of the originally proposed Resource Super Profits Tax (RSPT) that was shelved following significant criticism from the mining industry. In broad terms, the proposed MRRT will tax only coal and iron ore projects at a rate of 30% on profits in excess of the long term bond rate plus 7%. However, the design of the MRRT includes a 25% "extraction allowance" to recognise the value of know-how that the mining company contributes to the extraction process. The incorporation of this 25% allowance results in an effective headline tax rate of 22.5%. The change from the RSPT to the MRRT is generally seen as a positive move for the mining industry, as the design of the MRRT should reduce the proposed tax regime's impact on the value of existing projects. However, uncertainty still remains within the industry – the proposals must be passed through the Senate against the backdrop of an impending Federal Election and an Opposition Party committed to opposing the reforms. This lingering uncertainty has the potential to hinder



M&A activity. Peabody Energy Group reduced its US\$4.7 billion offer for Macarthur Coal in the wake of the potential implementation of the initial RSPT. It will be interesting to monitor what impact the MRRT will have on the relative attractiveness of Australian assets, particularly given the strong ties that already exist between China and Africa.

As we look towards the second half of 2010, there are signs of an upturn in deal activity. The balance sheets of the major miners are in good health: They have grown their cash reserves and reduced debt following a spate of capital raisings and rights issues throughout 2009, meaning they are well placed to pursue investment opportunities. The valuation gap between the largest and mid-tier mining companies has been increasing over the last five years. Given this background, there is significant incentive for the mid-tier miners to consolidate in order to remain competitive. The Newcrest-Lihir transaction may be representative of a broader shift towards industry consolidation over the next 18 months. However, in the short term, the continuing fallout from the European debt crisis and the uncertainty created by the MRRT is likely to continue to hinder deal activity and it may be some time before M&A activity reverts to pre-global financial crisis levels in the Asia Pacific region.



Ken Su
Asia Pacific
Oil & Gas Deals Partner

Deal activity in the oil and gas sector in the first half of 2010 continued its momentum following an upswing in activity in the second half of 2009.

With the shifting of assets within national oil company groups and the buying back of minority foreign stakes in Chinese assets, China's major oil companies continued their significant cross-border investment activities around the world.

In North America, Chinese companies made further investments in oil sands projects including Sinopec's announced US\$4.7 billion purchase of ConocoPhillips' 9% stake in Syncrude Canada and China Investment Corporation's US\$800 million acquisition of a 45% stake in oil sands properties from Penn West Energy Trust.

Beyond the speculation that a Chinese player would acquire YPF from Repsol, Chinese companies announced significant acquisitions of South American assets including CNOOC's US\$3.1 billion deal to form a joint venture with Argentina's Bidas Energy and Sinochem's purchase of a 40% stake in Statoil's Peregrino field in Brazil for US\$3.1 billion.

CNOOC is also moving ahead with its proposed US\$2.5 billion investment in a joint venture with Tullow and Total, in Uganda and CS CSG, a 50:50 joint venture between PetroChina and Royal Dutch Shell announced a US\$3 billion merger with Australia's Arrow Energy.

While there was not any significant activity involving South East Asian companies aside from San Miguel announcing a 20% acquisition of Philippines' refiner Petron, with San Miguel intending to acquire a controlling stake by the end of 2010, Japanese companies remained active including Nippon Oil Corporation's US\$12.1 merger with Nippon Mining Holding to form JX Holdings and Mitsui's entrance into the US shale gas sector with a US\$1.4 billion investment for a 32.5% stake in Anadarko's Marcellus Shale assets. In addition, India's Reliance Industries was also active in the US shale gas sector with a US\$1.7 billion investment for a 40% stake in Atlas Energy's Marcellus Shale operations and a US\$1.3 billion investment for a 45% stake in Pioneer Natural Resource's Eagle Ford Shale operations.

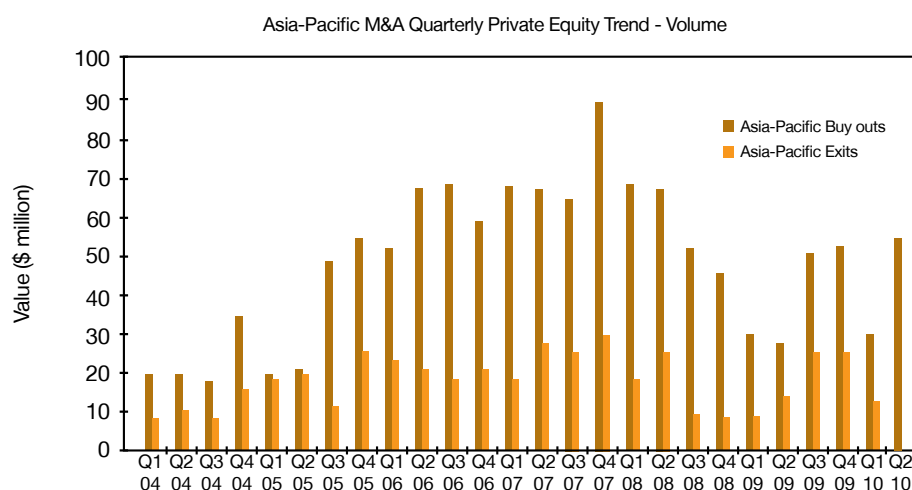
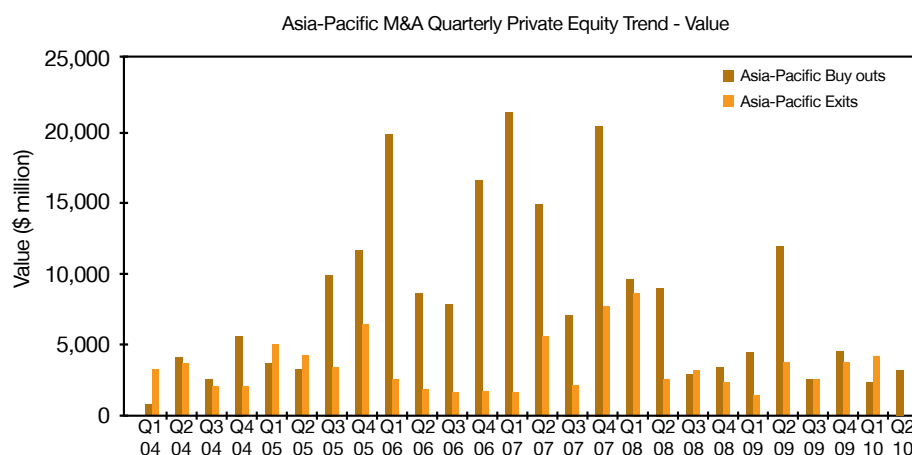
Overall, broader economic trends and the prospect of the forced sale of assets as a result of the BP/Transocean Horizon incident in the Gulf of Mexico indicates that deal activity for Asian companies will remain strong.

Private Equity




Charles Humphrey
East Cluster
Private Equity Leader

Merger and acquisition activity in the Asia Pacific region in 2009 was positive, with the region showing much stronger resilience during the economic crisis when compared to M&A activity in the rest of the world, boosted by several large deals in Australia, China and Japan. Whilst total deal volume in Asia Pacific declined by 5% (to 2,224 deals), total deal value increased by 5% from the prior year to US\$419 billion. This contrasts with the 27% decline in both volume and value of deals worldwide in 2009. As shown in the graphs below, the volume and value of PE buyout activity remained low and, despite some increased activity towards the end of 2009, uncertainty in the equity markets in early 2010 has resulted in a slower pick up in activity than many had expected.



Capital market valuations remained relatively high through 2009 resulting in a rush of private equity portfolio exits via initial public offerings. This momentum was evidenced by the re-opening of the IPO market in China, which included the launch of the Growth Enterprise Market in Shenzhen, with over 200 companies still in the IPO pipeline. However during late 2009 and most of the first half of 2010, markets were nervous due to a number of factors including: mixed data on



the global economic recovery, the worsening of the European debt crisis and lack lustre equity pricing performance of recent PE backed IPOs. This has resulted in the bulk of the outstanding IPO pipeline being deferred to the second half of 2010 and beyond, or even cancelled altogether. On the plus side, a number of these offerings have moved to a dual track process offering an opportunity for PE funds to participate – high vendor price expectations are an ongoing impediment but this gap should shorten as valuation multiples fall to more realistic levels, particularly where pressure to exit increases.

A trend of increasing globalisation has been evident in the PE industry. Funds are seeing the potential strategic advantages of holding portfolio companies in a variety of geographic locations and there is a renewed focus on understanding prospective investments resilience throughout various market cycles. In addition, PE funds have been targeting new markets, regions and specific sectors – this is most evident in the financial services sector, which was the most active industry globally and in Asia Pacific in 2009.

Other highly targeted sectors in 2009 were energy, resources and healthcare. The announcement by the Australian government of a proposed Minerals Resources Rent Tax (MRRT), has created uncertainty and, in spite of subsequent political changes, may impact investment in this sector and associated service providers during 2010. Healthcare remains an ongoing sector of interest for PE throughout the region. Interest is also growing in technology, media and telecommunications, agribusiness and infrastructure. Emerging markets are attracting a considerable amount of attention from North American and European LPs, and China is drawing the most investor interest by presenting some of the best investment opportunities, along with Indonesia, Malaysia and Taiwan. The resilience of China's domestic stock markets, rising demand for energy and resources and further consolidation in the food and beverage sector, technology sub-sectors and telecoms will fuel increased deal activity.

Activity across China was strong during 2009 with a number of PE funds raising Renminbi denominated funds (approximately US\$8.7 billion). This trend has continued in 2010, with China accounting for 84% of the US\$4 billion of Asian funds raised in the first quarter. Further evidence of increased PE focus in China was the direct investment in Apax Partners by China Investment Corporation in 2009. Sovereign government investment into the PE sector was also seen outside of China with the Malaysian government investing US\$2.8 billion in the launch of Ekuinas and Singapore government-backed Temasek announcing the launch of a new fund (Seatown). Korean PE activity levels are expected to increase in the near term due to restructuring opportunities around the Kumho group. Indonesia provides opportunities for PE funds to acquire undervalued companies in the energy and mining, consumer products and financial services sectors. Japan's PE activity in the second half of 2009 was dominated by the auction of Bell System 24 and a number of other pending secondaries. Taiwan offers PE deal flow opportunities in banking and insurance sectors with the Kbro/ Taiwan Mobile deal being a watershed deal for the PE sector there. India is also showing signs of improvement particularly in the financial services and IT sectors. In Australia, global PE funds spent much of 2009 focusing on restructuring and recapitalising portfolio companies although an IPO window in the third quarter of 2009 saw a number of portfolio company exits.

PE is no longer considered to have played a major role in exacerbating the global economic crisis and conversely it is likely to play a leading role in getting global markets out of it. Whilst PE has sat on the sidelines during the bulk of 2009, the



various disaster scenarios many predicted have not materialised. Since 2008, the level of fundraising for global PE funds has slowed as a result of the economic crisis but new funds continue to be raised and the proportion of funds raised in the Asia Pacific region has increased. With continued fund raising, and with capital raised during 2005 to 2007 yet to be invested, PE fund managers will begin to see pressure from LPs to allocate this capital into investments or alternatively return the cash. This pressure will increase when you take into account the fact that global PE funds are currently raising new funds with US\$165 billion of commitments being sought in Asia Pacific (US\$670 billion globally). New funds, unallocated capital and the easing of credit markets all point to significant dry powder.

The last quarter of 2009 was the best in terms of deal value since the third quarter of 2008 and coincided with several global PE funds achieving successful acquisitions and exits through both public-to-private and secondary market exits. Whilst this slowed somewhat in the first quarter of 2010, there is a sense that debt markets will return to more normal levels of availability towards the second half of the year, with most PE managers expecting an increase in acquisition and divestment activity to follow.

PE in 2010 will continue to focus on the basic fundamentals of value creation through identifying undervalued assets in stable growth markets instead of simple leverage and multiple arbitrage. We will also see more focus and investment on efficiency, synergy realisation and value creation (including bolt-ons) at portfolio companies during the investment cycle and in developing buy-out strategies. As leverage remains tighter than pre-crisis levels, price expectations will be met through additional equity contributions making the creation of value through operational and structural change even more key to generating the level of returns expected by investors.

Whilst equity markets are generally expected to settle and credit markets are expected to improve, both remain sensitive to shocks the likes of which have been seen in the first half of 2010. As recent stalled IPO processes have illustrated, shareholders' approach to IPOs as a form of exit is likely to remain cautious until stability returns and more consistent and positive data on the global economic recovery (including sovereign debt concerns) is received. The ability to help potential investors gain confidence in the security of future earnings is key to the success of most exits, for PE, the opportunity for secondary buy-outs is likely to increase and insight and experience from portfolio companies, advisors and in-house expertise may provide an advantage over public offerings – particularly as most fund managers expect to see some increase in current equity/debt multiples to enable larger transactions. Competition is likely to come from corporates with strong balance sheets, including those who have participated in equity raisings or have been able to de-merge or carve-out non-core businesses prior to, or during, the global economic crisis. As the IPO market returns, dual track divestment processes are likely to remain popular, the first companies to market are likely to be those in stable industries which have withstood the worst effects of the economic crisis and have successfully negotiated, or are less impacted by, the end of government stimulus.

No matter where you look in the Asia Pacific region, there is strong evidence of an ongoing recovery in sponsor activity, of corporates sitting on record levels of cash, of demergers and carve-outs of non-core businesses, and of a thawing credit market which bodes well for strong M&A activity towards the second half of 2010.



Andrew Li
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Real Estate Deals Partner

A little over a year after the failure of Lehman Brothers precipitated a global financial and economic collapse, asset markets in the Asia Pacific region are holding up surprisingly well compared to their peers in Europe and the United States. While both pricing and rentals in the region fell steeply in 2008 and early 2009 in step with those in the West, markets across the Asia Pacific region have been lifted in the second half of 2009 by the remarkable resilience of the Chinese economy, which has been buoyed by a series of fiscal and monetary stimulus measures.

As a result, many Asian markets began to show positive signs toward the end of 2009. Transaction volumes have rebounded, albeit from a very low base and were led overwhelmingly by China. Pricing has improved across the region; however the collective rise in property prices has given rise to concerns about asset bubbles. As a result, various governments have implemented or enforced policies to try to rein in excessive property speculation, which creates an overhang for markets and stock prices.

Asian REIT markets appear poised for growth as China and India contemplate enabling legislation, Singapore solidifies its position as the regional REIT hub, the Japanese market anticipates increased M&A activity to consolidate weaker companies and top tier REITs in Australia raised capital to de-leverage and reduce gearing levels.

Overall asset values in the region will continue to stabilise, and then edge higher, but a dramatic increase in value does not appear likely in the near term. For example, Japan could experience upticks after finally coming off bottom whereas China is likely to experience an adjustment after surging in an overdone rebound. Despite the inadequate transparency and lack of quality infrastructure, India is viewed as a long term opportunity. Malaysia, Thailand and Vietnam are in a high risk category with an unsettled political environment and transparency being major issues that are affecting values. Singapore has provided a relatively stable market, supported by underlying population growth and a reliable regulatory environment. Such stability has resulted in the lack of a short term investment increase in value. Australia continues to face challenges in availability and diversity of credit and access to equity to deliver sustainable growth to investors. Although Australian investment grade asset values are at, or close to, their cyclical trough values, unlisted wholesale funding markets are gaining in momentum.

During 2010 and into 2011, most investors' attention will concentrate on China, Japan and India. However, none offer compelling or obvious investment opportunities. Japan gets more immediate investor attention since China's rapid economic recovery could lead to uncomfortable volatility and the potential for another real estate correction which will lead to some opportunities but unlikely to result in a high level of activity as some investors expect. A combination of increasing CMBS defaults, JREIT consolidation, or a change in government policy will trigger deal flow and force distressed asset sales in Japan. The Indian economy is expected to be on a path to recovery, particularly on account of a revival in domestic demand as recapitalisation by players in equity markets across Asia has been successfully replicated by some Indian developers.



Regional investment flows have also changed significantly. Allocations to Asia from Western institutions continue, but at a much-reduced level. The Lehman Brothers bankruptcy and recent developments in Europe have impacted the region. Significant amounts of money have been withdrawn from the region by investment banks that want or need the capital for other purposes. In their absence, regional investors have stepped up to replace these sources of capital. Similarly, Asian investors are now looking to place funds in the West as more distressed opportunities begin to appear.

Major deals in the region include:

- China/Hong Kong: In January 2010, CapitaLand China (RE) Holdings Co. Ltd., a wholly owned subsidiary of CapitaLand Limited, a listed Singapore based real estate and hospitality company, agreed to purchase from Orient Overseas (International) Limited, a listed Hong Kong-based company, the entire issued share capital of Orient Overseas Developments Ltd., a Hong Kong based real estate developer, for a consideration of US\$2.2 billion. The consideration is to be fully paid in cash at completion.
- Japan: Two listed Japan based real estate investment trusts (REIT), Advance Residence Investment Corporation and Nippon Residential Investment Corporation, merged in March 2010. The merged investment corporation will have fully-diversified portfolio and is expected to become one of Japan's largest REIT in terms of asset size. The new entity is expected to have assets of around ¥370 billion (US\$4.13 billion).
- Japan: United Urban Investment Corporation, a listed Japanese real estate investment company, has agreed to acquire Nippon Commercial Investment Corporation, a listed Japan based REIT. Post transaction, United Urban Investment Corporation will be the surviving entity and Nippon Commercial Investment Corporation will be delisted from the Tokyo Stock Exchange. The transaction is expected to be completed on 1 December, 2010.
- China/Hong Kong: Shanghai Industrial Holdings Limited, a listed Chinese industrial conglomerate, acquired a 45% equity interest in Neo-China Land Group (Holdings) Limited, a PRC property developer listed in Hong Kong, with a consideration of US\$1 billion through its wholly owned subsidiary, Novel Good.
- Australia: Lend Lease Consortium, including Lend Lease managed funds, is to acquire the 14 assets held by the AUD\$1.4 billion ING Retail Property Fund. The transaction builds upon Lend Lease's investment management and retail platforms and its model of investing alongside other investment partners. Lend Lease expects to contribute up to circa 20% of the capital required for the transaction.
- India: A management buy-back by the promoters of DLF Ltd., one of the largest real estate developers in India, through a 36% stake acquired from DE Shaw, a US hedge fund, for a consideration of around US\$500 million.

Retail & Consumer



Carrie Yu
Global
Retail & Consumer Leader

Although significantly affected by the global financial crisis, the Retail and Consumer (R&C) sector still outperformed overall GDP growth of China. The growth of consumer products sales bottomed out in the first quarter of 2009 and has since been recovering steadily together with the consumer confidence index. Government stimulus packages, including measures to encourage domestic spending, had a positive impact on the sector such as the home appliance subsidy programme in rural areas, distribution of shopping vouchers and a provision for subsidies to farmers and low income groups.

The deal market in China recovered alongside the economy. M&A activities in the R&C sector have also been booming since the second half of 2009. Sectors with major deal activity include brewery & alcohol, dairy, apparel, supermarket chains and e-commerce.

A major feature of the past twelve months is that large state-owned companies have played an active role in M&A in the R&C sector including some notable outbound deals. For example Bright Food, the top Chinese food company's proposal for acquisition into CSR, the largest raw sugar company in Australia and China Investment Corporation's investment in Diageo, a world-leading alcoholic beverage company.

An exciting new development in China's capital market during the last twelve months is the opening of Chinese GEM (growth enterprise market), which greatly stimulated China's M&A market. Companies listing on the GEM include some leaders of rising niche markets in the R&C sector including Tread, an outdoor-wear company.



Greg Unsworth
Asia Pacific
Technology Leader

Whilst the global financial crisis severely dampened deal activity, the technology sector has weathered the storm better than most. M&A activity was significantly down in 2009, with global deal volume and value falling by 48% and 60%, respectively. The tide appears to be turning however, with a number of major transactions announced in 2010 and private equity returning to the market. This indicates a potential major upturn in deal activity.


Globally it is expected that the recovery will be driven by a number of larger transformational deals driven out of the US and the pursuit of growth in emerging markets in Asia and Latin America. Service offerings are being broadened to meet the demands of customers for more integrated solutions with technology companies expanding their capabilities to respond accordingly. The capital markets have also bounced back strongly in the first half of 2010 although it remains to be seen whether the momentum can be maintained through the rest of the year. Sceptics will note that there has not been such a notable outperformance of technology stocks since the dot-com bubble of 2000.

Turning to the region, Asia Pacific continued to increase its influence with its share of global technology deals increasing to 25% of all global deals (up from just 13% in 2008). There were 571 technology deals announced in Asia Pacific in the first half of 2010 compared to 858 deals for the second half of 2009 and 754 deals for the first half of 2009. Whilst deal levels were lower comparatively in the first half of 2010, there are more recent signs of a renewed focus on strategic acquisitions for growth.

In reviewing deal activity, the main theme for the last 18 months has been around industry consolidation. This was demonstrated by a number of large deals in the highly cyclical semiconductor sector in Japan, China, Taiwan and Singapore. The semi-conductor industry was particularly heavily impacted by the global economic crisis and some of the larger deals have included the Renasis acquisition by NEC for US\$5.3 billion in Japan, Innolux Display's acquisition of Chie Mei in China for US\$11.6 billion and the acquisition of Chartered Semiconductor for US\$3 billion by United Arab Emirates based, Advanced Tech Investment.

Other large technology deals included Tech Mahindra's acquisition of the troubled Indian software provider, Satyam, for US\$352 million and the purchase of Softbank IDG's data centre services business by Yahoo in Japan. With brighter economic prospects and increased investor confidence, it is expected that there will be more interest in software and solutions providers given increasing levels of automation and digital transformation.

In particular, an area attracting significant attention is the development of cloud computing solutions and software as a service (SaaS). Whilst efforts are being lead by significant players such as Salesforce.com for SaaS offerings and Internet powerhouses, Google and Amazon for infrastructure as a service (IaaS), the more established IT leaders including IBM, HP and Microsoft are also developing and promoting their service offerings extensively. This will drive significant industry collaboration and increased M&A is expected to follow. Cloud computing offerings are still at an early stage of evolution, although it is becoming clear that this will have a major transformational impact on technology service providers and business as a whole, as enterprises increasingly look to "the Cloud" to meet their IT needs.



North Asia continues to dominate the technology scene in Asia Pacific with more than 80% of the value of Asia Pacific deals announced in the markets of Japan, China, Korea and Taiwan. Whilst a number of the larger transactions in China are driven by an interest in investing in growth markets, by comparison, much of the transaction activity in Japan has been to achieve consolidation.

Consumer electronics is another area of interest with significant investment in the next generation of LCD and other display technologies, particularly in Korea, Japan and Taiwan, whilst advanced smart phone handset production is driving growth for mobile technology manufacturers. Digital transformation is driving cross sector activity with a number of technology companies also buying into telecoms equipment manufacturers and service providers. It is expected that this trend will continue as technology companies seek growth in on-line and mobile offerings.

Overall, the technology deal pipeline is looking increasingly strong with Asia Pacific likely to be a key area targeted for strategic growth. Investment is being made to capture growing enterprise and consumer demand in the larger emerging markets of China and India. This will continue to attract the attention of all leading global technology companies as well as newer market entrants expanding in the region.

Transportation & Logistics



Alan Ng
China/Hong Kong
Transportation & Logistics Leader

The operating environment continues to exhibit signs of recovery in the transportation and logistics industry since the financial crisis in 2008. The critical question is whether the recent market improvement is temporary or represents sustainable demand. Greater use of minority stakes in deals and an increase in local market deals in the first half of 2010 indicate that investors are still holding a prudent view towards the recovery.

Demand for freight and logistic services in the Asia Pacific region were the first to rebound in early 2010 after the global economic recovery, as businesses started restocking inventory. China, as a driving force behind the worldwide economic recovery and as an export-driven market, was a key driver in the high level of shipping trade in the Asia Pacific region.

In the current market, companies with strong balance sheets, robust cash reserves and access to capital are looking for strategic merger and acquisition opportunities. They are pursuing deals with a focus on synergies that will enhance productivity, enable cost savings and add value to their businesses.

For instance, Tanayong Public Company Limited (Tyong) acquired a 94.6% interest in Bangkok Mass Transit System Pcl (BMTS) at a consideration of THB\$40 billion (US\$1.3 billion). Tyong merged with BMTS in a reverse takeover and changed its name to BTS Group Holdings Public Company Limited (BTS). Management expects the acquisition to enhance BTS's competitiveness in the real estate development business and increase the attractiveness of its share price through increased market capitalisation.

In addition, some highly leveraged transportation and logistics companies faced liquidity challenges when paying back their debts due to unfavourable capital market conditions during the economic downturn. These companies have become attractively valued targets and will attract strategic investors who have excess cash.

According to the M&A statistic provided by Thomson Financial, 176 transportation and logistics related deals with a total value (including net debt of target) of US\$11.5 billion were announced in the first half of 2010. This contrasts with 160 deals with total value (including net debt of target) of US\$6 billion announced in the first half of 2009, which shows a significant increase in terms of deal value in the first half of 2010. This growth was mainly attributed to a growing number of strategic buyers and more attractively valued investment opportunities available in the market. The increase in deal value in the first half of 2010 is also driven by one mega-deal, with Japan Airlines being acquired by Japanese government-backed, The Enterprise Turnaround Initiative Corporation of Japan.

Outlook

Economic growth was not as strong as expected in the second quarter of 2010 but was still a significant improvement when compared with 2009. The positioning of acquirers to engage in deal activity continues to improve, supported by generally higher levels of traffic as well as better liquidity and capital market conditions.

In the Asia Pacific region, we expect that the growth will still largely be driven by the China export market. Reports on Chinese manufacturing showed that production in the country surged, pointing to a full recovery in 2010. It implies that the demand for transportation and logistics service should be sustained throughout 2010. Rising expectations for economic growth should encourage those acquirers that have remained on the sidelines to re-enter the deal market.

Reference:

Top 10 completed deals in the first half of 2010 in Asia Pacific region are tabled below.

Acquirer	Target	Region	Deal size (US\$ m)
1. Tanayong PCL	Siam Rail Transport and Infrastructure Co Ltd	Thailand	758.5
2. Tanayong PCL	Bangkok Mass Transit Sys PCL	Thailand	603.5
3. Hanjin Shipping Holding Co Ltd	Hanjin Shipping Co Ltd	South Korea	397.6
4. Chinese state-owned National Council for Social Security Fund	AVIC Intl Holding Corporation	China	177.4
5. Undisclosed acquirer	Hanjin New Port Co Ltd	South Korea	176.8
6. An investor group, comprised of Air China Ltd and Total Logistics (Shenzhen) Co Ltd	Shenzhen Airlines Co Ltd	China	150.9
7. Auckland International Airport Ltd	North Queensland Airports	Australia	123.3
8. STX Corp	STX Pan Ocean Co Ltd	South Korea	121.0
9. Cahaya Pratama Lestari PT	Mitratama Perkasa PT	Indonesia	120.0
10. Falcon Energy Group Ltd	CH Offshore Ltd	Singapore	101.0

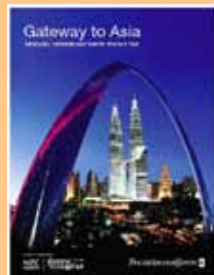
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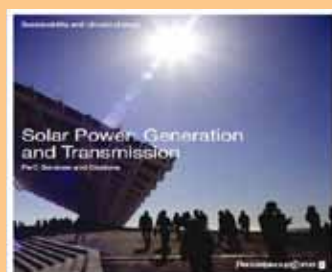
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