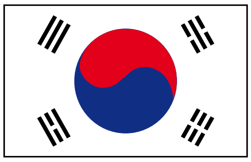

North Asia
Korea

Cautious optimism for 2010 with M&A activity expected to increase with ongoing restructuring of conglomerates and privatisation of state-run firms

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Current Environment

The Korean economy was one of the few economies not to enter a technical recession in 2009, posting positive growth of around 0.2% for 2009. Although exports started to rebound towards the end of 2009, government stimulus and low interest rates propped up domestic demand and kept the economy resilient throughout the year.

The Korean government played a key role in driving growth, spending nearly 3.6% of GDP in 2009. Government spending focused on job retraining efforts, tax cuts for the poor, assistance to troubled companies, and subsidies for firms promoting "green" products.

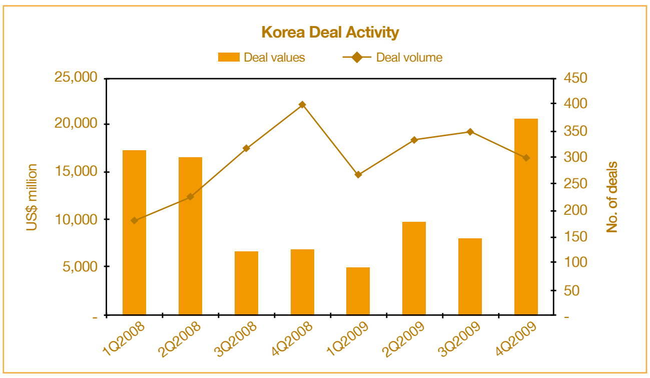
Exports declined roughly 14% year-on-year in 2009 resulting from lower demand in the US and EU. While Korean exports were lower for the year, the first half of 2009 witnessed a substantial drop off (a continuance of late 2008), but exports gradually accelerated during the year ultimately growing by 33.7% year-on-year in December, albeit from a much lower base. In particular, bellwether exports such as automobiles and IT products were down 20% and 8%, respectively; this fall in key exports was in spite of Korean auto and consumer electronics firms gaining substantial market share in western markets with aggressive pricing strategies. Although exports were sluggish, imports were hit harder as lower demand for intermediate goods and commodities resulted in a 26% decline for the year, resulting in an overall trade surplus of US$41 billion for 2009.

Domestic demand remained sluggish throughout 2009 as hesitant firms and consumers retrenched behind a feeling of economic uncertainty. Construction investment marginally ticked upward by 2% in 2009, as government stimulus boosted activity in the industry. However, as lower interest rates fed liquidity into the economy, the Bank of Korea (the central bank "BOK") tightened loan standards for property purchases, denting end user demand. Korean firms slashed capital expenditures roughly 6% in 2009 as flat revenues and concerns over ongoing viability focused efforts on restructuring and increasing efficiency in existing operations. Consumer sentiment, although depressed at the beginning of the year, spiked to a seven-year high in September. More optimistic sentiment coupled with greater certainty over a stable labour market and greater access to credit, led to a projected gain of 2% in personal consumption in 2009.

The BOK continued its loose monetary policy throughout 2009, leaving interest rates untouched at 2% in order to promote liquidity and increase credit allocation. An accommodating monetary policy, combined with positive sentiment over future economic prospects, spurred gains in the country's equity markets. The Korean equity markets had robust gains with the KOSPI up 45% and the KOSDAQ rising nearly 64% for the year. The global economic crisis and lower commodity prices slowed Korea's inflation rate to a 2.5% increase in 2009. Inflationary concerns came to the forefront at the end of the year, however, as the CPI gained 2.8% year-on-year in December of 2009.

The Korean won followed a highly volatile path in 2009, as overseas and changing economic dynamics influenced the exchange rate. The won started the year marginally below 1200 to US$1 and spiked to nearly 1600 to US$1 after the potential bankruptcy of Chrysler and GM roiled international markets in the first quarter of 2009. Ultimately, a stronger domestic economy and stable outlook for global markets led to a gradual appreciation with the won ending the year stronger at roughly 1150 to US$1.

Deal Activity



Source: Thomson Reuters, based on total domestic, inbound and outbound deals announced as of 31 December 2009.

M&A deal values decreased 8% year-on-year in 2009 to US$43.5 billion while overall deal volumes gained 12% year-on-year to 1,250 transactions for the year. Cross-border M&A continued to remain strong in 2009 as both inbound and outbound deals registered positive growth (9% and 12% in deal value, respectively), with inbound value registering a robust 28% increase in deal transactions. While data for cross-border deals are impressive, they are somewhat skewed by the KKR-OB deal that concluded in the first half of 2009 for US$1.8 billion. Overall, increases in deal volume were also bolstered by chaebols restructuring and spinning off underperforming units.

Some of the significant announced transactions of 2009 include:

- In July, GS, one of Korea's largest chaebols, purchased a controlling 69.6% stake in the Ssangyong Corporation for KRW130 billion (US$103.1 million). GS purchased the stake from Morgan Stanley who initially purchased the stake in 2006. The purchase, among other things, will provide new synergies allowing GS to tap into Ssangyong's global distribution network, particularly in importing gas and crude oil.

- In September, Doosan Heavy Industries and Construction purchased 100% of Czech power plant equipment maker Skoda Power for US$657 million. Through the acquisition, Doosan boosted its power plant equipment portfolio for boilers, turbines, and generators. The deal also boosted Doosan's presence abroad and its ability to compete in US and European markets.

- In October, Korean retailer Lotte won an auction to purchase a 72.3% stake in the Chinese retailer Times for US$625 million. Lotte acquired the remaining outstanding shares in a tender offer to minority shareholders. The acquisition will greatly boost Lotte's presence in China adding 65 stores in the southern province of Jiangsu. The transaction is pending approval by Chinese antitrust authorities.

- In October, Korea National Corporation acquired Canada's Harvest Energy Trust for US$4 billion. The transaction represented the largest acquisition by a Korean firm abroad to date, and indicated a more aggressive posture by Korean state-owned firms in acquiring assets overseas. KNOC offered to pay US$1.7 billion in cash and take on US$2.3 billion in debt in order to finance the deal. The deal was one in a long list of acquisitions by state-owned energy companies looking to purchase assets overseas.

- In December, LG Household and Health Care purchased a 90% stake in the country's third-largest cosmetic company The Face Shop, from Affinity Equity Partners for KRW420 billion (US$363.1 million). LG is slated to acquire 100% of the company after a two-year time period. The acquisition is a move by LG to gain access to the profitable lower and middle segments of the domestic market, while bolstering its overall position in the sector.

- In December, KNOC purchased Kazakstan's Sumbe (along with a Kazakh partner) for US$335 million, acquiring 100% of the oil producer which owns the two main oilfields in the country. The acquisition will give KNOC access to the valuable oil sector in Central Asia.

- In December, SK Telecom, the country's top mobile carrier, entered the country's credit card market by purchasing a KRW400 billion stake in Hana Financial Group. SK Telecom is slated to receive 49% of Hana Card, providing the telecom company a platform for further expansion in the nation's profitable credit card industry. SK Telecom plans to use the venture to increase synergies between the mobile phone (smart phone) and credit card markets by cross-selling products to consumers.

Outlook

The Korean economy is expected to grow by 4% in 2010 driven by a rebound in exports, corporate investment, and personal consumption. Although a fairly robust recovery is projected, there are numerous headwinds that might adversely impact growth prospects such as a slower than expected recovery in western economies and China and a substantial increase in commodity prices.

Korea's exports are expected to grow 14% in 2010 on the back of an increase in IT, automobile and petrochemical exports. Although Korea has actively diversified into different export markets over the past several years, emerging markets were also negatively impacted by a general downturn in the world economy. With prospects for emerging markets expected to improve in 2010, the diversification strategy is expected to pay dividends. Imports are also expected to increase from 2009 levels as firms increase production and consumption of intermediate goods used in production. As a result, Korea's trade surplus is expected to decrease as the gap between exports and imports narrows.

Domestic demand is also forecasted to increase in 2010. Personal consumption is projected to increase 3.1% supported by a stronger labour market as firms start hiring workers and wage levels gradually recover. Domestic firms are also forecast to increase capital expenditure this year by roughly 8% as years of decreased spending coupled with an increasing need to replace inventory and innovate new products, drives greater investment. Finally, construction spending will marginally increase as the government continues to deregulate allowing for more flexibility in real estate transactions.

The major domestic issue will be the restarting of President Lee Myung Bak's ambitious economic reforms after a brief respite due to the global financial crisis and economic slowdown. A key aspect will be further reforms in the labour market that will focus on allowing greater flexibility in the hiring and firing of workers and greater competitiveness when hiring union workers.

From an M&A perspective, another priority in 2010 will be the restarted privatisation and government auction of a number of large firms including financial entities such as KEB and Woori Financial, as well as Hynix, Daewoo Shipping and Hyundai Engineering. On the back of these proposed sales, the outlook for M&A in 2010 is certainly more optimistic based on an established pipeline of blue-chip companies for investors. M&A deal value and volume will likely increase in 2010 driven by deals in the financial sector and increased privatisation and conglomerate restructuring.

Financial Services Sector

Korea's financial services sector will continue to undergo consolidation as a result of government deregulation and greater industry consolidations as valuations and liquidity recover after a prolonged economic slump. After the Capital Market Consolidation Act (CMCA) went into effect in 2009, consolidation efforts were slowed by increasingly cautious banks and regulators. As the economy gradually improved and equity market valuations recovered, banks are looking to increase their scope through acquisitions. Slated auction sales will likely serve as one catalyst, as two of the country's largest banks, KDB and Woori, will likely be sold off in the near-term. In addition, the sale of other assets such as the stalled sale of KEB, might also occur. A number of financial institutions in Korea have tapped capital markets in order to build war chests for acquisitions in the sector.

Corporate Restructuring

After the brunt of the global financial and economic crisis has assumedly passed, many domestic firms are still seeking ways to improve efficiency and spin off underperforming units which should drive M&A activity in the future. Kumho Asiana, one of the nation's largest conglomerates, announced a large restructuring that will likely include asset sales of their insurance arm (Kumho Insurance) as well as engineering and construction (Daewoo Engineering and Construction) in order to streamline operations. Other large restructuring deals are expected as the Korean government has established a private equity fund (via KDB) to help firms who need financing and restructuring expertise. ■