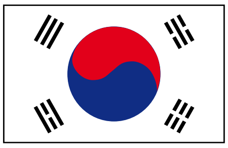


Korea

A temporary slowdown in deal activity, but fundamentals remain strong for the mid-term

Current Environment

In the first half of 2008, the Korean economy is expected to grow by 5.1%, a mild deceleration from the 5.5% growth rate achieved in the second half of 2007. With the economy facing a tough environment going forward, including high oil prices and a slowing global economy, moderate growth is forecast through the rest of 2008. The new administration assumed power in February, and has promoted economic policy reforms including greater industry deregulation, lower corporate taxes, and privatisation of state-owned enterprises ("SOEs"), which should help boost the economy's long-term economic competitiveness. In addition, the Korean government is in negotiations with the European Union ("EU") and India to complete free trade agreements that are likely to conclude in the near term. Finally, geo-political tensions on the Korean Peninsula seem to be stabilising further after the United States removed North Korea from its list of "State Sponsors of Terrorism" in June after North Korea handed over a dossier of its nuclear arms programme to China.

The Korean Composite Stock Price Index ("KOSPI") and KOSDAQ markets registered losses in the first half of 2008 after a prolonged period of growth in 2007. The KOSPI was down approximately 9% for the year at the end of June, while the KOSDAQ shed roughly 16% over the same time period. Losses on the Korean bourse were largely a result of sluggish global equity markets in the wake of the US sub-prime mortgage crisis, as well as concerns over slowing growth and escalating inflationary pressures in the domestic economy. Foreign investors were net sellers in 2008 unloading nearly US$15 billion worth of domestic equities in the first half of the year. While some institutional and retail investors still displayed an appetite for equities, foreign ownership of Korean equities (as a total percentage of domestic stock ownership) fell close to 30% in April, down nearly 14 percentage points from its peak of 44% recorded in April 2004.

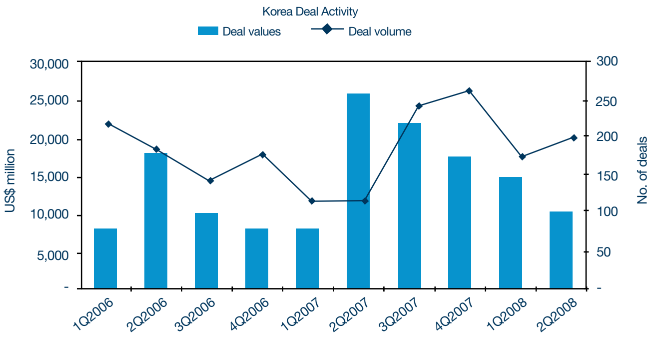
Resilient exports drove growth in the first half of 2008 offsetting sluggish individual personal consumption and corporate investment. Exports underwent 21% year-on-year growth through May on the back of increasing shipments to emerging markets that offset slowing sales to the US and EU markets. For the first half of the year, exports to ASEAN, China, and the Middle East, all posted double-digit growth with particularly strong sales in machinery, petroleum products, and wireless communications equipment. Import growth (measured by total value) also posted a solid increase in the first half of 2008 due to escalating costs for oil and raw materials. In fact, import value rose 5.2% in the first quarter of this year exceeding export values of 1.9%, contributing to Korea's overall trade deficit.

Consumer spending saw 3.4% growth in the first half of 2008. While spending remained strong in niche markets such as luxury goods, overall consumption moderated as record high oil prices and sluggish wage growth dented consumer confidence. Consumer price inflation ("CPI") averaged 4.1% in the first five months of the year exceeding the 3.5% upper band limit of the Bank of Korea's inflation target in every month. The Korean won's broad-based depreciation started in February, and amplified inflationary pressures by decreasing consumers' real purchasing power. The won's effective exchange rate (measured against a basket of currencies) fell 12% in the first half of the year; the won also depreciated 10% against the US dollar and 15% against the Japanese yen over the same time period. While there are likely numerous reasons behind the won's downward trajectory, Korea's deteriorating balance of payments position likely played a role as it recorded the largest current account deficit in January since 1997.

Capital investment was forecast to grow 1.5% in the first half of 2008 on the back of sluggish investment in facilities and construction. Tepid domestic consumption, coupled with concerns over a decelerating global economic growth, contributed to lowered corporate sentiment and an overall cutback in corporate spending. While investment in facilities noticeably decelerated, registering 2.6% growth in the first half, some manufacturers (most notably basic machinery and shipbuilding) continued to invest in factories and equipment on the back of robust new orders. Construction was projected to grow a meager 0.3% as a result of overhang in existing housing supply combined with a strong first half 2007 investment figures due to government fiscal frontloading.

The Bank of Korea ("BOK") kept interest rates fixed at 5% throughout the first half of 2008 as it faced a complex economic environment of slowing growth and escalating inflationary pressures. Facing the likelihood of further high oil prices and a rapidly depreciating won, however, the BOK's previous "pro-growth" bias will likely be replaced with a more hawkish stance on inflation moving forward.

Deal Activity



Source: Thomson Reuters, based on total domestic, inbound and outbound deals announced as of 30 June 2008

Deal values in H1 2008 were noticeably lower compared to H2 2007: total deal value was US$24.8 billion for the first two quarters of 2008, an approximate 37% decline from the third and fourth quarters of 2007. The total number of transactions also contracted 26% from 506 in H2 2007 to 376 in H1 2008.

Cross-border M&A remained resilient in H1 2008 totalling US$7.9 billion (inbound: US$1.2 billion, outbound: US$6.7 billion). Although this represented a 37% drop in value from H2 2007, one large cross-border transaction, HSBC's acquisition of Korea Exchange Bank, accounted for roughly 25% of that period's announced total value (although not yet completed). Cross-border M&A transactions also fell 26% during the same time period from 101 transactions in the second half of 2007 to 75 in the first half of 2008. In the near- to mid-term, cross-border M&A will continue to be a significant component of transaction activity in Korea. In fact, M&A in 2008 is likely to be dominated by Korean firms with strong balance sheets looking to deploy surplus cash abroad by expanding overseas and acquiring operational expertise and technology to build further economies of scale.

Some of the more significant announced transactions include:

- On 15 January, Korea Investment Corp ("KIC") announced it would invest US$2 billion in Merrill Lynch, a top US investment bank negatively impacted by the sub-prime mortgage issue. This was KIC's first strategic investment since the Korean government lifted restrictions on overseas investments last November and is a sign that KIC is shifting away from its previous low-risk, low-return platform.

- In February, Eugene Group, a Korean construction conglomerate, acquired Himart, the nation's largest home appliance distribution company, from a consortium of investors for US$1.95 billion. The Eugene Group, which also acquired parcel delivery service firm Logen in 2007, saw the acquisition as part of a strategy to maximise synergy between the Group's logistics and retail arms.

- In March, a consortium led by Kumho Asiana Group, a conglomerate with operations including logistics and transportation, signed a formal deal to acquire a controlling stake in Korea Express, the nation's largest logistics company. The Kumho Asiana consortium paid a total of US$4.3 billion to acquire 60% (or 24 million newly issued shares) of Korea Express. The acquisition is expected to impart particular benefits to two firms in the Kumho Group: Asiana Airlines will be able to expand its existing cargo service to include inland freight offerings, and Daewoo Engineering and Construction will be able to augment existing overseas logistical capabilities.

- In March, Kookmin Bank, Korea's largest bank, announced a 30% share acquisition of Bank Center Credit JSC ("BCC"), the fifth largest bank in Kazakhstan, for US$634 million. Kookmin also agreed in principle to acquire an additional 20.1% of newly issued BCC shares by 2010 through purchases on the local stock market. Kookmin's acquisition is significant for two main reasons. First, once the deal is completed, it will be the largest cross-border M&A transaction ever completed by a Korean financial group. Second, the deal represents Kookmin's formal entrance into the Commonwealth of Independent States ("CIS") growing banking market where it hopes to tap increasing local demand for lending and investment services to diversify revenue streams.

- In May, UK retailer Tesco agreed to acquire 36 Homever discount stores from E-Land, the country's second largest retailer. The deal, Tesco's largest acquisition ever, was estimated at US$1.9 billion. The acquisition will help improve Tesco's market position in the competitive South Korean retail industry which already includes operating 66 Homeplus hypermarket stores and 72 Homeplus Express stores jointly with the Samsung Group.

- In June, Hyundai Heavy Industries signed a Memorandum of Understanding to acquire stakes in CJ Investment Securities ("CJIS") and CJ Asset Management ("CJAM"). Hyundai Heavy Industries and affiliated units - Hyundai Mipo Dockyard and Hyundai Samho Heavy Industries - plan to acquire 73.7% of CJIS and 7.4% of CJAM in a deal estimated at roughly US$800 million. If successful, this is the Hyundai Group's second major acquisition in the financial sector after affiliated Hyundai Motor Company acquired a 30% stake in Shinheung Securities in February 2008 for US$209 million. The Group is looking to increase its profile and value-added service offerings in the domestic financial industry that is currently limited to commercial and consumer lending in the affiliated Hyundai Card and Hyundai Capital operations.

- In June, Korean shipbuilder STX offered to increase its existing stake in Norwegian shipbuilder Aker Yards. STX previously acquired a 39.3% stake in Aker Yards for US$800 million in October 2007 as a means to gain a foothold in the value-added cruise shipbuilding industry. STX's new offer would raise its total stake in Aker to 47.2%, crossing the 40% ownership threshold set by the Oslo Stock Exchange and triggering a mandatory bid offer for the rest of Aker Yard's shares.

Outlook

Korea's annual growth rate is forecast to reach 4.3% in 2008 on the back of resilient exports and moderate corporate investment and personal consumption in the second half of the year. A weaker won, as well as continued diversification of export markets, should play a key role in propelling exports to grow 15% in the second half of 2008. On the domestic demand front, personal consumption is forecasted to remain dampened throughout the second half of the year growing 3.2%, reflecting the toll on consumers of rising inflation and moderating wage growth. The Korean government's announced $10 billion stimulus package (a portion of which will be given to subsidise energy companies' losses) will be implemented in the second half of 2008, and may marginally boost consumption. Corporate investment is expected to grow 3.5% in the second half as manufacturers increase investment in facilities as robust demand in emerging markets continue; construction investment will likely remain sluggish due to existing tax regulations suppressing demand and an existing backlog of homes and apartments.

Interest rates will be subject to upward pressure in the second half of the year as excessive liquidity amplifies the effects of higher energy costs increasing the likelihood of higher core inflation and second-round inflation effects. The potential downside risks to economic growth outstrip the upside risks in this forecast; if the current slowdown in the US deepens or spreads to the European Union (with its attendant consequences on Asian export growth), or oil continues to remain at historical highs, economic growth could noticeably decelerate.

Looking ahead for the second half of 2008 and into 2009, M&A volumes are likely to be driven primarily by consolidation in the financial services sector, privatisation of SOEs and cross-border/outbound M&A.

Financial Services sector

The financial services sector will be a main driver of M&A activity as firms prepare for the implementation of the Capital Markets Consolidation Act ("CMCA") in February 2009. The CMCA will break down existing regulatory firewalls between different financial service offerings in order to help build globally competitive financial conglomerates and investment banks. In addition, the Act will give firms more flexibility in developing new products that will likely mean more integrated financial product offerings.

Largely as a result of industry anticipation, consolidation is rapidly occurring across all financial industries as larger players move to increase their scale and initiate or deepen existing service offerings. This trend has been particularly attenuated in two sectors: securities and insurance. The securities industry in Korea, arguably the least developed and most fragmented, is still dominated by small- to medium-sized firms who earn a majority of revenue through brokerage commissions. Securities firms' business model, however, is evolving as larger brokerage houses now offer value-added services (such as wealth management) in the hopes of securing higher margins to offset declining trading commissions. Indeed, impending deregulation, combined with the shifting competitive landscape, drew large strategic and non-strategic investors alike to conduct deals in 2007. Strategic investors, such as Kookmin Bank, acquired brokerage house Hannuri Investment and Securities in late 2007. A host of chaebols (conglomerates) are also entering into the industry to diversify revenue streams, increase overall returns, and increase their footprint in the financial services sector. Hyundai Heavy's bid for Shinheung Securities will likely serve as a harbinger as other chaebols such as GS and Lotte are also rumoured to be looking for potential targets.

The insurance industry is also undergoing rapid change as the need to build economies of scale is driving increased deal activity. With the existing dominance of large conglomerate players, coupled with the increasing entrance of foreign providers, the industry's competitive landscape is undergoing change. This is particularly true as the Korean government announced it would allow domestic insurance firms to apply for IPOs for the first time in 2007, combined with the already expected effects of further deregulation due to the CMCA. Anticipation of increased industry competition has already led to a flurry of activity in the non-life insurance sector where a consortium of investors led by the Lotte Group signed a formal agreement to acquire Daehan Fire and Marine Insurance in January. In addition, Meritz Fire and Marine Insurance, the nation's fifth largest property insurer, made a public tender bid to acquire a 20.68% stake in First Fire and Marine Insurance Company in April. Foreign insurers also see increasing opportunity as the Korean insurance market is liberalised: Aviva, the world's fifth largest insurance group, in concert with Woori Finance announced it would buy a 91.65% stake in LIG Life Insurance for US$145 million. HSBC Insurance also announced a joint venture with Hana Financial Group in March to form HSBC Life.

Government privatisation and restructurings

Plans to sell assets from successful financial restructurings and government plans to privatise state-owned enterprises will also drive activity in the M&A market over the near-term. As a result of the Asian financial crisis in 1997, many large Korean firms experienced financial difficulties and went through court-based restructurings that often featured debt for equity swaps with creditors, including several government-owned financial institutions. As these firms (many of them blue-chip chaebols) have emerged from restructurings, creditors sought to sell their stakes in auctions to recoup their investment. While many deals have already taken place, there is a solid pipeline of future deals including: Daewoo Shipbuilding & Marine Engineering, Hyundai Engineering & Construction, Hynix, and Daewoo International Corporation slated to be auctioned off in the future.

In addition, the Korean government announced in March a privatisation programme that could see the sale of the whole or part of some of Korea's nearly 350 state-owned enterprises. A main highlight of this privatisation plan will see the government sell off stakes in three of the country's largest financial institutions over the next two years (depending on market conditions): Industrial Bank of Korea, Korea Development Bank, and Woori Financial Group. While the Korean government is likely to retain a majority interest, it has stated it will seek investors through a variety of options potentially including strategic private placements, auctions, and IPOs. Besides banks, the government has identified a slate of deals in industries including rail, ports, logistics, utilities and energy, and land management.

Cross-border and outbound activity

The value and volume of cross-border and outbound M&A has steadily increased over the past few years, and will continue to play a major role in Korea's deal environment going forward. As Korean conglomerates continue to seek growth opportunities in a rapidly maturing domestic market, tapping new markets and acquiring brand, operational, and technological expertise is a top priority. In 2007, Doosan Construction's acquisition of three units from US manufacturer Ingersoll-Rand and STX's stake in Aker Yards illustrated Korean firms' strategic use of M&A to build up operational experience in new product segments and move up the industry's value-added chain. This trend has further intensified in the first half of 2008 and is expected to continue. Additionally, the divestment of non-core operations by domestic conglomerates may begin to contribute to deal activity in the mid- to longer-term.