



# Asian M&A: A sustainable future?

*With the global downturn hindering M&A activity, in-house counsel will have to be aware, more than ever, of the trends currently affecting activity levels in Asia Pacific, and plan strategically to get ahead. Rebecca Brookes investigates.*

**A**fter several decades of western and Japanese merger and acquisition (M&A) activity dominating Asian markets, the region has begun to steadily increase its proportion of investments in recent years, both domestically and outwardly into mature western markets. A significant drop in activity levels in the past year has seen Japan's mantle as a Far East leader of outbound activity largely pass to China, which is increasingly flexing its muscles as a major economic power. As Chinese companies have become large exporters of capital in their own right, using M&A as a vehicle by which to gain exposure to sophisticated companies and markets, technology, brands and distribution systems, so too has India flourished in the past decade as a forum for fund-raising and M&A activity. According to research firm Dealogic, more than 1,000 international mergers or acquisitions were announced between 2000 and 2008 in India, worth more than US\$72 billion.

Despite Asia's mounting profile in the M&A global

markets space, there is little doubt that the downturn has mired deal-making activity. According to Thomson Reuters' annual Mergers and Acquisitions review, as global emerging markets activity tumbled in the first quarter of 2009 from once loftier heights, with evidence of a 48.9 percent decline, so too did the volume of Asia Pacific mergers and acquisitions fall following the onset of the financial crisis, with activity levels plunging 43.7 percent (Asia Pacific ex Japan) compared with the same period last year. As David Putnam, managing director and head of Asia Pacific Investment Banking at Houlihan, Lokey, Howard & Zukin, explains, "There are companies looking for bargains but in reality, there are not many of these companies around. Most companies just need to save money – conserve their cash to stay alive – and consequently M&A takes a back seat however attractive prices might be on a historical basis."

#### Trends in 2009

Whilst individual markets, most notably China and Aus-

tralia, have continued to show relatively strong activity levels, they have not escaped the issues affecting M&A deals elsewhere across Asia Pacific and on a more global scale. These trends can be summarised as follows:

- firstly, the market is resonant with distressed assets, some of which have attracted government support and financing;
- secondly, buyers have become more selective and cautious amidst unstable market conditions, and are showing far more hesitation in 2009 to conduct deals involving private and leveraged capital;
- thirdly, there has been a significant reduction in the proportion of active transactions that are successfully completed, owing to a scarcity of capital, valuation uncertainties, and a greater risk aversion on the part of buyers and sellers; and
- fourthly, the role of regulatory oversight has gained more prominence in some jurisdictions, leaving governments to juggle the potentially conflicting situation of attracting foreign investors in order to stimulate their local markets, whilst taking protectionist measures to ensure that M&A transactions do not ultimately hurt their economies.

In light of the sensitive economic climate, in-house counsel in companies considering M&A action need to be switched-on to many factors including but not limited to political, regulatory, financing and tax considerations. Consequently, they will need now more than ever to undertake advanced and strategic planning, especially in the context of cross-border activity.

#### Industry activity

M&A industry activity across Asia in 2009 has largely mirrored global trends. With China looking to secure resources, the raw materials industry has proved by far the most resilient sector in the first quarter of 2009, claiming more than one third of all announced deals. But whilst Chinese com-

panies have been shopping for good deals, they have not limited themselves to natural resources. For example, China's Haier Group Corporation made an investment last month for a 20 percent stake in the struggling New Zealand white goods manufacturer Fisher & Paykel, who have been hit by a lull in consumer demand.

In direct contrast to recent years, there has been a marked slow-down of activity in the Financial and Real Estate sectors. According to Neil Torpey, partner and chair of Paul, Hastings, Janofsky & Walker's Hong Kong office, "Many investors who invested in 2006 and 2007, and during the first half of 2008, in some cases at a breath-taking pace, are now in asset-management mode: they are either out of money, or have money but also have the discipline (either self-imposed or imposed by their limited partners) to restrain themselves from making new investments and for now are simply looking after what they already have in their portfolios."

#### Anti-trust matters

Whilst it not unusual for countries to have protectionist legislation to safeguard sensitive industries (which historically have included the banking, media, transport and telecommunications sectors), there is some evidence to suggest that Asia's attitude to such measures is

changing. Johan Leven, Co-Head of M&A for Asia Ex-Japan at Goldman Sachs, says that for many years there has either been very little anti-trust regulation in Asia, or existing regulations which have not been vigorously enforced. Using China as an example, Leven says, "We are now seeing anti-trust rules somewhat similar to those in the United States and Europe, that are also affecting companies not domiciled in China that have previously not worried greatly about tax and anti-trust regulations. We are now finding demands on M&A anti-trust skills con-



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verging with those in the rest of the world." Putnam says that whilst China and other emerging markets are now catching up to what has been the status quo in other developed markets in Europe and the United States, "the practical application of anti-trust rules in Asia still tends to be a lot more liberal than those in Europe and the United States."



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Janet Hui of Jun He Law Offices says that despite the Ministry of Commerce's recent decisions in China imposing restrictions on some mergers and blocking the Coca Cola-Huiyuan merger from proceeding, some lawyers are continuing to overlook Chinese anti-trust measures when conducting cross-border deals, commenting, "They will file relevant applications in the United States and Europe, and only look to China at a later date." Hui says it is imperative to be aware of all anti-trust measures as early as possible. This allows the company time to meet all regulatory deadlines, and helps create an environment for the merger to meet as little resistance as possible.

When enacting new anti-trust measures, developing markets will also need to address any resulting issues of uncertainty. According to Vijay Sambamurthi, founder of Indian law firm Lexygen, the recent elections have had a very positive effect on the Indian market, with the incumbent governing party now in a much stronger position to push through reforms. However, new amendments to Indian competition law, previously inert legislation, have raised a lot of questions about how the Competition Com-

mission will function and regulate timelines of transactions, which he admits is likely going to be a concern for large M&A deals in India moving forward.

Hyeong Gun Lee of Korean firm Lee & Ko says there while there are no substantial legislative barriers to foreigners wanting to invest in South Korea, the country has experienced some significant rule changes this year with the introduction of the *Financial Investment Services and Capital Markets Act*. The Act has deregulated barriers between many financial industries, allowing investors to carry out business more easily between those sectors. After the enactment, Lee says many people thought that M&A activity would substantially change, but to date this has not been the case, undoubtedly a reflection of the economic climate.

The issue of regulatory approval of course extends to more developed markets in Asia Pacific also, and has been a hot topic in Australia in recent months. Although generally open to overseas investment, Australia's Foreign Investment Review Board applies strict policies relating to inbound investment, with foreign companies or individuals requiring regulatory approval where a proposed transaction involves the acquisition of more than 15 percent of a company with assets over A\$100 million, or where the transaction involves a sensitive industry.

The Australian government was forced to look closely at whether or not to block the proposed US\$19.5 billion strategic partnership between the Chinese state-owned enterprise Aluminium Corporation of China (Chinalco) and Australia's Rio Tinto, on national interest grounds. The transaction was set to be the biggest deal in both Australian and Chinese corporate history. Following months of negotiation between the companies, the Australian government was spared from making the decision after Rio Tinto announced the collapse of the deal on 6th June 2009, opting instead to launch a \$15.2 billion rights issue and enter a joint venture with Australian miner BHP Billiton. Rio Tinto chairman Jan du Plessis has indicated that the improvement in the financial markets provided the company with the ability to raise the equity it needed.

According to Antony Dapiran, a Shanghai-based partner with Freshfields Bruckhaus Deringer LLP, the fallen deal has implications for outbound investment that go beyond regulatory issues. "This development will strengthen views among Chinese corporates...that it may take more than cash to open the doors to deals for

them overseas. More creativity will be required in structuring deals which achieve the business goals of the parties and at the same time are acceptable to shareholders and other stakeholders, regulators and governments. Outright takeovers, equity investments and control positions may be out, and asset deals, supply contracts and soft loans may be in."

#### Treading with caution

Tom Deegan of Simmons & Simmons notes that whilst deal tables would lead you to believe there is only limited M&A activity across most sectors in Asia, the reality is somewhat different. Whilst deals are being investigated and negotiated (with law firms being involved), a significant number of active deals are failing to close largely due to valuation issues and a diminished risk appetite on the buy-side compared to 18 months ago. He notes, "There is still a gap between what sellers are seeking in the current environment, and what buyers are willing to pay. The sellers of quality assets are still unwilling to adjust their expectations downwards simply because the rest of the world is in the grip of a financial crisis."

Anne Hung, partner at Baker & McKenzie's Tokyo office, says that whilst companies are taking a very cautious approach after the market hit bottom in Japan during the first quarter, there are indications that the market might be starting to rebound. She says, "Where there are chances, the Japanese will consider them seriously. Japanese companies often have fairly good balance sheets and are supported by a strong Yen, coupled with the fact that Japan is a shrinking economy so they need to look outward." Hung notes however that Japanese companies will not open their purses too easily – in light of the economic climate, deals that get the green light tend to either have a solid projected return or are strategically important. She also believes that

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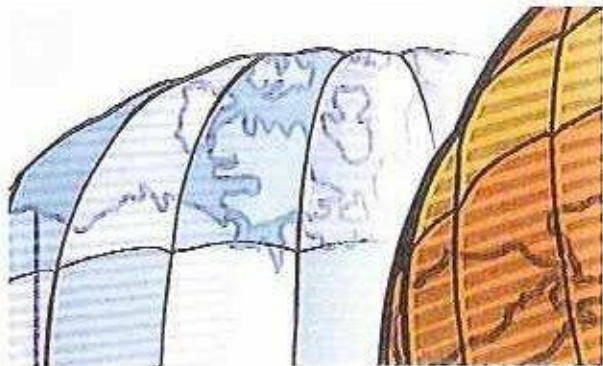
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Japan's blue-chip companies are becoming increasingly eager to form consortiums to undertake big deals, in order to share the burden of risk, and says that there is no legal framework to prevent them from doing so.

It appears that Korean companies are also largely waiting for the markets to improve. According to Lee, many large Korean companies reportedly have huge internal cash reserves but remain very concerned about the economic situation and so are refraining from investing at this time. Lee says these businesses are "already substantially globalised so when the markets do improve, they will be looking to invest in the world markets as well as domestically."

#### Taking advantage

But whilst many players are taking very deliberate, cautious steps in an uncertain market, the downturn has undoubtedly created opportunities for businesses with strong balance sheets to shop around for stakes in companies that may have been viewed as too expensive in 2006 and 2007. Leven maintains that had the crisis not occurred, we would not have seen some of the sales that have been announced in late 2008 and 2009, as it would have been easier for affected companies to refinance in other ways. He says, "In the raw materials industry, for instance, M&A





activity has been helped along by the fact that some companies have been hit by the financial crisis and have needed funding, whilst Chinese buyers have felt that share prices have dropped." Goldman Sachs advised Oz Minerals on the sale of most of the company to China's MinMetals, a transaction that has transpired owing to the fact that Oz Minerals' decision to enter into a separate merger last year had left the company with some debt. Oz Minerals' shareholders voted on 11 June 2009 to approve the acquisition. "MinMetals is now able to come in and stabilise the company," Leven says.



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#### Things to consider

Violet Ho, managing director of China operations for risk consulting firm Krill, believes that companies considering possible M&A opportunities in the current environment need to have the right attitude towards due diligence if they want to survive and ensure sustainable growth. The possibility otherwise exists, she says, for discovering issues down the track once companies have already jumped into bed with each other and then having to begin the troubleshooting process, which could be fatal in a downturn.

Ho says that companies should prioritise three things when considering whether to invest in another company, especially in China where there is often little transparency once money has been invested. "Investors need to

consider the target company's initial source of wealth, its track record, and also look at the target's additional business interests and relationships," to see if they might have any bearing on the potential investment in question. Ho says, "Companies need to take the time to understand why an investment target is trying to raise funds, and where the money will actually be going, questions which are not being asked enough. Companies might ask for a business plan, but they often fail to get down to the nitty gritty details."

#### Cross-border activity

Whilst cross-border activity has reduced in the current climate, Deegan believes that when M&A deals do come back with force, we will see a lot more intra-Asia deals as a result of continued restrictions on capital flows from North America and Europe, and more interaction between Asia and the growing Middle Eastern market, especially in terms of meeting demand for energy, infrastructure and consumer products.

In-bound activity in Japan, which has traditionally come from interest from Europe and the United States, is likely to remain quiet for the remainder of the year, with the high value of the Japanese Yen making Japan a less attractive option for foreign companies looking to invest. Conversely, M&A investment into India may not need as much encouragement. As Sambamurthy suggests, India's elections will reassure foreign investors of the growing stability of the Indian market. It is yet to be seen whether the elections will leave an impression on South African mobile giant MTN, which is currently in discussions regarding a merger with Bharti Airtel, India's biggest mobile-network operator. Although similar discussions between the companies fell through last year, if the deal is closed this time round it will result in one of the world's biggest mobile phone operators, with 200 million fixed and mobile subscribers across 21 countries.

There have also been signs of improving relations between the PRC and Taiwan, with China Mobile recently seeking to acquire a 12 percent stake in Taiwan's Far Eastone Telecommunications. The deal is currently subject to regulatory approvals, perhaps unsurprising given it involves telecommunications. Goldman Sachs advised China Mobile on the deal, and Leven says that irrespective of regulatory approval being granted, the transaction is evidence of "an exciting political thawing between the

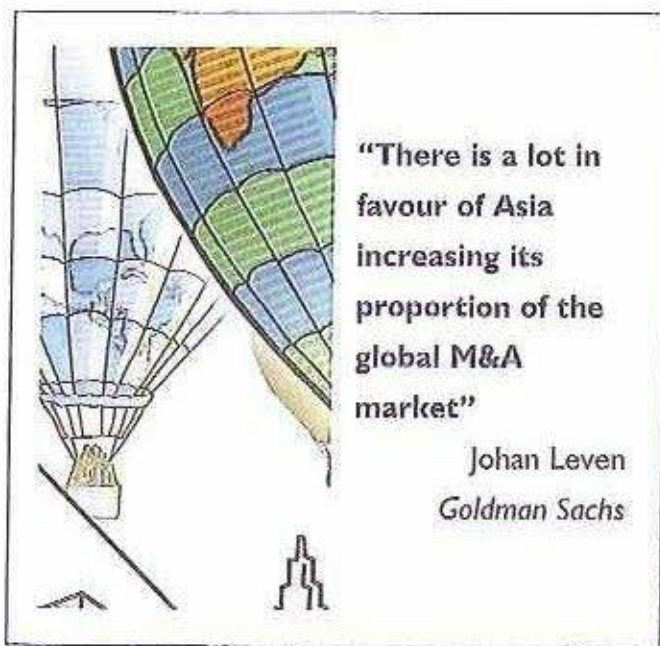
mainland and Taiwan, with the Taiwan stock market rallying after the news on expectations of more M&A activity, and with other businesses potentially interested in forming similar alliances."

It is possible that cross-border activity with Australia will also increase as the markets improve, with companies attracted to the country's stable political and economic climate, its transparent legal and regulatory framework, and its geographical exposure to China and Japan. KPMG reports however suggest that Australian companies will be reluctant to invest outside domestic markets as a result of large debt requirements and unfavourable exchange rates.

#### A sustainable future

Although recent transaction levels are considerably lower than in 2006 and 2007, it has been suggested that activity during those periods was both exceptional and unsustainable. Leven believes that when the economy does come back, "there is a lot in favour of Asia increasing its proportion of the global M&A market," noting that the downturn in M&A has been less severe in Asia than the rest of the world. He says this is, "partly due to the fact that we did not have the very large debt-funded equity buyouts that occurred in the US and Europe in 2006 and 2007."

Strengthening ties between Asia Pacific countries, for example between Australia and China and China and Taiwan, are likely to encourage intra-Asia activity, however regulatory oversight will continue to be a factor with



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national governments looking to protect their economies and sensitive industries. It is also likely that deals will continue to take longer to close, with lengthy negotiations unavoidable as a result of cautious actions and uncertainties surrounding valuations.

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## NAGASHIMA OHNO & TSUNEMATSU

#### Address

Kioicho Building,  
3-12, Kioicho, Chiyoda-ku,  
Tokyo 102-0034,  
Japan

#### Contact

Yuko Tamai (Dai-ichi Tokyo Bar Association)  
Email: [info@noandt.com](mailto:info@noandt.com)  
Tel: (81) 3-3288-7000  
Fax: (81) 3-5213-7800

#### Website

<http://www.noandt.com>