



Korea

After a slow start, M&A activity will accelerate on the back of financial services and construction deals

Current Environment

In the first half of 2007, the Korean economy is expected to grow by 4.4 percent, which was similar to the growth rate in the second half of 2006. Although the economy faces several headwinds going forward, including volatile housing prices and the appreciation of the Korean Won, South Korea's growth momentum is expected to remain intact. On the upside, the Korea-US FTA could provide substantial economic benefits to both countries while reinforcing important political and security relations. In addition, the recent agreement reached at the six-party talks on North Korea's nuclear program and the expected inspection by the International Atomic Energy Agency should significantly reduce the geopolitical risk on the Korean peninsula.

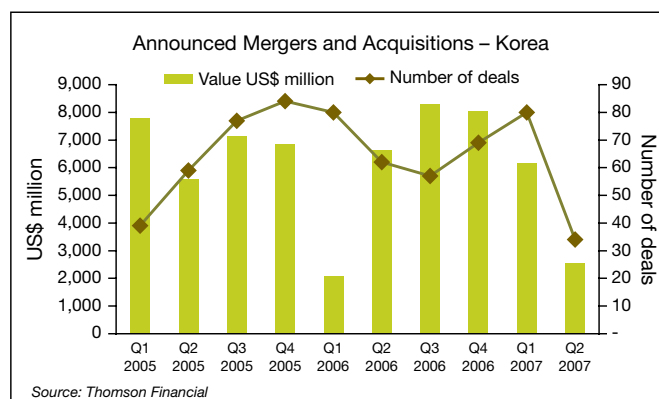
The Korean Composite Stock Price Index (KOSPI) closed above 1,800 for the first time in June 2007, eclipsing its previous record established in the prior month, when the index surpassed the 1,700 mark. The market capitalisation for both the KOSPI and KOSDAQ reached new milestones in the second quarter of 2007. While foreign investors had traditionally been the dominant players in the market, Korean stocks are benefiting largely from new individual investors as investments shift from the property market to the financial market. In addition, the amount of money in stock-focused mutual funds in Korea now exceeds US\$55 billion, according to Morgan Stanley.

Exports, capital investment and a solid recovery in the construction sector led growth in the first half of 2007. Exports continued robust growth estimated at 10.6 percent for the first half, and is expected to increase with strong sales of mainstay products such as automobiles, semiconductors, and LCDs. Capital investment is similarly expected to reach 10.6 percent due to heavy investment in machinery and equipment. The construction sector is expected to see growth of 3.5 percent for the first half, according to the Bank of Korea (BOK). Growth in this sector is largely due to the expansion of public construction projects.

Increase in private consumption of 4.0 percent for the first half was supported primarily by spending on durable goods, including automobiles and electronic appliances. With most household debt consisting of home equity loans, consumption will inevitably be somewhat sensitive to housing prices.

The BOK expects the economy to meet its 4.5 percent growth target for 2007, down from 5.0 percent in 2006. Despite oil price gains stronger growth is expected for the second half of the year, however, external risks such as the appreciation of the Korean Won against the US Dollar and Japanese Yen, a slowdown in the U.S. economy and China's tightening stance may cause problems for the country's export-oriented economy.

Deal Activity



Deal volumes declined from the second half of 2006 as the total number of announced M&A deals was 114, with deal values of approximately US\$8.7 billion for the first half of 2007. The corresponding deal values represent approximately a 47 percent decline from the second half of 2006. However, M&A volumes will continue to be driven primarily by sales of companies owned by creditor banks and financial sponsors. Activity in 2007 is likely to be dominated by the financial services and general industrial sectors.

Some of the more significant announced transactions include:

- In February, ARD Holdings, the holding company of Aekyung Group, a Korean-based consumer retail group, reached an agreement to purchase the retail business of Samsung Corporation, one of the largest chaebols in Korea. The deal, valued at KRW470 billion (US\$483 million), includes the department store, Samsung Plaza, and internet shopping mall, Samsung Mall
- In March, subsidiaries of the Hanjin Group, led by Hanjin Shipping, Korea Airport Service and Korean Airlines, established Hanjin Energy, a holding company, for the purposes of acquiring a stake in S-Oil Corporation, a Korean-based oil-refining company. The executed agreement to acquire a 28.41 percent stake in S-Oil Corporation was valued at KRW2.4 trillion (US\$2.5 billion). The investment will ensure a supply of transportation fuel and lower fuel costs for Hanjin Group's shipping and airline companies
- In May, Hana Financial Group (HFG), a financial holding company that operates three main businesses, including banking, securities and capital investment, agreed to acquire the 50 percent stake held by Allianz SE (a German insurance, asset management and banking company) in Hana Life Insurance for an undisclosed amount. Hana Life Insurance was established as a 50:50 joint venture between Hana Bank, a wholly-owned subsidiary of HFG, and Allianz SE in 2003. Allianz's divestment from Hana



Life Insurance will allow the global financial company to focus on its insurance business in Korea, Allianz Life Korea. In addition, the acquisition is in line with HFG's strategy to augment its life insurance business. Hana Life had total assets of KRW645 billion (US\$686 million) at the end of 2006

- In May, UBS Global Asset Management, the global financial services company based in Switzerland, announced plans to acquire a 51 percent stake in Daehan Investment Trust Management Company (DIMCO), a Korean-based asset management company, from Daehan Investment & Securities Company. The deal amount is valued at KRW180 billion (US\$195 million), of which KRW30 billion (US\$32 million) of the total is expected to be paid through earnouts. The acquisition will allow UBS to establish its position in the Korean asset management industry and enhance DIMCO's customer base by entering international markets
- In June, Woongjin Holdings, the Korean based holding company of the Woongjin Group, was selected as the winning bidder for a 98.14 percent stake in Kukdong Engineering & Construction. The transaction is valued at approximately KRW660 billion (US\$711 million)

Outlook

Annual growth is projected to reach 4.5 percent in 2007 spurred by strong exports, continued expansion in investment - particularly in manufacturing - and a recovery in construction over the year. Despite concerns about a strengthening Korean Won, growth in export volume of 11.4 percent is expected for the second half of 2007. On the consumption front, domestic consumption is also projected to grow in the second half by 4.1 percent, supported by improved consumer sentiment and improved income flows. Interest rates will be subject to upward pressure triggered by government efforts to control excess liquidity, but hikes in interest rates are still likely to be limited due to increased borrowings of foreign capital by financial institutions and net stock purchases by foreign investors. Potential inhibitors to this growth are a rise in oil prices, increase in household debt, strengthening of the Korean Won and a slowdown in domestic real estate.

Looking ahead for the second half of 2007 and 2008, M&A volumes are likely to be driven primarily by the financial services and construction sectors.

Financial services sector

The Capital Market Consolidation Act, currently under review by the National Assembly, is designed to further develop the Korean capital market by encouraging greater competition in the financial industry through deregulation. The securities industry will benefit from the legislation, as it will allow financial services firms to conduct activities that are broader in scope and use diverse investment tools. Legislation of the act will undoubtedly change the domestic financial landscape by removing boundaries in the financial sector. Furthermore, the sector should see greater consolidation and acquisitions in the market as Kookmin Bank, the largest Korean bank, and the Industrial Bank of Korea are likely to acquire securities and insurance companies. In addition, Dongbu Securities, NH Securities and Seoul Securities are also setting their sights on domestic players to increase their presence in the market.

Construction sector

2006 witnessed the acquisition of some of the nation's largest construction companies including Daewoo Engineering & Construction and Dong Ah Construction Industrial, and sales of large-sized construction companies are also expected to take place in the latter half of 2007 and in 2008.

The planned sale of Hyundai Engineering & Construction, a civil engineering and construction firm, is expected to be delayed to next year as the creditors of the company are scheduled to select a preferred bidder by the end of this year. The transaction is valued at approximately US\$4 billion for a 50.3 percent stake in the construction company and the major bidders are the Hyundai Group and Hyundai Heavy Industries.

In May, Korea Asset Management Company (KAMCO), the largest shareholder of Ssangyong Engineering & Construction with a 38.8 percent stake, announced that it will sell its shares and those held by other creditors. The preliminary auction will be held in August, which will be followed by the main bidding in September. The creditor group and KAMCO own 50.07 percent of the Korea Stock Exchange listed company. KAMCO plans to sell the entire stake and the sale is expected to attract a number of domestic construction firms and private equity funds.

Other notable M&A deals expected in 2007 that will be driven by financial creditors include Daewoo International, Daewoo Shipbuilding & Marine Engineering, Korea Express and Hynix.

Look for these and other deals in the second half of the year, to bring full year 2007 M&A activity back on par with 2006.