



Taiwan

Foreign partnership alongside industry consolidation fuels M&A activities

Current Environment

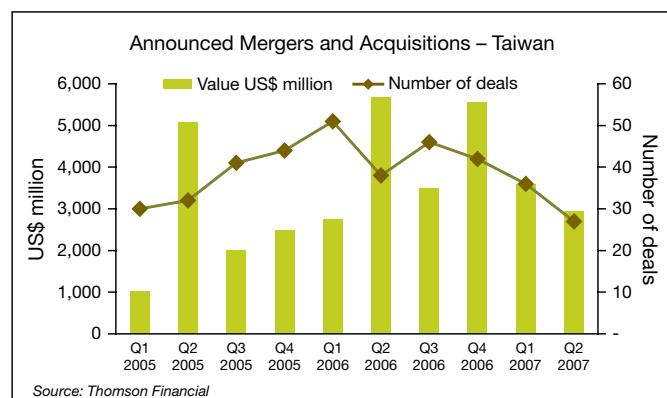
Taiwan's business economy shows signs of acceleration, and the momentum of the Taiwan economic engine remains strong. According to the Council for Economic Planning and Development (CEPD), benefiting from recovering global demand and solid exports to ASEAN and Greater China, the estimated Taiwan GDP growth rate is 4.40 percent in the first half of 2007, with an annual forecast of 4.38 percent. In addition, exports expanded 6.8 percent, depositing NT\$301 billion (US\$9.1 billion) of trade surplus in the first five months of 2007.

Employment conditions improved on the back of a bright economic outlook. The unemployment rate dropped to 3.84 percent in the first five months of 2007, a new low since 2000. Price levels diverged: the Wholesale Price Index jumped 7.6 percent in May, as the costs of basic metals and crude oil remained high, while the Consumer Price Index declined marginally, by 0.03 percent, due to price decreases in vegetables, prompting the central bank to raise the discount rate to 3.125 percent.

As the global economy cools, global demand will expand at a slower pace in the second half of 2007, as projected by the CEPD. With the job and consumer credit markets continuing to improve and the stock and real estate markets remaining buoyant, private consumption is expected to see faster growth than 2006. Despite completion of such mega projects as the high-speed railway construction and a weakening in the investment by optical electronic industries, moderate private investment growth could be sustained with the injection of capacity building by the semiconductor industries and new government investment projects.

In addition, as the Presidential election approaches, more favorable policies are expected to fuel investments from the private sector, and in turn, boost the overall economy.

Deal Activity



Announced M&A transactions totaling US\$6.5 billion in the first half of 2007 represent a decline on a year earlier, in both deal values and number. Activity was a bit stronger in the consumer sector, whilst the financial, technology, and communications segments remained active, with intent to consolidate either horizontally or vertically. Due to the robust earnings power of Taiwan corporations and extremely low borrowing costs, both domestic corporations and international investors played major roles in this merger wave. Highlighted transactions are detailed below.

Taiwan Mobile and Taiwan Fixed Network

Taiwan Mobile, which had a 9.95 percent stake in Taiwan Fixed Network, announced its intention to buy up to a 100 percent stake in this local fixed-line operator in a deal valued at up to NT\$53.6 billion (US\$1.62 billion) in cash. Through this combination, Taiwan Mobile, now the island's third-largest mobile operator in terms of revenue, is expected to offer triple play (transporting data, voice and video over an IP network), creating economies of scale, raising revenue, and saving on costs by avoiding duplicate capital expenditure through convergence of networks.

Oaktree Capital Management and Fu Sheng Industrial

U.S. private-equity firm Oaktree Capital Management planned to buy Fu Sheng Industrial, the world's largest maker of golf-club heads, as well as the largest manufacturer and distributor of air compressors in the Greater China region. As the equipment manufacturing market becomes mature and competitive, this partnership would help Fu Sheng expand its industrial air compressor business in Europe and the U.S., where Fu Sheng is still a mid-size player. Oaktree offered NT\$28.3 billion (US\$857 million) in cash for the whole company and is expected to delist Fu Sheng from the Taiwan Stock Exchange in the third quarter.

Longreach Management Corp. and EnTie Commercial Bank

A consortium led by Hong Kong-based private-equity firm Longreach Group announced its intention to acquire a majority stake in EnTie Commercial Bank (EnTie) by injecting NT\$23.0 billion (US\$696 million) into the lender. The investment would give the consortium a 51 percent stake and a majority on EnTie's board. It would also allow EnTie to address mounting bad loans and improve the bank's financial profile.

Citigroup Inc. and Bank of Overseas Chinese

Citigroup announced its intention to acquire Bank of Overseas Chinese (BOOC), a mid-sized Taiwan Bank, in an all-cash offer worth NT\$14.1 billion (US\$427 million). The combination would help Citigroup become the largest foreign bank in Taiwan, in terms of assets, and expand its number of branches to 66 from 11.



Primax Electronics and Hong Chuan Investment

A consortium led by Taiwan private-equity firm, Hong Chuan Investment, planned to buy a 100 percent stake in Primax through a tender offer valued at NT\$7.4 billion (US\$224 million). Primax is a contract-manufacturer of personal computer peripherals, such as PC mouse, scanner and multifunction printers.

ABN AMRO Holding and Taitung Business Bank

ABN AMRO Holding N.V. (ABN) will take over control from the Government of the branch network of failed Taiwanese lender Taitung Business Bank with payments of around NT\$6.9 billion (US\$209 million). The deal would increase the number of ABN's branches in Taiwan to 37 from 5.

Fairchild Semiconductor and System General Corporation

Fairchild Semiconductor, the leading global supplier of power semiconductors, announced an all-cash tender offer to acquire a 100 percent stake in System General Corporation, a maker of power management and analog microchips, for NT\$6.3 billion (US\$191 million). The combination would further accelerate the growth of Fairchild's overall power conversion business.

Chinatrust Commercial Bank and Enterprise Bank of Hualien

Chinatrust Commercial Bank (Chinatrust), Taiwan's largest credit card issuer, agreed to accept NT\$4.49 billion (US\$136 million) from the government in exchange for taking over financially-troubled Enterprise Bank of Hualien. The acquisition would give Chinatrust an additional 31 branches, expanding its network to 142.

Outlook

We expect M&A activities to remain buoyant in the second half of 2007, triggered by the financial, technology and industrial sectors. The Taiwan stock market index, which skyrocketed to over 9,000 in early July, the highest since 2000, may provide the impetus. For domestic conglomerates, abundant cash in hand and higher valuations will whet appetites for further consolidation. As for foreign investors, lots of buyout funds are seeking value in Taiwan, one of Asia's cheapest markets. As domestic corporations try to enhance competitiveness through integration, and multinationals regard Taiwan as a springboard for China's fast moving markets - also home to a large Taiwanese business community - we expect the number of M&A deals to increase in the Taiwan market in the second half of 2007. The mainstream transactions are illustrated below.

Financial sector

The Taiwanese government reiterated its intention to press forward with the second-phase of financial reform, namely halving the number of state-owned banks and financial holding companies, resulting in at least three financial institutions holding more than 10 percent of the market, and giving birth to a financial institution owned by foreign investors or listed overseas. The government's determination manifested in a series of successful auctions of troubled-banks in the first half of 2007, one of which was taken over by an international financial institution.

In the pipeline are two distressed financial institutions. Given successful auctions and government support, we expect to see more and more local banks, even small-sized financial holding companies, turn to either foreign buyers or larger counterparts for strategic alliance or for more capital to enhance asset quality in the second half of 2007.

Technology and industrial sectors

The desire of Taiwanese companies in the technology and industrial sectors to tap the Chinese and European markets has become the main lure of combination. Additionally, other transaction initiatives, such as restructuring product lines to focus on core-business, achieving economies of scale, and acquiring key components or technology, will spur deals.

Foreign partnership meets the needs by delisting public corporations to circumvent cumbersome regulations and allow for a global platform. Such transactions include Oaktree Capital Management's acquisition of Fu Sheng Industrial and Hong Chuan Investment's takeover of Primax Electronics, just to name a few. Government intervention and soaring valuations, however, might counter this force in the short-term. As Taiwan manufacturers gain presence in the global supply chain, we expect to see transactions grow steadily.

In summary, a bright economic outlook, vertical and horizontal integration needs from domestic enterprises, and attractive investment value for buyout funds and international investors, add up to a robust outlook for M&A activities in the second half of 2007.

