

Your gateway to industry information

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PwC event

A media round-table press interview was held in May 2008 on the topic of "Trends and 2008 outlook on mergers & acquisitions activities in the transportation & logistics industry", with references to our global thought leadership "Intersections".



Mergers & Acquisitions in the transportation & logistics industry: *How to make a smart deal?*

Introduction

The Transportation and Logistics (T&L) industry is now characterised by a significant level of merger and acquisition activities. Mergers and acquisitions (M&A) can add considerable values to a business, however, transactions are often complex and affected by different regulatory, economic and financing matters. Some frequently asked questions on M&A in the T&L industry are highlighted below.

Frequently Asked Questions

Q: What are the common M&A deal breakers in China?

A: Common deal breakers may include failure to bridge the valuation gap or culture differences between the sellers and buyers in the negotiation process, unrealistic projections or over-estimation of the future achievements of the acquired business and unexpectedly complicated tax issues.

Q: Under the current China tax laws, can the acquired business still enjoy the existing tax benefits after the acquisition?

A: It depends. Tax benefits of a target company may only be grandfathered when there is sufficient documentation as required by tax regulations and may need to be approved by the tax authorities at the local and/or state level. It is worth noting that under the new China Income Tax (CIT) regime, some new incentives may be applicable for certain qualified infrastructure projects, such as port operation in the T&L sector. In the event that any of the grandfathered tax benefits overlaps the new tax incentive for the same project, the target company can choose to apply for one of them only.

Q: How can modern logistics business enjoy the tax incentives for high/new tech enterprises (HNTEs)? How can the companies qualify?

A: Under the new CIT, if a modern logistics business satisfies the HNTE criteria, it will be eligible to enjoy a reduced income tax of 15% as opposed to the standard tax rate of 25%. To qualify as an HNTE, the enterprise has to be a Chinese tax resident having been set up for over one year, and has to satisfy certain criteria set out in the Assessment Guidelines under the CIT, including proprietary intellectual property rights of core technology, scope of service, headcount and R&D expenditures requirements.

Q: From an accounting perspective, how do a share deal and an asset deal make a difference in an acquisition in China?

A: With a share deal, IFRS 3 "Business Combination" would normally be applied to account for the acquisition. The biggest challenge to the buyers may be how to identify and ascertain the fair values of the assets (which include intangible assets, e.g. operating rights, customers' lists or existing lease arrangements) and liabilities (including contingent liabilities and other hidden liabilities) acquired. An asset deal is normally more straightforward in terms of accounting, however, in practice, it is rare for T&L industry players to simply buy an asset without the operating rights or other processes attached to it.

Frequently Asked Questions (Cont'd)

Q: What are the major differences between acquiring a state-owned enterprise as compared to a private-owned enterprise?

A: In practice, vendors of state-owned targets are normally less valuation sensitive as compared to those of the private-owned targets as they do not have direct ownership of the targets. However, they are more conscious of the representation and warranties that they are requested to give to the buyers. Also, vendors of state-owned targets are mostly more relationship driven and so to a foreign investor, the way of negotiating in acquiring a state-owned target could be quite different from that on a private-owned target.

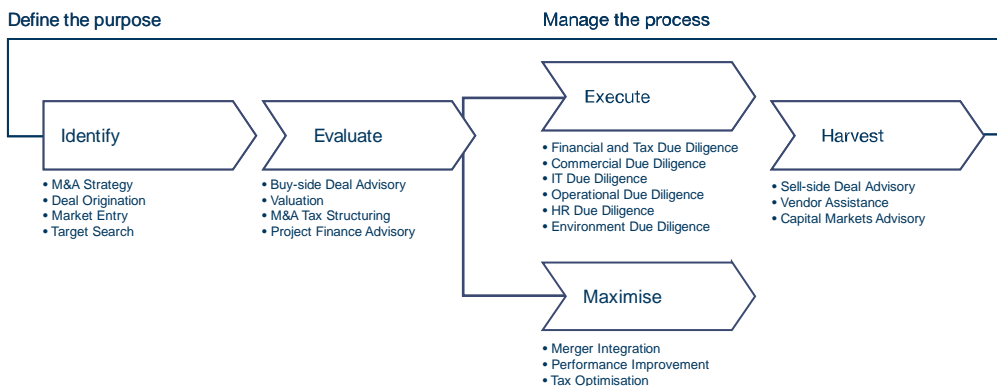
Q: Our research indicates that about 75% of acquisitions fail to meet the objectives set at the beginning. Why is this the case?

A: In increasingly fast moving markets it is essential to act decisively, otherwise value will quickly leak from your deal. Very often, buyers fail to study the effectiveness of the target business, in particular its operations, controls and personnel. They also fail to appreciate the need to plan appropriately and early for integration, in particular the people challenges. As a result, opportunities for synergies are lost and performance of the core business often suffers. A thorough review of the target's business plan will provide an understanding of potential for the target company to achieve its valuation objectives.

Our 7 tips to making a smart deal:

- Understand the business model of your target
- Make sure your target matches your M&A strategy
- Ensure effective planning from the identification to harvest stage
- Deal structure is always key: be aware of the potential regulatory and tax issues and the accounting implication
- Be aware of the implications of CIT law effective 1 January 2008 and new Merger & Liquidation Rules in the pipeline. Watch out for more changes and further guidance to maximise the deal structure planning
- A comprehensive due diligence process is crucial in identifying key deal issues at an early stage
- Do not underestimate the integration challenge

PwC Transaction Services deal continuum



Other references

Recent PwC publications:

- Intersections: Global Transportation & Logistics Mergers & Acquisitions Analysis
- Mergers & Acquisitions Asian Taxation Guide 2008
- Asia-Pacific M&A Bulletin
- Asia Financial Buyers Bulletin
- IFRS 3 (Revised): Impact on earnings
- HKFRS News (April 2008): Carved out/combined financial statements
- HKFRS News (March 2008): Business combinations

For enquiries on any of the publications above, please contact Annie Fong, Knowledge Manager (Tel: +852 2289 2845)

PwC event

Our "Mergers & Acquisitions: How to make a smart deal?" seminar was held on 28 May 2008 at the PwC Executive Conference Centre in Hong Kong, for 70 financial reporting and investment personnel from different T&L companies.

Topics covered include:

- Market overview on M&A trends in the global and China markets
- Challenges facing the deal process from perspectives of corporate finance, China tax, audit and performance improvements



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