

# 2010 Guide

to *mergers & acquisitions* in  
Southeast Asia

Pickering Pacific.  
M&A specialists in Southeast Asia



# Objective of this guide

Southeast Asia is growing in importance in the world and many foreign multinationals are expanding their presence in this region. This expansion often takes the form of acquisitions of local companies, especially mid-sized ones. This guide provides practical advice on how to successfully perform acquisition projects in Southeast Asia.

## The importance of Southeast Asia in the current world economy

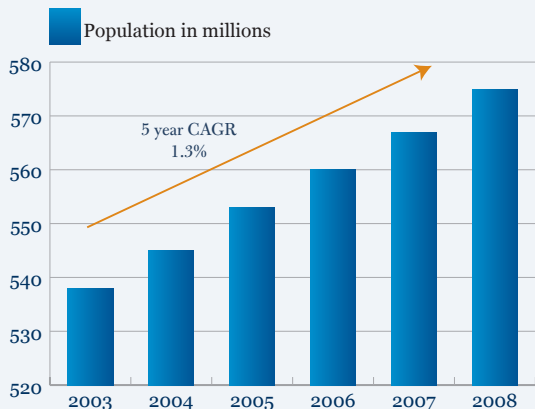
Southeast Asia has become a region that multinationals cannot ignore. Its share in world GDP is still small (2.5%) but it is on par with all of Africa and greater than new powerhouses like India<sup>1</sup>.



### A growing and richer population

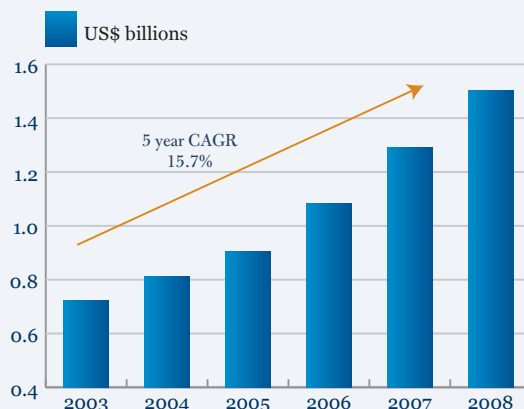
Southeast Asia’s population represents 8.5% of the world’s population, more than the European Union or the U.S.. This population is growing rapidly and becoming richer due to economic development. Since 2003, Southeast Asia’s population and GDP have been growing annually at a compounded rate of 1.3% and 15.7% respectively.

ASEAN Population from 2003 - 2008



Note: Figures pertain to national estimates at mid-year 2008.  
Source: National statistical offices & United Nations, 5 Jan 2010.

ASEAN GDP from 2003 - 2008



Note: GDP measured in US\$ at current fixed exchange rates.  
Source: Euromonitor International from International Monetary Fund, International Financial Statistics, 5 Jan 2010.

<sup>1</sup> GDP for 2008 measured in USD at current exchange rates. Source: Euromonitor International - Data for Southeast Asia only includes the ten countries of Southeast Asia (i.e., East Timor and Papua New Guinea are excluded)

## An economic hub

From a large and relatively poor country like Indonesia to a first-world city-state like Singapore, from land-locked Laos to the thousands islands of the Philippines, Southeast Asia is very diverse. The region is however slowly becoming more integrated and as a group, it is taking an important place in world economy.

From an economic and strategic perspective, the Malacca Straits<sup>2</sup> in Southeast Asia are one of the most important shipping lanes in the world. The Straits connect Middle-Eastern oil to Japan, China and Korea, and also major East Asian exporters to export markets such as Europe.

## A key exporter

Southeast Asia is a key exporter to major economic blocs. It was the 5th largest supplier of imports to the U.S. in 2008<sup>3</sup>. It is also the EU's 5th largest trading partner<sup>4</sup> and Japan's 2nd largest source of imports<sup>5</sup>, just behind China.

Southeast Asia is also a major exporter of raw materials and semi-finished goods to China (Southeast Asia was China's 4th largest import supplier in 2008) where such goods are processed and assembled before being re-exported to major developed markets. This link between Southeast Asia and China is also significant for mergers & acquisitions. Chinese companies are now turning their attention to Southeast Asia and starting to use acquisitions to secure their sources of raw materials and other supplies.

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# The importance of mid-market acquisitions in Southeast Asia

## Mid-sized targets for “bolt-on” acquisitions

In 2009, the number of acquisitions of targets in Southeast Asia with a value of less than USD 100m represented close to 91% of the total number of transactions. The relative small size of many companies in Southeast Asia explains this predominance of mid-market transactions.

Southeast Asia's mid-sized companies are good targets for “bolt-on” acquisitions by foreign multinationals. In a “bolt-on acquisition”, the acquirer fills a hole in its current coverage. It might fill that hole by acquiring a target company in a country where it is not yet present. It could be adding a complementary product to its existing product line. Sometimes, it could also be acquiring a capability currently missing from the acquirer's arsenal and that will enhance its existing businesses. Bolt-on acquisitions typically deliver higher relative synergy levels than larger transformational deals.

The idea for the acquirer is to buy something it can readily understand and that typically is small enough compared to its current business. For example, a company active in several Southeast Asia countries but not in Vietnam would buy a target in Vietnam in exactly the same business and requiring the same capabilities it has already developed elsewhere in the region. In this example, we can assume that the acquirer will find it fairly easy to understand the business it acquires. Such understanding will enable the buyer to make a reasonable assessment of the target's future. This will be required to determine a reasonable price for the business.

<sup>2</sup> Between Singapore and Malaysia on one side and Indonesian islands on the other

<sup>3</sup> Resource Center, Office of the United States Trade Representative.

<sup>4</sup> European Commission: Trade – ASEAN (Bilateral relations)

<sup>5</sup> Direction of Trade Statistics August 2009, International Monetary Fund.

<sup>6</sup> PRC General Administration of Customs, China's Customs Statistics.

## Opportunities arising of the recent downturn

The downturn in economic activity across the world during the past two years has made acquisitions comparatively cheaper than in the past. Valuations of Southeast Asian companies are down as reflected in the drop of the region's main stock market indexes in the past two years. This effect is even more pronounced in countries where some form of stock market bubble had taken place.

COUNTRY	INDEX	DEC 07	DEC 09	% CHANGE
Indonesia	JCI	2,740	2,534	-7%
Malaysia	KLCI	1,447	1,273	-12%
Philippines	PSEI	3,668	3,053	-17%
Singapore	STI	3,466	2,898	-16%
Thailand	SET	858	735	-14%
Vietnam	HCMSI	927	495	-47%

Mid-sized companies are not immune to this drop in valuations of listed companies. Private companies, that comprise a good proportion of the available mid-sized acquisition targets in Southeast Asia, are also affected. Potential sellers use the valuations of listed companies as a yardstick to estimate prices of private companies.

In hot “bubble” markets like Vietnam in early 2007, almost any private company of some significance was considering an initial public offering (IPO) at extraordinarily high valuations. In these “bubble” markets, a multinational wishing to buy a potential target at a reasonable price had little chance against the allure of a quick and very profitable listing. At the time, we saw many cases in Vietnam of acquisitions “priced out” by the possibility of lucrative IPOs. Some of these acquisitions have become a reasonable possibility today when the stock exchanges no longer offer the same type of “guaranteed” exit possibilities to potential sellers.

Some owners of mid-sized targets may not be willing to sell today at what they consider depressed prices. It is indeed difficult for an owner to rationalize selling at a price that may be significantly lower to what could have been expected a while back. However, many sellers have limited choices. Some have taken too much debt in the years where any investment seemed certain to give excellent returns and have now to sell assets to repay their creditors. Others need to finance expansion projects and cannot do so themselves. Loans are still difficult to obtain from the global financial industry, now in a more risk-adverse mode.

Although mid-market acquisitions in Southeast Asia can therefore make sense for foreign acquirers, successfully performing them requires a disciplined process, which we detail in *three distinct steps*:

# 1<sup>st</sup> STEP

## effective deal sourcing – finding the right targets

Southeast Asia presents challenges to the uninitiated. We cover the main challenges below and offer some practical steps to deal with them.

### Southeast Asia is diverse and complex

As the table below shows, Southeast Asia countries are very varied. Their size, political and legal systems and levels of development are different. Although they are geographically close, the countries of Southeast Asia also have very different cultures. This diversity even extends within many Southeast Asian countries with the existence of sizeable minorities (Malaysian Chinese in Malaysia, Bali Hindus in Indonesia, etc.).

Key Facts regarding Southeast Asian Countries

Country	Type of Government	Legal System	GDP (US\$ bn)	GDP per capita (US\$)	Ethnic Groups	Religions	Languages
Brunei	Constitutional sultanate	Common law; Islamic Sharia law for Muslims	15	51,300	Malay (66%), Chinese (11%)	Muslim (67%), Buddhist (13%)	Malay
Cambodia	Democracy under a constitutional monarchy	Civil law	11	2,000	Khmer (90%)	Buddhist (96%)	Khmer
Indonesia	Republic	Roman-Dutch Law	512	3,900	Javanese (42%), Sundanese (15%)	Muslim (86%)	Bahasa Indonesia
Laos	Communist state	French legal norms and socialist practice	5	2,100	Lao (55%), Khmou (11%)	Buddhist (67%)	Lao
Malaysia	Constitutional monarchy	Common law; Islamic Sharia law for Muslims	222	15,200	Malay (50.4%), Chinese (23.7%)	Muslim (60%), Buddhist (19%)	Bahasa Malaysia, English, Chinese
Myanmar	Military junta	Common law	26	1,200	Burman (68%)	Buddhist (89%)	Burmese
Philippines	Republic	Spanish and Anglo-American law	167	3,300	Tagalog (28%), Cebuano (13%)	Roman Catholic (81%)	Filipino, English
Singapore	Parliamentary republic	Common law	182	51,600	Chinese (76%), Malay (14%)	Buddhist (42%), Muslim (15%)	Chinese, English, Malay, Tamil
Thailand	Constitutional monarchy	Civil law with influence of common law	273	8,400	Thai (75%), Chinese (14%)	Buddhist (95%)	Thai
Vietnam	Communist state	Communist legal theory and French civil law	90	2,800	Kinh (86%)	Buddhist (9%), Catholic (7%)	Vietnamese

Source: Central Intelligence Agency, The World Factbook. Accessed: 6 Jan 2010. Languages edited by Pickering Pacific to reflect the reality of the local business landscape, GDP and GDP per capita data for year 2008

Because of this diversity, what works in a given country may not work in another. This may even apply to diverse ethnic groups within a given country.

1<sup>st</sup>  
STEP

There is of course a certain uniformity of the business elites in each country. To a large extent, elites in all the countries and communities use international standards of doing business. In many of the larger companies, executives (especially younger ones) would have been trained at the same top business schools all over the world. But despite this growing uniformity, one must still take into account the diversity of Southeast Asia in order to succeed in this region.

“...one must still take into account the diversity of Southeast Asia in order to succeed in this region.”

## Difficulties in finding relevant information and processing them

Many companies in Southeast Asia do not disclose much information. This applies both to listed and unlisted companies.

For listed companies, the inadequate disclosure results from several factors:

- With few exceptions, the stock exchanges in Southeast Asia do not have a good track record at enforcing proper disclosure practices.
- Many listed companies are owned by local tycoons who also own a separate unlisted group. There are often many transactions between the listed and unlisted groups which are not always in the best interest of the outside shareholders. Obviously, the owners will try to disclose as little as possible about these transactions.
- There is not yet a culture of active shareholders seeking to compel listed companies to achieve higher levels of disclosure.

For unlisted companies, there is often little information that is publicly available. In some Southeast Asian countries, it is possible to access the accounts of unlisted companies when they are filed with the relevant public registry. However, even for these countries, the information may be filed late or be inaccurate. In many cases, the inaccuracy is due to the desire by the company to minimize taxes. In one recent extreme case in Thailand, we found that the owners of a company we were investigating had been dutifully filing accounts for many years that reflected on average only about 1% of the actual profits of the company!

Language can also be a barrier. The region has many different official languages. For example, reading company accounts in Thai is not easy as the Thai script is not the alphabet to which many are used.

## Local sellers are difficult to approach

Many of the successful mid-size companies in Southeast Asia are owned by families or recent entrepreneurial teams. In both cases, the initial approach by a potential acquirer may not be welcomed.

Families often do not want to sell the family's company, often perceived as a heirloom to be passed on to future generations. In ethnic Chinese families, which are very common in the business world of Southeast Asia, it is often perceived that selling the business is an insult to the memory of the ancestor who founded the company a few generations back. In one case, we were dealing with a Malaysian conglomerate founded two generations ago. The conglomerate had diversified in many businesses, some of which were totally unrelated to the core businesses of the group and would have been of much more value to a focused acquirer. The current generation of family owners, all with MBAs from major business schools, fully understood the need to divest these non-core businesses. However, they could not bring themselves to sell anything that was bought or started by the previous generations. They were only happy to sell the parts of the business they had started themselves.

Entrepreneurial teams are also difficult to convince. Like elsewhere in the world, entrepreneurs tend to be very attached to the company they founded. It is often difficult for them to let go. In addition, many Southeast Asian entrepreneurs see a public listing as the pinnacle of a career. Quite a few would rather do a mediocre listing than a good trade sale. As Southeast Asian stock exchanges tend to accept listing by relatively small companies, the listing route is perceived as a credible exit strategy for many of the region's medium-sized companies.

## KEY RECOMMENDATIONS

### for effective deal sourcing in Southeast Asia

#### i. Good strategy, well conceived and adapted to the local context

The first step to find good acquisition targets is for the acquirer to know exactly what it is looking for. The overall expansion strategy of the acquirer needs to be adapted to a specific acquisition strategy for Southeast Asia.

#### ii. Good understanding of how the strategy translates into criteria for the right targets

Once a specific acquisition strategy has been developed for Southeast Asia, it is useful to translate this strategy into a set of key criteria that any suitable acquisition target must meet. For example, the size criteria must take into account that in certain industries company size may be smaller in Southeast Asia than elsewhere, especially in countries only emerging recently like Vietnam.

#### iii. Skills and knowledge to find the targets

Finding suitable targets is not easy. It requires a good knowledge of the region and specific skills. M&A intermediaries can help by initially talking to people in the relevant industry on a no-name basis: people are much more open to talk in this manner. Acquirers should also not stop at the feedback that "target X is not available for sale" or "the owners will never sell". Knowing how to probe further can result in convincing owners to sell targets initially "not for sale".

## Case study

A few years ago, we approached a target in Thailand for a client. We knew from people close to the company that its owners were not willing to sell. After reviewing the overall situation of the seller's group, we considered that the likely reason was the potential high tax on the proceeds of the sale. We devised a simple structure with the help of tax advisers that could greatly (and legally) reduce the taxation of the proceeds. During the first meeting, the owners indicated that the company was not for sale. We acknowledged this but stated that if the reason was taxation, there was a structure that could help the sellers. The owners said that this was not possible in Thailand. We showed them a short memorandum from the tax firm confirming what we said. The owners asked for a break and after a few minutes re-appeared telling us that they were happy to work on a sale.

## 2<sup>nd</sup> STEP

# Successful execution

## Lack of M&A sophistication

In many Southeast Asian markets, acquisitions are still a fairly new phenomena. In these countries, there are not enough lawyers, accountants and other advisers that can fully understand and apply M&A techniques. In these cases, it is most likely that the sellers end up having advisers who are incompetent. Although this could sometimes be perceived as a good thing for the acquirers, we generally find that it makes the successful completion of the transaction less likely as the owners, wrongly advised, ask for things that are impossible or do not make sense.

## Relationships with authorities and business partners

Many businesses in Southeast Asia rely on good relationships with the government and local authorities. Acquirers must be careful that these relationships subsist after the acquisition. In addition, the acquisition by foreign interests could lead to potential loss of business. This could be due either to the foreign acquirer's different way of doing business or to a general perception that foreign-owned companies may not be reliable partners. As an example of the first issue, one of our client had to abort a transaction in Vietnam when it became apparent that the target was achieving its sales using practices that the foreign acquirer could not condone (i.e., bribing doctors to prescribe the relevant health products).

## Knowledge of the local market

In order to properly assess the prospects of a target, the acquirer will need a good knowledge of the local market. Very often, the foreign acquirer making a bolt-on acquisition will, almost by definition, know well the market it is buying into. This is not always the case. We advised a European-based industrial group looking to make an acquisition in Thailand in a sub-sector of the industry where it is a world leader. However contrary to what senior management expected the local team did not have a good grasp of the Thailand markets for the products of the target.

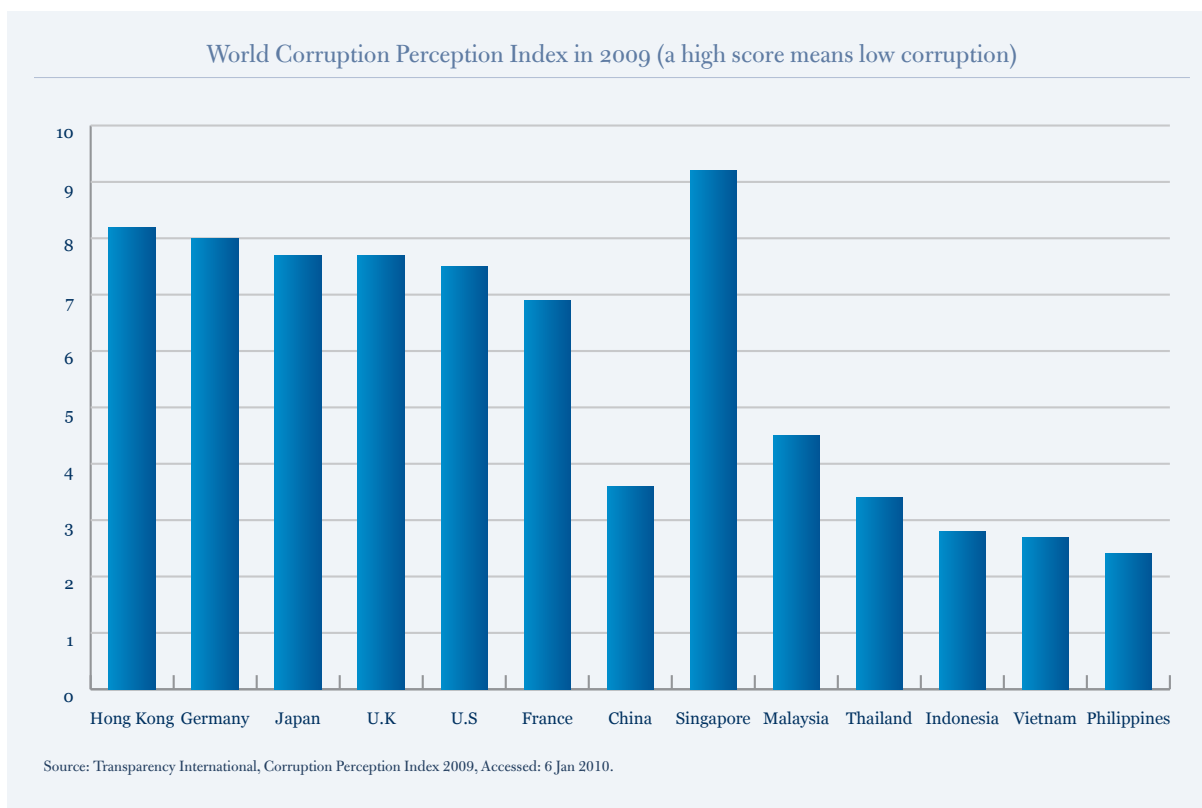
Unfortunately, but as is frequently the case in Southeast Asia where the markets are less well researched than in Europe or the U.S., there was no easy way to gain a quick overview of the relevant markets: none of the existing reports covered well these markets and no external firm seemed to be able to supply market intelligence at the desired level of precision. In the end, the client decided not to pursue the opportunity.

“ In order to properly assess the prospects of a target, the acquirer will need a good knowledge of the local market.”

## Due diligence issues

In many countries of Southeast Asia, there will usually be significant issues with the targets themselves. For example, in countries like Indonesia, Thailand and Vietnam the targets might be operating without having all the necessary licences. This is a risk that many local owners may be prepared to take. Foreign acquirers are reluctant to take such risk and are anyway often held to higher standards than the local owners they replace. Another frequent issue is corruption.

The table below shows the place of major Southeast Asian countries on the World Corruption Perception Index published by Transparency International (the higher the index, the less corrupt is the relevant country). Except for Singapore, the other major Southeast Asian countries are not well placed.



## KEY RECOMMENDATIONS

### for *effective deal execution* in Southeast Asia

#### i. Good team with the right external experts if they are not available in-house

The first key to the successful execution of an M&A transaction is to have a good team in place. In Southeast Asia, this means making sure that the relevant internal and external experts understand the region well. There are many traps in doing transactions in certain parts of Southeast Asia and people with relevant local experience are irreplaceable in making sure the acquirer avoid these traps. Simply wanting to apply a standard European or U.S. approach to a Southeast Asia deal will usually not work.

#### ii. Good process: do not skip steps

Following a good M&A process is critical to reaching a successful outcome. Skipping steps is usually not a good idea. Despite the small size of many targets in Southeast Asia, executing a transaction there is a complex process and it is prudent to make sure all steps of the process are carried out.

## KEY RECOMMENDATIONS

### for *effective deal execution* in Southeast Asia (cont'd)

#### iii. Timing

Negotiation techniques must be adapted to the local context, especially with regards to timing. Although it is difficult to generalize, we find that a “slow then fast” sequence often works best with the acquisition of mid-size companies in Southeast Asia. First, the approach to the sellers and getting all the way to an understanding on the proposed acquisition and its price must be slow. Usually the owners need a fair amount of time to come to the final decision to sell and to be convinced that the terms cannot be further improved. Once this milestone is reached however, it is advisable to go as fast as possible to the execution of the final agreements and the completion of the transaction as the owners could change their mind or try to negotiate for more. Although this sequence could be generalized to the acquisition of mid-size companies in other countries, we consider that it is even more relevant in developing Asia (including most of Southeast Asia) than in Europe or the U.S.

#### iv. Objectivity

As elsewhere, the acquirer’s team must maintain an objective view of the target at all times. Southeast Asia has a lot of potential and it is easy for the team to be carried away in making future projections of market growth. This can lead to dangerous overestimation of the value of the target and therefore in paying too high a price. A good example of this issue was the situation of Vietnam in 2007. Everybody was seeing Vietnam as the “new China”. Although less populous, Vietnam was in many ways going through the same rapid take off that China had seen a few years back. People would say things like “Vietnam is ten years behind China in its development level but will catch up in five” and “I invest in Vietnam today because I realize how much money I would have made if I had invested in China ten years ago”. Of course, like all bubbles, this one crashed. Although Vietnam is a very interesting country with past and probably future high growth rates, this does not justify just any price level.

#### v. Proper structure

Many of the mid-sized companies we come across in Southeast Asia are managed by their family owners or the founding entrepreneurs. In many cases, a significant portion of the value of the company lies with these managers, through their knowledge and contacts in a tightly-linked local community. To ensure that the value of the company is not diminished by the departure of these managers, it is frequent to put in place some form of earn-out scheme whereby the owners or the entrepreneurs are paid more if the company remains successful in the two or three year period after the acquisition is completed. These schemes must be devised very carefully to (i) make sure that they align the interests of the sellers with those of the acquirers, (ii) avoid any future legal disputes, and (iii) if legal dispute cannot be avoided, lead to enforceable recourses for the foreign acquirer. In a recent case that was discussed with us, the European acquirer had agreed to a minimum earn-out payment. When it became clear that the target company was no longer doing well and that no more than the minimum payment could be obtained, the sellers lost all interest in helping the target, at a great loss to the acquirer.

## 3<sup>rd</sup> STEP

### Smooth integration

Successful integration of the target into the acquirer's group is not always easy. Many issues may affect the integration process.

Cultural differences may be important. Southeast Asia is a complex and different place for many outsiders. Imposing the acquirer's new way of working is difficult and may not be readily understood by the staff.

Those cultural issues often apply to timing. Compared to New York, London or Paris, everything seems to go slower in large parts of Southeast Asia. The level of urgency is not the same. This is exacerbated in some countries by tedious and time consuming red tape.

The sellers themselves may slow down the integration when they stay as part of an earn-out process. Sometimes, they are not comfortable with the business plan of the acquirer. The acquirer may invest to develop the company and reap significant financial benefits. The sellers may see mainly the extra costs that are affecting the calculation of their earn-out. In other cases, the sellers will have non-financial issues, such as "keeping face". They may insist in participating in all key meetings. This will inevitably delay the integration.

Finally, when a company becomes foreign-owned, the local authorities usually take a much closer look at its operations. Suddenly, the tolerances that were in place are removed, grey areas are decided against the company, inspections take place, etc. This leads at best to time-consuming delays, at worst to significant losses of value.

#### KEY RECOMMENDATIONS

##### for *smooth integration* in Southeast Asia

###### i. Prepare, prepare, prepare

The first advice that we give to acquirers integrating a Southeast Asian company is to "prepare, prepare and prepare". Many of the issues mentioned above can be effectively dealt with if they do not come as last minute surprises. Plans must be in place to, inter alia, facilitate cultural integration, organize the integration teams so that they can work fast, align the sellers' interests with the acquirer's, and pre-empt any legal or regulatory issues.

Unfortunately, integration issues are often forgotten even by large multinationals which are also frequent acquirers. We have also seen in many global deals that Asia (including Southeast Asia) was left behind at the integration stage. As Asia often represented a small portion (say 10%) of the global business acquired, the integration efforts focused on Europe and the U.S., with an idea that Asia will take care of itself. This often meant that the Asia head of the acquirer was left with the task of integrating its region but without the professional integration teams that were deployed elsewhere and with no or little budget.

3<sup>rd</sup>  
STEP

KEY RECOMMENDATIONS  
for *smooth integration* in Southeast Asia (cont'd)

ii. Understand each other and explain: communication is key

Despite the general availability of local managers who understand the ways of working of large European and U.S. multinationals in Southeast Asia, there is still a significant culture gap at least at the middle and lower echelons of mid-size companies in Southeast Asia. For example, it might be difficult to make a middle-ranking Thai manager offer alternatives to the decisions of his superiors. A foreign manager keen on participative management may fail in this environment if he or she is not aware of the cultural differences at play.

Clear and open communication is always useful in this case, as well as cultural knowledge and awareness.

iii. Move as fast as possible

We consider that the integration should normally proceed as fast as possible. This reduces the time of uncertainty for employees. It also reduces the risk for the acquirer as some existing practices may need to be stopped immediately (e.g., issues around corruption of officials, improper tax filings ...).

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