

# Asia Pacific's New Corporate Landscape: Due diligence in uncertain times

ADVISORY

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# Introduction



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Due diligence is one of the most important information-gathering exercises an investor will conduct during a planned acquisition. Through the boom times of the past decade, deals have taken place in a climate of record economic growth and acquisition due diligence has become a thorough, well-planned and well-executed process.

When the global economy was expanding and financing was readily available, the risk of overpaying for a deal was mitigated by the likelihood that strong economic growth would add to shareholder value over a relatively short period of time. This is no longer the case. The global financial crisis and ensuing recession mean that conducting appropriate due diligence in an M&A deal is even more important.

Due diligence providers must also adapt to the current market environment: debt is now scarce, expensive and comes with onerous covenants, and the economies in which deals are conducted are full of uncertainties as to the depth and duration of the downturn.

During times of uncertainty, there are also many opportunities. Relatively cash-rich companies can make deals with confidence and strategically increase market share. Properly-conducted due diligence can unearth a goldmine of information on a target business to help the buyer understand and mitigate the uncertainties brought on by the credit crunch.

In this kind of economic environment, how do potential acquirers approach their target evaluations?

In our survey, respondents said that buyers and their financiers were more cautious than before. However, 55 percent felt that the processes, while taking longer, had not changed fundamentally. Due diligence was still being conducted according to relatively fixed procedures.

However, the level of uncertainty that buyers will accept has decreased, so obtaining a higher degree of comfort takes longer. In addition, assessments of market trends, cash and debt positions have been refined, particularly in the region's more mature markets.

This report explores this broad issue of how due diligence practices are changing and highlights important points for those planning to enter the M&A market in 2009.

This report is the third in our Asia Pacific New Corporate Landscape series, following reports on perceptions of private equity and trends in outbound M&A. We hope you find it insightful and we welcome the opportunity to discuss the key messages with you further.



## About the survey

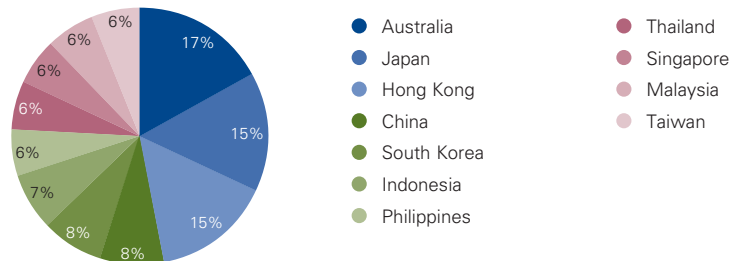
In September 2008, Remark, the research and publications division of mergermarket, canvassed the opinions of 150 mid-market Asian corporates, to uncover their views on Asian due diligence processes, especially in light of the credit crunch. The respondents were based across Australia, China, Hong Kong, Taiwan, Japan, South Korea, Philippines, Malaysia, Thailand, Singapore and Indonesia.

Ninety percent of respondents were from listed companies and 75 percent had turnover of more than USD 100 million per year.

Some 93 percent of respondents have undertaken due diligence processes in the past five years. They have done deals across the world: from their own domestic markets (70 percent), across other Asian markets (35 percent), the Americas (20 percent) and Western Europe (13 percent).

## Pre-qualifiers

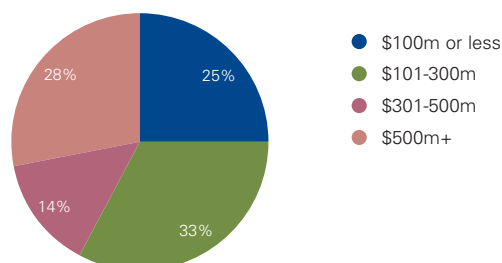
### What country or region are you headquartered in?



### What industry sector do you operate in?



### What is your turnover (in USD million)?



## KPMG findings

- Given the substantial deterioration in market conditions over the past year, it has become more difficult to establish the prospects of a target company. As a result, downside risk has increased and increasing attention needs to be paid to the liquidity, quality of debt and solvency of the target company, as well as its key suppliers and customers.
- The turmoil in the global financial markets has impacted Asian due diligence processes. Seventy-five percent of all respondents said that buyers were now more cautious about undertaking a transaction. Respondents in the relatively more mature deal markets such as Australia, Japan and Hong Kong had seen the biggest change in sentiment.
- In light of this increasingly cautious attitude to deal-making, 64 percent of respondents said that due diligence processes were getting longer, with the average exercise taking around one-and-a-half weeks longer than before the crisis.
- Similarly, 62 percent of respondents judged that due diligence exercises had become more detailed. Of those who agreed, 37 percent thought that a target's financial health would be the focus of further examination while 29 percent considered that deal financials would also be scrutinised.
- Country risk has always been a concern in acquisitions, even more so in the current environment. Forty percent of respondents said that they would avoid countries they perceive to be risky; a further 40 percent would conduct additional due diligence on a target located within a certain country. Only 20 percent said they would expect higher returns to compensate for country-specific risk.
- More than half of respondents (63 percent) agreed that a comprehensive due diligence process can alleviate many of the risks associated with conducting an M&A transaction in Asia. Some key matters to focus on in the current economic environment are:
  - Conducting more detailed work on current market conditions and the time to turn around
  - Conducting more detailed work on the target's competitive positioning
  - Understanding that current trading performance is not a reliable predictor of future performance
  - Gaining a closer understanding of operational performance
  - Performing detailed risk assessment
  - Examining financing arrangements, including working capital, loan arrangements, head room on cash flows and derivative arrangements.
- Vendor due diligence is likely to become an increasingly attractive option, particularly for large entities seeking to dispose of a regional portfolio of assets. Forensic investigations can also play a more critical role within due diligence in a downturn environment.

Unless otherwise stated, all statistics quoted in this report are attributable to mergermarket.

## The current deal market

As the third report in our *Asia Pacific New Corporate Landscape Series*, this paper follows our recent study of outbound M&A trends in Asia Pacific. In that report, we argued that many mid-market Asian corporates have relatively favourable cash positions that could potentially allow them to acquire undervalued or stressed assets during the coming year. Our research suggested that many companies were holding back investments primarily because of concerns over market sentiment.

Conditions have certainly deteriorated sharply since the peak of the M&A boom in mid 2007. The market is now characterised by significant volatility, tighter credit, bearish sentiment about the economy, declining commodity prices and worsening consumer sentiment.

Asian M&A activity, 2005-2008



Asian mid-market (USD 50-500m) M&A activity, 2005-2008



All these changes have affected the M&A market, with deal activity slowing over the course of 2008. This is most evident in the mid-market, which trailed off from its peak in Q2 2007. Overall deal figures also show a decline, although these numbers were skewed by large individual deals and increased volatility.

Market volatility has increased the difficulty of establishing a fair and accurate market value for a company, and the gap between a vendor's expectations of sale price and a buyer's willingness to pay has widened due to concerns over solvency, liquidity, downside issues and the time to turn around a potential business.

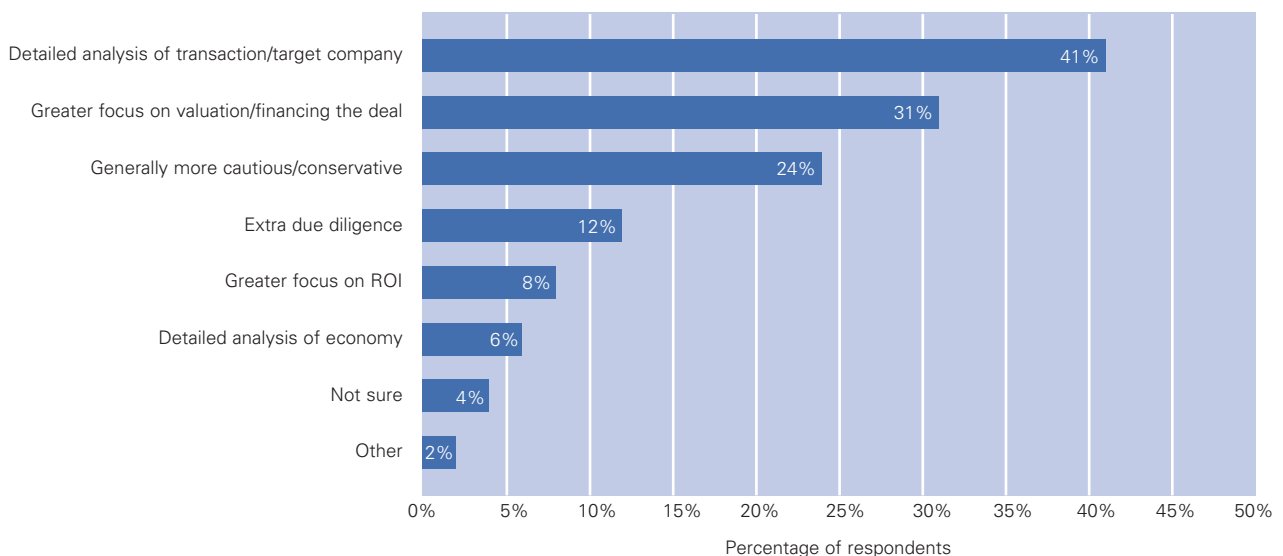
These concerns are particularly evident in mature deal markets such as Australia, Japan and Hong Kong. In newer markets, the assessment of a company's ability to realise future growth continues to affect valuations, in spite of the downturn.

## The deal makers' response

The worst of economic times can also be the best to complete a deal in, as asset valuations are more attractive and opportunities emerge to buy stressed and distressed assets. However, that has not stopped people from becoming more cautious.

A majority of the executives in our survey (75 percent) said that they had become more cautious when looking to undertake a transaction compared to before the credit crunch. KPMG firms have seen this leading to more rigorous due diligence and financial preparations.

### If cautions, how will buyers attempt to mitigate its effects?





Sixty-two percent of respondents judged that due diligence exercises were more detailed compared to before the credit crunch (see graph), and of those, 41 percent thought that purchasers would undertake a more detailed analysis of the transaction or the target. A further 31 percent judged that acquirers would spend more time looking closely at deal financing.

At the time of the survey, one respondent noted that buyers “are cautious about their target’s projections, as well as more cautious about the financial markets, both within that country and globally. They will have to have an eye focused on the transaction’s financial details and they will want to analyse all the risks involved prior to investing.” Another respondent said that “they are paying more attention to even minor aspects in order to mitigate risk and analyse their ROI, all of which can slow down the deal process.”

A respondent’s perception of whether buyers were becoming more cautious due to the credit crunch was heavily dependent on where their business is based and which industry they operate in. For instance, all respondents from Australia and Singapore, along with 91 percent of respondents in Hong Kong said they believed buyers had become more careful. This contrasted strongly with just 33 percent of respondents in China and 55 percent in Japan who believed this to be the case.

While the Energy, Mining & Utilities sectors have continued to see deal activity in recent months, 84 percent of respondents in these sectors said that buyers had become more cautious compared to 62 percent of respondents in the infrastructure, construction and transportation sectors.

The survey indicates that the global financial crisis has caused investors to seek far more detailed information from the due diligence process, with results carrying substantially more significance. Signs of business stress and distress in a target company can affect its value, as detailed in the following table.

	Common signs of stress	Common signs of distress
<b>Performance</b>	<ul style="list-style-type: none"> <li>• Forecasts show a material increase in loans</li> <li>• Headroom is becoming tighter</li> <li>• Profitability fallen or not risen as forecast</li> <li>• Plateau in top-line growth</li> </ul>	<ul style="list-style-type: none"> <li>• Liquidity has become tight</li> <li>• Borrowing limits have been exceeded</li> <li>• Loan covenants may have been breached</li> <li>• EBITDA insufficient to cover interest, financial commitments</li> <li>• Revenue has fallen despite market growth</li> </ul>
<b>Lender attitude</b>	<ul style="list-style-type: none"> <li>• Relationship with bankers under control but specialists at bank are overseeing credit issues</li> <li>• Lenders increase information requirements</li> <li>• Existing lenders signal unwillingness to extend their exposure</li> </ul>	<ul style="list-style-type: none"> <li>• Management of the account has been transferred to a specialist unit in the bank</li> <li>• Lenders restrict use or availability of funds</li> </ul>
<b>Corporate activity</b>	<ul style="list-style-type: none"> <li>• Acquisition/expansion plans shelved</li> <li>• Refinancing terms much more expensive than anticipated</li> </ul>	<ul style="list-style-type: none"> <li>• Disposal of assets necessary to free up cash for operations</li> <li>• Failed refinancing</li> </ul>
<b>Customers and suppliers</b>	<ul style="list-style-type: none"> <li>• Supplier terms tighter</li> <li>• Customers require more visibility of financial capacity</li> </ul>	<ul style="list-style-type: none"> <li>• Major suppliers exert pressure for repayment</li> <li>• Suppliers on "stop"</li> <li>• Customers demanding performance bonds</li> </ul>
<b>Management</b>	<ul style="list-style-type: none"> <li>• Difficulties in attracting new management</li> </ul>	<ul style="list-style-type: none"> <li>• Focus on cash and cost rather than growth</li> <li>• Rapid turnover</li> </ul>
<b>External communications</b>	<ul style="list-style-type: none"> <li>• First profit warning</li> <li>• Management downplaying growth expectations</li> </ul>	<ul style="list-style-type: none"> <li>• Two or more profit warnings</li> <li>• Delayed results production/announcements</li> </ul>
<b>Other issues</b>	<ul style="list-style-type: none"> <li>• Doubts over efficacy of accounting policies</li> </ul>	<ul style="list-style-type: none"> <li>• Accounting black hole</li> </ul>



## Changing due diligence strategies

In a period of economic volatility and slowing growth prospects around the world, due diligence strategies need to change if deals are to be successfully financed. M&A financiers are becoming more cautious and are requesting more information from buyers than from before the credit crunch.

One respondent observed that financiers “want to mitigate risk by conducting more detailed due diligence, verifying finance-procurement documents and collecting detailed information on the vendor’s credit history as well as the buyer’s tax profile.” Financiers also examine “regulatory clearance issues and general market conditions.”

However, these brief comments belie the substantial amount of additional due diligence required. For example, understanding “general market conditions” can entail an extensive analysis of how the sector is responding to the global financial crisis and recessionary forces; how a specific target is faring relative to its competitors; and the timeframes for turnaround given the sector’s financial performance and growth prospects.

Most respondents said that they thought financiers were becoming more careful as the credit crisis took hold. Among these respondents, all of those in Singapore and 95 percent of those in Hong Kong predicted that financing would become more conservative.

### Due diligence taking longer

A narrow majority of respondents (55 percent) believed that despite the onset of the credit crunch and the increased caution displayed by both buyers and financiers, the basic due diligence processes had not changed. One respondent felt that “the due diligence process has nothing to do with the credit crisis – it is primarily conducted according to fixed procedures.”

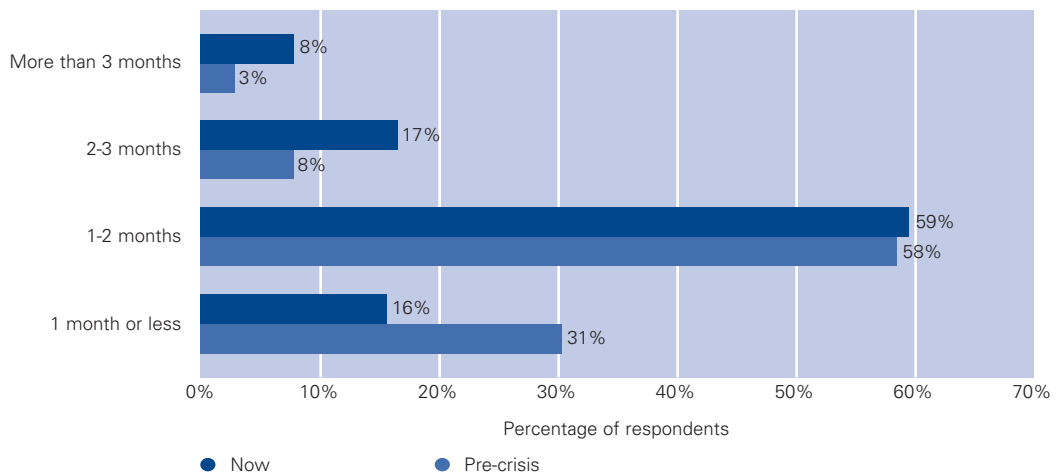
However, this comment is somewhat at odds with the broader sentiment that due diligence processes were getting longer, as cited by 64 percent of respondents. They were seen to be longer because the process is becoming more detailed, more robust, and new questions are being asked or more detail is being required. One respondent attributed this lengthening time frame to the fact that “everyone now needs more time to go through the data they get.” Another respondent said that processes are getting longer because “deal financials are getting more complex.”

Ninety-one percent of Hong Kong-based respondents and 80 percent of Malaysia-based respondents believed the average time of due diligence has got longer. Only 6 percent considered that procedures are becoming shorter.

Analysis of the responses suggests that the timeframe for due diligence is now perceptibly longer in almost every jurisdiction. In the more mature M&A markets of Singapore, Hong Kong, Japan and Australia, 14 percent of respondents claimed the average time deal time took less than a month compared to 31 percent pre-crisis.

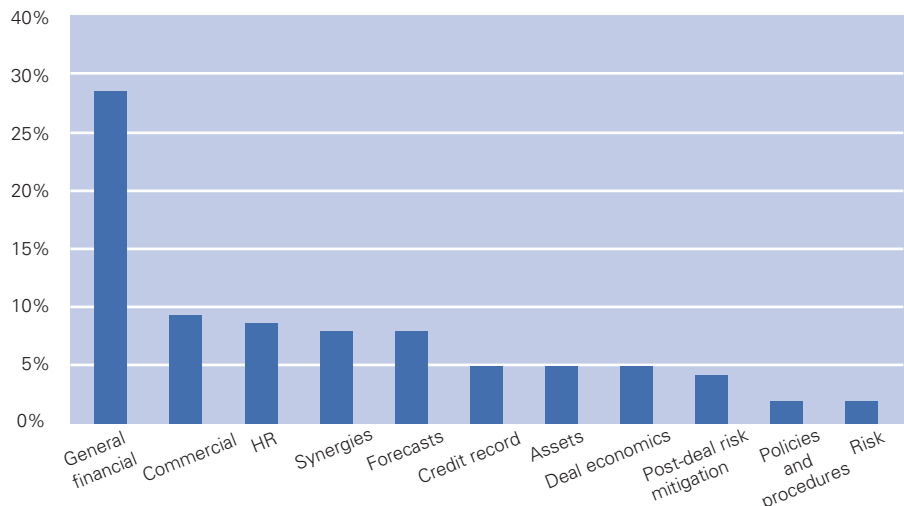
Across all markets, the number of people who thought that the average timeframe was less than a month has halved from 31 percent to 16 percent. Twenty-five percent of respondents allowed for an average due diligence process taking two months or more, compared to 11 percent who thought it would take this long pre-crisis.

**What is the average timeframe in weeks now as opposed to pre-crisis?**



**Respondents said that due diligence will focus on a target's financial health, as well as deal financials**

**If so, what areas would you examine in more detail?**



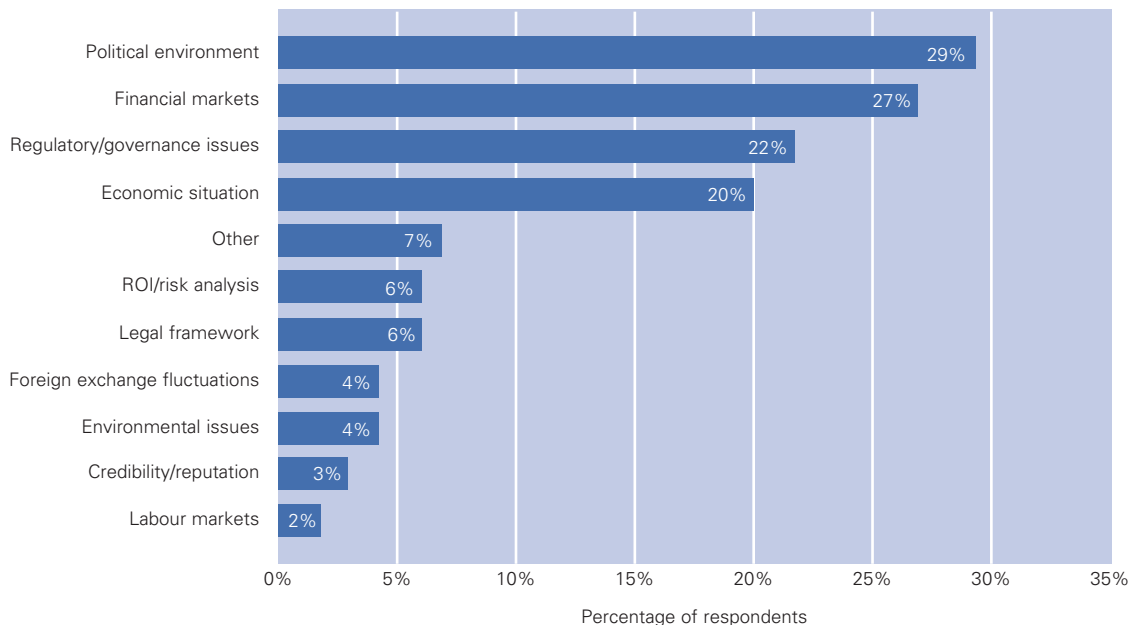
Of those respondents who said that due diligence procedures are getting more detailed, 28 percent thought that a target's financial health would be the focus of further examination, while 29 percent said that deal financials would also come under greater scrutiny.

One respondent said that "due diligence processes are now more detailed in terms of evaluating costs and investment guidelines." Another said that such exercises now "seek information related to market profitability, the technologies to be used, and the degree of compliance to rules and regulations, as well as areas such as human capital and synergies, which buyers will now want to quantify."

In many Asian countries, management teams are now seeking greater reassurance as to the synergies they expect will emerge from a deal. Both boards and their financiers are looking for a more detailed quantification of the benefits, and the time and cost needed to realise them. They also want to identify and understand potentially detrimental outcomes that may result from the deal.

Over 75 percent of respondents were bullish on Chinese and Indian economic growth prospects, although there was disagreement over the extent that risk premiums are, or should be, factored in. Eighty percent of respondents said they would conduct more due diligence in countries they perceived to be higher-risk or avoid these markets altogether.

**Which factors if any do you examine when forecasting country risk?**



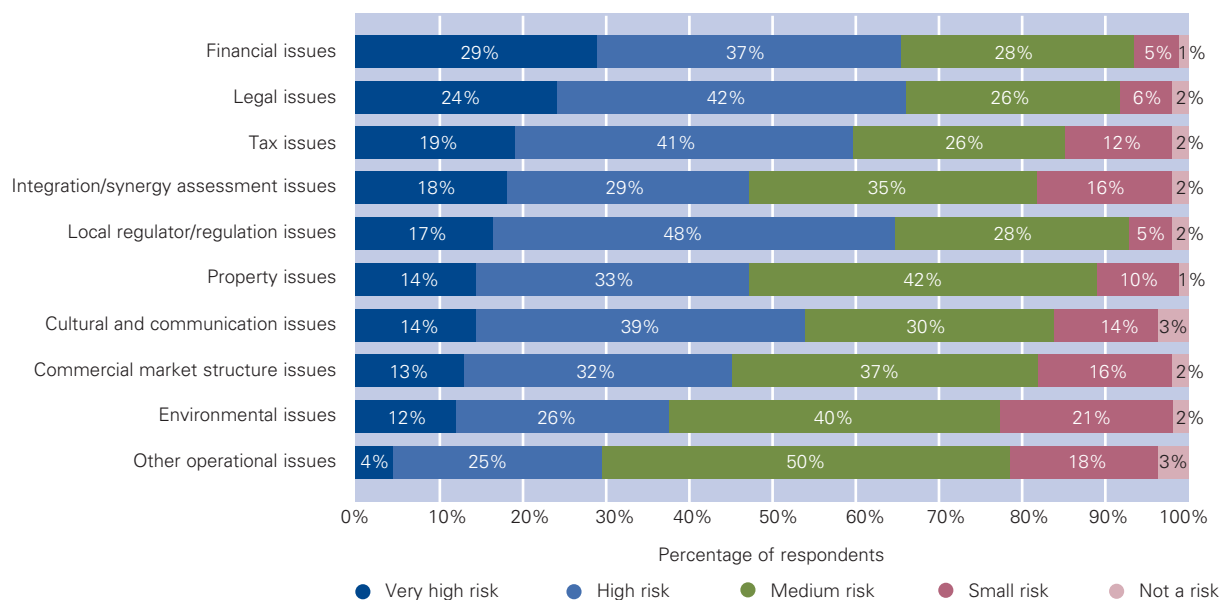
A country's political or cultural environment and financial markets are the most important country risk factors according to respondents, although some respondents were surprisingly dismissive about this consideration with one saying that "risk is unavoidable and the same in all market economies."

Hong Kong-based respondents seemed most prepared to accept higher levels of risk, with only 23 percent citing that they would avoid certain countries and a combined 77 percent either expecting higher returns (14 percent) or conducting more due diligence (64 percent).

Most respondents saw legal and local regulatory issues as the most risky or problematic areas during due diligence.

A smaller number of respondents also noted that tax issues (19 percent) and post-deal integration anxieties (18 percent) are the most problematic aspects of the due diligence process.

#### In general, how great is the risk associated with the following areas typically covered in a typical Asian due diligence process?



## Vendor due diligence

Many vendors no longer consider a standard Information Memorandum to be an adequate way to present a business to the market.

In recent years, a growing number of vendors have been commissioning their own due diligence on the business they intend to sell, well before the sale process begins. This can identify issues that need fixing, and once addressed, the due diligence report is refreshed and made available to the potential bidders.



KPMG firms' experience has shown that a vendor due diligence report delivers multiple benefits to the vendor:

- **Price erosion during bidder due diligence is minimised:** If potential deal issues have been identified and dealt with as part of the vendor due diligence, new issues arising are less likely to create risk or uncertainty. This in turn increases the ability of bidders to maintain, or even improve, their indicative bids.
- **The vendor retains greater control of the transaction:** The vendor is in a position of strength prior to bidder due diligence commencing, as the potential issues have already been identified and dealt with. Surprises during bidder due diligence are minimised, allowing management to focus on what is important to them.
- **Vendor due diligence provides a more detailed explanation of the key drivers and business assumptions:** These can be presented in a form directly relevant to bidders and their valuation models, minimising uncertainty on the bidder's part when interpreting management information.
- **It provides an independent assessment of the business, allowing bidders to bid with greater certainty:** A single due diligence report puts all potential bidders on a level playing field and can help in reducing warranty claims because the vendor can ensure all risks are appropriately dealt with or disclosed before the bids are made and the deal completed.
- **It can accelerate the sale process and reduce disruption:** The time needed by bidders is reduced as bidders simply perform their own 'top up due diligence' to take account of their own circumstances. The fact that only one due diligence is performed on the business rather than multiple due diligence processes by each bidder can also minimise disruptions to the ongoing running of the business.
- **Vendor due diligence can help in coaching management:** The process can help in preparing management for presentations to the potential bidders.

In these times when growth prospects are uncertain and there is focus on cash flow and debt levels, a vendor due diligence report can dramatically improve a vendor's chances of success in a transaction. While all of these benefits accrue directly to the seller, the buyer can also reap the benefits of greater understanding within faster timeframes.

As such, we can expect to see vendors using every tool available to enhance sale prices, to accelerate deal timeframes and to achieve greater certainty of a deal completing. Vendor due diligence can be particularly useful for large organisations seeking dispose of numerous assets or entities in different locations across the Asia Pacific region.

## Forensic investigations and due diligence

In times of recession, the chance of fraud increases and “earnings management” issues are more likely to be uncovered. Corporate intelligence investigations can help a buyer to be aware of a target’s relationship with counter parties, including customers and suppliers. Earnings management issues typically occur through the falsification of revenue or assets, where the collaboration of a counter party is required.

A target’s management and key personnel should also be reviewed to assess whether anti-bribery and corruption policies and procedures are in place. The Foreign Corrupt Practices Act (FCPA), a US act which applies to US-listed companies operating anywhere in the world, has particularly focused investors’ minds because any form of payment or exchange with a state official can present the risk of legal action or sizeable fines. Similar regulations have been imposed by a number of government authorities within the region.

Acquirers need to assess the existence and awareness of systems and controls with regard to the following areas:

- expense claims
- payments and petty cash disbursements
- use of agents and outside consultants
- entertainment and gifts provided to third parties
- contracting with government bodies
- FCPA violation or fraud response mechanism
- maintenance of books and records.

Based on the information learned through due diligence, a company may decide that the corruption and/or liability risk is tolerable. However, it may decide that the risk is so high that the value of the relationship is significantly reduced. In many instances, the client can then address corruption risks through appropriate contractual rights and contingencies with the counterparty. In other instances, the client may need to undertake further due diligence (or an investigation) and to seek assurances from the government regarding possible successor liability.

Every due diligence effort is different and should be evaluated on its own set of unique facts. However, forensic due diligence such as this should be seriously considered when acquiring not only a distressed asset but also an entity that appears to be performing strongly. Apparently strong financial performance may mask fraudulent activities, and during a recession the likelihood of these unravelling or presenting legal and operational risks increases.



## The role of the advisor

**There is no doubt that an experienced team of due diligence advisers can help the bidder evaluate a target by knowing what to report and in what detail. Open and honest communication is critical to smooth deal evaluation.**

Just 22 percent of respondents claimed to have had bad experiences with due diligence providers, and of this proportion, 27 percent cited the providers' inadequate or excessive attention to detail during the due diligence process. Twenty percent of respondents also noted that their due diligence providers did not effectively communicate with them.

However, respondents agreed that the insight provided by good due diligence can increase the understanding of a target and its appropriate value. Twenty percent of respondents said that their due diligence advisers provided additional, unexpected insights into the deal and risks.

Assessing a company's exposure to liquidity risk, credit risk and asset carrying values is also an important part of the process where advisors can assist. Any due diligence inquiry should seek to establish how, and if, recent market events have highlighted unexpected risks that the target was not fully aware of and whether market events have confirmed (or highlighted) weaknesses in established trading practices.

While such issues have always been part of a robust due diligence process, they have taken on heightened significance in the current economic environment.

### Key risks in a downturn environment

#### Liquidity risk

- Impact of market conditions on the fair value of financial assets or ability to dispose of financial assets to meet upcoming obligations
- Impact of reduced liquidity on ability to replace short term funding and impact of increased costs of replacement funding
- Impact of market conditions on current financing arrangements and any increases that may have been planned

#### Credit risk

- Impact of exposures to credit risk, both direct and indirect (via customers and suppliers who may be crucial to the business)

#### Impairment of non-financial assets

- Impact on non-financial assets, such as property, plant and equipment, and goodwill and other intangible assets

#### Derivative risks

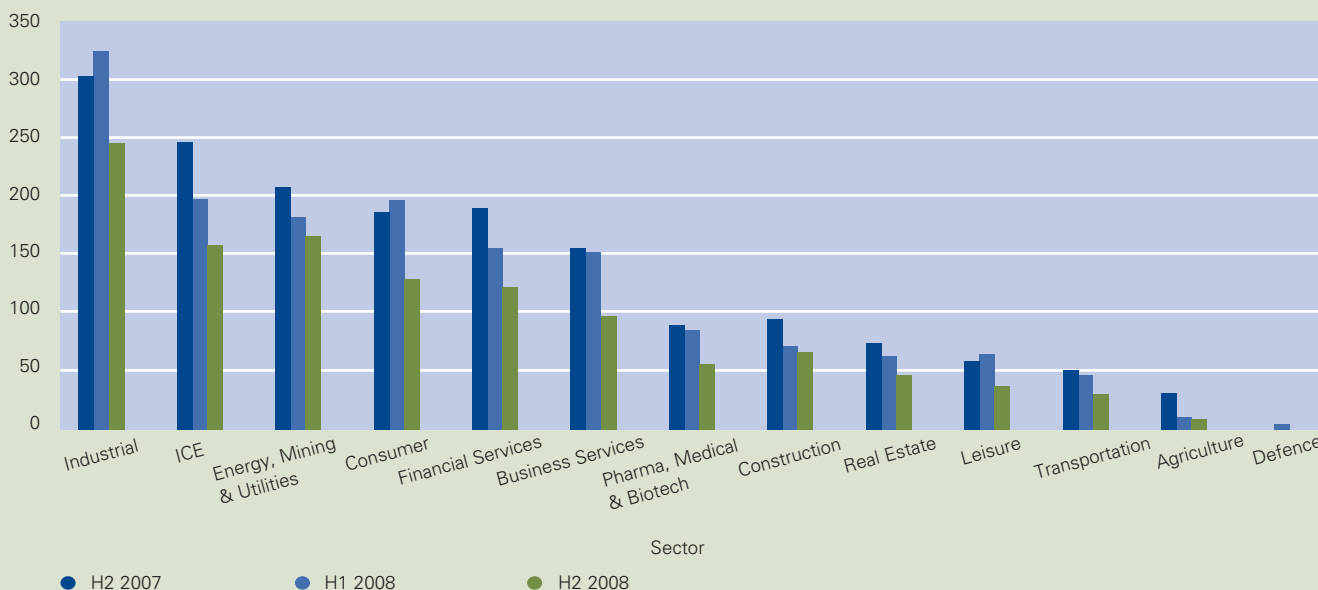
- Impact of foreign currency hedging, interest rate hedging and other derivative contracts

# Appendix:

## How the downturn is hitting Asia's M&A markets

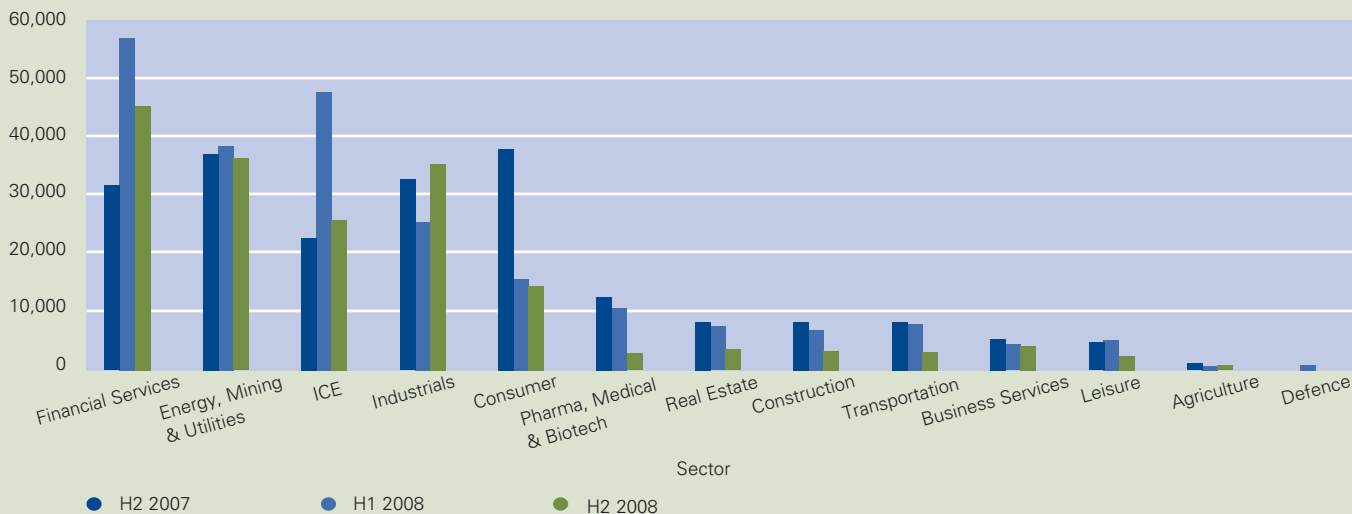
M&A activity in deal volume terms has slowed steadily since the second half of 2007, and this is reflected consistently across most industry sectors. However the decline is not reflected uniformly in value terms, with the financial services, and Information, Communications and Entertainment (ICE) sectors seeing a spike in H1 2008 and continued activity later in the year. Consumer Markets and Pharma, Medical & Biotech were two of the sectors that saw the biggest decline in activity, in both volume and value terms.

Deal volume **Asian M&A sector split by volume, H2 2007-2008**



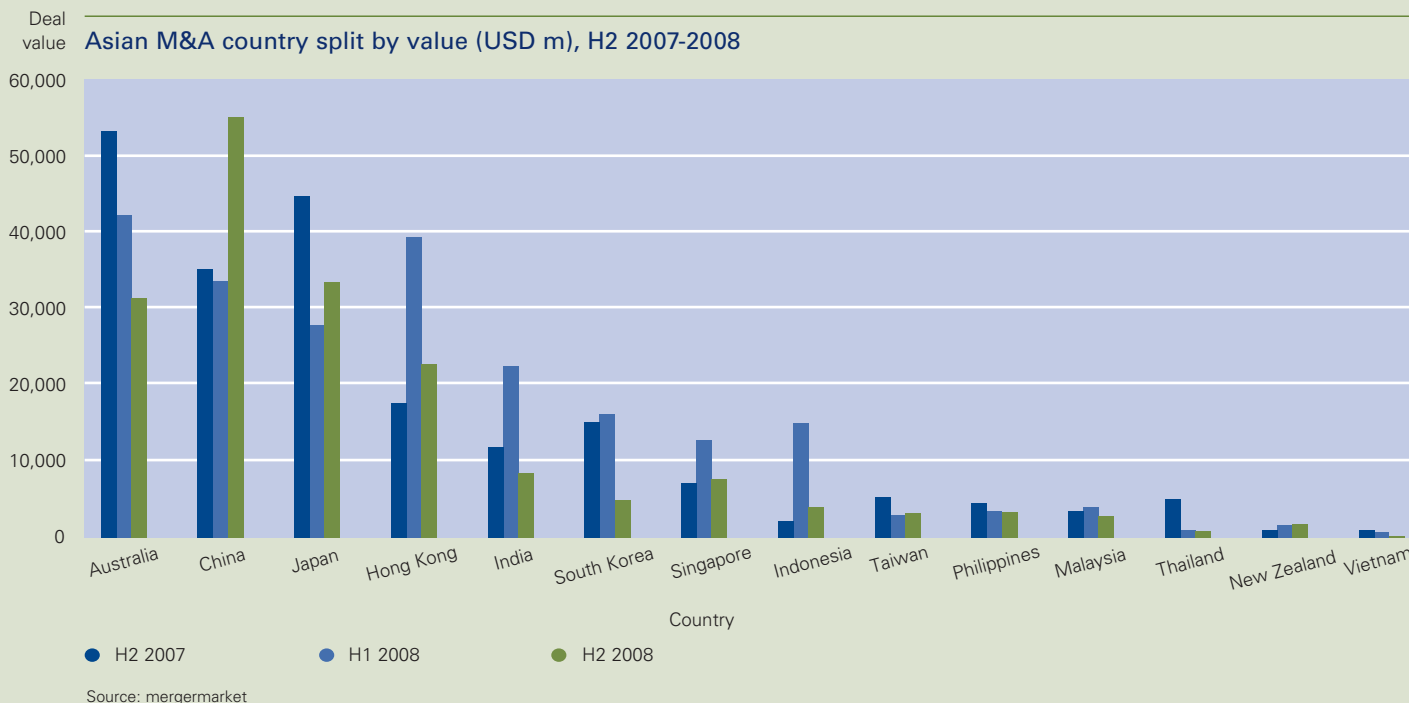
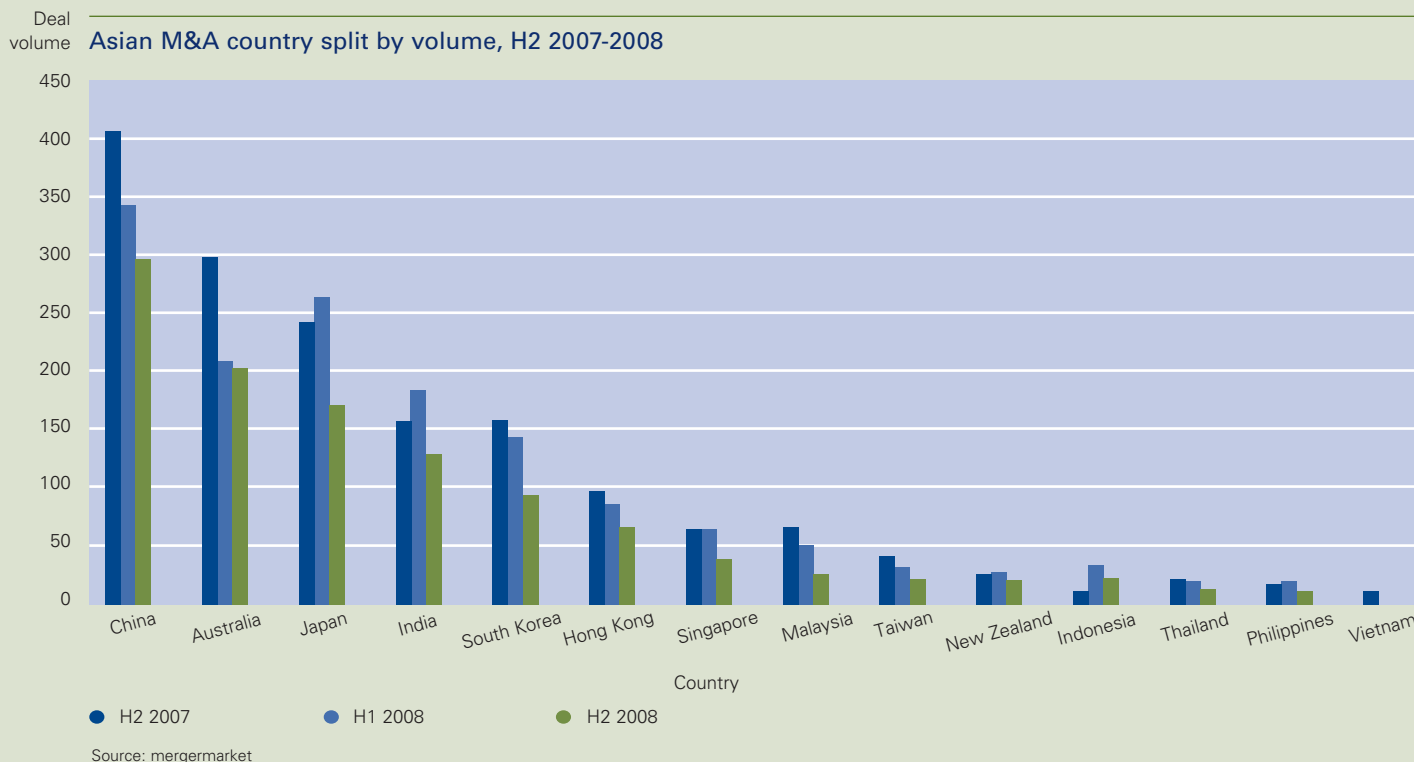
Source: mergemarket

Deal value **Asian M&A sector split by value (USD m), H2 2007-2008**



Source: mergemarket

M&A activity on a volume basis slowed consistently across most geographical markets, although several markets saw a notable surge activity in H1 2008. Japan and India both saw a surge in deal volume, while Hong Kong, India, Singapore and Indonesia saw strong increases in value terms. However, all these markets then saw contractions in H2 2008.



## Regional insights

Asia Pacific's M&A markets are diverse in terms of their size and level of activity. Due diligence approaches have also tended to vary, or to focus on different issues according to market conditions. In the following section, KPMG partners from firms around the region share their views on M&A practices in their markets.

### KPMG partners featured:

- Kevin Chamberlain (Australia, regional leader)
- Honson To (China)
- Thomas Whitson (Japan)
- Siewmei Chan (Malaysia)
- Vincent Chang (Taiwan)
- David East (Indonesia)
- Edward Kim (Korea)
- Vincente Sarza (Philippines)
- Rupert Chamberlain (Vietnam)

## How is sentiment affecting M&A around the region?

- Honson To:** While the number of completed deals has decreased, there is still a reasonable pipeline and a lot of negotiation going on. It is not surprising that both sides are becoming more cautious and negotiations more protracted. Any issues uncovered can affect the valuation to a greater extent in a bear market environment.
- Edward Kim:** There are a number of divestitures emerging, driven by the need to secure funds for liquidity and investments. However, seller price expectations are still too high as it had been a sellers' market up until mid-2008. Investors are also failing to execute proposed deals due to fund-raising difficulties.
- Rupert Chamberlain:** Vietnam has seen a definite slowdown in foreign direct investment since mid-2008, both in terms of commitments and the disbursement of prior commitments. The slowdown has forced a reassessment of public expectations and helped to put the brakes on inflationary pressures in some sectors of the economy, particularly real estate. A reality check was probably needed.
- Vincent Chang:** Taiwan's economy has always been highly dependent on exports and that makes it particularly vulnerable in the current downturn. Official GDP is expected to contract by 2 percent in 2009, although I expect the downturn to be felt more harshly in many key sectors and many companies will likely face distress.
- Vincente Sarza:** People, whether buyers or sellers, are becoming more deliberate in analysing and closing transactions. There are still deals being initiated, but it's happening in a more purposeful and calculated way. Many companies are trying to understand the weaknesses of their competitors and how they can capitalise on their own strengths.

**Siewmei Chan:** For Malaysia, corporates have adopted the wait-and-see attitude. We don't see a discernible trend yet and investors are being very cautious, especially with cashflow, debt levels, viability and valuations.

**David East:** Indonesia's M&A market has been something of an anomaly in the region, as deal flow held up throughout 2008 and even increased during the final months of the year as a result of several particularly large transactions. The deal sizes are typically smaller and there is less on the order book, but there is still the possibility of some cross-border deals and other transactions to move forward.

## Are people taking more time over due diligence?

**Thomas Whitson:** I have not seen the time allocated to the standard financial due diligence getting any longer, but some investors are now following up on that with more investigations in specific areas. This can also include commercial or market due diligence.

**Rupert Chamberlain:** As M&A activity slows, the due diligence processes may also be more drawn out, but in emerging markets this is unlikely to be noticeable given that these timeframes from inception to deal completion are already typically much longer than in mature markets.

**Kevin Chamberlain:** In Australia, I have seen due diligence taking a little longer on average, but still tends to be set on a fixed timeframe agreed by buyer and seller.

**Siewmei Chan:** Generally people are not taking longer, but people are perhaps waiting until the deal has reached a more mature stage before appointing consultants. There may be instances where certain pre-deal evaluation work is done in-house to save some costs.



## In what ways is the downturn affecting due diligence practices?

- Kevin Chamberlain:** Cash flows and working capital are naturally receiving greater attention in the current climate. Vendors need to invest time and resources to these aspects within their finance function, while acquirers will look to this as an area in which they can implement change and realise greater value. When acquiring a distressed asset, the general approach to due diligence may not alter, but greater timeframe pressure means the advisor needs to anticipate next steps and identify potential shortfalls in information or other hurdles.
- Honson To:** There is a need for due diligence to be more substantive in terms of underlying issues and understanding key trends and indicators. Due diligence cannot be a snapshot of a moment in time. It can also aim to bring more understanding as to why margins have declined or risen over time, or how the target has performed relative to its competitors.
- Thomas Whitson:** Our clients are asking for more assistance to manage integration issues after sign-off. Historically many thought they could manage these issues without assistance, but they are now requesting us to help more to help make their acquisition a success and minimise costs. Impairments are also becoming more common in the downturn, and this raises particular issues in Japan because Japanese reporting standards handle impairment differently to International Financial Reporting Standards.
- David East** Corporate intelligence services can be added into a due diligence process. This can be a quick and effective way to understand the reputational risks of a target company and relationships that it has with vendors, partners and public bodies. Forensic services can be particularly important as organisations often have strict compliance requirements, such as the US Foreign Corrupt Practice Act (FCPA), in their home jurisdiction.



## What cultural and regulatory factors affect due diligence in different markets?

- David East:** There are both local practical reasons and cultural reasons why deals proceed as they do and as an advisor we try to help our clients understand both aspects. Trying to push through a transaction timetable can cause tensions with the vendor and the seller. As we conduct the due diligence it is important for us to facilitate the deal by helping all sides set realistic expectations.
- Thomas Whitson:** Although this has always been an issue when doing business in Japan, foreign investors need to consider cultural differences even more carefully in the current environment. It is important to show respect and there can be suspicion towards foreign players that go in too aggressively.
- Edward Kim:** The effect of related-party transactions may not be appropriately reflected in financial statements as standard financial statements are prepared on a stand-alone basis under Korean accounting standards. Such risks, however, should be resolved when International Financial Reporting Standards (IFRS) is introduced from 2011.
- Kevin Chamberlain:** Related-party, separation and dependency issues characterise many businesses in Asia Pacific. Often a target company will form part of a larger conglomerate exhibiting complex related-party trading or non-trading activity, some of this unrecorded.
- Honson To:** The due diligence approach in China has become more similar to that of developed markets. China can still be viewed as an emerging market in some respects, but the sheer volume of foreign strategic and private equity investors that have set up in China in recent years means that Chinese companies have seriously upped their game and adapted to the expectations of foreign buyers.

## How soon do you see the M&A market picking up?

- Vincent Chang:** Many companies are underperforming and struggling with mounting debts. I expect the pain will continue to be felt in Taiwan at least through the second and third quarters of 2009.
- Rupert Chamberlain:** Vietnam has seen a definite slowdown in foreign direct investment since mid-2008, both in terms of commitments and the disbursement of prior commitments. The slowdown has forced a reassessment of public expectations and helped to put the brakes on inflationary pressures in some sectors of the economy, particularly real estate. A reality check was probably needed.
- Vincente Sarza:** In the Philippines, there have always been some companies very focused on expansionary activities. The market leaders in many industries remain hungry for growth, and open to opportunities to expand into new sectors. They haven't ceased to acquire so in that sense we haven't seen a real slowdown.
- Honson To:** I expect deal activity to pick up later in 2009 and during 2010, as the expectation gap between buyers and sellers narrows. Companies with sound business models and demonstrated earnings growth are sticking to the valuations they agreed 12 months ago. Eventually, they will have to come to terms with the shortage of funding options.
- Edward Kim:** Many investors including private equity houses are aware that now is a good time to make new investments. Those investors are currently considering new investments and I expect that M&A activities will pick up starting from the third or fourth quarter of 2009.

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