A turbulent but active year ahead in Asia Pacific

While current political and regulatory uncertainty has led some to forecast a sharp downturn in Asia Pacific M&A transactions in 2019, there is good reason to expect continued high levels of activity.

The increasingly unpredictable political, regulatory and economic environment faced by investors has led many commentators to suggest that 2019 will see a significant downturn in the Asia Pacific transactions market.

But while uncertainty will definitely present significant challenges for dealmakers, we believe there will be just as many opportunities, both within the region and globally, for those who remain agile and ambitious.

Chris Moore, Head of APAC Corporate and M&A, comments: “We don’t anticipate a massive drop in APAC M&A transactions this year, but everything we are seeing now points to a turbulent and challenging M&A market”.

A closer look at China

Geopolitical turmoil will inevitably continue to be a significant factor for investors this year. The China-U.S. trade war is having a clear impact, coming on top of tighter domestic controls on outbound investment from China and growing protectionism against Chinese investments in key markets – notably the U.S., but also certain parts of Europe.

It’s important to recognise, however, that, while Chinese investment in the U.S. fell by a staggering 80% in 2018, overall outbound activity remained at the same level as 2017. China partner Ling Li comments: “In 2019 Chinese companies are targeting more friendly regulatory markets such as parts of Europe, South East Asia and markets covered by the ‘Belt and Road Initiative’”.

M&A is intrinsically influenced by political developments in China and that will not change, even though the government appears willing to take a more liberal approach to inbound investment. In March 2019, the People’s Republic of China passed the Foreign Investment Law, which will replace the set of Chinese laws commonly known as the ‘Three Enterprise Laws’ and come into effect in early 2020. China M&A partner Jack Wang comments: “The Foreign Investment Law will undoubtedly be to the liking of foreign investors as it addresses a number of concerns that had long been the subject of complaints by U.S. companies doing business in China, such as forced technology transfer and theft of business and trade secrets”.

Politics can act as a stimulus. For instance, we are seeing some Chinese companies trying to regionalise their operations – relocating to South East Asia, for instance, to mitigate trade war risks. At the same time, with the Chinese government taking a much harder line on corporate debt, this is forcing some to divest overseas assets to deleverage.

Due to funding uncertainty, cash-rich Chinese companies are no longer the dominant buy-side force they were at the giddy heights of the outbound investment boom in 2016, but rather than dampening overall activity, this has opened the way for other investors, notably from Japan.

Japan has the firepower to go on a shopping spree

Japanese companies continue to look outwards for three main reasons: (1) an ageing and shrinking domestic market, (2) huge reserves of corporate cash (estimated to be worth some USD900bn), and (3) a steely belief – which has paid dividends in the past –
that good, attractively priced assets become available at times of greatest uncertainty.

In that sense, the factors that negatively impact Chinese outbound activity are being seen as a positive by the Japanese. Japan partner Nick Wall comments: “the competition Japanese buyers used to face from Chinese bidders and private equity has tapered, putting Japanese investors in a stronger position”.

Choosing markets and targets is becoming more tactical, too; attention is increasingly switching from the region to opportunities in Europe and the U.S., with a focus on mature, well-run companies in these markets. The financial services, automotive and life sciences sectors will be particularly active this year.

Thanks to Brexit, the UK is no longer seen as a bridgehead into the EU, spurring investment in Continental Europe instead. But Japanese companies still see opportunities in the UK in sectors that are weather-proofed against political storms – the drinks and life insurance industries, to name but two.

Japan itself is proving to be a positive hunting ground for inbound investors, notably private equity, as Corporate Japan undertakes large-scale restructuring and divestment efforts in response to a more active shareholder environment.

M&A in South East Asia remains active despite impending elections

M&A activity tends to tail off dramatically as national elections approach. Yet with polls across Thailand, Indonesia and India, we’ve seen little evidence of that this time. M&A activity in all three is holding up effectively.

“The level of uncertainty that dominates the M&A market in an election cycle is just not there. In fact, we are advising on some significant M&A transactions that would not even get off the ground in a normal electoral year but which seem to have significant momentum,” adds Chris.

Foreign investors are also still being drawn to what is South East Asia’s most populous country, Indonesia – with activity across a wide range of sectors (including banking, consumer and retail, and tech). A gradual easing in regulatory hurdles is also expected to attract investment in Indonesia and in other nations around the South East Asian region. For instance, we are witnessing deals in the wake of the liberalisation of the insurance sector in Myanmar.

A number of South East Asian clients are expanding beyond their home markets and becoming more sophisticated M&A players in the region and beyond – by way of example, Allen & Overy recently advised one of the Philippines’ biggest conglomerates on what was the largest outbound acquisition from the Philippines.

The Vietnam market is another exciting emerging market; while volatile and not without its challenges, it is one of the fastest-growing economies in the world. Investor interest continues to grow, and its strategic location and economic and demographic prospects make it a key jurisdiction for many of our clients.

While we saw a drop in M&A activity in Malaysia last year as a result of the commendable political uncertainty in the fall out from the 1MDB crisis, there are expectations that the country will become a hot spot for South East Asia M&A activity as the new government begins restructuring and disposing of assets to plug the Budget deficit. Another market to watch.

A new approach to deal-making in 2019

Disruption, in various forms, poses a significant challenge to M&A activity. We look here at how three forms of “disruption”: (1) regulatory; (2) financial; and (3) technological, are impacting our M&A markets.

1. The growth of antitrust and other regulatory interventions in an increasing number of jurisdictions will be a challenge for deal completion. When these are purely rules-based, investors know where they stand and what remedial action to take. When political considerations are driving interventions – as we see with the proliferation of national interest screening across the world – the risk becomes much harder to read and to manage.

2. Traditional financing options are being shaken up by the emergence of alternative funding sources, such as the provision of unregulated debt by credit funds, often the lending arms of private equity firms. This trend started in the U.S. and Europe and has now spread to Asia, with insurers and pension and sovereign wealth funds providing liquidity to these new lenders as they try to
diversify their portfolios and to achieve
higher returns.

APAC Banking partner Vicki Liu comments:
“This is largely an unregulated activity which
means credit funds are able to provide the debt on
flexible terms and flexible governance to enable
borrowers to structure their business in a way
which gives them more certainty. It also coincides
with the needs of the private funds providing this
source of liquidity, such as the pension funds, the
insurance funds, and sovereign wealth funds who
are looking for higher returns on their investments
and trying to diversify their investments into
different types of assets”.

3. Technology disruption is boosting activity in two
senses. The big tech companies continue to
aggregate technologies on their expanding
platforms, investing heavily and at great speed; at
the same time traditional industry players are
investing in technology, often through acquisition
or joint ventures, not just to stave off disruption
impinging on their operations but also to embrace
more efficient business models.

Partner Connell O’Neil comments: “There is a
trend of technology companies bringing new
disruptive and scalable technology-enabled
business models to market which challenge
traditional industry. This is forcing corporates to
look at their future and what technology will bring.
These traditional industry incumbents are
increasingly addressing disruption through
technology company acquisitions or joint ventures
that they think will enable them to digitally
transform to stay ahead of the new competition”.

Significant activity by the tech players is driving up
asset prices and changing the way deals are done.
Traditional players are being forced to relinquish
their conservative approach to deal-making to
manage the super-quick, “buy first, fix it later”
tactics of the tech companies – something that’s
particularly evident in South East Asia’s booming
tech sector and China.

It all adds up to a more dynamic picture than some
forecasters suggest.

Partner Bernardine Lam concludes: “While there is no
guarantee the market will match the USD688bn of deals
seen in 2018, we see good reasons to expect activity to
remain buoyant with plenty of opportunities for those
investors who hold their nerve and remain nimble.
Like we are already seeing, when there is a shift in one
market it opens up the opportunity for another market
to participate”.
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