Intersections

Second-quarter 2009 global transportation and logistics industry mergers and acquisitions analysis

China: Balancing the risks and opportunities

Welcome to *Intersections*, PricewaterhouseCoopers' quarterly analysis of mergers and acquisitions (M&A) in the global transportation and logistics industry. In addition to a detailed summary of M&A activity in the second quarter of 2009, we supplement this issue with a special report that highlights potential growth opportunities and considerations of engineering and construction companies doing business in China. Included is a discussion around China's role and stature in the international economic order, its spending priorities, and equal-partner expectations of foreign investment.

Special report:
China looks for global partners

For global companies struggling through the recession, China's growth rate, which forecasters in China and the United States now expect to approach or even exceed 9 percent for 2009[1], is enticing. So, too, are the hundreds of billions of dollars that China has committed to bolster its domestic demand and pursue investment in a multi-layered economic stimulus effort. World Trade Organization (WTO) chief economist Patrick Low said China is likely to overtake Germany as the largest merchandise exporter because of the weak European economy.

But it is important for companies that see opportunity in China's robust anti-recession efforts to recognize how China's role and stature in the international economic order are maturing, driven by national aspirations, financial capabilities, and the realities of the global recession. It is also important for companies to be aware that China's worldwide exports are diminishing and may never return to prerecession levels. If China is to achieve its economic objectives, it can no longer be through export-led growth alone.

In our experience, the companies best positioned to succeed are those willing to align themselves with China's strategic development priorities and approach Chinese business relationships as partnerships, rather than investor-investee transactions.

A stimulus mind-set

China does not have a discrete stimulus plan. Although the Chinese central government in December announced a RMB 4 trillion ($586 billion) spending program, the parameters, details, and funding of that program remain somewhat opaque and subject to change. It is difficult to establish, for instance, which spending was already programmed for initiatives such as earthquake reconstruction and which is truly incremental.

Spending priorities appear to have shifted over the last few months, with quick-hitting health, education, and social spending accounting for a larger portion than first anticipated, when traditional infrastructure was the emphasis.

In fact, the most aggressive stimulus efforts are coming through monetary policy. The government-influenced banking sector blew by the 2009 target of RMB 5 trillion lent by the end of May, according to The Conference Board. That figure exceeds the government's entire two-year spending plan. Most of that lending is providing financing for Chinese businesses and local government projects rather than consumer spending.

Economic indicators show these measures are working, with most economists crediting China's aggressive fiscal and monetary stimulus policies with sustaining economic growth. At the same time, many of the same observers say that China needs to formulate a plan for ratcheting down its stimulative lending policies to a more sustainable level before they lead to inflation and asset bubbles.[2]

An equal partner, not a subsidiary

For many years, foreign investors have moved into China for two essential reasons: to capitalize on its sustained growth and to pursue cost rationalization through lower-cost labor, particularly in manufacturing.

But this transactional approach to doing business in China is waning. And in recent years, the Chinese government has continually rewarded companies willing to align themselves with the nation's strategic economic goals of increased industrialization, technological transfer, and infrastructure development.

[1] "China needs exit plan for monetary policy—economist," *Thomson Reuters*, July 28, 2009; "Merrill Lynch hikes China growth forecast," *The Wall Street Journal*, July 27, 2009

[2] "Reality check for China's monetary policy," *Caijing*, July 23, 2009

Moving forward, successful companies will see China as more than a marketplace of 1.3 billion people with a growing GDP. For example, a company that just wants to sell a piece of equipment into the Chinese market or cut labor costs may find less opportunity than a company willing to partner with the Chinese on a rural development project.

It is clear that China's spending and lending plans aim primarily to help Chinese citizens and Chinese companies. A major company operating in China may enhance its business prospects by partnering with or acquiring a strategic Chinese firm. As the demand for Chinese exports declines, industrial, technology acquisition, and infrastructure priorities will not be enough to sustain China's economy. However, government programs aimed at spurring consumer confidence, such as health insurance plans and pensions, likely will create a domestic market to help compensate for this drop.

Rural development, seen as critical to long-term Chinese social stability and exemplified by the response to the devastating Sichuan province earthquake last year, is a key priority for stimulus spending. For instance, the central government recently announced more than $100 billion in new hospital construction for rural areas. This demonstrates how economic and social priorities often mix in China.

China's global impact

The influence of the Chinese government can have important consequences, both for companies looking to do business with the Chinese and for companies whose business overlaps with Chinese priorities, such as resource- and technology-related sectors.

For instance, on June 23, 2009, the United States and European Union filed a WTO complaint alleging that China has been placing export restrictions on certain industrial raw materials. According to the complaint, such restrictions lead to excess capacity within China and lower prices for domestic Chinese companies needing to purchase the materials for internal business ventures, many of which are funded by the stimulus efforts. At the same time, China has been importing many of the same raw materials, propping up international prices.

Most observers have seen these moves by the Chinese as an officially sanctioned stockpiling effort, a point of view confirmed in late June by Yu Dongming, chief of the metallurgical division of China's National Development and Reform Commission's industry department.[3]

Media reports at the time said Yu also said that the State Reserve Bureau had ceased its purchases and that the stockpile program had run its course and achieved its objectives of stabilizing prices and replenishing stocks.

The stockpiling effort has helped many companies in transportation and logistics as it partly compensated for the drop in demand from the United States and European Union as the financial crisis and global recession have deepened since late 2008.

However, now that China has announced a halt to stockpiling, some observers worry that underlying demand for raw materials will slacken.

Given how important China has become economically, companies wishing to build or maintain relationships with Chinese counterparts should recognize they are expected to act as an equal partner and may be asked to give up technological and management know-how in exchange for market access.

[3] The Globe and Mail, "As China Hoards, Concern Grows About Recovery," June 24, 2009

Perspective:
Thoughts on deal activity in the second quarter of 2009

Welcome to the second-quarter 2009 update of *Intersections*, our global transportation and logistics deal analysis. In this update, we have examined the historical contribution of BRIC mergers and acquisitions to the sector's overall deal activity this decade and find that the importance of BRIC entities has increased significantly — driven primarily by large increases in deals within Russia and China. The outlook for BRIC deals, which should continue to benefit from the growing wealth and industrialization of Brazil, Russia, India, and China, remains a bright spot in an otherwise anemic deal environment.

Aggregate deal activity during the first half of 2009 remained weak, far behind the pace of recent historically strong years. Companies mostly focused on weathering the economic downturn instead of committing their available capital to new deals. As highlighted in earlier editions of *Intersections*, deal interest has shifted to smaller deals, including more minority stakes and modest acquisitions of remaining interest. In fact, the three largest deals announced so far in 2009 were all minority stake purchases or purchases of remaining interest.

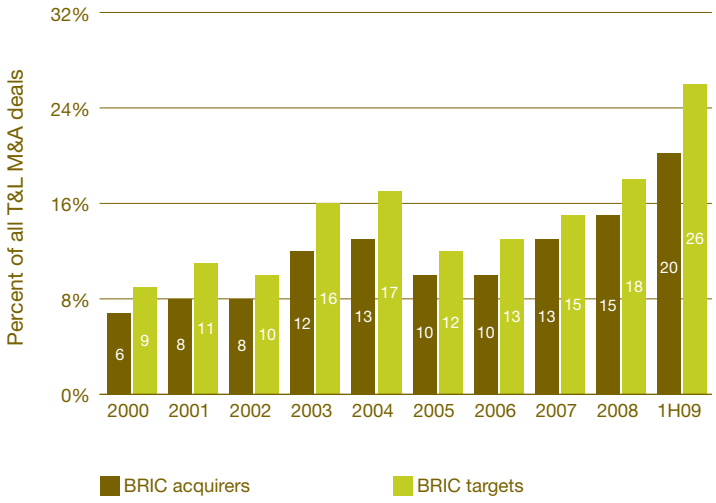
Our expectation that deal flow would also focus on distressed targets held true, as exemplified by several passenger airline deals involving targets that include Alitalia, Frontier Airlines, and Midwest Airlines. Even though regulatory barriers to deals between passenger airlines are generally substantial, operational challenges such as a prolonged recession and high oil prices could still lead to more deals for distressed targets in this part of the sector.

We continue to expect more local-market than cross-border consolidation for the balance of 2009 because of a preference for generating near-term synergies domestically instead of attempting to grow in foreign, and possibly new, markets. In addition, the rise of nationalism in the face of weak economies and a tougher regulatory environment should continue to hamper cross-border activity for large deals. In particular, the US Department of Justice has signaled it will amplify scrutiny of new deals.

Although we still see improvements in credit market liquidity, with increases in both investment-grade and high-yield debt issuance in the first half of 2009 compared with the first half of 2008, syndicated lending continues to be negatively impacted by weakness in the banking sector, which could remain an impediment to future deal activity. For the second half of 2009, we continue to believe that economic recovery is necessary for aggregate deal activity to improve because it will provide the impetus for sector constituents to reevaluate how M&A can improve their competitive positioning.

Commentary

BRIC deal activity relative to all M&A deals
Measured by percent of deals (2000-1H09)



Russia, China lead BRIC acceleration

In what mirrors a broader M&A trend, the contribution of BRIC entities to transportation and logistics deals has increased significantly since 2000. In 2000, BRIC acquirers and targets participated in only 6 percent and 9 percent of deals in the sector, respectively. During the first half of 2009, BRIC acquirers and targets accounted for 20 percent and 26 percent of deals in the sector, respectively.

Entities from Russia and China have accounted for most of this relative increase in BRIC deals, and deal activity involving these entities has also grown on an absolute basis. Specifically, for 2009, deals involving Russian entities are on pace to exceed, and Chinese deals to approximate, 2008 levels.

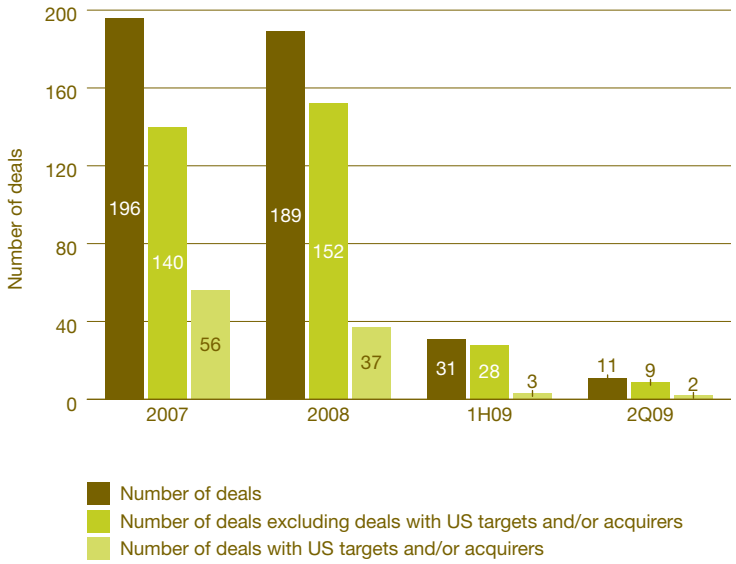
In Russia, the most common characteristics of deals for transportation and logistics targets are that they tend to be heavily skewed toward local-market transactions and despite the credit market turmoil, involve financial investors. For example, during the first half of 2009, approximately 95 percent of deals by Russian acquirers were for local entities, and almost 60 percent of deals were initiated by financial investors. In particular, these local-market and financial investor deals have contributed to the consolidation of the trucking and logistics areas of the sector, with individuals and investor groups taking a number of minority and incremental stakes in these targets.

In China, most activity has also come in local-market consolidation. However, strategic acquirers have played a much more significant role in deals compared with the Russia market. Local-market acquirers have approximated 67 percent of deals for targets in China since 2000, with this number edging up to 75 percent during the first half of 2009. In addition, strategic investors have generally contributed the majority of deals for these targets in each period since 2000.

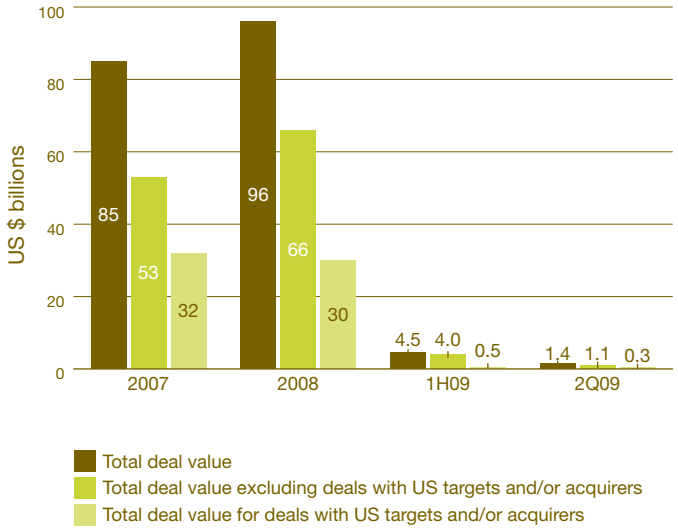
Recently, the passenger air category has seen a fair amount of consolidation. In 2009, state-owned enterprises have made several deals for passenger air targets; the largest of those with a disclosed value was state-owned Jinjiang International Holdings' incremental stake in Shanghai Airlines.

The overall outlook for deal activity involving BRIC entities is positive, supported by adequate access to capital as well as the general growth in wealth and population of these nations as they industrialize and integrate into the global economy. Although BRIC entities in more commodity-driven sectors such as energy and metals have flexed their financial muscle through cross-border acquisitions of natural resources, it is likely that the strategy for deal making by BRIC companies will remain focused on benefitting from domestic growth by building scale and share within home geographies.

Deal activity by number of deals
Measured by number of announced deals worth $50 million or more



Deal activity by total deal value
Measured by value of announced deals worth $50 million or more



Deal makers hit the brakes globally

Deal activity for transportation and logistics targets has slowed dramatically, with both the number and value of deals worth $50 million or more announced during the first half of 2009 far behind the pace of the prior two years. The 31 deals and $4.5 billion of deal value announced during the first half of 2009 significantly lagged the historically high pace of activity of 2007 and 2008. Over this same period, the contribution of US entities to overall transportation and logistics deal activity also slowed, with US entities involved in approximately 10 percent of deals announced so far in 2009, compared with 29 percent in 2007 and 20 percent in 2008. Overall in 2009, 11 deals and $1.4 billion in deal value were announced during the second quarter, compared with 20 deals and $3.1 billion in the first quarter.

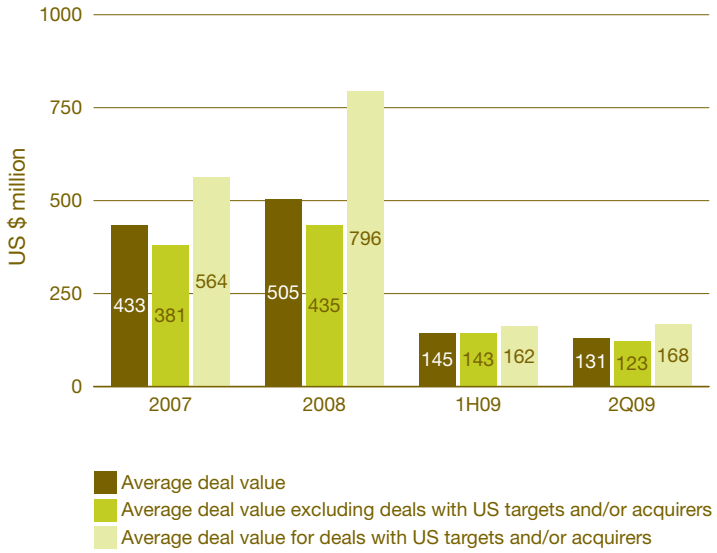
In previous reports, we noted the tendency of M&A activity in this sector to follow trends in economic growth. Although it is still too early and the environment too uncertain to make a formal projection, should the US economy recover sooner than the economies of other developed nations, it is possible that a rebound in deals involving US entities could portend a recovery in the overall deal market for targets in the sector.

Lack of large transactions keeps values lower

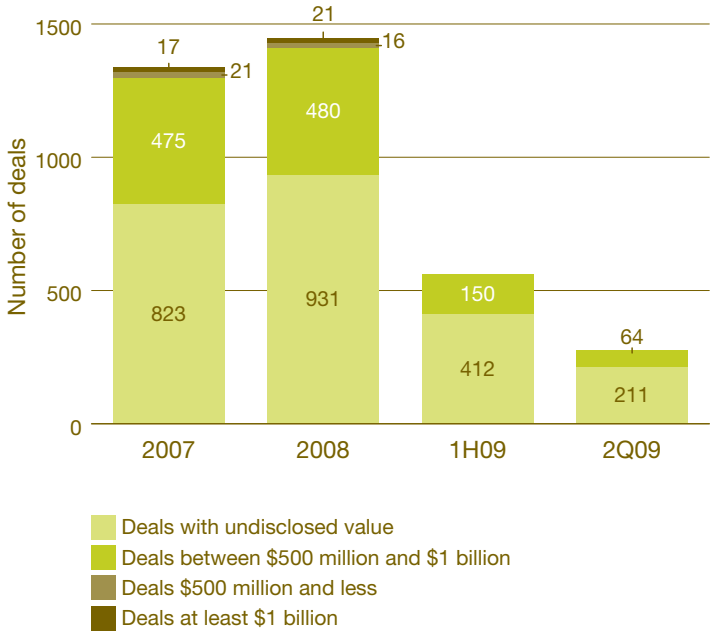
Average deal values during 2009 remain below the levels of the prior two years because credit restraints and the overall weaker deal market have contributed to an absence of large deals (worth at least $1 billion) this year. The impact of these factors is also demonstrated by the trends in the number of deals and range of deal value, which show an absence of deals topping $500 million in 2009, compared with 38 and 37 such deals in 2007 and 2008, respectively.

Although the lower end of the deal market remains robust, the collapse of the higher end of the market is very apparent. Clearly, transportation and logistics companies have spurned large M&A transactions in favor of performance improvements such as boosting liquidity and reducing costs.

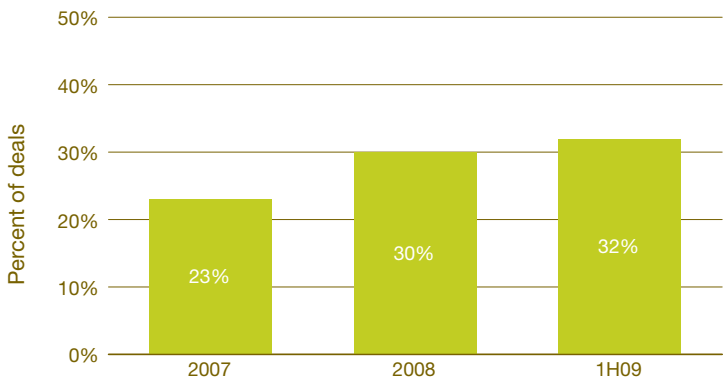
Deal activity by average deal value
Measured by value of announced deals worth $50 million or more



Deal activity by number and range of deal value
Measured by number of announced deals



Minority stake purchases
Measured by percent of deals worth $50 million or more for <50% ownership

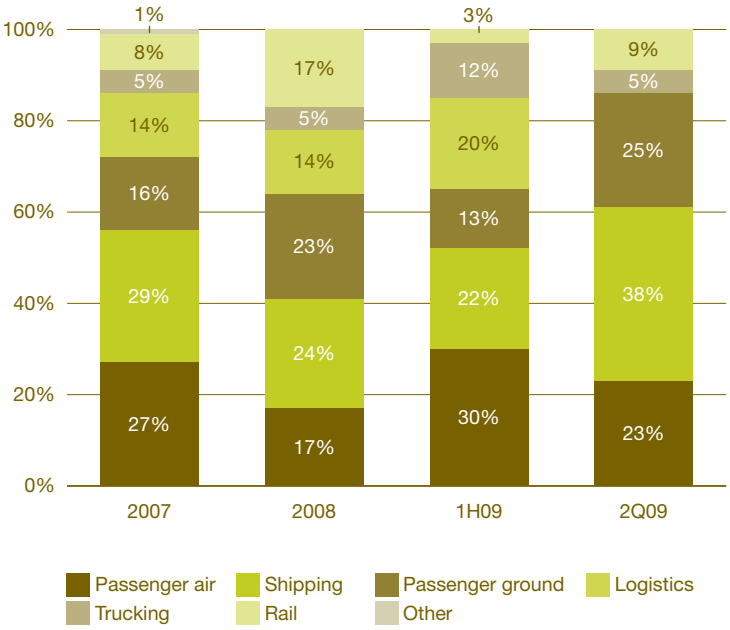


Buyers favor minority stake purchases

The more cautious deal environment is also reflected in the proportional increase in minority stake acquisitions since 2007. Deals that involved the acquisition of a minority stake have increased from 23 percent of transactions in 2007 to 32 percent during the first half of 2009. This confirms our expectation, noted in recent editions of *Intersections*, that interest in minority stakes will remain high, relative to all deals.

We continue to expect relatively high interest in minority stakes during the balance of 2009 because of the influences of tight credit and greater risk aversion on the part of potential acquirers.

Deal activity by transportation and logistics mode
Measured by value of announced deals worth $50 million or more



Wheels up for passenger air acquisitions

Interest in transportation and logistics targets has shifted among modes during 2009 compared with 2008. In particular, the relative interest in passenger air and trucking targets has increased significantly in the first half of 2009 compared to 2008. Given that the current economic woes should be expected to lead to more deals of necessity, it is noteworthy that several of the recent deals for targets in these modes could be thought of as distressed.

For example, among passenger air deals, the Air France-KLM acquisition of a minority stake in Alitalia from the Italian government follows a series of transactions involving the airline. These include government-sponsored Compagnia Aerea Italiana's September 2008 acquisition of Alitalia's passenger air assets out of bankruptcy (a transaction that is highlighted in our 2008 large deals table).

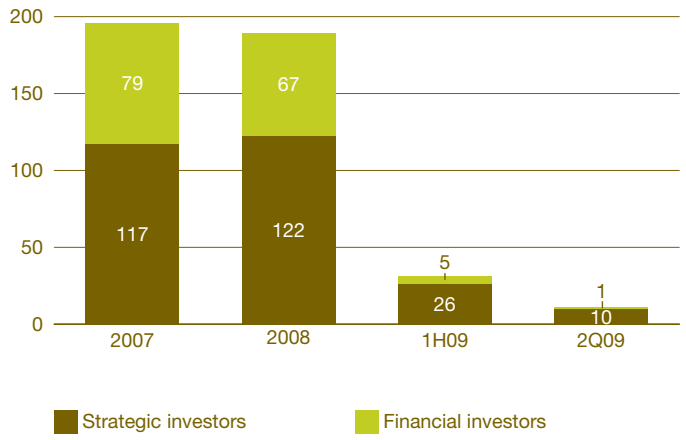
In addition, during the second quarter, US regional jet service provider Republic Airways Holdings announced a plan to purchase Frontier Airlines Holdings out of bankruptcy, as well as a plan to purchase Midwest Airlines from private equity firm TPG Capital. Both of these transactions would shift Republic's focus away from a business model centered on fee-for-service flying for the major airlines and toward more direct competition with these major airlines. Also, both of these transactions represent acquisitions of distressed targets.

Investors increasingly wary

While strategic and financial investors both have demonstrated a general disinclination to engage in deals during 2009, the decline in financial investor participation in deals for transportation and logistics targets remains particularly acute. This trend was predicted in previous editions of *Intersections*. Financial investors have been involved in only 16 percent of the total deals announced in 2009, which compares with 40 percent and 35 percent of the deals announced in 2007 and 2008, respectively.

Financial investors have historically demonstrated a strong interest in shipping targets, though there has been a lack of interest in these targets so far in 2009. But when this trend is considered in conjunction with the large decline in total deal involvement by financial investors, it is difficult to infer that the interest of these acquirers has shifted over time. Looking forward, it would be reasonable to expect that both financial and strategic interest in transportation and logistics deals would improve only if concurrent with an economic recovery, given the strong relationship among healthy credit markets, economic output, and deal activity.

Deal activity by investor group
Measured by number of announced deals worth $50 million or more



Large deals in 2007 (deals with a disclosed value of at least $1 billion)

Month announced	Target name	Target nation	Acquirer	Acquirer nation	Status	Value of transaction in US$ bln	Category
Nov	Iberia Lineas Aereas de Espana SA	Spain	Investor group	Spain	Intended	5.47	Passenger air
Mar	Iberia Lineas Aereas de Espana SA	Spain	Investor group	Spain	Withdrawn	4.59	Passenger air
Aug	Mexican Toll Roads	Mexico	Investor group	Mexico	Pending	4.03	Passenger ground
Feb	Laidlaw International Inc	United States	FirstGroup PLC	United Kingdom	Completed	2.82	Passenger ground
Feb	State Highway 121	United States	Cintra Concesiones de Infraestructuras de Transporte SA	Spain	Completed	2.80	Passenger ground
Jul	Sabiha Gokcen International Airport	Turkey	Investor group	India	Completed	2.66	Passenger air
Sep	Dakota, Minnesota & Eastern Railroad Corp	United States	Canadian Pacific Railway Ltd	Canada	Completed	2.54	Rail
Mar	EGL Inc	United States	Ceva Logistics	Netherlands	Completed	2.24	Logistics
May	Florida East Coast Industries Inc	United States	Fortress Investment Group LLC	United States	Completed	2.24	Rail
Jun	Scandlines AG	Germany	Scandlines AG Special Purpose Vehicle	Denmark	Completed	2.09	Shipping
Jan	EGL Inc	United States	Investor group	United States	Withdrawn	1.92	Trucking
Apr	OMI Corp	United States	Investor group	Bahamas	Completed	1.81	Shipp
Oct	Labroy Marine Ltd	Singapore	Dubai Drydocks World LLC	Utd Arab Em	Completed	1.60	Shipping
Jan	Guggenheim Aviation Investment Fund LP-Aircraft Assets(38)	United States	Aircastle Ltd	United States	Completed	1.60	Passenger air
Oct	UN Ro-Ro Management Inc	Turkey	Kohlberg Kravis Roberts & Co	United States	Completed	1.30	Shipping
May	Port of Izmir	Turkey	Investor group	Hong Kong	Completed	1.28	Shipping
Aug	NCL Corp Ltd	Bermuda	NCL Investment Ltd	Bermuda	Completed	1.00	Shipping

Large deals in 2008 (deals with a disclosed value of at least $1 billion)

Month announced	Target name	Target nation	Acquirer	Acquirer nation	Status	Value of transaction in US$ bln	Category
May	Pennsylvania Turnpike	United States	Investor group	Spain	Withdrawn	12.80	Passenger ground
Jun	Angel Trains Ltd	United Kingdom	Investor group	Australia	Completed	7.01	Rail
Oct	Hapag-Lloyd AG	Germany	Albert Ballin GmbH & Co KG	Germany	Completed	4.70	Shipping
Jan	Korea Express Co Ltd	South Korea	Investor group	South Korea	Completed	4.33	Logistics
Oct	Porterbrook Leasing Co Ltd	United Kingdom	Investor group	Germany	Completed	3.11	Rail
Apr	Northwest Airlines Corp	United States	Delta Air Lines Inc	United States	Completed	2.96	Passenger air
Aug	Asciano Group	Australia	Asciano Group SPV	United States	Withdrawn	2.68	Rail
Sep	Midway International Airport	United States	Investor group	United States	Withdrawn	2.52	Passenger air
Apr	Prosafe SE-FPSO Business	Cyprus	Shareholders	Cyprus	Completed	1.66	Shipping
Jan	Quintana Maritime Ltd	Greece	Excel Maritime Carriers Ltd	Greece	Completed	1.63	Shipping
Sep	Smit Internationale NV	Netherlands	Koninklijke Boskalis Westminster NV	Netherlands	Withdrawn	1.55	Shipping
Feb	Japan Airlines Corp	Japan	Investor group	Japan	Completed	1.48	Passenger air
Jan	Cia de Distribucion Integral Logista SA	Spain	Imperial Tobacco Group PLC	United Kingdom	Completed	1.40	Logistics
Sep	Alitalia Linee Aeree Italiane SpA-Passenger Assets	Italy	Cia Aerea Italian Srl {CAI}	Italy	Completed	1.31	Passenger air
Oct	Hapag-Lloyd AG	Germany	Albert Ballin GmbH & Co KG	Germany	Intended	1.24	Shipping
Mar	Rodoanel Oeste	Brazil	Integracao Oeste	Brazil	Completed	1.18	Passenger ground
Jun	XB Luxembourg Holdings 1 SA	Luxembourg	DSV Air & Sea Holding A/S	Denmark	Completed	1.17	Logistics
Oct	Dom Pedro I Highway	Brazil	Integracao Dom Pedro I	Brazil	Pending	1.14	Passenger ground
Jan	LLX Logistica SA	Brazil	Shareholders	Brazil	Completed	1.12	Logistics
Dec	Los Lagos	Chile	Atlantia SpA	Italy	Pending	1.06	Passenger ground
Mar	Global Ship Lease Inc	United Kingdom	Marathon Acquisition Corp	United States	Completed	1.03	Shipping
Mar	Groupe Eurotunnel SA{GET SA}	France	Goldman Sachs Group Inc	United States	Pending	1.02	Rail

Top 10 midmarket deals 1H09 (deals with a disclosed value of less than $500 million)

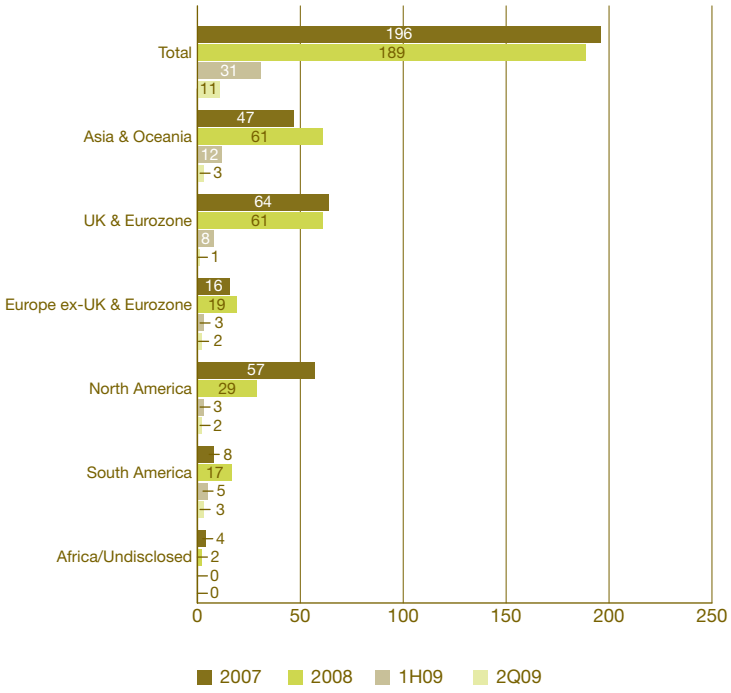
Month announced	Target name	Target nation	Acquirer	Acquirer nation	Status	Value of transaction in US$ bln	Category
Feb	De Post-La Poste	Belgium	CVC Capital Partners Ltd	Luxembourg	Pending	0.48	Logistics
Jan	Alitalia Linee Aeree Italiane SpA	Italy	Air France-KLM SA	France	Completed	0.43	Passenger air
Jan	JPExpress Co Ltd	Japan	Japan Post Service Co Ltd	Japan	Completed	0.37	Logistics
May	Ayrton Senna & Carvalho Pinto Highway	Brazil	Impregilo SpA	Brazil	Completed	0.30	Passenger ground
Feb	Olympic Airlines SA	Greece	Marfin Investment Group	Greece	Pending	0.24	Passenger air
May	Lider Aviacao Holding SA	Brazil	Bristow Group Inc	United States	Completed	0.23	Passenger air
Apr	Rem Offshore ASA	Norway	Rem Offshore ASA	Norway	Pending	0.17	Shipping
Apr	Korea Line Corp-Drilling Barges(5)	South Korea	Tiger United SA	Panama	Completed	0.16	Shipping
Jan	Seibu Transportation Co Ltd	Japan	Seino Holdings Co Ltd	Japan	Completed	0.16	Trucking
Mar	Port of Oakland	United States	Highstar Capital	United States	Pending	0.15	Shipping

Midmarket deals occurring globally

Large deal activity remains moribund, with no large deals announced during the first half of 2009, as credit illiquidity, a greater focus on capital preservation, and a weaker operating environment have shifted attention in the sector toward smaller deals, minority stakes, divestitures, and distressed targets. The largest announcements during the first half of 2009 could be classified as midmarket. They were led by two logistics deals and one air deal: the purchase of a minority stake in Belgium's largest postal service provider, De Post-La Poste, by CVC Capital Partners; Japan Post Service's incremental stake in JPExpress; and the Air France-KLM-Alitalia passenger air deal.

Though well-capitalized strategic buyers should continue to be relatively advantaged in this market, it is likely that these acquirers will shy away from large deals until the certainty of any economic recovery is established.

Regional distribution of all deals by target region
Measured by number of announced deals worth $50 million or more



Local-market vs. cross-border deals (all nations)
Measured by number of announced deals worth $50 million or more

Regional distribution

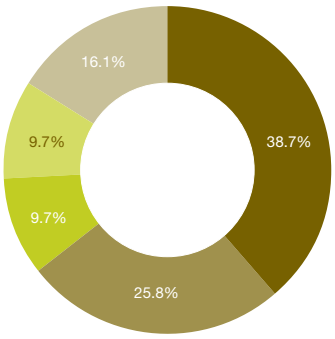
The regional distribution of all deals indicates that interest in Asia and Oceania and South America targets has increased, relative to all deals, during the first half of 2009 compared with the previous two years. Over this same period, interest in targets from regions with more developed nations, including the UK and Eurozone and North America, has declined on a relative basis. The former has been driven by relative strength in demand for targets in China and Japan, with the latter driven by declines in activity for targets in the United States, the United Kingdom, and France.

The proportion of deals that involve local-market entities, relative to cross-border transactions, has increased for deals announced during 2009. Several factors have likely contributed to this trend, including a preference for using M&A transactions to generate synergies and build scale in existing geographic markets rather than to expand into new geographies. In addition, the rise of protectionist sentiments in the face of concern over the global economy has also contributed to the relative deterrence of cross-border deals.

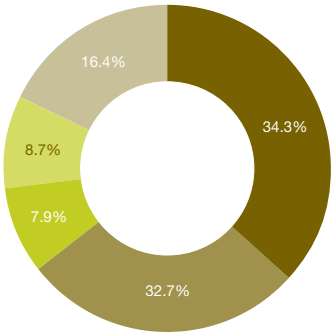
Hottest spots are Asia and Oceania

Acquirers and targets in the Asia and Oceania accounted for the majority of deal activity as measured by both the number of deals and deal value announced during the first half of 2009. The UK and Eurozone region had the next most significant amount of deal activity, despite the decline in targets in this region as previously noted. Asia and Oceania activity was led by several deals for logistics targets involving entities from Japan, as well as several deals for shipping targets involving entities from Indonesia. Meanwhile, the activity involving UK and Eurozone entities was largely diversified across several nations in the region.

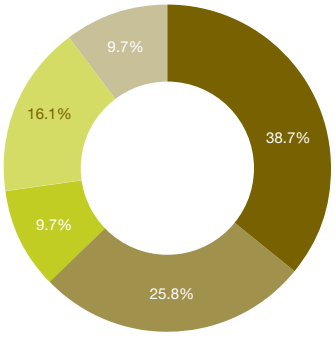
Regional distribution of deals by target region
Measured by number of deals worth $50 million or more (1H09)



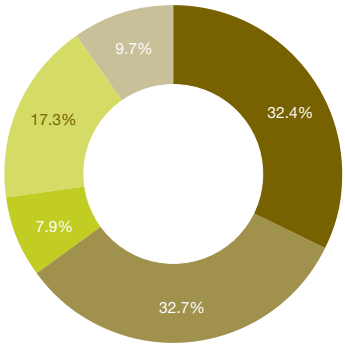
Regional distribution of deals by target region
Measured by value of deals worth $50 million or more (1H09)



Regional distribution of deals by acquirer region
Measured by number of deals worth $50 million or more (1H09)



Regional distribution of deals by acquirer region
Measured by value of deals worth $50 million or more (1H09)



Asia & Oceania | UK & Eurozone | Europe ex-UK & Eurozone | North America | South America | Africa/Undisclosed

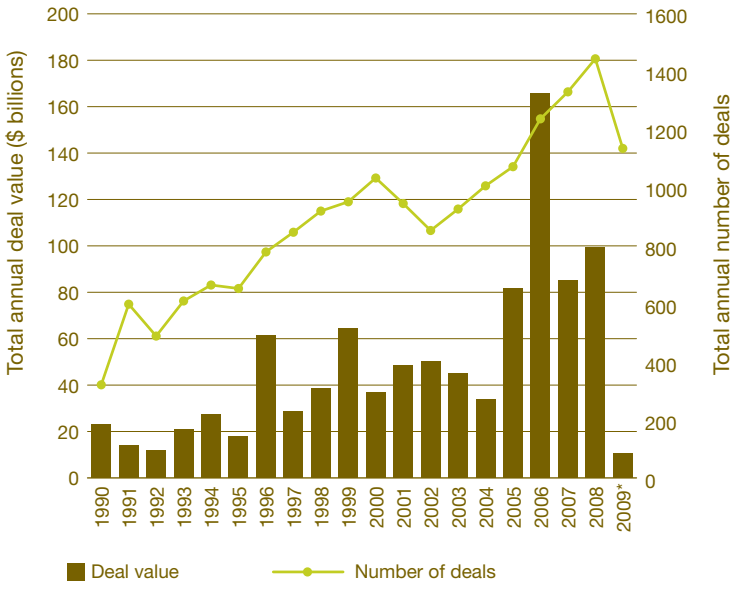
Many deals taking place, but at lower values

A historical comparison of the annualized number of deals and deal value announced during the first half of 2009 presents an interesting dichotomy. The annualized number of deals announced for transportation and logistics targets during the first half of 2009 would represent the fourth-highest number of deals in any year since 1990, while the annualized deal value would represent the lowest deal value announced in any year over this same period.

Historically, the number of deals announced for targets in the sector tends to decline during recessionary periods. However, the value of deals announced during 2009 has declined to a far greater extent than the number of deals because of the additional, and exacerbating, factor of illiquid credit markets. In conjunction, deal activity during recessions shifts toward transactions for smaller targets or targets with an undisclosed value.

Looking forward, deal value is likely to remain relatively weak in a historical context because the environment in the transportation and logistics sector could remain hostile to large transactions. However, we expect the long-term drivers of consolidation, including the need to improve growth potential, to provide some support for M&A transactions even in this difficult economic time.

Historical value and volume of announced deals (*2009 annualized)



Preparing your company to enter the Chinese marketplace?

China's reported 7.9 percent growth for the second quarter of 2009 is creating hope that the world recession may be easing. Bank of America Merrill Lynch recently raised its forecast for this year's China economic growth rate to 8.7 percent from 8 percent. In late July, copper reached its highest price since early October.[4] Also in July, a Sino-US strategic and economic dialogue, the first of its kind, took place in Washington, D.C. Amid these developments, recent surveys show that US, European, and other Asian company CEOs and boards are spending time considering their China strategies. However, in their effort to align the opportunity and achieve greater partnership balance, there is also increasing concern about the potential risks and penalties involved, which is requiring more thoughtful analysis.

Industrial product company executives thinking about entering China must ask themselves several questions:

- **What do we each bring to the party?** Perhaps most important to success in China is to demonstrate value to the transaction. China is acutely aware that its market is highly attractive to foreign investors, and officials know that this gives them leverage to make demands. Chinese laws and regulations preferentially encourage foreign companies that bring R&D capabilities, advanced technology, other forms of intellectual property, environmental protection systems, innovative manufacturing processes, or a combination thereof to the market.
- **Am I willing to share what I have?** In almost every case, the government aims to take foreign technology and produce its own version. That may be the price of admission to the Chinese market, but not all companies are willing to pay.
- **Am I aware of all potential risks?** The media attention around the recent arrest of four Rio Tinto staff members in China on charges of spying highlights a potential risk of doing business in China.
- **Am I in this for the long haul?** Consider the current and future objectives in China. Do you want to outsource materials/components or assemble finished products? Or make products for consumption in the local market?
- **Have I clearly mapped all relevant supply routes?** This includes thinking about backup routes or modes of transportation that can be used in the event of a disruption.

Finding the right entry strategy

After a company has assessed its preparedness and feels ready to navigate the various obstacles posed by China's regulatory and logistical infrastructure, it must focus on a strategy that emphasizes collaboration over pure control by adhering to the following practices:

- Harmonize company goals and objectives with those of stakeholders in China. Map out stakeholders in China, beyond factory workers and immediate consumers, to include local, regional, and national government, local community, regulatory bodies, etc.
- Ensure corporate headquarters understands the needs and aspirations of these stakeholders and understands existing and potential conflicts. Where conflicts exist, establish broad guidelines that can be applied and understood by all so that conflicts are resolved strategically rather than tactically.
- Instead of selling specific products, understand the objectives of the local community, such as rural and infrastructure planning, and cater to these needs.

With the emergence of China as a world economic power, its attitude toward international companies' participation has changed. The Chinese people, while providing a source of labor for mass market products, also represent a source of growth. Additional Chinese attributes that should be understood by industrial products companies considering expansion into China include:

- Chinese companies appear to lag international companies in management processes, value creation for shareholders, and brand perception among consumers.
- Existing Chinese-owned and -operated companies dominate the low-end market, Western companies predominate the high-end luxury goods market, but the mid-level market is up for grabs.
- Since joining the WTO, China has gradually eased its regulatory structure and has become more "corporate" friendly.
- China's new generation of young managers appears to be well-educated and sophisticated. Although they may lack real-world training, they eventually will bridge the gap between global multinational corporations and the Chinese market.

PricewaterhouseCoopers' Transaction Services group advises corporations and private equity firms on acquisitions, divestitures, joint ventures, initial public offerings, and other capital market transactions. Our practice consists of dedicated, experienced deal and industry professionals providing financial, tax, and other due diligence advisory services. With global transaction experience serving corporate and private equity clients, we can provide information and assistance to help you choose the right deals and enhance your ability to negotiate with power and control, which could create opportunities for greater returns from transactions. Our integrated M&A services are designed to help you minimize your transaction risks and maximize returns on investments. Our services span your entire deal continuum, from target identification and screening to execution to synergy capture to exit. PwC offers services designed to help you achieve greater returns over your deal continuum.

[4] "METALS - China demand helps copper rally to 10-month high," *Reuters*, July 27, 2009

Specialty case study:
A Hong Kong company looks to acquire a port facility in China

Client: Transportation and logistics company

Client Issue	A Hong Kong company with existing infrastructure and logistics services in China needed more information on a potential target operating a port facility in Korea. Before making a decision on whether to proceed with the acquisition of the target, the client wanted a thorough understanding of the port's business performance and competitive position in the region. In particular, the client needed information on the local market size and future growth potential for the transshipment and non-transshipment sectors in Northeast Asia and Korea. Also of concern was the potential threat presented by other local ports and Chinese ports in the area and how they would affect target market share forecasts.
Approach	A PricewaterhouseCoopers strategy team was engaged to forecast future demand for container handling in Korea and assess future capacity for transshipment in Chinese ports. The PwC analysis included research and interviews with government and industry specialists to assess the competitive advantages of location, ability to accommodate larger vessels, and favorable prices. We also assessed customers' interest and reaction to the Korean facility and helped forecast the port's capacity utilization rate in future years via potential customer interviews. In addition, the team identified some risk factors based on customers' concerns about the Korean facility.
Impact	The PwC team helped the client understand the regional market potential and the target company's future growth and competitive position in the target location. Based on PwC's findings and analysis, the client has a well-founded outlook for the future profitability of the new Korean port when it starts operation. The client was also better able to assess the target company's management projections. By acquiring the target company, the client was able to further expand its business coverage in Northeast Asia.

PricewaterhouseCoopers' transportation and logistics experience

Deep transportation and logistics experience

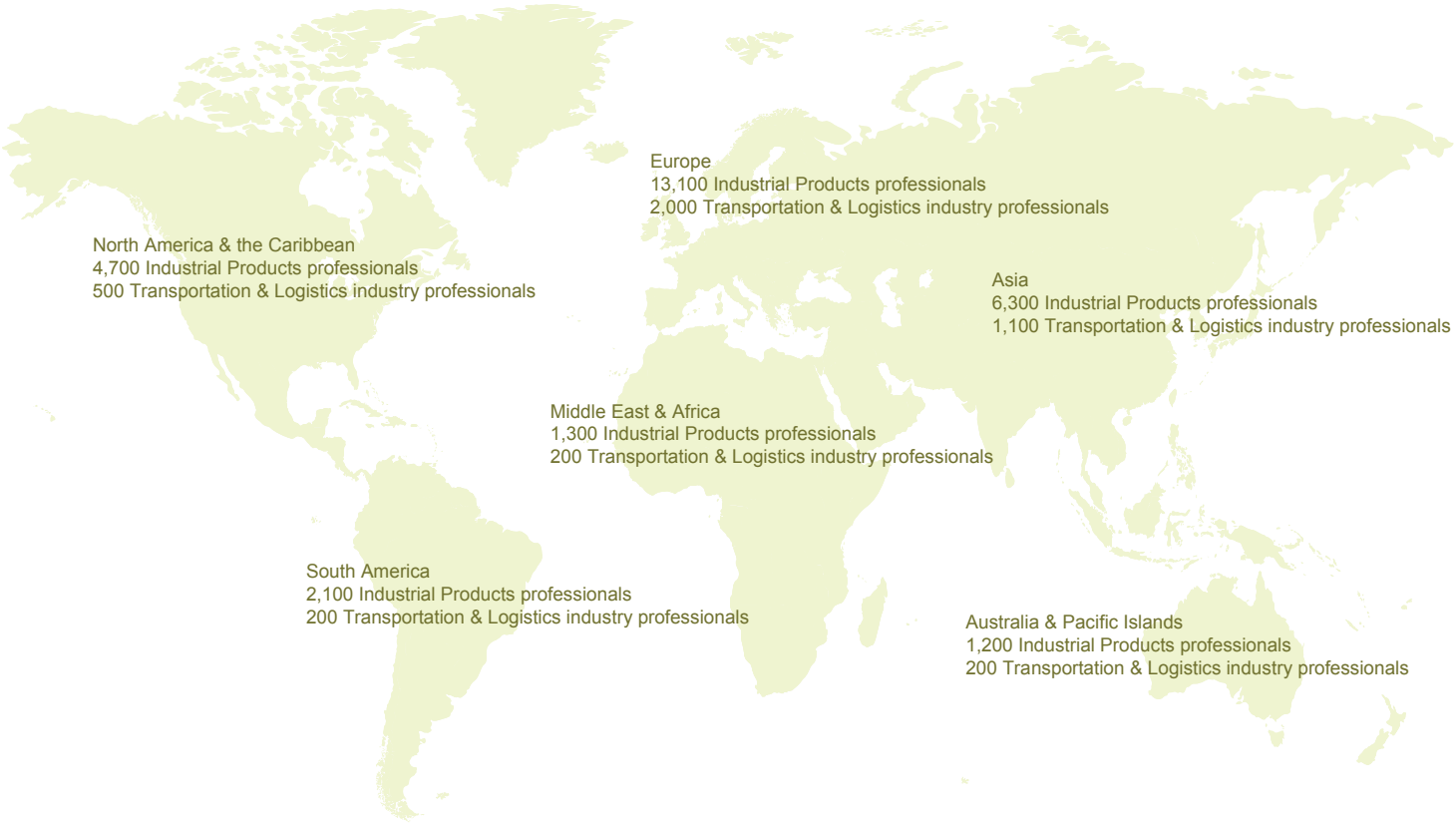
PwC continues to have the leading Fortune Global 500 market share in the industry. Our Transportation & Logistics practice is composed of a global network of more than 4,200 industry professionals who provide assurance, tax, and advisory services to public and private transportation and logistics companies around the world. Central to the successful delivery of our services is an in-depth understanding of today's industry issues, in addition to a wealth of specialized resources and "best practices" that help in solving complex business challenges. Our highly skilled team encourages dialogue on top-of-mind trends and issues through active participation in industry conferences and associations, such as the American Trucking Association, the Air Transport Association, the American Railroad Association, and the European Logistics Association. To address your industry needs wherever they arise, our professionals are concentrated in areas where the transportation and logistics industry operates today and in the emerging markets where it will operate in the future.

Quality deal professionals

PwC's Transaction Services practice, with more than 3,800 dedicated deal professionals worldwide, has the right industry and functional experience to advise you on factors that could affect the transaction, including market, financial accounting, tax, human resources, operating, information technology, and supply chain considerations. Teamed with our Transportation & Logistics industry practice, our deal professionals can bring a unique perspective to your transaction, addressing it from a technical as well as industry point of view.

Local coverage, global connection

In addition to having more than 4,200 professionals who serve the transportation and logistics industry, our team is part of an expansive Industrial Products group that consists of more than 28,700 professionals, including approximately 16,700 providing assurance services, 7,000 providing tax services, and 5,000 providing advisory services. This expands our global footprint and enables us to concentrate efforts in bringing clients a greater depth of talent, resources, and know-how in the most effective and timely way.



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PwC's Transportation & Logistics practice provides industry-focused assurance, tax, and advisory services. Through our global network, we can draw upon the in-depth industry experience of specialists in every country in which your company operates in. Our people can help you deal with the challenges of today, and they understand the implications for tomorrow.

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Methodology

Intersections is an analysis of mergers and acquisitions in the global transportation and logistics industry. Information was sourced from Thomson Reuters and includes deals for which targets have primary NAICS codes that fall into one of the following NAICS industry groups, NAICS industries, or national industries: scheduled air transportation; nonscheduled air transportation; rail transportation; deep-sea, coastal, and Great Lakes water transportation; inland water transportation; general freight trucking; specialized freight trucking; urban transit systems; interurban and rural bus transportation; taxi and limousine service; school and employee bus transportation; charter bus industry; other transit and ground passenger transportation; support activities for air transportation; support activities for rail transportation; support activities for water transportation; other support activities for road transportation; freight transportation arrangement; other support activities for transportation; postal service; local messengers and local delivery; general warehousing and storage; refrigerated warehousing and storage; other warehousing and storage; and process, physical distribution, and logistics consulting.

This analysis includes all individual mergers and acquisitions for disclosed or undisclosed values, leveraged buyouts, privatizations, minority stake purchases, and acquisitions of remaining interest announced between January 1, 2007, and June 30, 2009, with a deal status of completed, intended, partially completed, pending, pending regulatory approval, unconditional (i.e., initial conditions set forth by the acquirer have been met but deal has not been completed), withdrawn, seeking buyer, or seeking buyer withdrawn. The term *deal*, when referenced herein, refers to transactions with a disclosed value of at least $50 million unless otherwise noted.

Regional categories used in this report approximate United Nations (UN) regional groups as determined by the UN Statistics Division, with the exception of the North America region (includes North America and Latin and Caribbean UN groups), the Asia and Oceania region (includes Asia and Oceania UN groups), and Europe (divided into United Kingdom, plus Eurozone and Europe ex-UK and Eurozone regions). The Eurozone includes Austria, Belgium, Cyprus, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Malta, Netherlands, Portugal, Slovenia, and Spain. Oceania includes Australia, New Zealand, Melanesia, Micronesia, and Polynesia. Overseas territories were included in the region of the parent country, and China, when referenced separately, includes Hong Kong.

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