



Through the storm

How the Asia Pacific economies are weathering the financial crisis

KPMG INTERNATIONAL



Contents

Foreword	1
Big bang - how the world got swept up in a US-originated crisis (and which countries may be coming out on top)	3
The crisis begins	3
The immediate aftermath in Asia Pacific	3
Signs of revival	4
Automotive - impact, repercussions and recovery	5
Financial health	5
Future outlook	6
An industry shift	7
Electronics and semiconductors - impact, repercussions and recovery	9
Financial health	9
Future outlook	11
Financial services - impact, repercussions and recovery	13
Financial health	13
Future outlook	14
Healthcare - impact, repercussions and recovery	16
Financial health	16
Future outlook	17
Infrastructure - impact, repercussions and recovery	19
Financial health	19
Future outlook	20
Conclusion	21
Market winners	21
Deciding factors	23
Sales and profit performance	23
Access to funding	24
Investments	25
Exchange rates	25
Bankruptcies	26
Trade pacts	26
Some trends to consider	27

Foreword



The world economies are showing signs of exiting one of the most severe financial crisis in recent history. Asia Pacific is leading the way.

Irrespective of which nations emerge most successfully from this crisis, the world continues to face a very challenging economic environment. We are unlikely to return to the pre-crisis world of easy credit and corporate absorption with top-line growth and market share. The future could look very different with issues such as cost and working capital and risk management elevated to business critical status.

This whitepaper draws on interviews with industry specialists and KPMG firms' professionals, supported by global media and research. It seeks to identify how Asia Pacific's economies are coping with crisis and to assess its impact on specific sectors – automotive; electronics and semiconductor; financial services; healthcare and infrastructure. It looks at their experiences and explores how state intervention has rejuvenated their revival in the short term. It looks to the future and asks how business models might change and who the likely winners and losers will be.

This study also draws together similar themes in an attempt to show how seemingly different sectors and economies are displaying similar characteristics in their recovery – and where they differ from their western rivals. Some of the key findings are detailed below:

- All five sectors saw companies defer plans to go public due to withdrawals of foreign institutional investment from Asian stock exchanges. But despite the slowing IPO market, China State Construction Engineering raised US\$7.3 billion in one of the world's largest IPOs in 2009¹. Many others are in the pipeline as companies across Asia Pacific look to resurrect IPO plans deferred in 2008.
- The M&A market is accelerating for financial services, automotive and electronics and semiconductor companies. However, the quick revival in regional stock indices leaves an expectation gap between values that buyers and sellers are prepared to accept.
- In healthcare and infrastructure, investments are up in the Asia Pacific region – the latter due to major stimulus packages, notably in China, to fuel job creation and GDP growth. But in the electronics and semiconductor sector, although capex spending is down, FDI (foreign direct investment) into the region is up.

¹ State Construction raises US\$7.3 billion in China, Bloomberg.com, July 24 2009

- Exchange rate fluctuations are having different impacts on nations and industries. While lending on infrastructure projects in Australia, Japan, Singapore and Taiwan has been hit hard, China, with its focus on domestic bank loans, has proved less exposed to fluctuations. Large exporters in Japanese electronics and semiconductor companies have seen earnings eroded by a high yen while some South Korean automotive companies are using favorable exchange rates to fund expansion.
- Across all sectors, the Asia Pacific nations have largely withstood bankruptcies far better than their western counterparts. In banking, this is largely attributed to the more conservative characteristics of lenders and the lessons learned during the 1997 financial crisis which enhanced governance in the industry.
- In electronics and semiconductors, healthcare, infrastructure and automotive, there are moves towards trade pacts and mutual cooperation between Asia Pacific nations. However, some countries are imposing 'buy local' restrictions to exclude foreign companies.

This report is a snapshot of the impact of the global crisis. We hope it not only provides valuable insights into Asia Pacific markets and leading industries but also gives an interesting and credible view on what the future might hold.

Our thanks to external industry specialists and sector heads that provided opinion and insight on the current and future state of the Asia Pacific economies.

Sean Collins

Asia Pacific Region Head of Markets, KPMG in Singapore

Big bang

How the world got swept up in a US-originated crisis
(and which countries may be coming out on top)

GOVERNMENT INTERVENTION

AUSTRALIA: Total packages of US\$26.8bn to guarantee bank deposits and wholesale bank funding; infrastructure; schools and housing projects and bail-outs for car dealers.

CHINA: US\$586bn for transport, housing, infrastructure, technological innovation, energy and the environment. Automotive and infrastructure stimulus plans.

JAPAN: US\$287.5bn in government spending, loan guarantees and small business support. Tax breaks and public financing to boost employment.

KOREA: Total packages of US\$70.6bn in tax cuts, rebates and subsidies; expenditure increases for infrastructure and support for SMEs and low-income families.

"The global economy appears to be expanding again, pulled by the strong performance of Asian economies and stabilization or modest recovery elsewhere," said the International Monetary Fund (IMF) on October 1, 2009. The IMF predicts gross domestic product (GDP) in developing Asia will expand at more than twice the pace of advanced economies in 2010. It warns that a return to pre-crisis growth and demand patterns is unlikely and that many Asian economies will need to look to domestic demand, rather than the US and Europe, to fuel growth².

Is this upturn in Asia Pacific fortunes, after the biggest financial crisis since World War II, the beginning of the end for western dominance in world commerce? Andrew Dickinson, Sector Head for Retail Banking at KPMG in Australia, thinks it could be. "This crisis may well be the tipping in point in what was always going to be the natural transition from the US to China as the dominant economy," he says.

The crisis begins

It was the collapse of the US housing market in 2007 that precipitated the global financial crisis. Confidence plummeted as consumers curtailed spending and started saving. Banks began to accumulate funds, reducing available credit for consumers, commerce and international trade. Corporations reduced industrial production, which had a knock-on effect on demand for commodities and energy. Jobless totals escalated and the crisis spread rapidly across borders.

The immediate aftermath in Asia Pacific

Asia Pacific, which had come out of financial crisis in the late 1990s with stronger banking regulations and economies better insulated from external shocks, was hit, nonetheless, by this fresh onslaught.

The fall in global demand led to a decline in exports. Japanese exports fell 35 percent and industrial production dropped 9.6 percent in December 2008 compared with the previous year. Chinese exports were down year-on-year 17.5 percent and imports 43.1 percent. Export-dependent South Korea witnessed a 32.8 percent contraction³. As companies ran down inventories, the knock-on impact on industrial production resulted in widespread factory closures, rising unemployment and falling wages. More than 20 million Chinese migrant workers were forced to find new work away from the more industrialized cities of the Southern region.

Banks in Asia Pacific initially responded like their western counterparts by tightening lending policies and shoring up their reserves which, in turn, increased the cost of loans in the wider economy.

² IMF raises China 2010 forecast, Trims India, Bloomberg.com, October 1 2009

³ Asia's export economies in free fall, Global Research, 14 February 2009

Signs of revival

However, Asia Pacific governments responded swiftly and decisively with expansionary monetary and fiscal policies. In Australia, China, Hong Kong, Japan, Korea, Singapore, Taiwan and Korea, the monetary authorities cut rates to generate liquidity and ensure availability of credit. This allowed them to avoid the severity of the liquidity crisis that plagued western markets. Realignment of fiscal policy to reinforce domestic demand is a common thread in Asia Pacific governments' aid programs.

MALAYSIA: Total packages of US\$18.5bn for low and medium-cost housing, tax cuts and incentives; investment in schools and infrastructure.

SINGAPORE: US\$13.6bn in job credit schemes, bank lending programs, business tax concessions, help for the vulnerable and infrastructure rejuvenation.

TAIWAN: US\$5.6bn in stimulus packages to stabilize the money markets, encourage consumer spending, industrial growth and infrastructure development.

THAILAND: US\$3.6bn in tax cuts, cash transfers to civil servants and low-income people; training and education provision; irrigation and healthcare projects.

When foreign institutional investors withdrew from the Asian stock exchanges, companies across all sectors put capital expansion plans on hold. Now access to funding via capital markets, IPOs and M&A deals is resuming. Equity capital market deals in the Asia Pacific region hit US\$17.3bn in the month of May 2009, the highest level in nearly 18 months as companies sought to cash in on rising investor appetite for regional stocks. In May, 183 deals were carried out compared with 130, valued at US\$8.8 billion in April, according to data provider Dealogic.

Many companies are now raising equity to bolster balance sheets and to repay debt. As a consequence, investor appetite is growing for Asian stocks and, according to Dealogic, Australia, Japan, South Korea and China rank among the top ten global countries for equity issuance in Q3 2009⁴.

Bankruptcies that blighted companies worldwide have been less pronounced in the Asia Pacific economies. Job losses, initially targeted at temporary labor, are short-term in nature. Shenglei Zhu, Director of Technology and Economics at Shanghai Automotive Industry Corporation, cautions that they may be effective initially but that they could lead to future "quality issues and technological impotency" where organizations operate on too lean a workforce.

Asia Pacific is far from immune from the crisis. Despite lower debt levels and higher domestic consumption, Asia Pacific countries have been stung by the recession that has ravaged the US and Europe. For them, the impact was more sudden (the west showed signs of a downturn long before the events of September 2008) and even as government stimulus packages get economies back on track, the reality is that Asia Pacific corporates may feel the pain of eroded profit margins for a long time to come.

For now, improvement is most evident in the sales and profit performance of the automotive, electronics and semiconductor, financial services, healthcare and infrastructure sectors. Many companies, notably in the automotive industry, are taking advantage of cheaper asset prices and robust financials to make acquisitions and achieve strategic objectives.

In several Asia Pacific economies – China, Hong Kong, Japan, Taiwan and South Korea – strong growth figures indicate that they may be moving out of recession. The IMF predicts China's GDP will grow from 8.5 percent in 2009 to nine percent in 2010; Hong Kong will improve from -3.6 percent to 3.5 percent; Japan will see a revival from -5.4 to 1.7 percent; Taiwan from -4.1 to 3.7 percent and Korea up from -1 percent to 3.6 percent.

So while business activities are yet to pick up in several sectors, the outlook for most remains cautiously optimistic, even upbeat.

⁴ <http://www.ft.com/cms/s/0/21a608d0-5b3d-11de-be3f-00144feabdc0,s01=1.html>

Automotive

Impact, repercussions and recovery

AUTO INCENTIVE SCHEMES

AUSTRALIA: For small businesses, 50 percent additional tax deduction on the cost of a new vehicle until the end of 2009.

CHINA: From January 2009, reduction on sales tax on cars with engine capacities up to 1.6 liters from 10 percent to five percent. Under the package, the government allocated allowances to farmers, mini-truck and mini-van owners to upgrade vehicles. Subsidy for scrappage and replacement to increase to RMB 5 billion.

JAPAN: Temporary tax reduction on vehicles which meet higher environmental standards. Scrappage scheme worth US\$2,500 for replacing vehicles older than 13 years with more fuel-efficient models.

SOUTH KOREA: From May to December 2009, 70 percent cut on individual consumption, acquisition and registration taxes for buyers replacing vehicles older than 10 years.

The automotive sector is central to many Asia Pacific economies, not least as a major employer. With global light vehicle sales down 5.6 percent between 2007 and 2008⁵, governments acted proactively in 2009 to combat falls in demand. Key measures included 'scrappage schemes' and tax cuts.

The schemes proved successful. In China, the tax reduction on small cars resulted in 19 percent growth in sales between December 2008 and January 2009. Between January and August 2009, China's passenger vehicle sales rose by 37 percent to 6.23 million units, while total vehicle sales, during the same period, rose by almost 30 percent from a year earlier to 8.33 million units, according to the China Association of Automobile Manufacturers (CAAM)⁶.

Although effective in restoring consumer confidence and preventing bankruptcies, Patrick Ross, President of the Society of Automotive Engineers, Australasia, calls these schemes short-term measures that kept alive some companies which, arguably, should have failed.

Financial health

While weak investor sentiment and depressed automobile sales led to a 20 percent year-on-year drop in sums raised by Asia Pacific Original Equipment Manufacturers (OEMs) in 2008, the situation is now improving. From an 88 percent reduction in capital raised via equity instruments in 2008, there is, to August 2009, more than 100 percent uplift. Bonds and loans are also faring better.

The conservative nature of the region means that none of the Asia Pacific OEMs has experienced financial conditions on the scale of either General Motors or Chrysler. Although Ssangyong in South Korea, filed for bankruptcy in January 2009, its application was rejected by the court and the company given protection from creditors⁷. However, many of its suppliers went out of business, with those remaining switching to the more robust Hyundai brand.

Asia Pacific suppliers are largely protected by OEMs whose limited supplier bases rather than multiple sourcing strategies mean they simply cannot afford to let their suppliers go bust. Some suppliers have switched product offerings to respond to the upturn in small car sales. While this may help in the short term, as demand for medium and large cars resumes, inflexible suppliers could be hit.

Also working in Asia Pacific automakers' favor is their propensity to plan production according to usage levels rather than future growth (reserve) patterns. As a consequence, they have benefited from lower leveraging without the massive overcapacity experienced by their western rivals.

5 <http://www.csmauto.com/news/csminsights/2009/01/Global+Sales:+How+Low+Will+They+Go>

6 <http://www.konaxis.net>

7 http://www.chinadaily.com.cn/world/2009-01/09/content_7384062_2.htm

“Government support [in China] is not required on a long-term basis as it deters the normal development of the market. Market forces should always be decided by demand and supply.” Shenglei Zhu, Director of Technology and Economics at Shanghai Automotive Industry Corporation

“The technologies of traditional vehicles are already very mature across countries and companies. There is not too much room to upgrade here. To raise one’s market competency, new energy cars are a route and a necessity.” Fuming Lu, Investment Manager, Liuzhou Wuling Motors Co. Ltd

Future outlook

The Economic Intelligence Unit (EIU) estimates that the automotive market will rebound in 2010 with near double-digit growth for the next three years. As a consequence, Asia Pacific will have a greater share of the world market, with China surpassing all major developed markets in total automotive sales. Meanwhile, CSM Auto forecasts that China, South Korea and Australia will achieve 2007 sales volumes or above by 2011⁸.

There are fears, however, of cannibalization in the industry once incentives are withdrawn. However for Chang Soo Lee, KPMG’s Regional Head of Automotive for the Asia Pacific region, the present political support should lead to a stable economic recovery which, in turn, should reinforce consumer confidence, translating into higher automobile sales. Andrew Thomson, Head of Automotive at KPMG in China, thinks sales of 12 million vehicles are possible for China in 2010 given the massive potential for car ownership in the emerging rural sector and the fact that the market will remain under a degree of government influence even when incentives are withdrawn or scaled back.

Hopes are also pinned on a revival in the medium-to-large car sector which took a hit when incentives were biased towards small cars.

To survive, suppliers will face more aggressive negotiations with OEMs focused on extracting greater margins and there will be increased use of third-party logistics (3PL) hubs to reduce the total cost of ownership and the generation of lean manufacturing techniques. Some companies can expect less government support once the financial crisis has abated. China and Malaysia, for instance, have kept OEMs from bankruptcy despite laggard performances.

Global companies in Asia Pacific may consolidate manufacturing locations or cooperate with other OEMs. This could help to resolve overcapacity in the market. Volkswagen, for instance, is in talks with Proton to operate its unused production lines. Production hubs may be rationalized due to price pressures from OEMs.

Green energy-efficient vehicles are expected to rise from the ashes of recession but may take three to five years’ investment and development. In China, new government policy will require companies to prioritize energy saving in existing vehicles and the development of new electric vehicles.

⁸ <http://www.csmauto.com/news/csminsights/2009/03/2011:+Get+Ready+for+Revival>

An industry shift

The upshot of the financial crisis is, according to industry specialists, a radical shift in the global automotive industry from the west to Asia Pacific. Regional bases, with strong preferences for local suppliers, are likely to emerge. M&A activity is already increasing in response, although deal values are down due to low valuations and reduced negotiating power at target companies.

South Korea is a likely winner given its inroads into the small to medium-sized car markets.

“Automotive is a sunrise industry in China. There will be at least ten years before the market is saturated. Export is also where China can make efforts to seize more foreign market.”

Fuming Lu, Investment Manager,
Liuzhou Wuling Motors Co. Ltd

For Chinese automakers the domestic market continues to be a priority, although the financial crisis is an opportunity to upgrade technology, gather assets at low valuations and improve brand, quality and distribution channels to compete internationally. The country, according to Shenglei Zhu, Director of Technology and Economics at Shanghai Automotive Industry Corporation, will benefit from an influx of technical workers and expertise from overseas. On assets, Andrew Thomson cautions that acquisitions should add value to operations rather than be viewed as an opportunity to mop up large-scale and hard-to-integrate businesses.

The impact of the financial crisis; global falls in demand for cars and a strong yen hit all automakers, notably the Japanese, hard. The world's largest automaker, Toyota, recorded its first operating loss since 1950 in 2008. The company responded with major restructuring initiatives and cuts in production and workers. Its turnaround, however, is hampered by its product portfolio and the continuing strength of the yen.

Alongside restructuring, cost-cutting initiatives and increased sales efforts, automakers are concentrating on developing environmentally friendly cars.

While Toyota is leading in hybrid (gasoline and electric) cars with over 80 percent of global market share, the spotlight is now on the pure electric car. Japanese maker Mitsubishi unveiled the world's first mass-produced electric vehicle, the i-MiEV, in June 2009. Nissan has plans for the mass production of electric cars to replace hybrid vehicles. American automakers such as GM are looking to unveil their own electric car models as early as next year while Chinese manufacturer BYD (Build Your Dreams) claims its new E6 electric car, due out before the end of 2009, will do 400km on a single charge⁹.

⁹ Harrabin's notes: Electric Promise, BBC news, October 20 2009

The focus on electric cars is even persuading hybrid leader Toyota to bring forward its electric concept to 2010. Meanwhile, the South Korean government has announced plans to speed up mass-production of its electric cars. The plan calls for full-scale production of electric cars in the second half of 2011, two years earlier than its original target.

Whether hybrid or pure electric technology triumphs is largely down to technological developments in the life of electric batteries, recharging methods and how governments support the infrastructure to facilitate recharging. What is clear, however, is that whoever succeeds in taking a leading position in the environmentally-friendly auto market is likely to have a dominant role in the future global car market.

China, meanwhile, has the potential to become a world leader in alternative fuel technologies. Following a fragmented and locally-led start, central government is now playing an active role in coordinating development activity. Of a RMB10 billion package of special funds, a proportion will be set aside for alternative energy development¹⁰.

Elsewhere in Asia Pacific, several global OEMs are assessing their manufacturing footprints and are deliberating whether or not to pull out of certain locations. This could impact suppliers significantly in countries where the manufacturing base is under threat. However, automakers may set up assembly centers in alternative low-cost labor countries, notably Vietnam. They may also look to extend supply bases to cheaper locations, such as India, in the medium to long-term.

The overall outlook, as Shenglei Zhu states, is good. "In Asia Pacific, companies are coming out of their negative margins on account of rising demand. Market confidence has recovered tremendously and is only expected to get better in the future."



10 Momentum: The development of alternative fuels in China's automotive sector, KPMG, April 2009

Electronics and semiconductors

Impact, repercussions and recovery

“In the long-term, the semiconductor industry will see a substantial, if not complete shift to the Asia Pacific region. I wouldn’t restrict it to China or Taiwan. Some of the ASEAN countries, such as Malaysia, will also play a significant role in the migration. The US and Europe may be unable to compete at the same level, and I think you could see a complete shift in less than 15 years.”

Kieran Lane, KPMG’s Regional Head of Electronics, Software and Services for Asia Pacific

The electronics and semiconductor industry, which provides essential components for computers, televisions, MP3 players and other household equipment, saw operations shift from the US to Asia Pacific even before the financial crisis began. However, this high industry concentration has made Asia Pacific a big casualty of the financial crisis in this sector.

In the first half of 2009, global industry revenues fell 24.8 percent on 2008 figures due to weakening demand and declines in consumer confidence. World Semiconductor Trade Statistics (WSTS) predict a 21.5 percent year-on-year decline for 2009.

What will salvage the industry, according to many industry commentators, is companies’ ability to respond to next generation products and technologies such as cloud computing.

Financial health

Many of the industry’s problems stem from investments made to boost capacity before the crisis began. Oversupply coincided with commoditization of chips and storage devices and massively reduced demand, leaving the industry feeling the pinch from Q3 2008 until Q1 2009. Non-branded manufacturers, notably the Taiwanese, were hit especially hard.

For an industry that needs funding to support R&D, the sector struggled to raise just US\$17 billion in 2008, down 50 percent on 2007¹¹. In the Asia Pacific region, funding through equity, bonds and loans saw steep declines in 2009. Chinese fabless companies (specialists in hardware devices on semiconductor chips) are especially vulnerable with 20 percent of the world’s total expected to disappear over the next two years due to lack of funding according to research by iSuppli. The Global Semiconductor Alliance (GSA) claims that 100 electronics and semiconductor companies have been acquired or shut down since October 2008.

¹¹ http://en.ce.cn/subject/financialcrisis/financialcrisisim/200904/11/t20090411_18771759.shtml

Yet bankruptcies in Asia Pacific are surprisingly few. Kieran Lane, KPMG's Head of Electronics, Software and Services in Asia Pacific, suggests the worst is over unless another wave of crisis hits the industry. The main casualties have been Asia Pacific subsidiaries of global companies. State intervention has helped. Japan bailed out Elpida and Taiwan created Taiwan Memory Company (TMC) to save smaller players from bankruptcy. State intervention is, however, less intrusive than in the automotive sector.

Worldwide, the industry laid off around 59,000 workers in 2008; Asia Pacific accounted for around 10,000 of which Japan laid off half and China just over one quarter.

While leverage ratios in the automotive sector differ widely between the US and Asia Pacific, they are similar in the electronics and semiconductor industry. However electronics companies, the likes of Toshiba, Fujitsu, Hitachi and LG, have much higher leverage ratios than western equivalents such as Apple and Motorola. Japanese companies borrowed more, spent more, made less as a percentage of revenue, paid less in dividends and grew faster. Some have debt-to-equity ratios of more than 2:1, compared with 0.2:1 for major American electronics and semiconductor manufacturers.

Taiwan has been the most active in IPOs in the region while China has been relatively dormant. Many companies, as in the automotive sector, put plans to go public on hold and some industry specialists predict that IPO activity will not pick up until 2010.

"An interesting aspect is that the semiconductor industry started to recover faster than other industries."

Liu Yen-Shu, Advanced Wireless Semiconductor Company, Taiwan

Globally, sales dropped 31 percent year-on-year in 2009 as demand fell for products such as personal computers, which account for 40 percent of the world's chip production. Demand began to pick up in Q2 2009 due to governments' stimulus packages. Sales rose 17 percent over Q1 2009 and DRAM (Dynamic Random Access Memory) prices began to rebound. In Asia Pacific, companies managed to hold onto their dominance and increase market share by two percent year-on-year in 2008 despite the decline in global revenues. China, Taiwan and Japan were top performers.

Future outlook

Steven Wang, a semiconductor industry specialist in Taiwan says: "This is an industry which was hit by the crisis but which is bouncing back quickly. However, players have to prepare themselves for challenges in the coming two to three years."

All the signs point to ongoing innovation – patent applications are increasing and spending on R&D is undiminished despite the global economic downturn.

"I think the future will be different because the situation will be different and the market will be different. There will be more demand for devices such as netbooks and smartphones which will see a lot of innovation in the coming years. The companies will need to rethink their market focus to cater for this new demand." Kieran Lane, KPMG's Regional Head of Electronics, Software and Services for Asia Pacific

At Intel's Circuit Research Lab, Director Shekhar Borkar says: "Semiconductor technology is far from mature. We are barely starting to see quantum effects in design. This technology has ten years to go." Handel Jones, President at International Business Strategies, claims: "Year-on-year profits are declining and we are seeing consolidation. But, in another respect, this is not behaving like a mature industry at all. R&D is rising as percent of revenue – some companies are spending over 30 percent – and we see huge untapped potential in China."¹²

However, capital expenditure (capex) spend fell 35 percent worldwide and 36 percent in Asia Pacific. Samsung, for instance, has reduced overall capex but plans to invest US\$2 billion in R&D for chips alone in 2009 – a 25 percent increase on 2008. According to Kwon Oh-hyun, chief of its memory business, this is to maintain Samsung's leadership in technological innovation¹³.

Japan's Elpida and Toshiba plan to cut capex spending by 50 percent; Singapore's Chartered Electronics and Semiconductor by 35 percent while Taiwan's TSMC and UMC, betting on recovery in 2009, plan to spend eight percent more than in 2008^{14, 15}.

While forecasts indicate a 21.6 percent decline in the global market in 2009, demand is expected to surge in electronic products in the coming quarters, resulting in growth of 7.3 percent in 2010 and 8.9 percent in 2011. Demand for PCs, digital consumer appliances, mobile communications and automotive electronics will fuel demand, according to WSTS. Asia Pacific, the only market to record growth (0.1 percent) in 2008, is expected to lead the sector.

¹² <http://www.edn.com>

¹³ <http://www.koreatimes.co.uk>

¹⁴ Global Semiconductor Alliance's Q1 2009 report (Page 8)

¹⁵ TSMC raises capex, yields up in strong Q1, EETimes, 30 July 2009

Increasingly, companies are cooperating across boundaries. Japan, for instance will invest in Taiwan's TMC to overhaul the DRAM segment. This comes after TMC partnered with Japan's Elpida to help struggling DRAM manufacturers exit the downturn. This move will enable Japan and Taiwan to compete with market leaders Samsung and Hynix in Korea. China too is set to receive huge investments from Taiwan as it opens its doors to trade. This should support growth in the Chinese electronics and semiconductor industry in the longer term and force domestic players to innovate. Technology giant Intel plans to invest in both Taiwan (wireless communications) and China (fabrication plant where employees will increase from 500 to 2,000 by 2010).

"We haven't seen much consolidation but a lot of strategic alliances are in the planning stage."

Liu Yen-Shu, Advanced Wireless Semiconductor Company, Taiwan

Heightened M&A activity in 2008, as major players took advantage of lower prices, is expected to continue in the near term, according to Steven Wang. Furthermore, watch out for more alliances and partnerships as companies lacking cash to make acquisitions join forces to take on larger players.

In the future, demand, according to Kieran Lane, is likely to come from handheld devices and netbooks rather than PCs. While the profits of the past are unlikely to be reinstated, "the industry will rebound as demand bounces back and many companies diversify their businesses."



Financial services

Impact, repercussions and recovery

“The US has very large leverage – currently 80 percent of GDP. Most AsPac countries are considerably lower, like Taiwan at 39 percent. The exception is Japan with almost 200 percent leverage to GDP. However the Japanese own Japanese debt. US debt is largely owned by foreign governments.” YC Chou, Director at Value Services Corp.

“Having reacted to the Asian crisis successfully, the Asian banks were a little more prepared this time around which I think had a part to play in their resilience currently.” Andrew Dickinson, Head of Retail Banking, KPMG in Australia

“Within Asia Pacific, each country has its own regulations and regime. Major banks are often owned by the government of the country. There is, therefore, greater vested interest and banks are more directly controlled by regulators than in the freer markets of the western world.” Chee Meng Yap, Head of Financial Services practice, Asia Pacific region

The financial services sector in Asia Pacific has been insulated from the severe financial crisis that beset western markets. This is largely due to banks being better capitalized, more risk averse in their lending and less exposed to exotic products, subprime securities and high-risk mortgage lending. In fact, Asia’s subprime losses were just 0.1 percent of the global residential debt market – around US\$19.5bn¹⁶.

The region also benefited from restructuring initiatives put in place in the aftermath of the 1997 Asian Financial Crisis which left them with lower debt-to-equity ratios, better profitability and liquidity. Furthermore, greater rigor by Asian regulators, notably in Australia, stood banks in very good stead,

The region’s monetary authorities stepped in quickly to stave off the liquidity crisis that afflicted the US and Europe. In Australia, China, Hong Kong, Japan, Singapore, South Korea and Taiwan, key policy rates were cut to generate liquidity and maintain the availability of credit.

Financial health

Many banks in the Asia Pacific region have fared very well compared with their western counterparts. However, the interdependency of banks globally meant they did not escape entirely unscathed – and they too initially reacted by tightening lending. There has been, nonetheless, some deterioration in bank portfolios from late 2008, as well as a spike in non-performing loans.

Fiscal stimulus packages and monetary easing have seen lending standards relaxed in many countries in the region and now bank credit to the private sector is growing, albeit at a lower rate than before the crisis.

Access to funding has been less of an issue for the Asia Pacific economies than for the US and Europe. Here, companies have taken advantage of strong equity markets to raise capital to bolster their balance sheets or to repay debt, making them an attractive investor choice¹⁷. As a consequence, corporate bankruptcies are less severe than in the west, with Taiwan even seeing a decline in the number of companies dissolved in the first half of 2009¹⁸. Only Japan has seen a significant jump, with bankruptcies up almost 17 percent on a year earlier¹⁹.

Liquidity is such that many Asian banks now have more deposits than loans, with the exception of South Korea which is more exposed to Western banks²⁰. As Andrew Dickinson, Head of Retail Banking at KPMG in Australia says: “By and large, there haven’t been losses as great as those seen in the US. Earnings have gone down to be sure, but not significantly. It’s far from the disaster scenario associated with the financial services sectors in the US and UK.”

¹⁶ <http://www.adb.org/Documents/Speeches/2009/ms2009059.asp>

¹⁷ Asian companies eager to tap capital markets, FT.com, 17 June 2009

¹⁸ Asia and Pacific Global Crisis: The Asian Context, World Economic and Financial Surveys, May 2009

¹⁹ Bankruptcy Report (First Half Year 2009), Teikoku Databank, Ltd., 2009

²⁰ <http://www.ft.com/cms/s/0/a3c16e76-9199-11de-879d-00144feabdc0.html>

The region experienced a nine percent decline in investment banking revenues in the first half of 2009 but that compares favorably with a 24 percent drop globally and 30 percent fall in the US alone. The region now accounts for 15 percent of global investment banking revenues, up from 13 percent in the first half of 2008. Australia and Japan fared particularly well²¹.

Fewer side effects from the crisis mean that Asian banks have been able to eschew the level of downsizing that faced western banks. Andrew Dickinson says: "There is a need to hold onto well-trained staff, and to manage costs without slashing staff numbers significantly."

As with other sectors, IPOs in financial services in 2009 are down on previous years. However, across the region, deal values in M&A surged 85 percent from Q1 to Q2. This appetite bucks the global trend with Japan trebling its expenditure on acquisitions. The financial services sector was the second most-active in Asia Pacific after mining, with 597 deals worth US\$51.9bn according to Dealogic²².

Outbound M&A made headlines as Asia Pacific banks picked up low-priced assets from international institutions needing to adjust their balance sheets. ANZ Bank in Australia acquired distressed assets from Royal Bank of Scotland; Japan's Nomura Bank acquired Lehman Brothers assets. Meanwhile AIG, the insurer bailed out four times by the US government, spun out its Asian life business (AIA) into a special purpose vehicle. AIA has more than US\$60 billion in assets under management. An IPO is scheduled for the first quarter of 2010 which will see shares sold to repay loans to the US government²³.

Future outlook

China is emerging from this crisis as a powerhouse – one that could, given China's increasing ascendancy in the economic and political sphere, redress the global balance of power. It is, explains Fraser Howie, author of *Privatizing China*, because "China is the only big economy in the world that is growing strongly. It is contributing more to world gross domestic product than before, so its markets have become more important to investors²⁴."

"I really think that looking back in five years' time, we'll see that the crisis hastened China's rise to becoming the dominant global economy. Everyone talked about China overtaking the US by 2035-2040. Now it looks as though it may be 2020-2025." Andrew Dickinson, Head of Retail Banking, KPMG in Australia

²¹ Slump in investment bank revenues less severe in Asia, *Asia Money*, 26 June 2009

²² China banking trio quit Morgan Stanley, *Asia Money*, 18 August 2009

²³ AIG's AIA says has assets of more than \$60 billion, *Reuters.com*, March 4 2009

²⁴ <http://www.ft.com/cms/s/0/f056342e-8ce9-11de-a540-00144feabdc0.html?catid=94&SID=google>

Andrew Dickinson acknowledges that as China's economy is driven by government policy rather than the free market, it can have a very significant impact across the whole of Asia. Others, such as Chee Meng Yap, Head of KPMG's Financial Services practice in the Asia Pacific region, caution that despite China's six to eight percent growth, "the economy may be overheating and there are signs that the government is trying to rein back on the availability of credit. Most of the expansion is due to state-owned financial institutions funding state-owned enterprise activities ... and there is a risk that growth is managed. I am sure the government realizes that it needs to encourage the private sector to also participate strongly in expansion for growth to be sustainable."

A major concern is, however, the flight of capital out of Asia. This is partly down to foreign banks needing to repatriate capital to cover balance sheets at home but also because countries, notably China, have dealt with the financial crisis too well. China cut its rates so aggressively and encouraged banks to continue lending throughout the crisis that the markets are now flush with liquidity. The fear is that this could lead to asset bubbles and inflation in the near future.

YC Chou, a director at Value Services Corp in Japan, believes that: "Foreign investment withdrew from the financial sectors in China because the banking debt ratio is increasing upwards quickly and profitability is decreasing." She warns that investors anticipate a very bumpy road ahead for the Chinese banking industry. The currency markets in Asia Pacific are expected to continue to do well with the Korean won (which has recovered from low points and is poised to strengthen) and Indonesian rupiah the most attractive bets. David Mann, senior foreign exchange strategist at Standard Chartered in Hong Kong, predicts that "there's going to be a weaker US dollar against Asian currencies."



Healthcare

Impact, repercussions and recovery

“Once a health problem is born, it cannot wait or be withheld. So the impact of the financial crisis on healthcare sector is very small.” Yaqi

Ji, CEO, Dongguan Shijianlian Health Consultant Co Ltd

As an essential service to the growing middle classes around the region, healthcare has been shielded, to a degree, from the financial crisis. But it is not immune.

Healthcare companies in Asia Pacific should not ignore global policy and funding issues. The US private healthcare sector has been especially hard hit²⁵ by the financial crisis. In Europe, where governments have a larger stake in healthcare provision, falling tax revenues and rising unemployment are making the task of funding healthcare an uphill struggle.

Financial health

In the Asia Pacific economies, healthcare provision by the 15 major healthcare companies has been hampered by access to funding. Companies raised just US\$0.46bn in 2009 compared with US\$6.42bn in 2008. However, they have fared relatively well by raising cash through equity offerings – US\$0.38bn in 2009 down from US\$0.8bn in 2008²⁶.

Private equity investment has been equally hard to come by for small and mid-sized providers, down from 26 deals between August 2007 and July 2008 to just two between August 2008 and July 2009.

At Columbia Asia, a consortium of healthcare companies, a senior executive comments: “It’s getting tougher to borrow money. Banks are getting a little uncomfortable in giving out loans.” He believes that banks are more inclined to lend to smaller specialist hospitals than larger facilities.

Despite falls in lending, many Asia Pacific healthcare providers are in better financial shape than their western counterparts. With debt-to-equity ratios generally less than 1:5, they are significantly less leveraged than businesses in Europe and, specifically, the US. Investment opportunities still exist – notably in the private sector – and capital expenditure by the 15 major healthcare companies grew at a compound annual growth rate (CAGR) of 79.9 percent from 2006 to 2008.

Revenues across the region are down seven percent in the first half of 2009 compared with the same period in 2008, with larger companies most affected due to a decline in medical tourism and domestic demand for elective surgeries. Profitability is badly affected by the financial crisis. Falls in profits in the first half of 2008 were not fully felt until the second half of the year (down 41 percent on the second half of 2007) but have begun to recover slightly in the first half of 2009.

15 MAJOR HEALTHCARE PROVIDERS IN ASPAC²⁶

AUSTRALIA:

Aevum Limited
Healthscope Limited
Sonic Healthcare Limited
Primary Health Care Limited
Ramsay Health Care Limited

HONG KONG

Hua Xia Healthcare Holdings Limited
Quality Healthcare Asia Limited

JAPAN

Tsukui Corporation
Japan Care Service Group Corporation

SINGAPORE

Parkway Holdings Limited
Raffles Medical Group Ltd
Pacific Healthcare Holdings

THAILAND

Bangkok Dusit Medical Services PLC
Bumrungrad Hospital Public Co Ltd
Samitivej PCL

²⁵ Impact of Recession on US Hospitals, EH Online, 1 March 2009

²⁶ Evalueserve analysis of OneSource data accessed on 18 August 2009

“Healthcare reform is a major emerging theme across the region given the demographics and current level of provision,” Andrew Weir, Head of KPMG’s Infrastructure, Government and Healthcare practice in the Asia Pacific Region

Healthcare jobs (with the exception of Australia which has suffered from curbs in government spending) have been largely insulated from the downturn. This is due to pre-existing shortages in the industry across Asia Pacific and continuous demand for healthcare services. Even private healthcare providers have maintained staff levels despite declines in medical tourism and elective surgeries.

The financial crisis brought about a fall in M&A activity – down from 65 deals in 2007-2008 to 37 deals in 2008-2009. The mature markets were most impacted, with nursing and residential care facilities in Japan and Australia seeing the biggest decline.

Future outlook

With healthcare spending forecast to grow at a healthy CAGR of 8.9 percent between 2009 and 2013, the outlook for the Asia Pacific nations is positive²⁷.

Healthcare reforms, increased uptake of medical insurance, greater demand for spending and ageing populations all have the potential to fuel growth in the sector. This is already translating into work opportunities for healthcare professionals. China has hired 1,000 doctors in township hospitals while 120,000 rural health personnel and 53,000 community health officers have been trained following a reform plan initiated in April 2009²⁸. Japan is looking to hire and is collaborating with the Philippines, under the Japan-Philippines Economic Agreement of November 2008, to allow Filipino nurses and caregivers to work in Japan²⁹. Malaysia too is responding to staff shortages with plans to train 7,600 nurses³⁰.

China’s healthcare reforms, designed to provide universal medical services to citizens, will result in a forecast CAGR of 13.43 percent in public spending from 2009 to 2013. The government is actively encouraging private healthcare operators too and is making efforts to open up the market to foreign players. However, according to Yaqi Ji, Chief Executive at Dongguan Shijianlian Health Consultant Co, this will be a gradual process, initially targeted at peripheral medical services rather than treatment.

In Japan, the largest healthcare market in Asia Pacific, spending is predicted to continue to grow at a CAGR of 6.87 percent. But with one-fifth of its population already aged over 65³¹, there is likely to be a knock-on impact on spending.

²⁷ EIU forecasts

²⁸ \$10.5b poured into China health care reform, China Daily, 9 August 2009

²⁹ JPEPA to take effect December 11, Bilaterals.org, 11 November 2008

³⁰ Market Watch 2009 – The Healthcare Sector, MGCC, 7 August 2009

³¹ Japan sees biggest population fall, The Guardian, 2 January 2009

HEALTHCARE STIMULUS PLANS

AUSTRALIA, although hit by decreased state government funding, has announced a five-year US\$54.56bn spending plan.

CHINA has a US\$124bn healthcare stimulus package for 2009-2011
JAPAN announced a 3.7 percent year-on-year increase in its public healthcare budget.

MALAYSIA has allocated US\$3.8bn to improve health facilities.

SINGAPORE has allocated US\$2.4bn to its health ministry

THAILAND has increased per capita budgets for 2010.

THE PHILIPPINES has approval for a US\$50m loan to improve the quality of healthcare to the poor.

Singapore, Malaysia and Thailand, hubs for medical tourism, should also benefit longer term as rising healthcare costs in the west entice people overseas. The Tourism Authority of Thailand expects two million medical tourists in 2009, up from 1.4 million in 2008³². However, at Columbia Asia, a senior executive predicts this business will only survive so long as there are no alternatives. "We are seeing people from Africa. We are not trying to chase these people down, they are just finding us. Well, it's only a matter of time before someone figures out how to go to Africa and deal with it there. It's a dead-end business in our opinion."

Healthcare spending in markets such as Korea, Hong Kong and Singapore remains low – around five to 10 percent of GDP compared with 10 to 15 percent in most western markets³³. Consequently, there is likely to be an uptake of medical insurance – either commercial or government-backed – which is a largely under-penetrated market in Asia Pacific.



³² Thailand: Private hospitals gear up for growth, IMTJ
³³ EIU Forecasts, February - August 2009

Infrastructure

Impact, repercussions and recovery

Infrastructure is the lifeblood of an economy. It provides the roads, ports, water, electricity, communications and core services that are vital to long-term growth, trade and competitiveness. In times of financial hardship, investment in infrastructure can create new jobs, jump-start economic activity and grow GDP. From 2008 to 2017, an estimated US\$21tn needs to be invested in infrastructure in the emerging markets³⁴.

Infrastructure investment is typically a blend of public and private funding. However, cash shortages have seen new projects worth approximately US\$110bn face delay or postponement³⁵. Hardest hit are the American and European economies which bore the brunt of the financial crisis. The Asia Pacific economies are holding up relatively well thanks to public sector intervention.

“The financial crisis impacted the banking system’s liquidity, leading to the closure of many property, infrastructure and resource projects during the first quarter of 2009. There are many indications that projects are now coming to market.”

Ashley Mason, Executive General Manager of Operations, Leighton Holdings Limited, Australia

Globally, an estimated five million construction workers lost their jobs in 2008 according to a report by the International Labour Office.

Financial health

Worldwide, existing and new infrastructure projects are being squeezed³⁶. However, after a short interruption in government projects at the beginning of 2009 in Asia (and Australia specifically), they bounced back. The decline is most keenly felt in the private sector where the increased cost of money and currency volatility have left it struggling to raise finance and rendered many projects uneconomical.

The 18 major infrastructure companies in Australia, China, Japan, Hong Kong Singapore and South Korea only managed to raise US\$194.5m through equity offerings in 2009, down from US\$6,054.3m in 2008, while funds raised by way of loans and bonds are just one-quarter of 2008 totals. Revenues are up approximately four percent in 2009 although net income margins are down 1.4 percent in the first half of the year.

Bankruptcies have taken their toll. Of the total number of bankrupt Japanese companies in the second half of 2008, 29 percent were in the construction sector³⁷. In South Korea, 328 small construction companies filed for bankruptcy in the first 10 months of 2008 prompting corporate restructuring programs to help struggling businesses³⁸. Most Vietnamese construction companies, facing increased costs of materials, avoided bankruptcy by delaying or halting projects³⁹. China, where 99 percent of construction companies are state-owned, bucks the trend. Companies that lack funds or suffer losses are bolstered by the state says independent consultant Chunping Gao.

34 Issue Brief: IFC Infrastructure Crisis Facility, International Finance Corporation, December 2008

35 [http://www.ifc.org/ifcext/about.nsf/AttachmentsByTitle/IssueBrief_ICF/\\$FILE/IssueBrief_ICF.pdf](http://www.ifc.org/ifcext/about.nsf/AttachmentsByTitle/IssueBrief_ICF/$FILE/IssueBrief_ICF.pdf)

36 <http://web.worldbank.org/WBSITE/EXTERNAL/NEWS/0,,contentMDK:21972885~pagePK:64257043~piPK:43376~theSitePK:460700.html>

37 http://www1.fidic.org/news/news_docs/AsPac09_hirotni_may09.pdf

38 http://www.koreatimes.co.kr/www/news/opinon/2009/08/202_34446.html

39 <http://www.vnrealestatemarket.com/2008/06/viet-nam-builders-halt-projects-to.html>

“The sector will not be negatively impacted [in China] in the long term, provided the recession doesn’t last too long. The US\$586bn investments brought into the sector will last for a long time, and the government’s support will maintain the dynamics for at least ten years from now.”

Chunping Gao, independent consultant

“Infrastructure spending is the foundation of much of the fiscal stimulus packages in the region, both in terms of upgrading existing infrastructure and developing new primary infrastructure, notably in transport, water and alternative energy industries”. Andrew Weir, KPMG Head of Infrastructure, Government and Healthcare

IPOs appear to be back on companies’ agendas globally after a decline between July 2008 and June 2009. Figures indicate a rise in the number and value of deals in the second quarter of 2009 over the previous quarter. China’s largest housing construction company issued one of the world’s largest IPOs at US\$7.3bn in 2009⁴⁰. M&A activity – by number and value – has dipped.

However, foreign direct investment is up despite shrinkages in global trade and investment. Japan increased its investment in Australia from US\$31bn in 2007 to US\$36bn in 2008, adding 8,000 jobs to Australia’s workforce. China attracted an additional 23.6 percent in foreign investment in 2008 while Taiwan became the largest investor in Vietnam.

Future outlook

Top sector performers are China and Australia. China’s US\$586bn⁴¹ and Australia’s AUS\$42bn⁴² (US\$39bn) stimulus packages are helping to revive activity and boost infrastructure growth.

China, with its high demand and abundance of infrastructure investment projects, expects growth of 7 percent during 2009 to 2010 as values rise from US\$259.5 to US\$275.9bn⁴³. In Australia, the construction sector faltered at the beginning of 2009 and is forecast to grow at only 1.4 percent but should see more positive growth by 2010 as recession ends.^{44, 45} Vietnam, with its wide-ranging opportunities, is expected to do well and attract further foreign investment.

According to a Japan Infrastructure Report for the third quarter of 2009, Japan is set to see negative year-on-year sector growth of -11.2 percent in 2009, rising to 1.9 percent by 2013⁴⁶. Singapore, too, can expect negative growth (-7.4 percent for 2009) to continue to 2010.

To help companies conquer the funding gap, the International Finance Corporation (IFC) has stepped in with US\$300m in crisis-related infrastructure financing over three years. It also expects to mobilize between US\$1.5 and 10bn from other sources. The fund will provide roll-over financing and help recapitalize existing, viable, privately-funded infrastructure projects in developing countries⁴⁷.

40 <http://www.bloomberg.com/apps/news?pid=20601080&sid=aw8iNnYtqx14>

41 China Sets Big Stimulus Plan In Bid to Jump-Start Growth, Wall Street Journal, 10 November 2008

42 Australian Government Nation building stimulus plan web site, www.economicstimulusplan.gov.au/pages/theplan, 15 September 2009

43 http://www.reportbuyer.com/countries/asia_pacific/china/china_infrastructure_report_q3_2009.html

44 http://www.reportbuyer.com/countries/australia/australia_infrastructure_report_q1_2009.html

45 <http://www.bharatbook.com/Market-Research-Reports/Australia-Infrastructure-Report.html>

46 http://www.reportbuyer.com/countries/asia_pacific/japan/japan_infrastructure_report_q3_2009.html

47 <http://web.worldbank.org/WBSITE/EXTERNAL/NEWS/0,,contentMDK:21972885~pagePK:64257043~piPK:47376~theSitePK:460700.html>

Looking ahead, private sector participation is expected to resume once interest rates drop and money supply increases. "The economy will witness a gradual return to a higher level of private sector funding as business confidence in the world economy revives," says Ashley Mason, Executive General Manager of Operations at Leighton Holdings in Australia. In the meantime, public-private partnerships will be relatively few compared with the recent past.

In Australia, private sector input is expected to contract by 5.1 percent in 2009 and 15.4 percent in 2010 but will be cushioned by growth in public sector non-residential building projects⁴⁸. Water supply, power generation and transportation projects will record growth. In China, state monopolies over construction will, according to Chunging Gao, continue for the next few years.

Compared with western economies, which have witnessed a slowdown in growth and a reduction in near-term projects in the infrastructure sector, the Asia Pacific economies looks set to emerge from the financial crisis in reasonable shape. Ashley Mason says: "There is a huge infrastructure backlog throughout the Asian region. As the global economy turns to growth, it will give impetus to more infrastructure projects in the Asia Pacific region."



48 http://www.aigroup.com.au/portal/binary/com.epicentric.contentmanagement.servlet.ContentDeliveryServlet_LIVE_CONTENT/Economic%2520Indicators/Construction%2520Survey/2009/7597_construct_may_web.pdf

Conclusion

As the world emerges from recession, Asia Pacific is leading the recovery. A shift in economic dominance, already underway in the automotive and electronics and semiconductor sectors, is catching on in other industries.

US and Europe, the outgoing powerhouses, have faltered badly in the financial crisis despite their own bail-outs, stimulus and rescue packages. While many western companies – the likes of AIG, Lehman Brothers, GM and Chrysler – have courted disaster and substantial job losses, their Asia Pacific counterparts have escaped relatively unscathed thanks to government intervention and their prudent appetite for lower leverage ratios and greater aversion to risk and exotic products.

Market winners

In the automotive sector, the Koreans (with their penetration into the small car market thanks to changes in buyer behaviors in the west) and the Chinese (with their government backing, mass demand and potential to expand beyond domestic boundaries) look to be among the major winners. Low cost labor markets, particularly Vietnam, may attract automakers to set up assembly centers. Longer-term, developers of green vehicle technologies (Japan and Korea) are well-positioned to prosper.

Although badly affected by the downturn, the electronics and semiconductor industry seems to be recovering faster than other sectors. The crisis hit at an unfortunate point in the industry cycle but many companies are already responding with next-generation products and technologies. Countries likely to get ahead are South Korea and Japan; Taiwan, which dominates the contract market, is also likely to prosper.

The financial services sector, though battered by the shockwaves of the crisis in the US and Europe, is riding the storm relatively well. Well capitalized with limited exposure to subprime losses and with lessons learned during the Asian financial crisis of 1997, the region has more conservative regulation and better debt-to-equity ratios than in the west. China, with its large, government-driven economy, stands out as the most likely winner. There are fears, however, that potential asset bubbles caused by excess liquidity in its domestic market could compromise China's dominance.

However, among the major international banks, those with significant Asia Pacific presence – notably HSBC and Standard Chartered – appear to be outperforming their peers.

Many healthcare companies, although hampered by falls in lending, are in good financial shape. Their debt-to-equity ratios are very low. Those likely to triumph in this sector include China (given its massive investment in public spending); Singapore, Malaysia and Thailand (as hubs for medical tourism), and less developed countries in which medical insurance take-up is currently low or non-existent.

Infrastructure investment is helping to kick-start economies and to revitalize job markets globally. The private sector is suffering due to the increased costs of borrowing, lack of funds and currency volatility. Many governments are ploughing billions of dollars into infrastructure. China, where there is massive demand for roads, communications, education and healthcare, has pledged US\$586bn which is benefiting other countries in the Asia Pacific region too. Australia is doing well after a small hiatus in projects at the beginning of 2009. Vietnam, which has witnessed GDP growth during the financial crisis, is another likely winner.

Across all sectors, Asian stock market indices (most notably China and Hong Kong) are also rising significantly compared with the west. This is driven by high liquidity, low interest rates, a return to confidence and portfolio managers making greater allocations to Asia, especially China. This upturn in Asian stock markets is also encouraging a strong revival in IPO activity in the region.

Deciding factors

So what factors drive the financial health of Asia Pacific companies?

Sales and profit performance

Across the five sectors, the story seems to be one of initial decline followed by a quick rebound in 2009.

“While rating the healthcare sector on a scale on one to five, with one being the most impacted by the crisis and five being the least impacted, a score of four should be more suitable for these geographies, as it is expected that the high-end hospitals with high-tech, expansive equipment have been impacted by the crisis.” Senior executive, Columbia Asia

Many financial institutions, in particular, have been spared the fate of their western counterparts. For the most part, traditional banking models have gained in strength as a result of the crisis. The insurance sector too has stood firm, especially where institutions have eschewed credit derivatives and other exotic instruments that brought down western giants like AIG.

In the automotive market, South Korea is looking buoyant following the switch in consumer appetite from medium-large to small-medium cars. Daihatsu, Japan's only OEM to record profits in the first half of 2009, is benefiting from its small car range and lower exposure to western markets. But it is China, where a resurgence in sales is attributed to stimulus measures and the government's mandate that banks continue lending, which is leading the recovery.

In the electronics and semiconductor market, the Asia Pacific region has hung onto its market dominance with a moderate two percent year-on-year increase which accounts for 69.4 percent of global sales in 2008. Taiwan and South Korea maintained positive profit margins but China did not fare as well. Japan suffered due to the drastic fall in DRAM prices.

Many healthcare companies in the region have come out of the crisis relatively well although some large businesses have seen revenues fall due to decreasing medical tourism and domestic demand for elective surgeries.

Access to funding

Since the beginning of 2009, many Asia Pacific companies have taken advantage of buoyant capital markets to raise equity capital to bolster balance sheets or repay debt. As a consequence, investor appetite for Asian stocks is growing. Dealogic rated Australia, Japan, South Korea and China among the top 10 countries for equity issuance globally in Q3 2009⁴⁹. The bond market is flush with activity too, with China, South Korea, Thailand and Australia leading the region in bond sales.

In the automotive sector, which is highly dependent on credit, global light vehicle sales dropped 5.6 percent between 2007 and 2008. In 2008, Asia Pacific car manufacturers experienced a 20 percent year-on-year fall. Capital raised via equity and loans fell by more than 88 percent and 29 percent respectively. The electronics and semiconductor market met the same fate although the electronics industry saw a slight revival in bond issuance and loans. However, 2009 tells a different story as growth in most sectors, notably automotive, has seen many companies begin to bounce back.

Healthcare and infrastructure struggled with access to funding in 2009. The 15 major Asia Pacific public healthcare companies raised just US\$0.46 billion between them in 2009, down from US\$6.42 billion in 2008. Many construction projects have been halted or delayed in the infrastructure sector due to funds' shortages.

All five sectors saw companies defer plans to go public due to the withdrawal of foreign institutional investment from Asian stock exchanges.

However, the M&A market is springing back to life, especially for financial services, automotive and electronics and semiconductor companies. In financial services, deal values surged 85 percent from Q1 to Q2 2009. While the value of deals is down 64 percent on 2008 figures in the automotive sector, the number of deals is up. The surge in electronics and semiconductor M&A deals is marked by major transactions such as the Renesas and NEC deal.

⁴⁹ <http://www.ft.com/cms/s/0/21a608d0-5b3d-11de-be3f-00144feabdc0,s01=1.html>

“Our analysis suggests that foreign investment withdrew from the financial sectors in China because the banking debt ratio is increasing upwards quickly and profitability is decreasing ... We really think that the withdrawal of FDI is because investors anticipate that the Chinese banking industry may face a very bumpy road ahead.” YC Chou, director Value Services Corp in Japan

Investments

In healthcare (notably private healthcare), investments are up in the Asia Pacific region. Capital expenditure by the 15 major healthcare companies grew at a CAGR of 79.9 percent from 2006 to 2008. In infrastructure, China’s investments have driven large macroeconomic benefits such as job creation and GDP growth. Other regions’ stimulus packages target healthcare, transportation and education.

Meanwhile, major electronics and semiconductor companies have cut capex spending by 36 percent from 2008 to 2009. However there have been notable increases in FDI flows into the region. Intel intends to invest in Asia Pacific while Taiwan is likely to invest in China’s electronics and semiconductor sector. Japan’s Elpida is to work with Taiwan Memory Company (TMC) as strategic technology partner to overhaul the DRAM sector. This will increase competition for Korea’s Samsung and Hynix brands. Betting on a rebound in DRAM chips, foreign investors are buying up shares in both companies.

Exchange rates

Although currencies in the Asia Pacific region weakened as a consequence of the financial crisis, the Korean won and Indonesian rupiah are now showing signs of strengthening against a weakening dollar.

Exchange rate fluctuations have hit lending on infrastructure projects in Australia, Japan, Singapore and Taiwan, yet China is less exposed due to its focus on domestic bank loans rather than foreign participation. However, the outlook for Chinese banks could be rocky given the withdrawal of FDI. Some commentators think this is for repatriation purposes; others consider that China’s insistence that banks continue lending during the crisis has led to excess liquidity which could be the precursor to asset bubbles and inflation.

Meanwhile, an appreciating yen has eroded export earnings for Japanese electronics and semiconductor companies like Toshiba and for the automotive industry. The automotive sector across Asia Pacific has taken a hit, but some countries, such as Korea, are capitalizing on favorable exchange rates to expand their operations.

Bankruptcies

The financial crisis has seen the bankruptcy and/or bail-out of some iconic names such as GM, Chrysler, AIG and Lehman Brothers. Yet, across all five sectors, Asia Pacific economies have fared better than their American and European counterparts.

Nonetheless, some of the western automotive giants are now emerging from bankruptcy and are ready to fight back. They have done much to reinvent themselves in the past six months and are now leaner and fitter with business models better attuned to the current environment. The 'new GM', now well placed to take advantage of markets and demand in Asia Pacific, is currently setting up an international headquarters (for all markets except the US, Canada and Mexico) in Shanghai. A restructured Chrysler, meanwhile, has gone through Chapter 11 bankruptcy protection in record time. The crisis has enabled both companies to aggressively restructure their businesses. The industry in Europe, specifically in relation to GM's European operations, is also going through significant change and is set to emerge with healthier business models.

The banking sector has performed significantly better than the west, largely due to more conservative and traditional lenders and lower leverage ratios. OEMs in Asia Pacific have protected their limited automotive supplier bases.

The electronics and semiconductor sector has withstood large-scale bankruptcies relatively well by negotiating agreements with banks. While several Korean infrastructure companies have failed, Chinese companies are faring well.

Trade pacts

There is an increasing emphasis on mutual cooperation across the region as the electronics and semiconductor, healthcare, infrastructure and automotive sectors look to optimize monetary policies, trade networks and pacts. Among the initiatives are the removal of trade restrictions and increases in limits on foreign ownership in companies within the ASEAN region.

Conversely, some Asia Pacific nations (mimicking the 'Buy American' provision in the US stimulus plan) are implementing non-tariff barriers.

Some trends to consider



- The IMF predicts GDP in developing Asia will expand at more than twice the pace of advanced economies in 2010.
- China could usurp the US and become the dominant global economy within 10 to 15 years as a consequence of this financial crisis.
- The automotive market is in good shape for a rebound in 2010, with near double-digit growth giving Asia Pacific a greater share of the world market, according to the EIU.
- Green vehicles are predicted to make a bigger impact post financial crisis. The Chinese, Japanese and Koreans are likely to expedite development of hybrid electric vehicles.
- A continued west to east shift is anticipated in the automotive industry in the aftermath of the financial crisis.
- Greater cross-border cooperation will result in greater competition and innovation in the electronics and semiconductor market. M&As and strategic alliances will increase.
- The financial services sector is expected to continue to do well, when compared with the US and UK, and is continuing to make significant profit.
- The country with the lowest debt to budget ratio is likely to survive the crisis best. China is an obvious contender but Japan is also doing well. Japanese financial institutions have done most of their deleveraging and have strong balance sheets.
- In the aftermath of the crisis, many banks will increase their focus on Asia.
- Healthcare spending across Asia Pacific is forecast to grow at 8.9 percent CAGR between 2009 and 2013⁵⁰.
- Medical tourism is expected to lure over two million people to Asia Pacific in 2009 – expect to see this market grow, in the short-term at least.
- China is expected to come out on top in infrastructure with predicted 7 percent growth during 2009 to 2010.

⁵⁰ OneSource, as accessed on 11 September 2009

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