



Thailand

M&A will be dominated by smaller domestic deals pending political certainty

Current Environment

Almost since the start of 2006, political uncertainties, high oil prices, a strengthening Baht and rising interest rates have been a cloud over the Thai economy. Economic growth for 2006 was expected to outpace last year's 4.5%, which was largely impacted by higher oil prices and such domestic negative factors as drought, the Asian Tsunami, bird flu and the unrest in the Southern border provinces.

As we enter the second half of 2006, most predictions of annual growth expectations are at just over 4% for the year, below initial expectations of 5% or more. High oil prices appear to be the biggest culprit with Thailand heavily dependent on imports. In addition, the strengthening Baht is expected to impact exports, which reportedly comprises for as much as 60% of GDP.

The impact of political uncertainties on the economy is difficult to quantify; however, it appears that investor and business sentiment has been cautious at the very least. It remains unclear when a new Government can be formed following the court's invalidation of the results of the hastily organised 2 April election, together with certain legal and political matters still to be clarified. Nevertheless, the economic impact of budget delays is expected to be relatively small for 2006, as the fiscal budget reportedly comprises for approximately 8% of GDP.

Data shows a slow down in investment since the second half of 2005 which is believed to be mostly attributable to rising costs and slowing economic growth. Delays in the Government's Baht1.8 trillion (US\$44 billion), five-year infrastructure megaproject programme has also impacted investors' mood. Private investment is estimated to account for 11% of GDP and is heavily weighted by equipment investment and construction.

According to the Bank of Thailand ("BoT"), higher oil prices have had a greater impact on headline inflation than on economic growth. Fears of rising inflation pushed the central bank to raise its 14-day policy rate to 5% by late May 2006, the highest level since 1998 and the 13th increase since mid-2004 when the rate was 1.25%. However, the central bank's Monetary Policy Committee, which meets every six weeks, hinted that the May increase could be the last in the near term, notwithstanding further shocks in oil prices. The inflation trend is one factor expected to cause the BoT to hold its 14-day policy rate steady.

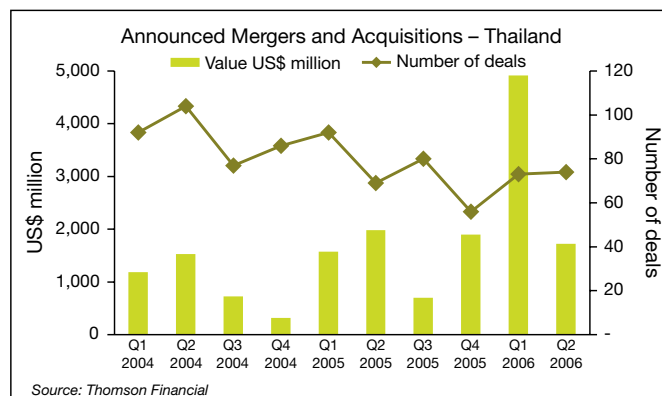
Other factors that may influence the BoT are the weakening trend of domestic consumption and private investment. Consumer prices in the year to June rose by 4.7% from the year before, while core inflation, which excludes food & energy prices, rose 2.7% in June from the year before. The Ministry expects inflation to range between 4.5% and 5.5% for the second half of 2006.

Hope that the Stock Exchange of Thailand ("SET") would take a giant leap forward was dealt a blow late in 2005 when the Administrative Court questioned the legality of the privatisation process of the Electricity Generating Authority of Thailand and decided that it be discontinued. In addition, Thai Beverage, the brewer of Chang Beer and Thailand's market leader in beer and alcoholic beverages, elected to list on the Singapore Stock Exchange in May after its attempts to list on the SET were hindered by strong protests by social and religious groups.

During the first half of 2006, the SET Index has fluctuated over a fairly wide range, but has started the second half below the 2005 close of 713.73, following what appears to be a general sell-off of Asian stocks. Analysts again cite high oil prices, rising interest and inflation rates, slowing economic growth and political uncertainties as factors influencing market volatility. However, expectations remain for the SET to reach 800 by the end of 2006, with many fund managers still bullish on the country and viewing Thailand to be fundamentally sound; and taking advantage of the downturn as an opportunity to buy into companies trading at what appear to be relatively good values.

The dissolution of the House of Representatives in February 2006 has stalled Free Trade Agreement (FTA) negotiations between Thailand and its two biggest trading partners – the US and Japan. Even if the House dissolution had not derailed them, it remains doubtful whether the agreements will meet the deadlines given strong criticism against them. The Government, however, likely wants to move forward with the FTAs to help boost foreign investment, which had stalled due in part to political uncertainties and may help clear doubts among certain investors. FTAs with China, India, and Australia, other important trading partners with Thailand, have already been implemented.

Deal Activity





Over the past few years, deals in the energy, communications and financial services sectors have accounted for the majority of deal values. For the first half of 2006, deal values reached US\$6.6 billion, surpassing the value of all deals for 2005 of US\$6.2 billion. Deals for the first half of 2006 are dominated by one very large transaction in the communications sector, the largest transaction in the history of Thailand M&A.

After months of rumours and speculation, the biggest deal in Thailand's corporate history was finally announced. The deal involved the founding family of then Prime Minister Thaksin Shinawatra (current caretaker Prime Minister) selling its 49.6% stake in Shin to Singapore's Temasek Holdings ("Temasek") for Baht73.3 billion (US\$1.9 billion) in cash in January 2006. With the deal, the Shinawatra family exited the telecom business founded by Mr. Shinawatra 22 years ago. In order to comply with the Telecommunication Operation Act, as recently amended, Temasek has restricted direct ownership to the 49% foreign-shareholding limit for Thai telecommunications companies. To help finance the transaction, Temasek borrowed Baht11 billion (US\$275 million) from Siam Commercial Bank and Baht14 billion (US\$350 million) from Bangkok Bank, with the remainder funded through overseas loans.

Temasek later made a mandatory tender offer to the remaining shareholders of the company to acquire a total 96.3% stake in Shin. The total deal value for Temasek's acquisition of Shin is approximately Baht 67.5 billion (US\$4.2 billion), representing approximately 64% of the value of all deals for the first six months of 2006.

Another deal of note in the Communications sector was the acquisition of an additional 56% stake in United Broadcasting Corporation ("UBC") by True Corporation ("True"), a fixed line, broadband and mobile operator. The deal, valued at approximately Baht12 billion (US\$300 million), increased True's shareholding to over 96% of UBC, the dominant cable TV provider in Thailand.

Notable deals in other sectors include:

- In March 2006, Tata Steel increased its shareholding from just under 25% to over 66% of Millennium Steel. The total completed deal value was just over Baht12 billion (US\$303 million)
- CH. Karnchang, which had just completed its phased purchase of the ordinary shares of Thai Tap Water Supply (TTW) in August 2005, sold 35% of TTW to Mitsui & Co. in March 2006. The deal value was approximately Baht3.7 billion (US\$93 million)
- In April 2006, Siam Commercial Bank increased its shareholding from just under 37% to over 92% of Siam Panich Leasing. The total completed deal value was just over Baht4.6 billion (US\$115 million)

Outlook

In June, the Office of the National Economic and Social Development Board maintained its forecast of GDP growth in the range of 4.2% to 4.9% for 2006. Risk factors that could affect the economy going forward include external factors such as higher oil prices, a world economic slowdown and continued appreciation of the Baht.

On-going positive internal factors include upward export trends and a continued recovery in tourism. However, the threat of Avian flu, security issues in the Southern border provinces, and high inflationary pressures remain as risks.

Investment trends will likely depend largely on political developments. The new Government, when it is formed, is likely to focus on accelerated budget disbursements and public investment to help spur economic growth.

Delays in forming a new Parliament have definitely affected fiscal policy, with the 2007 fiscal budget likely to be delayed until mid-2007, resulting in a nine-month delay in spending on state investment projects. As a result, the announced economic stimulus measures designed at buoying the economy, both in the short and long term, have been delayed. Significant long-term initiatives were aimed at improving the country's infrastructure (US\$41 billion mega-infrastructure projects for 2005-2009 originally planned).

If political uncertainties continue to escalate, economic growth could slow with a drop in foreign and domestic investment as well as domestic consumption. Some fear that the ongoing political uncertainty will begin to have a greater impact on the economy than continued rising fuel prices. Doubt exists as to whether the general election can be held on October 15 as planned, and when a new Government can be formed.

With the exception of the Shin deal, M&A has seen a slow down from previous years, particularly with respect to deal sizes, as international investors show caution with a general wait-and-see policy. As a result, the majority of M&A activity in Thailand is being driven by the domestic market, which traditionally has lower deal values. This is likely to continue throughout the rest of 2006.

