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M&A Outlook 2011 - 2012

Advisory

i-fact@nalysis, Inc.

China & India Investment Opportunities / Due Diligence Challenges

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Investment Opportunities in China and India Present Due Diligence Challenges

China's Bilateral Trade with India Surges:

China and India continue to offer high growth investment opportunities for U.S. companies. Bilateral trade between China and India reached $61.7 billion in 2010 and is currently growing at a rate of 40% annually. China has become India's largest trade partner and in turn, India has become China's largest trade partner in South Asia. In September 2011 China's Industrial and Commercial Bank of China Ltd.'s "ICBC" Vice Chairman and President, Mr. Yang Kaisheng announced the opening of the bank's first branch in Mumbai. ICBC is the first mainland Chinese commercial bank to enter the Indian banking sector. "Opening banking operations in Mumbai shows our commitment towards bridging the commercial gap between India and China," said ICBC's President, Mr. Yang Kaisheng. ICBC is looking at funding Chinese companies that want to invest in India's power, telecom and infrastructure sectors through its Mumbai branch. ICBC is also considering helping Indian firms raise yuan-denominated bonds.

ICBC is the largest of China's four state owned banks with assets of US $1.9 trillion. In 2009 ICBC was ranked the 17th largest bank in the world by assets, the 6th in the world by tier 1 capital and the world's largest bank in terms of market capitalization. The Indian gross domestic product "GDP" is estimated to have grown by 8.6% in fiscal 2010-2011. The United Nations Conference on Trade and Development predicts that India will become the third largest recipient of foreign direct investment.

Although ICBC's establishment of banking operations in India and other recent events are promising, the relationship between the two countries has been precarious. China backed Pakistan in its 1965 war against India. The turbulent relationship between China and India continued through the 1980's over border and territorial disputes. Relationships began to improve in the 1990's and continue to present. However, the business environment between the two countries remains somewhat cautious. Therefore, affirming the presence of elevated risk factors for foreign investors. The renewed cross-border business cooperation between China and India, and each country's popularity as a foreign investment destination, has significantly increased the demand for **i-fact@nalysis's** due diligence solutions. i-fact@nalysis's China offices, and soon to open India office, will provide direct local support to these important markets.

Indian Companies Foreign M&A Reaches US $43.9 Billion (2010 – 2011)

Indian companies are actively pursuing M&A investments in the U.S. and a study conducted by the Federation of Indian Chambers of Commerce and Industry and the India-US World Affairs Institute reported, from 2004 to 2009 Indian companies invested over $26 billion in America. The majority of the M&A investments (80%) were in the manufacturing, information technology, biotechnology, chemicals and pharmaceuticals, telecom and the automobile sectors. Information released by the Reserve Bank of India reports that overseas investments by Indian companies jumped 144% in 2010 – 2011 to US $43.9 billion from approximately US $18 billion in 2009 – 2010. In the first four months (April to July) of fiscal 2011 there was an outward Foreign Direct Investment "FDI" of U.S. $13.26 billion. The Indian Embassy reported investments in the U.S. from India has grown approximately 75% annually from 2002 to present.

The Indian luxury market is growing at 20% a year and is expected to reach $5.8 billion in 2011. One in every four luxury stores is opening outside of Mumbai, Delhi and Bangalore, according to the CII-AT Kearney Report released in October 2011. The White House is also weighing a plan to lure a minimum of $1 trillion in new foreign investment from emerging countries, including China and India, over the next five years in an attempt to create jobs in the U.S.

There are significant differences in conducting due diligence investigations in China and India in relation to M&A, capital investments, joint ventures, partner and executive screening. In China approximately 85% of the country's largest global companies are state-owned enterprises, whereas, in India 85% are private or publically listed companies and are operated by a "promoter". A promoter is defined as the person responsible for founding, organizing and/or selling the company. There is also a distinct difference in record keeping between the two countries. India has an adequate records infrastructure and corporate documents are accessible and recorded in English. Whereas, in China records are maintained in simplified Chinese characters and may not always be readily available.

When conducting due diligence in China or India, it is local knowledge, "boots-on-the-ground", coupled with a global platform that ensures timely, accurate, reliable information and intelligence. This is especially true in China were influences at the provincial level, where regulations and policies may differ, could jeopardize an acquisition, merger, investment, partnership or business opportunity. This is also true to some extent in India at the state level. India also has a rapidly evolving regulatory environment, which foreign investors need to be made aware of.

When conducting due diligence assignments in China and India companies need to focus on the corporate entity and its owner(s) and promoter(s). It is common in India for promoters and their family members to have ownership and/or holdings in other companies, which involve inter-company related party(s) transactions. These third party transactions may not be at arm's length. Shareholdings and ownership in Chinese companies are often complex involving multiple acquisitions, subsidiaries, joint ventures and partnerships, which are difficult to decipher.

Conducting Due Diligence in China

It is important to fully understand Chinese business practices and culture when conducting due diligence investigations in China. U.S. companies that rely on audited financial statements of a company, which are readily available from large credit reporting agencies and government repositories, should be aware that audited accounts submitted to the government often, do not reflect the company's true financial position. The Chinese government's auditing of domestic businesses is not well-organized or effective.

Additional challenges in conducting due diligence in China are that company registrations are maintained at the province level and all records are in simplified Chinese Characters. Therefore, requiring the exact legal name of the company in simplified Chinese Characters, and in which province it was registered, to obtain the official company filings.

Obtaining accurate historical data on a Chinese company can be time consuming and extremely difficult. Larger companies in China, more likely than not, are, or at one time, were, state-owned. Companies may have been privatized; however, the government may hold shares in the company. The company may be insolvent and its affairs run by an appointed administrator. The company may have been acquired by another Chinese entity and/or is a wholly owned subsidiary of a state-owned conglomerate. The acquiring entity may be registered in another province necessitating research be conducted in that and/or other provinces. Therefore, identifying the true shareholders in a company often requires extensive research. This is an area of concern for U.S. and UK companies in their efforts to be compliant with the FCPA, UK Bribery Act and money laundering statutes.

Conducting due diligence on an individual requires the subject's full name in simplified Chinese Characters, National ID card number and the province the subject is residing in. Without a National ID number it is virtually impossible to obtain any information on a subject. Clients routinely provide copies of a subject's Chinese passport when requesting i-fact@nalysis to conduct a due diligence investigation on an individual. Contrary to U.S. beliefs, a Chinese passport number is of very little use in conducting a due diligence investigation on an individual in China. Clients will also conduct their own research on Google and forward the information obtained on the subject company(s) or individual(s). Google is not the preferred search engine in China and rarely provides the detailed information required.

Conducting Due Diligence in India

There are significant differences in conducting due diligence in India than in China. India is a democratic state with a more diversity among the different Indian states. China is a one-party state with centralized control over the country's provinces. India's repositories, holding government records, are more accessible, and are better organized from an IT perspective. And records are maintained and/or translated into English. One similarity China and India share is the limited availability of public and private sector searchable databases.

Although, record keeping is more advanced and accessibility is better in India, conducting proper due diligence, to know who you are doing business with, is a vital, and often overlooked requirement. Indian companies' financial reporting, regulatory compliance and corporate governance practices are not as developed as the processes utilized in the U.S.

In-depth research is required to identify the shareholders, directors, subsidiaries and affiliated companies and to determine the legal corporate structure of a company. In general, government transparency is better in India; possibly due to a majority of companies have no government ownership. Whereas, in China 85% of large multinational companies have some form of government ownership. Moreover, Indian companies tend to be family-owned and operated with complex ownership structures. This form of ownership may result in the board not being independent and power may be held by a few individuals. Under these circumstances reputational due diligence is a critical step in the overall process. An individual's political connections, shareholdings in other companies, involvement with government contracts, fraudulent business activities and involvement in criminal or civil proceedings related to third party transactions may have FCPA or UK Bribery Act implications for U.S. and UK companies.

India is more susceptible to public opinion were its population has the right to vote. The building of factories and other land usage plans by corporations have resulted in local demonstrations that have prevented the opening of factories and forcing companies to relocate to other areas. Local politicians eager to be seen as champions of the underprivileged are prone to align themselves with the local populace against domestic and foreign corporations.

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