
THE MERGERS & ACQUISITIONS REVIEW

SECOND EDITION

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Chapter 54

TAIWAN

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I OVERVIEW OF 2007/2008 M&A ACTIVITY

M&A transactions in Taiwan have nearly doubled in number and value since 2002. While 2007 transactions declined slightly from the 245 transactions reported in 2006, 197 domestic transactions valued at over US\$32 billion were completed in 2007 according to figures from Taiwan's Ministry of Economic Affairs. Official figures are not yet available for 2008, but a string of sizeable transactions in the first half of 2008 suggest that the Taiwanese appetite for mergers remains strong.

Thirty-one domestic (including inward-bound) transactions were valued at over US\$67 million in 2007 while 124 were transactions of US\$16.6 million or less. This accurately reflects the predominance of specialised family-owned concerns in Taiwan's economy. M&A activity was most common in the IT, semiconductor, financial services, and chemicals sectors.

Outward bound M&A transactions by Taiwan's rapidly globalising technology and financial services companies have become commonplace. In 2007, for example, Mediatek, a fabless-semiconductor design company, acquired US-based Analog Devices' mobile-phone chipset business for US\$350 million and also took a 70 per cent equity stake in K-WILL Corporation of Japan, a manufacturer and developer of digital and audio-test equipment, for just under US\$300 million. Notably, the Fubon Financial group, one of Taiwan's largest financial services conglomerates, acquired nearly 20 per cent of Xiamen Commercial bank in China's Fujian province after regulations in Taiwan barring China investments by Taiwanese banks were relaxed in early 2008.

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II GENERAL INTRODUCTION ON THE LEGISLATIVE M&A STRUCTURE

In Taiwan, the laws and regulations relevant to M&A activities are found in a number of statutes including:

- a* the Business Mergers and Acquisitions Act ('BMAA');
- b* the Company Act;
- c* the Securities and Exchange Act;
- d* the Statute for Upgrading Industries;
- e* the Fair Trade Act;
- f* the Labour Standards Act;
- g* the Statute For Investment By Foreign Nationals;
- h* the Financial Institutions Merger Act; and
- i* the Financial Holding Company Act.

In general, the BMAA supersedes other laws and regulations concerning M&A. Article 2 of the BMAA provides that any merger or acquisition shall be conducted pursuant to the provisions of that Act and that matters not provided for therein are governed by other relevant acts and regulations. One exception involves financial institutions, in which the Financial Institutions Merger Act and Financial Holding Company Act supersede the BMAA where there are conflicting provisions.

The BMAA was announced by the Taiwan government on 6 February 2002 and substantial amendments were subsequently promulgated on 5 May 2004. The intent of this legislation was to create an independent act to simplify the application of the various laws in connection with M&A activities, to streamline procedures and to avoid unnecessary and time-consuming amendments to the various other laws related to M&A. The main purposes of the Act are to simplify and facilitate M&A procedures, balance the interests of employees and employers in M&A transactions, and to provide tax benefits.

In general, the BMAA regulates mergers, acquisitions, and corporate divisions. The term 'acquisition' as defined in the BMAA means any company acquiring shares, business or assets of another company in exchange for shares, cash or other assets. However, the definition of 'acquisition' has been explained and limited by the Ministry of Economic Affairs to include only:

- a* the assumption or transfer of the whole legal entity;
- b* transfer of the whole of or substantial operations or assets;
- c* acquisition of the entire operations or assets of another company such that it will have a material impact on the acquiring company; and
- d* share exchanges.

Only acquisitions that fall under these categories qualify for benefits under the BMAA such as tax benefits and simplified procedures.

III DEVELOPMENTS IN CORPORATE AND TAKEOVER LAW AND THEIR IMPACT

i Foreign investment approval

Effective 1 April 2008, the purchase or sale of stock in Taiwan-listed companies by foreign investors does not require prior approval from Taiwan's Investment Commission where the transaction does not exceed 10 per cent of the company's total shareholdings (regardless of the total value of the purchase). Before this change, any foreign investment in a local listed company equal to or greater than US\$50 million required prior approval from the Investment Commission. In contrast, transactions below the US\$50 million threshold were recorded with the Financial Supervisory Commission. Under the previous system, an Investment Commission review could take several months while recordation with the Financial Supervisory Commission could be completed in one or two business days. It is hoped that this amendment will not only simplify regulatory procedures and expedite transaction closings but also facilitate and encourage the flow foreign capital into Taiwan-listed companies.

ii Employee stock bonuses to be expensed

In order to bring Taiwan's financial reporting regime in line with current international practices, Taiwan's Financial Supervisory Commission announced that, beginning in 2008, the costs to the issuer of employee stock options or bonuses shall be listed as a business expense. Prior to 2008, these shares were treated like distributions of profit. Under the new system, financial statements for the first quarter of 2008 for all public companies must list employee stock bonuses as an expense, while public companies not applying calendar-year accounting methods will apply the new system to the first financial statement after 1 January 2008. This measure is meant to ease foreign shareholders' concerns over improper inflation of capital and annual after-tax profits and provide more confidence in the EPS values of public Taiwan companies in the long term.

Taiwanese companies tend to issue significant stock bonuses as incentives to their employees. The practice is common due to the relative low cost and is especially prevalent in high-tech industries. The profit ratio, which is distributed to employees as bonuses, is stipulated in a company's articles of incorporation. An estimate of employee bonuses can be calculated based on the company's interim financial report and the number of shares to be distributed can be calculated based on the stock's market price.

iii Reporting requirements

With the increasing number of mergers and acquisitions in the country, Taiwan's Financial Supervisory Committee has tightened related reporting requirements. In order to prevent disputes and increase the clarification of combination procedures, the Financial Supervisory Committee has revised related laws and regulations (most notably the Securities and Exchange Act and Regulations Governing the Acquisition and Disposal of Assets by Public Companies) to require that local listed companies involved in mergers, acquisitions, divisions or spin-offs record the names and basic information of any administrative and managerial staff involved in material discussions or resolutions related to the combination, as well as relevant dates, memoranda of understanding

signed by the company, or any other documents, agreements, meeting minutes or plans in connection with the combination.

Furthermore, where an independent director of a listed company expresses reservation or opposition to the combination, this must be duly noted in the minutes of the relevant board of directors' meeting. All of the above information shall be reported to the Financial Supervisory Commission for recordation.

iv Relaxation of thresholds for new listings

To meet its goal of adding 250 new exchange or OTC listings, the Taiwan Stock Exchange has relaxed the five main listing thresholds. These include:

- the lowering of profitability requirements for listed companies;
- drastically shortening the requirements that newly exchange-listed or OTC-listed companies place shares in compulsory central custody;
- revoking restrictions on the transfer of substantial shareholdings;
- slightly relaxing restrictions prohibiting the listing of companies whose responsible persons have violated the principle of good faith; and
- relaxing of listing requirements for construction companies.

v Biotechnology and New Pharmaceutical Development Act

In June of 2007, Taiwan's legislature passed the Biotechnology and New Pharmaceutical Development Act, which is expected to drive even more growth in the country's biotechnology sector. Taiwan's biotechnology industry, which includes pharmaceuticals, medical devices, and other emerging biotechnologies, has enjoyed double-digit growth since 2000. The new act provides various incentives to invest in the sector including a five-year tax exemption for up to 35 per cent of a firm's R&D and personnel training costs.

The government has also earmarked significant funds for direct investment in biotechnology enterprises. One of the major projects is the Nangang Biotech Park, which is set to begin operations in 2012. The project has received over US\$600 million in funding from the National Science Council and Academia Sinica. A US\$1 billion biotech joint venture is also being established with foreign investors, with 40 per cent of shareholdings owned by Taiwan investors.

IV FOREIGN INVOLVEMENT IN M&A TRANSACTIONS

Foreign involvement in Taiwan M&A transactions in recent years has focused on financial services, cable television systems, and specialised technology companies. Total foreign direct investment ('FDI') reached US\$7.42 billion in 2007.

European firms have been especially active in purchasing Taiwanese technology companies, especially those with significant manufacturing presences in China. Bayer Material Science's acquisition of Taiwan's Ure-Tech Group, a major producer of thermoplastic polyurethane ("TPU") was typical of this trend in 2007. In 2008, the UK-based Elementis plc paid US\$75 million for Deuchem Co, Ltd, which supplies additives and resins to the coating and related industries. Again, Deuchem's significant presence in China was a major incentive in the deal.

On the private equity front, the Carlyle Group's US\$5.6 billion offer for Advanced Semiconductor Engineering ('ASE') was ultimately rejected, but another consortium of investors led by Carlyle successfully took a 36.6 per cent stake worth US\$656 million in Ta Chung Bank in 2007. This deal was followed by Citibank's acquisition of the Bank of Overseas Chinese for US\$460 million, also in 2007. Meanwhile ABN AMRO of the Netherlands agreed to take over Taitung Business Bank in 2007 while Singapore's DBS Bank took over Bowa Bank at the beginning of 2008. Continuing this string of acquisitions in the financial services industry, Deutsche Bank took a 60 per cent stake in Deutsche Far Eastern Asset Management Company Ltd.

The wave of bank acquisitions follows a string of acquisitions of Taiwanese life insurance firms a few years earlier. The strong interest in banking acquisitions is a response to the widespread perception that Taiwan, while significantly over-banked, presents unique opportunities for sophisticated international banks who believe that Taiwanese financial institutions may soon be providing financial services to the fast-growing, entrepreneurial economies of Fujian (population 35 million) and Zhejiang (population 47 million) provinces of China just across the Taiwan Strait. It should also be noted that unlike neighboring South Korea, foreign acquisitions of Taiwanese banks and other targets are generally welcomed and there are few equity caps on foreign ownership outside the telecommunications and broadcast media industries.

V SIGNIFICANT TRANSACTIONS, KEY DEVELOPMENTS, AND HOT INDUSTRIES

i Significant transactions

The most significant domestic transactions completed in 2007/2008 were the acquisitions or takeovers of Taiwanese banks by foreign financial groups or private equity consortiums.

In addition, in 2007, Oaktree Capital Management acquired Fu Sheng Industrial Co (the world's largest contract manufacturer for golf club heads) through its subsidiary Valiant International Co, Ltd. Not only was the takeover Taiwan's first-ever management buyout (MBO), but it was the largest investment in terms of value by an international private equity fund in Taiwan's traditional industry sector (valued at approximately US\$1 billion).

Major outward bound transactions included Acer Inc's purchase of the US's third largest PC brand Gateway for US\$710 million in 2007. This transaction was notable because Taiwan's BenQ Corporation acquired the Mobile Devices business (and certain branding rights) from Siemens AG in 2005 but was forced to close its German operations in 2006. Despite this setback, the Gateway acquisition shows that Acer is determined to learn how to expand globally through strategic acquisitions of major brands.

ii Key developments

In a closely watched case, Taiwan's Fair Trade Commission decided to delay a planned merger between Uni-President and Weilih Foods that would leave Uni-President with a market share of over 70 per cent in Taiwan's instant noodle industry. While the Commission is ultimately expected to approve the deal, the Commission is showing greater concern

about mergers that may affect the interests of consumers and smaller upstream suppliers and downstream distributors. This trend could affect future acquisitions of Taiwanese financial institutions by foreign firms if the Commission decides that drives to make formerly state run banks more efficient are detrimental to the interests of consumers.

The Fair Trade Commission also fined Yageo Inc close to US\$150,000 for acquiring more than 43 per cent of Ta-Yi Technology Inc, Ltd in 2007 but failing to apply to the Commission for a merger review. Yageo and Ta-Yi, both listed companies, are Taiwan's largest and second-largest makers of chipset resistors. The Financial Supervisory Commission also fined Yageo US\$7.2 million for failing to report indirect acquisitions of Ta-Yi's shares that led to a 400 percent increase in Ta-Yi's share price. Meanwhile, Ta-Yi delayed a scheduled June 2007 shareholder meeting until August 2007, despite possible legal sanctions, presumably to collect sufficient shareholder proxies to resist Yageo's efforts to elect a new board that would give it control over Ta-Yi. Ta-Yi then used block voting to nominate slates of directors controlled by Ta-Yi. Despite holding more than 43 per cent of Ta-Yi, Yageo was unable to elect a single director to Yageo's board. Yageo has filed some 10 legal actions against Ta-Yi, while members of the family that controls Yageo became the subjects of criminal investigations in mid-2008 for insider trading related to the run-up of Ta-Yi stock prices in spring 2007.

The *Yageo* case, along with a similar attempted hostile takeover of DRAM manufacturer Macronix by Powerchip Semiconductor, both illustrate the difficulties of executing a hostile takeover in Taiwan, even when the incumbent board controls less than 4 per cent of the target's issued shares as in the *Macronix* case. Notably, the successful defense in both failed takeovers did not involve poison pills, the right of shareholders to acquire new shares. Instead, protracted legal manoeuvring over shareholder meetings, nomination procedures as well as successful challenges to the validity of proxies in the *Macronix* case proved to be effective deterrents against hostile takeovers. While attempts to take over competitors are becoming more common in Taiwan's IT and semiconductors sectors, no hostile takeover has yet been successful in Taiwan despite regulatory restrictions on classic poison-pill strategies.

iii Hot industries

While foreign acquisitions in the banking sector have attracted much attention in Taiwan and the region, most M&A activity takes place domestically in Taiwan's IT manufacturing industry. Hon Hai Precision Industry, one of the world's largest manufacturers of electronic equipment, eschews the use of outside investment banks (and outside law firms) as it expands its supply chains by acquiring manufacturers of key components, such as compact camera module ('CCM') maker Altus Technology for US\$36.6 million. Many of Hon Hai's acquisitions are start-ups that Hon Hai's in-house venture capital unit has already funded. This seed-and-acquire, go-it-alone approach is favoured by Taiwanese entrepreneurs because it allows them to conclude deals quickly and save on large fees to investment banks and also minimises due diligence efforts.

VI FINANCING OF M&A: MAIN SOURCES AND DEVELOPMENTS

In general, the two main channels for raising capital for businesses in Taiwan are the same as in other countries, namely through equity or debt financing. Due to the significant number of local small and medium-sized enterprises in Taiwan, borrowing from financial institutions is still a key method of acquiring funds. Public companies also issue corporate debt to raise funds, with both standard and convertible corporate bonds being very common in Taiwan.

Private equity funds also play an important role in channeling capital to Taiwan corporations. International private equity funds have become much more active in Taiwan in recent years due mainly to the deregulation of cable media and a government policy encouraging consolidation in the finance industry. Private funds such as LoneStar and Cerberus have also been actively acquiring non-performing loans in Taiwan. Another merger that recently made headlines in Taiwan was Carlyle's US\$1.5 billion acquisition of Eastern Multimedia Co, which controls almost a quarter of the nation's cable television market.

Domestic private equity funds are also taking off. Interest rates in Taiwan (as in Japan) are comparatively low in global terms, creating a more favorable environment for leveraged buyouts preferred by private equity firms.

In 2007, Oaktree Capital Management acquired Fu Sheng Industrial Co (the world's largest contract manufacturer for golf club heads) through its subsidiary Valiant International Co, Ltd. Not only was the takeover Taiwan's first-ever management buyout ("MBO"), but it was the largest investment in terms of value by an international private equity fund in Taiwan's traditional industry sector (valued at approximately US\$1 billion).

Approximately 20 per cent of publicly-reporting but not yet listed companies in Taiwan are obtaining capital through private equity firms. In addition, the total value of funds raised by listed companies through private equity is steadily rising year on year, and currently stands at approximately 25 per cent of the amount raised by listed companies through public offerings. Of particular note, Taiwan's electronics and insurance industries are the sectors still raising funds mainly through public channels.

Taiwan's new administration, which came to office on 20 May 2008, has focused policy efforts on relaxing restrictions on investment from, and into, China. For example, the government has announced plans to allow companies with Chinese capital to invest directly in Taiwan manufacturing companies, though with some upper limit on the equity share the Chinese company could acquire. The government has also announced plans to allow companies with Chinese ownership to list in Taiwan, though at what ceiling of Chinese ownership of the issuer remains to be seen. Such relaxations of current restrictions can only be realised through legislation, such as amendment by the legislative body of the Act Governing Relations between Peoples of the Taiwan Area and the Mainland Area. In parallel, the government is also relaxing restrictions on outbound investment into China by Taiwan companies and funds.

VII EMPLOYMENT LAW

In July of 2008, Taiwan's Legislative Yuan passed amendments to the Labour Insurance Act. The amendments, which enter into effect on 1 January 2009, allow retired employees to choose monthly old-age benefit payments as an alternative to the current lump-sum payment. The monthly payments would be calculated on an income replacement ratio of 1.55 per cent and are subject to an added premium rate. The current minimum rate is 6.5 per cent and, with the new amendments, this minimum rate will be raised to 7.5 per cent. The added burden of the premium rate will be borne by the employer. This Amendment will affect the approximate 8 million laborers covered by Taiwan's Labour Standards Act.

Note that this labour insurance provision is in addition to the new retirement pension system (effective as of July 2005) that requires employers of domestic non-professional employees to contribute monthly to the employee's portable, lifetime pension fund, in addition to the salary payment, an amount equivalent to 6 per cent of the employee's base salary payment

Major labour disputes often arise during mergers and acquisitions in Taiwan. For example, during the 2007 purchase of Cosmos Bank by US private equity funds SAC Private Capital Group (SAC PCG) and GE Capital, Cosmos issued common shares, preferred shares and convertible bonds to both SAC PCG and GE Capital. This capital increase gave SAC PCG and GE Capital a combined 80 per cent shareholding in Cosmos. However, since the acquisition failed to provide a suitable plan for post-merger placement of workers, Cosmos workers opted to strike, a dispute that brought the attention of Taiwan's Securities and Futures Bureau as well as local legislators.

Furthermore, Standard Chartered's recent buyout of Taiwan's Hsinchu International Bank was fraught with difficulties including major differences in corporate culture, disputes over worker's rights and uneven standards for compensation and benefits. Subsequently, the newly renamed Standard Chartered Bank (Taiwan) Ltd's union voted almost unanimously to strike in 2007. These examples highlight the importance of careful labour planning during the transfer to new ownership and the challenges facing managers in helping employees adjust to changing work terms, environment, and other issues.

VIII TAX LAW

Taiwan does not tax capital gains, but does assess on the seller a 0.3 per cent tax on the value of a securities transaction.

i Developments in the treatment of share swaps

Under a new tax policy announced by the Ministry of Finance in February 2007, shares 'sold' through a share swap are exempt from the securities transaction tax. In addition, when an acquiring company issues preferred shares in exchange for shares in the target company, the difference in value between the preferred shares of the acquiring company and the shares originally held in the target company shall be treated as capital gains, and thus exempt from income tax. However, if the acquiring company later redeems the

preferred shares, the difference in value would be considered dividends and subject to income tax. This is consistent with the treatment described in the next development, *infra*.

ii Developments in the treatment of cash-out mergers

Another major development concerns a Ministry of Finance ruling at the end of 2007 that makes shareholder gains in a merger transaction in the form of cash (rather than in the form of stock in the surviving entity) subject to income tax. The ministry ruling found that ‘cash-out mergers’ are not securities transactions and are, therefore, subject to income rather than securities transactions taxes (with the taxpayer allowed to deduct its cost basis from the income).

iii Goodwill obtained in mergers may be subject to business income tax

According to an interpretation announced by the Ministry of Finance on 4 January 2008, beginning 1 January of this year, any fixed assets obtained from a non-surviving entity as a result of a merger shall be reported as income and subject to business income tax. In addition to applying this treatment to fixed assets, Taiwan’s National Tax Administration has reported an intention to extend this treatment to goodwill and other intangible assets obtained through a merger, which would subject those assets to the 25 per cent business income tax.

According to statistics provided by the National Tax Administration, the average total value of goodwill exchanged in mergers each year totals NT\$120 billion and, based on that figure, this could mean an additional NT\$30 billion in tax revenues should a similar ruling be applied to intangible assets. However, many professionals have expressed concern about the policy, indicating that such a move could adversely impact Taiwan’s merger and acquisition environment and possibly prompting a reassessment by the regulatory authorities.

IX COMPETITION LAW

The main objective of Taiwan’s fair trade regime is to maintain a competitive yet orderly market. Therefore, when considering whether to accept or reject any applications for business combinations (mergers), the guiding principle of Taiwan’s Fair Trade Commission (‘FTC’) is whether ‘the overall economic benefit of the merger outweighs the disadvantages resulting from restraint of competition’. As such, the FTC has full discretion to set special conditions to the approval of a combination.

For example, in 2007, Taiwan’s Uni-President held a 25 per cent market share in the beverage industry. When it sought to acquire Tait Marketing & Distribution Co, Ltd (Nestle’s agent in Taiwan), the FTC’s decision restricted Uni-President from using its market position to force distributors and retailers to enter into exclusive agreements with Uni-President, or to restrict distributors or retailers from transacting with other beverage suppliers. The same restriction was applied by the FTC in connection with Yahoo Taiwan Inc.’s purchase of all outstanding shares of Monday Tech Co.

In recent years, Taiwan’s largest karaoke operators – Cashbox Partyworld Co, Ltd and Holiday Entertainment Co, Ltd – have twice filed applications for merger with the

FTC. However, both applications were rejected as the combined market share across Taiwan exceeds 50 per cent and in some areas is as high as 90 per cent. The issue was further complicated by the fact that Cashbox also has a significant market share in other related sectors.

X FUTURE DEVELOPMENTS AND OUTLOOK

For many years, tensions across the Taiwan strait resulted in a number of laws and regulations that severely restricted the investment environment. However, 2008 saw the Chinese Nationalist Party ('KMT') claim both the presidency and a supermajority in the Taiwan legislature largely because of its argument that Taiwan's economy needs to be fully opened to China. China became Taiwan's largest trading partner in 2003 and Taiwan's trade surplus with China is close to US\$80 billion a year.

The most significant restriction on Taiwanese investment in China was a rule that a Taiwanese company could not invest more than 40 per cent of its net worth in China. The new administration has already raised this cap to 60 per cent and removed it entirely for companies that keep their operating headquarters in Taiwan. On the one hand, the new freedom to invest should spark more outward bound M&A activity by Taiwanese firms in China, where many already have very significant investments. On the other hand, foreign acquirers will be taking fresh looks at Taiwanese firms because of their new opportunities in China.

The opening to China will likely permit Chinese firms to invest in Taiwan more easily. There is already anecdotal evidence that Chinese firms are acquiring indirect stakes in Taiwanese targets through regional acquisitions where the target already has Taiwanese subsidiaries. In addition, Chinese QDII (qualified domestic investment institutions) have been allowed to invest directly in Taiwan's stock exchanges in addition to new rules that will allow Taiwanese firms in China to list on the Taiwan Stock Exchange. Chinese interest in real estate development projects is also expected to be substantial. In short, China may soon join North American and European investors as major players in Taiwanese M&A activity.

Domestically, a second round of mergers of domestic banks is expected to mainly involve Taiwan's major state-invested banks. Those state-affiliated banks that do not merge may also become targets for acquisition by foreign banks or private equity groups. The new administration also plans massive investment in Taiwan's transportation infrastructure that could total more than US\$130 billion although the sources of funding for these projects remains a question. If these projects do materialise, their scale will encourage consolidation among the many Taiwanese construction companies that gained considerable technical experience as subcontractors building Taiwan's mass rapid transit systems in Taipei and Kaohsiung as well as constructing the US\$15 billion Taiwan High Speed Rail System.

In sum, Taiwan's greater economic integration with China, consolidation in its banking sector, and ambitious new infrastructure projects coupled with the doubling of M&A activity in recent years all point to many more deals in the remainder of 2008 and especially in 2009.