Around Asia Pacific – Malaysia

Contents

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The big picture

"Around Asia Pacific" is Hogan Lovells' periodic overview of the private equity landscape in Asia Pacific and supplements our "Around Europe" series. Following our inaugural Asia-Pacific edition looking at Greater China (including Hong Kong), and our August edition looking at Vietnam, in this edition we turn our attention to Malaysia. Future editions in the series will look at other private equity markets in the Asia Pacific region.

Malaysia has a population of around 30 million people, a literacy rate hovering around 95%, and is Southeast Asia's third-largest economy.

Foreign investment has steadily risen throughout 2015, with the most popular sectors for inbound investment being manufacturing, mining & quarrying and services. The biggest deals by value occurred in the petroleum products, electronics & electrical products and non-metallic mineral products markets.

The Malaysian private equity market has been buoyant in the retail, technology and consumer sectors. According to a recent report by Bain & Company, the Asia Pacific region has seen a private equity surge in 2015, although this was mainly led by Greater China. Sovereign wealth funds, such as Malaysia's Khazanah Nasional, have contributed to this surge.

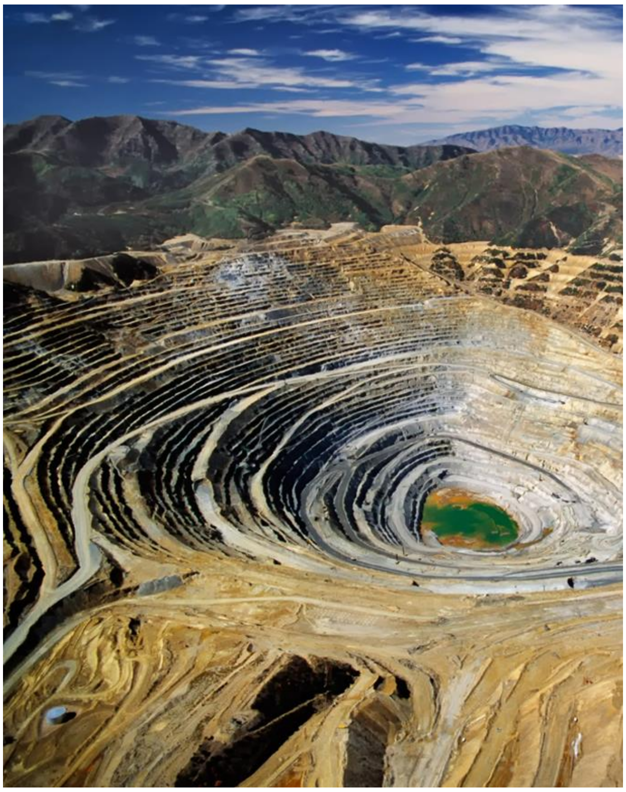
Inbound investment in Malaysia has increased throughout 2015: in Q1 FDI investment totalled RM10 billion (approx. US$2.36 billion); in Q2 FDI investment totalled RM21.3 billion (approx. US$5.03 billion); and in Q3 FDI investment totalled RM27 billion (approx. US$6.37 billion). Malaysian domestic deal activity has remained steady throughout the year with the Malaysian Investment Development Authority reporting a total of RM132.4 billion (approx. US$31.26 billion) in Domestic Direct Investment for Q3.

Malaysia presents many investment opportunities for foreign investors including private equity houses, now being a particularly opportune time to invest given the weakness of the Malaysian ringgit. Malaysia has set its sights high in aiming to attain developed-nation status by 2020, which it hopes to achieve by attracting US$444 billion private investment between 2010 and 2020.

In 2014, private sector investment represented 64% of total investment in Malaysia. The government would like this to be significantly higher to fuel its planned economic boom over the next few years. UNCTAD 2015 World Investment Report ranked Malaysia as the fifth-largest recipient of foreign investment in Southeast Asia.

In this edition of Around Asia Pacific, we will look at the significant deals of 2015, the current investment climate, our expectations for the remainder of 2015 and 2016, what investors need to know, and key legal developments.

We would like to thank Skrine, whom we regularly work with on deals involving Malaysia, for collaborating with us in the production of this edition of "Around Asia Pacific".



The deals

OLS digs deeper in Malaysian phosphate industry

Singapore-listed investment company OLS Enterprise Ltd. ("**OLS**") had already invested in a wide variety of industries prior to 2015, including film and advertising, pharmaceuticals, cosmetics, green technology, and corporate consulting and contracting. In August 2015, OLS decided to further expand its operations by agreeing to acquire Malaysian Phosphate Additives Sdn. Bhd. ("**MPA**"), the leading producer of phosphorus-based nutrients in the region.

The deal will take the form of a reverse takeover, with OLS acquiring the stakes of Right Earth Sdn Bhd ("**Right Earth**"), Casa Lite Sdn Bhd ("**Casa Lite**"), Malaysian Technology Development Corporation ("**MTDC**") and Lim Lee Wan in exchange for US$222 million of newly allotted OLS shares. When the deal is completed, Right Earth, Casa Lite, MTDC and Lim Lee will own over 30% of the enlarged share capital of OLS.

Right Earth and Casa Lite are both Malaysia-based investment holding companies specialised in the inorganic feed phosphate market. MTDC, though also Malaysia-based, is a venture capital firm that invests in the early stages of a wide variety of technology companies.

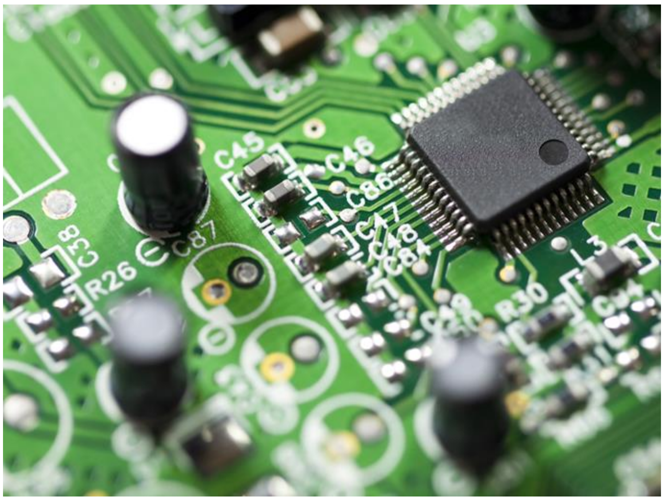
Given MPA's standing in the market, OLS expects the acquisition to provide a sustainable and growing income stream for its business, as well as enhancing shareholder value and strengthening OLS' balance sheet. MPA's 40% subsidiary Malaysian Phosphate Additives Sarawak is currently in the midst of a US$400 million project to build Southeast Asia's first integrated phosphate complex. The completed plant is expected to generate annual sales revenue of US$550 million.

BlackRock exits, Royal Group enters in Kuala Lumpur DoubleTree deal

BlackRock's first exposure to the Asian property market came when it bought Macquarie Global Property Advisors in October 2013, in a deal that included the 540 room DoubleTree by Hilton hotel in Kuala Lumpur. Two years later, BlackRock announced it was selling the KL DoubleTree to Royal Group Investments Pte Ltd. ("**Royal Group**"), a Singapore-based company that invests in hotels and commercial real estate properties. The acquisition was part of Royal Group's strategy to expand its hotel business and broaden its hospitality sector in Asia.

The DoubleTree was up for sale for a year before the deal with Royal Group was agreed, as were the three other parcels of office blocks and malls that make up the Intermark complex in Kuala Lumpur. The sale of another Intermark parcel, the 39-storey Integra office block, was announced only a week before the DoubleTree deal. Getting deals over the line in Malaysia can be slightly more challenging than in more developed jurisdictions, with deal timelines often extending further than would be expected.

BlackRock and Royal Group have not disclosed valuations, but the deal is estimated to be valued at RM388 million (approx. US$91.6 million), to be paid in cash.



US-based Austin Powder makes explosive entrance into Malaysia with acquisition of Tenaga Kimia

Listed investment company Tropicana Corp Bhd ("**Tropicana**") put its 73% stake in Tenaga Kimia Sdn Bhd ("**Tenaga Kimia**") up for sale as part of its new strategy to refocus on its core property development business and divest itself of peripheral holdings. As a manufacturer and supplier of explosive products and accessories, Tenaga Kimia was designated as "non-core" by Tropicana management.

Tropicana found a willing buyer in Austin Powder Asia Pacific Inc. ("**Austin Powder Asia**"), a US-based supplier of civil explosives and blasting services to the global mining, stone quarry, construction and oil and gas industries. Austin Powder Asia has agreed to acquire Tropicana's 73% stake, plus a 2% stake held by a private individual investor based in Malaysia, for a total consideration of RM194.7 million (approx. US$46 million) in cash.

The sale is one in a spate of disposals by Tropicana, which has also sold Tropicana City Mall and Office Tower, 300 acres of land in Canal City and a parcel in Bukit Bintang in an effort to bring down gearing and borrowing costs. Tropicana will use some of the proceeds of the Tenaga Kimia sale to further repay bank debts, with the rest to be used as working capital.

Singapore investors swap and delist public battery business Yokohama Industries

Private companies were not the only deal targets this year, as Yokohama Industries Bhd ("**Yokohama**") was delisted from Bursa Malaysia in June 2015 as a part of its takeover by Singapore-based Fordington Pte Ltd ("**Fordington**"). Yokohama's business is batteries, including manufacture, recycling, charging services and accessories.

Fordington completed the deal in stages. It first acquired a 62.17% stake in Yokohama from another Singapore-based investment company, HSG Investments Pte Ltd ("**HSG**"). Malaysian listing rules then required Fordington to launch a mandatory offer to acquire the remaining shares of Yokohama. With its own holding and acceptances of its offer, Fordington was able to control 96.34% of Yokohama, well above the required threshold for delisting.

The offer price per share was MYR1.70 (US$0.40), representing close to a 33% premium over the pre-announcement closing price of MYR1.28 on 26 December last year.

Market commentary and analysis

Ambitious plans for Malaysia's economy

Since 2010, Malaysia has prioritised investment and policy support through its Economic Transformation Programme on twelve National Key Economic Areas (NKEAs). The NKEAs and a brief insight into their targets are as follows:

Oil, gas & energy a) target 5% annual growth from 2010 to 2020 b) make Malaysia the No.1 Asian hub for oil field services c) grow Malaysian downstream operations
Palm oil & rubber a) develop downstream sector of palm oil industry b) expand production of valuable oleo derivatives c) commercialise second generation biofuel for power generation d) commercialise green rubber
Financial services a) increase the insurance, private pension and wealth management industries b) revitalise equity and bond markets c) integrate electronic payment systems
Tourism a) increase spa and sporting retreats b) establish Malaysia as leading business tourism centre c) enhance and market biodiversity activities
Business services a) accelerate the growth of: aviation maintenance, repair and overhaul services, outsourcing and data centre provision b) develop growth segments: green technology, pure play engineering and Islamic finance knowledge-process outsourcing
Electronics and electrical a) increase research & development, design and manufacturing capabilities b) focus on integrated circuits, solar technology, LEDs and integrated electronics

Wholesale and retail a) improve IT, customer service and stock management b) remove import duties to encourage shopping
Education a) focus on early childcare market, pre-school education, primary and secondary education and technical/vocational training
Healthcare a) focus on public-private collaborations especially in pharmaceuticals and biotechnology, medical technology and health services
Communications content & infrastructure a) use of Radio Frequency Identification Technology (RFID) b) development of applications and content especially for online learning, healthcare and access to government services c) develop communications infrastructure with a focus on coverage, affordability and quality
Agriculture a) transform small-scale into large-scale agribusiness through economies of scale and value chain integration
Greater Kuala Lumpur / Klang Valley a) attract MNCs and foreign talent b) upgrade public transport system c) provide high-speed travel between Kuala Lumpur and Singapore d) upgrade waste management and sewerage services

These NKEAs signify a level of commitment by the Malaysian government to driving growth over the long term. Private equity investors may look to capitalise on the government's commitment and focus by considering investments in these areas.

Macroeconomic and political issues: corruption at the top

According to the Transparency International 2014 rankings, countries within the Asia Pacific region averaged 43/100 on the Corruption Perceptions Index, where 100 means "very clean". New Zealand came highest with a score of 91/100 and North Korea came lowest with a score of 8/100. Malaysia scored 52/100.

There is a perceived grey area between public and private in Malaysia, and it is not uncommon for individuals to alternate employment between public and private entities, which somewhat facilitates government participation in the private economy. Malaysia is one of very few countries globally to not restrict political parties from possessing corporate enterprises.

Opportunistic investors may find that there are bargains to be had due to rival investors' hesitation in investing in the wake of certain recent political issues coupled with a dip in the ringgit's value to a 17-year low that may undervalue desirable assets.

Looking ahead…where do we go from here?

Exciting growth in the ASEAN region

As the ASEAN region is poised for economic integration beginning in early 2016, Malaysia is in a prime position to act as a gateway for foreign investors to the other ASEAN member countries and also throughout the Asia Pacific region.

Over the medium to long term, ASEAN has an enviable growth forecast, meaning it is set to remain among the fastest growing regions globally.

The combined Gross Domestic Product of ASEAN in 2014 was almost US$2.5 trillion. Significantly, the "ASEAN 4" (Indonesia, Malaysia, Thailand and the Philippines) are projected to have average combined growth of 4% year-on-year in the period 2015 – 2020.

Further integration and cooperation between the ASEAN 4 countries could increase growth by an estimated 50% to 60% per annum.

The rise of the middle-income groups and the spread of urbanization in ASEAN countries, including Malaysia, will undoubtedly lead to greater demand for:

a) quality education, from pre-school right through to tertiary-level education and vocational training;

b) healthcare, including greater space for insurers and private healthcare providers to have an increased presence in the market;

c) personal banking and financial products tailored to the changing needs of the new middle classes; and

d) telecommunications infrastructure, applications and content.

It is hoped that both economic and financial integration in ASEAN will be achieved steadily over the next few years, and that this will bring a more liberalized investment environment.

Trans-Pacific Partnership Agreement due to open up trade

The landmark Trans-Pacific Partnership Agreement ("**TPP**") free trade deal was agreed in October 2015 by 12 countries in the broader Pacific region, including Malaysia. Together these countries account for approximately 40% of the world's economy, so the TPP has the potential to make a big impact. Participation in the TPP will give Malaysian firms access to the markets of the US, Canada, Mexico and Peru – all of which are countries where Malaysia does not already have favourable free trade provisions in place. TPP will also cement more free trade with other countries in the Southeast Asia region, such as Brunei, Singapore and Vietnam, where Malaysian ties are already strong. Malaysia is expected to gain substantially from the TPP, with the biggest booms to the textiles, apparel, commodities and electronics industry sectors, and Malaysian GDP and net exports expected to increase substantially by 2025. Foreign investment into Malaysia in these sectors will likely follow on from the freer trade and increased market access.

One of the sticking points for Malaysia in the negotiation of the TPP was its position on state-owned enterprises ("**SOEs**"). The Malaysian government's original position was that SOEs should be completely exempted from all disciplines required under general TPP rules, such as transparency, open competition and limitations on subsidies. The Malaysian government has since announced that it has compromised on this strict position, however, the extent of such compromise is unclear. Putting SOEs on a level playing field with other companies could make private investment and procurement in Malaysia significantly more attractive.

At the time of writing, the TPP still needs to be ratified by the relevant authorities in each participating country.

Doing deals in Malaysia: key issues and considerations

Key advantages

Malaysia has competitive operational costs, a mature infrastructure system, significant natural resources and a prime location with land borders to Thailand, Singapore, Indonesia and Brunei.

Incentives

Various incentive packages are available to foreign investors, for example:

a) a reduction in tax applied to profits for a fixed period;

b) unabsorbed capital allowance and up to 100% investment tax allowance;

c) exemption from Customs duties, sales tax and excise duties; and

d) total or partial exemption from income tax for a fixed period.

The government also grants certain privileges to foreign investors to encourage exporting manufacturing industries and technology-intensive industries, such as electronics, biotechnology, hydrocarbons, chemistry and multimedia.

Tax incentives may be offered to foreign entities for the following:

a) establishment of a Principal Hub which is defined as a locally incorporated company that uses Malaysia as a base for its regional and global businesses and operations to manage, control, and support its key functions.;

b) a locally incorporated company which is expanding its operations into Less Developed Areas;

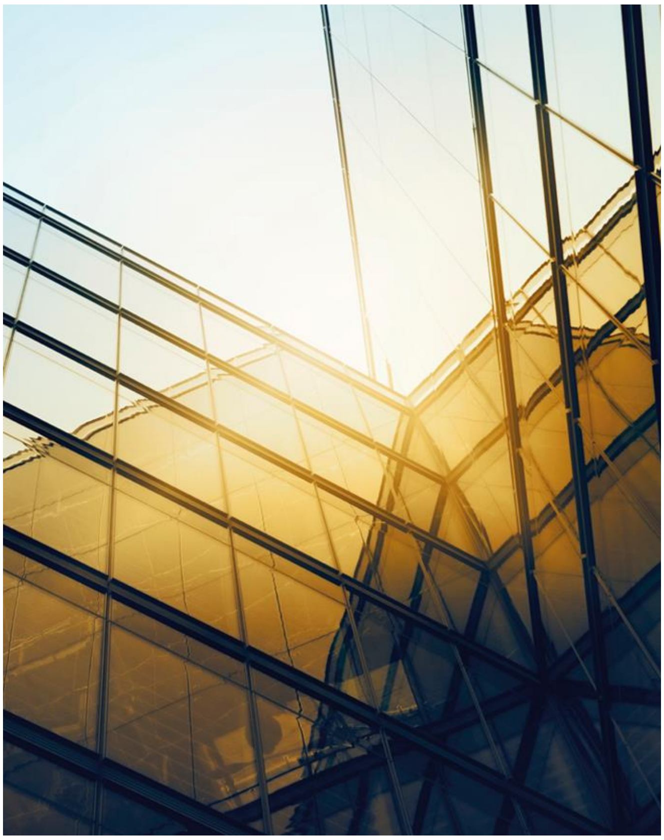
c) a locally incorporated company which undertakes the management of an existing Industry Estate specified by the Local Authority; or

d) a locally incorporated manufacturing company which has been operational for at least 36 months directly using automation equipment in its manufacturing activities.

This is not surprising, considering Malaysia's push to increase investment and employment.

Ease of getting money out

The Central Bank of Malaysia regulates exchange transactions and permits repatriation on a foreign investor's investments including in the form of dividends, interest, profits and capital.



Foreign ownership restrictions

Generally speaking, foreign investment in Malaysia has few restrictions compared with other countries in the region. Foreign investors are permitted to hold 100% equity in all investments in new projects and in expansion / diversification projects in existing Malaysian companies. However, there are sector-specific regulations issued by various government departments to be mindful of. In some cases regulatory approval must be sought, which should be factored into deal timelines, allowing some elbow room for unforeseen hold-ups.

The main industries subject to foreign investment restrictions are:

a) financial services;	i) education;
b) stock exchange and leasing companies;	j) healthcare;
c) capital markets;	k) freight forwarding and shipping;
d) insurance and Takaful (Islamic insurance);	l) water distribution;
e) oil and gas industry (upstream and downstream);	m) energy supply;
f) the automobile industry;	n) employment agencies;
g) communications and multimedia (including broadcasting);	o) security services; and
h) wholesale and distributive trade (in relation to hypermarkets);	p) professional services.

Foreign participation in the abovementioned sectors are restricted and it would be advisable to obtain legal advice at an early stage should an investment in any of these sectors be on the cards.

Parent company liability

From a deal structuring perspective, investors should be aware that Malaysian courts may be willing to lift the corporate veil where the relationship between a parent company and its Malaysian subsidiary is sufficiently close, holding one corporation legally accountable for the actions of the other**.**

Post-acquisition management structure

Certain industries impose licensing and local equity conditions where an entity is foreign owned, the purpose of which is to reserve a stake in the entity for Bumiputera (roughly meaning indigenous) ownership. Management structuring requirements may also apply, for example a mandate for hiring at all levels to reflect the equity requirements in the licences.

Red tape

Malaysia is still perceived as having its fair share of red tape when it comes to doing business. Other common complaints include inefficiency, lack of transparency and bureaucracy.

Key legal developments

Changes to Securities Commission to modernise capital markets and takeovers in Malaysia

Between May and July 2015, the Malaysian legislature passed the Capital Markets and Services (Amendment) Bill 2015 ("**CMSA**") and the Securities Commission (Amendment) Bill 2015 (“**SCA**”), amending financial markets regulation in Malaysia.

Part of the Securities Commission’s aim was to increase transparency over its governing structure, which manages capital markets in Malaysia. The Securities Commission will now have a Board of Commission with duties set out in statute and a process for vetting candidates as fit and proper for their positions. This should result in higher quality leadership at the Securities Commission, with a positive focus on transparency and accountability.

The CMSA will also grant the Securities Commission power to supervise auditors of certain entities, including public interest entities and schedule funds (including unit trust schemes and private retirement schemes) through its new Audit Oversight Board. This change may drive investors in Malaysia to use other vehicles which are not caught by the new oversight powers.

Some of the new provisions have the potential to give "take private" transactions greater certainty of succeeding as new squeeze-out rules mean compulsory acquisition will be triggered more easily by extending the count to convertible securities. However, a broader category of persons will now be deemed to be "acting in concert" with an offeror, which could, conversely, make key threshold levels harder to hit.

Eleventh Malaysia Plan pushes towards high-income status with government support for private investment

In 1991 Malaysia kicked off its goal to become a high-income country by 2020 with its programme Vision 2020. The Eleventh Malaysia Plan ("**EMP**") launched in May 2015 is the last in a series of five-year plans to help Malaysia reach this goal.

The EMP will incorporate a number of new initiatives, including the SME Investment Partner ("**SIP**") programme, which will introduce new ways of financing for early stage companies, by combining equity and loan financing features and providing up to 100% margin of financing. SIP financing is intended to complement the existing venture capital, private equity and angel financing landscape.

The Malaysian government also plans to maintain "continuous engagement" with private financial institutions, venture capitalists and angel investors to widen options for financial support and increase the financing of research and development, commercialisation and innovation projects. This includes the expansion of the Technology Park Malaysia Angel Chapter, an alternative funding group that also provides incubation and accelerator programmes for start-ups.

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