Japan Rebooted

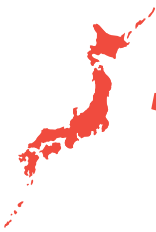
Sleepers wake: Corporate Japan on the march

$61bn

Total of Japanese FDI in Australia

¥150tn

Nikkei 225 Japanese companies' current cash reserves ($1.5 trillion)



Japan

is the largest Asian investor into Australia

pwc

www.pwc.com.au/asia-practice

Introduction

Jason Hayes

Partner

T: +813 3546 8517
M: +81 80 3445 0854
E: jason.j.hayes@jp.pwc.com

Tsuyoshi Yoshino

Director

T: +61 (2) 8266 3032
M: +61 (4) 02 968 753
E: tsuyoshi.a.yoshino@au.pwc.com

With the key policy changes under Abenomics that we discussed in the previous article in our Japan Rebooted series either in place already or in the pipeline, the Japanese government likely feels that the ball is now in corporate Japan's court.

The Abe government hopes that by slaying the deflation dragon – or at least driving it back into its cave – it can convince both consumers and corporates to begin spending and revive soggy domestic demand.

At the same time, it hopes to encourage cashed-up corporates to embark on a round of mergers and acquisitions, and to begin to pay their workers more, to start the envisaged 'virtuous cycle' of rising income, spending, prices and economic growth.

At PwC we agree that a new Japan Rebooted cannot be built by government alone and it is the actions of companies that will, in large measure, decide the outcome of the country's latest attempt at reinventing itself.

In this second article in our series, we aim to set out what sort of shape corporate Japan is in, and to analyse how it is expected to adapt to the new policy parameters set down by the Abe government.

Japan's industrial and electronic giants – and its trading houses – are accelerating their plans to diversify abroad. While Japan's economy and manufacturing sector remains heavily dependent on China, Japanese investment in ASEAN nations is rising, in part due to the political friction being generated as Asia's two giants rub up against one another.

Japan's best firms are striving – and in some cases succeeding – at becoming truly international powers and global brands. But others lag behind, hamstrung by ageing and myopic management and lack of international savvy and globally capable staff.

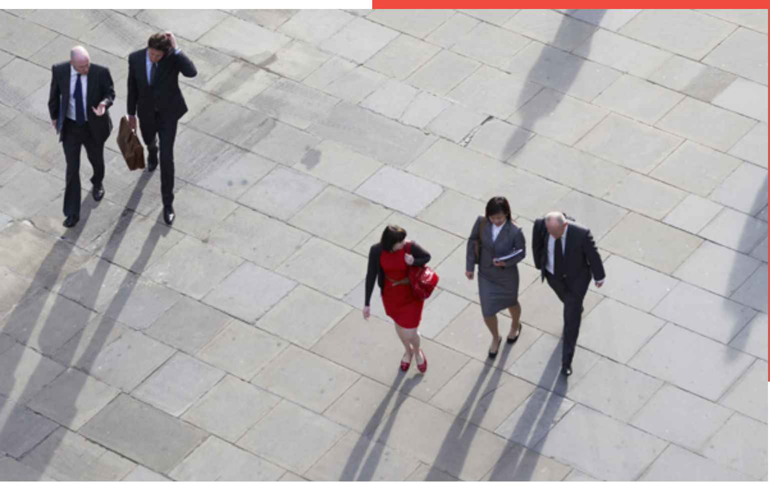
In Sleepers Wake … we examine the external environment facing Japanese companies as they join this process of transformation, and attempt to become more innovative and globally competitive.

We look at where M&A activity is likely to occur in the coming years and what are the driving forces behind these currents of economic and investment activity.

Jason Hayes
Partner

Tsuyoshi Yoshino
Japan Desk Leader

Contents



Highlights

Japan

is the largest Asian investor in Australia and the third-largest overall behind the US and UK

46%

Decline in total Japanese outbound M&A activity in 2013

$61bn

Total Japanese FDI into Australia

¥150tn

Nikkei 225 Japanese companies' current cash reserves ($1.5 trillion)

Metals & Mining

Dominates the Top 10 deals into Australia, with agriculture also appealing to Japanese firms

<1%

Japanese SMEs have subsidiaries or offices outside of Japan

All figures shown in this report are denominated in US dollars (unless otherwise stated).

Corporate Japan on the march

The state of many Japanese companies in this post-Abenomics era is one of suspended animation.

They are watching and waiting and planning their next moves.

The global financial crisis – or the Lehman shock as it is known in Japan – forced firms to confront the end of the job-for-life social contract and begin to cut costs and boost efficiency.

The upshot of this – amid the China-driven post-crisis global recovery – has been that Japan's better companies are sitting on huge reserves of cash.

Analysts expect them to soon snap into action unleashing a wave of mergers and acquisitions and offshore expansion moves that Japan hopes will create sustainable profits that will allow firms to pay their workers more and boost overall growth prospects.

As we discuss in this article, that's yet to happen; for now companies are keeping their powder dry. But the signs point to a dramatic expansion of these activities in the future.

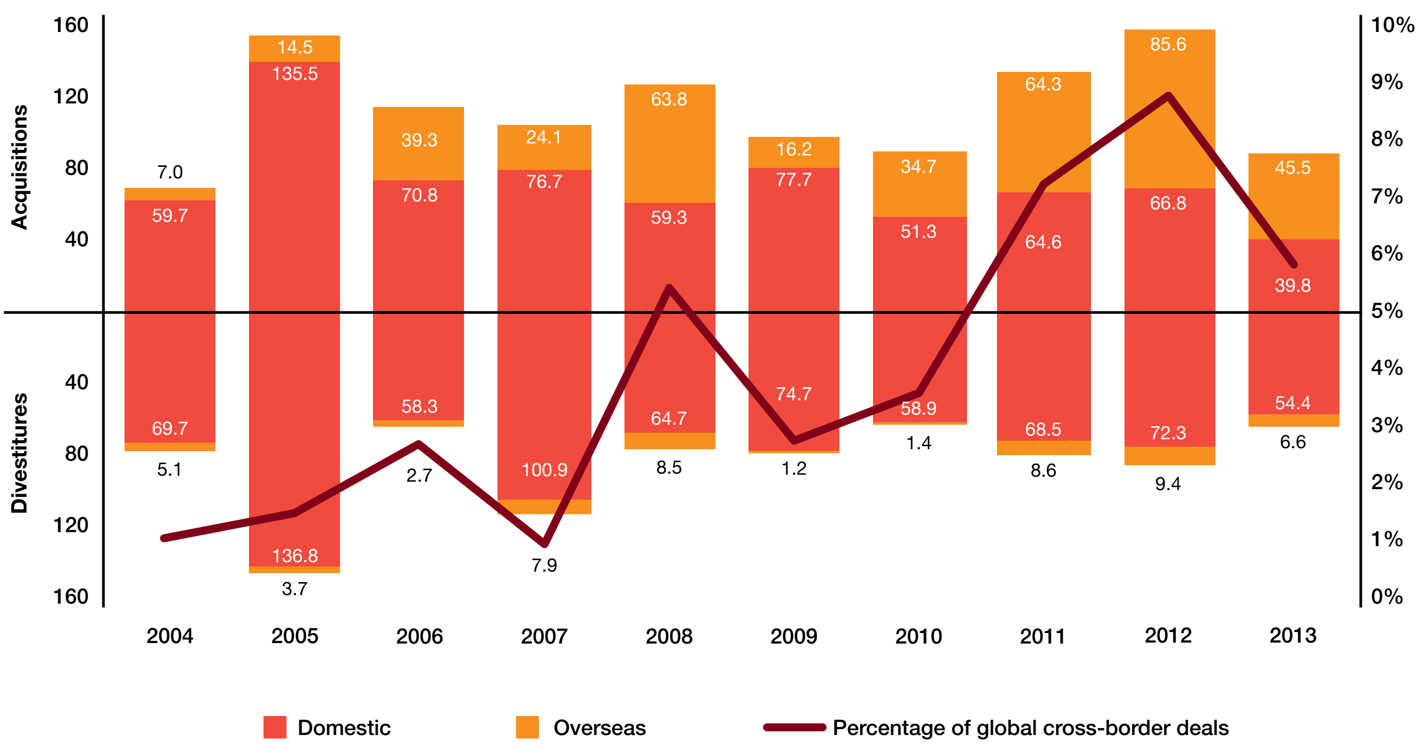
If there is a problem with having too much cash, it's arguably the pressure of finding something profitable to do with it, especially in the low interest rate environment prevailing in Japan and much of the rest of the world.

Recent figure put the size of Nikkei 225 companies' cash reserves at a near record 150 trillion yen ($1.5 trillion). That's about 25 per cent of Japan's annual GDP, or 100 per cent of Australia's annual output.

But despite being so flush with cash, merger and acquisition activity among Japanese companies has been muted since the onset of Abenomics with analysts blaming the rapid, and at times volatile, depreciation of the yen.

Data compiled by Thomson Reuters shows that during 2013, announced acquisitions by Japanese firms decreased by 44 per cent, to US$85.3 billion, from the US$152.4 billion recorded during the same period last year.

Figure 1: Japanese M&A, $bn



Source: Thomson Reuters

Note: Announced deals are included in 2012 and 2013 totals

In recent years, though, Japanese companies have been gradually accounting for a greater share of global M&A action.

The Thomson Reuters data points to accelerating activity. The third quarter of 2013 saw an almost 250 per cent increase (by value) driven by big deals such as Applied Materials' merger with Tokyo Electron, Bank of Tokyo-Mitsubishi UFJ's proposed purchase of Thailand's Bank of Ayudhya and housing and construction materials company LIXIL's majority stake acquisition in European homewares maker Grohe.

Decades of cheap debt has allowed poor performing investments to survive, however, this is changing as investors demand greater capital discipline and dividend returns. The data shows divestitures for 2013 accounted for almost as much value as acquisitions, a trend that is already underway in the electronics sector and one that PwC believes will continue.

As firms look to boost their global competitiveness in an era of more expensive debt, they realise they cannot afford to retain subsidiaries that don't boost profits and have poor prospects. Firms are also likely to look for higher quality acquisitions in the future with increased demands on the returns from investments rather than making acquisitions almost for the sake of it.

Thanks to its post-war economic revival, Japan still has the world's second-largest pool of financial assets. According to the Bank of Japan, combined household savings and pension assets exceeds $15.6 trillion as of December 2013. Japanese pension funds, with assets of at least $3.4 trillion, are under pressure from Prime Minister Abe to lift caps on their equity holdings and manage their portfolios more aggressively. As a result, they are expected to continue recent investment trends towards foreign assets that are attracting much higher yields than domestic assets.

The recent M&A data confirms that leading Japanese firms are increasingly looking overseas with domestic M&A accounting for 46 per cent of overall activity for 2013. Domestic M&A was the majority of activity in almost all years prior to 2012.

Online retail group Rakuten's recent acquisition of Cyprus-based digital messaging service Viber for $US900 million is another example of a major listed firm expanding its international interests, although the internationalisation of the smaller firms in Japan is proceeding at a far more modest pace. A recent report from JETRO (the Japan External Trade Organisation) showed that less than 1 per cent of Japanese small and medium-sized enterprises had subsidiaries or offices overseas.

Better prepared firms realise that with Japan's demographic profile and declining population – and refusal to embrace immigration – growth prospects at home, except in certain sectors, are declining.

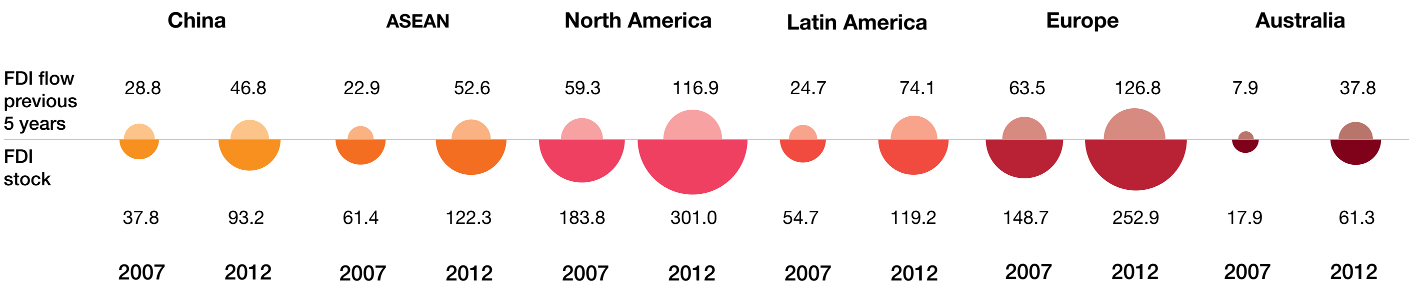
Osaka Gas, a traditionally inwardly focussed utility firm in a conservative sector, is a useful example of how the adapt or perish message is sinking in. The firm has always invested heavily offshore in upstream operations (Japan has no conventional LNG deposits) but has now expanded its foreign presence in downstream operations by striking a deal with City Gas to participate in a retail gas business for firms in Singapore. It is also participating in the Freeport LNG export terminal in the US as it moves to establish income streams outside of Japan.

Japanese government projections show that if current trends continue, today's population of about 127 million will halve by the end of the century. This year, the number of Japanese aged 65 or older is expected to top 25 per cent of the overall population.

This greying demographic profile has already been driving Japanese outbound M&A as firms grapple with worker shortages and comparatively high wages at home by establishing production facilities in lower-wage economies.

That has seen billions of dollars invested by Japanese companies in factories in both China and ASEAN nations in recent years.

Figure 2: Japanese FDI Stock & Flow, $bn



Source: JETRO

Table 1: Significant cross border deals since 2011

Date Announced	Target	Country	Industry	Acquiror	Post Deal Share	Value $bn
Oct 2012	Sprint	US	Telecomm	Softbank	78%	21.6
Jan 2014	Beam	US	Beverages	Suntory	100%	13.9
May 2011	Nycomed	Switzerland	Pharma	Takeda	100%	13.7
Jul 2013	Bank of Ayudhya	Thailand	Banks	MUFG	75%	5.7
Nov 2011	Anglo American	Chile	Mining	Mitsubishi	24.5%	5.4
Jul 2012	Aegis	UK	Advertising	Dentsu	100%	4.1
Sep 2013	Grohe	Germany	Construction	Lixil	50%	3.9
Aug 2012	Goodman	US	Industrial Products	Daikin	100%	3.7
Feb 2012	EnCana	Canada	Oil & Gas	Mitsubishi	70%	2.9
May 2012	Gavilon	US	Agribusiness	Marubeni	100%	2.7
Dec 2011	Delphi Financial	US	Insurance	Tokio Marine	100%	2.6
Feb 2012	Boston Biomedical	US	Biotech	Dainippon Sumitomo Pharma	100%	2.6
Mar 2011	CaridianBCT	US	Med Tech	Terumo	100%	2.6
Feb 2013	Robeco	Netherlands	Asset Management	ORIX	90.1%	2.6
Aug 2011	Aleadri-Schinni	Brazil	Beverages	Kirin	100%	2.5
May 2011	Landis	Switzerland	Electronics	Toshiba	100%	2.3

Source: Thomson Reuters

The main driver for much of this investment has been to reduce the cost of production, but future mergers and acquisitions will be as much about accessing growth markets and creating synergies. In some cases it will be about securing raw materials for production, or rolling out a strategy that's worked in Japan abroad, or developing an entirely new business model for foreign markets.

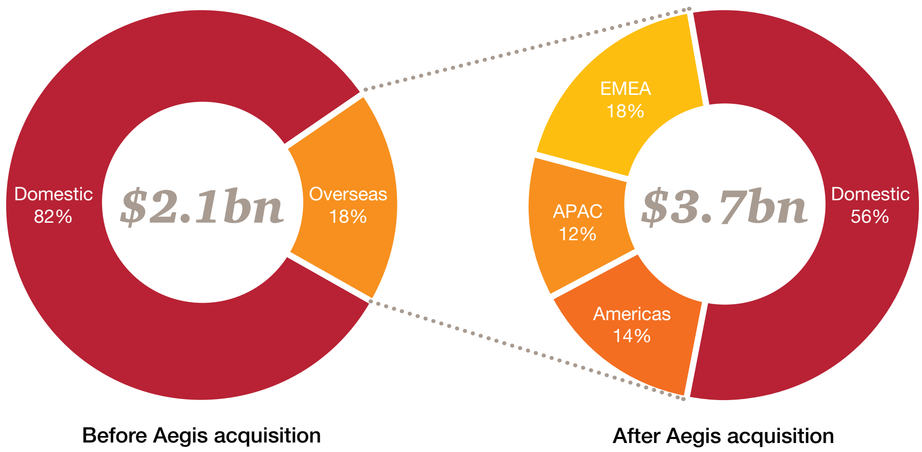
These trends are already emerging in some of the more high-profile recent deals where Japanese companies have acquired assets in a string of foreign countries ranging from the US and Europe, to Brazil, Thailand and Chile.

Japanese advertising giant Dentsu's takeover of UK firm Aegis was an example of a Japanese firm dominant in its home market positioning itself to better capture future growth.

The Y400 billion ($US4 billion) acquisition, gave Dentsu an instant international foothold as Aegis has operations in 80 countries, centred on Europe, but also with a decent presence in China and Russia.

The deal puts Dentsu in a position to pitch for the overseas advertising accounts of Japan firms as they look to shift from local to overseas markets.

Figure 3: Dentsu's gross profit by geography, FY13



Source: Dentsu 2017 and Beyond

The profit composition before and after the acquisition shows a dramatic reduction in the firm's previously heavy dependence on the Japanese market.

Air conditioning firm Daikin's purchase of the leading US maker of home air conditioning systems – Goodman – for $3.7 billion was another example of the drive to diversify sales internationally and it has coincided with a handy upswing in housing activity in the US. Daikin can now use its technology to boost the environmental performance of Goodman's product range ahead of new restrictions soon to be introduced in the United States. The firm is also expected to adopt aspects of Goodman's more streamlined management structure.

Bank of Tokyo-Mitsubishi UFJ's proposed Y560 billion ($5.6 billion) takeover of the largest Thai bank, Bank of Ayudha, gives it a presence in the second-largest economy in South East Asia. The proposed purchase would gives it a consumer and business banking operation in the centre of the high-growth ASEAN region. Japanese companies have historically invested heavily in shifting production to Thailand, this deal shows the growing interest in tapping into financial markets within fast-growing ASEAN countries as well.

Table 2: Japanese outbound FDI by country, $m

Country	FDI Stock 2012	FDI Stock CAGR (07-12)	FDI Flow 2013*	FDI Y/Y % Change
US	286,529	10.5%	43,670	36.6%
China HK	93,215	19.8%	10,413	(34.3%)
Australia	61,344	27.9%	5,837	(46.4%)
UK	53,956	11.0%	13,319	47.2%
Singapore	36,063	15.4%	3,557	127.1%
Brazil	35,402	26.3%	4,038	(1.8%)
Thailand	35,040	12.1%	10,153	1,757.5%
South Korea	25,594	16.2%	3,286	(17.8%)
France	20,077	10.1%	(237)	n.a.
Indonesia	18,427	17.3%	3,913	2.7%
Germany	16,906	12.2%	2,645	12.1%
India	15,107	29.1%	2,155	(23.1%)

Source: JETRO

*2013 data is preliminary

Perhaps more than any of these deals, this one highlights the likely future direction of Japanese investment trends away from China and towards ASEAN and other regions in line with the economic and political shifts occurring in Asia.

China, which has historically attracted such a large share of Japanese FDI, is likely to see its attractiveness wane amid deepening structural tensions between the two largest economic and military powers in Asia.

Since the Japanese government's September 2012 purchase of the disputed Senkaku/Diaoyu islands, Sino-Japanese ties have deteriorated to the extent that anything other than working level contacts between bureaucrats has been suspended.

Prime Minister Shinzo Abe is an unabashed China hawk who aired fears that China's accelerating military spending could lead to an inadvertent conflict with Japan when he spoke to a group of editors at the World Economic Forum in Davos in January. Meanwhile China's resolve to enforce some kind of sovereignty over the strategically located islets in the East China Sea has hardened.

A flare-up of rioting and consumer boycotts of Japanese products after the acquisition of the islands in 2012 served as a warning to many Japanese companies to increase their production in ASEAN countries at the expense of China to minimize risk.

Figures from JETRO show this trend is already happening. For 2013, Japanese firms ploughed almost $23.6 billion into ASEAN countries, versus about half this amount into China. For the past decade, Japanese firms have invested in China and ASEAN in roughly equal proportions ($95.8 billion and $98.7 billion, respectively).

Tabulated figures from JETRO show big increases in Japanese investment in Singapore and Thailand, as well as in the US, and declining investment levels in China.

"Against the backdrop of rising Chinese country risk, investment in ASEAN countries by Japanese companies picked up speed at the beginning of 2013. There was a clear gap between the value of investment for ASEAN and China," JETRO concluded in its annual Global Trade and Investment Report for 2013.

The high-growth economies of ASEAN lie at the heart of Abe's vision of economic diplomacy and it's no surprise to see rapid expansion of Japanese corporate activity in both the rich and poor countries within the region.

In Myanmar, which is both the largest and poorest country in South East Asia, Japanese firms have seized on the long-awaited chance to invest in what was until recently a closed economy.

A Japanese consortium is behind what has been called the region's most ambitious industrial zone – a 250 square kilometre deep-sea port, petrochemical and heavy-industry hub at Dawei in the south of the country.

Japan's long-standing interest in Myanmar, and generous aid contributions over the years, meant its companies and trading houses were perfectly poised when the military government stepped back from dictatorship and authoritarian rule and the country began to open up in 2010.

Japanese firms including Mitsubishi, Marubeni and Sumitomo have been making fast progress on the 2,400-hectare Thilawa economic zone near the biggest city, Yangon (Rangoon). Mitsubishi and Jalux have won the right to redevelop and operate Myanmar's Mandalay International Airport.

The Singapore Sling

If the dusty streets of Yangon are one end of the investment frontier for Japan, the high-tech island metropolis of Singapore represents the other.

The city state sure knows how to roll out the welcome mat with a raft of incentives and grants for firms relocating there or setting up new premises.

Led by the logistics sector, Japanese companies are increasingly eyeing business-friendly Singapore as the ideal base from which to conquer ASEAN and beyond.

A recent Asian Development Bank Institute report highlighted the growing trend in some sectors to use Singapore – which it described as the most FDI-friendly nation in ASEAN – as a base for South East Asian operations.

"A commercial presence in Singapore enables these companies to provide logistics services, not only domestically in Singapore, but also in other ASEAN countries across borders," the report said.

Opening a regional operating headquarters in Singapore has become a popular route for many Japanese companies wanting to tap into its proximity to key markets, as well as its skilled workforce and its suitability as a place to send employees from the Japanese head office from the point of view of minimising culture shock.

In 2010, Nippon Express – in response to a 276 per cent surge in sales in ASEAN over a decade – decided to set up regional headquarters in Singapore servicing South East Asia.

Yamato Transport has followed suit with an ASEAN headquarters in Singapore and Mitsubishi Logistics has also established a logistics base on the island.

It hasn't only been logistics firms seizing on the appeal of Singapore. Mitsui Chemicals has been one of the most prominent among Japanese firms investing there.

The company has manufacturing plants in Singapore and the island is also home to its Asia-Pacific headquarters, which takes in sales and marketing, technical support, logistics and business planning.

In recent years, it has set up research and development centres in Singapore – the first such Mitsui Chemicals facilities to be located outside Japan.

Food and beverage giant Kirin opened its regional headquarters in Singapore in 2010 with a mandate to oversee the company's businesses in Vietnam, Thailand and elsewhere in South East Asia.

Hiroshi Fujikawa, the head of Kirin Asia-Pacific, said the company previously had a toehold in Singapore through its wholly owned National Foods subsidiary (which is now part of its Lion business) and initially shared an office with that company before creating an integrated Kirin operation in the city state.

"Being in Singapore provides us with an ongoing stream of information about investment opportunities in ASEAN markets, as well as access to legal, tax, financial advisers and marketing and trading companies that have strong links to Singapore and the broader ASEAN region," he said.

Kirin has also found Singapore provides good access to talented staff.

Japanese banks, insurers and financial institutions are also eyeing Singapore, but so far they have been held back by licencing restrictions that remain in place even in this most open of economies.

Australia: open for business?

Japanese foreign direct investment in Australia now totals $61 billion with the bulk of it coming in the development of the resources industry from the iron ore operations of the Pilbara to the coalfields of the east coast and offshore LNG projects in the north, east and west of the country.

Japan remains the largest Asian investor in Australia and the third-largest overall behind the US and the UK. Japanese investors were recently responsible for one of the largest investments in Australian history when the Ichthys LNG project received final investment decision from majority owner and operator Inpex.

The latest PwC Melbourne Institute Asialink Index report, released in December last year, showed a lift in Japanese investment in Australia on the latest available figures (for 2012).

“Japan continued to dominate Australia’s investment engagement with Asia in 2012, and its two-way investment share rose strongly from 32.4 per cent in 2011 to 39 per cent in 2012,” the report says.

“This rise followed a significant fall in investment engagement from 2010 to 2011, due in large part to the disruption to normal Japanese life in the wake of the March 2011 earthquake and tsunami.”

The construction phase of Australia’s resources boom is beginning to wind down, in the process some have described as a looming capital cliff, although significant amounts of goods and services will be required for remaining committed projects and for the operating phase of those that are, or will be, completed. The Australian Bureau of Resource and Energy Economics (BREE) noted in its October 2013 Quarterly report that the value of committed investment in the resources and energy sectors had declined from $268 billion to $240 billion in six months.

This large drop was attributed to two records being set – a record for the value of projects being completed ($30 billion) and the lowest value of new projects being added in a decade ($1.7 billion). With 80 per cent of the value of committed projects in the LNG sector, this trend is set to continue as a number of mega-LNG projects complete over the coming four years.

Table 3: Japan outbound top deals into Australia, 2012 and 2013

	Target	Sector	Acquiror	Deal Value US$M
1	Woodside Browse – LNG	Oil & Gas	Mitsui/ Mitsubishi	2,000
2	BHP Iron Ore (Jimblebar)	Metals & Mining	Itochu	800
3	BHP Iron Ore (Jimblebar)	Metals & Mining	Mitsui	700
4	Clermont Mine JV	Metals & Mining	Sumitomo	508
5	Isaac Plains Coal	Metals & Mining	Sumitomo	444
6	Salmat – BPO Division	Professional Services	Fujifilm	391
7	Little World Beverages	Food and Beverage	Kirin	259
8	CSG Services	IT Consulting & Services	NEC	252
9	AGL Energy Ltd-53 MW Hallett 5	Alternative Energy	Toyota Tsusho	188
10	Cliffs Australia Coal	Metals & Mining	JFE Shoji Trade	144

There are still in excess of $300 billion of projects in the pipeline, but lower commodity prices and a strong Australian dollar, coupled with high labour, material and regulatory costs, and opportunities elsewhere – such as Africa, Central Asia and (in the energy sector) in US shale projects – have raised doubts about some of these projects proceeding.

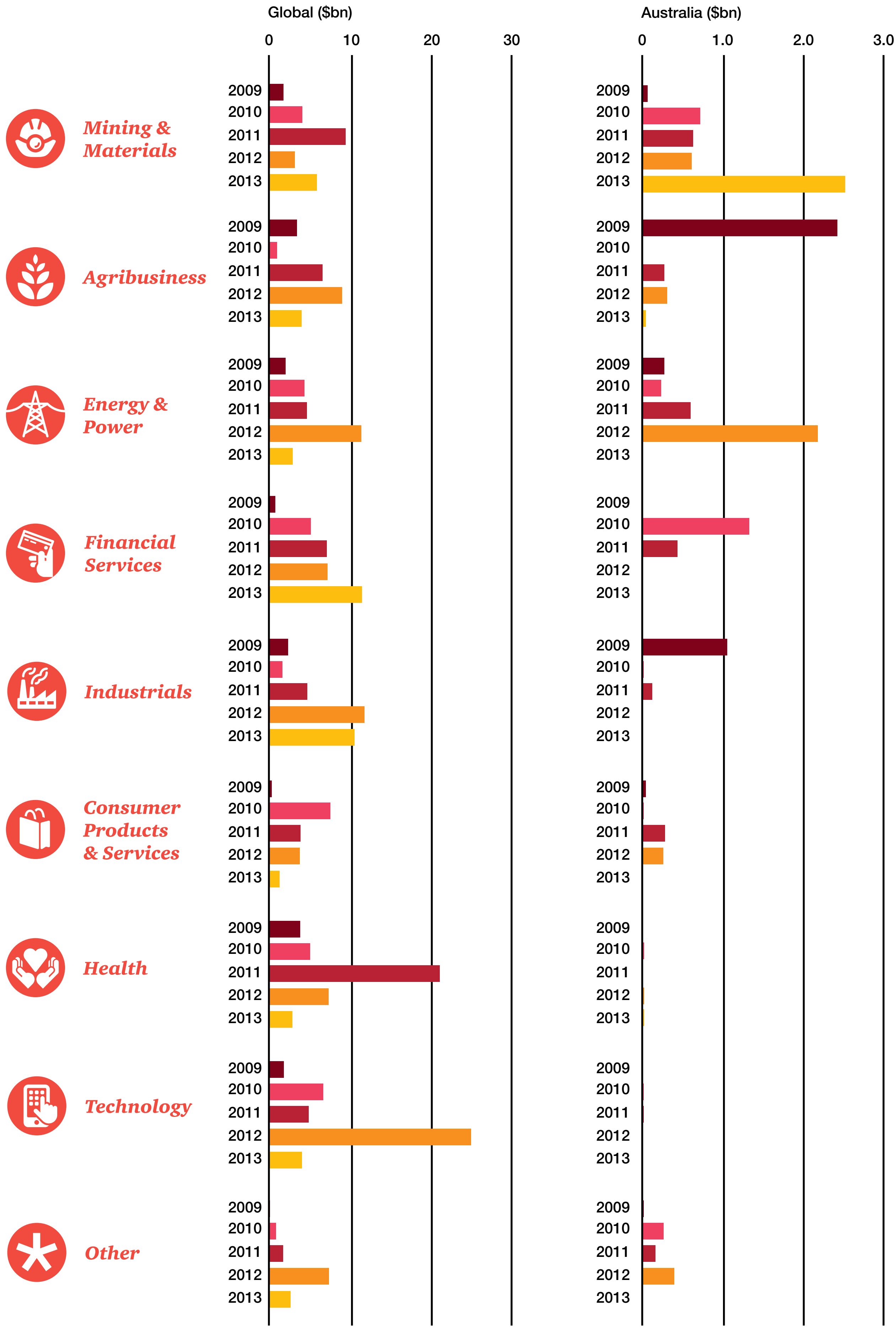
The question is, will other sectors take up the slack? And are there appealing acquisitions and investment opportunities for Japanese firms available?

One Japanese firm, Mitsui, believes the answer to that question is an unambiguous yes. The trading house, which says it has invested more than $13 billion in Australia in the past decade, has revealed it is shifting the emphasis from mining to agriculture. The company recently picked up a 25 per cent stake in West Australian grain handler Plum Grove to add to its agricultural industry portfolio here. It is a small investment, but the start of things to come.

“Agriculture is our new target because we expect demand from Asian countries like China to increase,” Yota Orii, deputy general manager of Mitsui’s corporate strategy department, said in a recent interview with The Australian newspaper. “We are trying to focus on agribusiness, it’s a very strategic area for us. Our Plum Grove investment was an early indication of this direction.”

Mitsui’s rival Sumitomo has also upped its interest in Australia’s agricultural industry moving in February this year from a 50 per cent stake in grain trader Emerald Grain to full ownership in a deal reported to be worth $240 million, although the companies have not confirmed this amount.

Figure 4: Japan outbound deals by sector, globally and in Australia



Source: Thomson Reuters

A recent PwC Report 'Funding Australia's Infrastructure' put Australia's infrastructure deficit at $700 billion. The report notes that this is unlikely to be achievable through government funding alone and calls for a sustained program of capital recycling – releasing funds through the privatization of existing assets with the funds being used to invest alongside the private sector in critical new projects. The New South Wales government sold its interests in Port Botany and Port Kembla in 2013 under a 99 year lease for $5 billion. The New South Wales government is also in the process of selling its interest in the Port of Newcastle as well as the State's interest in a number of electricity generation assets. State governments in Western Australia and Queensland are following suit presenting significant greenfield and brownfield opportunities for Japanese companies.

The PwC Melbourne Institute Asialink Index report also noted the shift in emphasis among Japanese investors. "While historically Japanese investment has been focused on direct investment in energy and mineral resource development, consistent with the country's lack of such natural resources, in more recent times Japanese investment in Australia has reached into diverse sectors such as financial services, infrastructure, ICT, property, food and agribusiness," the report says.

"Like Japan, China has also been actively investing in Australia outside the traditional resources sector (in particular, and controversially, in agricultural farmland)."

The investment environment has been one of mixed signals with many investors citing the introduction of the mining tax and carbon tax by the former Labor government as introducing a sovereign risk factor that has not historically been a feature of the Australian investment landscape. The Abbott government came to office in September 2013 declaring Australia 'open for business'. The government has secured a free-trade agreement (FTA) with South Korea and has set itself an objective of concluding the long-awaited FTA with Japan.

While recent reports indicate Japan is investing in other sectors away from energy and mineral resources, there is still a lot more rebalancing that needs to be done for the portfolio of investments in Australia to more closely reflect the profile of corporate Japan's global portfolio.

Sir Rod Eddington, chairman of the Australian Japan Business Co-operation Committee, says Australia has a good story to tell to attract a broader spread of foreign investment, including from Japan, but needs to promote this message.

"Australia still maintains a leading position in Asia that many other countries envy, but greater attention and focus is needed by both government and private sector to highlight the strategic appeal of the country and our non-resource sectors to foreign investment, including that from Japan," he says.

"Australia continues to have one of the healthiest economies among the developed countries since the global financial crisis, it has a growing population with a high GDP per capita, has an internationally talented and diverse workforce, maintains a stable political system, its financial markets yield relatively high rates of return and above all, it is situated on the doorstep of South East Asia."

"Australia also has a demonstrated commitment to trade liberalisation – and the lifting of foreign investment thresholds – through its pursuit of FTAs with a range of trading partners and we hope an FTA with Japan is just around the corner."

PwC believes that each of these attributes form an important part of corporate Japan's M&A checklist, and any effort to accelerate companies' acquisition plans in Australia is a necessary step forward.

Australia can lay a strong foundation to attract more investment across its economy when the sleepers of this rebooted Japan wake from their slumber.

Australian sector outlook: A snapshot

PwC's subject matter experts share their perspectives and insights on the investment outlook for a number of sectors in Australia

Infrastructure & Utilities

"It is expected there will be significant activity in the sector due to the governments need to recycle capital which will then create opportunities in Greenfield infrastructure as capital is redeployed into new infrastructure projects."

- Infrastructure is a priority for both government and business in Australia.
- Infrastructure Partners Australia and Citibank have estimated an infrastructure funding gap of $700bn.
- State governments have an agenda of capital recycling, which is expected to drive deal activity.
- NSW government is currently undertaking processes to privatise Newcastle Port and the States Generation Assets with the proceeds to be invested into new infrastructure projects.
- Governments are also considering varying forms of private sector financing to stimulate additional investment into infrastructure.
- There is uncertainty in the renewable energy sector due to likelihood that the Federal government will implement changes to Australia's tax regime and carbon energy policies.

Retail & Consumer

"Organisations with adequate capital reserves can make aggressive investment choices to expand or change their business models. Companies with limited capital (or a short-term view of investment returns) must rely on cost savings and non-core asset divestments to outlast the current cycle."

- This is a broad sector, resulting in companies within the sector being diverse and impacted by a variety of different factors.
- At a macro level the key themes include; an environment where consumer confidence is challenging, value-conscious consumers, arrival of international brands both with physical and online stores, supermarket price wars, the relative strength of the Australian dollar, high local labour and property costs and the rapid pace of technological change.
- Many retailers will continue to face financial stress, while others actively explore both organic and inorganic growth options.

Metals & Mining

"High quality investment opportunities are available but in many cases vendor expectations remain relatively high."

- There is commentary about headwinds facing this sector including; high cost of capital projects, high cost of operations, infrastructure bottle necks, changing regulations, capital rationing, high Australian dollar and commodity price volatility.
- Although it still remains that Australia has a vast natural wealth and world class resources.
- It is also within close proximity to Asian markets and is considered a low sovereign risk.
- The Asian Century has only just begun and there is an argument that the long term demand outlook remains favourable.

Government & Health

"Current deal activity focuses on restructuring and market positioning - rather than asset transfers and transformative deals."

- Changes by government to funding rules are impacting aged care and public education resulting in a change to funding models. The aged care sector can expect to see more deal activity.
- Challenge for aged care sector will be understanding the new risk profiles and price points for transactions.
- Health and education are staples of a developed economy. Aged care in Australia is a growth industry driven by Australia's demographic profile with 'baby boomers' reaching 60+ years of age.
- There is the opportunity for the private sector to become more involved in providing healthcare to public patients. Government bodies such as the Australian Defence Force and NSW Health are outsourcing services to the private sector. This is a trend that needs to continue to sustain Australia's ageing population.

Financial Services

"The financial services sector continues to evolve rapidly, which will drive significant mid-market activity, fuelled by ongoing regulatory change and a growing appetite for distribution."

- Banks continue to struggle to grow loan books given the low customer appetite for borrowing.
- Banks are shedding non-core businesses that generate low return on regulatory capital.
- The Financial System Inquiry is expected to produce new deal flow activity, with large institutions reconsidering aspects of their business models.
- Increased access to funding for non-banks will create consolidation opportunities.
- Regulatory reform remains uncertain in wealth management, although the sector remains attractive to all large financial services groups.
- The insurance market will remain active, with brokers seeking scale and increased specialism to withstand the threat of disintermediated distribution.
- The impact of changes in technology continues to 'disrupt' this sector with major spending on IT systems for large institutions.
- Smaller players are gaining market share due to their ability to take advantage of disrupting the status quo via digital and create acquisition opportunities.

Services and Industrial Materials

"A strong Australian dollar and high wages continues to exert pressures on export competitiveness. Businesses that have intellectual property or a productivity focus will fare much better – as they can add more value compared to entrenched, slower-moving peers."

- Depressed asset prices and a less favourable reputation with credit providers means it's a good time to buy in the Services and Industrials businesses.
- Businesses that are high on technical hierarchy and drive productivity improvements for major miners and producers have particularly strong prospects.
- Industrials need to act conservatively – the Australian dollar is still relatively high which continues to be a dampening factor.
- Industrial relations and high wage rates is a factor in determining the viability of sub-sectors and a key concern for management.

Private Equity

"The Australian PE Sector continues to be led by the larger local PE houses. With the increasingly competitive global landscape we are seeing more and more global funds, both traditional and industry specialists, considering Australian assets as investment targets."

- The rebound in IPO markets since last July has fuelled a number of PE portfolio company exits in Australia.
- More recently a number of IPOs have been withdrawn and there is evidence that pricing is under pressure as investors focus on quality and adequate short term returns.
- Fundraising is a recent focus with larger local PE funds either having raised new funds (Archer and Quadrant) or are in the process of closing funds (PEP and Ironbridge).
- On the buy-side, secondary PE transactions continue to lag other developed territories.
- Recent trends also point to a shift towards more distressed or turnaround investments by PE funds.
- A number of portfolio companies (for example Healthscope, a major hospital operator) are looking to offload their property assets through sale and leaseback transactions.

Where to now?

Knowing where a company should focus its efforts when in search of its next stage of growth is not an easy exercise and often the search uncovers more uncertainty and questions than answers. A key to navigating these uncertainties is acknowledging that profitable growth involves a high degree of due diligence and holistic planning which includes assessing the business environment, evaluating your sector's market and identifying the right customers, designing local capabilities for growth and building the right partnerships and teams.

Key questions and considerations:

Navigate the business environment

- What are the risks of entering a new market?
- What tax and regulatory considerations do I need to be aware of before deciding to enter the market?
- What are the political and economic risks? Are the governments' policies complimentary to my company's expansion ambitions?

Enter the right market effectively

- Which market or sector will bring me the most value when I enter or expand into it?
- Which consumers should I target? Where are they?
- Which of my products / services are most suitable to this market?

Develop the capabilities for growth

- Who will be my most reliable suppliers? Do they meet our global standards?
- Which distribution channels will be most suitable for my target consumers in this market?
- What capabilities and processes can be imported from my home country, and which need to be localized?

Build effective partnerships and teams

- Which is the best local firm to partner with or target company to acquire?
- How can I identify, train and retain the right talent for my business?
- What are the cultural nuances, both social and business, that I will need to adapt to?

PwC's Growth Markets Centre

PwC's Growth Markets Centre brings together PwC's global expertise to help clients overcome these uncertainties in new growth markets, using its Growth Markets Framework to assess and prioritise a company's key market entry and expansion needs.

Linking all of these elements is the change in mind-set needed to understand what it takes to succeed in a Growth Market.

PwC uses this framework and our proprietary tools to help our clients:

- **Establish** a new approach and mind-set to growth from what succeeded for them in developed markets
- **Uncover** the opportunities and issues related to the company's stage in their entry and expansion journey
- **Prioritise** and structure the activities needed to address the opportunities and issues

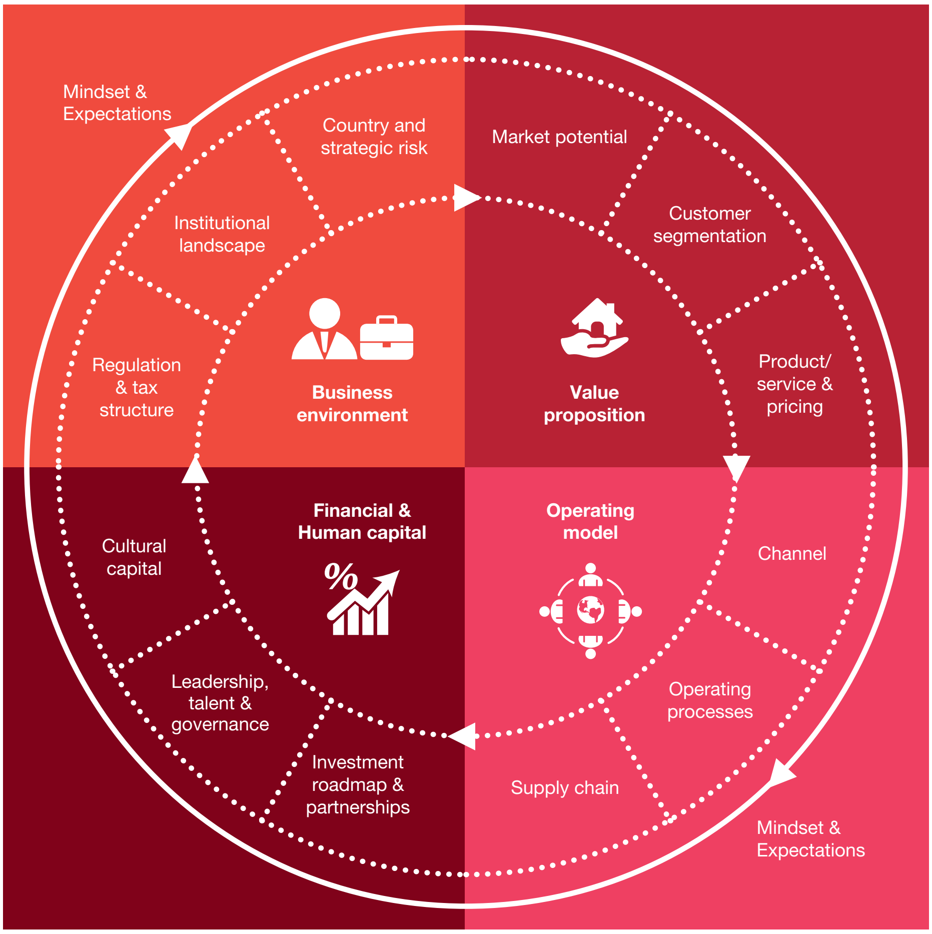
Successful growth needs creativity, experience, insights and deep relationships. Our PwC team are striving to help you create value by understanding your goals.

Business environment

Acknowledging the complexities associated with a territory's laws and regulations, including its political and economic stability.

Value Proposition

Assessing the attractiveness of new markets or regions, identifying the right customers and evaluating which products and services to take to market and at what price.



Financial and Human Capital

Addressing the 'softer' challenges of acquiring talent, developing partnerships, securing financial support, and appreciating cultural differences.

Operating Model

Establishing the necessary balance of global and local expertise to be able to source, manufacture, and distribute effectively in a market.

Contacts

Jason Hayes
Partner
T: +81 80 3445 0854
E: jason.j.hayes@jp.pwc.com

Tsuyoshi Yoshino
Director – Japan Desk Leader
T: +61 2 8266 3032
E: tsuyoshi.a.yoshino@au.pwc.com

Andrew Parker
Partner – Asia Deals Leader
T: +61 2 8266 0218
E: andrew.parker@au.pwc.com

Adrian Green
Partner
T: +61 2 8266 7890
E: adrian.green@au.pwc.com

David Earl
Partner
T: +61 3 8603 6856
E: david.earl@au.pwc.com

Graham Sorensen
Partner
T: +61 7 3257 8548
E: graham.sorensen@au.pwc.com

John Dovaston
Partner
T: +61 3 8603 3820
E: john.dovaston@au.pwc.com

William Campbell
Partner
T: +61 8 9238 3343
E: william.campbell@au.pwc.com

Naoto Tanaka
Principal
T: +61 2 8266 7348
E: naoto.tanaka@au.pwc.com

Richard Gruppetta
Director
T: +61 3 8603 1093
E: richard.gruppetta@au.pwc.com

Toru Aikawa
Associate Director
T: +61 2 8266 0462
E: toru.a.aikawa@au.pwc.com

Haruo Nire
Senior Manager
T: +61 3 8603 3759
E: haruo.nire@au.pwc.com

Masao Kamiyama
Senior Manager
T: +61 3 8603 4383
E: masao.kamiyama@au.pwc.com

Hayato Mori
Manager
T: +61 8 9238 3155
E: hayato.a.mori@au.pwc.com

Koichiro Shimada
Manager
T: +61 3 8603 5186
E: koichiro.a.shimada@au.pwc.com

Keisuke Kimura
Senior Accountant
T: +61 2 8266 2778
E: keisuke.a.kimura@au.pwc.com

Kenta Shimizu
Senior Accountant
T: +61 7 3257 8234
E: kenta.shimizu@au.pwc.com

Ryohei Ekawa
Senior Accountant
T: +61 2 8266 0231
E: ryohei.a.ekawa@au.pwc.com

Yuichi Tanaka
Senior Accountant
T: +61 3 8603 1005
E: yuichi.a.tanaka@au.pwc.com

Hiromi Yuguchi
Senior Consultant
T: +61 3 8603 5734
E: hiromi.yuguchi@au.pwc.com

Kota Oizumi
Senior Consultant
T: +61 2 8266 3035
E: kota.a.oizumi@au.pwc.com

Nobu Terasaki
Senior Consultant
T: +61 7 3257 8240
E: nobu.terasaki@au.pwc.com

Join the conversation

@PwC_AU
PwC Australia
PwC Australia

Rika Tamura
Senior Consultant
T: +61 2 8266 1639
E: rika.tamura@au.pwc.com

Shiori Fukui
Senior Consultant
T: +61 3 8603 0760
E: shiori.fukui@au.pwc.com

Akiko Urasaki
Accountant
T: +61 2 8266 0443
E: akiko.a.urasaki@au.pwc.com

Kei Nishida
Consultant
T:+61 3 8603 0523
E: kei.nishida@au.pwc.com

Mami Kojima
Consultant
T: +61 3 8603 0794
E: mami.a.kojima@au.pwc.com

Meg Ito
Consultant
T: +61 3 8603 0635
E: meg.ito@au.pwc.com

Satoko Fujita
Practice Assistant
T: +61 2 8266 2874
E: satoko.fujita@au.pwc.com

Otone Sugawara
Business Assistant
T: +61 3 8603 5363
E: otone.sugawara@au.pwc.com

Peter Gerendasi, Partner, leads PwC Australia's Asia Practice. For more information on our Asia Practice, please contact Peter (peter.gerendasi@au.pwc.com) or visit our website www.pwc.com.au/asia-practice.

www.pwc.com.au/asia-practice