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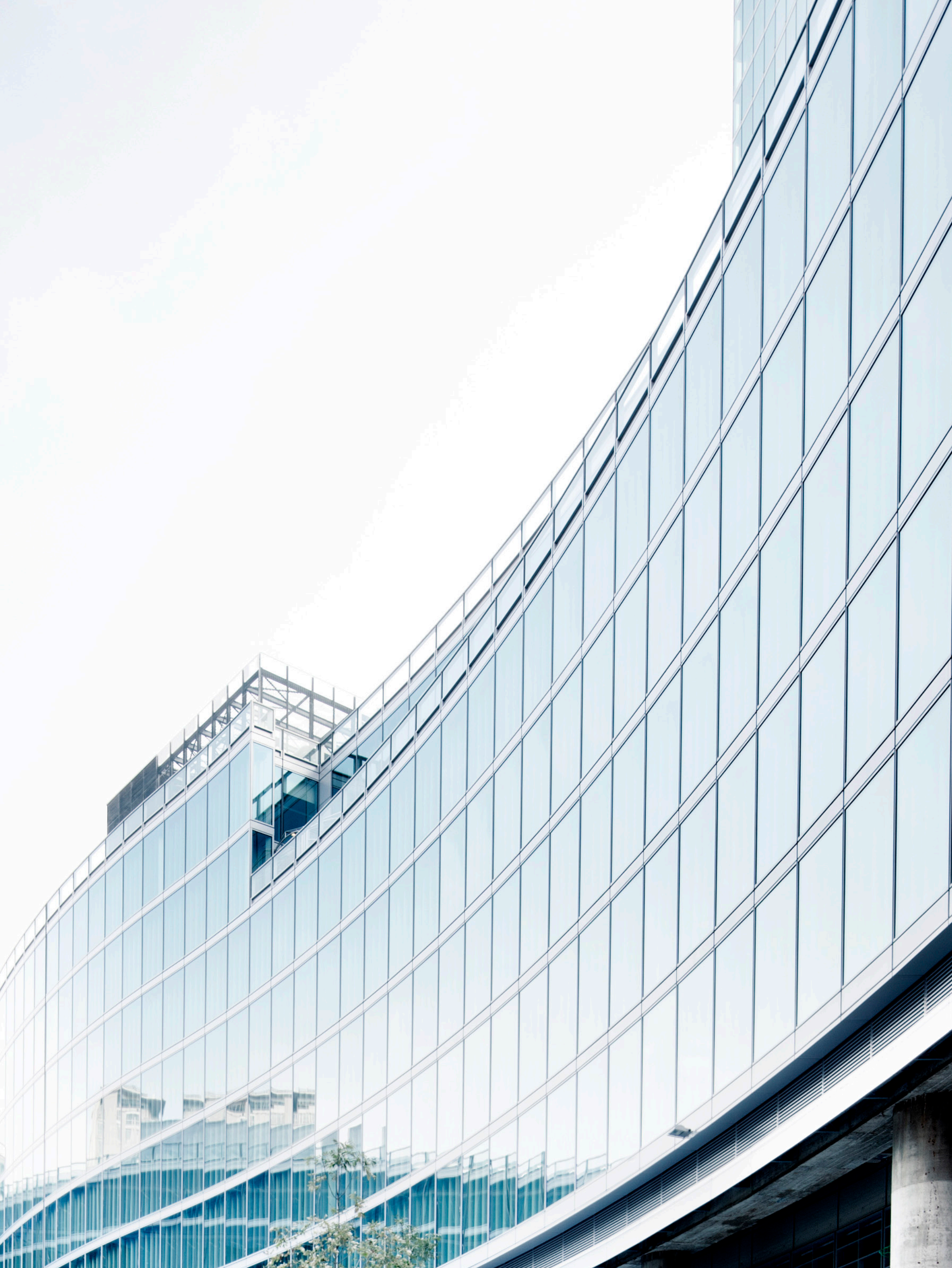
INSIDE



China NDRC Updates "Sensitive Sectors" for Outbound Investment

China's National Development and Reform Commission (NDRC) published the 2018 list of sensitive sectors for overseas investment [i] on its website on February 11, revising the list of "sensitive sectors" for outbound investment that may be subject to additional regulatory oversight.

The restrictions are part of the Chinese government's efforts to curb "irrational" overseas investment; the latest round of revisions added the arms industry to the list and removed telecoms and electricity.

Sensitive sectors on the new list include: research, manufacture, production and maintenance of weaponry; cross-border water resources development and utilization; news media; real estate; hotels; cinemas; the entertainment industry; sports clubs; and establishment of overseas equity investment funds or investment platforms with no specific industrial projects.

The new list which took effect on March 1, 2018 now requires Chinese investors to seek approval of the NDRC for overseas investments in these sensitive sectors, whether made directly or through offshore enterprises under their control.

Conversely, Chinese overseas investments in telecoms operations, land development, and electric mains and power grids need only file records with authorities; these previously sensitive sectors now require no official approval.

The Chinese government had earlier announced plans to tighten oversight of outbound investments of at least $300 million. [ii] The increased scrutiny has adversely affected China's nonfinancial outbound direct investment, which fell 29.4% to $120 billion in 2017.[iii]

i. 中华人民共和国国家发展和改革委员会. (n.d.). Retrieved March 12, 2018, from http://www.ndrc.gov.cn/zcfb/zcfbtz/201802/t20180211_877272.html

ii. China's outbound investm ent faces tighter supervision. (2018, January 26). Retrieved March 12, 2018, from http://www.xinhuanet.com/english/2018-01/26/c_136927404.htm

iii. China outbound investment drops 29.4% in 2017. (2018, January 16). Retrieved March 12, 2018 from http://africa.chinadaily.com.cn/a/201801/16/WS5a5dab1ea3102c394518f95c.html

CFIUS Reform Spurred by U.S. Government Concerns on Chinese Investments

Proposed reforms introduced by the Committee on Foreign Investment in United States (CFIUS) have shined a spotlight on U.S. concerns about the security threats posed by Chinese Foreign Direct Investment (FDI), particularly given China's soaring investments in U.S. technology companies.

Committees in the U.S. Senate and House of Representatives have recently completed hearings on the Foreign Investment Risk Review Modernization Act of 2017 (FIRRMA), [i] a CFIUS reform bill introduced on November 9, 2017.

CFIUS is an interagency committee that reviews the national security implications of transactions that could result in foreign control of a U.S. business. CFIUS may block transactions or impose sanctions to mitigate threats to U.S. national security.

Given CFIUS's current statutory and regulatory frameworks, the committee may lack the tools necessary to review a surprisingly large number of foreign investments targeting these sensitive technologies. For instance, CFIUS may only exercise jurisdiction over cases where a foreign investor acquires direct control of a U.S. business.

To plug such loopholes, FIRRMA broadens the categories of transactions that will require CFIUS's automatic review:

- For U.S. "critical technology" companies: transfers of "intellectual property and associated support" to a foreign person through a joint venture or any other arrangement other than an "ordinary customer relationship";

- For both U.S. "critical technology" and "critical infrastructure" companies: "nonpassive" minority-position investments of any type; and

- Real estate transactions near locations with significant national security value, such as military bases.

FIRRMA also addresses the acquisition of early-stage technologies by unspecified "countries of special concern" by practically doubling the list of national security factors for CFIUS to consider in its risk reviews.

Finally, FIRRMA gives CFIUS authority to create a "white list" of countries whose investors may be exempted from CFIUS review.

Some key FIRRMA sponsors have made it clear that the proposed legislation is intended to address

China's aggressive foreign investment strategy. Even without FIRRMA, Chinese companies make up about 19% of notices issued by CFIUS from 2013 to 2015. [ii]

China's FDI in the United States more than tripled between 2015 and 2016, [iii] much of it concentrated in sensitive sectors like real estate (more than $39 billion of investment in 2017) and the information and communication technology (ICT) industry (238 deals concluded in 2017 alone). [iv]

Assuming it passes, FIRRMA will set up barriers for Chinese FDI in the United States, particularly in ICT and financial services, where a significant amount of dual-use technology plays a part. This technology includes artificial intelligence and robotics, access to which may increase Chinese military modernization at the expense of the United States.

Security hawks will consider FIRRMA's reforms to be long overdue, considering the perceived threats to national security posed by foreign investment. Business leaders, though, worry that FIRRMA simply ties up sources of foreign capital in red tape.

The longer-term impact of FIRRMA on U.S.-China relations is unclear. Certainly, future ventures between Chinese and American firms will receive greater scrutiny. Whether this will affect China's market liberalization initiatives or influence upcoming legislation like China's draft Foreign Investment Law remains to be seen.

i. Foreign Investment Risk Review Modernization Act of 2017 (2017).

ii. Committee on Foreign Investment in the United States, Annual Report to Congress (2015).

iii. He, A. (2017, April 26) Chinese FDI in US tripled to $46 billion in 2016. Retrieved from chinawatch.washingtonpost.com/2017/04/chinese-fdi-in-us-tripled-to-46-billion-in-2016

iv. Rhodium Group, China Investment Monitor (2018).

China Relaxes Restrictions on Foreign Investment within Free Trade Zones

A new set of policy changes will ease investment rules within China's 11 free trade zones (FTZs), according to a decision released by the China State Council on January 9. [i]

The Decision on Temporarily Adjusting Relevant Administrative Regulations, State Council Documents and Departmental Rules Approved by the State Council within FTZs offers policy changes that apply to all FTZs. [ii] The changes affect the following business sectors: shipping, printing, civil aviation, certification and accreditation, entertainment venues, education, travel agencies, direct sales, gas stations, maritime transportation, retail and wholesale, aircraft, urban rail, internet cafés, banking and performance brokerage.

Many of the changes are designed to open more business areas for foreign capital. For example, new rules relating to the transportation sector ease restrictions on foreign ownership in aircraft manufacturing and maintenance, shipping and rail transportation.

Full ownership will also be granted to foreign investors for the construction and operation of gas stations and for the design and production of aircraft with a maximum takeoff weight of 6 tons.

Wholly foreign-owned entertainment venues will be permitted to provide services in FTZs; foreign investors will also be permitted to invest in internet access businesses for the first time.

The decision offers more regulatory clarity to foreign investors, formalizing many changes introduced in 2017's FTZ Negative List [iii] and the Catalogue for the Guidance of Foreign Investment Industries. [iv]

The decision sets out 16 policy changes that apply to all FTZs in China. Nine of these policy changes were already in effect in the Shanghai, Guangdong, Tianjin and Fujian FTZs, but the decision formalizes their effect in all 11 FTZs throughout China.

Not all the changes are intended to be permanent. The decision empowers the departments in charge of the relevant industries to issue or amend regulations that formalize the changes.

The rules changes are intended to leverage China's FTZs to better integrate the economy with international practices. The new policies will enable Shanghai FTZ, for example, to open up its burgeoning services sector to foreign competition and liberalize the financial sector overall, bringing the FTZ closer to its goal of becoming a global financial center by 2020. [v]

Data from China's Ministry of Commerce [vi] showed that in the first 11 months of 2017, the presence of about 30,815 newly approved foreign-invested enterprises in China amounted to an increase of 26.5% year-on-year; the actual use of foreign investment reached 803.62 billion yuan, up 9.8%.

i. Decision on Temporarily Adjusting Relevant Administrative Regulations, State Council Documents and Departmental Rules Approved by the State Council within FTZs. (2018, January 9). Retrieved March 12, 2018, from http://www.gov.cn/zhengce/content/2018-01/09/content_5254764.htm

ii. Tan, X. (2018, January 10). Govt to ease investment rules in FTZs. Retrieved March 12, 2018, from http://www.chinadaily.com.cn/a/201801/10/WS5a55b156a3102e5b17371e09.html

iii. China introduces new negative list for FTZ foreign investment. (2017, June 16). Retrieved March 12, 2018, from http://english.gov.cn/policies/latest_releases/2017/06/16/content_281475687826506.htm

iv. Catalogue of Industries for Guiding Foreign Investment (2017, June 28). Retrieved March 12, 2018, from http://www.fdi.gov.cn/1800000121_39_4851_0_7.html

v. Wan, A. (2015, April 1). Too ambitious? Shanghai aims to be both top financial hub and 'China's Silicon Valley' by 2020. Retrieved March 12, 2018, from http://www.scmp.com/news/china/article/1753387/too-ambitious-shanghai-aims-be-both-top-financial-hub-and-chinas-silicon

vi. China's policies support foreign investments. (2017, December 20). Retrieved March 12, 2018, from http://english.gov.cn/policies/policy_watch/2017/12/20/content_281475983478530.htm

Hong Kong Stock Exchange to Allow Dual-Class Shares for Listing Companies

Hong Kong Exchanges and Clearing (HKEX) announced that listing reforms — key among them amendments of listing rules to accept companies with dual-class shares, otherwise known as "weighted voting right" (WVR) structures — may be implemented by the second half of April 2018, with amendments to be implemented from June onward. [i]

Companies with a dual-class share structure give one set of shareholders greater voting rights than others, affording greater control over executive decisions, even with minority owner status.

Younger tech firms favor a dual-class share setup that permits them to raise capital without diluting their control. Executives enjoying weighted voting rights also can better resist shareholder pressure for short-term returns.

The previous prohibition of issuers with WVR structures may have influenced Chinese technology company Alibaba [ii] to launch its 2014 $25 billion IPO on the NYSE instead of HKEX.

Technology groups account for almost a third of present-day Hong Kong IPO fundraising, compared to just 3% in 2015.

It is hoped that the relaxed rules on WVRs, among others, will prime the pump for a flood of Chinese tech companies listing in Hong Kong, not to mention "homecoming" listings for Chinese tech companies with existing listings in the United States.

Hong Kong and Shanghaibourses are perceived to be caught in a tug-of-war over listing resources, with HKEX's reforms to WVRs announced following the Shanghai Stock Exchange's debut of services aimed squarely at "unicorns," or tech firms valued at more than US$1 billion. [iii]

WVRs may lead to dual listings in Hong Kong by Chinese technology companies that are already listed in the United States as American depositary receipts. Price-to-earnings multiples of Chinese technology American depositary receipts are expected to increase — along with their respective share prices —narrowing the valuation gap between Chinese and U.S. technology stocks listed in the United States.

Yet some analysts and investors in Hong Kong worry that such changes may undermine corporate governance [iv] and take a turn for the worse for shareholders. In response, HKEX proposes that only "innovative" issuers be permitted to list using a WVR structure and that additional safeguards be put in place [v] to prevent abuse of relaxed listing rules and to protect investors.

Such safeguards include a mandatory minimum market capitalization of 10 billion Hong Kong dollars (US$1.28 billion) and a continuing record of high growth, along with rules that prohibit such companies from switching to a different business after listing and ensure that certain crucial votes be conducted on a one-share, one-vote basis.

With safeguards in place for investors, it is hoped that WVRs will help HKEX become a preferred listing venue for Greater China technology companies preparing for multibillion-dollar IPOs.

i. Yiu, E. (2018, February 23). HKEX says listing reforms could be in place by late April. South China Morning Post. Retrieved March 12, 2018, from http://www.scmp.com/business/companies/article/2134495/hkex-says-listing-reforms-could-be-place-late-april

ii. Curran, E. (2014, March 15). How Hong Kong lost the Alibaba IPO. Wall Street Journal. Retrieved March 12, 2018, from https://www.wsj.com/articles/how-hong-kong-lost-the-alibaba-ipo-1394891944

iii. Ren, D. (2018, March 12). Mainland takes on HK in tussle for tech floats. South China Morning Post, p. B3.

iv. Gillis, P. (2018, February 27). Hong Kong races to bottom in corporate governance. Retrieved March 12, 2018, from https://seekingalpha.com/article/4150991-hong-kong-races-bottom-corporate-governance

v. Hughes, J. (2017, December 15). Hong Kong to push ahead with controversial dual-class shares. Retrieved March 12, 2018, from https://www.reuters.com/article/us-hkex-regulation/hong-kong-to-push-ahead-with-controversial-dual-class-shares-idUSKBN1E90UR

How will the U.S. Tax Reform Impact Business and Asset Valuations?

The Tax Cuts and Jobs Act (the "Act"), which became effective on December 22, 2017, has a number of important implications for business and asset valuations. Cost of capital, a key component of any valuation analysis, will be specifically impacted by the new provisions of the Act. The Act's impact on value is really a story of two powerful competing forces: the increase in value caused by the expectation of increased net cash flows, and the decrease in value caused by potentially higher costs of capital.

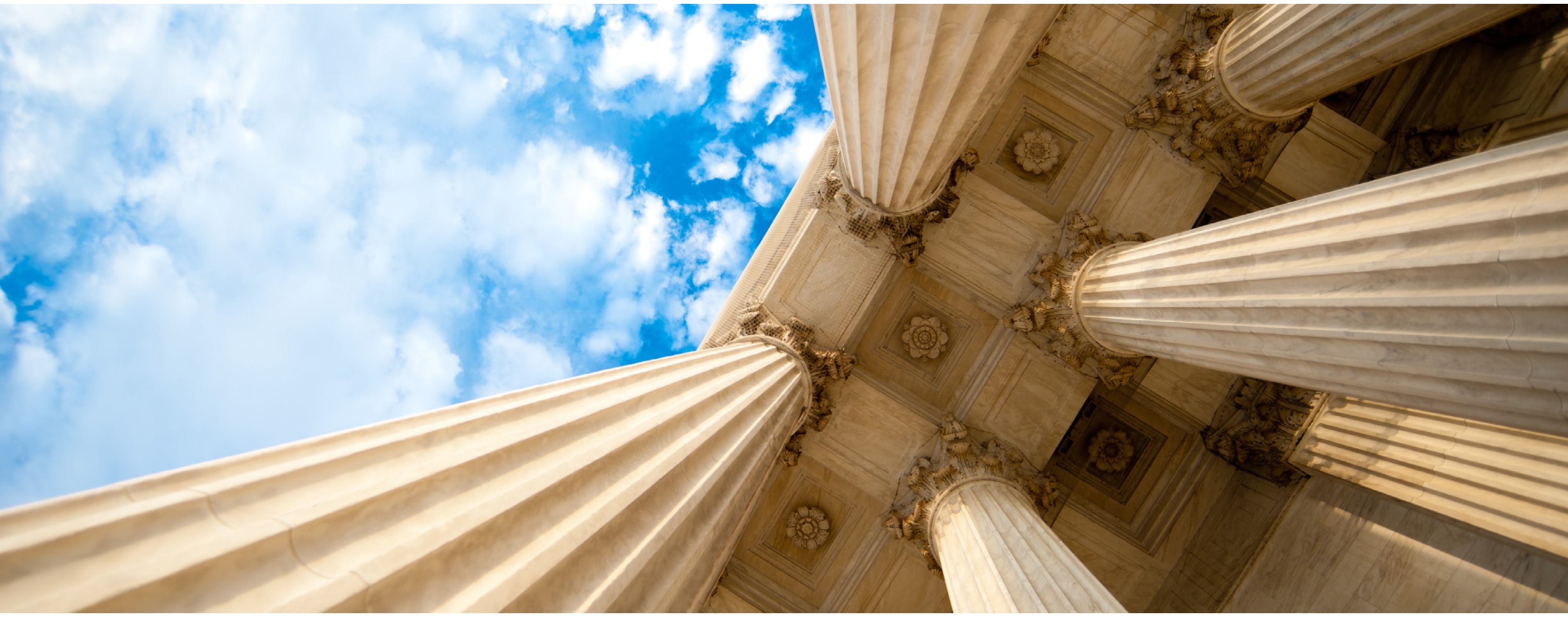
Before exploring the impacts of the Act on cost of capital, it is important to remember the components of the Discounted Cash Flow (DCF) valuation method. DCF value is a function of expected future net cash flows (the numerator) and present value factors (the denominator), which are a function of the estimated cost of capital or the discount rate.

The Act will generally increase the available net cash flows for businesses, increasing the numerator in a DCF model, leading to greater value. We have seen the run-up in stock prices in the U.S. generally driven by the expectation that net cash flows will increase, allowing for an increased return of profits to shareholders (in the form of increased dividends and stock buybacks).

But the impact on the cost of capital is more complicated. The cost of equity capital, in its simplest form, is typically expressed as a function of the risk-free rate, a market risk factor known as "beta", and the equity risk premium, which is the equity return that investors demand to compensate them for investing in a diversified portfolio of large common stocks rather than investing in risk-free securities.

For more information regarding the Tax Reform impact, please visit our Valuation Insights - Special Tax Reform Edition https://www.duffandphelps.com/insights/publications/valuation-insights/valuation-insights-first-quarter-2018

U.S. Tax Reform May Lead to Billions in Capital Investments



In the wake of the recent passage of the Tax Cuts and Jobs Act of 2017 ("the Act"), [i] major corporations have announced plans to reinvest billions of dollars in the United States, encouraged by the corporate tax rate cuts established by the Act.

Exxon Mobil Corp. intends to invest an additional $35 billion [ii] in the United States over the next 5 years. Apple also expects to invest over $30 billion [iii] in U.S.-based capital expenditures over the same period.

Provisions in the law that permanently reduce the statutory C-corporation tax rate from 35% to 21% and allow for temporary expensing of capital investments, among others, encourage U.S. firms to invest and hire within the United States instead of overseas.

Such provisions are welcome given that investment growth has slowed significantly: S&P 500 companies increased capital expenditures by just 1% in 2016, compared to 9% in 2014 and nearly 10% in 2015. [iv]

Yet the law's ability to prevent companies from shifting profits out of the United States to lower-tax jurisdictions abroad remains open to question.

On one hand, the Act establishes a minimum tax abroad on certain types of income, increasing companies' taxes on foreign profits. This minimum tax is intended to create disincentives for controlled foreign corporation subsidiaries of U.S.-based multinational firms to transfer intangible property to low tax jurisdictions.

On the other hand, the act allows foreign subsidiaries of U.S.-based multinational companies to repatriate cash back to the U.S. without subjecting the earnings to U.S. taxation, after payment of a one-time "transition tax" on their cumulative earnings and profits held outside of the U.S. Under previous tax law, as long as a foreign subsidiary of a U.S. company did not distribute its foreign earnings to the U.S., it did not have to pay U.S. income taxes on these earnings. Thus, most companies deferred the repatriation of their foreign earnings, and accumulated high cash balances which were invested outside of the U.S. This transition tax, which can be paid in eight (8) annual installments, can be viewed as the cost of being able to distribute all future earnings to the subsidiary's parent entity on a tax-free basis.

The benefits of the repatriation of cash back to the U.S. include an increase in capital spending in the U.S., as well as an increase in cash bonuses to employees, cash dividends to shareholders and stock buybacks.

In fact, during the 2017 fourth-quarter earnings season, a record $151 billion in buybacks [v] was announced, and the trend is expected to continue throughout 2018, with nearly half the purchases funded with the windfall from the new law.

Financial analysts have revised projected earnings from U.S. enterprises in light of the act's passage. A record 75 percent of businesses have reported increasing their profit guidance; [vi] with double-digit profit gains predicted for 2018 compared to single-digit forecasts without the tax cuts. Wall Street also predicts domestic entities will increase capital expenditures by up to 6.8 percent in 2018, five times higher than expected growth in 2017. [vii]

The effects on the cost of capital cannot be predicted at this point in time, although all else equal, it is expected that U.S. firm's weighted average cost of capital should slightly increase. This is attributable to the decrease in the benefit of the interest tax shield in the cost of debt component of the cost of capital due to the lowering of the tax rate from 35% to 21%, and the limitation on the ability to deduct interest expense on a company's consolidated U.S. tax return. The latter will likely impact highly-levered firms the most. However, it is expected by most analysts that the benefit of the lower tax rate, combined with the immediate expensing of certain capital investments, will be more significant than any increase in firms' cost of capital. This is reflected in the increase in the dramatic run up in U.S. equity markets around the time of the announcement of tax reform. However, time will tell as to whether these impacts will be sustainable.

i. Walsh, D., Mattingly, P., Killough, A., Fox, L., & Liptak, K. (2017, December 20). White House, GOP celebrate passing sweeping tax bill. Retrieved March 12, 2018, from https://edition.cnn.com/2017/12/20/politics/house-senate-trump-tax-bill/index.html

ii. DiChristopher, T. (2018, January 29). Exxon Mobil announces $35 billion in new US investments over 5 years, citing tax reform. Retrieved March 12, 2018, from https://www.cnbc.com/2018/01/29/exxon-mobil-to-invest-50-billion-in-us-over-5-years-citing-tax-reform.html

iii. Apple accelerates US investment and job creation. (2018, March 2). Retrieved March 12, 2018, from https://www.apple.com/newsroom/2018/01/apple-accelerates-us-investment-and-job-creation

iv. Aeppel, T., & Sanders, C. (2017, December 19). Businesses like investment tax breaks, but will they spend? Retrieved March 12, 2018, from https://www.reuters.com/article/us-usa-tax-capex/businesses-like-investment-tax-breaks-but-will-they-spend-idUSKBN1ED2Y8

v. Cox, J. (2018, March 2). Companies projected to use tax cut windfall for record share buybacks, JP Morgan says. Retrieved March 12, 2018, from https://www.cnbc.com/2018/03/02/companies-projected-to-use-tax-cut-for-record-share-buybacks-jp-morgan.html

vi. Townsend, M. (2018, February 4). How is big business using the Trump tax cut? What we know. Retrieved March 12, 2018, from https://www.bloomberg.com/news/articles/2018-02-05/how-is-big-business-using-the-trump-tax-cut-what-we-know-so-far

vii. Huckabee, T. (n.d.). The big business reaction to the Tax Cuts & Jobs Act reform. Retrieved March 12, 2018, from http://tehcpa.net/tax-reform-corporate-eranings/the-big-business-reaction-to-the-tax-cuts-jobs-act-reform

Transaction Trail in South East Asia Annual Issue 2017

The total value of M&A, PE/VC investments and IPOs in Singapore exceeded US$100 billion, with a growth of over 15% compared to 2016, led by PE buyouts. A total of 842 deals (M&A, PE/VC and IPOs) worth US$101.9 billion were recorded for 2017, compared to 800 deals worth US$88.1 billion for 2016.

M&A composed the bulk of the deal volume in Singapore, constituting 698 deals valued at US$75.4 billion in 2017, compared to 684 deals valued at US$82.7 billion in 2016.

M&A deal values continued to be driven by sizeable outbound M&A transactions by Sovereign Wealth Funds (SWF), GIC and Temasek Holdings in consortium, complemented by other notable M&A deals such as Exxon Mobil Corp.'s acquisition of InterOil Corp., Mitsui Sumitomo Insurance's acquisition of First Capital Insurance Ltd., Mapletree Investments' acquisition of U.S. student housing assets, and Mercatus Co-operative's acquisition of Jurong Point mall.

Based on M&A deal values, the top three sectors (Real Estate, Technology and Healthcare) accounted for over 70% of total deal values.

Malaysia experienced the highest transaction value through M&A, PE/VC investment and IPO capital raised over the last 5-year period, totaling US$20.3 billion in 2017, higher by 30% year-on-year (y-o-y) compared to US$15.6 billion in 2016.

As of November 2017, 445 deals were concluded in Malaysia, of which 408 were M&A, 23 were PE/VC deals, and the balance were IPOs. Inbound deals led the M&A activity in Malaysia, accounting for 60% of the total 408 M&A deals valued at US$17.6 billion during the year.

According to Duff & Phelps, the Energy sector was responsible for high deal value activity for inbound M&A for Malaysia. The top M&A transactions in 2017 for Malaysia were the acquisitions of 50% stakes in refinery and petrochemical integrated development (Rapid) and PRPC Polymers Sdn Bhd, both by Saudi Arabia's Aramco.

PE/VC investments transacted in Malaysia amounted to 23 deals this year, with a combined deal value of approximately US$1.04 billion.

Indonesia sustained deal momentum and attracted significant technology investments. Deal activity in Indonesia maintained similar levels for 2017, with total deal values at US$ 9.6 billion, driven by sizeable transactions in the Technology, Materials and Agriculture sectors. Inbound M&A took up the majority share (61%) of total deal value.

Agriculture was the largest sector in value terms, reaching approximately US$1.3 billion in 2017, followed by the Technology and Materials sectors. Topping this year's high-value deals was Alibaba Group's investment in PT Tokopedia for US$ 1.1 billion. More information here: Transaction Trail in South East Asia Annual Issue 2017 https://www.duffandphelps.com/insights/publications/valuation/transaction-trail-annual-issue-2017

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