



# Switching gear

Global financial turmoil means accountants face a shrinking IPO market, but other businesses are in good shape, writes *Wendy Chan*

**I**t seems not so long ago that accountants were working around-the-clock to get China's big banks and state-owned enterprises listed on the Hong Kong stock exchange in record deals that stunned the world.

Good times, however, never last long.

The volume of initial public offerings in the first half of 2008 dropped almost in half to US\$6.5 billion, from US\$12 billion during the same period last year, Hong Kong Stock Exchange figures show.

Mega stock offerings by mainland companies have obviously dwindled and stock valuations have fallen dramatically. Hong Kong accountants say the slump in the initial public offering market will continue in the coming six to 12 months.

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Hong Kong recorded more than 20 IPOs in the first seven months of this year, versus 87 in 2007 and about 60 in 2006, according to Deloitte Touche Tohmatsu.

“The business is getting difficult, though we won’t call it tough. It’s not super like last year,” Edward Wu Chi-keung, a Deloitte partner, tells *A Plus*.

### Ripple effect

Some say the market may recover in early 2009, while others expect it may take longer.

“We don’t think all the bad news is out yet,” says Andrew Lam, an assurance partner at Grant Thornton. “We worry about the ripple effects [of a U.S. downturn].”

Lam says stalled deals are on the increase and create uncertainty and affect staff morale. For example, Chinese retailer ITAT Group Ltd. recently shelved its HK\$1 billion initial stock offering in Hong Kong amid allegations of improper accounting, *The Wall Street Journal* reported in August, citing unidentified bankers.

Staff scheduling has become more difficult because it is hard to predict when an IPO will be complete, Lam says. “The road show may take longer than before, depending on the market situation, leading to delay in the launch of an IPO. This in turn may lead to additional auditing work as well as more financial information disclosure,” he says.

To pick up the pace, Deloitte is tapping potential IPO candidates likely to be well received by investors despite recent jitters, such as mainland companies that focus on the domestic Chinese market instead of overseas exports. Beyond the mainland, the firm is also exploring Japanese, Korean, Taiwanese and Russian companies that have investments in China.

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“We are in talks with IPO potentials in Kazakhstan, Mongolia and Russia. These companies are involved in the telecommunication, mining and resources sectors,” Wu says. “The IPO fund-raise size we are talking about is US\$1 billion or above.”

While IPOs may be in a slump, accountants say auditing, due diligence, transaction support, business risk services and international tax work remain robust.

“If the economy deteriorates further, we expect a rise in forensic accounting and expert witness activities. As a whole, the impact on the accounting profession is less than on some other industries,” Lam says.

### Active mergers and acquisitions

Another business area recording strong growth is mergers and acquisitions, which are fuelled by Chinese companies buying overseas peers whose stock prices have plunged in recent months, and increased overseas investments in China.

“Chinese manufacturers would like to buy downstream businesses such as brands and distribution networks,” says Lam.

Within China, pre-IPO valuations have fallen to 10 to 12 times price-to-

earnings ratios from the previous high of 20 times, making targeted companies more attractive, says Deloitte’s Wu.

“The valuations are now at a realistic level, driving more potential deals. The pipeline is strong,” says Robert Partridge, leader of transaction advisory services for the Far East at Ernst & Young.

“Smart investors are now looking for deals that they would not have eyed three, six or 12 months ago,” though they have now become more cautious, he says. Transactions are expected to come from across all sectors, including telecommunication, real estate, retail and consumer products.

“Financial services continue to be strong even though not as robust as they were two to three years ago when China’s financial services markets had opened up pursuant to joining the World Trade Organization,” Partridge says.

Paul Chau, a corporate finance services principal at KPMG China, is optimistic about other industries, too. KPMG estimates that the volume of mergers and acquisitions in Hong Kong and China in the second half of the year will reach or even exceed the first half’s US\$32 billion.

“If the announced deals in the telecommunication and media, and



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banking sectors are to be completed in the second half, the total transaction value will be over US\$30 billion,” he says. Recently unveiled mergers and acquisitions and restructuring deals include China Mobile, China Telecom and China Unicom.

Private equity funds have also increased their investments in China and will likely be more active in the second half of 2008 because of Chinese companies’ falling valuations, he says. Transaction volume already rose 3 percent year-on-year to US\$5.8 billion in the first six months this year.

Such funds are also exploring new mergers and acquisitions in sectors such as continuing education, which includes

online and classroom professional education and related test-preparation courses, according to Edward Au Chun-hing, a Deloitte partner.

“We see a trend that private equities are interested in this area, which was not on the radar before,” Au says.

Private equity outfits are looking for balance in their portfolios by targeting companies with counter-cyclical business models. Companies offering continuing education have good business potential because Chinese professionals, faced with growing job competition, are eager to obtain more professional licenses and certificates, he says.

Another hot industry is e-commerce because the slowdown has made Internet

companies cheap buys, he says.

### **Strong revenue growth**

All in all, the accounting profession is upbeat about its revenue growth this year. “The business is growing very strong. We expect to report at least 25 percent revenue growth across Asia this year,” says Ernst & Young’s Partridge.

Deloitte is forecasting double-digit growth worldwide for fiscal year 2008, while KPMG says business growth in China continues to be quite strong.

Grant Thornton says the firm is continuing to expand. “Our hiring budget is at a historic high, we expect to continue hiring in the coming three to six months,” Lam says. **A+**