SPECIAL COMMENTARY: IMPLICATIONS FOR TAIWAN OF THE FAILED CARLYLE/ASE BUYOUT DEAL

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Last week, Taiwan's Advanced Semiconductor Engineering (ASE) announced that global private equity firm The Carlyle Group had broken off negotiations to purchase the company, the end of a process begun late last year when Carlyle proposed a buyout of ASE stock at NT$39 per share. In a press release, ASE stated that its investment committee "decided that the offer still fails to reflect the company's value, hence is unable to support the buyout plan," this despite Carlyle increasing its offer to NT$39.50 per share.

Why was this deal so important? What exterior forces negatively impacted a timely consummation? What are the implications of the failure of this deal on Taiwan?

It seems clear that Carlyle, and by extension the global private equity sector, is seeking to capitalize on a major trend within the semiconductor industry, where most Integrated Device Manufacturers (IDMs) are moving away from developing new manufacturing technologies and are instead focusing their research and development (R&D) dollars on new chip products. Given the priority such companies place on the bottom line and the pressure that puts on R&D budgets, the arrival of private equity on the scene is accelerating this move away from the IDM business model. Private equity is well positioned to drive rationalization and specialization in the semiconductor industry, and companies such as Carlyle (and Kolberg Kravis Roberts with its interest in China's SMIC) are well positioned to capitalize on this trend and the role Taiwan companies might play not only in Taiwan, but also increasingly in China.

Taiwan's companies are perfectly positioned to capitalize on this trend - by purchasing non-core assets divested in the rationalization process, and by taking advantage of the new business garnered by its manufacturing facilities - if their government puts the right suite of policies in place to enable them to take advantage of this change. Taiwan should be embracing the role of private equity around the world and in its own market as it acts as a catalyst for positive change.

It is critical for the Taiwan government to realize that acquisitions by private equity companies are as effective a means of sector rationalization as buyouts by companies within the same sector. It's a lesson many of the world's markets need to learn. Carlyle already manages a global portfolio of semiconductor companies, and by joining that group ASE would have been positioned to take advantage of opportunities to purchase synergistic business units from other portfolio companies.

Coupled with follow-through on Taiwan's January 2006 decision to liberalize its cross-Strait investment policy in the chip assembly sub-sector, a consummated deal might have allowed ASE to accelerate its growth by purchasing operations from Freescale, for example, or perhaps even from non-portfolio companies (such as NXP) looking to capitalize on the trend towards shedding global chip assembly operations. Not only would the Taiwan sub-sector as a whole have benefited, but other Taiwan companies like TSMC and UMC would have seen benefits as well.

It is not surprising that in the days that followed the end of the deal, press reports have linked ASE with other private equity partners, and neither is it surprising that Carlyle looks to proceed with its investment in Japan's Nakaya Microdevices. This global trend within the semiconductor industry will continue to accelerate.

So why did this deal collapse? Ironically, the bid itself contributed to an upward pricing trend for chip assembly companies that resulted in an eventual bid that was under priced. The news of Carlyle's interest in ASE sparked a market-wide rise, with the TAIEX gaining 7.2% between late November 2006 and mid April

2007. When the initial offer was made, ASE stock was valued at NT$35.50 per share, meaning that the initial offer of NT$39 per share reflected fair market value with a small premium. At the close of the market on April 17, however, ASE's share price had risen over 15% to just over NT$41 per share.

ASE set up an investment committee to examine the proposal and to ensure that all ASE shareholders, not just founder and largest shareholder Jason Chang and his family, would benefit from the transaction – a key step in today's market where minority shareholder interests can not be ignored. In the end, and due to the excessive delays, the market value of ASE had risen past both the original and the revised offer. Ultimately, it was failure to agree on a price for ASE that scuppered the deal.

While the TAIEX's 7.2% overall rise was modest, it still represents gains from the attention paid to a single deal, and a potential increase in M&A activity will surely have an even greater positive impact on the valuation of Taiwan's companies. It's a huge opportunity to increase the overall value of Taiwan's economy, and to increase the capital it has at its disposal. It is also an opportunity to increase the attention paid to Taiwan by the global business community, since it is also a fact that Taiwan's companies still are not paid nearly enough attention as gateways to mainland China.

However, Taiwan does not have a great deal of experience with mergers and acquisitions (M&A) of this size, particularly outside the banking and financial services sectors, so the bureaucracy is thrown into turmoil when such deals occur. The lack of a permanent and transparent process for M&A activity to be reviewed in a timely manner can result in confusion and delays. For example, Taiwan presently requires in excess of 17 different government agencies to review acquisitions such as the proposed Carlyle/ASE deal. Not only does this add costs to any such transaction – costs that may inhibit capital from even exploring Taiwan's market - but it also leads to delays that may even cause deals to ultimately collapse, like it did in this case.

Taiwan's semiconductor sector is a jewel in the Taiwan economic crown, but the government's legacy policies on chip investment in China and its inability to create a process for M&A activities have combined to undermine the efforts of Taiwan's companies to become global leaders. How can they act as critical partners to global capital if their own government fails to support them in this effort?

In Taiwan, deals such as this one become inexorably wrapped in lingering issues regarding control, authority to make decisions, convoluted government processes, and China policy. Here Taiwan again has demonstrated that it cannot get its story straight when it lays claim to a seat as a major global technology player and a strategic economic partner to the United States. Every Taiwan candidate for president in the 2008 elections should be taking a hard look at the decision of Carlyle to withdraw its offer, and then ask what it might mean for the Taiwan they will run.

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