Will you set the divestment pace, or try to keep up with it?

Spotlight on Asia-Pacific

Global Corporate Divestment Study 2019

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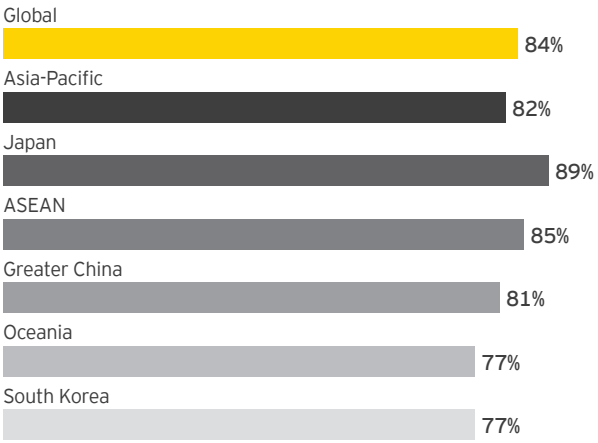
Asia-Pacific

Asia-Pacific companies are increasingly seeking to sharpen their focus on capital allocation decisions, and increasing investment in their core businesses, as they continue to search for growth in a slowing economic environment.

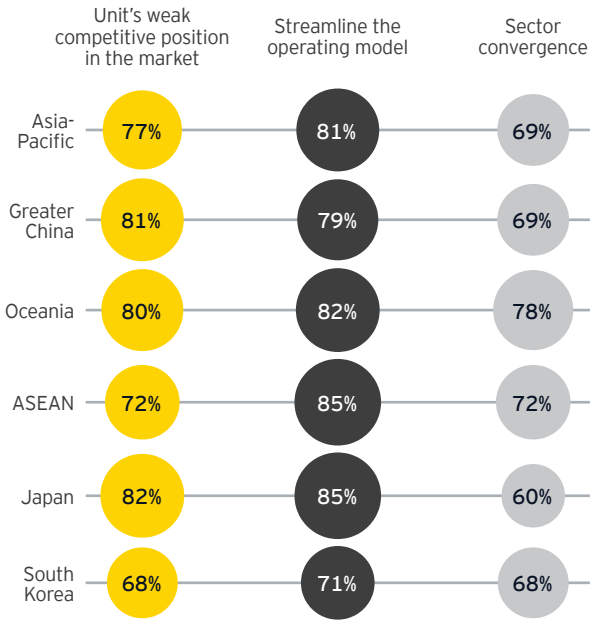
According to the 2019 EY *Global Corporate Divestment Study*, executives in Asia-Pacific (including India and Japan) are signaling a near record intention to divest over the next two years (82%, close to last year's 83%) a significant increase from low previous averages with Asia-Pacific divestment intentions at just 35% in 2017, and even lower at 17% in 2015. Divestment drivers in the region vary, however, with sector convergence (69%), a weak competitive position in the market (77%) and a need to streamline the operating model (81%) dominating the triggers for divesting over the coming year.

82% of Asia-Pacific companies are planning to divest within the next two years.

Companies that expect to initiate their next divestment within the next two years.



Q **Which of the following factors will affect your divestment plans over the next year? Select all that apply.**



Country spotlight: Japan

Japanese companies proactively deleveraging for growth

Japanese corporations are actively looking for divestment opportunities, with the highest divestment intention in Asia-Pacific. Encouraged by recent amendments in labor regulation, 89% of Japanese companies state that they will divest in the next two years – one of the highest percentages out of all surveyed countries for this edition. Interestingly, Japanese corporates have been active in the acquisition market as well, where they are pursuing growth opportunities abroad to address shrinking domestic customer bases. For the first time in five years, Japan ranked as first in Asia-Pacific outbound M&A value for 2018.

This study shows that companies continue to look at their portfolios and align their strategy and growth prospects, which in turn is creating a focus on recycling capital through divestitures.

Why are so many companies divesting?

Two-thirds (67%) of Asia-Pacific companies highlight that streamlining the operating model triggered their most recent major divestment – it is also ranked as the top factor in affecting a company's decision to divest over the coming year. The survey data suggests that companies are recognizing that a streamlined operating model enables them to more quickly execute on their capital agenda. Companies must continually reformulate their capital agendas and go-forward strategies relative to their competition, particularly with technology accelerating the pace of transformation.

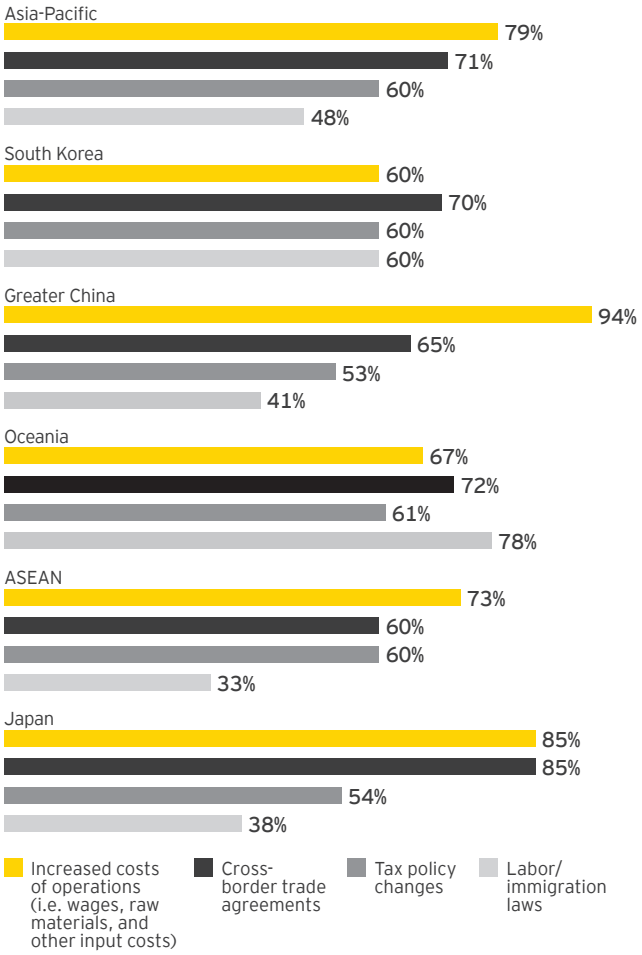
81% of Asia-Pacific companies say streamlining their operating model is a key factor in divestment decisions over the coming year.

Less than half (47%) of Asia-Pacific companies see geopolitical and macroeconomic factors impacting their divestment appetite, a noticeable decline from the 58% reported last year, and below the global average of 51%. This is consistent with the findings of the October 2018 EY *Global Capital Confidence Barometer* (CCB), where Asia-Pacific M&A remained relatively resilient amid rising competition and geopolitical disruption.

47% of Asia-Pacific companies say geopolitical uncertainties and macroeconomic volatility will impact their divestment intentions.

Three key areas highlighted by this survey, and posing greater challenges to executives in Asia-Pacific than their counterparts globally, include the increased cost of operations (79%), cross-border trade agreements (71%) and tax policy changes (60%). This varies by country, for example, almost all (94%) of Greater Chinese companies indicate that the increase in cost of operations will be the main geopolitical driver to divest. In Australia, labor laws (78%) and cross-border trade agreements (72%) are seen as the key geopolitical shifts affecting their divestment plans. And regionally, legal and regulatory developments seen during 2018 are reflected by 73% of ASEAN respondents viewing regulatory change as a major geopolitical challenge, one of the highest percentages from the surveyed regions.

Q Which of the following geopolitical shifts may affect your plans to divest? Select all that apply.



75% of Asia-Pacific companies see the number of technology-driven divestments increasing.

In this year's study, Asia-Pacific's view on the market has changed noticeably in comparison with 2018. Seventy-five percent of Asia-Pacific companies see the number of divestments increasing from technology-driven changes, such as in consumer habits and supply chain. This view has increased from last year, where 68% of respondents saw the number of technology-driven divestments increasing.

Another key trend that Asia-Pacific companies are seeing is industry consolidation with companies pursuing inorganic growth strategies for a higher market share. In 2019, 81% of respondents are expecting divestments to drive industry consolidation, up from 63% last year. From the survey, 87% of South Korean respondents say that greater industry consolidation will be seen over the next 12 months, one of the highest percentages of all the surveyed countries. South Korea was also one of the leading regions for cross-sector investment in 2018[1].

How can you be divestment-ready?

The October 2018 EY *Global Capital Confidence Barometer* (CCB) found that Asia-Pacific executives are more proactively reviewing their portfolio than their global counterparts, with results indicating that 84% of Asia-Pacific respondents review their portfolio at least every six months, versus 66% for global respondents.

71% of Asia-Pacific companies say they held onto assets for too long.

With companies now speeding up the frequency of their portfolio reviews, the survey finds that executives are now better at identifying assets that should have been divested – but are increasingly slower in launching the divestment process. In Asia-Pacific, awareness of this issue has gained significance from 59% in 2018 to 71% this year, a welcome development considering that, globally, sellers who had not held onto assets for too long were twice as likely to secure a better transaction price.

Faced with evolving sector landscapes – sector convergence – and external challenges, businesses are continuously evaluating their growth strategies and competition, to be responsive to market changes. For Asia-Pacific executives, 61% say shortcomings in their portfolio or strategic review process have sometimes resulted in failure to achieve the intended divestment results.

1. Dealogic, 75% of deal volumes where Korean companies were investing in cross-sector deals.

Regional spotlight: Greater China

Companies in the Greater China region are advancing their portfolio strategies to enhance shareholder return

Companies in Greater China today are increasingly identifying assets that should be divested. Eighty-four percent of Greater China respondents say they held onto assets too long, up from 74% in 2018.

Seventy percent say their last divestment took five months or longer from sign to closing, this is longer than the three-month close that shareholders have come to expect suggesting a need for greater divestment-readiness. Sixty-three percent of Greater China respondents say that their last divestment did not meet expectations in impacting the valuation multiple of the remaining business. With 71% of executives in the region saying that limitations on deal perimeters impacted their last divestment, increased flexibility is likely to attract buyers and improve deal closing efficiency.

> "Asia-Pacific corporates are displaying a shift toward deleveraging as a tool for more effective management of their capital agendas. A well-defined portfolio strategy – addressing the timing of selling assets, pre-sale preparation and the consistent use of advanced analytics – will help Asia-Pacific corporates to retain value during the deal process."
>
> Paul Murphy
> EY Asia-Pacific Divestment Leader

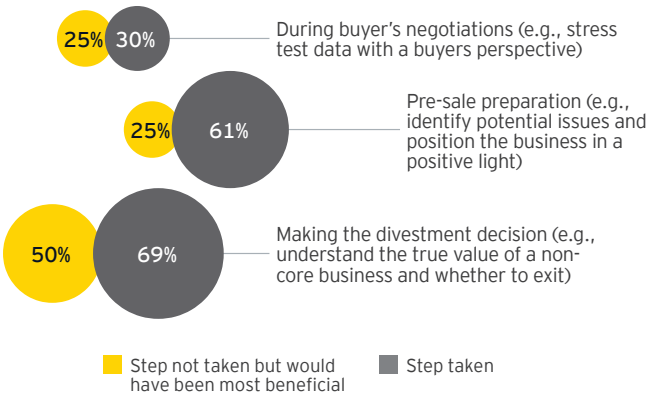
Advanced analytics can produce greater insights for buyers on the historical and future performance of a business, while also enabling sellers to tailor, and in turn to strengthen their value story, for different buyers. The EY *Global Corporate Divestment Study* finds that companies using analytics in negotiations are three times more likely to achieve a higher sales price and to increase the valuation of the remaining business, as well as to close the deal faster, than those that do not.

Reflecting global trends, 69% of Asia-Pacific respondents highlight the importance of using analytics early on in the divestment decision-making process. Analytics is categorized as important to 61% of companies in their pre-sale preparation, assisting with identifying potential issues and positioning the business in the best light.

However, only 30% of sellers in Asia-Pacific compared with 39% globally say they used analytics during buyer negotiations, but 50% says it's a step they should have taken. The EY *Stress Test* book shows that as part of the due diligence, "buyers expect a comprehensive self-service virtual data room that supports buyer confidence in the numbers." Leveraging analytics effectively at every stage of the divestment process can help both sellers and buyers optimize value and lower risk.

49% of Asia-Pacific companies find that advanced analytics create the most value in making a divestment decision.

Q **In which of the following areas of your most recent divestment did you leverage analytics? And where would it have been most beneficial?**



*Among Asia-Pacific companies only

How can you maximize value for future divestments?

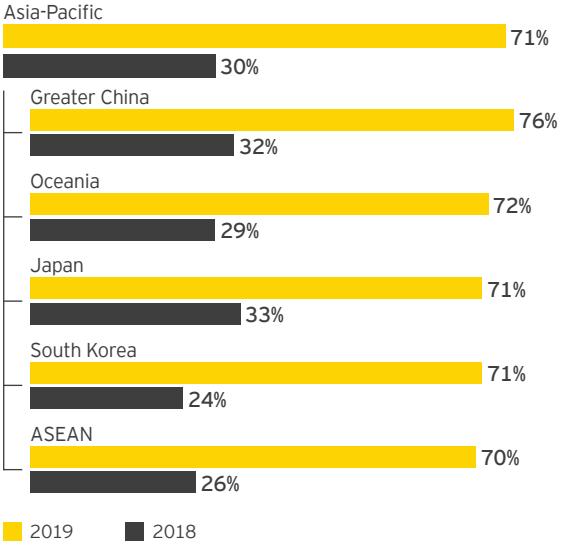
71% of Asia-Pacific companies report a 20% price gap between seller and buyer expectations.

Over the past year, sellers are also facing an increased gap in what they think their business is worth and what buyers are willing to spend. Over 70% of Asia-Pacific respondents reported a gap of more than 20% between sellers' expectations and buyers' offers, up a significant 41 percentage points from 2018.

Sellers of businesses often value assets based on projected earnings and growth. Buyers, on the other hand, tend to calibrate value against historical earnings with growth often discounted for short-term or unquantified risks. From a buyer's perspective, this conservatism needs to be balanced with the desire to stay in the deal process.

This widening price gap may indicate increasing buyer caution in valuations, especially given an unclear macro-environment. Now, more than ever, it is critical for sellers of quality businesses to build a credible value story with supporting data and start the related preparation early to achieve their desired valuation. Thorough preparation can reduce the value gap through limiting uncertainty for bidders.

The percentage of sellers reporting a price gap between what sellers expect versus what buyers are offering is more than 20%.



53% of respondents cite increasing tax challenges as having impacted deal execution during the past 12 months.

Tax also emerged as an important contributor to value erosion: 68% of Asia-Pacific respondents say a lack of preparation in dealing with tax risk has impacted divestment outcomes. Fifty-three percent of respondents cite increasing tax challenges as having impacted deal execution during the past 12 months, a noticeable increase from 29% of respondents in 2018.

Despite tax being a central consideration during the carve-out process, a decision to divest is made too often without appropriately considering tax implications. Sales processes often stall when sellers fail to recognize that potentially skeptical buyers may have a completely different view of the risks associated with tax-efficient structures implemented historically.

65% of Asia-Pacific companies optimized legal structures during their last carve-out to present the business as an independent unit to potential buyers.

Companies are increasingly pursuing a "carve-out platform" approach to make businesses divestment-ready. Under this approach, systems, processes and even legal entity separation work begins before the deal process starts.

For Asia-Pacific companies, an optimized legal structure – which puts carve-out assets into a new legal structure – is becoming a critical part of presenting a business to buyers. In 2018, just 50% of respondents considered legal structures in their divestment process. In 2019, it is rated the most important step in enhancing sale value by 34% of sellers.

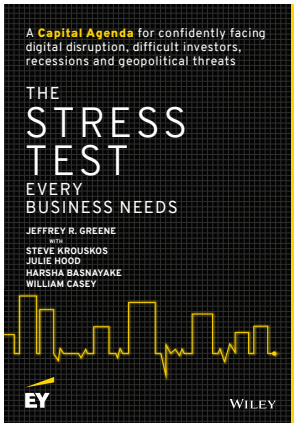
A further 29% of respondents credit partially or fully separating business operations as a key value driver. Given that the Asia-Pacific divestment market is highly competitive, a clear stand-alone business with an optimized legal structure is likely to be more attractive to buyers, including private equity, and may positively influence purchase price.

Looking to the future – adopting a well-prepared capital recycling strategy for growth

Despite the geopolitical uncertainty and macroeconomic volatility, Asia-Pacific respondents appear resilient and focused on portfolio optimization. A well-defined portfolio strategy can help to identify capital recycling opportunities for future growth prospects. Streamlining the operating model, advance preparation leveraging analytics, and tailoring the value story for potential buyers will help to manage price expectations.

> "Asia-Pacific corporates appear resilient in the face of continued geopolitical challenges, however it is prudent for corporates to stress test their businesses with growth and value at the forefront."

Paul Murphy
EY Asia-Pacific Divestment Leader



Further reading on divestment execution

In the new EY book, *The Stress Test Every Business Needs: A Capital Agenda for confidently facing digital disruption, difficult investors, recessions and geopolitical threats*, the EY authors explore how companies can better manage capital, execute transactions, and apply corporate finance tools to strategic and operational decisions.

In particular, the book takes a deep dive into the most critical aspects of planning and executing a divestment to maximize value and minimize disruption to the remaining business. Learn more at www.ey.com/capitalagenda.

"Divestments should be a fundamental part of your Capital Agenda, especially in a volatile and disruptive environment where you need to fund growth and essential innovation."

How EY can help

Our dedicated, multifunctional divestment professionals work with corporate and private equity clients on sales of the entire company, carve-outs, spin-offs and joint ventures. We help companies evaluate their strategy, manage the portfolio, improve divestment value and grow their remaining business.

Connected Capital Solutions

Whether you're preserving, optimizing, raising or investing, our Connected Capital Solutions can help you drive competitive advantage and increased returns through improved decisions across all aspects of your Capital Agenda.

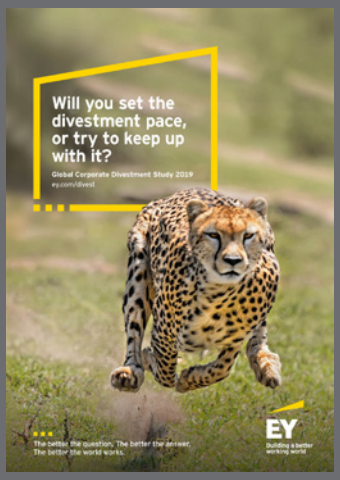
Enabling fast-track growth and portfolio strategies that help you realize your full potential for a better future

Enabling better decisions around financing and funding capital expansion and efficiency

Enabling strategic growth through better-integrated and operationalized acquisitions, joint ventures and alliances

Enabling strategic portfolio management, and better divestments to help you maximize value from a sale

Helping you transform or restructure your organization for a better future by enabling business-critical and capital investment decisions



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