Building a better working world

Asia-Pacific divestment intention remains high as companies look beyond the crisis

2020 Global Corporate Divestment Study

ey.com/divest

In response to the COVID-19 health crisis, governments have implemented unprecedented measures, including border closures and lockdowns, to first and foremost safeguard lives and livelihoods. The situation has triggered severe business shocks and disruption that will fundamentally reshape our future.

As the world starts to look beyond the pandemic, it is possible that a tentative resurgence in global economic activity will be led by core Asia-Pacific economies, due in part to the early and decisive response by some governments in the region.

Early indications are that the containment actions taken by governments appear to be working enabling lockdown restrictions to be eased and economic activity to tentatively begin to resume. However, safe distancing measures and its impact on revenues for affected sectors will remain for some time.

The actions Asia-Pacific companies take during this period of emergence from the crisis will be crucial. Indeed, looking beyond the safeguarding phase during the height of the crisis to repositioning businesses for growth will require a change in mindset.

It seems almost counterintuitive, but core to re-establishing a growth platform will be a well-thought out capital recycling strategy through divestments. Experience from the Global Financial Crisis indicates that companies that were proactive with portfolio review and divestment outperformed their peers. We expect divestments to rebound sooner in Asia-Pacific compared to other regions.

A high intent to divest was clearly evident among the Asia-Pacific companies EY surveyed pre-COVID earlier this year and upon re-surveying post the onset of COVID-19 crisis in April, the intent was affirmed. Indeed, three quarters (75%) of Asia-Pacific companies we surveyed in April said they planned to initiate their next divestment in the next two years — marginally up from 74% of Asia-Pacific companies pre-crisis — with 59% saying they aim to divest in the next 12 months.

Forty percent of companies EY surveyed in April also said they expect to see an increase in the number of willing strategic sellers over the same period.

How is the crisis influencing Asia-Pacific divestment activity?

There are four key factors that individually and collectively will likely drive and influence corporate divestment activity in Asia-Pacific over at least the next 6-12 months.

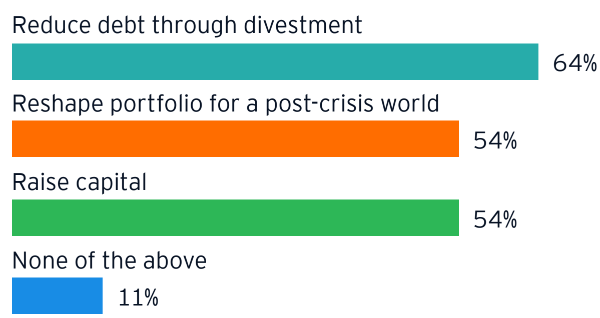
The first is the balance sheet strength of companies. Some are already turning to the capital markets to fortify weakened balance sheets through equity raisings, in turn reducing the need for divestment to raise liquidity during this period of volatility. However, companies whose access to capital markets is more constrained may need to turn to divestments instead. These companies will need to think more proactively around capital recycling through a divestment strategy.

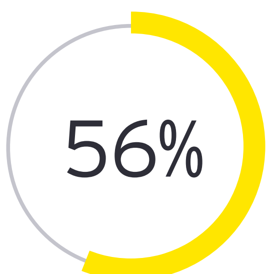
These strategic capital decisions were teased out in the April EY survey where just over half (54%) of Asia-Pacific companies said they would need to raise capital in response to the potential impact of COVID-19 on their business. What's more, the majority (64%) said they would seek to reduce their debt through divestments.

EY survey also indicates that for companies severely weakened by the crisis distressed asset sales are likely to proliferate; 58% of Asia-Pacific companies said they expect to see an increase in distressed divestitures over the next 12 months.

The second factor is companies' digital transformation which has ultimately been galvanized by the crisis. In fact, if digital transformation was not a strategic priority before COVID-19, it is now. Companies have been forced to rely almost entirely on their digital infrastructure to communicate and function.

Q **Does the potential impact of COVID-19 pandemic on your business mean you will need to: (Select all that apply)**





say they will be more likely to divest to fund new technology investments over the next 12 months.

As a result, divestments have become an even more attractive option to fund needed investment in technology; indeed, 56% of Asia-Pacific companies say they are now more likely to divest for this purpose, a sharp increase from 31% of companies that said the same pre-crisis. Remarkably, 67% of executives* from Greater China said they would divest to fund technology investment, up from 42% pre-crisis.

The third factor is supply chain diversification. Globally, 36% of companies plan to put more emphasis on their supply chain prior to divesting, rising from 27% before the crisis. US-China trade tensions had already brought this issue into focus. Now the crisis is forcing them to rethink and re-engineer their supply chains to increase control and minimize the risk of future disruption. This will likely lead to increased investment and divestment activity in Asia-Pacific as elsewhere. In fact, 67% of Asia-Pacific companies (73% of Greater China respondents*) said they had already taken active steps to restructure their supply chains, according to the most recent EY Global Capital Confidence Barometer.

The fourth factor is portfolio optimization. Asset portfolios will, for many companies, need to be re-shaped for a post-crisis world, an action over half (54%) of Asia-Pacific companies we surveyed in April said they will take. Sixty-eight percent of Asia-Pacific companies stating that they held onto assets for too long driving the need to execute their portfolio optimization strategies which are expected to be accelerated as a result of the COVID-19 pandemic. While visibility of what the future looks like in the short term is challenging, companies need to start making adjustments based on macroeconomic scenarios that are likely to emerge.

For instance, a resurgence in global economic activity is expected to be driven in part by significant spending by governments on infrastructure projects, which should boost commodities markets. Ahead of this, companies, especially in the natural resource industry, are already accelerating acquisition plans for assets attractively priced due to weak commodity prices from the fall in economic activity, as well as seeking disposals to further optimize their portfolio for a post-COVID-19 environment.

*Note: including respondents from Mainland China, Hong Kong SAR and Taiwan

How must sellers prepare?

Asia-Pacific companies need to be actively refocusing attention on preparing assets for sale as part of pursuing their medium-term divestment strategies, most of which remain intact from before the crisis and in-play. In some cases, the havoc wreaked by COVID-19 may cause an acceleration of the divestment plans.

Strategies will, however, need to be adjusted due to a number of different effects from the crisis. More than half (53%) of Asia-Pacific companies EY surveyed in April said, for instance, that the economic impact of COVID-19 would likely increase the price gap between what sellers expect and buyers are offering. In addition, 52% said the impact would create less certainty regarding which assets to divest, which has significantly increased from 28% before COVID-19.

Importantly, some 46% said their level of divestment preparation would also have to increase.

As ever, how companies prepare their assets is crucial for a successful sale. The standard approach is for sellers to ensure that the business is as attractive as possible by aligning management incentives with a good sale outcome and making sure that corporate overhead allocations are thought through.

Yet, given the impact of the current crisis, this approach will need to be augmented by other key considerations, including:

- Due to the impact on financial results over two or more quarters, sellers must prepare a credible story based on credible assumptions to explain to prospective buyers how the company will look and perform in a post-COVID-19 world. This could be a positive as COVID-19 has resulted in a rethinking in the way many organizations run their businesses and close scrutiny of cost models.
- Sellers need to present a story portraying at least the next 12–18 months. The more clarity and certainty they can provide the buyer pool over a longer period of time, the higher the likelihood of receiving higher bids for their assets.
- Assess the vulnerability of supply chains to a future COVID-19-type risk. Buyers will be focused on this and sellers will need to have a robust solution for mitigating this risk. As companies rethink sourcing, there will be inevitable consequences for lead times, cost efficiency and, therefore, working capital.
- COVID-19 has also been the ultimate test of demand elasticity for which the aftermath analysis will provide some very interesting insight.

How can companies maximize value in a distressed sale?

Fifty-eight percent of Asia-Pacific companies (65% of Southeast Asia companies) are expecting distressed sales to increase in the next 12 months. Strikingly, in Oceania, 70% of companies are expecting distressed sales to increase, as they are seeing a rising number of financially troubled corporates in the market, particularly in the aviation and retail sectors.

Compared to controlled divestments, distressed sales can be significantly quicker to execute, enabling sellers to secure needed capital sooner.

Asia-Pacific companies are also expecting some ambitious companies to take advantage of these times to acquire overleveraged companies at a discount. Forty-one percent of Asia-Pacific companies are expecting prices to decrease by 5-10% in the near term. Interestingly, they are also expecting to see strategic buyers from outside of the target's sector, as strategic buyers see it as an opportunity to expand into new businesses and invest in new business models.

This represents a shift in thinking from earlier this year when about a third (36%) of Asia-Pacific companies said they expected the number of this type of buyer to increase. In the April EY survey, this leaped to 54% of companies. In addition, less than a third (29%) of companies are expecting divestments related to industry consolidation to increase.

Divestors in the near term will be forced to address declining transaction multiples and an ever-widening price gap between buyers and sellers. Unlike the results from the global survey, where companies cited that they will likely increase the size and scope of divestments, Asia-Pacific companies are now likely to decrease the size and scope of the divestments and execute a more focused and well-prepared divestment before going to market.

With a new normal of increased distressed sales, shorter transaction time frames, diverse buyer pools from outside the sector and an anticipated increase in the price gap between buyers and sellers, it is more important than ever to start early and prepare meticulously to present a well-structured divestment and a well-perceived equity story. In a post-COVID world, operational agility, business model adaptability and supply chain resilience are also important considerations to communicate to the buyer pool.

Crisis provokes strategy rethink on portfolio management

While some large companies from Australia, Japan and Greater China more recently have led the region's increasingly sophisticated approach to divestments and active portfolio management, a buy-and-hold strategy remains all too common among many Asia-Pacific companies.

The impact of COVID-19 could, however, help accelerate this shift toward a more sophisticated, focused and intensive portfolio management approach in the region.

The economic impact of the pandemic helped to shine a spotlight on balance sheet strength, capital allocation, supply chain interconnectivity and vulnerabilities and adaptability of business models. Coming out of this crisis, EY teams expect to see far more sophisticated thinking and strategy around these topics which will ultimately provoke a strategic rethink around portfolio management driving both investment and divestment activity.

Conclusion

The Asia-Pacific region has a history of coming out stronger than before through major crises. The decisiveness shown by governments in the region to deal with COVID-19 gives confidence and hope that the region will potentially lead a resurgence in global economic activity.

For Asia-Pacific companies, now is a crucial time for them to be decisive too as they position themselves to come out of the crisis with greater operational agility and resilience than before. Core to achieving that will be a divestment strategy shaped by one or more key factors from their financial and technological strength to supply chain risk, and the need for portfolio optimization in preparation for a post-crisis world.

Key considerations:

- A more aggressive rebalancing of portfolios will help Asia-Pacific companies free up capital and refocus on their core business.
- Greater divestment preparation will be required to preserve value in a downturn with 71% of Asia-Pacific sellers reporting they would only accept a 10% or less reduction in sales price in the next 6–12 months.
- Companies can use divestments to help fund technology in response to rapidly changing customer demand.

EYG no. 003769-20Gbl
BSC No. 1908-3237361

ED None

Contacts

Paul Murphy
EY Asia-Pacific Divestment Leader
paul.murphy@au.ey.com
+61 3 9288 8708

About this study

The EY *Global Corporate Divestment Study* is an annual survey of C-level executives from large companies around the world, conducted by Thought Leadership Consulting, a Euromoney Institutional Investor company.

Results are based on an online survey of 1,010 global corporate executives and 25 global activist investors pre-COVID (conducted between November 2019 and January 2020), and an online survey of 300 corporate executives and 25 global activist investors following the onset of the crisis (conducted between April and May 2020), including companies from 11 industries, with 75% of respondents holding the title of CEO, CFO or other C-level executive.