

## Blueprint for success: optimising China asset portfolios to unlock value

With today's fast-changing business and regulatory dynamics, portfolio optimisation has become a top-tier issue of the C-suite agenda for multinationals (MNCs). And in China – an enduring drawcard for MNCs – such agenda has more recently increasingly taken the form of divestment, typically with the view to unlocking value and reinvesting in line with the MNC's China strategy to more profitable segments; despite various headwinds globally, the nation's efficiency, infrastructure, upgraded consumer affluence, and sheer market size remain highly attractive.

In 2021, total deal value of China divestments by MNCs rose to USD312.8 billion, up 17.4% from 2020, with local Chinese buyers making up circa 91% of the buyers<sup>1</sup>. While divestment has long been a part of business for many MNCs regardless, we anticipate such rise in divestment to continue in our view – at least in the near term given fiercer competition and broader economic/transnational uncertainties. Key related rationales for such divestment often include higher operational costs compared with leaner local players, or pressure from the MNC's overseas headquarters in light of global restructuring or other financial/operational concerns.

Typically, many China business divestments have entailed small (less than CNY200 million in sales), non-core/non-strategic, and loss-making business units, but not an exit of China by the MNC. Manufacturing has been among the most common sectors for divestment, though disposals from diverse sectors have also transpired. A small sample of the numerous divestments we've helped conclude include the following:

- USD2.2 billion divestiture of Reckitt Benckiser's infant formula subsidiary in China to Primavera Capital
- Divestiture of a French group's Chinese elevator business to a Chinese industrial player
- Privatisation of Canadian Solar's core solar module manufacturing business as part of a de-listing from NASDAQ, with a view to ultimately listing in China
- Divestiture of an Israeli company's valve manufacturing business in China as part of its group strategy to concentrate on the semi-conductor business
- Divestiture of a Japanese MNC's factory site and staff dormitory in southern China to a local SOE
- Divestiture of a Japanese company's factory site in China as part of its group strategy

### Blueprint assembly

However, the sale of an underperforming asset brings certain challenges in order to avoid operational disruption and realise appropriate valuations, synergies, and smooth deal-flow. To this end, building a solid disposal story – buttressed by judicious communications, compliance, and deal blueprint management – becomes imperative in justifying a premium price.

Typical complexities in arriving at apt go-to-market documentation – along with carve-out financials on a standalone basis – may include:

- 1) confidentiality/communications issues (from both employee and market/PR perspectives)
- 2) separation of shared assets (especially systems, intangible assets and facilities), people and operations (process and shared services)

1. DealLogic data; MergerMarket

- 3) tax (capital gains) and subsidy/incentive clarity (which may affect financials/sustainability given possible buyer ineligibility to benefit from such historical incentives).

A raft of standard considerations (clear deal parameters, interim operational measures, stakeholder alignment, carve-out financials generation etc.) would then all require diligent if not delicate handling given inherent sensitivities and to present best-light prospects for a successful deal closure. To this end, a comprehensive deal blueprint must be clarified at the outset to avoid any related setbacks.

Value-creation analysis can also be included for notable benefit – to help the seller undertake deep benchmark evaluation against local companies and reap more enterprise value in context of likely post-deal synergies and market-positioning.

When relevant stakeholders are aligned on all key aspects, proposal requests, letters of intent (LOIs), or indicative offers can then be sought from prospective buyers.

As Chinese buyers can often be more agile in their decision-making, trusted mediation is crucial to bridging any cultural gaps and clarifying on deal milestones and expectations. Similarly, the potential Chinese buyer may typically have a Chinese lawyer, while the MNC may have a home-country lawyer; given PRC law would usually be applied if the target is in China, mutual understanding of respective presumptions needs clear – and timely – articulation for a smoother deal flow.

Normally, an auction process may take place – which can be advantageous in terms of building competitive tension – though whether to go this route must be weighed up at the start. Regardless, with a valid LOI or indicative offer, buyer due diligence would then follow, with the milestone of arriving at a binding offer.

### A win-win

Undoubtedly, MNC-related assets still present attractive prospects to potential buyers given perceived (if not actual) favourable quality, brand, and tech/know-how considerations; with the right, structured approach from the get-go, there's no reason why strategic divestment should not be a win-win for both seller and buyer – with appropriate, advantageous sell-side valuations realised, and a gainful, well-integrated business addition to the buy-side.

*\*In certain circumstances a spin-off/carve-out of the specific business segment of an MNC with a view to a subsequent separate listing in Hong Kong SAR (or China Mainland capital markets) may be an option. Assessment as to feasibility would entail an initial high-level evaluation to gauge rationale and prospects. A notable example includes Yum Brands spin-off of its China business unit, Yum China Holdings, to Primavera Capital and Ant Financial Services Group and its more recent announcement of a primary listing in Hong Kong. AB Inbev has also since listed in Hong Kong a stake of its shares in its Asia Pacific business unit.*

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