Our view

KPMG China, Deal Advisory

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Opportunity knocks: evaluating investments in a post-COVID China

In a world seemingly in a state of flux, amplified by competing global headlines and opinions, the reality is – for multinational corporations (MNCs) – business prosperity remains top of the agenda. To this end, strategy and ability to spot opportunity in the world's second-largest economy – China – could, for many, prove make-or-break.

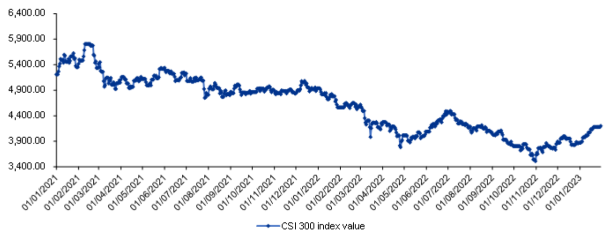
Buoyed by an on-the-ground optimism in terms of the phased opening up with the nation's easing of COVID restrictions, and backstopped by a commitment earlier this month at the first session of the 14th National People's Congress (NPC) to encourage even further foreign direct investment (FDI), in all practical senses, it's business as usual in the PRC. Notably, FDI rose 8% in 2022 from 2021[1], and the government has now just added more than 200 items to the latest catalogue for encouraged FDI (with a focus on advanced manufacturing, modern services, energy and environmental protection, and scientific innovation).

Along with pockets of recent positive economic data and a 5% GDP target set for 2023 by the NPC[2], domestic dynamics clearly brace sounder prospects. But regardless of potential volatility or the ebb and flow of global macro concerns, to seize on current or pending opportunities – whether a buyer or seller – preparation and objective assessment remains key.

From an investment standpoint, current company valuations across numerous sectors may be reflecting healthier levels compared with the at-times dizzying heights of years prior (e.g. the *Buffet Indicator*, which measures market cap to GDP ratio, currently signals stocks in China as "fair valued"), while higher valuations could lay ahead based on the current forward multiples generated by market participants.

As seen in the chart below, CSI 300 performance (which tracks value weightings of the top 300 A-Share listings across the Shanghai and Shenzhen exchanges) shows a notable decline over the past 2 years:

CSI 300 index value trend (from 1 Jan 2021 to 30 Jan 2023)



Source: Capital IQ

Meanwhile, the forward multiples[3] for EV/EBIT (enterprise value to earnings before interest and tax) and P/E (price-to-earnings) may arguably be implying – particularly with the lower projected EV/EBIT multiples – that the market expects a trajectory of healthier company financial performances over the next 3 years:

SH& SZ listed market — selected sectors

Median	EV/EBIT				P/E			
Sectors	31/01/2023	FY+1	FY+2	FY+3	31/01/2023	FY+1	FY+2	FY+3
Industrials	30.06x	22.41x	16.31x	12.55x	32.51x	26.27x	19.12x	14.76x
Pharmaceuticals , Biotechnology and Life Sciences	35.39x	24.80x	19.45x	15.76x	38.09x	32.43x	24.51x	20.07x
Chemicals	25.12x	17.51x	13.44x	10.85x	27.39x	20.15x	15.89x	12.51x
Consumer Staples	35.29x	25.38x	18.48x	15.05x	38.67x	32.31x	23.80x	19.64x
Consumer Dis cretionary	28.70x	17.86x	13.88x	11.34x	30.71x	23.50x	17.89x	13.72x
Automobiles and Components	39.07x	n/a	n/a	n/a	41.88x	n/a	n/a	n/a

Source: Capital IQ (*see notes below)

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The inference being, that should market confidence consolidate in realising such financial expectation, the valuation multiples would increase and the listed companies would have higher *absolute* valuations.

1.;2. www.globaltimes.cn, accessed 24 March 2023

3. The forward multiples are based on current market caps, actual financial data, and brokers' financial data forecasts for listed companies on the Shanghai and Shenzhen exchanges)

** Industrials sector includes the sub-sectors of Capital Goods, Commercial and Professional Services and Transportation; 2. Consumer Staples includes the sub-sectors of Food and Staples Retailing, Food, Beverage and Tobacco and Household and Personal Products. 3. Consumer Discretionary sector includes the sub-sectors of Automobiles and Components, Consumer Durables and Apparel, Consumer Services and Retailing; 4) FY+1, FY+2 and FY+3 multiples are forward multiples based on the valuation date of 31 January 2023.*

Of course, market expectations may not always be 100% indicative of ultimate outcomes, but the point is moot: Either way, regardless of what does transpire, without sufficient preparation and objective assessment of current sentiment and practical realities, opportunities can be lost if unable to effectively execute major business decisions at an opportune time.

Policy support and trends

In general, sectors set to attract more pronounced interest in China include those with favourable government policy (e.g. new energy, high-tech, life sciences), while ESG-related investment is also expected to attract greater funding going forward.

For the industrials sector, heavily influenced by oil price variance, Beijing's supportive measures for the real economy – not to mention the easing of COVID restrictions – are expected to support further M&A, especially within the new energy, auto manufacturing, and advanced manufacturing segments.

In the life sciences sector – a pointedly attractive space given its higher industry barriers – regulatory shifts in China's medical policy and capital market (IPO) success rate remain key focal points. Bio-focused PE remains active in seeking out good quality targets, while other transactions – particularly regarding JV models between MNCs and private-owned entities wherein the MNC contributes pipeline assets to the JV – remain a focus area.

In terms of the chemicals sector, a key determinant going forward will likely be a company's handling of the 'E' (environment) in ESG, as governments (and investors) in general ramp up scrutiny in this regard. (Since November 2022, China has promulgated six major sets of ESG-related standards/guidance, in addition to various ESG-related standards/guidelines developed by local governments).

For the consumer sector, market cap and P/E multiples were trending down in 2021 and 2022, before showing signs of a rebound (along with most sectors) late 2022. Consumer sentiment and confidence indices will remain a general focus – spurred by the unfurling of Beijing's various consumption-oriented policies.

In the auto sector, ongoing government supportive measures are expected to fuel momentum, with China's auto market projected to increase 3%, according to the China Association of Automobile Manufacturers. Despite some headwinds (chip shortages, manpower, rising raw materials price for power batteries etc.), the sector has proven fairly resilient – particularly the NEV (new energy vehicle) segment, in which 6.89 million NEVs (representing 25.6% of China's total auto market, up 12.1 percentage points from 2021) were sold in the PRC in 2022 (up 93.4% year-on-year).[4]

Positioning ahead of the curve

With COVID restrictions all but gone and value targets drawing increasing interest from both domestic and overseas channels, the current softer competitive landscape – and current relatively lower valuations – may prove transient sooner rather than later. Meanwhile, to shore up positioning and ability to leverage on buy (or sell) opportunities, objective assessment – ahead of time – of feasible options in context is a must.

4. MOFCOM website, *Economic Watch,* 13 January 2022

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