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cutting through complexity

VANTAGE

The global view from Transactions & Restructuring

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Find the Hidden Value in Your Portfolio

Today's companies are developing new ways to rationalize assets for sustainable growth. Recent activities by chemical and pharmaceutical companies show that divestiture is still an important option. But major players in this sector are also buying assets, streamlining operations, changing business models, and entering into partnerships to help optimize their portfolio value. In many ways, these companies are using rationalization from a position of strength and not distress by exploring all options and keeping in mind the long-term business goals of the company.

Delivering portfolio value

Although rationalization is sometimes considered only in terms of divestiture, the process should always be about delivering optimal value to the portfolio. Management should consider and assess the five options available to deliver value – sell existing assets, buy a new asset, concentrate asset productivity by streamlining operations, close the business, or enter into partnerships, alliances or joint ventures with distributors, suppliers or other business entities.

Asking the following questions can help management choose the right options that will maintain their strategic direction during the rationalizing process.

Who is the best owner for the asset? Too many companies develop deep, historical attachments to legacy assets and postpone divestitures despite the fact that holding onto such assets can limit performance, increase management time, add complexity and erode differentiation. However, companies can also be too quick to bring non-performing assets to market and have been disappointed by either a lack of buyer interest or low valuation multiples. An objective assessment supported by data and analysis to test the planned course of action with the company's strategic direction is required to accurately determine the best owner.

What is the asset's market? Is the market attractive on multiple levels? Does it support strong growth, attractive margins and other business advantages? Are any significant market changes expected? A large number of chemical companies have been successful at establishing an emerging market footprint

over the last twenty years. DuPont, for example, now earns approximately 30 percent of its total global revenue in fast growing markets, while BASF has over 25 subsidiaries in Greater China. An analysis of future market development should be a part of any portfolio rationalization evaluation.

Does the company have the time, resources and expertise to successfully undertake a transaction? Often, the skill set, time and effort required to support a transaction is underestimated. Transaction issues involving IT integration, for example, can add a new and unforeseen level of complexity to a transaction for businesses.

What will we do with the income from the sale? By determining upfront the best use of proceeds, the rationalization can maximize value for the group. Proceeds might be distributed to shareholders, or they might be used to drive growth through new investments, increasing research and development (R&D) and introducing new products.

Will our new portfolio fully support our company strategy? The impact of the rationalization needs to be understood in terms of one, three or even five years in the future.

Returning to core businesses

Divestiture is used by many companies to reduce complexity and return to core businesses. In a recent KPMG Global Divested Industrials survey, four out of 10 executives stated they plan to exit non-core businesses or product lines in the next two years.[1]

Selling a non-core business or part of a business assumes that the maximum value can be derived from assets that no longer fit with overall strategy. The key to maximizing value on disposal is taking time to prepare for sale. Underlying performance issues need to be addressed before bringing assets to market, undertake robust financial and operational carve outs to disentangle businesses, and have a clear view of both the value proposition of the business and the value as perceived by bidders.

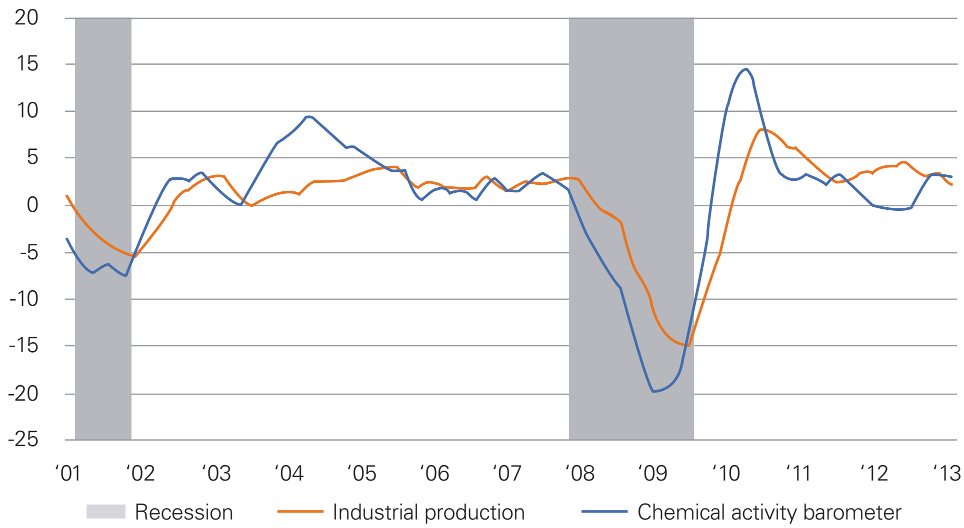
Cost cutting measures

Where the decision is to fix the asset, there needs to be a clear focus on strategic value improvement – using specific financial and organizational baselines and an analytic, numbers-driven approach to drive improvement across the asset. However, some assets are beyond fixing or cannot be sold for various reasons, including long-term cost and revenue projections. In such a case, the only option is closure.

For example, LyondellBasell shut down a 100 KT per year high-density polyethylene (HDPE) unit in Wesseling, Germany.[2] The unit was among the smallest and least efficient of the LyondellBasell HDPE units in Europe. Mitsubishi will permanently shut a 390,000-m.t./year ethylene unit in Kashima, Japan, sometime in 2014.[3] Mitsubishi and Asahi Kasei plan to combine ethylene operations at Mizushima by April 2016. Operations will be consolidated at the Mitsubishi facility at Mizushima, and Asahi Kasei's facility will be closed.[4]

Chemical activity barometer versus industrial production index

% change year-over-year three-month moving average [3MMA]



Source: American Chemistry Council, March 2014

1. 2014 M&A Outlook Survey Report:M&A expected to rebound in 2014, KPMG, 2013
2. LyondellBasell European Restructuring to Include HDPE Unit in Germany, company press release, May 15, 2013
3. Global ethylene capacity expansion poised for major expansion, Oil & Gas Journal, July 1, 2013
4. Japan: Heading for Higher Ground, IHS Chemical Week, April 28, 2014

Novartis and GSK

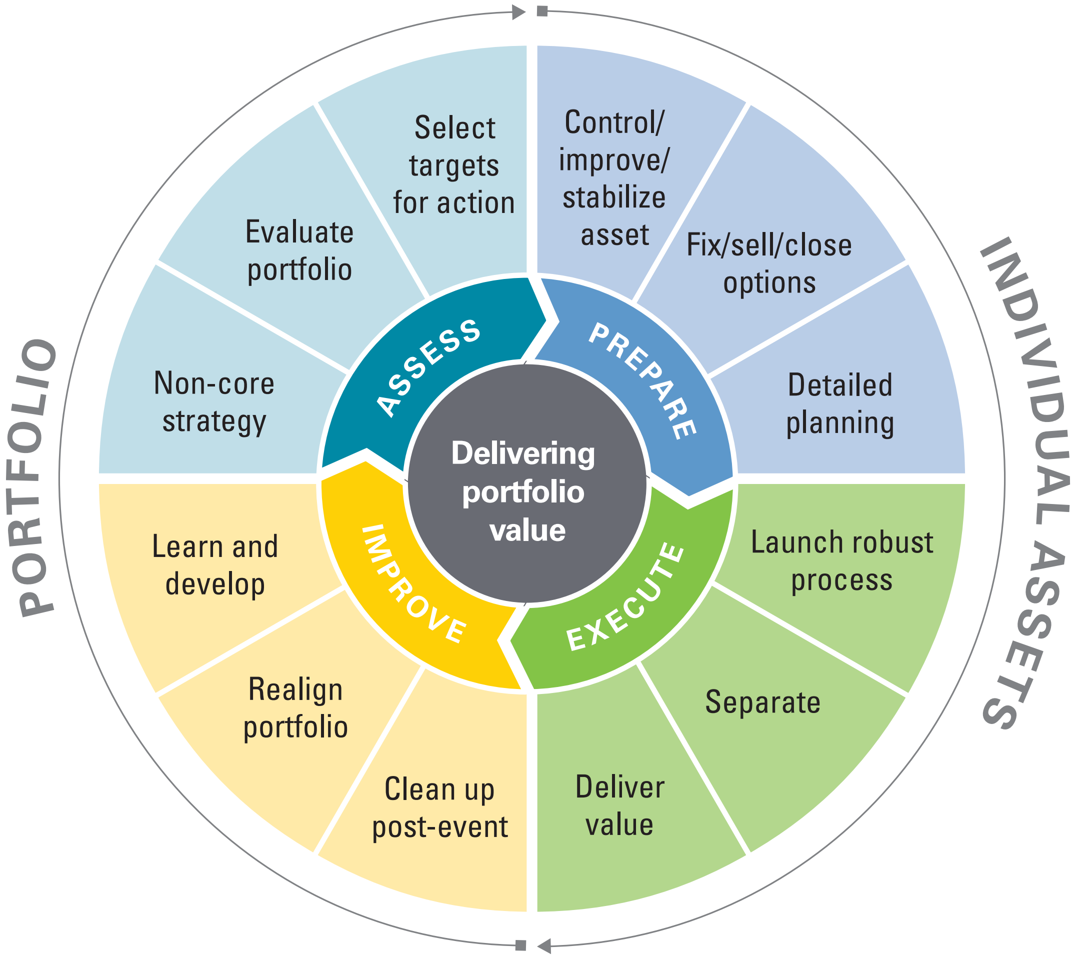
Sometimes a combination of options such as transactions, partnerships or joint ventures can help introduce synergies, increase supply chain efficiencies or enable companies to enter new markets.

GlaxoSmithKline (GSK) and Novartis recently announced a three-part transaction that involves an asset-swap between the two companies to create a new consumer healthcare business.[5] GSK will acquire Novartis' global vaccines business for an initial cash consideration of USD5.25 billion with subsequent potential milestone payments of up to USD1.8 billion and ongoing royalties. Novartis will acquire GSK's marketed oncology portfolio, related R&D activities, rights to its AKT inhibitor and commercialization partner rights for future oncology products. GSK shareholders will receive GBP4 billion capital return to be funded by net cash transaction proceeds.

A deal of this size and complexity shows the opportunities available for companies that take a flexible and creative approach to portfolio rationalization.

Regular reviews

We believe that portfolio rationalization is a powerful tool for optimizing portfolio value. As such, we think reviews should be performed on a regular basis, factoring in recent shifts in the business landscape, regulatory developments, actions by competitors and adjustments in company business goals and requirements. Combined with other strategies, rationalization will help companies maintain a competitive advantage in today's markets.



Source: KPMG International, 2014

5. Information from GlaxoSmithKline and Novartis press releases, April 22, 2014

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