Consumer Products, Services and Retail

Take Private Opportunity in Asia?

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PE and corporate investors have been significantly impacted by travel restrictions imposed by governments round the world. Critical on-site and face-to-face due diligence has been hindered and many investors have hunkered down focussing on their existing portfolio or closing only those deals that were already in advanced staged at the time the lockdowns hit Asia.

But with $400bn in dry powder targeting PE investment across Asia, many players are eager to get back into deal making mode. Take privates and private investments in public entities ('PIPE') have become a viable source of potential deal flow since much of the early DD has to be done based on public sources and without direct access to the target company.

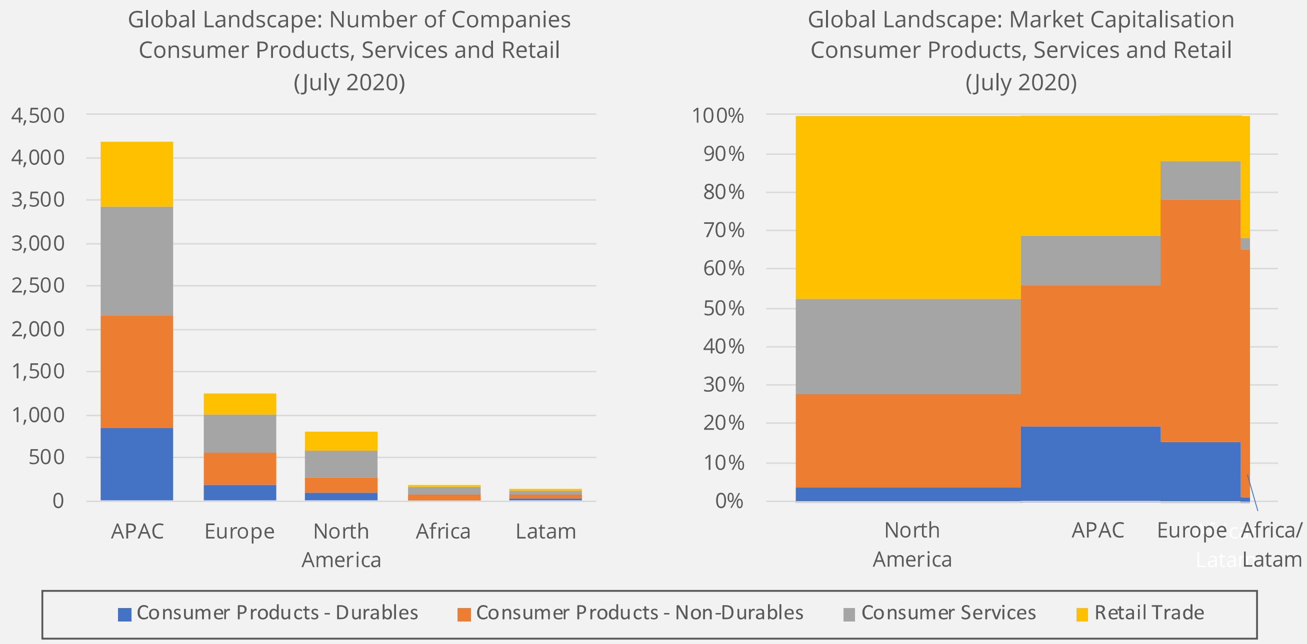
Wide range of Winners and Losers across Asia's consumer sectors

In this article we explore the opportunity for take privates and PIPE's across the consumer sector, a perennial favourite amongst PE investors in Asia. The broader sector consists of many subcategories in durable and non-durable consumer products, consumer services and retail trade. The fortunes of different players has varied markedly through the COVID-crisis with some players being impacted severely and others actually benefitting strongly from changes in consumer behaviour and channel dynamics caused by the pandemic.

Asia's Consumer Company Landscape

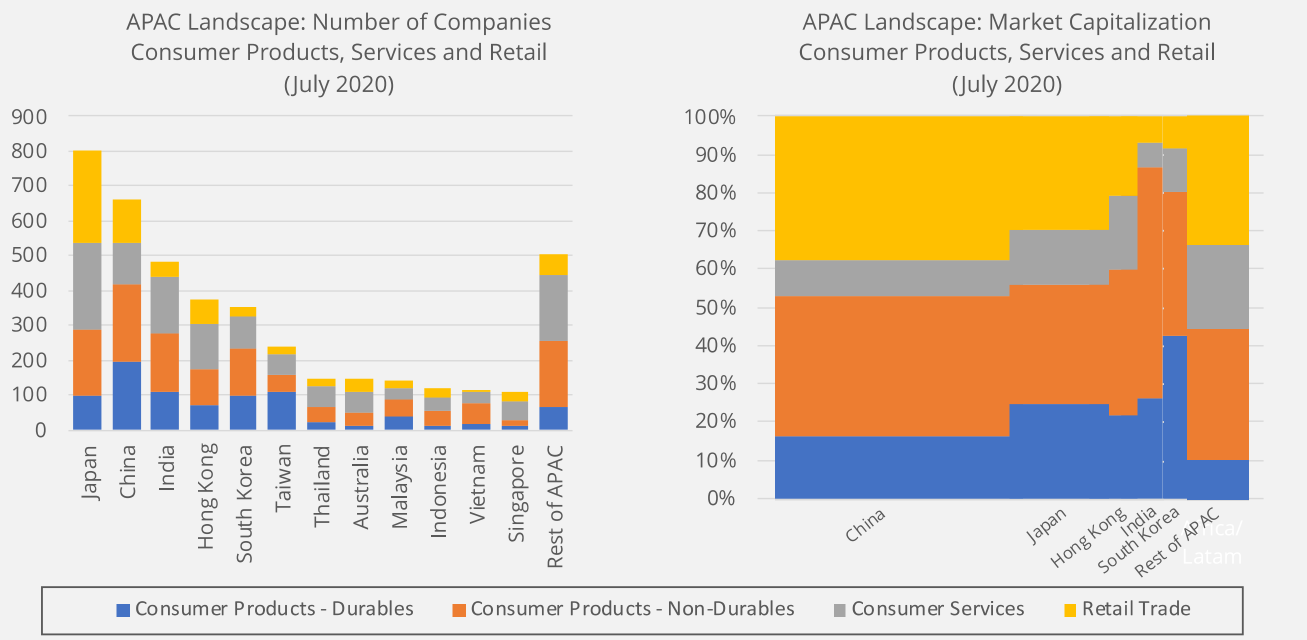
Asia is home to over 4,000 public companies in the consumer product, services and retail sectors. This represents 64% of all global listed companies across the consumer sectors. In terms of market capitalisation, Asian companies represent 34% of the global total behind North America whose consumer companies represent around

46% of the global total. In other words, the listed companies in Asia are relatively smaller on average compared North America.



Source: SCP/Asia Research & Analysis

Within Asia, Japan has the most listed companies in the consumer space, followed by China, India and Hong Kong, which host many China mainland companies on the HKEX. In terms of market cap, China represents almost half of all public consumer company value in Asia, followed by Japan with around 20% share.

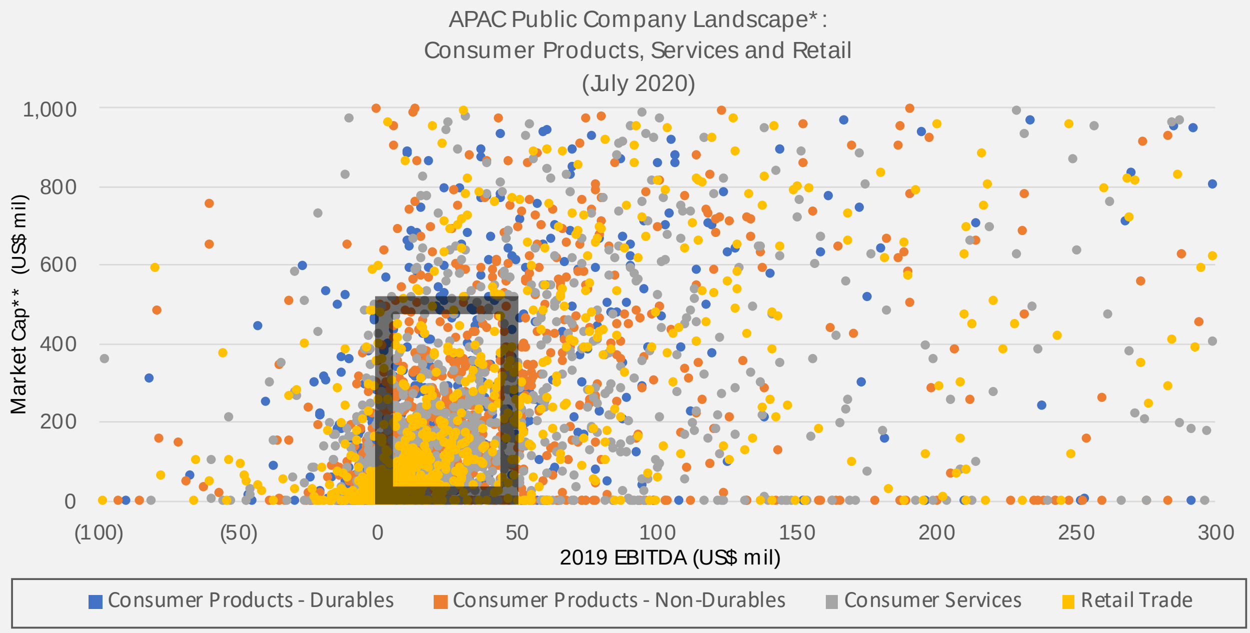


Source: SCP/Asia Research & Analysis

Size matters: addressable target pool

Not all listed companies are suitable candidates for PIPE investment or take privates. Size matters. PE firms have capital to deploy and a minimum deal size is required to make the effort worth their while. At the same time, some of Asia's consumer behemoths are out of reach of even the largest sovereign wealth funds.

We have banded the players in terms of 2019 EBIDA excluding al players with EBIDTA below US$1m and greater than US$50m. Likewise we have also excluded players with a market cap below US$10m or greater than US$500m.



Note * outliers not shown in chart; ** per 18 July 2020

Source: SCP/Asia Research & Analysis

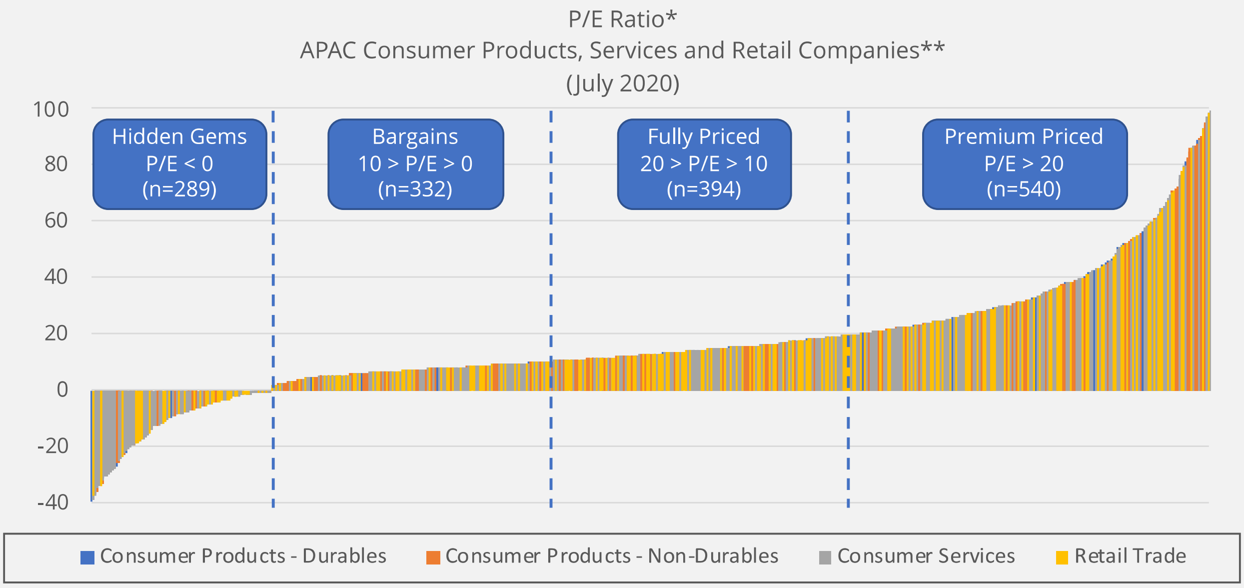
Focus for take privates and PIPE's

By applying the filters above, we remain with ~1,500 companies that could be potential targets for PIPE or take private deals in Asia; this is roughly a third of the total listed consumer companies in Asia. Roughly a quarter of these has an EBITDA of US$1-5m, which could be a suitable for smaller funds; 50% of the addressable set has an EBITDA of US$5-20m which puts them in the sweet-spot for a typical mid-cap transaction; the remaining 25% consist of companies with an EBITDA of US$20-50m which takes it into the territory of the larger regional or global funds.

Valuation Rationalisation

With 1,500 companies in the pool, how do we narrow down to a more manageable set? PE's, like most investors, don't like to pay more than the prevailing market rate. Better still, they are looking for value creation opportunities that result in significant exit multiples down the line.

One way to identify candidates for take-privates and PIPE's is to look at the P/E ratio and categorise and filter out players with premium pricing or, potentially, negative P/E rations. We have segmented the pool of companies in four categories based on their P/E ratio.



Note: * per 18 July 2020 ** Only shows companies prioritized for take private and PIPE potential based on EBITDA and Market Cap; outliers not shown in chart (P/E > 100 or P/E < -0)

Source: SCP/Asia Research & Analysis

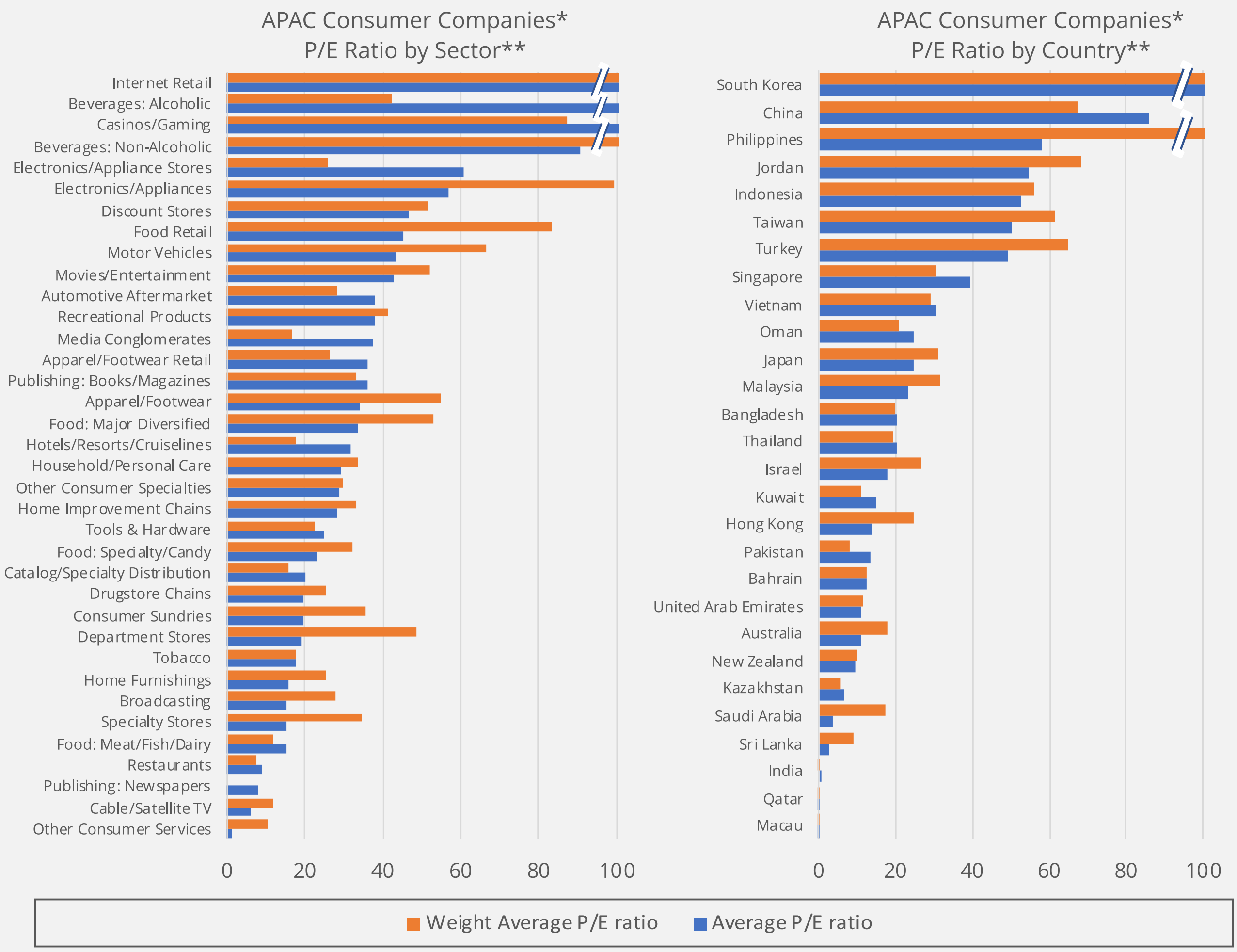
There are 289 companies with negative P/E ratios, meaning negative PAT (but positive at the EBITDA level to be included in our set). Amongst this group there could be some bargains, companies that are on a path to profitability that is yet to be recognised by the market.

There are 300+ companies with a P/E ratio up to 10x. This would be a valuation level that most PE firms would be comfortable with. By paying a 20-30% premium above the market rate, PE's may be able to take private a business and help management focus on managing through the current COVID turbulence and work on a number of strategic initiatives before exiting down the line, hopefully with improved profitability and at a higher rating.

Beyond that, there are ~400 companies in the 10-20 P/E range and a further 540 companies with P/E multiples above 20x. The latter group would represent many companies from China and tech oriented businesses with high growth prospects. Not all PE firms will be comfortable backing companies at those valuation levels, but several large players have pivoted their investment focus towards these types of businesses in search for higher returns compared to typical mid-market MBO's in more traditional sectors.

Sector or Country Themes

Many PE investors have clear sector or country mandates for investment. Looking across the landscape we can see clear differences in valuation levels by consumer sub-sector and country:



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*Source: SCP/Asia Research & Analysis

Internet retail commands the highest valuations. Profitability in these business is often low as players are aggressively investing to develop the market and capture share. Investors are willing to back these companies on the back of high growth expectations but most traditional PE firms will shy away from these business model in search for more established players with established track records and more predicable cash flows.

At the lower end we see traditional retail and media sectors which are facing a lot of headwinds from digital disruptions. Restaurants are also lowly valued. Already before the pandemic, many restaurant businesses were facing challenges with rising labour costs, increasing property rental rates in prime locations and fickly customer demand. The pandemic has created further turmoil due to lockdowns, social distancing requirements and reduced footfall.

Taking a country perspectives we see several countries with large populations and growing middle classes having high valuations for listed consumer countries. Countries like China, Indonesia and The Philippines with in this category.

India consumer P/E is low due to outliers in the local travel and tourism sector

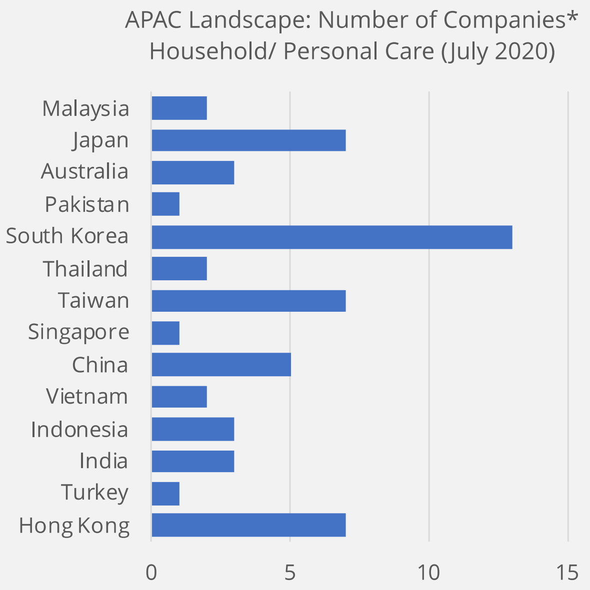
India, however is very low on the list of consumer company valuations despite its large population base and growing wealth levels. The P/E premium of Indian FMCG stocks dropped to an 11-year low earlier this year as there has been derating of FMCG stocks on the bourses, against a P/E expansion in the broader market. The volume growth in the industry, that was 11-12% until a year ago, has now shrunk to 6-7% for most FMCG companies. This raises a question mark over the companies' ability to generate strong double-digit growth in earnings, leading to some sell-off in richly valued FMCG stocks.

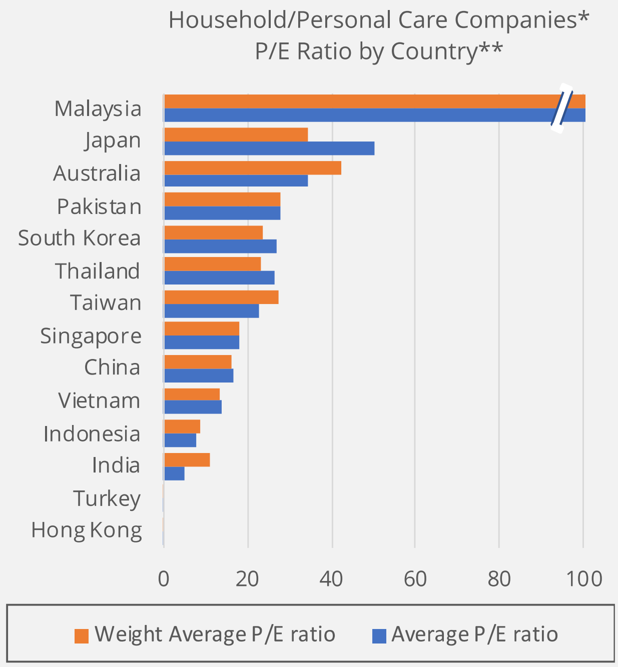
The India numbers are heavily skewed by several particularly poor performing companies including for instance Thomas Cook India, the travel and tour operator which swung into the red in its latest financial year and has seen its prospects severely diminished due to travel restrictions domestically and internationally. Other outliers which pull down the India average substantially include other travel related businesses such as Chalet Hotels and Lemon Tree Hotels.

Deep Dive into a Sector

As the India example above shows, taking a broad sweep across a sector or country theme is quite meaningless in identifying the right opportunities due to skewed results from outliers. We'd have to deep dive into a specific sector to get more meaningful results and identify the companies that could potentially be interesting take private targets.

We picked the household and personal care category to illustrate a deep dive:





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Source: SCP/Asia Research & Analysis

There are 57 public companies in the household/ personal care space in APAC suitable for take private or PIPE investment (based on our EBITDA and market cap criteria). Most companies are listed in South Korea, followed by Japan, Taiwan and Hong Kong with 7 companies each.

The highest valued companies are in Malaysia. Valuations in Thailand, Singapore and China are more reasonable whilst the companies in Indonesia are valued relatively low on average.

Let's take a look at the companies in these countries the develop a better understanding of their relative performance and home in on what might be good targets for a take private or PIPE deal. The table below lists a select number of household and personal care companies and summarises several key indicators for each player.

Table: Household/ Personal care companies in select APAC countries

			Scale			Performance		Profitability					Valuation		
Company	Country	Latest Reported Year	Sales (USD Mil.)	Mcap. (USD Mil.)	EV (USD Mil.)	Revenue Growth (%)	PAT Growth (%)	GP (%)	EBITDA (%)	EBIT (%)	PBT (%)	RoCE (%)	EV/EBITDA (x)	MarCap/ EBITDA (x)	P/E (x)
Rubberex Corp (M) Bhd.	Malaysia	2019-12-31	52.8	232.2	221.8	3.7	27.3	26.1	12.9	9.3	7.2	9.8	32.6	7.8	431.6
NTPM Holdings Bhd.	Malaysia	2020-04-30	186.2	142.2	234.1	4.7	(31.2)	-	4.5	4.5	2.9	6.5	27.7	22.0	94.5
S&J International Enterprises	Thailand	2019-12-31	149.3	127.7	140.0	0.2	(24.3)	24.9	7.5	2.5	5.3	2.7	12.5	13.3	15.3
Asian Phytoceuticals	Thailand	2019-12-31	8.0	70.0	54.5	(30.3)	(36.4)	79.1	31.7	26.2	28.9	10.8	21.6	3.2	37.5
Hanwell Holdings Ltd.	Singapore	2019-12-31	338.1	79.6	85.0	(9.1)	(47.3)	20.6	7.6	4.4	3.8	5.5	3.3	13.2	17.9
Nafine Chemical Industry Group	China	2019-12-31	173.1	234.4	316.9	(35.9)	(117.2)	18.7	5.7	0.0	(2.8)	0.0	32.1	17.5	(33.3)
Mingchen Health Co., Ltd.	China	2019-12-31	74.3	300.8	239.4	(9.4)	(25.6)	37.0	5.5	3.3	5.1	3.0	59.0	18.3	90.0
Luo Lih-Fen Holding Co., Ltd.	China	2019-12-31	46.8	178.4	129.1	3.8	12.5	67.7	38.9	36.5	39.4	28.4	7.1	2.6	11.1
Guangdong Rongtai Industry Co., Lt	China	2019-12-31	208.5	454.6	523.0	(18.2)	(434.9)	19.4	11.3	6.4	(35.3)	3.3	22.2	8.9	(5.8)
China Ludao Technology Co. Ltd.	China	2019-12-31	59.7	76.1	98.3	(2.5)	(2.1)	26.0	13.1	10.1	7.6	11.5	12.6	7.7	22.1
PT Multi Indocitra Tbk	Indonesia	2019-12-31	51.9	12.1	26.4	15.7	4.6	50.9	6.3	3.6	6.2	3.6	8.0	15.8	4.6
PT Mandom Indonesia Tbk	Indonesia	2019-12-31	198.4	97.5	77.1	6.4	(15.7)	32.2	13.1	6.8	7.2	8.3	3.0	7.6	9.5
PT Kino Indonesia Tbk	Indonesia	2019-12-31	331.0	323.7	388.8	30.3	245.3	46.4	11.1	9.5	13.6	15.0	10.6	9.0	8.8

Source: SCP/Asia Research & Analysis

Rubberex and **NTPM** are Malaysian companies with the highest valuations in the Household / Personal care sector in Asia. Both companies are benefitting from significantly increased demand for their products due to the COVID pandemic. Rubberex is a manufacturer of rubber and synthetic gloves and NTPM is the maker of Premier brand tissue paper and witnessed a surge in demand for its products due to the coronavirus outbreak. Profits should increase in the coming years but question whether the high valuation is sustainable in the long run.

Luo Lih-Fen is a company from China with relatively high profitability yet low valuation. The company is principally engaged in the research and development, manufacture and sales of facial beauty care products. It's main products include facial cleanser, toner, essence, face cream, mask and eye suits. The company distributes its products to end consumers through dealers in each province and also provides consultation services. The sector is facing competitive pressure from challenger brands like Perfect Diary but given Luo Lih-Fen's recent growth record and high profitability this company should be studied further as a potential take-private candidate.

Scrolling further down the list we see **PT Multi Indocitra Tbk (MICE)**, with a P/E multiple of only 4.6, one of the lowest valued companies in the peer group. On first glance the performance of the company seems quite strong with good revenue and profit growth last year and relatively high profitability. The company is engaged in general trading of commercial baby's products and health care and cosmetics products through the Pigeon and Lock & Lock brands in Indonesia.

A substantial proportion of MICE's revenue comes from traditional channels, i.e. retail outlets in and showrooms and shopping malls. Pigeon showroom stores and baby stores in malls and other locations have been closed due to large scale social restrictions in response to the coronavirus outbreak in Indonesia. MICE management estimates that the revenue affected by the pandemic may reach 25% to 50% of its total revenue during the first quarter (Q1) 2020. Online sales recorded by the company could not compensate for the decline in offline sales caused by the COVID-19 pandemic.

Low valuation due to corona-crises provides window for a take private of the business

The question is whether MICE's low valuation is justified assuming that eventually social distancing will be eased and with a stronger push into e-commerce? Also, Indonesia is expected to be one of Asia's bright consumer stories over the coming decade with growing income levels and an expanding middle class. Should MICE also be considered a good candidate for a take private or PIPE investment?

Beyond the Crunch

The example above shows that a process of 'database screening' focussed on sector and/or country themes combined with a bottom up assessment, company by company, can yield interesting ideas for potential take-private or PIPE opportunities. In the current environment, with travel restrictions severely hindering the due diligence process, this may well be a path to pursue for many PE's looking to deploy capital.

The search for suitable candidates can be finetuned beyond the process described above. Examples of additional analyses include:

- Looking at revenue and EBITDA growth over time to understand management track record
- Looking at P/E over time to understand sudden valuation shocks caused by the pandemic and whether this creates take-private arbitrage opportunities
- A review of analyst outlook for the company to the extend available
- Benchmarking of profitability and operational performance against peers
- Looking at the ownership structure of the business in terms of the free float and private shareholders to make an assessment of the potential complexity of a take private effort

Once a couple of take private candidates have been prioritised there is much that can be done in terms of critical due diligence without necessarily getting access to management:

- Detailed analysis of audited financial and investor presentations to understand the performance of the business;
- Map out the business strategy based on management announcements and 'facts on the ground' (i.e. products / brand launches, store openings, etc);
- Large quantitative consumer surveys to understand the strength of the target's brands versus competitor brands as well as critical consumer behaviour including changes in channel preferences, changes in customer behaviour and brand preferences by segment, price sensitivity, brand loyalty, etc;
- Store visits to understand the strength of the target's store locations or shelf positioning;
- Interviews with stakeholders in the value chain, e.g., distributors, store managers or competitors to understand the industry dynamics and which brands are the winners and losers in the industry;
- Desktop analysis and modelling of market demand outlook, potentially by relevant geography, market segment and/or channel to assess the outlook of the business based on the market outlook;
- Analysis of competitive landscape, including emerging challenger brands. Which players appear to be the winners in the industry? How is the target positioned?

Take privates and PIPE's will likely become a more regular feature in the PE deal headlines in the coming 6-12 months. With face-to-face due diligence significantly hampered due to the ongoing travel restrictions, take-privates and PIPE's can partially help fil the void for PE's eager to get back onto the deal-making track.

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