PRIMEIRO PARTNERS

The Daily Dispatch

Friday Special Feature

September 11, 2020

Joint Ventures and Partnerships in a Downturn

By: James Bamford , Gerard Baynham and David Ernst—Harvard Business Review *(From the September-October 2020 Issue)*

Companies will need every tool they've got to survive the downturn and rev up their businesses as the economy rights itself. They'll have to rewire operations, reallocate resources, and in some cases reinvent business models.

At many firms, joint ventures and partnerships will play an outsize role in those efforts, both as a vehicle for sharing costs and reducing capital needs during the crisis and as a way to position themselves for growth once it ends. After all, in industries experiencing great pressure—like automotive, retail, and upstream oil and gas—joint ventures are quite common. GM and Volkswagen, for example, each have several dozen, and JVs account for almost 80% of the upstream production of the largest international oil and gas companies. At these and other energy businesses, joint ventures are also key to managing the transition from fossil fuels to renewables. More than 50% of the largest assets in offshore wind and solar are structured as joint ventures—and such investments are a critical way for companies like Royal Dutch Shell, BP, Total, and Equinor to share risks, build capabilities, and meet ambitious targets to reduce greenhouse gas emissions.

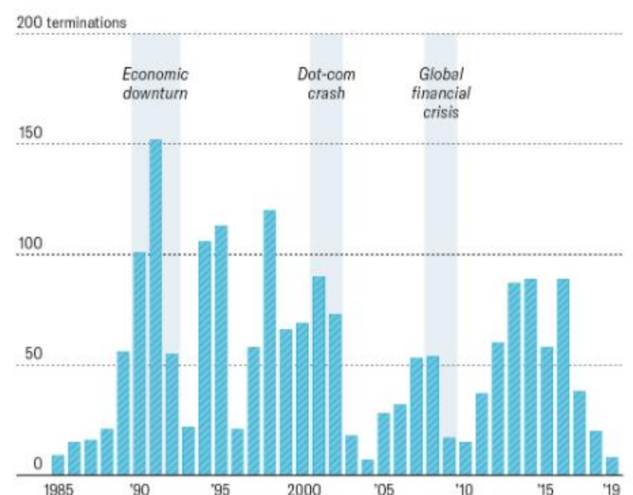
In health care and life sciences, joint ventures and partnerships are crucial to innovation: More than two-thirds of new health insurance products in the United States are built on cobranded or JV offerings, while life sciences companies depend on such ventures to accelerate time to market and broaden distribution of lifesaving products. In March 2020, for instance, Pfizer and BioNTech announced they were teaming up to bring out a Covid-19 vaccine. Other partnerships aimed at developing Covid vaccines have been announced by Sanofi and GSK, and by Hoth Therapeutics, Voltron Therapeutics, and Mass General Hospital.

JVs now drive a material share of companies' profits as well. In 2019 Airbus, Celanese, Engie, Vodafone, and Volkswagen relied on noncontrolled JVs for more than 20% of their earnings, while at Coca-Cola, GM, and many others that figure was above 10%.

Moving forward, we expect the impact of JVs and partnerships to remain significant and, in some sectors and geographies, to increase. We recently analyzed trends related to joint ventures across the past 35 years. Our analysis showed that in most industries, terminations of them didn't always increase during downturns—and often fell. Use of JVs also tended to rise on the eve of a recovery. This may be partly due to the time it takes to negotiate a restructuring or an exit, as well as corporate management's tendency to look first to wholly owned operations when cutting costs. In addition, JVs' returns on assets have been climbing recently—and are higher than those of wholly owned companies in the same industries. That means the number of terminations during this economic dip is likely to be even lower. Meanwhile, our analysis also showed that new joint venture and partnership transactions tend to increase during a downturn and to accelerate during a recovery, because they allow companies to get off to a much quicker start than organic growth does and are less risky than M&A.

Joint Venture Terminations by Year

Terminations don't always increase during recessions and decline quickly afterward.

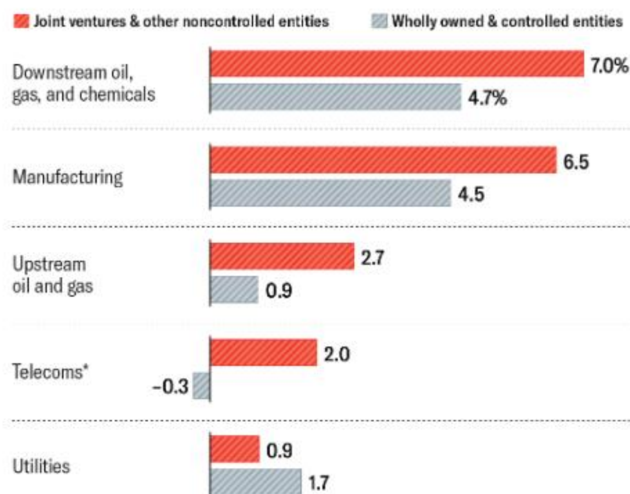


Note: Chart plots 1,873 JV terminations; non-JV partnerships excluded.
Source: SDC Platinum, public announcements; analysis by Water Street Partners

HBR

Average Return on Assets, Select Industries

Joint ventures' ROA is higher than the ROA of alternative investments.



*Excludes 2016

Note: Based on an analysis of 20,000-plus investments, 2014 to 2017. Investments include JVs, mergers and acquisitions, and organic growth.

Source: Department of Commerce; analysis by Water Street Partners

In this article we'll look at how during this period of retrenchment firms might stabilize their existing joint ventures by raising cash, cutting operating costs, reducing capital spending, managing risk, and restructuring. These are commonsense moves for the most part, but they require sustained focus; JVs are hard to restructure even in the best of times, owing to differing owner-company agendas, politicized processes, and general inertia. However, a crisis can serve as a catalyst for change. In addition, we'll look at how companies might enter into new, "counterdownturn" JVs and partnerships, both to manage the challenging economic environment and to tap into growth opportunities in capital-light ways.

Shoring Up Existing JVs.

Joint ventures are facing many of the same financial challenges—severe revenue shortfalls from fractured supply chains, curtailed operations, evaporating market demand, and frozen credit markets—as their owners and wholly owned peers. These new economic realities require both short- and long-term responses.

Efforts to reduce working capital, cut costs, tap additional credit lines, and take advantage of government subsidies and relief programs are already well under way in most joint ventures. To help pull off these near-term interventions, their boards will need to get far more involved than usual. Under normal conditions, joint ventures' board directors spend an average of 5% to 10% of their time on governance. But during economic storms, an effective board can be the factor that determines whether a JV thrives, stagnates, or dies an untimely death. Working with managers, directors are convening special board and committee meetings and fast-tracking decisions.

JV partners, boards, and management teams will also need to evaluate opportunities to more fundamentally reset their businesses. Because of their shared ownership, joint ventures can use restructuring tools that aren't available to wholly owned businesses. These approaches may benefit a venture, its parents, or both. They come in various forms.

Raising capital in unconventional ways.

Some joint ventures will have opportunities to secure low- or interest-free loans or capital from their cash-rich owners—such as state-owned companies, sovereign wealth funds, private equity firms, and multinationals with strong balance sheets. In exchange, those owners might get additional interest in the venture, preferred returns, or increased control. In 2015, when Russian automobile sales collapsed amid wider economic problems, Ford Sollers, a 50:50 joint venture between Ford and Sollers PJSC, received additional funding from Ford, which in return got preferred shares that gave it majority voting rights.

To free up cash, improve future liquidity, or open up new markets, joint ventures may also want to bring in new owners, such as PE firms, pension funds, other financial institutions, or strategic industry partners. Earnouts for the current owners could be pegged to the future performance of the business to make adding more owners attractive. Many investors, like PE firms, can bring in capabilities that give ventures a boost, including a better understanding of value creation, a sharp focus on cost reduction and talent management, governance discipline, M&A experience, and a portfolio that can double as an ecosystem of customers, suppliers, or partners.

Structuring creative commercial arrangements with suppliers, customers, lenders, and other business partners is another option for JV owners. In the past we've seen an ownership interest or option sold to a major supplier or

customer in exchange for better commercial terms including cash advances. If one of the owners is a major supplier to the JV, the parties might renegotiate their agreement (to, say, narrow the band of prices). Similarly, a joint venture might negotiate with a lender to convert debt to equity, making the creditor a direct owner.

Reducing costs through synergies and new operating models.
While JVs can cut costs on their own, much greater savings may come from consolidating or otherwise optimizing activities and assets with their owners. Ventures and owners might make joint purchases, integrate their supply chains, or combine some infrastructure, logistics, warehouses, or other operating assets. In 2003, Vodafone entered an agreement with SFR, its French mobile-telecommunications JV with Vivendi, to collaborate to improve economies of scale in operational areas like the development and rollout of new offerings and procurement, especially of technology.

JVs might also save money by insourcing certain functions (such as legal, HR, IT, or finance) currently being provided by an owner. Our analysis has shown that although owner companies rarely profit from providing administrative services to joint ventures, their cost structures are often 10% to 30% higher than those of the JVs or of third-party providers they might contract with. Conversely, a joint venture that lacks scale might benefit from outsourcing certain functions to an owner or a third party.

In some cases cost cutting may lead to more-fundamental changes to the operating model. Those that reduce operating expenses or increase strategic and financial flexibility are especially popular during downturns. A lower-cost partner in a joint venture or a third party might become the controlling partner or operator, which can open up synergies with that organization. In our view many joint ventures should aggressively pursue this option, which allows greater nimbleness and offers more potential for performance improvement than do JV models in which control is shared by the partners and the joint venture's management doesn't have much authority.

In response to the Asian financial crisis in the late 1990s, BASF and Mitsubishi creatively restructured their equally owned and controlled joint venture in Japan, Mitsubishi Chemical BASF. It was split into two joint ventures, one focused on dispersants and the other on foam products—the business's two core segments. Each was placed under the operational leadership of the parent best positioned to strengthen it—with BASF responsible for the dispersants venture, and Mitsubishi responsible for the foam products one.

Regearing financial ratios.
Joint venture boards might also consider authorizing or compelling management to increase external borrowing, especially if the entity is underleveraged, as JVs tend to be. Conversely, if a venture has excess cash, the board might seek to repatriate it to fund other, pressing corporate needs. During the 2008 financial crisis, the board of a large liquefied-natural-gas JV found that it had almost $500 million in cash on hand—enough to cover six months of operating costs. The board immediately approved a $300 million dividend, giving the owners cash to weather the storm elsewhere in their businesses.

Assisting owners through buyouts and other means.
Downturns tend to expose strategy and performance differences among partners. While the data doesn't suggest they cause buyouts to spike, inevitably there will be some buyouts and sellouts, and some JVs will be terminated or liquidated.

In the current environment, routine decisions about budgets and capital expenditures may become deadlocked, triggering buy-sell options in about a third of joint venture contracts. In other cases the potential synergies will be greater if a single partner has full ownership, and the one for whom the JV is more core—or already more integrated—will buy out the other partners. Or one owner might acquire and integrate parts of the joint venture or sell out to a third party. After the 2008–2009 financial crisis forced the Canadian company Nortel to file for bankruptcy protection, for example, it sold its controlling stake in a high-performing Korean joint venture with LG to Ericsson. Alternatively, all the owners might sell the venture to a consortium of financial investors.

Creating New Joint Ventures and Partnerships.
New JVs and partnerships can also help companies navigate the economic crisis. They can be used to raise

cash, secure cost synergies, or pursue lower-risk and more-capital-efficient growth. When funding is tight, such benefits make joint ventures and partnerships a popular alternative to mergers and acquisitions or organic investments. Our analysis shows that JVs and partnerships tend to increase in the late stages of a downturn, signaling a recovery and outpacing M&A. Right after the 1990–1992 and 2001–2002 downturns, for instance, the number of new joint ventures and partnership transactions was 20% above normal levels.

Partial divestments.

For companies that need more liquidity, a joint venture can be a good alternative to a full divestiture. One approach is to use it as the first step in a planned exit: A seller puts a noncore business into a joint venture with a potential buyer and negotiates to sell the full business over time, typically within three to five years. This kind of deal is especially worthwhile for sellers when prospective buyers don't recognize the full potential of the business or its assets or may not be able to buy or operate the business on day one. IBM used this staged-exit structure when it sold its personal computer business to Lenovo, and so did Lanxess when it folded its specialty plastics business into a joint venture with Ineos, in 2007. In that case, Lanxess received one payment when the joint venture was set up and a second after two years, when it fully exited the JV. The second payment was based on the performance of the business—a useful method when it's difficult to arrive at a valuation.

Another approach is to sell a partial interest in a business unit to a third party, effectively converting the business into a joint venture. Dow Chemical famously pursued such a game-changing structure in 2008, when it tried to sell key elements of its commodity-chemical business to Kuwait's state-owned Petrochemicals Industry Company to raise cash and reduce exposure to the cyclical commodity-chemical business. But it was left at the altar when the Kuwaiti parliament rejected the deal at the last minute. During the Asian financial crisis, Doosan agreed to sell a 50% interest in its Oriental Brewery unit to the global player Interbrew to raise cash. The deal gave Oriental Brewery access to new technologies, marketing networks, and cost management capabilities that lifted its performance. In a similar move, from 2008 to 2010, Chesapeake Energy raised more than $8 billion by selling a partial interest in its U.S. shale gas assets to BP, Equinor, Total, and others.

A creative third alternative is an asset sale with a leaseback. Through such deals, companies typically divest certain (noncore) assets but tie them to a joint venture. For instance, as part of an aggressive corporate restructuring program it ran from 2005 to 2007, Sony sold its chip-manufacturing facilities to Toshiba for more than $800 million; those assets were then leased back to a new joint venture between the companies, which produced chips for the PlayStation and other Sony consumer electronics.

Business consolidations.

Synergies from this kind of joint venture can be substantial. There is a range of options here. At the narrower end of the spectrum, companies (especially those in the natural resources sector) consolidate a set of adjacent assets into a single joint venture to align all the parties' incentives better and save money on infrastructure. Extending that logic more broadly to an entire region, country, or business unit, companies can consolidate similar operations with those of an industry peer or competitor to capture additional scale or cost synergies. In 2009 Morgan Stanley and Citibank consolidated their retail brokerage and wealth management businesses into a 51:49 joint venture in which Citibank also received an up-front cash payment of $2.7 billion. In a similar vein, in 2013 Bertelsmann and Pearson combined their trade-book publishing businesses, which were facing headwinds, into a 53:47 joint venture, Penguin Random House.

Companies might also team up with industry peers to consolidate back-office, sales, or purchasing functions into joint ventures and realize greater economies of scale. The big three U.S. automakers have done this in forming global purchasing joint ventures. Oil and gas companies have also pursued purchasing cooperatives, logistics pooling, shared maintenance and inventory management ventures, and other collaborative structures. So have telecom companies. For instance, Deutsche Telekom and France Télécom-Orange formed BuyIn, a purchasing joint venture in which the companies pooled procurement activities in an effort to save more than a billion dollars annually.

Partnerships for capital-light growth.

Companies looking for growth but seeking lower investment risk can consider a range of transaction structures. Some firms may enter global strategic partnerships with cash-rich players—including state-owned companies, sovereign wealth funds, or PE firms—to identify and develop a portfolio of opportunities within a sector or a market. The global oil corporation BP, the European chemicals maker Borealis, the Brazilian state-owned oil company Petrobras, and the French automaker Renault are among the dozens of companies that have pursued such arrangements over the years.

Alternatively, companies might acquire a partial stake in troubled business units of their peers operating in attractive markets. In 2003 the French oil giant Total took a 50% position in Samsung Chemicals through its chemicals unit Atofina, creating Samsung Atofina, to which it transferred technology, operating capabilities, and marketing expertise that jump-started the business's growth. In some cases firms might jointly acquire third parties, as competitors Votorantim and Suzano did when they bought majority voting control in the Brazilian pulp and paper maker Ripasa during a market downturn. That transaction was structured to maintain the market independence of the two owners, converting Ripasa into a jointly controlled production unit. The agreement also provided the purchasers with the option to acquire additional preferred and common stock of Ripasa within six years.

A similar strategy is to invest in or partner with innovative suppliers and technology companies. Toyota's investments and deep partnerships with core parts suppliers in the 1990s were credited with compressing the time necessary to go from concept to production, reducing manufacturing costs, and lowering defects. Similarly, in the 1990s, Samsung Electronics developed a program that nurtured suppliers with financial support and help building their technical capabilities, which led to technology improvements, savings on materials, and shorter order lead times.

Today power, chemical, mining, and petroleum companies could set up similar deals, making minority investments in clean-tech, renewable energy, recycling, or autonomous vehicle firms and agreeing to pilot those firms' technologies in their operations. Such arrangements would allow large incumbents with lower PE ratios to participate in firms with much higher growth prospects and valuations and to speed up their transition to a carbonless future.

Yet another approach is to team up with industry peers and adjacent players to create and commercialize new products. Within the chemical sector, companies have been forming consortia and small partnerships to establish standards for, develop, and sell new sustainable technologies. Similar patterns will play out in other sectors; partnerships are especially valuable in disruptive markets and on technology frontiers. Many of these will start as simple nonequity collaborations with an option to convert to a full-scale joint venture once certain technology or financial milestones are passed, as a way to hedge bets and reduce up-front investments.

CONCLUSION

As an epigram often attributed to Vladimir Lenin goes, "There are decades where nothing happens, and there are weeks where decades happen." In 2020 we have lived through a ridiculous number of those weeks. Yet periods of disruption can be rich in opportunity. A strategic examination of your current joint ventures and partnerships and the thoughtful creation of new ones can strengthen your position as you come out of the crisis and help you tap opportunities for growth during the coming rebound.

Source:
James Bamford , Gerard Baynham and David Ernst (2020) 'Joint Ventures and Partnerships in a Downturn', *Harvard Business Review, 19* Aug. Available at: https://hbr.org/2020/09/joint-ventures-and-partnerships-in-a-downturn (Accessed 10 Sept 2020)

The Daily Dispatch

September 11, 2020
TODAY'S TOP NEWS

Banks' soured loans highest in 6 years

Local banks' bad loans continued to rise in July as the economy was battered by the coronavirus pandemic, bringing the industry's nonperforming loan (NPL) ratio to its highest level since 2014. Gross bad loans climbed by nearly a third (32.1%) to P290.1 billion in July from P219.6 billion a year ago.

Pepsi-Cola to delist from local bourse

Pepsi-Cola Products Philippines, Inc. will be exiting the PSE after its public ownership dropped below the min. requirement. Its board of directors had approved the delisting of shares from the PSE main board due its inability to comply with the 10% minimum public float after a Korean conglomerate bought its shares in June.

AC Energy pulls out of Australian firm Infigen

An affiliate of Ayala Corp. sold its material stake in an Australian energy firm, which might be delisted from the market soon. UAC Energy Holdings, a 75%-owned company of the Ayalas' power arm AC Energy, Inc., divested its 20% shareholdings in Infigen Energy, Ltd. for A$0.92 per share to former rival bidder Iberdrola, S.A..

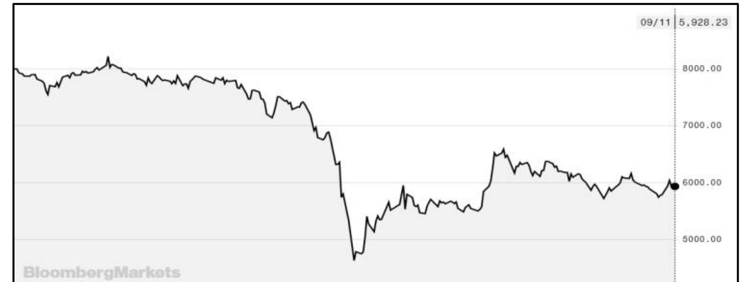
Tiu's Greenergy ventures into medicinal cannabis

Antonio L. Tiu's Greenergy Holdings, Inc. has forayed into the production of medicinal cannabis as it built a new AUS subsidiary with a US firm. Its board has approved the formation of Yakuru Group Pty. Ltd., where it will hold a 51% equity interest in. Yakuru is a cannabidiol distributor that started in Denver, USA.

Phoenix sets sights on SEA expansion with Indo deal

Dennis Uy-led Phoenix Petroleum Philippines, Inc. will partner with a subsidiary of Indonesia's state-owned oil and gas company for "fuel product supply and other trading activities" between the two countries.

Philippine Stock Market Update



Previous Close:
5,902.39

1 Yr Return:
-24.09%

Open:
5,906.94

YTD Return:
-24.11%

52-Week Range:
4,039.15 - 8,216.92

Source:
Bloomberg

Foreign Exchange

As of Sept. 10, 2020

US Dollar	Philippine Peso
1	48.6

BVAL Reference Rates

As of Sept. 10, 2020

Tenor	Rate
1Y	1.829
3Y	2.287
5Y	2.584
7Y	2.797
10Y	2.971
20Y	3.667

Daily Quote

"I really think a champion is defined not by their wins but by how they can recover when they fall."
-- *Serena Williams*

PRIMEIRO PARTNERS

The Daily Dispatch

MORE LOCAL NEWS

PH qualifies for US aid for infra, poverty reduction

The Philippines is eligible to avail itself of financial aid from the United States' Millennium Challenge Corp. (MCC) next year for mostly infrastructure and poverty-reduction projects.

Jobs to return in 2021, but millions to remain poor

The Philippine government is expecting jobs to come back in 2021, but also admits that millions of Filipinos who have slipped into poverty due to the coronavirus pandemic will remain poor next year.

NTC recalls ABS-CBN frequencies

In another blow to media giant ABS-CBN, the National Telecommunications Commission (NTC) issued an order recalling its frequencies.

PH gets fresh $500-M ADB loan

The Asian Development Bank (ADB) has approved a new loan allowing the Philippines to quickly access emergency financing in the event of disasters triggered by natural hazards and public health emergencies. ADB announced yesterday the approval of a $500 million policy-based loan to boost the Philippines' disaster resilience.

Digital banking to revolutionize local industry

The entry of digital banks in the time of COVID-19 social distancing will redefine the Philippine banking landscape and would give the traditional banks – or those with brick and mortar branches – much competition in terms of higher deposit rates due to its low-cost setup, according to S&P Global Ratings.

DITO telco discounts threat to national security

The third telco will never compromise the country's security. In fact, DITO Telecommunity's Memorandum of Agreement (MOA) with the Armed Forces of the Philippines (AFP) has the same provisions and commitment to national security as the MOAs signed with PLDT Inc. and Globe Telecom Inc.

Peso may stumble with decline in foreign bond sales

Philippine borrowers are looking to raise fewer bonds overseas in the coming months, taking away a pillar of strength for the peso. The peso led the advance among Asian currencies this year with 4.3% gains as the nation's borrowers raised a record $11.4 billion dollars via international bond sales in 2020.

Natural Gas Bill sets 2-tiered permitting

A proposed Natural Gas Industry Bill in the Senate is eyeing to enforce two-tiered permitting for liquefied natural gas (LNG) import terminals to clearly demarcate if the facility is for the own-use of the owner and operator; and a separate permit is required if it targets to market the gas commodity to other end-users.

Stocks fall anew as vaccine trials halted

The stock market fell for a second consecutive day as hopes for a COVID-19 vaccine took a hit with trials temporarily halted. The benchmark Philippine Stock Exchange index finished 0.51 percent or 30.45 points lower at 5,902.39 yesterday.

DOT requires beach resorts to deploy safety marshals

The Department of Tourism is requiring beach resorts to employ safety marshals along with lifeguards before they can reopen under the "new normal." It said the safety marshals should be on site to monitor physical distancing among guests and beach goers.

The Daily Dispatch

TODAY'S TOP ASIAN NEWS

Toyota's research arm says to form an US$800m fund

Toyota Motor Corp's research arm said on Thursday that it would create an US$800 million global investment fund. The fund called Woven Capital is to invest in companies in areas including autonomous mobility and smart cities.

Singtel to pace out investment for 5G technology

Singtel is pacing its investment for 5G deployment, and is on track to roll out its 5G network coverage to half the island in two years' time and nationwide by 2025, said Mr Yuen Kuan Moon, Singtel's chief executive for its Singapore consumer operations.

Utico extends deadline for Hyflux rescue offer

Utico has extended the deadline for Hyflux to accept its proposed rescue package by 11/2 months to Oct 15. The water treatment company had attached a letter it received from Utico about the decision in a filing to the Singapore Exchange.

Waze to shut Sg sales offices, cut 5% of staff

Navigation app Waze is closing its sales office in Singapore and laying off about 5% of its global workforce, as the pandemic has resulted in fewer vehicles on the road in many countries. Chief executive Noam Bardin said Waze users in many cities and countries are driving less or have stopped driving entirely due to the pandemic.

StanChart to reorganise business units, leadership

Standard Chartered said that it would merge several of its businesses and reduce the number of top executives as the bank seeks to trim costs and create a leaner business. StanChart said it would merge its retail, private and business banking divisions together under the leadership of current Asean and South Asia chief executive Judy Hsu

TODAY'S TOP GLOBAL NEWS

Fraser to be first woman CEO of Wall Street bank

Citigroup Inc C.N named consumer banking head Jane Fraser as its next chief executive on Thursday, making her the first woman to lead a major Wall Street bank. Fraser, 53, has been a rising star in the financial industry, with a career that spans investment banking, wealth management, troubled mortgage workouts and strategy in Latin America.

LVMH to countersue Tiffany, accuses of 'dishonesty'

French luxury giant LVMH said on Thursday, September 10, it would countersue United States jeweler Tiffany, accusing it of "dishonesty" as their plans for a sparkling tie-up descended into bitter recrimination.

BP's deal marks first step into offshore wind

BP, the oil giant that announced a seismic strategy shift last month, made its first venture into offshore wind power with a US$1.1 billion purchase of US assets from Norway's Equinor. The deal marks the start of an offshore-wind investment partnership in the region for the two companies.

ByteDance poised to miss deadline for TikTok sale

ByteDance is increasingly likely to miss a Trump administration deadline for the sale of its TikTok US operations after new Chinese regulations complicated negotiations with bidders Microsoft and Oracle, according to people familiar with the matter.

Ailing oil market prompts return to floating storage

A stalled global economic recovery from the coronavirus pandemic is leading to a fresh build-up of global oil supplies, pushing traders such as Trafigura to book tankers to store millions of barrels of crude oil and refined fuels at sea again.