Analysis on the motivation and economic consequences of Humanwell Healthcare asset stripping

Xiaoyan Lu[1]

1School of Business, Beijing Technology and Business University, Beijing, China

Abstract: Due to the rapid economic development, many listed companies blindly pursue diversification, resulting in the company into the main business diversification, loss of core competitiveness, performance decline and other difficulties, therefore, the means of asset stripping came into being. Taking Humanwell Healthcare as an example, this paper not only analysizes the motivation of enterprise asset stripping, but also measures the economic consequences of enterprise asset stripping from two aspects of market reaction and financial performance. In terms of market reaction, it makes a comprehensive evaluation through the event study method. In the aspect of financial performance, the financial indicators are used to analysize the performance changes of enterprises before and after asset stripping. Through the research of Humanwell Healthcare asset stripping, it can provide reference for other enterprises planning to carry out strategic contraction.

1.Introduction

From 2008 to 2017, the number and amount of assets divestiture of Chinese listed companies increased continuously, reaching new highs repeatedly. More and more companies have embarked on strategic transformation, and are considering streamlining their businesses through divestitures, returning to the main business, and reshaping their core competencies.

Many scholars believe that asset stripping is a bridge for enterprises to adjust their ownership and business portfolio structure[1], an effective means for enterprises to optimize the allocation of resources and capabilities, and also a strategic performance of enterprise management to continuously optimize enterprise boundaries[2]. In the research on the impact of asset stripping on corporate financial performance, scholars usually use accounting indicators and market indicators to measure corporate performance. However, For enterprises with poor performance, asset stripping is the reflection of its vicious circle; For enterprises with good performance, asset stripping is the strategic adjustment to achieve sustainable competitive advantage[3]. Some studies show that asset divestiture has a negative effect on the future financial performance of enterprises and increases the possibility of enterprise acquisition. Some scholars believe that the asset stripping of Chinese enterprises has improved the value of enterprises, and the performance of enterprises has been significantly improved through the implementation of refocused stripping[3]. However, some studies have shown that asset stripping has limited impact on corporate performance, and the overall reaction of the market to asset stripping of listed companies is negative[4], and asset stripping has brought overall damage to enterprise EVA [5]. In recent years, Chinese enterprises have been actively carrying out asset reorganization to get rid of financial crisis, but asset stripping is a relatively small research field, Chinese scholars on the motivation of asset stripping and economic consequences are still a great debate. In this paper, through the case study of Humanwell Healthcare asset stripping, in-depth analysis of the company's asset stripping motivation and economic consequences.

2.Humanwell Healthcare assets stripping case introduction

Humanwell Healthcare Group Co., LTD. (hereinafter referred to as Humanwell Healthcare) is the first listed private high-tech enterprise in Hubei province, has become a comprehensive pharmaceutical industry group, more than 10 subordinate pharmaceutical production enterprises and a number of pharmaceutical commercial enterprises in Hubei Province is the strongest production capacity, the most complete dosage forms, the most variety, the most abundant resources of the pharmaceutical enterprises, is the capital market of the most recognized and the most investment value of listed pharmaceutical companies. It is mainly engaged in the research and development, production, sales and technical services of medicine, medical devices, reproductive health and other products and technologies.

In the past 30 years, due to the large-scale acquisitions made by Humanwell Healthcare through bank loans. By the end of 2016, the asset-liability ratio reached 54.66%. Therefore, since 2017, the company has carried out the strategy of "refocusing on core" and started to sell a large

Corresponding author. Email: lxymxbj@163.com

number of non-core assets to repay debts.

On June 13, 2017, Humanwell Healthcare issued the "Humanwell Healthcare Sale of Assets Announcement", which transferred 80% of the equity of its wholly-owned subsidiary Zhong Yuan Rui De to CSL Behring Asia Pacific Limited. This divestiture is hereinafter referred to as the first divestiture. On June 21, 2018, Humanwell Healthcare once again released the announcement of the sale of assets, hereinafter referred to as the second asset stripping. On December 31, 2019, Zhongxiang Medical, a wholly-owned subsidiary of Humanwell Healthcare, signed an Asset Purchase Agreement with Zhongxiang Xingrui Asset Management Co., Ltd. Zhongxiang Medical intends to sell its real estate of Zhongxiang People's Hospital New Area to Xingrui Assets. In 2014, Humanwell Healthcare announced that it would set up about 20 hospitals in the next 3-5 years, but the development was not smooth. First of all, hospital investment is an asset-heavy project with a long return cycle. Secondly, the quality doctor resources of public hospitals are far less than that of public hospitals, so patients will not give priority to them. The brand promotion of general hospitals is not as good as that of specialized hospitals, so it is not easy for general hospitals to gain popularity. As a result, the company rarely makes profits. Therefore, it begins to divest off hospital assets and gradually withdraw from subdivisions with weak competitive advantages or synergies such as medical services, so as to concentrate resources and focus on core business. This divestiture is hereinafter referred to as the third divestiture.

3.Humanwell Healthcare asset stripping case analysis

3.1Motivation analysis of asset stripping

3.1.1Analysis of refocusing motivation

Among the theories explaining the main motivation of asset stripping, "specialization" and "efficiency theory" hold that asset stripping is a kind of value-creating behavior of enterprises to strengthen core competitiveness and improve efficiency [6][7]. "Low valuation theory" holds that stripping assets or business units can highlight an enterprise's main business and enhance the market's valuation of the enterprise [8]. Humanwell Healthcare is the leading narcotic drug subdivision with high quality in China. Its main business is Sufentanil, Remifentanil and other narcotic and analgesic drugs. These two kinds of products have a very stable competition pattern in China . Originally, the main business was clear, but the original management pursued diversification blindly, and mergers and acquisitions were frequent. They not only leveraged and acquired some non-main assets, but also bought back the assets sold at a higher price, which led to a decrease in operating efficiency and an increase in asset-liability ratio[9].

Compared with other pharmaceutical enterprises in the same industry, Humanwell Healthcare has a very high policy barrier for narcotic and analgesic drugs, as well as profound research and development strength. It can focus on core business, increase research and development investment to develop new products, and is expected to maintain a good competitive pattern and achieve sustainable development. In the past three years, the company has implemented the strategy of "refocusing on the core" in its asset reorganization, stripping Zhongyuan Ruide, which makes blood products, and medical services, from the listed body. The overall business layout is streamlined compared with before, which helps the listed company get rid of the dilemma of scattered business resources, tight capital chain and low operating efficiency caused by excessive diversification.

3.1.2Analysis of financing motivation

Table1: Cash flow from Humanwell Healthcare financing activities

Report date	2015/12/31	2016/12/31	2017/12/31	2018/12/31	2019/12/31
Absorb cash received from investments (ten thousand yuan)	257338	24332	183293	8354	9961
Obtain cash received on loan(ten thousand yuan)	385899	959520	894495	927095	1216784
Other cash received in connection with fund-raising activities(ten thousand yuan)	232078	383370	489132	368956	411756
Cash to pay off debts(ten thousand yuan)	408103	344503	596196	802038	1177890
Cash disbursed to distribute dividends, profits, or interest payments(ten thousand yuan)	54811	60267	79214	114906	107175
Disburse cash in connection with other fundraising activities(ten thousand yuan)	148164	379832	384726	449930	639767
Net cash flows from financing activities(ten thousand yuan)	264237	582620	506784	-62469	-286332

As can be seen from Table 1, the cash inflow from Humanwell Healthcare's financing activities is mainly loans, which makes the company's short-term debt repayment pressure, and the cash paid for debt repayment is large. Cash disbursed to distribute dividends, profits or interest payments has also shown an increasing trend year on year, with even negative net cash flows generated from financing activities in 2018 and 2019. In general, the company's financial risk is increased, the capital chain is tight, and it faces greater short-term debt repayment pressure and working capital management pressure. Therefore, the company recovered 3.7 billion yuan of cash through asset sales, optimized the debt structure and eased the pressure on working capital. And the recycled cash will be used for the research and development of core business, to enhance the competitive advantage in the industry.

3.2Comparison of financial performance before and after divestiture

3.2.1Profitability

Profitability refers to an enterprise's ability to obtain profits, which is related to the interests of enterprise owners and creditors. This paper chooses two representative indicators, return on equity and net profit rate of total assets. Figure 1 shows the change chart of profitability index.

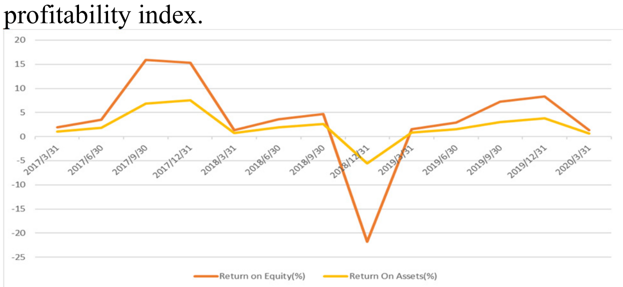

Figure 1: Chart of changes in profitability indicators

As can be seen from Figure 1, ROE and net profit on total assets both increased after the three asset divestments, but the increase was only short-term. Especially in the next quarter of the third asset divestment, ROE and net profit on total assets both decreased significantly. Therefore, Humanwell Healthcare asset divestiture can only improve the profitability of the enterprise in the short term.

3.2.2Debt paying ability

Debt paying ability refers to whether an enterprise has the ability to pay cash and repay debt. In this paper, interest payment multiple and asset-liability ratio are selected to measure the changes in debt paying ability of an enterprise after asset divestiture. Figure 1 and Figure 2 respectively show the changes of these two indicators.

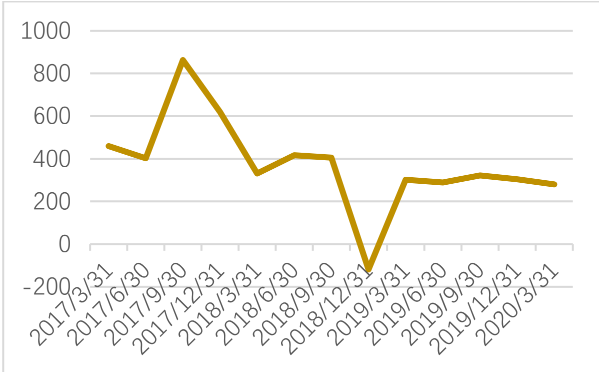

Figure2: Interest payment multiples chart

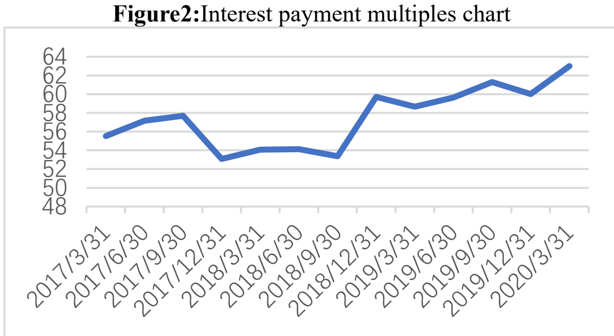

Figure3: Asset-liability ratio change chart

Figure 2 shows that the interest payment multiple has an upward trend after the first asset divestiture, indicating that the solvency of the enterprise has been improved, but the other two asset divestitures have not improved the solvency of the enterprise. As can be seen from Figure 3, the asset-liability ratio of Humanwell Healthcare has been maintained at a high level, and the three asset divestitures have no significant impact on the high asset-liability ratio. Through the analysis of the above two indicators, the company is likely to continue to sell assets, reduce financial risks and relieve the pressure of debt repayment.

3.2.3Operating capacity

Operating capacity refers to the utilization level of assets, that is, the turnover of assets. In this paper, accounts receivable turnover, fixed assets turnover and total assets turnover are selected to represent the operating capacity of enterprises. Figure 4 shows the movement of operating capacity indicators.

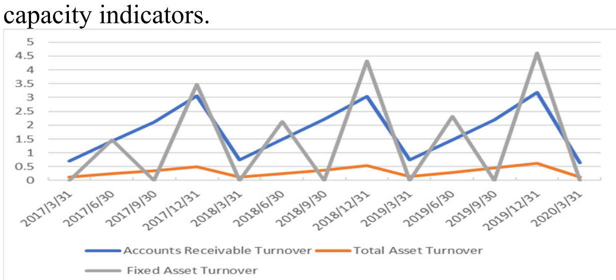

Figure 4: Chart of changes in operational capacity indicators

As can be seen from Figure 4, the three asset divestitures have not significantly improved the company's operating capacity, especially the turnover rate of accounts receivable and total assets. Therefore, Humanwell Healthcare's asset stripping can not effectively improve the operating capacity, improve the utilization level of assets.

3.2.4Development ability

Development ability refers to the potential ability of an enterprise to expand its scale and strength. In this paper, the growth rate of net profit and the growth rate of total assets are selected to represent the development ability of an enterprise. Figure 5 and Figure 6 respectively show the changes of these two indicators.

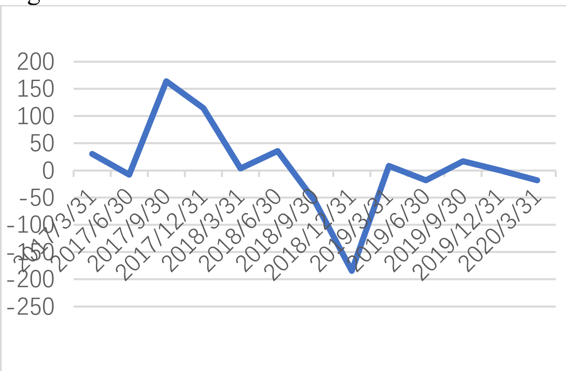

Figure5: Net profit growth rate change chart

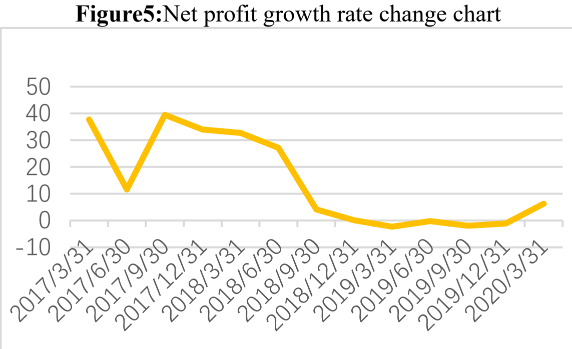

Figure 6: Total assets growth rate change chart

As can be seen from Figure 5 and Figure 6, the first asset divestiture increases the growth rate of net profit and total assets of the enterprise, which improves the enterprise's development ability. However, since asset divestiture will sell the company's assets, the growth rate of total assets keeps declining. In general, these three asset divestitures do not significantly improve the enterprise's development ability.

3.3Comparison of market reaction before and after asset divestiture

Some scholars point out that compared with the difficult enterprises, the sellers' enterprises with good operation have achieved significantly positive excess returns. The reason is that financially strong companies are able to negotiate asset sales from a position of strength to capture a larger share of the seller's premium [10]. The event study method is usually used to study the market reaction to the divestiture of Human Fortune Pharmaceutical assets. The cumulative excess rate of return (CAR) after excluding market fluctuations is selected in this paper to reflect the market performance of Humanwell Healthcare asset divestiture. The base date of the event is the first announcement date of asset divestiture, the window period is [-30,30], and the calculation formula is $CAR_{it}=\sum_{t=-30}^{30} AR_{it}$, $AR_{it}=R_{it}-R_{mt}$, where AR_{it} refers to the excess return rate, R_{it} is the daily return rate of individual stocks in the trading day of t, and R_{mt} is the market index return rate in the trading day of t. The relevant data in this paper are obtained from the National Tai 'an database, and the Shanghai Composite Index is selected as the market index. Figure 7-9 shows the trend charts of AR and CAR in the 30-day window period before and after three asset divestitures.

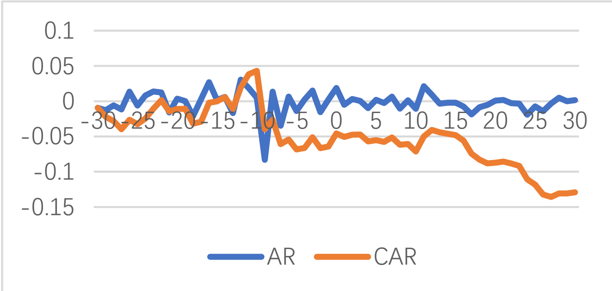

Figure7:AR and CAR trend chart of Humanwell Healthcare's first asset divestiture

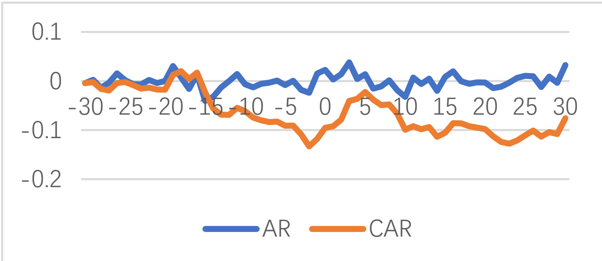

Figure 8:AR and CAR trend chart of Humanwell Healthcare's second asset divestiture

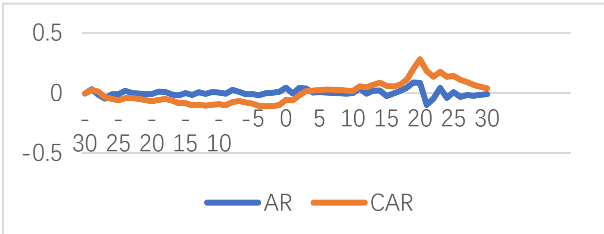

Figure9:AR and CAR trend chart of Humanwell Healthcare's third asset divestiture

It can be seen from the trend chart of excess return of 30 days before and after the announcement that asset stripping did not bring significant excess return to the company, and the change range was small before and after the announcement. Figure 7 and Figure 8 show that CAR values of Human Fortune's first two asset divestitures are positive or negative, but most of them are negative, indicating that the market reaction of Human Fortune's asset divestiture is not very positive. However, it can be seen from Figure 9 that the CAR value after the third asset divestiture is positive, indicating that the market reaction of this asset divestiture is positive.

4.Conclusion

At present, the number of asset stripping is increasing, but the quality of asset stripping is not high. In this case study, the quality of Humanwell Healthcare's asset stripping is also not high, which may be related to the excessive diversification of the company and excessive non-main business assets. In recent years, the asset stripping only sold part of its assets, and other non-core assets need to be stripped further, which makes the effect of asset stripping not obvious. In addition, the information of asset stripping is disclosed in a hurry, and there may be related transactions. Thereby harming the interests of minority shareholders. In general, further research on asset stripping is needed to strengthen the supervision of asset stripping information disclosure, so that more enterprises can achieve sound development through asset stripping. The government should introduce corresponding policies to constantly regulate the behavior of asset stripping.

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