

# 10 Minutes on Making Divestitures Successful\*

What you need to know about emerging topics essential to your business. Brought to you by PricewaterhouseCoopers.

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## Getting the most value out of the sale—in any market

### Highlights

- A well-managed divestiture process allows the seller to evaluate the business from a buyer's perspective and best position it for sale.
- Avoiding delays in deal execution is critical to protect the value of the sale.
- Sellers must start separating the operations of the unit and the parent company at the same time they start preparing for a deal.
- Market uncertainty has many buyers waiting for the right time to act. Smart sellers are preparing for the unexpected, including dual-track transactions (sale or spin-off) or other alternative structures.

**Market dynamics have changed dramatically since the second half of 2007. The credit crisis, volatile stock markets, and recession have put sellers at a disadvantage: they face fewer buyers, more caution, and lower deal multiples. At the same time, those same market forces are exposing marginally performing businesses and are compelling companies to explore multiple options—including divestitures—as a way to raise cash, shed debt, or improve performance.**

**In such an environment, the onus is on the seller to get the deal done. It begins by understanding which dynamics have changed and how effective sellers are operating within the new constraints. The reality is that for the most part, the fundamentals of effective deal making haven't changed; it's just never been more important to apply them.**

### What does today's deal market mean for sellers?

1. High borrowing costs and tighter lending standards—amid a recession—have shrunk the pool of buyers willing and able to do deals. Sellers need to understand buyers' motivations so they can best position their business for sale and anticipate their due diligence requirements.
2. Extremely volatile stock markets have made investors skittish. Sellers should expect intense buyer scrutiny and challenge as well as longer deal timelines. Sellers should prepare accordingly, preventing surprises from derailing a deal, pushing the deal value below asking price, or causing costly delays.
3. Given today's uncertainties, various other options—initial public offering, joint venture, or strategic alliance—may make sense. The most-prepared sellers are considering multiple paths to their ultimate objective.

## At a glance

### Practices of a prepared seller:

- Approach the deal from the buyer's perspective by performing due diligence of its own business before buyers get involved
- Create a dedicated divestiture management team to manage and execute both the deal and the operational separation simultaneously
- Identify and correct any significant operational issues before going to market
- Prepare deal-basis financial statements that represent the unit as a stand-alone entity
- Anticipate critical buyer requests and prepare accordingly to avoid delays and value erosion

### Costly missteps to avoid:

- Have certain unrealistic expectations—especially at the senior management and board levels—regarding what the unit is worth
- Overlook or ignore financial or operational problems with the business for sale
- Fail to tailor key contractual terms—such as postclosing adjustment mechanisms and net working-capital targets—to protect the seller
- Provide inconsistent data for buyers or fail to achieve forecasts set out for the unit, leading to a loss of credibility
- Lose talent—or lose management's focus on the unit's operations—as negotiations drag on

## Package the business for maximum value

In the current market, many companies are underperforming, and potential buyers know it. Buyers submit lower-than-expected bids and ask complicated questions that sellers are sometimes not prepared to answer. A seller that fully understands the market value of its unit is more likely to command its price.

### **Know your buyer and the strengths and weaknesses of your business**

An objective examination by the seller of a unit slated for sale can reveal its value. Such a review is essential, particularly in a market where the gap between sellers' and buyers' pricing expectations is so wide. Diligence in advance also enables the seller to identify and emphasize the unit's strengths as well as to consider alternative transactions and structures from an informed perspective.

### **Fix operational issues before the sale**

Issues that a buyer might have overlooked in the past can easily derail a deal today. Sellers should identify ahead of time any operational issues (such as excess

back-office costs and low plant efficiency) and restructuring options. Even if such actions can't be completed prior to the transaction, buyers must be able to understand and buy in to the expected costs and benefits.

### **Present the business in the most compelling way**

Historical financial results often need to be adjusted to reflect the unit accurately as a stand-alone unit and exclusive of nonrecurring items. Those results should be clearly and convincingly linked to forecasts and key actions to drive future profits.

When preparing financial information, sellers should consider all of the various tax and accounting structures available to them and choose the one that works best from a deal perspective. This can directly impact deal value; experience shows that sellers that present adjusted results alongside reported results, with clear explanations, receive higher opening bids from buyers.

## Prepare for possible questions and concerns—there will be many

Most divestitures are characterized by value destruction from inception to close. But today, the delays and surprises that otherwise would have simply reduced the price may now derail the deal entirely. To protect the value and outcome of the deal, sellers must be prepared to anticipate and neutralize any potential buyer concerns before they arise.

### **A strong divestiture process is critical**

Preparation requires a strong process driven by a dedicated divestiture management team that is responsible for planning and executing the deal quickly and correctly. The team also ensures that possible buyer questions have been answered in advance and all requirements satisfied. This team must be given the time and resources needed to consider and prepare for dual-track transactions or other alternative outcomes for the unit.

The divestiture management team should also evaluate and anticipate the need for audited carve-out financial statements and prepare them in advance to avoid delays.

### **Consistent, relevant information is a must**

Data provided for buyers—within offering memorandums, management presentations, data rooms, and by other means—should be consistent, and all forecasts should be credible and supported. Buyers, for example, will review monthly financial results (both historical and real time during the process), so all forecasts must be realistic. In today's skittish deal market, any inconsistency—real or perceived—can destroy a deal.

### **Be realistic in terms of resources**

Many sellers today are trying to manage all aspects of the divestiture internally despite all the other pressures and responsibilities of running the business. But even a dedicated internal team may not be enough to respond with speed and accuracy to demands for information throughout the process. A seller must arm itself with experienced hands from outside the company—hands that can also bring much-needed objectivity.

## Protect yourself from unforeseen value deterioration

There are many issues involved in the separation of a unit from a parent company that can negatively impact the deal value, especially if left unaddressed until late in the deal process. To preserve the value of the deal, sellers should negotiate these points up front.

### **Determine separation issues early on**

Systems and processes—such as human resources, intellectual property, information technology systems, and employee benefit plans—that often took years to create must be disentangled. The process includes the development of key transition service agreements (TSAs), which provide for services between the seller and the buyer postclosing. Buyers will want not only to outline all of the issues and timelines involved but also to incorporate all TSA and post-TSA costs into their initial valuations.

### **Immediately address stranded costs**

Too often, sellers fail to address proactively the stranded costs that remain when a business gets divested. While such costs do not directly impact deal proceeds, failure to eliminate that stranded overhead in a timely fashion postclose can have essentially the same negative effect on shareholder value. Handling these costs often requires postdeal restructuring by the seller, which should be part of the divestiture plan from the beginning.

### **Tailor contracts to avoid leakage**

Sellers sometimes fail to tailor to the specific transaction certain contract language regarding postclosing adjustment mechanisms. This can give buyers a second bite at the apple—and significantly affect deal value. Anticipating such issues and addressing them in purchase and sale agreements have become more important today than ever.

## Keep your options open by getting ready now

There are still buyers out there. Private equity firms raised \$421 billion globally in the first three quarters of 2008—down less than 6% from the same period in 2007.<sup>1</sup> International buyers and sovereign wealth funds continue to eye US assets—particularly in certain sectors, such as automotive and technology. And companies with strong balance sheets in several industries are exploring acquisitions to take advantage of the current conditions. Nevertheless, a climate of fear and uncertainty has slowed deal activity.

The unpredictability of the current market means it's more important than ever to be prepared for any eventuality. Many sellers are preparing for a dual process (spin-off or divestiture) to be ready to act regardless of which market—equities or mergers and acquisitions—recovers first or in case their own market conditions force them to act. The viability of other alternative structures, including strategic alliances and joint ventures, is also being considered.

### **The cost of unpreparedness is clear**

In the financial services industry, for example, sellers surprised by the speed and scope of the economic crisis are finding themselves with little bargaining power against buyers that can cherry-pick attractive assets and operations and leave others behind. In many of these cases, negotiations move too rapidly to allow sellers to argue the value of those assets. Having waited too long to prepare for the transaction, these companies have little choice but to take what they're offered or scramble for survival as an extended process unfolds.

### **Now is the time to start planning**

Success in uncertain times requires flexibility. Preparing early will enable even pressured sellers to act when necessary, retain negotiating power at the table, and realize the most value from the deal.

<sup>1</sup> Prequin, Ltd., 2008. Q3 2008 private equity fundraising update.

## Upcoming 10Minutes topics

### **Health reform under Obama**

Employer-sponsored health insurance could be in for a jolt as President-elect Barack Obama and Democratic leaders set out to reform the healthcare system as part of their economic recovery. The next 10Minutes will examine their proposals for a new public health insurance option and mandates on employers to offer insurance.

### **Why climate change matters today**

The incoming administration promises that climate and energy policies will work together to breathe life into the economy, combat climate change, and strengthen national security. 10Minutes explores how to link business responses to climate change more strongly with business strategy and corporate performance.

### **Top concerns for boardroom directors**

As a year of unprecedented challenge and change draws to an end, directors are revisiting their oversight of risk management and corporate culture. 10Minutes looks at how the ongoing

credit crisis affects these and other corporate governance issues, sizing up the potential impact on your business.

### **Finance and accounting (F&A) shared services**

Until recently, companies expected F&A shared services centers to reduce F&A costs by 20% to 40% over three to five years. Faced with the current crisis, however, executives can't wait. 10Minutes explores a number of downturn-capitalizing strategies for companies with centers either in place or under development.

### **Realizing enterprise resource planning (ERP) value in a downturn**

Across industries, at one level or another, enterprise applications (and whether they're agile, efficient, and cost-effective) sit at the core of a company's ability to weather the current economic downturn—or capitalize on it. 10Minutes discusses how economic downturns can be the best times to undertake a wide range of ERP-related actions.

## How PwC can help

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