

Divestitures in difficult times:

A survey of U.S. executives on the drivers of divestiture activity and the challenges for 2010 and beyond.

The heart of the matter

Divestiture activity will increase, but not without greater complexity

The economic downturn of 2008 and subsequent global recession have forced businesses of every size and description to rethink their fiscal strategies and models. Some businesses and processes will be slow to recover, while others will gain momentum more quickly as the economy strengthens.

The latter is especially true of divestiture activity, which is expected to increase, although not without its own set of challenges. In light of the recent financial crisis, exactly what has been happening in the divestiture market, and what can be expected in the coming year are relevant questions.

Investigating these questions is the scope of PricewaterhouseCoopers' Divestiture Survey. Completed in September 2009, the survey was designed to gauge the condition of the current mergers and acquisitions (M&A) market as it pertains to divestitures, determine key drivers and success factors and provide some perspective on the near term outlook. Participants included 215 C-suite executives and corporate development directors from public and private companies, as well as private equity-venture capital professionals in all major industry sectors.

The survey conveyed several key highlights.

Job titles of respondents

Chairman/President/Chief Executive Officer	26%
CFO/COO/General Counsel	20%
Head of Corporate Development	10%
General Partner, Partner of Investment Partnership	14%
Principal, Vice President of Investment Partnership	11%
Principal, Vice President of Investment Partnership	19%

More than half the respondents (60%) called the current conditions "clearly a buyer's market," and yet, an additional 30% see changes on the horizon. This reflects optimism among sellers, although they also expect a new set of challenges awaiting them.

More than 60% of respondents said divestiture activity had dropped off or had been deferred in the last 12 months. This suggests a pent-up need to divest when conditions improve, which could lead to an increase in divestitures over the coming year.

Although the survey showed that the condition of the economy and the availability of credit remain significant unknowns for divestitures, 69% of respondents plan for either a similar or increased level of

divestiture activity in the coming year compared with the past 12 months. Again, here is perhaps some cautious optimism. The difficulty is that valuations remain moving targets and significant factors contributing to the stagnant M&A market. Ninety percent of respondents placed the value expectation gap between buyers and sellers in 2009 between 0 and 4 turns of EBITDA. As long as these conditions continue, getting deals done will likely remain a challenge. Interestingly, half of the respondents (50% identified corporate domestic buyers as the source of higher valuations in the coming year.

These headline statistics show some of the issues sellers face in this market. The survey underscores how the divestiture process has become more complex with 51% of those who reported transactions saying they had taken greater than 20% longer to reach completion. The demand by potential buyers for increased access and information was seen as a driver of the extended time frames, again consistent with the limitations of credit and valuation gap that are driving the behavior of buyers.

Although sellers are optimistic as the world slowly recovers from its financial crisis, they will need to overcome the inherent hurdles of a new and evolving marketplace.

An in-depth discussion

Current market conditions

Coming as no surprise, 60% of respondents described the 2009 divestitures market as a "buyer's market," with survey respondents from public and private companies

in equal agreement (60% of each respondent segment).

The survey still showed a ray of optimism, perhaps reflecting the more upbeat tone seen in the M&A market during the third quarter. Thirty

percent of all respondents said that while it's been a buyer's market since the credit crisis hit, it is beginning to change. Again, this response was consistent between public and private company representatives (32% and 31%, respectively).

The poor economy and its related uncertainties were cited as the leading reason for characterizing the current environment as a buyer's market (40%), followed by lack of credit to complete deals (26%) and the valuation expectation gap between buyers and sellers (20%). Again, no big surprise but these findings underscore the reality that the macro market conditions have changed from those existing for most of this decade and sellers must acknowledge these dynamics in their divestiture planning.

When asked to define the current market's expectation gap, 45% of all respondents placed it between 0 and 2 turns of EBITDA and an equal number (45%) said it was between 2 and 4 turns. While the actual price paid for a business is often driven by a number of valuation approaches and negotiations, there is no debate that a valuation expectation difference of potentially 50% will likely be a deal breaker for most transactions. For illustrative purposes, if a business was valued by a seller at 8 times EBITDA given prior market conditions, while current buyers value the same business at 4 times EBITDA, this would represent a 50% value gap. As such, this finding is clearly one of the most significant messages the survey results identified.

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In analyzing the value gap responses further, public and private company respondents generally agreed on the extent of the expectation gap, with 40% of all those representing public

companies and 44% of those from private firms placing it between 0 and 2 turns of EBITDA. In the two-to-four-turns category, 49% of all public company responses and 45% of those from private companies held this view. Although there are some differences in view as to the extent of the gap, the consistent view of the existence of the gap between respondents is certainly the compelling takeaway.

2009 divestiture activity

The survey confirmed the lull in divestitures this past year. The highest level of all respondents (35%) said they had delayed or deferred divestitures this year because of economic conditions. Twenty-six percent of all survey participants reported reduced divestiture activity while, interestingly, 18% reported increased activity. The remaining 21% of respondents reported no change in divestiture activity.

61% of respondents reported divestiture activity was reduced or deferred in the past 12 months.

The trends by type of respondent differed somewhat. Of those who reported there had been a delay or deferral of activity due to economic conditions, 36% of all private company responses fell into this category as opposed to 25% of all public company responses, suggesting private companies were more affected. Regarding reduced activity in the past 12 months, 29% of respondents were from private companies and 15% were from public companies. In the increased activity category, 22% of responses were from public companies and 18%

were from private companies. These results may simply suggest that public companies are more likely to continue making decisions regarding business strategy throughout difficult cycles given shareholder demands, availability of capital, etc., than private companies.

Projected 2010 activity

When asked about expectations for 2010, 69% of respondents offer a reason for cautious optimism, with 39% expecting to increase divestitures and 30% forecasting activity to stay the same as the current levels. Less than one-third of the respondents expected reduced or deferred activity.

69% of respondents said they planned similar or an increased level of divestiture activity in 2010.

Of those who foresee an activity boost, the primary reason for holding this opinion was that corporations continue to desire to sell off noncore or non-performing businesses. This reflects the experience of PwC's Transaction Services professionals who have noted an increasing emphasis by client companies on refocusing, restructuring and reorganizing their businesses, particularly in terms of analyzing the appropriateness of acquisitions made in the last 10 years.

In terms of macroeconomic factors affecting the future market, the extent of the economic recovery was the overwhelming response, cited by 87% of respondents as the most important.

Domestic corporate buyers were forecast to be the primary players

in the 2010 market by 56% of all respondents. Public and private company respondents were in close agreement on this, with 51% of all public respondents and 53% of private firm representatives selecting domestic corporate buyers as the most likely acquirers. This anticipated return of strategic buyers falls in line with PwC's Transactions Services practice experience that companies are acquiring businesses that strengthen their positions by filling a gap in their business models. It also suggests that private equity is not expected to play as big a role in acquisitions as it has in the past given the continued constraints on lending.

Domestic corporate buyers were forecast to be the primary players in 2010 and the source of most improved valuations.

Domestic financial buyers, however, were selected by 23% of all respondents to take center stage next year. Agreement between public and private respondents was not so close, however. Eighteen percent of all public company survey takers selected domestic financial buyers, as compared with 28% of all private company respondents. Perhaps public companies have not forgotten the number of transactions with private equity buyers that didn't quite get across the finish line when the market dynamics changed virtually overnight and are not willing to take that leap again quite yet.

When it came to choosing which prospective buyer group would be the best source of improved valuations in 2010, domestic corporate buyers were the choice of

50% of all respondents. Public and private company responses were similar; 45% of all public company respondents chose domestic corporate buyers and 47% of all those from private firms. This is not surprising considering that corporate buyers may be more motivated to reach consensus on price in order to achieve their overall strategic purpose which is often growth oriented and can expect to generate synergies. It is also consistent with the reality that absent some significant change in the credit markets, the ability of private equity to obtain the leverage that it did earlier in this decade to pay higher multiples than corporate buyers is doubtful.

The divestiture process: it is growing more complex

So what happens when you combine a buyer's market with limited financing to get transactions completed? The survey results answer this question by clearly showing that the divestiture process is getting more complex, creating even greater headwinds for potential sellers. Of the survey participants who said they completed transactions in the past 12 months, 51% said they had taken at least 20% longer to conclude and an additional 21% said completions had taken at least 10%-20% longer than in prior years.

51% of respondents said divestitures had taken at least 20% longer to complete.

Consistent with this, the survey indicated that 43% of these respondents reported that potential buyers are asking for some additional

information and access and an additional 32% said buyers were requiring extensive additional information. Although this is partly because buyers today have leverage in negotiating transactions, it is also a result of lenders' stricter requirements than existed several years ago. Adding to this is the reality that many businesses are underperforming due the economy, hence increasing the risk and buyer due-diligence requirements.

This is a clear indication that sellers in this market would be wise to invest time and effort to perform due diligence on themselves before going out to market. Many buyers are suspicious that a divestiture is a simple way for companies to rid themselves of a problem asset. To combat that concern, it is essential to ease buyer concerns about the seller's motivation, the reasons a business is underperforming, if it is, and why it will do well outside the selling company. Providing credible financial information will ease the negotiation process.

When those who reported divestiture activity in the past 12 months were asked to rate the importance of having audited financial statements available for a divestiture target, 49% said it had become more important now than in previous markets and 27% referred to it as critical. This again underscores the need by sellers for sound process and preparation, as learning late in the process that an audit will be required will likely only delay or derail the sale process.

In general, companies appear to struggle with their divestiture process. When asked to compare their organizations' acquisition and divestiture processes, 46% of all

participants said their acquisitions process was better defined. In addition, 39% said they had no formal pre-divestiture review process that was performed consistently. Considering the tough market conditions, the survey results suggest companies may better achieve their goals by improving their divestiture review processes.

When asked to identify the most complex part of a divestiture, especially a carve-out, 25% of all survey participants selected finding a buyer, followed by executing the separation of the business (23%) and producing carve-out financial statements and recasting historical results (21%).

Public and private company respondents differed in their view of the most complex component of a divestiture. Finding a buyer was the No. 1 difficulty of 29% of all private company respondents, while executing the separation was the first choice of 35% of all public company survey takers. Experience suggests that public

companies in particular must undergo significant time and effort to complete a carve-out, given the often shared nature of many services and personnel. Although buyers were willing to take greater risk in carve-outs in very competitive seller's markets, as existed in the earlier part of this decade, that is not likely to be the case today. A seller needs to present the business for sale as it is expected to operate from the buyer's perspective, and this will often take extensive time and analysis.

Private companies struggle more with finding a buyer whereas public companies struggle with executing the separation.

In terms of identifying the most complex aspect of the financial reporting involved in a divestiture, the allocation of costs and other carve-out requirements was

selected as the most difficult, cited by 25% of all respondents. Too often a seller limits its concern to what a buyer will need to review; although that is critical, as discussed here, the implications to the seller in terms of its own financial reporting are equally important.

Respondents also appear to be interested in finding creative ways to close divestiture deals. A majority were open to considering seller financing, joint ventures or other structures when divestitures cannot be completed using traditional methods. Twenty-seven percent of all survey participants said these alternatives are already under consideration where appropriate, while 19% said they are likely to consider seller financing and 18% said they are open to joint ventures or similar transactions. This is no surprise as sellers continue to deal with the reality that completing transactions has become more complex, therefore requiring greater creativity and flexibility.

What this means for your business

Over the next year, the business world slowly will emerge from the shadow of the worst economic crisis since the Depression. No one, however, will remain unchanged, and those that adapt to new models and strategies are the ones most likely to move forward with vigor. Certainly, the divestiture market will be subdued in the coming months, but the new year shows promise for rapid growth. As organizations develop plans for the expected upswing in the economy, strategic buyers will enter the market in greater numbers. The re-emergence

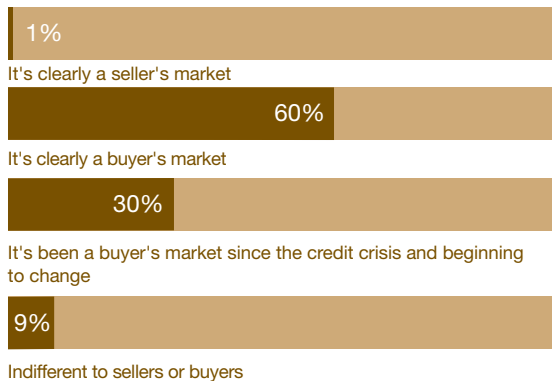
of strategic buyers and sellers will stabilize valuations, although with a gap between the two for the foreseeable future.

Uncertainties over the economy and availability of credit could counter the positive signs in the M&A market, one reason sellers will face buyers demanding more detailed information about a target company. Historically, divestitures take longer to complete than acquisitions, and this emphasis on due diligence will only extend the process. Gone are the days

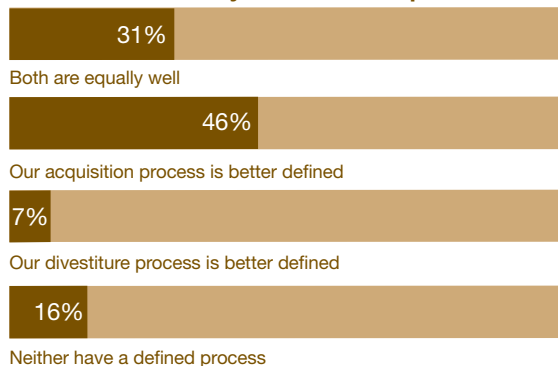
when a seller would put out a "for-sale" sign and be rewarded with competitive offers. Now, sellers must embrace a more challenging economic environment by paying closer attention to managing the divestiture process. If they hope to close deals and capture value for their assets, they must better understand the new complexities of the divestiture market, the full scope of buyer concerns, and how the financial meltdown of the last year has changed not only the rules of the game, but the playing field itself.

Divestitures market: survey summary of key findings

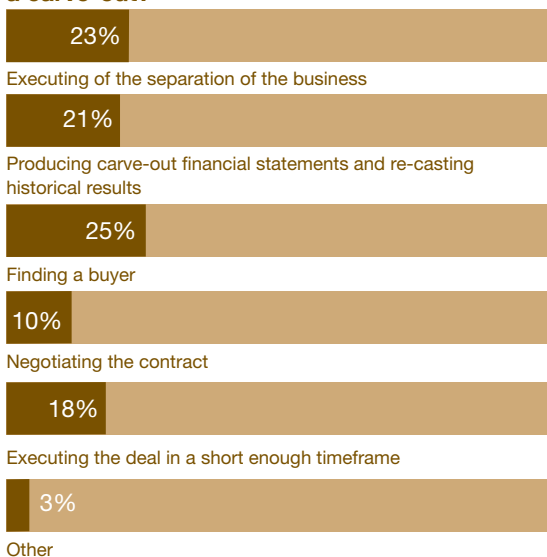
Compared to 2000-2007, how favorable do you feel the current market is for divestitures?



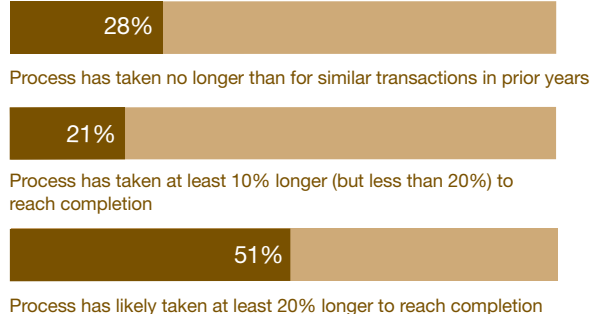
Compared to your organization's acquisition process, how well defined is your divestiture process?



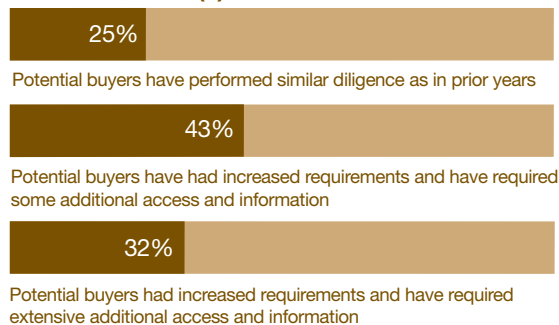
From your historical perspective, what is the most complex part about doing a divestiture, particularly a carve-out?



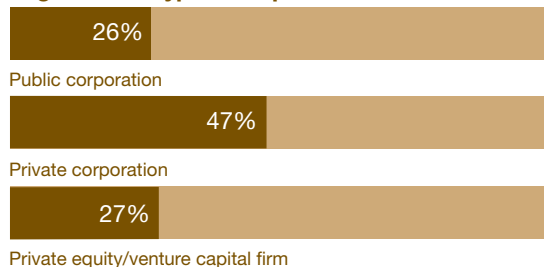
How has the time required to complete divestiture transactions changed in the last 12 months? (1)



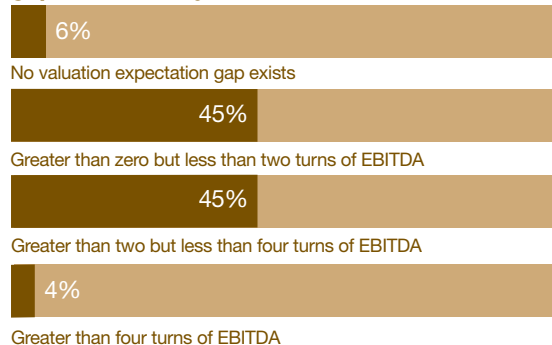
How have the due diligence and information requirements of potential buyers changed in the last 12 months? (1)



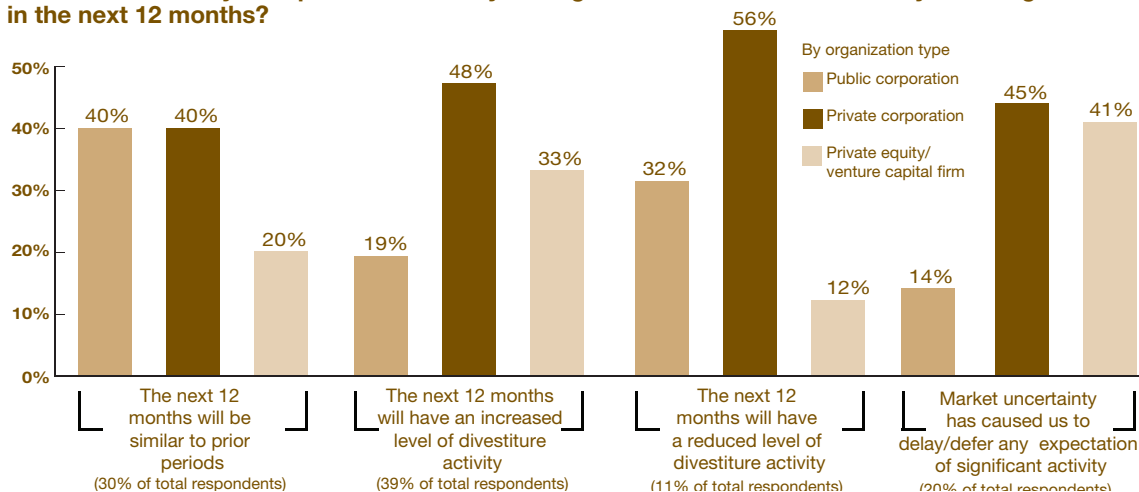
Organization type of respondents



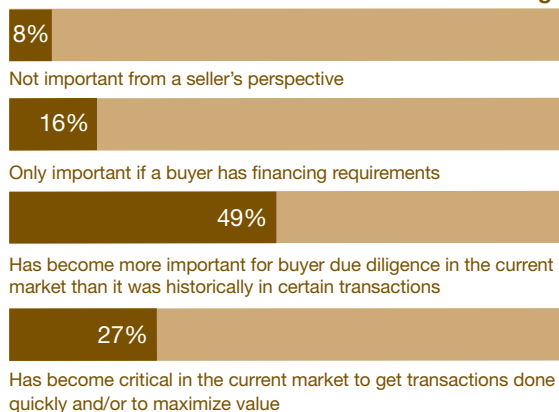
Using EBITDA multiples as a basis for this question, how do you assess the extent of a value expectation gap between buyers and sellers in 2009?



To what extent do you expect the level of your organization's divestiture activity to change in the next 12 months?



Given your recent divestiture experience, how important do you believe it is to have audited financial statements available for a divestiture target? (1)



Source: PricewaterhouseCoopers Divestiture Survey, September, 2009

(1) Footnote: Data reflects responses only from those who reported divestiture activity.

Would current market conditions make you willing to consider seller financing, joint ventures or other structures when traditional divestitures can't be completed?



Professional perspectives

Attention to process will help sellers navigate today's divestiture market

As the PricewaterhouseCoopers survey confirmed, buyers remain in the driver's seat in the current M&A market. While macro reasons cited by survey respondents for this situation are factors that sellers cannot control (such as the uncertain economy and the continuation of a tight credit market), experts at PwC's Transaction Services practice believe proactive management of the

divestiture process can help sellers increase their chances for success.

Divestitures have always been hard work and have gotten even more difficult this past year, a view confirmed by the 72% of respondents with divestiture transactions in the past 12 months, reporting deals took at least 10% longer to complete. Buyer requirements for more due diligence information were the primary reason cited by 75% of the respondents for

the prolonged timeframe. In light of these heightened requirements, experts say managing the process has never been more important to sellers than it is today.

Sellers face a new environment

Clearly, prospective sellers must approach things differently today. "Companies are in a mode of refocusing, reorganizing and restructuring themselves right now,"

says Bryan McLaughlin, a partner in PwC's Transaction Services practice. "They've used the last nine to 12 months to take stock in their strategy over the past 10 years, particularly in terms of their acquisitions and product lines, to assess whether they are strategically focused for the next 10 years. Consequently, 'returning to the core' has emerged as a common theme for many organizations."

In addition to the lack of available financing resulting from the current credit market, the valuation expectation gap between buyers and sellers remains a challenge to getting deals done. Forty-five percent of survey respondents placed it between 0 and 2 turns of EBITDA and the same percentage said it was between 2 and 4 turns. These dynamics underscore the importance for sellers to be prepared and to package their businesses in the most compelling light.

"Sellers need to put themselves in the shoes of the prospective buyers," says Mark Ross, a partner in PwC's Transaction Services practice. "You have to present your business in the most compelling way possible, and, in order to do that, you need to truly understand its strengths and weaknesses and address both before entertaining prospective buyers. A seller needs to do its own due diligence of the business to be sold as its first step."

Ross advises scrutinizing the presentation of historical and forecast information. "You need to be sure that

the financial information is consistent and credible. In the past six months, we've seen numerous instances in which a buyer got in to look at a company only to discover it was underperforming significantly versus plan, and walked away. As soon as information begins to unravel, you lose interest and value, something sellers can't afford in this market."

"A 12- to- 18-month forecast that bridges to historical results is essential, and those numbers must be defensible," says Ross. "In most transactions, there are often numerous different issues and adjustments that can be presented in alternative supportable ways. Sellers need to carefully review each of these items to determine what presentation is the most meaningful, particularly in a carve-out situation." The takeaway here is that although a seller may not be able to influence the current multiples being offered, it can often make a positive difference by how it presents its financials, and this can translate into higher value.

Commitment and advice make a difference

An effective divestiture process, according to PwC's Transaction Services professionals, has four primary components: management commitment, effective project management, setting of appropriate expectations and access to good advice.

"The survey showed that corporate divestiture processes are often

not as well designed as those for acquisitions," McLaughlin says. "Divestitures often place additional stress on a company and distract management from its primary responsibility: running the business."

Divestitures require that an organization's team of legal, finance, human resources, and other professionals work symbiotically to complete the transaction. In this environment, managers need a mechanism to mitigate conflicting priorities and internal politics and ensure that multiple cross-functional dependencies are achieved. Process helps accomplish this.

Regarding access to expert advice, McLaughlin believes this addresses what survey respondents chose as the most complex components of a divestiture: finding a buyer, producing carve-out financial statements, and re-casting historical results. "These are not easy tasks," he says, "so, working with professionals who have that precise background and experience can truly help to relieve the burden on a seller."

Until market dynamics change significantly, sellers will likely continue to find themselves with limited bargaining power against buyers. Preparing early and fully however, will enable sellers to have greater influence over the process, retain buyer interest and negotiating power and ultimately realize the most value from the deal.

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Mark has been a partner at PricewaterhouseCoopers since 1999, and is the site leader for the Transaction Services Miami practice. He has led numerous divestiture efforts for underperforming and/or non-core divisions of large public companies and leads the firm's initiatives surrounding divestitures.

Bryan is a partner in the firm's Northern California Transaction Services practice. He has advised on numerous capital markets projects in both the U.S. and Europe, and currently leads the west coast divestiture advisory services efforts.