Take Control of Your Divestiture

Although the first quarter of 2013 saw significant declines in M&A activity, the economy appears to be recovering and the U.S. stock markets have reached record highs. While the stock markets appear upbeat, other factors indicate that there is still plenty of economic uncertainty. Europe is dealing with a debt crisis and U.S. unemployment rates have remained stubbornly high. In this environment, it is probable that divestiture activity may increase. Sellers should be aware of several factors as they consider the possibility of a divestiture.[1]

In general, sellers should recognize how current economic sentiment will affect the sale of their business. Although general economic factors have improved over the last few years, the recent recession means that many of the businesses that are currently being sold may show several years of uninspiring revenue growth. Also, in some cases, businesses are being sold to help companies restructure their balance sheets or to deal with increased regulations. In these instances, sellers may need to work harder to develop realistic revenue projections to help maximize their sales price.

Additionally, to drive efficiencies and improve margins, many companies have sought to realign their business models and processes through consolidation. That realignment may have increased the complexity of carving out a business since there may now be greater integration across product lines, functions and geographies.

Take control

Companies that are interested in selling non-core assets or who want to be acquired need to be prepared well in advance of the actual sale. "Selling an entire company or business unit is extremely challenging. However, several leading practices can greatly enhance the sales process and maximize shareholder value," according to KPMG's John McPhee. "One of the most important actions for the seller is taking control of the process," he says.

Buy-side due diligence has been professionalized for many years. But frequently, sell-side processes are less formalized and sophisticated. In order to create a smooth process, avoid surprises and help maximize value, sellers need to be in control of the process. "This means that sellers should conduct a rapid readiness assessment of the business for sale well before the selling process begins," according to KPMG's Steve Miller. "Sellers are advised to conduct their own due diligence of their businesses, using the same lens that a buyer would apply," McPhee advises.

During this process, a seller should assess the readiness of the business for sale. This includes knowing the key issues a buyer will raise, and conducting an analysis of what information is available and what needs to be created. The analyses should cover: legal entity structure, historic financials, business plan and forecasts, tax, pensions and separation issues.

This assessment will highlight critical issues and gives the seller the information it needs so that it does not launch into the process without adequate preparation. According to Phil Isom, Head of KPMG Corporate Finance, "In order to execute a successful transaction and position the company for sale, sellers need to answer fundamental questions and address all relevant business and legal issues." These should include: what is the perimeter of the transaction (what is included in the sale and what is retained), tax implications, the extent of work to be done pre-sale, how to address due diligence issues and enhance the value in advance, what information is available and how reliable it is, what is a realistic timeline for the process and what resources will be required.

One of the most difficult moments during the sales process—and one that all sellers should seek to avoid—occurs when a buyer discovers a significant "problem" during its due diligence. This can be especially damaging if the due diligence reveals a problem that was previously unknown to the seller itself. That scenario creates a loss of seller credibility and makes the buyer suspect other problems may exist. Taking control of the process is vital to avoiding surprises.

[1] A more in-depth version of this analysis can be found in the white paper, "Exit Right M&A: Delivering successful divestments," which is available at kpmg.com.

Create a robust information package

"Part of management's job is to make the business being sold as attractive as possible to each potential buyer," says McPhee. This requires an understanding of not only the value of the business, but also how the business will create value for a specific buyer. Therefore, a sales message may be somewhat different for a private equity (PE) vs. a corporate buyer.

Value is won or lost depending on whether a seller presents a coherent and consistent information package which underscores the key sales messages, supports the upsides, and counteracts potential downsides. The information presented needs to be tailored to the likely bidders and their anticipated due diligence and related questions and must be substantially considered before issuing a Teaser or Information Memorandum.

The key elements of this package may include:

- Summaries of the financial information linked to the key value issues;
- An explanation of the bridge between historical results and the projected results and cash flows;
- Business plans, and upside analysis;
- Carve-out financial statements;
- Stand-alone cost estimates;
- Synergy analysis;
- Management presentations;
- Financial models;
- Data room materials which support the information package, including contracts, the Transitional Services Agreement (TSA) and Sale and Purchase Agreement.

"Based on KPMG's corporate finance investment banking experience, it is important to deliver consistent key sales messages to a comprehensive buyer universe in order to maximize value for the business," commented Isom.

Understand the true cost of separating a business

The cost and operational implications of separation can have significant impacts to value that are often underestimated, according to Miller. Separating a business is a complex procedure that needs to be mapped out in great detail. A separation blueprint should be created that determines how each functional area within the business is expected to operate through the transaction, the nature and extent of transitional and long term agreements required to help ensure operational integrity, a transitional timeline, and the headcount implications and the cost impacts of the divestiture.

Separating a business usually involves five types of costs. Incremental recurring costs are annualized costs/savings that arise from moving a parent company's billing and allocation system to one that belongs to a stand-alone business. "One-off costs," are those such as recruitment, a new IT system or terminated leases. TSA costs are those that arise for services between the retained business and the sold business. Double running costs occur when the buyer is building the capability it needs to exit a TSA, but is not there yet. Finally, "stranded costs" are those left with the seller for overhead allocations that were previously charged to the sold entity. Each of these needs to be understood by the seller.

Think like a buyer

It is important for sellers to understand that buyers will be seeking to identify issues in the business or areas of uncertainty that they can use to negotiate a price discount. Anticipating what these issues are and preparing responses in advance will allow the seller to be better prepared during price negotiations and help maximize the ultimate sales price.

"Soft" issues should be addressed

Managing the soft people issues is critical to securing the best value for a divestment. In general, there are three distinct constituents that exist within the seller's organization and who need to be considered. These include the M&A team that is eager to complete the transaction; the management team of the business being sold; and the management team of the retained business. Keeping in mind that people mentally separate long before an actual sale takes place, the seller should understand the potential for value destruction from such behavior and develop a communication plan into the sales process that provides checks and balances to help ensure maximum value is delivered for the seller.

Conclusion

Sellers need to be creative and thoughtful about planning for divestments. The divestment process needs to be tailored to the specific transaction and incorporate a set of leading practices to avoid surprises and deliver maximum value for sellers.

For more information, please contact:

John McPhee
Partner, Transaction Services
T: 415-963-7557
E: jmcphee@kpmg.com

Steve Miller
National Lead U.S. Integration/Separation Practice
T: 281-216-5015
E: stevenmiller@kpmg.com

Bill Steciak
Principal, Accounting Advisory Services
T: 312-665-8975
E: wsteciak@kpmg.com

Phil Isom
Principal, Head of Corporate Finance
T: 312-665-1911
E: pisom@kpmg.com

kpmg.com