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Divestiture X's and O's: Why a Playbook for Divestitures is Your Best Way to Combat Value Leakage

How Developing a Structured Framework Can Help Companies Get the Most Out of Divestitures

M&A transaction activity has been on the rise, as more companies consider growing through acquisitions while divesting parts of their businesses that do not align with their overall strategies. With global and domestic M&A activity at an all-time high during the first half of 2018[1], it is more imperative than ever for companies to be prepared to execute transactions efficiently and effectively, thereby maximizing enterprise value.

Most large organizations have corporate development teams for this purpose, hiring top talent with investment banking and transaction advisory backgrounds. But because healthy companies tend to focus on growth, corporate development teams often are not as well equipped to execute divestitures as they are acquisitions. Carve-outs are intrinsically more complex transactions which present a greater risk of missing initial deadlines and prolonging the overall amount of time spent on the deal. This in turn increases the amount of "value leakage" incurred during the transaction period. Value leakage, a commonly overlooked metric in a divestiture, refers to the total value lost between the time an asset sale process is initiated to its consummation. This can come in the form of personnel costs, one-time costs, or diminished enterprise value. Implementing a customized divestiture framework can help companies sell assets more quickly, minimizing the risk of value leakage and maximizing the final selling price.

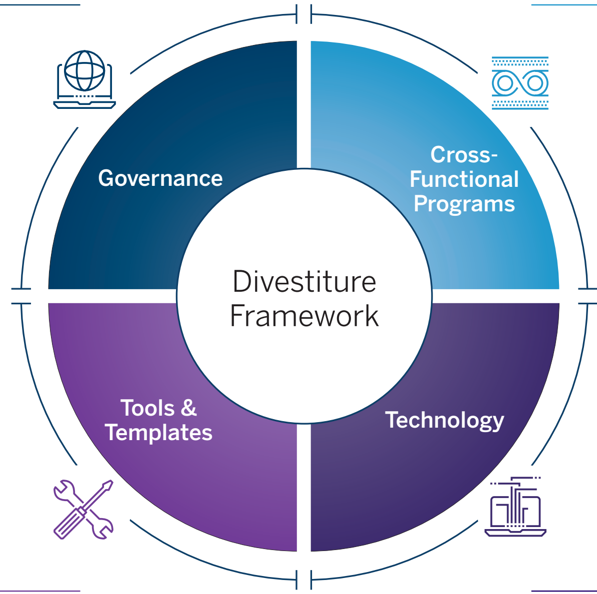
This paper will focus on the four primary areas that serve as the backbone of a well-structured divestiture framework: Governance, Cross-functional Work Plans and Processes, Tools and Templates, and Technology. Although the final framework will vary based on each company's particular needs and strategies, the primary themes within each of these components apply across all organizations pursuing divestitures.

The sections that follow describe common challenges that companies face during the divestiture process, how a framework can help overcome these issues, and what companies can do to develop their overall transactional capabilities.

1 https://www.axios.com/mergers-and-acquisitions-all-time-high-first-half-2018-5fde1567-0b81-44d9-b438-42c250681399.html

- A set weekly communication cadence resulting in more efficient discussions and reducing overall need for ad hoc calls and meetings
- Defined roles, responsibilities and organizational structures to promote individual and functional team accountability and task ownership

- Detailed functional work plans to provide cross-functional visibility on upcoming deal deliverables
- Post-signing separation planning kick-off meeting to give buyers confidence in the seller's ability to separate by the targeted close-date



- Standardized set of template which can be leveraged for ongoing and future transactions to save time
- Guides and training tools to help teams leverage industry-leading practices on due diligence, buyer interaction, separation planning, etc.

- Centrally located work plan and status dashboards, reducing time spent on manually collecting inputes and distributing files to stakeholders
- User access and version control prevent multiple and outdated docuemnts from being used in analysis or uploaded to the VDR

Governance

Establishing a proper governance structure that defines the roles and responsibilities of the various stakeholders throughout the divestiture cycle is a key aspect to successfully running a divestiture. In most instances, corporate employees have minimal transactional experience, if any. Therefore, detailed documentation of the role each person has in the carve-out will help address any questions each stakeholder may have about his or her individual responsibilities in the process.

Without appropriate governance, sellers risk incurring unnecessary costs and missing deliverable deadlines, extending the overall deal timeline and resulting in value leakage. For example, in a transaction where the seller's IT team is unaware that developing the user acceptance test (UAT) plans for the systems offered in the Transaction Services Agreement (TSA) is their responsibility, they will be working under the presumption that each function will create plans for their respective systems. This misalignment will lead to UAT plans being finalized late in the separation planning process, resulting in systems not being fully tested prior to the closing of the deal. This in turn will raise concerns by the buyer, and the seller may be forced to commit additional IT resources to be on stand-by in order to resolve potential issues that come up on Day 1. In this instance, potential delays and misunderstandings can be avoided if responsibilities are documented and communicated to their functional teams ahead of time.

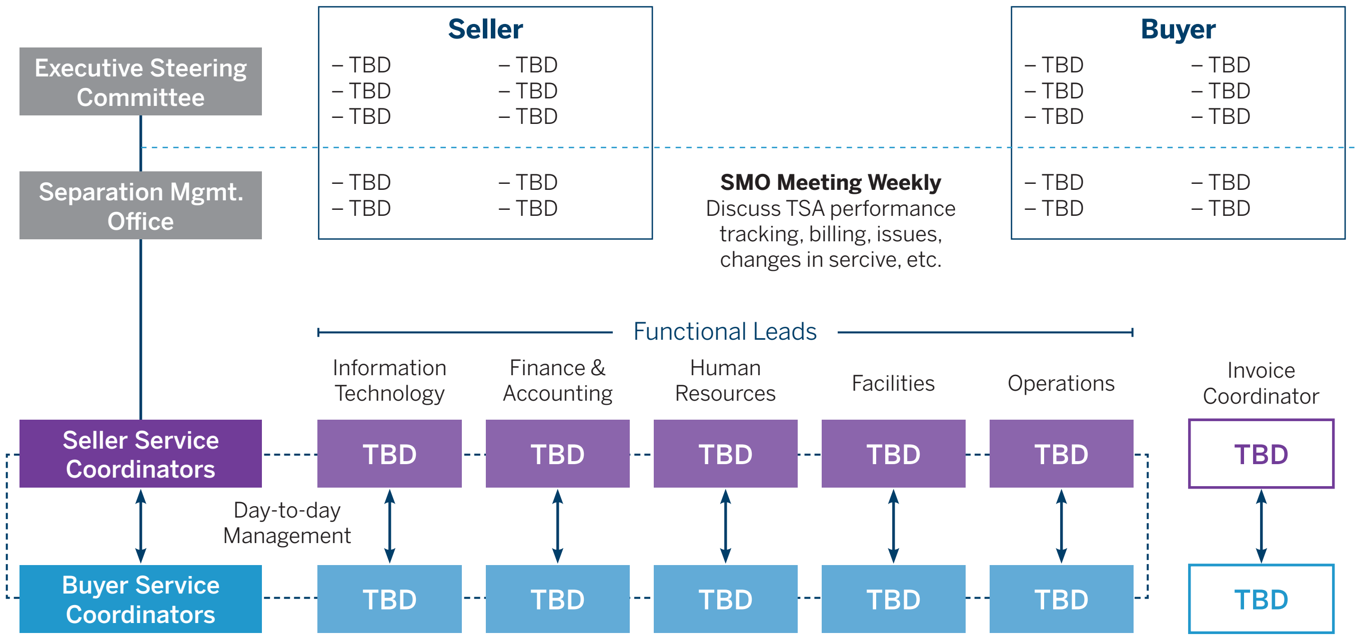
Transaction organizational charts and weekly communication cadences are also critical aspects of a governance framework that should be documented and distributed to all stakeholders. Having this structure in place helps outline the connection between the executive steering committee, the corporate development organization, and the functional subject matter teams. These communications should address not only the seller teams, but also the responsible buyer teams for the separation planning and Day 1 readiness process.

A recommended approach is to conduct comprehensive kick-off sessions to review organizational charts and weekly communication cadences during the post-signing phase. This will provide clarity on who the key players are and how teams will communicate with each other during the separation process. An agreed-upon meeting cadence will help both sides stay aligned on outstanding tasks and upcoming due dates and provide dedicated time to discuss cross-functional issues and dependencies with all necessary stakeholders in attendance.

Cross-functional Work Plans and Processes

In organizations where corporate employees do not possess divestiture experience but are attempting to undertake the responsibilities of managing one, the seller may be facing constant "fire drills" and missed deadlines – common symptoms of value leakage. More severe consequences can also occur, such as legal risks, which can prove costly and greatly impact the financial aspect of the deal itself.

In one recent example, a seller's procurement team discovered only after signing the deal that they had to receive vendor consent for the enterprise contracts offered in the TSA prior to Day 1. Upon starting the process, it was discovered that one of the vendors was not going to provide consent, resulting in a potential breach of the seller's TSA obligations. This led the buyer to question the seller's separation readiness for Day 1, resulting in the seller having to perform damage control through buyer meetings. The



seller eventually decided to pay the vendor for individual licenses, which came at a 20% premium. The added license costs and the time spent on the additional buyer meetings could have been avoided had a structured divestiture framework been in place.

This is also where cross-functional work plans and processes protect value during the divestiture process. Work plans and processes provide visibility into key tasks and work flows within a divestiture lifecycle and can help prepare companies for Day 1 more efficiently without putting the transaction at risk.

In this instance, a properly detailed separation process document would have revealed to the seller's procurement team that they needed to begin checking vendor consents ahead of buyer negotiations to verify which contracts could be included as part of the TSA. From a Day 1 readiness perspective, documenting the current-state and future-state work flows for all processes offered within the TSA will help ensure a smooth separation, minimizing the risk of disruptions to business operations.

Foreign site cash balance agreements are another example where a seller could incur value leakage due to a lack of work plans and processes. For example, a seller who has agreed to a zero cash balance for foreign countries as part of the purchase agreement may find that its treasury team is unaware of this clause, which will lead to a rushed effort to sweep cash balances from these accounts. In this instance, the seller may end up paying fees and leaving cash in some locations due to withholding taxes and regulatory mandates. The total cost of the seller's mishap can be exorbitant, excluding the additional time that teams had to spend on resolving the issue, which could have been avoided if a structured framework was in place.

Another common area sellers often overlook is the management of internal and external communications around the transaction. Having a schedule of how and what sellers should communicate during each phase of the divestiture process is pivotal in relaying the strategic value that the transaction will bring to employees, customers, and other stakeholders on both sides.

Some other internal seller work plans and processes that should be considered include a TSA billing coordination work flow, an issue escalation and resolution process, and a guide around buyer communications. For example, in the previous scenario, a buyer communications review process could have minimized the issue of inexperienced functional teams submitting documents to the Virtual Data Room (VDR)that included more information than what is normally shared prior to signing. This "oversharing" may have led to the buyer revising its targeted enterprise value and resulting in a lower bid.

Tools and Templates

Tools and templates provide selling organizations with a starting baseline in developing deal deliverables. This, in turn, gives sellers more time to focus on creating and executing value-adding tasks, such as issue and risk mitigation, and on buyer interaction. Having tools and templates in place also instills buyer confidence that the seller is prepared and positioned to execute the deal efficiently.

By showcasing the framework tools and templates used in prior deals, sellers are more able to show the buyer their transactional experience early in the process. When buyers are confident that sellers have the capability to run a deal, the overall process will typically run more efficiently despite the separation complexities involved in a particular transaction.

Tools can also come in the form of guides for sellers when performing common transactional activities such as estimating stand-alone and stranded costs or pricing TSAs. TSAs frequently are underpriced, which often results in significant value leakage, essentially providing buyers with a service at the seller's expense. When this occurs, not only does the seller leave money on table, but the transaction timeline is extended. A recommended approach is to develop a guide for pricing a TSA, by leveraging leading practices, such as the use of benchmarks and a bottom-up approach. Simple tools such as these guides can often help sellers avoid common pitfalls and minimize value leakage.

Examples of other tools and templates include status dashboards, a RAID (Risks, Actions, Issues, Decisions) log, TSA billing invoices, buyer diligence guide, and the target operating model. Tools and templates should be standardized and stored in a centralized location for teams to use in future deals.

Technology

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Closing Remarks

Investing the time and resources to develop a framework can help fill the gaps that organizations may have in their knowledge of, and capabilities within, the transactional lifecycle. Companies should assess where they stand in the process maturity cycle and consider developing a framework tailored to their overall strategies, especially as transaction activity continues to grow. Doing so can help augment their corporate development teams' competencies and adhere to divestiture deadlines, minimize value leakage, reduce dependencies on external resources, and streamline the divestiture process as a whole.

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