



Beyond Carve-out: The New Divestiture Playbook

Unlock the hidden value from your next divestiture

More than simply ways to generate cash, divestitures are value-creating opportunities, just like acquisitions.

Organisations have traditionally gone down the path of creating shareholder value through mergers and acquisitions. Indeed, many have become quite adept at the process, and have established rigorous management steps with in-house capabilities to match.

However, as a world of stable markets and steady, predictable growth recedes into the rear-view mirror, there's a continual drive towards simpler and clearer business models – focussing instead on what remains 'core'. In the effort to provide more compelling value propositions, strengthen the balance sheet and generate more predictable cash flows, divestitures¹ are strategically becoming more attractive, if not necessary.

Some executives shy away from divestitures, often holding onto assets far too long. Maybe there's a concern about the impact on corporate earnings, or that it will be seen as a failure of some kind. But the logic is straightforward and compelling: if another party is prepared to pay more than the business is worth – more than the business will generate for your group over the coming years – then they are indeed value-creating opportunities, just like acquisitions.

At BTDD we encourage a positive value-creating approach to divestitures, and challenge organisations to look beyond the common urge to simply 'get rid of the asset' and 'do the deal'. In our experience, this traditional approach is a sure-fire way of selling a business for a 'song' with shareholder value forever lost. Instead, we suggest that divestitures are given the same management rigour, support and focus on value – again, just like acquisitions. Organisations taking the value-creating approach will be rewarded with much higher transaction premiums, and therefore more value returned, than the more typical asset offload approach.

Beauty in the eye of the beholder

Our value-creating approach comes from a recognition that every divestiture contains 'buried treasure'. Buyers are often quite prepared to pay far more for a business than the seller's own estimate. The reasons why a buyer would pay a premium are wide and varied; too many to list out here, but in general they revolve around a buyer's ability to exploit value from the business in ways the seller simply can't; making them the better owner. It's important for the seller to know who that better owner would be and 'walk a mile in their shoes': their profile, their plans for the acquisition, what challenges they would face, and what would motivate them to come to the negotiating table.

Buyers come in all shapes and forms, but broadly speaking there are two types. **Corporate buyers** are seeking new operations to complement their existing business. As a result, they will want to integrate the carve-out assets into their

¹ In this article we use the term 'divestiture' to equally refer to 'divestment', 'disposal' or any similar business entity sale activity.

BTD's playbook helps business leaders map out the treasure-finding journey and provides clear steps to get there.

own operating structure. **Financial buyers**, such as private equity firms, can be looking to purchase a standalone operation to enhance and further grow before it's sold to another company; integrate it into portfolio company as part of 'buy and build' strategy; or float it through an IPO. Knowing the type of buyer will help the seller craft a value-creating approach and price premium in the sales process.

It should be said at this stage that the more potential buyers, the more competitive the situation becomes. A seller should therefore try to use an auction or competitive bidding process to avoid being boxed in by a demand from one buyer for exclusivity. By having multiple buyers, each can be played off against the other. Even the perception of multiple interested parties can help to maximise the sale price.

Attracting a price premium comes down to two things: *preparation* and *communication*. **Preparation** is about packaging a business so that it becomes a going concern, running as independently from its parent as possible. This makes it easier for the buyer to understand the business and how it would integrate into their own operations, so minimising the buyer's transaction risk and accelerating their own value creation. It also means valuation, due diligence and negotiation is centred on the business being sold and how it would add value to the specific buyer quickly. **Communication** is then about guiding potential buyers to the 'buried treasure' in the business, compelling them to act.

Over the past 18 years, BTD has provided M&A, integration, divestiture and separation advisory, planning and execution services across dozens of transactions. While every divestiture has its own unique set of challenges there are nonetheless common strategies, process steps and tools that can help the seller *prepare* and *communicate* the value of their divestiture.

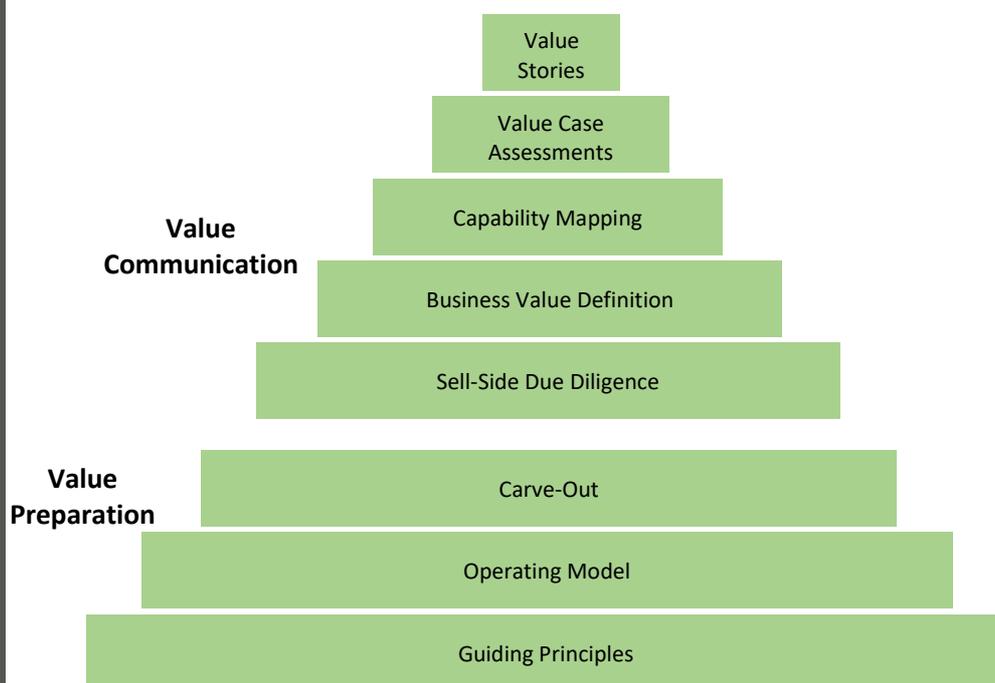
BTD's Divestiture Value Equation



BTD has incorporated the best of this experience into a divestiture playbook aimed at unlocking hidden value and maximising the sales premium. This article shares key aspects of our approach and playbook and explores a few case studies in which this was applied.

A near-standalone entity is a much more attractive proposition to a potential buyer.

The Divestiture Value Pyramid: Building the Case for a Value-added Divestiture



Preparation: Guiding Principles

Successful divestitures are built on a set of foundations known as guiding principles: A set of beliefs, precepts, values and maxims; short, sharp strategic statements that indicate the course of the divestiture and its intended goals. While some principles define a set of values and code of conduct, others express a shared organisational focus that's both specific and actionable.

The guiding principles will be different for every divestiture, but regardless of the motives for selling the business they should address these questions:

- What level of leadership commitment is required?
- What kind of governance is required to keep the divestiture on course?
- What are the likely operational challenges?
- What priority does this divestiture have over other business initiatives?
- What is the business currently worth and what is an acceptable premium?
- How can those within the carved-out entity feel like they're part of the team?
- What are the primary sources of value that buyers would be interested in?
- What are the stories we want to be telling potential buyers?
- Is transaction speed more important than deal value?
- What type of buyer will be motivated to purchase and why?
- How can we gather a pool of potential buyers who are likely to pay a premium?

Rather than something soft and impractical, Guiding Principles for your divestiture are critical to ensure everyone involved in the exercise is clear and agrees on the why and the how of the deal process, to help steer the what of individual process steps and activities.

Rather than something ‘soft and impractical’, these guiding principles are critical to ensuring everyone involved in the exercise is clear and agrees on the *why* and the *how* of the deal process, to help steer the *what* of individual process steps and activities. The creation of clear statements provides simple and direct messages capable of being cascaded and inculcated to relevant stakeholders. They provide the contextual understanding, empowerment and direction on the role they need to play during the course of the divestiture. If this isn’t done, control of the agenda is lost leaving it to others make it up as they go along.

Preparation: Operating Model

Stepping up the pyramid, operating model analysis and design is used to describe the elements of the business and how they are to contribute to creating and delivering value to customers. It is an essential part of any M&A toolkit as it provides the much-needed connection between strategy, operations and execution.

We regularly see operating model analysis stopping at organisational design. Even when it goes beyond this to other areas, it is often not done very well. This is unfortunate as it represents a core component of the divestiture process. Beyond financial, legal and tax considerations, operating model analysis and design provides much-needed clarity on how the divested business is intended to work post-sale. In fact, understanding operational links and entanglements is usually one the biggest issues executives face when divesting a business. Without operating model clarity, the pain of surprises increases, resulting in costly transaction delays and lower buyer confidence.

A well-designed operating model, on the other hand, depicts how the business is intended to work at deal close, and upon Transitional Service Agreement (TSA) exit (if there is one). This is a significant topic requiring a separate discussion altogether. However, it’s worthwhile just outlining the key attributes that should be part of any operating model:

Processes: how the business creates and delivers value. Typically, these would include ‘Order to Cash’, ‘Opportunity to Order’ and so on. For any business there can be a dozen or more key processes responsible for driving customer value.

Organisation: how the various groups and individuals are linked to the delivery of products and services.

Information: systems and applications that provide information and enable the value chains.

Data: what key data is required to support the processes (both digital and physical), what groups and systems generate and ‘own’ it, and who has access to it.

Suppliers: business partners who collaborate in the delivery of products and services.

Governance: processes used to set targets, make decisions, resolve issues and measure performance.

While there's often a good deal of merit to extensive TSAs, most of the time this results in reducing the number of interested buyers and minimising the sale price. It delivers a false economy while simply kicking the can down the road.

Done properly, operating model analysis and design is essential to driving the carve-out process down a clear path towards clearly-defined divestiture goals.

Preparation: Carve-Out

The guiding principles and operating model design will define the direction and key parameters for the carve-out exercise itself.

Finance, Tax & Legal Carve-Out

Essential to any carve-out transaction, comprehensive financial statements for the business being divested will have a large impact on deal mechanics and transaction timing. To maximise deal value and maintain credibility among buyers, it pays to be diligent in their preparation.

The seller can also benefit by looking into tax-saving opportunities in the business to be divested; and any potential savings in corporate cost allocation. These savings directly impact profit margins and are of considerable interest to potential buyers. Similarly, a well thought out legal structure for the carve-out will help drive tax efficiency, what legally will be sold (assets vs. shares), and how the transaction should be structured.

Once the financial, tax and legal requirements for the carve-out have been identified, management needs to turn its attention to operations.

Operational Carve-Out

Planning, time and resources will certainly be required to operationally carve-out the business from its parent. It can be a time-consuming and resource-intensive affair. As a result, there's often a marked reluctance from management to take this work on, or to give it the effort it deserves. As mentioned previously, divestitures are not always seen as value-creating opportunities. There's a strong temptation to lump all carve-out work together and do it under a post-deal transitional service arrangement between the buyer and seller. After all, it reduces the need to lock up time and resources to do the carve-out until after the deal is done. Secondly, it's a way of getting the buyer to pay for the work through an agreed set of Transitional Service Agreements (TSAs) and associated fees. While in some cases there's a good deal of merit to this, most of the time it results in reducing the number of interested buyers and minimising the sale price – it delivers a false economy while simply kicking the can down the road.

To maximise sale price, try to keep control of the sale agenda, reduce deal risk and increase the pool of interested parties. It therefore pays to carve out the entity so it can operate standalone as far as possible, regardless of who the buyer might be. From the buyer's perspective, a near stand-alone entity is a much more attractive proposition. It makes it much easier to value the asset, perform due diligence and avoid any nasty operational surprises or delays. Importantly, it instils buyer confidence and helps reduce and simplify the scope of negotiation down to the business being sold.

Seller due diligence can help reduce surprises during the transaction, increase the pool of potential buyers and so reduce the threat of buyers trying to negotiate the price down.

Naturally, there will be areas where the carve-out cannot occur without a better understanding of the buyer and their intentions. This is to be expected. It may even be preferable to leave something for the buyer to do as part of the value/price proposition. This is where a well-structured TSA, created from a position of mutual trust, can be used as an effective negotiating tool prior to signature.

Communication: Sell Side Due Diligence

Sell side due diligence is the first and most crucial step in the value communication exercise. Potential buyers will do their own due diligence, so they can understand and evaluate what they're intending to purchase, but it helps considerably if the seller does same thing to help shape the ultimate conversation. A thorough sell side financial and operational due diligence prior to opening a dialogue with potential buyers will give you a deeper understanding of risks and issues that may impact deal value. This also provides the opportunity to fix such problems or change the approach and plan before going any further.

Such seller due diligence can also help reduce surprises during the transaction, increase the pool of potential buyers and so reduce the threat of buyers trying to negotiate the price down. It also helps shorten the time buyers decide to spend on their own due diligence efforts navigating through unfamiliar data room documentation.

Communication: Business Value Definition

The financial aspects of the divestiture derived from seller due diligence need to be ably supported by an operational understanding on the way the business delivers value to customers. To help potential buyers see how value is delivered, it's helpful to convert the operating model analysis and design into a series of value-focused deliverables that communicate and educate. Examples include:

Business Inventory: more than the typical 'asset register' found in sales & purchase agreements, the business inventory lists every aspect of the entity that is to be sold in detail: employees, buildings, equipment, IP, policies, software, insurance arrangements, contracts, supplier agreements, customers, etc.

Value Chains: a map showing each of the process steps in value generation, who performs the work, where processes are shared, and how they link to shared-service processes (e.g. procurement, AP, AR and so on).

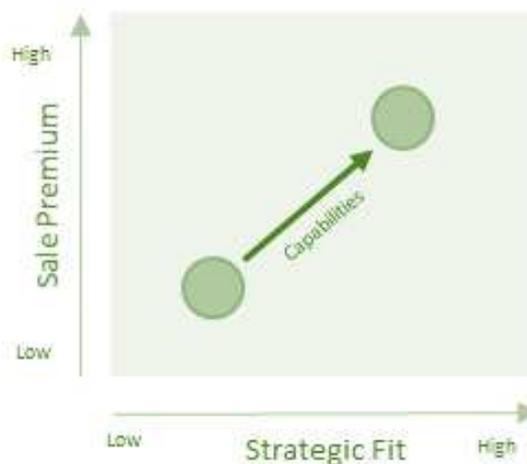
Performance: a table laying out the types of people, incentives, accountabilities and cultures.

While financial analysts may focus on spreadsheet valuations, and lawyers on deal structure, attention to organisational capabilities can make the biggest difference of all.

Communication: Capability Mapping

Capability Mapping is a cogent way of identifying, understanding and communicating the things the business is really good at, what makes it unique and differentiates it in the market – the ‘secret sauce’.

A capability is the combination of people, tools, processes, proprietary knowledge or technology, and organisational design that deliver value propositions to the customer. While financial analysts may focus on spreadsheet valuations, and lawyers on deal structure, attention to these capabilities can make the biggest difference of all.



Buyers (corporates in particular) pay a premium when they better understand how capabilities from the divested business can be seen to fit with their own operations, or strategic goals.

The methodology behind capability mapping is simple and intuitive. Call out the small number of key things the business does that makes it competitive. The elements in the operating model that deliver upon these capabilities are then broken down, analysed and pieced to together like stepping stones from left to right (to use the theatrical metaphor, the left is back stage and internally focused; the right is on stage and customer focused).

The result is a value chain that moves from the back-stage inner workings of a business, through to business processes, and then followed by the on-stage customer-facing elements.

Capability mapping is a systematic and powerful method for demonstrating strategic fit between the seller and buyer. Potential buyers get to understand not just the value of the divested business but also how they can profit from it.

When done well, storytelling allows the seller to control the sales narrative and agenda.

Sessions with buyers will invariably have the documented facts and figures, but it's the stories that create meaning, grab interest, inspire confidence and lower defences - a great set of stories changes everything!

Communication: Value Case Assessments

Moving further still up the pyramid are Value Case Assessments. It is common for a business entity to have been targeted for sale for some time. Opportunities to invest and grow the business may have been left wanting, starved of the necessary capital or operational injection of funds, leading to a drift in operating performance. Seeing the writing on the wall (if publicly known or an open secret), high-potential employees may have already voted with their feet. Key capabilities, once the source of competitive advantage, may have weakened and fragmented over time.

Value case assessments are business cases tailored for buyers justifying the undertaking of work that deliver business benefits in excess of the costs involved. The development of value case assessments can help potential buyers with the much-needed evidence that justifies the link between historical operating results and future prospects.

Organisations are never short of opportunities. Developing value case assessments gives management and staff a platform to describe their view of much-needed investment opportunities to enhance and grow future operations. Similarly, buyers will readily seize upon these to help justify their value assessments and the stories they develop for their own audience.

Communication: Value Stories

At the top of the pyramid are the stories that weave together a rich narrative around the business, its vision and growth prospects. *“Humans think in stories rather than facts, numbers or equations, and the simpler the story, the better.”*²

Telling and listening to stories is part of who we are. When done well, storytelling allows the seller to control the sales narrative and agenda. Sessions with buyers will invariably have the documented facts and figures, but it's the stories that create meaning, grab interest, inspire confidence and lower defences - a great set of stories changes everything!



It was Aristotle through his 'artistic proofs' of ethos, logos and pathos who showed all those years ago that there's a way to communicate that helps persuade with depth and meaning. These days much emphasis is put into data and data rooms – the

world of M&A is awash with data. But never forget that data in itself means nothing, unless it's given meaning - human beings are *meaning seeking creatures*.

² 21 Lessons for the 21st Century, Yuval Harari, 2018

Every hunt requires a reliable map, leadership commitment and a skilled and trustworthy crew.

During the bidding process there will be multiple occasions to meet and engage with potential buyers. Probably the most important of these, and most formal, will be the management presentations to each of the prospective buyers.

Here's the opportunity to weave stories and anecdotes that bring together the hard, financial facts, the way the business works, the key capabilities and areas for investment. Naturally, care needs to be taken not to overdo it. An over-reliance on storytelling will make the buyers think there's only anecdotal evidence instead of hard facts. In such high-profile events, the value communication exercise will need to be crafted and rehearsed a number of times before entering into the buyer's den.

Conclusion

Maximising deal value doesn't happen on its own. Sometimes executives get so immersed running the business that they lose sight of what might make the divestiture intriguing and exciting to others. Hence the reason why divestitures are so often treated like an afterthought with the desire to rush through the sale process and 'do the deal'.

The Value Pyramid from BTD's new divestiture playbook represents a different kind of thinking. By taking a value-creating approach it assumes there is 'buried treasure' inside every divestiture. It therefore goes beyond the normal carve-out approach by helping sellers unlock the value and profit from it.

ABOUT THE AUTHOR

Toby brings over 20 years of experience leading a range of M&A initiatives across several industries in the United States, UK and Australia.

He spent a substantial part of his career working for Bankers Trust until it was acquired by Deutsche Bank in 2000. Since then he has focused almost exclusively on M&A-related initiatives, advising organisations around the world on synergy realisation, operating model design and project management support throughout the entire deal process. Over recent years Toby has focused on divestitures - helping organisations successfully separate and sell a carve-out in a way that adds value to the seller.

Toby holds an honours degree in Aeronautics from Imperial College, London and an MBA from the Macquarie Graduate School of Management. He is a member of the Australian Institute of Company Directors (MAICD).

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Case Study:

Delivering a smooth and successful separation requires attention on more than IT systems.

Background:

Our client was a major manufacturing firm with operations in North America, Europe and the Far East. In 2018 they agreed to sell its largest business unit to a private equity firm for \$360m. Representing the original division of the business from its inception over 150 years ago and generating approximately 50% of its revenue, the carve-out and separation of this entity from the rest of the organisation would be logistically and technically challenging, and emotionally charged. While our client acquired many firms over the years, this was in fact their first divestiture for many years.

The Challenge:

More than simply the separation of IT systems, our client knew they would need broader experience of how to complete the separation of people, processes, facilities, data and more; and resources to make sure it took place smoothly and quickly. With a multitude of business, technology, people and communications activities to co-ordinate and complete prior to close, they needed not just thought leadership and experience, but also a mature approach, tools and processes to help the assembled teams on both sides of the transaction define and complete the work at hand, under a tight schedule and within an environment of confidentiality and employee uncertainty.

The Solution:

BTD was asked to assess, design, prioritise, plan and lead the activities needed to prepare the business for sale completion, then less than two months away. Using a small team of highly-experienced specialists, BTD led the process to complete the carve-out by Day 1. This allowed management to remain focused on business-as-usual, and helped the new owner take on a high-performing business post-close without interruption. BTD brought deep knowledge of what needed to be done; tailor-made solutions to direct and empower the teams; experienced project management; and structured collaboration with the buyer – in short, a clear vision of the future, a plan to reach it, and help getting there. This gave the client carve-out teams the transparency, accountability and focus they needed to complete the heavy workload; while providing their executive team confidence and peace-of-mind that risks and disruption were being managed along the way. To help minimise potential issues and resource strain post-close, BTD also delivered and implemented a comprehensive operations guide to support every transitional service active in the months post-Day 1.

The Result:

Through their partnership with BTD, the closing process turned out to be smooth with no impact to business continuity on either side of the deal. The client – and the buyer - were glad they had selected BTD: “It was absolutely the right choice” they told us. With BTD’s guidance and advice, the remaining post-deal transition work continued on a clear of path for success.

Case Study:

Selling assets specifically designed to add revenue to their bottom line.

Background:

BTB were called in to help carve-out a business and work with management to create a sales process aimed at maximising transaction value.

The board and executive understood that a successful sale would require time, resources and plenty of planning. We established the governance and management disciplines early in the process. It was a complex exercise as the business was deeply integrated with the parent however the operational carve-out was going well. Potential buyers knew what they were going to get and were comfortable in the knowledge that they would be able to take over the business as a going concern.

The Challenge:

Unfortunately, the first offers were below expectations. Management rightfully felt the bid process could be made more competitive with higher offers being made.

We saw the opportunity to dust off several old internal investment opportunities that previously went unfunded and give them a new lease of life. These included various memos, documents and other artefacts suggesting that with proper funding and resources the business could be performing far better than it currently was.

The Solution:

With the help of management and staff, buyer-specific value stories – supported by compelling and robust business cases – created the link between historical and forecasted operating results. It effectively created a promissory note waiting to be cashed in following the sale.

The Result:

After a number of management presentations, the potential buyers saw the business in a new light. The executive and corporate advisers successfully sold the business at the desired premium, equating to tens of \$millions, 20% higher than previously offered.

This experience taught a simple lesson: when you are selling part of your company, don't just offer buyers a potential asset; give them the tools and vision of how to gain value from it.

Case Study:

Understanding what carve-out means and ensuring it can be fully delivered before deal completion.

Background:

Recently BTD was engaged by a listed high-tech business to help them acquire a global computer analytics business put up for sale by the parent firm.

The buyer saw a unique opportunity to complement cutting-edge computer analytics with their current business offerings. Unlike previous acquisitions the buyer had made, this deal was special, representing a transformational opportunity to reposition themselves in the market and grow revenue like never before.

The Challenge:

However, there was a problem. The seller was going through financial difficulties and wanted to sell quickly. The buyer, on the other hand, wanted to acquire the business and its IP as a standalone operation, and not be exposed in any way to the seller's financial position post-close. For this and a number of other reasons, it was a risky deal.

To compound the problem, the seller had almost no experience in separating or selling a business. Significant effort had already been expended in carving out financial statements and creating new tax and legal entity structures pre-deal. Beyond this, based on their own perception of what was required and external advice from traditional deal advisers, the seller believed there was nothing more to do.

And all the while, the agreed time to complete the deal was rapidly approaching.

The Solution:

At the buyer's request, BTD worked with the seller to map out the remaining operational carve-out work so the business could operate as a going concern once the transaction closed. This was initially met with some resistance from the seller: *"But we have already completed the carve-out!"*. After intense work with the seller up-front, they quickly recognised how the business operations must be made sufficiently discrete for the transaction to take place: systems, IP, data, organisational accountabilities, physical location of staff and systems, contractual obligations. Once clearly defined, the work required to ensure that proper ownership and control could be achieved at sale was significant and was tightly project-managed within a few short weeks.

The Result:

The entity was successfully carved out from the parent company as a stand-alone entity – people, processes, systems, and more – on time and within budget; and, most importantly, in time for sale completion.

It was powerful lesson for the seller: Think like the buyer, carve-out the business ahead of time and don't let it become an obstacle to the deal.

ABOUT THE AUTHOR

Toby Tester is a specialist in M&A Integration, and a Partner of Beyond the Deal. In addition to leading M&A and integration programmes, Toby advises businesses on corporate and acquisition strategy; operating model design; integration strategy, planning and execution; and turnaround of poorly performing acquisitions.

Before working with Beyond the Deal in 2014, Toby was an independent consultant who worked with the major consulting firms in M&A integration. Based in Australia, Toby's work has taken him across Europe and the US.

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BTD is an independent specialist firm providing M&A, divestment, integration, and separation support to businesses around the world.