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Divestiture Survey Report 2013

Sharpening your strategy

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January 2013

Will your divestiture strategy hold up in 2013?

It's hard to imagine a year beginning with more economic uncertainty than 2013. Many are wondering, how will the last-ditch efforts to head off the fiscal cliff play out? Will the slow economic recovery continue or could we be hit with another recession? How will European economic challenges influence the capital markets?

In the first nine months of 2012, U.S. divestiture volume was down 14 percent, by far the lowest level over the past six years. At the same time, the average deal size has increased by 16 percent (from $129 to $149 million[1]), making the magnitude of each transaction that much more impactful for both buyers and sellers. Will this continue in 2013 or can we expect a return to the strong deal-making volume of 2011?

1 Source: Thomson One Financial

As you plan your annual corporate development goals, many questions about your divestiture strategy may emerge. Is now a good time to divest? How do I receive a desirable value for my business? How do I motivate employees around the transaction? What are the preferred uses of TSAs?

To understand how companies are addressing these and other issues, Deloitte surveyed approximately 150 professionals who have been involved in divestitures or carve-outs. Survey respondents were from companies that varied in size from less than $500 million to multibillion dollar global enterprises. Perspectives span across the public and private sectors, domestic and international operations, and a broad range of industries. Read on to learn what we found in our survey results and insights from Deloitte's experience in the marketplace.

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As the U.S. economy strengthens, divestitures are becoming more a matter of strategy than survival. During the challenging economic conditions of the last few years, many divestitures were driven by the need to reinforce balance sheets, raise capital, and improve financial positions. While the ups and downs of the economy and market conditions will likely still play a big role in 2013 decision-making, divesting is becoming an important tool for implementing corporate strategic goals and making a statement in the marketplace. With this heightened strategy comes a wave of tactical considerations to contemplate as you consider the important question: to divest or not to divest? And if yes, how to divest and to whom? Using divestitures to advance corporate strategy demands careful financial analysis to prepare a deal for market, a clear communication strategy for disseminating divestiture plans to stakeholder groups, and a recognition of the need to be sensitive to employee morale during the process.

Deloitte surveyed nearly 150 executives regularly involved in divestitures to assess the past experience of their companies, their outlook for the future, and the challenges they face.[2] While some findings were consistent with the results of Deloitte's 2010 survey, we did notice the emergence of some new, noteworthy themes.

Lead the way
Carve-out trends and leading practices

Companies are increasingly looking at divestitures in terms of strategic goals such as getting rid of non-core assets, rather than simply financial survival. But many companies are failing to undertake the strategic preparations needed to get the price they want.

Sellers looking for a fast close and multiple bidders may want to consider a new tool: seller diligence.

A preference for domestic buyers continues, but larger companies are often more inclined to look across borders. Companies with a global perspective can increase bidders and value.

Many companies that bled talent in the recession are now rebuilding corporate development teams so they can make divestiture a core part of their strategy — from annually evaluating business units to preparing them for increased buyer value.

TSAs may not always be the cheapest, more effective option, and if they are used, it's important to define costs and an exit plan.

2 In this report, a divestiture or carve-out is defined as the sale of a subsidiary or a portion of a company's business, whether a plant or other facility, product line, business unit, or division.

Focus more on strategic, rather than financial, considerations

Many companies are increasingly realizing that divestitures need to become part of their core strategy rather than simply a way to improve finances. Eighty-one percent of executives surveyed indicated that pruning their business of non-core assets was one of the two most important reasons for divesting, up from 68 percent in the 2010 survey. In contrast, only 37 percent of executives surveyed selected financing needs as one of the two most important reasons to divest, down from 46 percent in 2010. As the economic recovery strengthens corporate balance sheets, the need to raise capital or unload poor performing assets appears to have become less important in driving deals.

Be a prepared seller

Careful preparation, including approaching the sale from the buyer's perspective, is important to increasing transaction value and reducing time-to-close. According to the survey, in choosing a buyer, *highest price* is ranked as one of the top two factors by 76 percent of executives, followed by *speed and certainty to close* by 54 percent. Yet many companies are not doing everything they can to prepare for the sale — only 55 percent of survey respondents say that *performing detailed pre-sale due diligence* is a key task in bringing a deal to market, and less than half say their companies evaluate individual business units at least annually to determine whether they should be divested.

Don't neglect people issues

Keeping employees motivated and providing clear line-of-sight into the divestiture strategy is critical to retaining and mobilizing talent around executing the transaction. Companies should prepare employees for change and help them manage through it. More than 90 percent of executives surveyed indicated managing employee morale is very or somewhat challenging when attempting a divestiture. Yet, only 46 percent of the companies surveyed establish a retention/incentive plan for management of the business for sale in their planning.

Consider cross-border deals

U.S. companies have historically preferred selling to domestic buyers, but a global perspective can result in more bidders and higher value. Fifty-nine percent of executives surveyed say their companies prefer domestic corporate buyers, down from 70 percent in the 2010 survey. While the overall trend is moving toward a global view of potential buyers, many companies are still limiting their target buyers to select geographies and potentially leaving money on the table.

Learn to manage TSAs/stranded costs

Transaction Service Agreements (TSAs) are viewed as a necessary evil by many companies, but they can be used as a strategy to close deals. Plan for them by developing accurate costs, defined service levels, and detailed exit plans. More than 50 percent of companies surveyed would prefer to avoid TSAs, but 80 percent of companies surveyed do provide TSAs if necessary to close the deal. Given these figures, it is in the seller's interest to be prepared to provide services and reduce the need during integration planning. In the survey, after TSAs, stranded costs were named as the biggest challenge once the deal closes. Addressing stranded costs requires a detailed program that considers the required cost/expense footprint for the entire organization.

Emerging trends

In addition to the survey findings, this report reflects the experience of Deloitte LLP's practitioners in divestiture services. Here are highlights of what we are hearing from the field:

- Demanding, impatient buyers are forcing tough deal negotiations.
- Good deals are pricing very well, with private equity bidding aggressively. But bad deals are struggling to close.
- Sellers are starting to focus more on preparation than in the past.
- Sellers are also working to close the gap between go-to-market and closing, which means less time for diligence.
- The mid-market is where the action is.
- Cross-border buying is driving a lot of deals. But cultural challenges should not be underestimated — they take time, patience and perspective.
- Corporate development teams are re-tooling and re-staffing after being cut during the recession. Companies are looking for creative ways to handle the ebb and flow of deal activity.

Economic uncertainty makes divestiture planning a challenge

The uncertainty over how the federal government might act to prevent the economy from falling off the so-called "fiscal cliff" made business planning for 2013 especially challenging. In late 2012, there was growing evidence the recovery was picking up steam in the U.S., with stronger than expected GDP growth and the unemployment rate dropping below eight percent. Yet, despite recent clarity on the fiscal cliff, the business community may continue to be cautious in decision making.

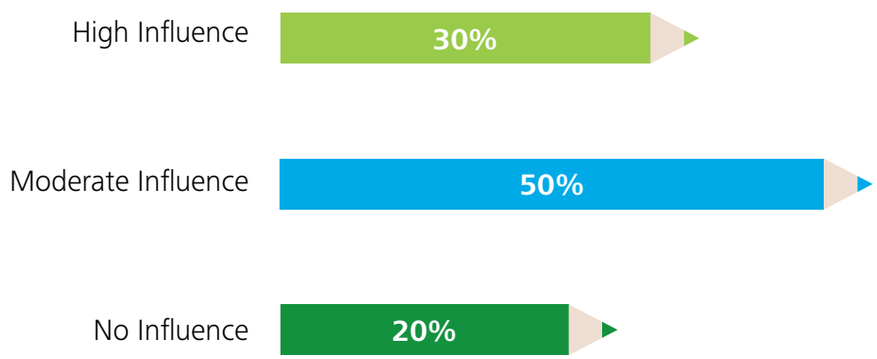
Both global and U.S. divestiture volumes were down significantly in 2012. Global volume was down 14.6 percent for the first nine months of 2012 compared with that period for 2011, the lowest volume in the past six years. In contrast, the first nine months of 2011 were the strongest three quarters in volume since 2005.

Global divestiture volume declined because of a dramatic drop in U.S. divestitures. U.S. volume was down 14.3 percent for the nine months ending September 2012 from that period a year earlier. That's the lowest level over the past six years and down 33 percent from 2006. If U.S. deals are removed, global divestiture volume in the first nine months of 2012 was actually higher than it was in 2006 and 2007. The decline in divestitures in 2012 may be partially explained by strengthening balance sheets, which reduced the need to raise money, especially compared to 2011 when companies were still climbing out of the recession.[3]

Mixed outlook for 2013

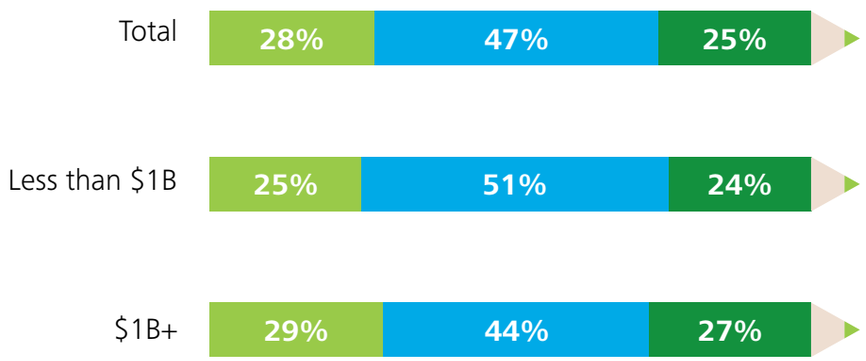
When surveyed in October–November 2012, most respondents indicated economic conditions would influence their company's decision to attempt divestitures in 2013, but few thought they would become more difficult to complete. (Figure 1) The survey results also indicate that executives, in general, expect 2013 divestiture activity to mirror what we have seen in 2012. These findings are both consistent with an outlook for near-term economic uncertainty and suggest the likelihood of continued strategic and opportunistic divestiture activity.

Figure 1: Expected influence of economic conditions on divestitures in 2013



3 Source: Thomson One Financial

Figure 1a: Expectations of divestiture activity in 2013



"The M&A market continues to be a buyer's market. Buyers are driving tough negotiations, especially around divestitures, and while financing conditions have improved, economic uncertainty continues to drive the need for speedy deal execution. Both buyers and sellers need to be prepared and rigorous in their M&A process to sign and close before market conditions swing due to geopolitical or global economic shocks."

Andy Wilson
Partner, M&A Services, Deloitte & Touche LLP

Only 29 percent of executives surveyed believe divestitures in their industry would become more difficult to complete in 2013. These results appear to suggest that most surveyed executives are expecting the economic recovery to continue with no major setbacks. As the economy recovers, financing often becomes more available and companies are usually more willing to assume risk and invest their cash reserves, leading to a more active deal environment.

When asked about divestiture over the next 24 months, 72 percent of executives surveyed expect that their companies will attempt divestitures during this period. Surveyed executives at large companies were much more likely to anticipate their companies would attempt divestitures over the next 24 months than their counterparts at smaller companies.[4] Eighty-two percent of respondents from large companies anticipate that they will attempt at least one divestiture, including 29 percent who expected three or more deals. In contrast, 56 percent of executives at smaller companies expect to attempt divestitures during that time period, with 13 percent expecting three deals or more.

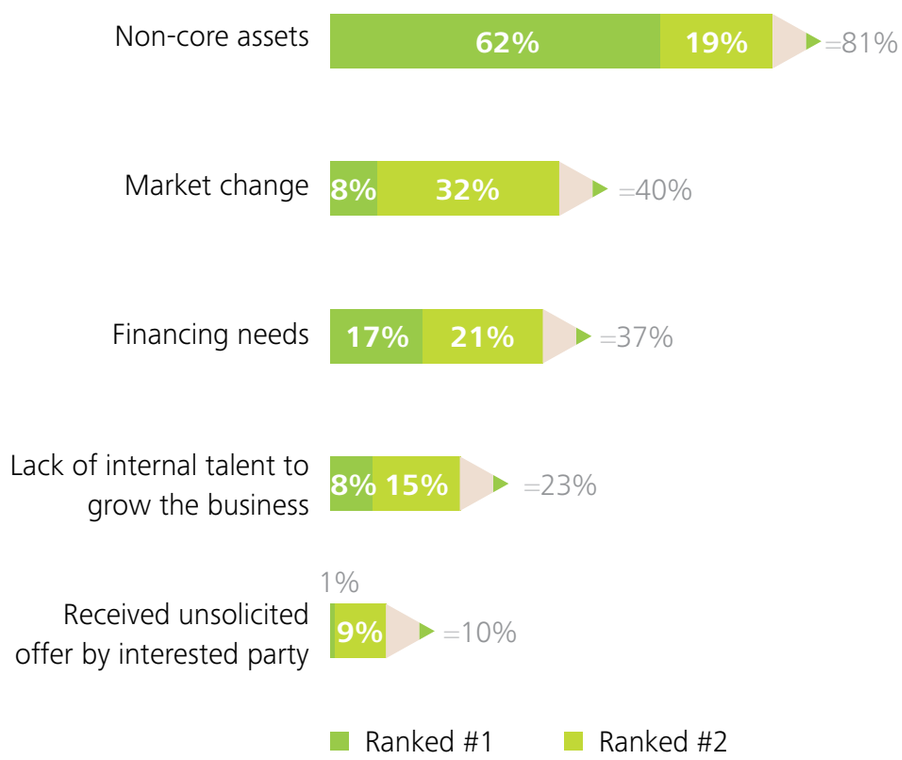
Although surveyed executives at smaller companies expected they would attempt fewer deals, these divestitures would represent a larger portion of their revenues. Among surveyed smaller companies that expect to divest business units over the next 24 months, 74 percent of these executives say these deals will represent 5 percent or more of their companies' revenues, compared to only 39 percent for the deals planned by large companies.

4 In this report, "large companies" refers to companies with annual revenues of $1 billion or more; "smaller companies" refers to companies with annual revenues of less than $1 billion.

Strategic factors important in driving divestitures

The deep recession of 2008–2009 and the subsequent slow recovery forced many companies to divest business units in order to raise cash or improve their financial position. Many of these divestitures were driven more by a corporate survival imperative and less by a long-term strategy for growth. As the economy has stabilized over the past year, strategic considerations have become a much more important driver for divestiture activity. The strengthening of corporate balance sheets, coupled with historically high levels of cash, is not just often increasing the appetite for acquisitions, but also leading companies to develop a more focused, longer-term strategy for divesting.

Figure 2: Most important reasons for divesting a business



Note: Some percentages do not add up to total due to rounding.

In the 2012 survey, 81 percent of respondents indicated that one of their two most important reasons for divesting is that the business was considered a *non-core asset*, up from 68 percent in the 2010 survey. (Figure 2) Further, 62 percent of executives surveyed indicated the decision that a business unit was a *non-core asset* was the single most important reason for divesting. In contrast, only 37 percent of surveyed executives chose *financing needs* as one of their top two reasons in 2012, down from 46 percent in 2010.

Strategic considerations are important at large companies as well. Seventy-three percent of surveyed executives at large firms indicated a unit being a *non-core asset* as the most important reason for divestitures, compared to 48 percent among executives at smaller companies. According to the survey, following the recession, smaller companies are more likely to have already contracted to their core businesses, or they never left it, while large companies are consistently refining their product portfolio. Among executives at large companies, only 13 percent of respondents indicated financing was the most important driver, along with 20 percent of those at smaller companies.

"Deals where the seller has prepared from a buyer's perspective are pricing very well, but if the fit isn't right, there can be a struggle to close."

Ellen Clark
Managing Director, Deloitte Corporate Finance LLC

Underscoring the importance of market conditions in the decision to divest, among surveyed companies, market change continues to be a strong secondary reason for divesting, ranked as the second most important reason by roughly one-third of executives in 2012. (Figure 3) According to the survey, *market change*, especially in healthcare, energy, and technology sectors, may provide the opportunity or drive the business' need to divest, often in relation to an unsolicited offer from a buyer.

Non-core assets drive break-ups

When surveyed executives were asked specifically about the most important reasons their companies pursued divestitures over the last 24 months, their responses were similar, with roughly three-quarters saying the business unit was determined to be a *non-core asset*. *Market change* was selected by 37 percent of surveyed executives and *financing needs* by 32 percent.[5]

Interestingly, the only significant difference between the responses to these two questions appears to be that 21 percent of executives surveyed chose *received an unsolicited offer by an interested party* as a primary reason they pursued a recent divestiture, even though just 10 percent selected that as an important reason to divest in general.
This may suggest that some companies allow others to drive their divestiture decisions more than they care to admit. If companies frequently initiate divestitures in response to unsolicited offers, it can be an indication they are not doing a good job of regularly evaluating candidates for divestiture.

Among surveyed companies that divested non-core assets, the most common reasons were concerns over growth and product fit. Thirty-seven percent of executives surveyed selected *limited growth potential* as the primary reason, while 30 percent selected *non-synergistic products*. Other top reasons given for divesting non-core assets were *poor operating performance* (22 percent) and *weak market position* (11 percent). While non-core assets are traditionally defined as those that are not central to the company's strategy, companies can conclude that assets are non-core for a wide variety of reasons.

5 Percentages total to more than 100 since respondents could make multiple selections.

Raising the bar
Receiving more value from your carve-out

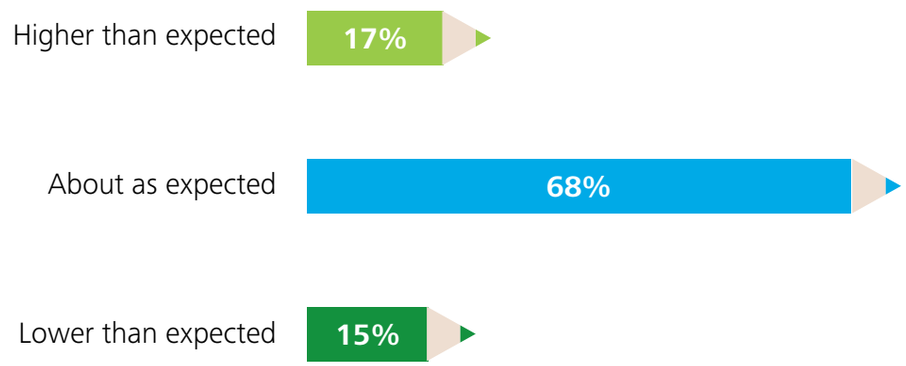
Although strategic, rather than financial, factors are considered the most important drivers in the survey, companies remain intent on achieving the expected value, and an impressive 85 percent of sellers reported being satisfied with the value of their most recent divestiture. Sixty-eight percent of surveyed executives reported receiving the value they expected, while 17 percent walked away with a price that exceeded expectations. (Figure 3)

According to the survey, all-cash sales are by far the more common terms when divesting. Ninety percent of respondents indicated they typically accept an all-cash sale of the full business unit divested. Other terms commonly accepted are a seller note (25 percent) and continuing equity interest (22 percent).[6]

The most common reason selected in the survey for receiving a higher value than expected was *multiple competing bidders* (44 percent). Other factors selected by surveyed executives at companies that received a higher value than anticipated in their last divestiture were *strength and preparation of management team* (40 percent), *greater synergies than expected* (36 percent), *no significant diligence 'surprises/issues'* (32 percent), and *availability of financial information and analysis* (32 percent).[7]

In Deloitte's experience, sellers are now focusing more on preparation than they have in the past. However, sellers also want faster deal closure. Shortening the gap between putting an asset on the market and closing the deal often means less time for diligence. To adjust for this change in deal mechanics, sellers should develop a detailed separation plan: mobilizing resources around the deal execution and transition and to prepare themselves to support the buyer's diligence needs and mitigate the operational challenges that the buyer will likely face in closing the deal.

Figure 3: Value of most recent divestiture compared to expectations



"Companies can assess their business needs over a longer term, with short-term survival less of an issue than in 2010. Portfolio assessment and divestitures that might have been necessary to keep the lights on in recent years can now be more strategic and focused."

Andy Wilson
Partner, M&A Services, Deloitte & Touche LLP

6 Percentages total more than 100 since respondents could make multiple selections.

7 This question was answered by 25 respondents at companies that received a greater value than expected in their last divestiture.

When it came to surveyed companies who had received a lower value than expected, only one-third blamed their management team. Instead, surveyed executives were more likely to cite factors outside the control of those handling divestitures — 64 percent indicated the most important reason for a lower value was *deteriorating market conditions* and one-half chose *deteriorating operating performance*.[8]

Increasing the number of bidders for increased value

Forty-five percent of surveyed executives at the companies that received less value than expected for their last deal indicated a *limited number of bidders* was an important factor. The fact that the number of surveyed bidders was chosen by nearly one-half of both those receiving more value and less value than expected reinforces Deloitte's experience that sellers who want to increase sales price should avoid single-bidder, exclusive deals. While these deals can be attractive for reasons other than price, multiple bidders can increase the seller's leverage for improved terms overall. Additionally, a well-run auction, with proper levels of preparation by the seller, can actually be more timely than a single-bidder, exclusive deal, due to the competitive nature of the process.

Sellers looking for a quick deal with multiple bidders might want to consider commissioning a seller diligence report, an emerging trend for U.S. transactions. In Deloitte's experience, it can be an effective tool for facilitating a highly competitive auction process. In Europe and the UK, it is known as vendor due diligence.

8 This question was answered by 22 respondents at companies that received a lower value than expected in their last divestiture.

Seller diligence reports — an emerging trend

What is it?

- Independently prepared, broad due diligence report used to facilitate a sale
- Allows prospective purchasers to receive identical independent information and analysis
- Paid for by the seller
- Supports auction/managed sale process with deep access to data
- Cleared with management for factual accuracy

Why do it?

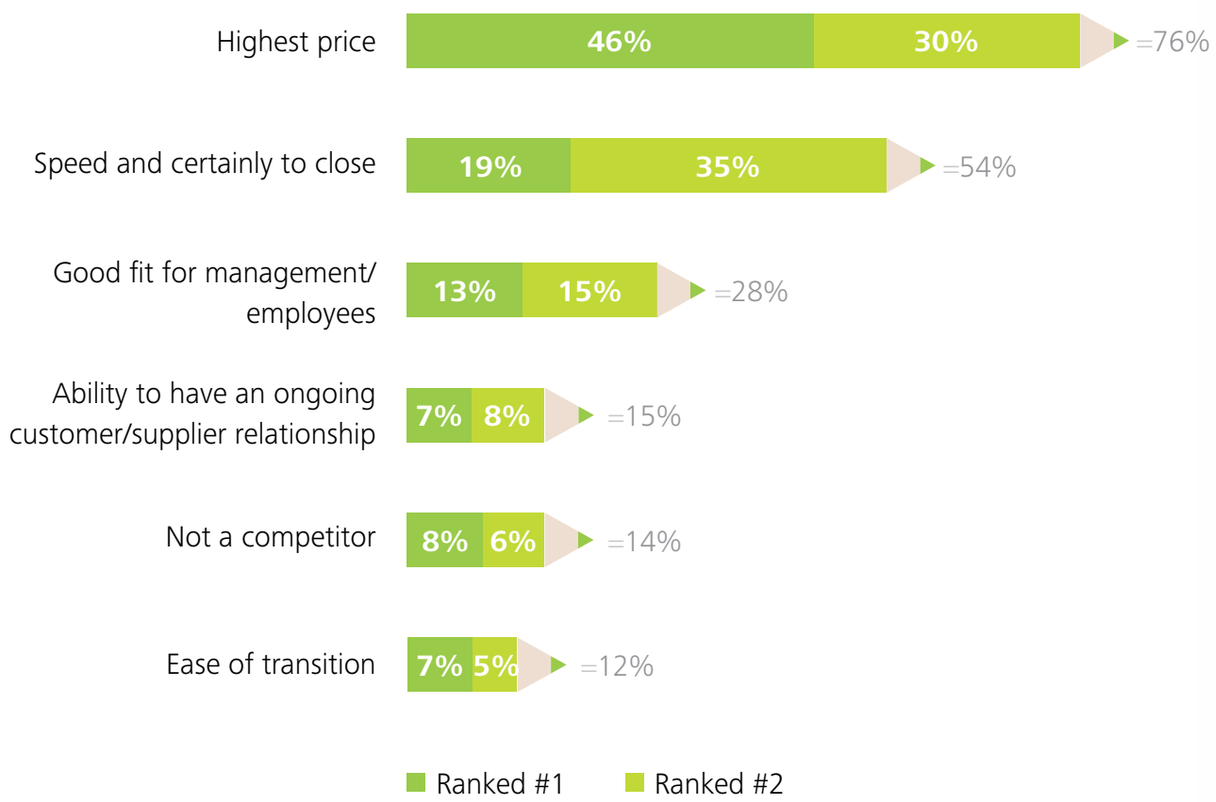
- Facilitates and accelerates the sales process
- Reduces opportunities for buyers to re-trade on price
- Reduces disruption — target is subject to only one detailed due diligence process controlled by seller

A separation can offer significant opportunities to increase the tax efficiency of the separated business, potentially increasing the transaction's long-term value. Yet, many companies overlook these tax-saving opportunities until after the deal is done, when it is usually too late. Tax savings can benefit both the separated business and the parent company. As the parent company changes its operations and structure to fit its new size and scope, there may be opportunities to restructure operations in a more tax-efficient manner that can significantly impact its performance going forward.

Finding the "right fit," at home and abroad Foreign and domestic buyer trends

According to the survey, price once again leads the reasons for choosing a buyer by a wide margin, with 46 percent of responding executives calling it the most important factor and roughly three-quarters placing it in the top two. (Figure 4) Fifty-four percent of surveyed executives ranked *speed and certainty to close* as one of their top two factors, but just 19 percent indicated it was the most important. The third most selected reason for choosing a buyer was *good fit for management/employees*, with 28 percent of respondents ranking it as the number one or two reason.

Figure 4: Most important factors when choosing a buyer



Declining preference for domestic corporate and private equity buyers

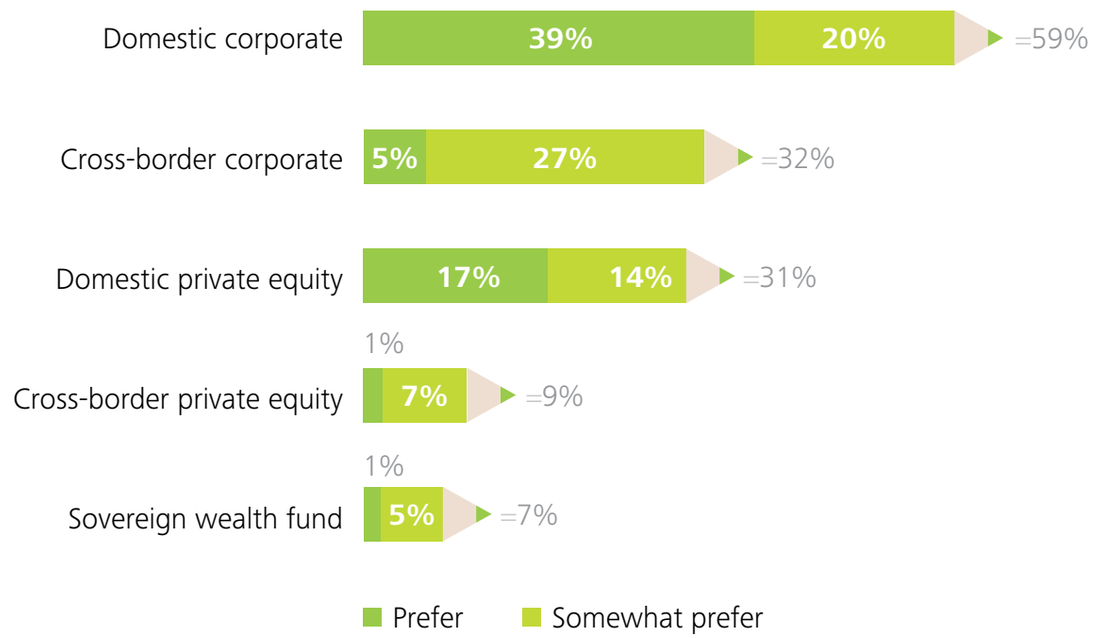
In the survey, respondents indicated that domestic corporate buyers were more often preferred, but somewhat less than in the 2010 survey. Fifty-nine percent of surveyed executives indicated their companies prefer or somewhat prefer domestic corporate buyers compared to 70 percent in 2010. (Figure 5) According to the survey, the other types of buyers that respondents favored were cross-border corporate (32 percent) and domestic private equity (31 percent). However, surveyed executives were less likely to prefer private equity buyers than they were in 2010. Only 31 percent of surveyed executives indicated their companies prefer or somewhat prefer domestic private equity buyers, compared to 42 percent in the 2010 survey.

The declining preference for domestic corporate buyers among the companies surveyed is reflected in the actual deals in the marketplace. Domestic corporate buyers have represented roughly 70 percent of the buyers for U.S. divestitures from 2006 to 2010, but dropped to 57 percent in the first nine months of 2012. In contrast, domestic private equity bought 27.5 percent of the deals during that same period, showing significant growth. In Deloitte's experience, private equity has been bidding aggressively on good deals.

Foreign strategic buyers also declined significantly as a percentage of the overall market for U.S. divestitures in the first nine months of 2012. They accounted for 11.8 percent of the buyer base compared to 14.5 to 19.4 percent from 2006 to 2011. But cross-border private equity buyers have become more prominent, acquiring 3.7 percent of the deals in the first nine months of 2012, up from no more than 1.1 percent from 2006 to 2010.

9 Source: Thomson One Financial

Figure 5: Preference for types of buyers



Note: Some percentages do not add up to total due to rounding.

Based on these trends in the marketplace, companies might want to reduce their overwhelming preference for domestic corporate buyers when it comes to marketing deals. Eighty-four percent of surveyed executives indicated their companies marketed divestitures over the last 24 months to domestic corporate buyers, followed by domestic private equity (49 percent) and cross-border corporate buyers (45 percent). Companies that market more broadly beyond domestic corporate buyers will likely have the ability to expand the number of bidders and potentially the value they achieve.[9]

2012 showed big changes in who is buying U.S. assets, with a significant decline in domestic corporate buyers. Companies that look across borders and to private equity for potential buyers can increase their number of bids, which in turn, may increase their chances of getting the price they want.

Middle market heats up

It appears that when a large company looks across a border for an acquisition, its goal is a big entity, and so the company is usually more likely to acquire a unit of a large company. But when it comes to cross-border private equity, even the larger private equity firms aren't often willing to take on a major commitment in another country, so they may look more to mid-market companies. Many private equity funds increased their focus on mid-market transactions following the financial crisis, and the middle market is expected to continue to play an important role in private equity deal activity going forward. In October 2012, year-to-date middle market multiples were at their highest levels since 2005[10], and quality assets continue to trade at a premium.

Looking at the private equity market overall, the current high levels of uninvested capital held by private equity firms may significantly increase the demand for quality assets. In addition, companies continue to hold historically high cash balances. If the economy continues to improve and the capital markets stabilize, investors will likely press firms to put their excess capital to work. This potential increase in private equity and corporate activity may have a significantly positive impact on transaction multiples.

10 Source: Thomson One Financial

Potential obstacles in cross-border deals

Cross-border buying is driving more and more deals. But don't underestimate the challenges.

Considerations	
Target identification	• Difficult to define target • Multinationals may struggle to get initial interest from targets • Initial discussions may be one-sided with unreliable information provided
Negotiation process	• Traditional "Western" M&A process model often requires modification • Hesitancy of target to fully "open up" often necessitates long-term commitment • Significant amounts of patience and energy required • Decisions are often revisited, extending negotiations • Difficulty in enforcing and honoring terms
Price expectations	• Higher price expectations/premiums due to local growth and equity market • Aggressive growth model • Seller's price not always supported with valid valuation methodology/financial data • Peer comparisons can occur even when under confidentiality agreement
Information expectations	• Data often unavailable or unreliable (multiple sets of books) • Reluctance to provide actual financial statements • Timeliness of information
Due diligence process	• Unwillingness/slowness to disclose information • Target's lack of experience handling due diligence • Target can be overwhelmed by team and complex information requests

Shorten the waiting game
Closing your deal

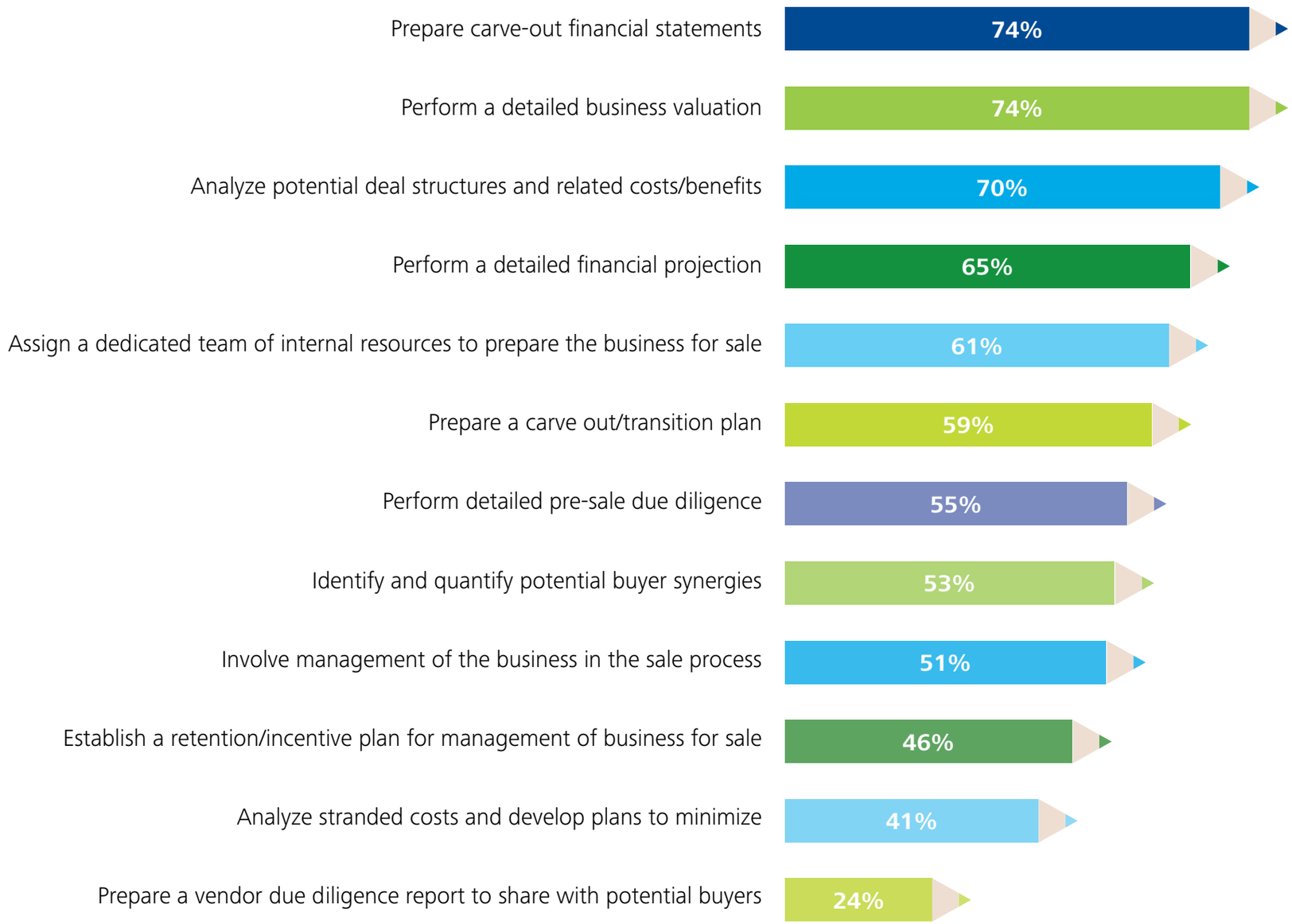
Points to maximizing value:

- ***Presale preparation:*** Identify risks and potential issues that could derail the process or affect value retention; line up advisors early and clarify their roles.
- ***Buyer courtship and qualification:*** Provide buyers with the right information to engender commitment.
- ***Closing:*** Execute smoothly and relentlessly — establish a clear timeline for the sales process and post transaction services.

Getting a good deal for a carve-out should start with looking at the asset from a buyer's perspective. Sellers should study financial and operating data well before they reach out to potential buyers so they can develop a strategy for addressing issues buyers believe will cause difficulty and diminish value once the business is separated and sold. But less than half of survey respondents (43 percent) indicated their companies evaluate individual business units at least annually to determine whether they should be divested. Forty-five percent only consider divestiture when there are performance or strategic issues. This lack of routine evaluation may cause companies to miss opportunities, or rush distressed units onto market without adequately preparing for a sale.

Surveyed executives were more likely to list financial tasks as being important to bringing a deal to market. The top tasks named in the survey were *prepare carve-out financial statements* (74 percent), *perform a detailed business valuation* (74 percent), *analyze potential deal structures and related costs/benefits* (70 percent), and *perform a detailed financial projection* (65 percent). (Figure 6) These are of critical importance for deal execution — getting from first bid to signing to closing — and often have a long lead time, with support needed from internal parties as well as from external advisors. But a variety of more intangible tasks — such as developing a strategic focus for the business, development and succession planning in the carve-out, and separation planning for achievement — can ultimately drive value for both the buyer and seller six months, one, and five years later.

Figure 6: Key tasks in bringing a deal to market

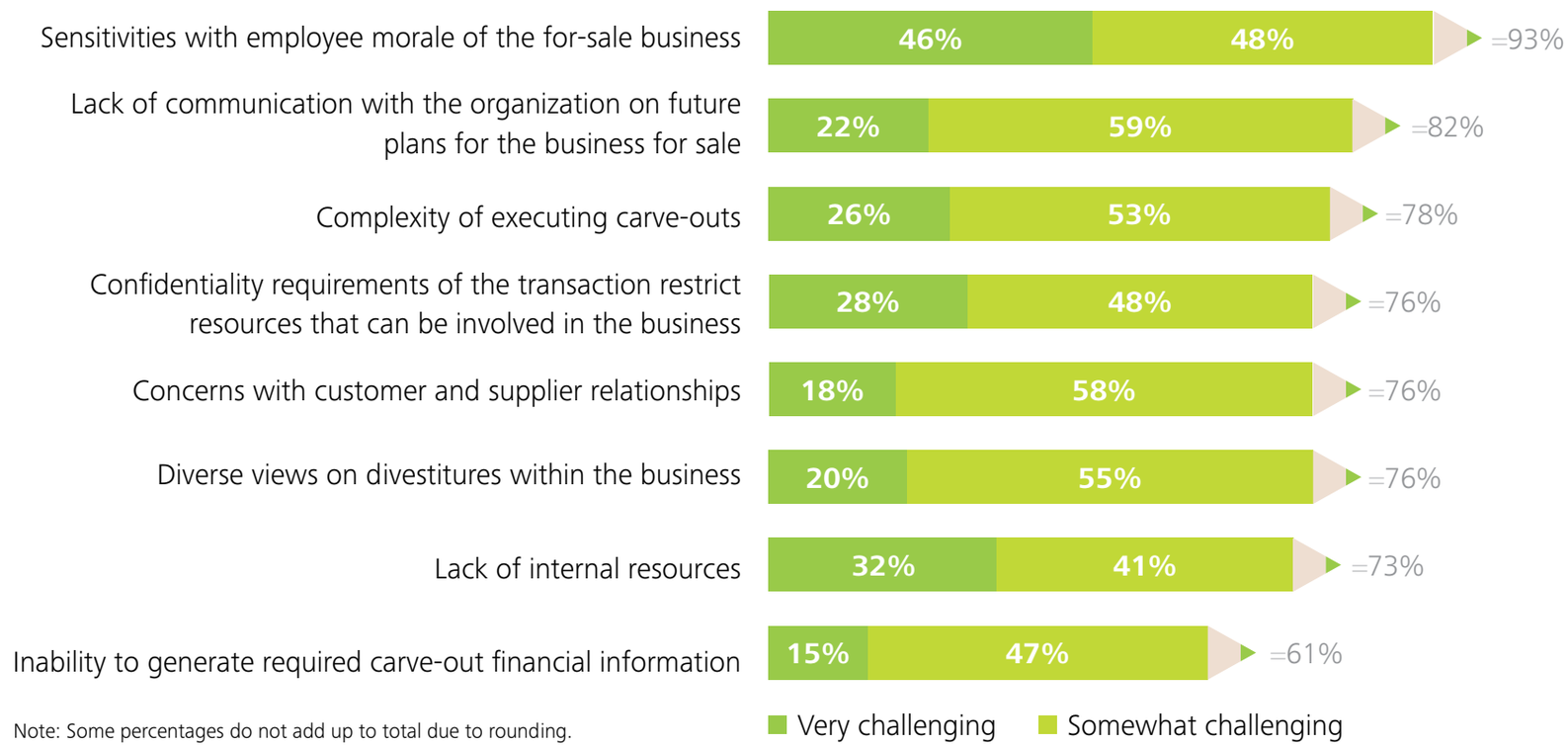


Engage employees to boost morale

Major challenges when attempting divestitures have to do with employees and communicating with them. *Sensitivities with employee morale of the for-sale business* was selected as a challenge by 93 percent of executives surveyed, with 46 percent indicating that it was very challenging. (Figure 7) Nearly as challenging was *lack of communication with the organization on future plans for the business for sale*, selected by 82 percent of surveyed executives.

These two issues are closely related — morale is often likely to suffer when rumors abound and employees speculate about their future. Effectively transitioning an organization requires a strategy to proactively engage employees and reduce their uncertainty. Preparing managers and executives to communicate with their people and lead them through change is important to the process. Employees need to understand the decisions that may impact them before any public announcements are made. Functions such as human resources, internal communications, and finance are critical in influencing employee morale.

Figure 7: Challenges when attempting divestitures
Percentage responding very or somewhat challenging



Note: Some percentages do not add up to total due to rounding.

But many companies fail to address employee engagement and morale when planning a divestiture. When asked about important tasks to perform in bringing a deal to market, only 46 percent of executives surveyed chose *establish a retention/incentive plan for management of* business for sale. (Figure 6) Short-term incentives based on performance milestones or a time horizon are effective for retaining specific employees and maintaining their focus. A divestiture often leads to ambiguity in roles and accountability, with conflicting priorities between the new and old companies, resulting in escalating levels of anxiety for employees. In Deloitte's experience, companies that implement an effective employee engagement strategy mitigate these challenges and bring their deal to market in a timely manner and more efficiently.

According to the survey, after employee morale, the factor most often selected as very challenging when attempting divestitures was a *lack of internal resources*, chosen by 32 percent of executives, with an additional 41 percent saying it was somewhat challenging. (Figure 7) Deloitte views the lack of qualified internal talent as a growing obstacle to effective divestitures. In the economic downturn, many companies dismantled their corporate development teams due to a lack of deals and a drive to reduce expenses, and no longer have the talent needed to pull them off. However, many development teams are now retooling and re-staffing as companies look for new ways to handle the ebb and flow of deal activity. If a company doesn't have the know-how to plan and execute divestitures, it can be a critical obstacle to effectively closing deals.

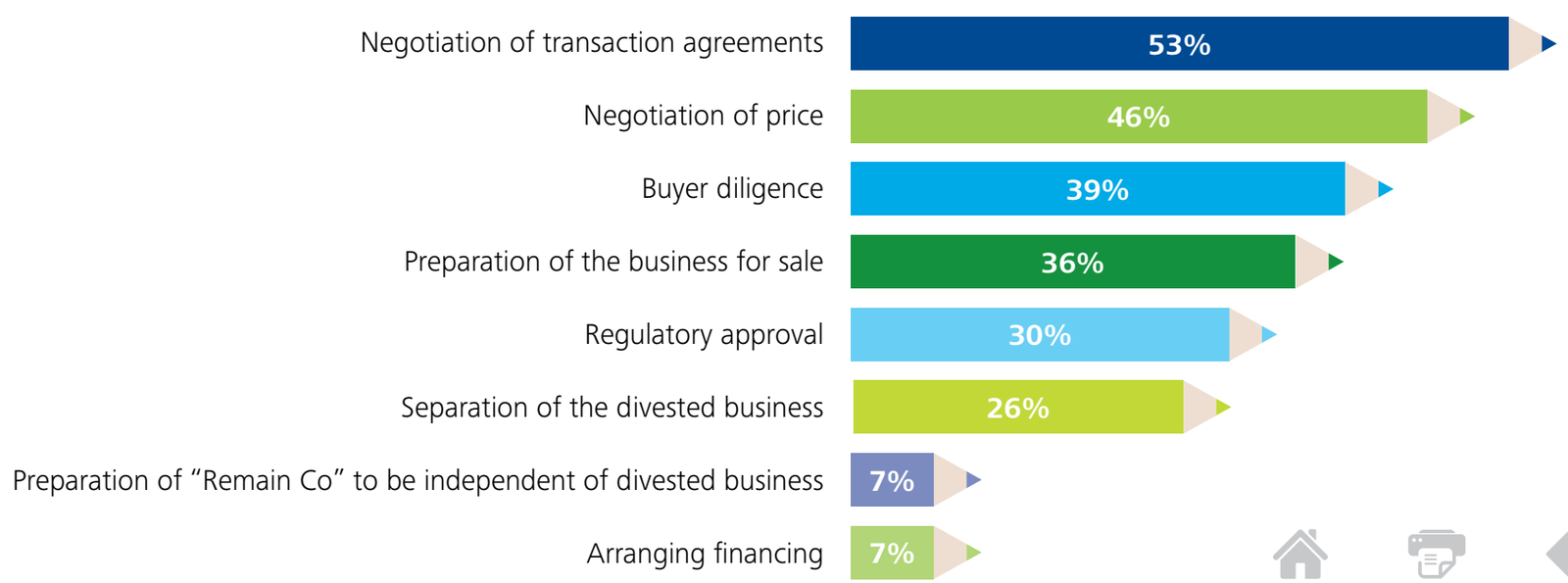
Since nearly three-quarters of executives surveyed selected a *lack of internal resources* as a challenge, it's not surprising that nearly all reported using external service providers to assist in completing divestitures. Ninety percent of the companies surveyed use external service providers, such as consultants, legal advisors, and banking advisors in divestitures at least sometimes, with 62 percent saying they use them always or often. Executives surveyed were more likely to say an important factor in their decision on whether to use an external service provider was the *complexity of the* deal (81 percent.) A little more than half of executives surveyed each chose the *deal size*, *availability of resources*, and *lack of internal expertise/capabilities*.[11]

When it came to the time required to complete divestitures, roughly three-quarters of surveyed executives indicated their last divestiture required 12 months or less from the time the decision was made to sell the business until execution of the purchase agreement, including 25 percent who indicated it took six months or less. However, 51 percent indicated their last divestiture took more time than expected, while just 6 percent indicated it took less time.

Negotiating the deal was blamed as the biggest hold-up for executing divestitures. Roughly half of executives surveyed indicated both the *negotiation of transaction agreements* and the *negotiation of price* were primary reasons their company's last divestiture didn't close as quickly as planned. (Figure 8) Other common reasons chosen were *buyer diligence*, *preparation of the business for sale*, *regulatory approval*, and *separation of the divested business*.[12]

11 Percentages total more than 100 since respondents could make multiple selections.
12 Percentages total more than 100 since respondents could make multiple selections.

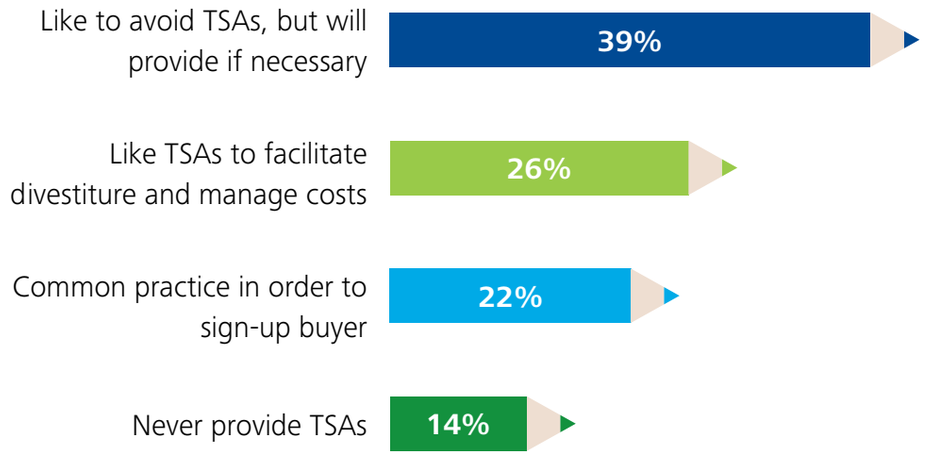
Figure 8: Primary reasons divestiture required more time than expected
Base = executives at companies where most recent divestiture required more time to complete than expected



Transition Services Agreements (TSAs)
Planning now for post-close

Transition service agreements (TSAs) are typically the default option when complex, hurried transactions require the parent company to provide transitional services to the divested unit after a deal closes.[13] Eighty-seven percent of executives surveyed indicated their companies provide TSAs, but the largest percentage (39 percent) indicated they *like to avoid TSAs, but will provide if necessary.* (Figure 9) Twenty-six percent indicated their organizations *like TSAs to facilitate divestiture and manage costs*, while 22 percent indicated they are *a common practice in order to sign-up buyer.*

Figure 9: Organization's practice for providing TSAs



Companies can benefit by using TSAs as a deal-making strategy. Based on Deloitte's experience, transition services are a necessary, if undesired, part of many divestitures. Even in situations where the deal team does not want to use TSAs, planning for them avoids the possibility of unfavorable last-minute service negotiations. Companies can be better prepared for Day 1 and reduce risk if they plan for the contingency of using TSAs and then later, if feasible, remove or reduce the scope of services.

Divestiture tip
Often, the preferred candidates for developing the TSA language are the people who will manage the daily activities. They will likely have the experience to make the agreement more accurate and complete. Further, these individuals may also be in the best position to develop the TSA exit strategy and transition.

For surveyed companies that do provide TSAs, the services offered most frequently are finance/accounting (72 percent) and IT (71 percent).[14] Twenty-eight percent of executives surveyed indicated their company typically provides services in purchasing and 23 percent provide other types of services. In addition to being offered more frequently, these services agreements for these services tend to have the longest required durations and the most cross-functional dependencies. Companies will likely want to consider this as they develop service delivery and exit plans to help avoid business disruption when the transition agreement ends.

Companies should consider drafting TSAs with the end in mind, having a clear idea of how they will exit the agreement. Roughly 80 percent of surveyed companies typically provide TSAs or Reverse TSAs for one year or less. Forty-one percent indicated the typical duration is six months or less while 39 percent indicated the agreements last 7–12 months.

13 Source: "*CFO insights: Divestitures and Carve-outs: Becoming a Prepared Seller,*" Deloitte, 2010
14 Percentages total to more than 100 since respondents could make multiple selections

Don't lose money on TSAs

When it came to costs, 69 percent of executives surveyed indicated that they had found that cost estimates for TSA services were fairly accurate compared to expectations. Among the remaining executives, 23 percent reported costs were under-estimated, and 8 percent indicated they were over-estimated.

This finding indicates roughly a quarter of companies may routinely fail to charge a sufficient fee when they offer TSAs. When developing a proposed TSA service price, it is important for companies to do their internal homework. What are the one-time costs? What are the monthly recurring costs? In setting the service price, companies should consider different pricing options including cost-plus (cost plus a percentage surcharge), cost escalation (percentage increase each month over the duration of the TSA), and minimum fee (to protect against investments such as the cancellation of services soon after legal close of transaction).

In Deloitte's experience, there are often cheaper and more efficient options to TSAs since neither party is typically in the service-providing business. However, TSAs can also benefit the seller by giving it more time to restructure its systems and mitigate stranded costs.[15] Organizations that provide TSAs should not rely on them as a way to avoid tough decisions. Parent companies should develop accurate costs, defined service levels, and detailed exit plans.[16]

The impact of inflation is often overlooked in service agreements. The option to increase or pass-through cost increases is an important negotiation point for sellers, particularly for multi-year agreements. For buyers, cost surprises tend to materialize in the form of TSA exit and replacement costs. If the seller is benefiting from economies of scale that the buyer cannot replicate, a pragmatic sourcing process can help reduce unexpected budget overruns.

TSAs and stranded costs were named in the survey as the biggest challenges after a deal closes. Twenty-eight percent of executives surveyed indicated TSAs were the biggest continuing challenge after their companies' most recent divestiture, while 23 percent indicated stranded costs. But neither issue appears to receive the attention it deserves at many companies. Only 55 percent of executives surveyed listed *prepare a carve-out/transition plan* as an important task to perform in bringing a deal to market, and only 41 percent selected *analyze stranded costs and develop plans to minimize*. Other common challenges after a transaction ends are *retained contingencies/exposure* (19 percent) and *shared customer issues* (12 percent).

When developing a stranded cost program, companies should not limit their view to exiting TSAs since they will risk "moving the sand around." Addressing stranded costs requires a detailed program that focuses on the required cost/expense footprint for the entire organization.

15 Source: "*Corporate Development 2012: Leveraging the Power of Relationships in M&A*," Deloitte, 2012
16 "*CFO insights: Divestitures and Carve-outs: Becoming a Prepared Seller*, " Deloitte, 2010

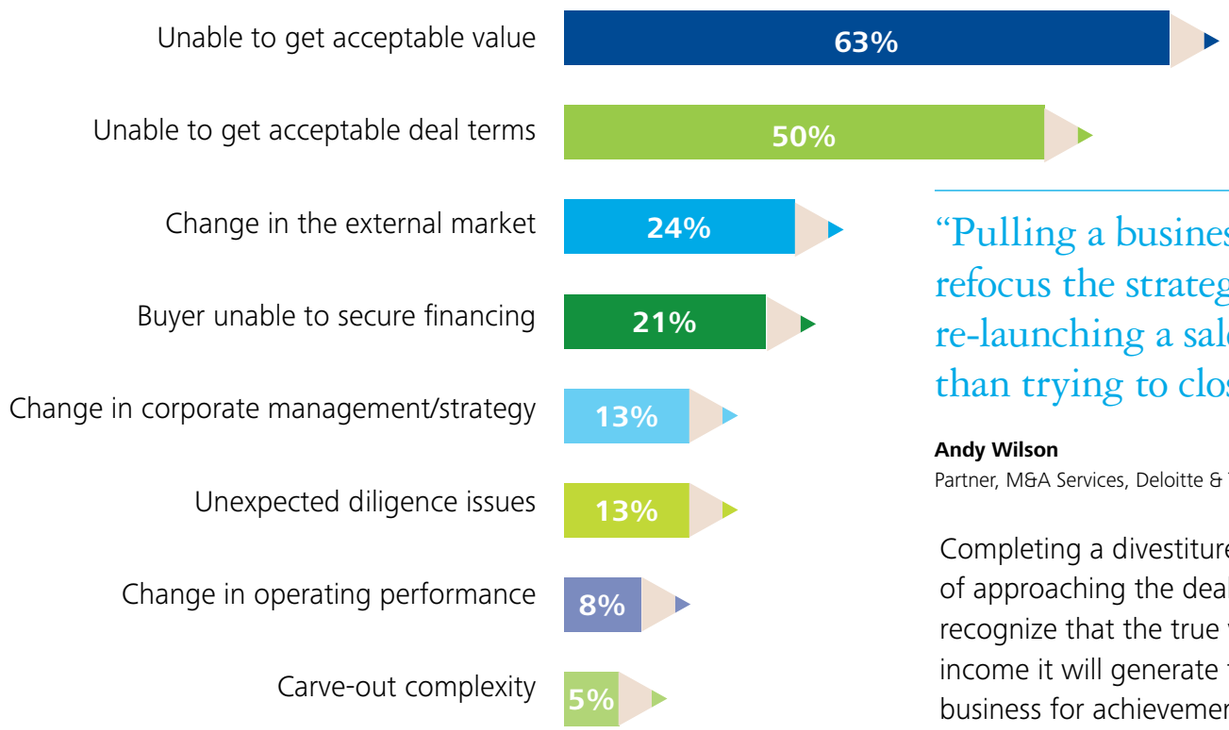
If at first you don't succeed… consider putting your business back on the market

Nearly one-third of executives surveyed indicated their companies had one or more planned divestitures that didn't succeed over the last 24 months. The most common reasons for not completing divestitures, chosen by half or more of surveyed executives, were *unable to get acceptable value* and *unable to get acceptable deal terms*. (Figure 10) Roughly one-quarter blamed both *change in the external market* and the *buyer's inability to secure financing*.

Whatever the reasons a divestiture was derailed, many companies don't wait long to begin searching for a new deal. Among surveyed companies that had planned divestitures over the last 24 months that didn't succeed, 64 percent reported they had put the business back on the market or were planning to. In Deloitte's experience, the sooner a company can bring a deal back to the table, the more its chances are improved. That way, they don't lose momentum, and much of the diligence work and financial preparation remain relevant.

Figure 10: Reasons for not completing divestitures

Base = Executives at companies where some divestitures over last 24 months did not end in a closed transaction



Note: Percentages total to more than 100 since respondents could make multiple selections

> "Pulling a business from the market so you can refocus the strategy, refine its market message before re-launching a sales process, can be more effective than trying to close a deal that is going bad."
>
> **Andy Wilson**
> Partner, M&A Services, Deloitte & Touche LLP

Completing a divestiture effectively requires a proactive strategy of approaching the deal from a buyer's perspective. It's critical to recognize that the true value of a business is the current and potential income it will generate for the new owner. Carefully preparing the business for achievement after it is divested is another way to increase value. Identifying gaps for a buyer builds credibility and helps to eliminate uncertainties.[17]

17 "*Corporate Development 2012: Leveraging the Power of Relationships in M&A*," Deloitte, 2012

Afterword

The federal budget negotiations, coupled with a fragile recovery, create significant uncertainty over the outlook for divestitures in 2013. Despite the lack of clarity, pent-up demand remains with both corporate and private equity buyers looking to spend cash and position themselves for growth.

Companies should consider making divestitures part of their core business strategy by regularly evaluating their portfolios to identify potential candidates for divestiture, rebuilding their corporate development teams, assessing sale readiness from a buyer's perspective, and carefully evaluating the effectiveness of TSAs. Thorough preparation and solid execution are important to increasing deal value and closing deals in a timely manner and efficiently.

The art of divesting: Enhance value and save time

1. Make divestiture part of your core business strategy, regularly evaluating all assets as potential candidates.
2. Increase the number of bidders and strengthen your management team's understanding of the business being sold to increase the odds of getting the value you want.
3. Look across borders for potential buyers with ready cash and a need for growth.
4. Prepare for diligence and deal execution to streamline and accelerate the process.
5. Position the business from a buyer's perspective, anticipating their priorities and considering potential stumbling blocks.
6. Be prepared with detailed, consistent, accurate data (historical and forecast) and regularly update it.
7. Set and execute against a timeline.
8. Initiate tax planning up front.
9. Don't rely on TSAs as a default option — look for improved, cheaper solutions.
10. If you need to put an asset back on the market after a failed deal, move in a timely manner.

Profile of respondents

Deloitte conducted a survey of 148 executives who have been involved in divestitures or carve-outs to gain insights on their experiences. The survey was conducted online from October to November 2012. Deloitte conducted a prior divestiture survey in 2010.

Roughly 60 percent of respondents worked at companies that had completed at least one divestiture within the last 24 months. Thirty-six percent of their companies completed one or two deals and 23 percent completed three or more. Sixty-six percent of the large companies (annual revenues of $1B or more) participating in the survey had completed divestitures compared to 51 percent of smaller companies (annual revenues of less than $1 billion).

Forty-two percent of the respondents worked for companies with less than $1 billion in annual revenues, with 23 percent at companies with revenues of $1 billion to $5 billion and 35 percent at companies with revenues of $5 billion or more.

The companies surveyed represented a variety of industries including 33 percent from manufacturing, 16 percent from financial services, and 12 percent each from the technology/media/telecommunications and energy/resources sectors. Seventy-eight percent of the companies are headquartered in the United States, and 60 percent are publicly-held.

Regarding the role of the respondents, 42 percent work in strategy or business development, 41 percent work in finance, and the remainder had other responsibilities.

Deloitte's Divestiture Services practice

Deloitte, together with the Deloitte Touche Tohmatsu Limited (DTTL) member firms around the world, is a leading, global divestiture advisor. We have developed a divestiture methodology that leverages cumulative experience from thousands of transactions, and is tailored to the specific needs of each client. Deloitte has advised many of the world's leading companies through large, complex divestitures by helping them become a prepared seller, reducing risk, accelerating separation timing, and protecting the value of both the divested entity and the parent company. Whether they are sellers, buyers, or part of a business unit changing hands, Deloitte's approach can help business leaders confront the challenges across the divestiture lifecycle.

Our Divestiture Services practice is made up of more than 6,100 financial advisory, consulting, tax and accounting professionals within Deloitte and the DTTL member firms around the world. We provide corporate buyers and sellers as well as private equity investors with a broad continuum of advisory services supporting divestiture strategy, pre-sale due diligence, transaction execution and separation planning and value realization across many industries and business functions.

Meet our authors

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Ellen Clark is a managing director and member of the Deloitte Corporate Finance LLC's Manufacturing group where she focuses on Automotive OEMs, Suppliers and Service Providers. Ellen has more than 19 years in investment banking and has served as lead advisor for the sale or acquisition mandates of numerous public and private companies in industries that include automotive, metal, industrial, specialty chemical and marketing services. She has completed more than 75 transactions, including public and private debt and equity placements and merger and acquisition transactions for public and private clients.

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Principal, M&A Services
Deloitte Consulting LLP

Anna Lea Doyle is a principal in Deloitte Consulting LLP's M&A practice. She has helped clients solve complex integration and divestiture opportunities ranging from $450 million to $30 billion. She has been with Deloitte over 13 years of her total professional career (23 years) supporting engagements in banking, high technology, consumer products and manufacturing. Anna leads our U.S. consulting divestiture service offering. Her expertise and experience spans integration and divestiture (both global and regional) in the areas of program management and blueprinting, merger & acquisition (M&A) capability development and diagnostics, Day 1/Day 2 planning and readiness assessment (including cutover), synergy planning, transition services agreements, and implementation.

Andy Wilson
Partner, M&A Services
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Andy Wilson is the U.S. leader of M&A Seller Services, specializing in providing accounting, tax, and finance services relating to divestitures, carve-outs, joint-venture combinations and sales of businesses. Over the last 20 years, he has worked with many of Deloitte & Touche LLP's most significant strategic and private equity clients, leading buy- and sell-side due diligence services for domestic and international M&A transactions. In connection with this work, Andy has significant experience in helping companies increase the value of dispositions through effective sell-side due diligence. Previously the U.S. leader for M&A in the automotive sector, Andy's experience covers a broad range of industries, including industrial and consumer products, as well as general manufacturing, distribution and services. He has significant global experience, managing complex, global carve-out transactions and has established a broad network of global resources. Andy has been part of M&A Transaction Services for almost 15 years, before which he worked with Deloitte & Touche LLP's audit group.

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Bob Coury leads the General Industrials practice at Deloitte Corporate Finance LLC (DCF). DCF specializes in middle market transactions in various industries. These transactions include corporate sale mandates, corporate carve-outs and divestitures, buy-side transactions, capital raising, fairness opinions, and general business advisory.

Since 1986, Bob has been performing corporate finance and investment banking services including, mergers & acquisitions, business valuation, bond trading/portfolio management and general business advisory services. He utilizes DCF's industry specialists combined with the Deloitte and Touche LLP's Global Industry team to bring a targeted global solution to his clients.

Bob is a principal of Deloitte Financial Advisory Services LLP and a managing director with Deloitte Corporate Finance LLC. In each of his roles, he is focused on the marketplace. He utilizes the strength of a leading global financial services firm, with over 165,000 professionals, to solve client specific issues.

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Jeff Weirens leads Deloitte Consulting's Global Merger Integration and Divestiture practice. He serves as a trusted advisor to senior client executive teams and Boards of Directors on improving shareholder returns through effective execution of acquisition, divestiture and restructuring strategies.

With over 20 years of experience, Jeff works closely with both strategic and private equity clients across the entire M&A lifecycle. He specializes in establishing merger integration and divestiture governance, organization, operating models, exceeding synergy targets, optimizing transition service agreements and resulting cost structures and planning and executing an issue-free Day 1 customer and employee experience.

Jeff has led many of Deloitte's most complex projects through his work in Belgium, Brazil, Canada, China, Finland, France, Germany, Greece, Italy, Japan, Poland, Romania, Spain, Singapore, Switzerland, the United Kingdom and the United States.

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