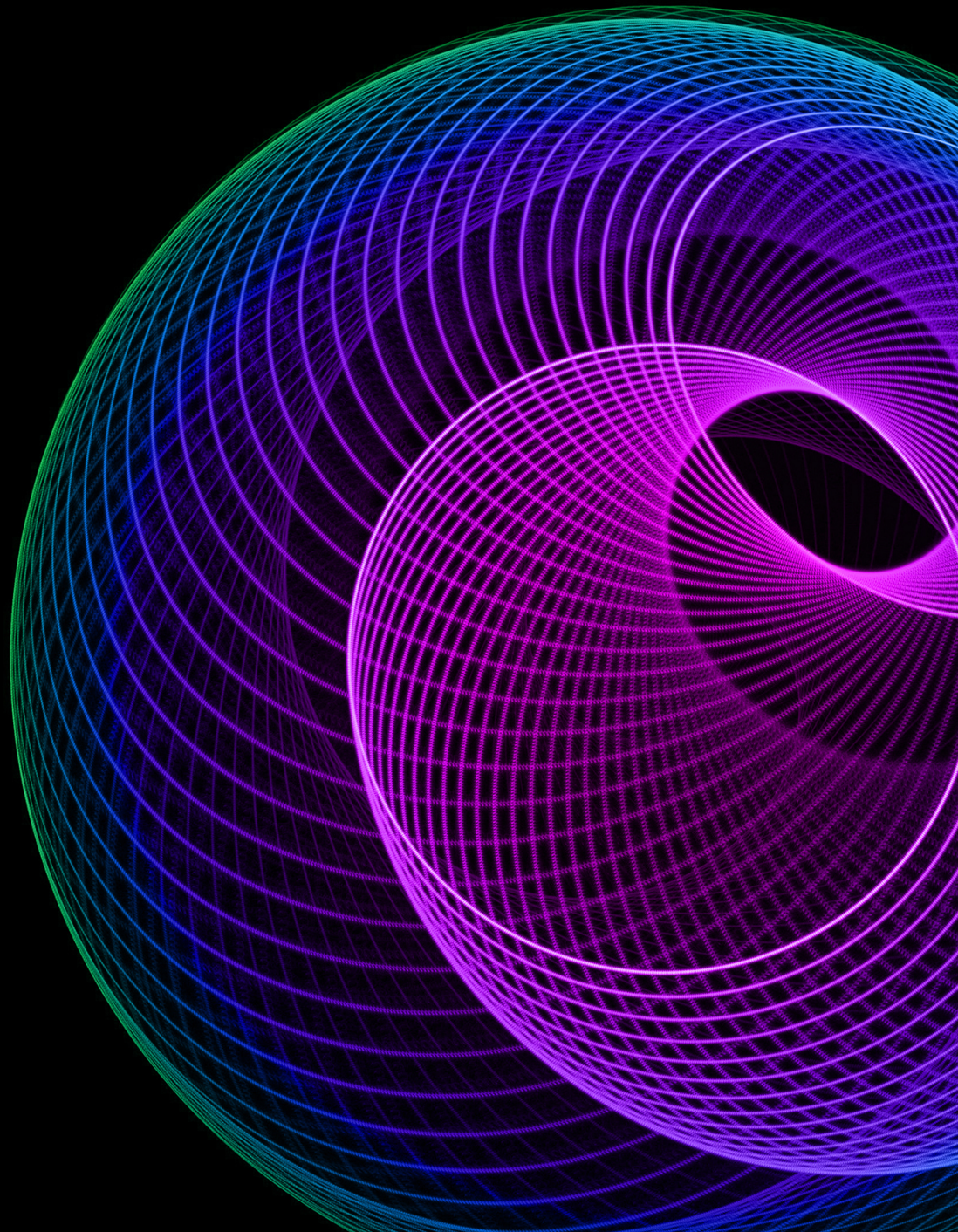


Deloitte.

Planning for the
financial elements of a
divestiture transaction



Companies make divestitures for a variety of reasons. Some are looking to raise cash. Others are seeking stability, responding to regulators, or doubling down on their core business. And then there are those pursuing a new vision of the future.

The routes to divestiture may differ, but the key considerations to make along the way are often the same. Regardless of what the current economic outlook is, most divestitures can be favorably influenced by becoming an informed and prepared seller—even if the economic environment is uncertain. In this primer, we discuss some of the most important considerations for planning for a divestiture as seen through the lens of corporate leaders. Use the following table of contents to navigate to each section.

Contents

Types of divestitures and buyers	2
Planning for separation.....	5
Financial statements and reporting	7
Enhancing and preserving deal value	9
Contacts.....	9

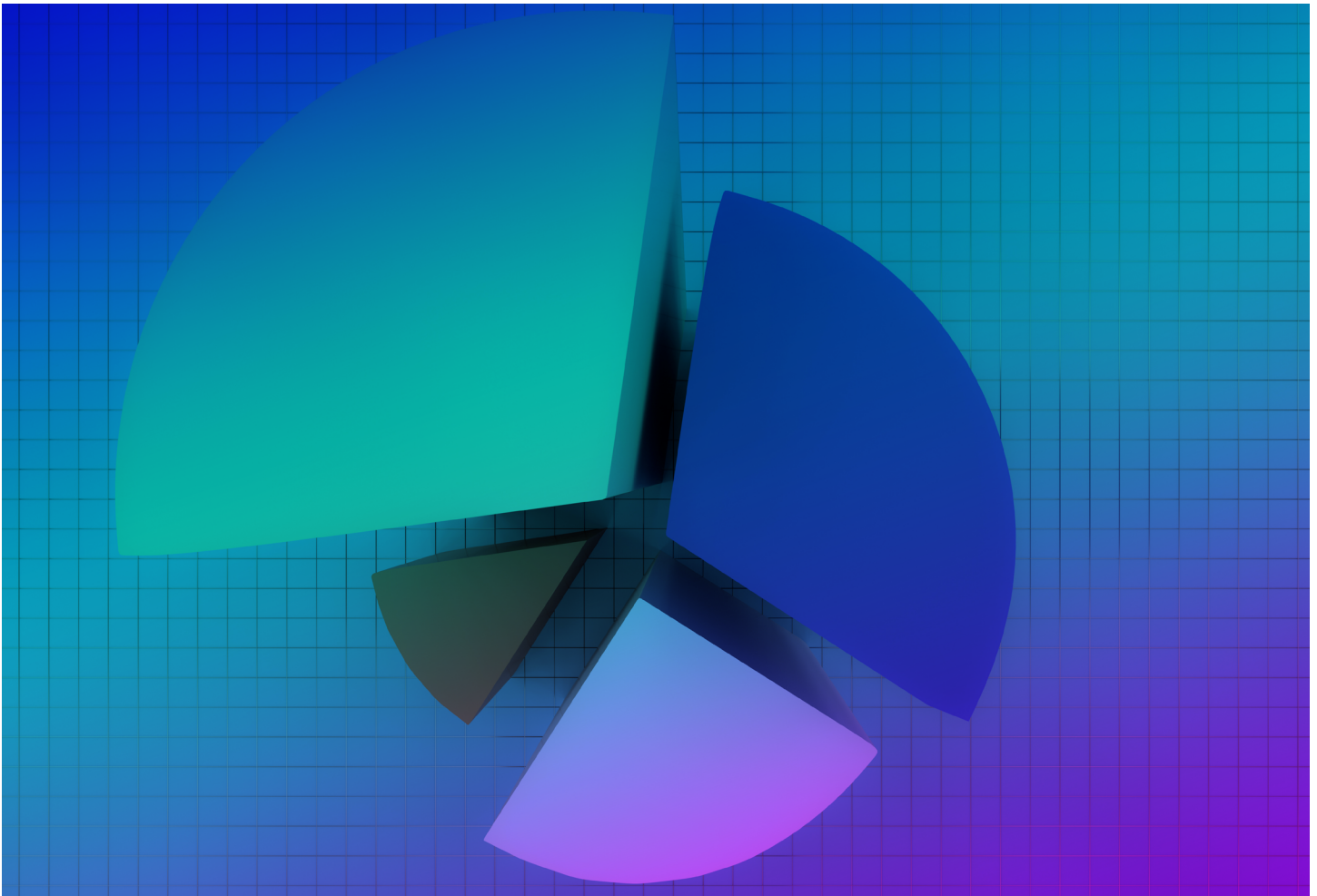
Types of divestitures and buyers

Divestiture planning and execution can vary significantly depending on the transaction type as well as the seller's and the buyer's individual objectives and their ability to efficiently separate and integrate, respectively. Examples of transaction types that companies can use to divest an asset, group of assets, or business unit include, but are not limited to, the following:

- **Sale/sell-off** – Represents the most common form of a divestiture and involves divesting via disposal of a complete asset, group of assets, or business unit.
- **Spinoff** – Divesting a business unit by distributing shares of the new issuer of the spunoff business (SpinCo) to existing shareholders of the parent, typically through a Form 10 registration statement, thereby creating a separate public company.

- **Equity carve-out** – Divesting a business unit through an initial public offering (IPO). Companies often retain a stake in the divested business when exiting through an IPO.

In a sale/sell-off, buyers can be a strategic corporate buyer or a private equity buyer. Selling to a strategic corporate buyer versus a private equity buyer involves distinct considerations due to their differing objectives and operating models.



	Sale to strategic corporate buyer	Sale to private equity buyer
Buyer motivation	<ul style="list-style-type: none"> • Ability to increase overall company value through synergies and complementary capabilities • Buyers will often be driven by synergies and their integration strategy 	<ul style="list-style-type: none"> • Ability to increase value for future sale • Buyer is responsible for standup of carve-out business and may be motivated to negotiate transition service agreement (TSA)
Due diligence focus areas	<ul style="list-style-type: none"> • Does the business unit align with our business strategy? • Can the combined company derive synergies upon integration? 	<ul style="list-style-type: none"> • Can the carve-out business operate on a stand-alone basis? • Does the carve-out business have cash flow or the ability to service debt?
TSA focus areas and volume	<ul style="list-style-type: none"> • Generally covers less functional areas as buyer can often absorb the carve-out business • TSA volume varies based on buyer's capabilities and pace at which they can integrate 	<ul style="list-style-type: none"> • Generally covers broad range of functional areas required to stand up carve-out business as a stand-alone organization • TSA volume is high given that private equity buyers lack an existing business to integrate the acquired business into
TSA duration ¹	<p>Medium (~6 to 12 months)</p>	<p>Long (~12 to 18 months)</p>
Transaction speed	<p>Varies Depends on complexity of the deal and resources of the buyer involved</p>	<p>Fast paced Generally as fast as possible to capture deal value</p>

¹TSA duration may vary based on the buyer's capabilities and level and complexity of entanglements.

A strategic corporate buyer is typically another existing company (public or nonpublic) in the same or related industry. These buyers often assign significant value in transactions to potential synergies and how well the acquired assets and businesses or operations align with their strategy. A private equity buyer typically acquires assets and businesses as investments and assigns significant value in transactions to the business's ability to service debt and generate an increase in enterprise value over a three- to five-year window.

While a strategic corporate buyer can generally integrate a business unit into its existing operations, a private equity buyer needs to be comfortable that the divested business unit can operate independently as they generally lack an existing business to integrate the acquired business into. Accordingly, if selling to a private equity buyer, management of the divested business or the seller will likely need to assess how to carve out the business so it can operate on a stand-alone basis. Additionally, management should be prepared to spend significant time and effort on substantiating the stand-alone cost structure and assessing opportunities for operational improvements during the due diligence process. Strategic corporate buyers are less interested in stand-alone cost structure and instead focus on broader areas such as how the acquired assets and business align with their existing business strategy and the synergies they can derive upon integration.

TSA volumes and duration and level of stranded cost risk may also be impacted by the type of buyer. Strategic corporate buyers typically have an existing support infrastructure of sufficient scale to absorb the new acquisition. Thus, when selling to a strategic corporate buyer, there are generally shorter-term TSAs covering fewer functional areas. However, there is a higher likelihood of stranded costs for the remaining business (RemainCo). For a private equity buyer, TSAs are used to maintain business continuity until the acquired business can operate independently and could be longer in duration.

As it relates to transaction speed, private equity buyers generally move at a much faster pace than strategic corporate buyers and may even try to outpace strategic corporate buyers to get a deal signed, making it difficult for strategic corporate buyers to compete for divested businesses.



Planning for separation

Planning for a separation involves many facets that contribute to a successful divestiture transaction. Below are some key considerations management should take into account when planning for a separation.

Deal perimeter

Prior to initiating a divestiture process, sellers should have a thorough understanding of the business they are looking to sell and a clearly defined transaction perimeter. A clearly defined perimeter should:

- Drive deal economics.
- Form the basis of tax structuring activities.
- Inform the content of the financial information shared in the diligence process and included in the audited financial statements (if needed).

The deal perimeter refers to the assets and liabilities that will be included with the sale and that are expected to convey as part of the transaction. Establishing the nature of the assets that will be transferred and liabilities that will be assumed is critical to valuation discussions and in determining how the balances will be identified or attributed. The assets being divested may include property, plant, and equipment (PP&E); products; patents; employees; and more—even information technology (IT) infrastructure, furniture, and office supplies. In the case of carve-out transactions, some of these assets and liabilities could be entangled with the parent company. Both the seller and the buyer should understand the nature of the services historically shared between the parent company and the business to be divested, how the cost of shared services has historically been charged or allocated to the business to be divested, and how these costs might differ on a stand-alone basis going forward. Shared services typically include back-office functions such as finance and accounting, human resources, tax, treasury, and legal. In addition to services, it is common for there to be shared facilities, personnel, and contracts that will need to be replaced or separated following a potential transaction. The degree to which the assets and liabilities are entangled may have an impact on the economics of the deal and level of support required from the seller post-transaction in the form of a TSA. Going through a detailed analysis of the business to identify potential entanglements, including the preparation of a stand-alone cost estimate for the business to be divested, will help the buyer and the seller make informed economic decisions during the negotiation process.

Sellers should also consider the transaction perimeter from a jurisdictional perspective, determining whether the transaction will affect only entities in the United States or if it will include a global footprint. If the perimeter expands beyond the United States, the seller should consider which jurisdictions are most significant to the transaction since they will likely require greater preparation from a tax perspective. Early recognition of tax structure and related implications is typically imperative to both the timeline and potential value of the transaction and avoiding disruptions during the deal process.

The transaction perimeter definition can also help inform the financial information that will be shared with potential buyers. In some cases, the transaction perimeter is clearly identifiable from a financial reporting standpoint, having been historically tracked by the seller. In other cases, the seller may need to prepare separate financial information for the first time in anticipation of the potential transaction. Depending on the basis of presentation, the financial information presented in the carve-out financial statements may not mirror the transaction perimeter of the business to be divested. Refer to the [“Financial statements and reporting”](#) section below for additional discussion around reporting requirements. A seller should identify the nature and quality of financial information that will be required for buyers to complete their financial due diligence of the entity being divested.

Financial due diligence

The divestiture process often involves extensive due diligence performed by several potential buyers. Financial due diligence involves a detailed analysis of financial information of the business with buyers looking to identify potential red flags, risks, and impacts to transaction value. To prepare for the due diligence process, sellers will often perform sell-side due diligence in advance of initiating the divestiture process. Seller due diligence involves analyzing and preparing information expected to be provided to potential buyers during their due diligence, which can help the seller identify and address key deal issues before buyers begin their due diligence, enabling sellers to stay ahead of critical items and reduce business disruption once the actual divestiture process kicks off. The financial information for the entity being divested that sellers can expect to provide to potential buyers during the sale process often includes, but is not limited to, the following:

- A confidential information memorandum (CIM) is usually prepared with the help of an investment bank and is used as a marketing document to highlight the operations, management team, market position, products and services, and key financial information.
- Audited financial statements for the most recent annual periods.
- Monthly trial balance information for the most recent annual periods. Buyers will typically expect to be able to reconcile the trial balances back to the audited financial statements.
- Board packages and internal reporting used to manage the business, including a view of forecasted financial information for future periods.
- A view of normalized earnings (oftentimes referred to as “quality of earnings” or “normalized EBITDA”). The bridge from reported net income to adjusted EBITDA is typically composed of both standard definitional EBITDA adjustments (e.g., interest, taxes, depreciation and amortization) and adjustments for non-operating and one-time revenues and expenses. A presentation of pro forma adjusted EBITDA is also common, which can account for operating results of recently acquired or divested parts of the business as well as for the potential impact of operational improvements. A prepared seller should have detailed analysis supporting the EBITDA adjustments. Sell-side due diligence reports and workbooks can help summarize this information in a clear and organized manner, limiting additional requests from buyers and saving seller management time during the divestiture process.
- Historical working capital trends analysis can help to determine target working capital in purchase negotiations as well as cash flow needs of the business, which are used to inform modeling and financing considerations.
- Transactional data is also typically requested, allowing buyers to analyze trends at the customer or vendor level. Buyers increasingly are requesting and performing complex data analytics on this transactional data, often utilizing emerging technologies in order to manage large data sets. It is also common for buyers to request information around key customer and vendor contracts.
- In the case of a carve-out, a clear basis of presentation that outlines how the financial reporting transaction perimeter was determined.
- Cost structure analysis, which analyzes direct versus allocated costs included within the transaction perimeter, along with a stand-alone cost analysis to assess additional costs that may be incurred post-close to support the business.
- Tax fact books that proactively address the tax profile of the business being sold, legal entity structure, asset jurisdictions, and employee locations, as well as tax-related questions that potential buyers may have.

The preparation that goes into seller due diligence can help the seller articulate the business’s “story” and respond to diligence requests in a timely and coordinated manner, enhancing credibility as a seller and facilitating a smoother divestiture process. It can also help the seller retain control over the diligence process by providing buyers with consistent and timely information needed for potential buyers to submit competitive offers and increase deal value. Financial information is typically provided through a private virtual data room in a phased data approach that allows the seller to facilitate efficient data flow from the seller to the potential buyers, only providing what is needed at each phase without negatively impacting transaction value. This also allows the seller to be mindful about which potential buyers receive access to information that could be considered commercially sensitive.

Financial statements and reporting

“Carve-out financial statements” is a general term used to describe financial statements derived from the financial statements of a larger parent entity. In certain situations, carve-out financial statements may be required in addition to the diligence information noted above to meet regulatory or financing requirements. There are common elements to the preparation of the carve-out financial statements, irrespective of the buyer and regulatory requirements. As it will take significant time and effort to both create and complete an audit of carve-out financial statements, sellers should understand the financial statement requirements at the outset of a divestiture.

Carve-out financial statements typically include (1) balance sheets; (2) statements of operations, comprehensive income, cash flows, and changes in stockholders' equity for the relevant periods; and (3) related financial statement disclosures. When preparing the carve-out financial statements, there are typically complexities that require careful consideration, which may include allocation of costs, assets and liabilities such as intangible assets, goodwill, and employee compensation liabilities to the business being divested. Expenses that are clearly applicable to the business should be reflected in its income statements. In situations where specific identification is not practicable, management should use a reasonable method, such as incremental or proportional cost allocation, for the allocation of shared expenses to the carve-out financial statements. These expenses may relate to the parent's commercial and corporate functions including distribution, quality, regulatory, IT, finance, executive human resources, and legal. In these situations, an explanation of the allocation method used should be included in the notes to the financial statements along with management's assertion that the method used is considered reasonable.

If audited carve-out financial statements are required, it is important to engage the external auditors early and have proactive conversations to provide enough time for the auditors to audit the financial statements and issue an audit opinion. The lead time required for auditors will be dependent on a number of factors, including the complexity of the transaction and the number of periods subject to audit. The auditors will need to understand the process undertaken by management to collect and prepare supporting documentation used in the preparation of the carve-out financial statements. For balances in which judgment or complex estimates are required, management should ensure that its documentation contains enough detail for auditors to reach conclusions about the reasonableness of the amounts allocated to, and balances presented in, the carve-out financial statements.

Carve-out financial statements can vary depending on the needs or requirements of potential buyers and any regulatory requirements applicable to the divestiture. If the business being divested is small, a buyer may be satisfied with an unaudited balance sheet and income statement for the most recent year. Other buyers, such as an SEC filer, may ask that the financial statements cover multiple periods and be audited. Often, even when no regulatory requirement exists, buyers may require audited financial statements for purposes of financing. Accordingly, carve-out financial statements might be in the form of (1) public entity financial statements subject to SEC requirements, (2) nonpublic entity financial statements to which certain US GAAP presentation and disclosure requirements do not apply and for which reporting alternatives developed by the Private Company Council may be elected, and (3) special purpose financial information that a user may ask for in a specific form or for it to be prepared in accordance with another comprehensive basis of accounting.

Carve-out financial statements may be subject to SEC requirements if the business is being acquired by an existing public company or if the business will become public after the divestiture. When a business is acquired by an existing public company, the carve-out financial statements may be used for a significant acquired or to-be-acquired business in certain SEC filings (e.g., a Form 8-K announcing the consummation of a business acquisition that exceeds certain SEC-defined significance levels). In certain circumstances, however, the SEC may allow registrants to file abbreviated financial statements in lieu of carve-out financial statements. These abbreviated financial statements typically consist of a statement of revenues and direct expenses (in lieu of a full statement of operations) and a statement of assets acquired and liabilities assumed (in lieu of a full balance sheet).

If the carve-out is a spinoff or equity carve-out of a company, the shares must be registered in a Form 10 or Form S-1. Both filings will require audited historical financial statements and pro forma financial information. In addition, the filings may require unaudited interim financial statements. The form and content of such financial statements must comply with SEC requirements and should follow US GAAP presentation and disclosure requirements.

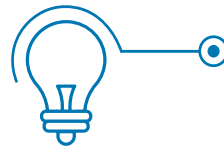


Learn more about [preparing carve-out financial statements](#), [initial public offerings](#), and [SEC reporting considerations for business acquisitions](#).

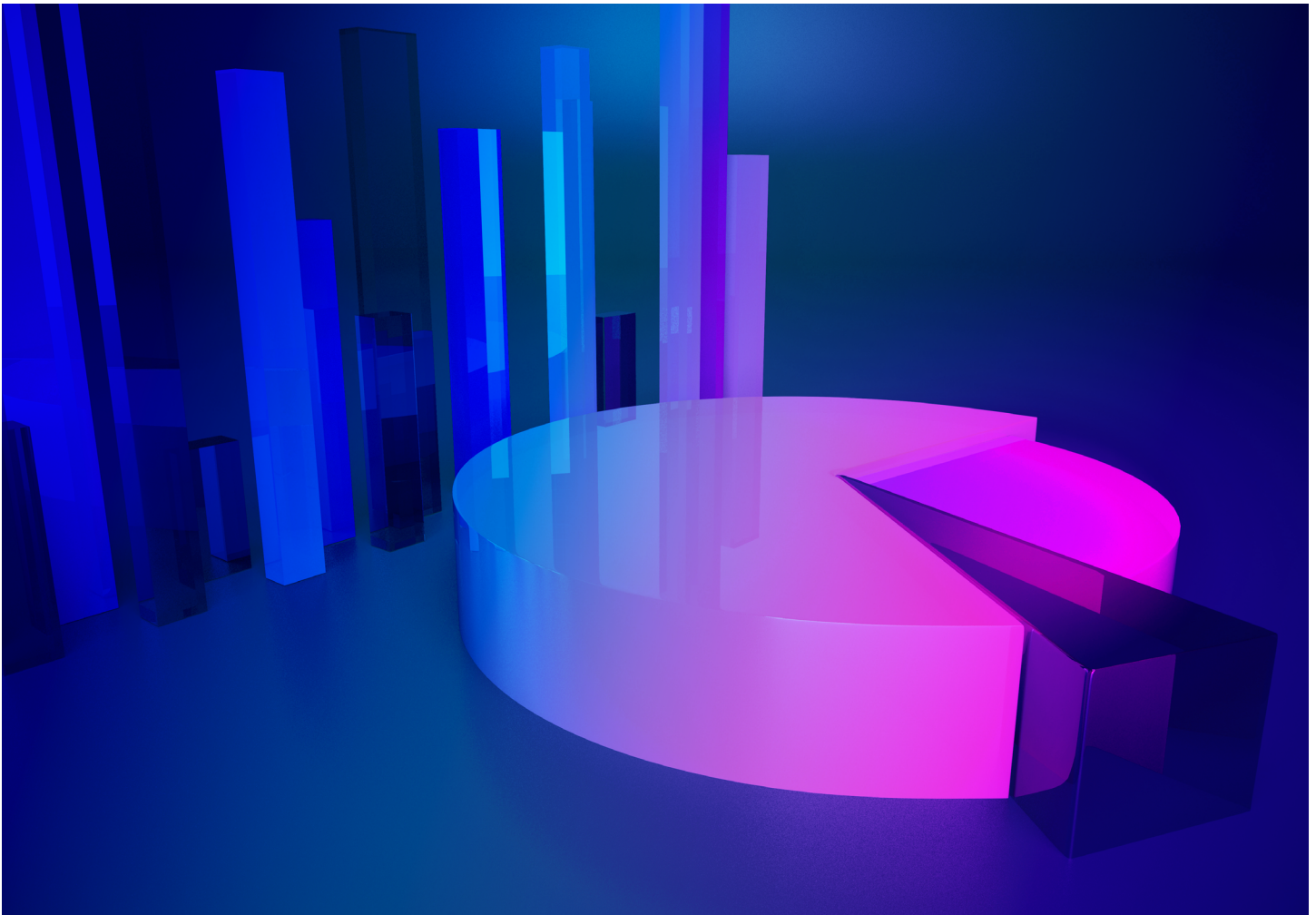
Remaining entity reporting obligations

In addition to the reporting requirements for the carved-out business, there are also financial reporting considerations for RemainCo, including evaluating if the business divested should be presented as a discontinued operation. If the divestiture meets the conditions to be reported as a discontinued operation, RemainCo will need to determine the amounts presented as discontinued operations, which may be different from amounts presented in the carve-out financial statements (e.g., there may be differences between how expenses may have been allocated in the carve-out financial statements and how expenses associated with the discontinued operation are determined).

Further, if RemainCo is an SEC registrant, RemainCo is required to file a Form 8-K within four business days after a consummated divestiture of (1) a significant amount of assets or (2) a business that is significant. The Form 8-K should include pro forma financial information if certain SEC-defined significance levels are met and a description of the divestiture such as the completion date of the transaction, a brief description of assets involved, and certain information about the buyer.



Learn more about [discontinued operations](#).



Enhancing and preserving deal value

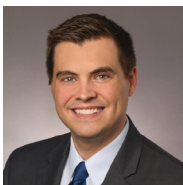
As the organization transforms through the divestiture of assets or businesses, management should consider the operations and cost structure of RemainCo with a focus on enhancing and preserving deal value. Below are some considerations management should take into account.

- Enhance cost structure – When a company undergoes a divestiture, its management should carefully evaluate whether its existing cost structure aligns with the needs of RemainCo. For example, the seller might not always be able to transfer all of the employees who have historically supported the divested business to the buyer, potentially leaving the seller with stranded costs. Companies can therefore use a divestiture as an opportunity to rethink their cost structure and make necessary adjustments to rightsize their organization. As part of its assessment, companies will often perform enterprise and functional benchmarking to compare their remaining cost structure (e.g., total cost of sales, total operating costs, EBITDA, functional costs as a percentage of revenue, and other metrics) against norms and peers to determine where enhancement opportunities may exist. It’s important to note that when making its assessment, management should balance the long-term needs of RemainCo with the company’s immediate needs to support the divested business during the TSA period, as retaining the right people is often essential to fulfill the requirements of the TSA (if any).
- Reimagine operations – Companies often view divestitures as a catalyst for transformation. Thus, depending on what was sold, management may also use a divestiture as an opportunity to reassess the operating model across different functions such as sales and marketing, research and development, finance, human resources, and IT.
- Limit the dependency and duration of TSAs – TSAs often may be necessary to close divestitures in an expedited time frame. In a TSA, the seller agrees to provide specific services—such as accounting, IT, or purchasing—to maintain business continuity while the buyer prepares to operate the new business. TSAs can be both complicated and costly, especially if they involve significant entanglement (shared resources) between the seller and the buyer’s newly acquired business. Since TSAs can be both complicated and costly, questions often arise how management can reduce the reliance on TSAs and their duration, given that these agreements can lead to interdependencies after the deal is finalized, which may prove challenging to manage. Management should balance speed to close and the impact of TSAs on the organization and its ability to enhance its cost structure.



For further consideration around leading practices, refer to [Deloitte’s divestiture survey](#).

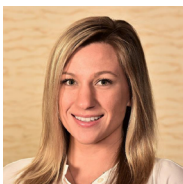
Contacts



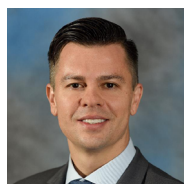
David Oberst
Partner
Deloitte & Touche LLP
doberst@deloitte.com
+1 312 486 1322



Elena Cilenti
Partner
Deloitte & Touche LLP
ecilenti@deloitte.com
+1 216 589 5051



Melissa M. Saraceno
Deloitte & Touche LLP
Senior Manager
mmsaraceno@deloitte.com
+1 312 486 1572



Derek Gillespie
Deloitte & Touche LLP
Partner
dgillespie@deloitte.com
+1 212 492 4356



This document contains general information only and Deloitte is not, by means of this document, rendering accounting, business, financial, investment, legal, tax, or other professional advice or services. This document is not a substitute for such professional advice or services, nor should it be used as a basis for any decision or action that may affect your business. Before making any decision or taking any action that may affect your business, you should consult a qualified professional advisor.

Deloitte shall not be responsible for any loss sustained by any person who relies on this document.

About Deloitte

Deloitte refers to one or more of Deloitte Touche Tohmatsu Limited, a UK private company limited by guarantee ("DTTL"), its network of member firms, and their related entities. DTTL and each of its member firms are legally separate and independent entities. DTTL (also referred to as "Deloitte Global") does not provide services to clients. In the United States, Deloitte refers to one or more of the US member firms of DTTL, their related entities that operate using the "Deloitte" name in the United States and their respective affiliates. Certain services may not be available to attest clients under the rules and regulations of public accounting. Please see www.deloitte.com/about to learn more about our global network of member firms.