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# Divest and deliver

## How consumer products companies can maximize deal value and minimize disruption when selling-off brands

There has been much activity of late in the consumer products industry — especially in the food and beverage sector — with companies selling-off non-core brands (Figure 1). Examples include Procter & Gamble's sale of Pringles to Kellogg's, Pfizer's sale of its infant nutrition business to Nestlé, Sara Lee's divestiture of its foodservice coffee and hot beverage business to J.M. Smucker's, and — in early January 2013 — Unilever's sale of its Skippy peanut butter business to Hormel Foods[1].

**Figure 1: Representative list of recent food & beverage deal activity[2]**

| Acquiror | Target | Value (US $B) |
|---|---|---|
| Nestlé S.A | Pfizer Nutrition | 11.9 |
| Heineken International BV[3] | Asia Pacific Breweries Ltd. | 4.4 |
| Molson Coors Brewing Co | Starbev Management Services | 3.5 |
| Kellogg Co | Procter & Gamble Co - Pringles | 2.7 |
| Campbell Soup Company | Wm Bolthouse Farms Inc. | 2.2 |
| Thai Beverage PCL | Fraser & Neave Ltd. | 2.2 |
| Bright Food(Group)Co Ltd. | Weetabix Ltd. | 1.9 |
| Asahi Group Holdings Ltd. | Calpis Co Ltd. | 1.5 |
| Saputo Inc. | Morningstar Foods LLC | 1.5 |
| Baltic Beverages Holding AB | Baltika | 1.1 |
| AmBev Brasil Bebidas SA[4] | Cerveceria Nacional Dominicana | 1.0 |
| General Mills Inc. | Yoki Alimentos SA | 1.0 |

1 "Hormel Jumps on Deal to Buy Skippy Peanut Butter: Chicago Mover," Bloomberg.com, January 3, 2013, http://www.bloomberg.com/news/2013-01-03/hormel-to-buy-unilever-s-skippy-peanut-butter-for-700-million.html. Accessed January 11, 2013

2 Thomson Reuters' pre-defined Target Mid-Industry called "Consumer Staples" is composed of: Agriculture & Livestock, Food and Beverage, Household & Personal Products, Other Consumer Staples, Textile & Apparel, and Tobacco

3 A unit of Heineken NV (Heineken), a majority-owned unit of L'Arche Green NV's majority- owned Heineken Holding NV subsidiary

4 A unit of the Cia de Bebidas das Americas {AmBev} subsidiary of Stichting Interbrew SA's Anheuser-Busch Inbev unit

5 CFO Insights: Divestitures and carve-outs: Becoming a prepared seller," Deloitte 2010

6 "Smucker to Pay $3 Billion for Folgers Coffee,"NY Times, June 5, 2008, http://www.nytimes.com/2008/06/05/business/05folgers.html?_r=0

7 "Unilever Sells Mrs.Dash to B&G Foods," Forbes.com, October 31, 2011, http://www.forbes.com/2011/10/31/bg-foods-buys-mrs-dash-other-brands-from-unilever-marketnewsvideo.html

8 "Unilever Sells off Bertolli," Yahoo Finance, August 23, 2012, http://finance.yahoo.com/news/unilever-sells-off-bertolli-164436686.html. Accessed January 10, 2013

### What is driving divestitures?

The drivers of CP company divestitures may be internal or external, and are as diverse as the business strategies they support. Among common drivers are the decision to focus resources on core brands/segments/markets or higher-margin products; the desire to jettison non-core brands that were part of a prior acquisition; the need to respond to changing consumer trends; the pressure to enhance shareholder returns; and the quest to raise capital to pay down debt or to fund future growth and/or acquisitions.

One increasingly visible driver is that of large, multinational CP companies seeking to maximize overall shareholder value by concentrating on their core products and "mega brands" while exiting lines of business, and/or shedding smaller, underperforming brands. Divesting such non-core assets may not only increase strategic and financial flexibility, it may also allow sellers to focus attention and allocate more resources to the core business[5]. Recent examples include former P&G brand Folgers coffee moving to J.M. Smucker's[6]; and Unilever's Mrs. Dash, Sugar Twin, Bakers Joy, and Static Guard (collectively inherited in the acquisition of Alberto Culver) to B&G Foods[7]. Additionally, companies refocus their product portfolio and geographic footprint from time to time, leading them to divest brands or exit product lines that are performing well but not necessarily seen as a core offering in the future. Unilever's recent sale of its North American frozen foods operations (Bertolli and P.F. Chang's) to ConAgra[8], a move in line with its previous exit of the European frozen food segment, is one such example.

Market dynamics can also fuel CP company carve-outs. In Europe, for example, the stressed economic climate has generated an increase in carve-out activity in the past 12 months, as overleveraged companies seek to raise cash and get their balance sheets in order. For example, Britain's Premier Foods recently announced the sale of its sweet spreads and jellies business to Hain Celestial to cut its ballooning debt, which was accumulated prior to the credit crisis[7].

In addition, the lingering economic downturn has prompted many consumers to re-evaluate their brand preferences and change their shopping habits, both of which can negatively impact a brand's revenue and market share and prompt CP company executives to consider potential divestitures. According to Deloitte's Market Pantry study, 80 percent of surveyed consumers say that "Going through these economic times has caused me to realize which brands I really care about and which ones are less important to me,"[8] sentiments that often prompt consumers to switch to less-expensive branded products or private label offerings.

### CP divestiture challenges

Sometimes companies think of divestitures simply as "acquisitions in reverse" and underestimate the effort and time the sales process requires, especially for businesses that are tightly integrated. When CP executives consider divesting one or more brands, they typically face a number of general and industry-specific challenges, among them:

## 1 Separating integrated businesses

Over the past two decades, many CP companies have leveraged advances in information technologies to enable financial integration across multiple business units. The tighter the integration, however, the more difficult and costly it can be to decouple an individual brand or business unit for a potential sale. From a financial perspective, two issues can be particularly troublesome: First, the availability of standalone financial information may be limited when multiple brands are co-mingled, inhibiting a broad view of operating costs and required capital. Product line/brand financial information is typically confined to a "direct margin" view versus a full P&L and balance sheet. Additionally, "direct" expenses such as trade spend (advertising, slotting fees, discounts, co-op advertising, etc.), production overhead, distribution, etc., are often allocated to the individual brands based on revenue, units shipped, or some other metric and do not represent the actual expenses that were or may be incurred for the individual brand on a standalone basis.

A problem for the seller may arise with potential purchasers challenging the cost allocations, asserting that they understate true direct expenses and, therefore, overstate profits. Second, a company may have standalone GAAP-basis financial statements for the brand or business line being divested with full allocations of not only the "direct" expenses discussed above, but also division and corporate overhead that will not be assumed by the buyer. Depending on the size of the transaction and the ultimate buyer, there may be a need to prepare and furnish audited, SEC-compliant financial statements. Companies typically anticipate this need in advance of undertaking the sale process and prepare the requisite carve-out financial statements. The challenge then becomes bridging the fully-burdened GAAP-basis financial statements to pro forma financial information[9] to reflect only the relevant operating costs that a purchaser may likely incur so that the valuation is based on the most pertinent financial data.

It also can be difficult to divest individual brands from business units that are operationally entwined. Many CP companies today share fixed-cost elements such as IT systems, support services (e.g., human resources, procurement), and multi-use facilities. Shedding one or more brands often can require major system or process reconfigurations, something a company often does not anticipate.

Another operational challenge may scuttle a potential deal before it gets off the ground: CP companies typically distribute their products via either Direct-Store Delivery (DSD) or warehouse delivery, and P&Ls can look completely different for the two models. If a company using a DSD channel wants to spin-off a product line and the prospective purchaser doesn't have DSD distribution, it may be impractical and cost-prohibitive for them to develop a DSD model if there is only one product they will distribute that way. When Kellogg's acquired Keebler, the latter company had a DSD channel and the purchase gave Kellogg's an opportunity to increase its own product distribution via DSD. However, disparate distribution channels may be a deal-breaker for other CP companies[10].

If a company has co-mingled products manufactured in the same facility and distributed via the same channels, the financial team needs to identify the potential operational impacts of a sale, as well as the divested unit's standalone costs from two perspectives: What is the true cost to a buyer to get that product to market, and what costs will the seller be able to eliminate from its P&L post-sale (see #2)?

7 "Hain Buys Premier Foods Brands," Yahoo Finance, October 30, 2012, http://finance.yahoo.com/news/hain-buys-premier-foods-brands-211916881.html
8 The 2011 American Pantry Study, Deloitte 2011
9 Note: This is not referring to SEC/S-X pro formas
10 "The Man Who Fixed Kellogg Stale offerings. Soggy profits," CNN Money, September 6, 2004, http://money.cnn.com/magazines/fortune/fortune_archive/2004/09/06/380333/index.htm

## 2 Avoiding stranded costs

Shedding non-core businesses or brands can leave the seller with stranded costs — expenses previously incurred in operating the divested unit that may not be possible to eliminate because they are largely fixed in nature (e.g., manufacturing costs, shared service centers, etc.). The financial team should be wary of loss of scale, increased purchasing costs due to reduced volumes, redundant capabilities, etc., and their impact on the remaining business. Even if the need for cost reduction is apparent, management's inability to deal with competing priorities during a time of transition, insufficient resources to execute, and a failure to follow through may saddle the seller with unnecessary costs[11] that are disproportionate for its new size. Conducting a stranded cost analysis to determine whether the seller is going to be left with overhead that won't be redeployed is an important, yet often overlooked, part of the process.

## 3 Providing post-transaction support

Sometimes a CP company is required to provide transitional services to the divested unit for a period after the transaction closes. Traditional Transition Service Agreements (TSAs) are, too often, utilized as the default option without questioning whether there are quicker, cheaper alternatives. Because neither the seller nor the buyer is typically in the service-providing business, the result can be expensive and time-consuming. Organizations should craft TSAs to reflect accurate costs, defined service levels, and specific exit plans[12].

## 4 Managing multiple priorities

When the individual or team responsible for a brand that is being carved out has broader responsibilities (e.g., overseeing a number of brands or the overall business), the divestiture process becomes just one of multiple priorities to manage. It can be difficult to focus employee attention on important transaction activities such as conducting due diligence and developing business transition plans while they concurrently perform their day-to-day jobs. Divided attention may also negatively impact the focus and financial performance of the business being divested, which can have a corresponding impact on valuation. Adding complexity to the situation is uncertainty as to whether brand owner(s) will stay with the parent company post-sale or follow the divested entity to its new home. In either case, both the seller and buyer are incentivized to avoid distractions or operational lapses during the transaction that could jeopardize market position or business continuity.

## 5 Mitigating external deal-breakers

Regulatory or marketplace issues outside of the seller's control could potentially derail a divestiture. For example, a potential acquirer with a strong presence in the seller's product category could present anti-trust issues. Also, given the choppiness in the credit markets in recent years, financing issues could be another key consideration, depending on who the buyer is. Mitigating external challenges such as these should be key factors when developing prospective purchaser lists and evaluating if and when to enter into exclusive discussions.

### Leading practices to maximize value

Proper planning is critical to facilitate an effective divestiture: A prepared seller is focused on more than getting the financials in order and the data room populated; the seller develops and articulates the upside potential and considers the potential challenges from a focused buyer's perspective[13]. It has increasingly become a buyer's market, with the buyer insisting on a more robust diligence process in regards to timetable and scrutiny of information. The following leading practices can help facilitate a smooth transaction and drive value maximization.

- Create a credible, standalone P&L for the entity being carved out and tailor the presentation of the financials and investment highlights to the audience (e.g., highlight buyer-specific cost and revenue synergies, articulate future growth opportunities or underleveraged brand equity, etc.). Credibility with potential buyers is key to maximizing value. The risk of losing credibility begins the first time the buyer receives information; therefore, proper preparation is critical to ensure that due diligence questions a buyer may raise have already been considered and addressed by the seller.
- Conduct pre-sale, sell-side diligence. This allows management to anticipate and formulate responses to key due diligence focal points from a buyer's perspective, decrease potential surprises during the process, and have confidence that potential buyers are basing their proposals on credible information that will stand up through diligence (especially when multiple candidates are expected to participate via an auction process). Effective pre-sale diligence allows sellers to run a more efficient, competitive process and decrease the potential risk of re-trading of key terms by prospective buyers.

11 CFO Insights: Divestitures and carve-outs: Becoming a prepared seller, Deloitte 2010
12 Ibid
13 Divestiture Survey Report: Carve-out trends and leading practices, Deloitte, 2011

- Consider pre-sale structuring to maximize the seller's after-tax proceeds and minimize taxable gains. Sellers with expiring tax attributes, such as net operating losses, may also be able to monetize these tax attributes by restructuring the target business to provide on an amortizable basis to the buyer.
- Help prospective buyers envision the entity's potential. Work closely with current management to explore what the business could do with additional focus and resources and effectively convey that vision to potential buyers during management presentations.
- Also, leverage untapped brand equity: If the brand has a loyal consumer following and positive brand awareness, what could the new buyer do with those equities?
- Consider personnel issues early in the process. There are a couple of potential outcomes for the brand's current management team: Key personnel may be retained with the seller if the divested brand is just a small part of their responsibilities. However, if the brand's management represents a substantial portion of their time, they may be asked to separate with the brand. A stay bonus or similar arrangement may be required to ensure that existing management is incentivized to maximize value through a transaction.
- Use independent, external advisors to augment internal resources before, during, and after the sale. Merger & Acquisition (M&A) accounting professionals, for example, can help to conduct pre-sale financial due diligence with a focus on earnings quality, normalized working capital, and financial commitments (net debt). M&A tax professionals can advise how to structure the sale of the business so it will yield the greatest tax benefit and avoid adverse consequences. M&A seller advisory services professionals can provide a broad spectrum of customized services and recommendations, including deal planning and preparation, deal structuring, transaction execution, and transaction closing and post-closing support. M&A consulting professionals can assist with standing up a business for sale, establishing a clear separation strategy, assessing functional impacts, and preparing post-sale, "Day One" readiness plans.

By becoming a prepared seller in advance of transaction execution, CP companies divesting a brand or business unit are likely to realize better deal values, a shorter time to close, minimal transition services duration and scope, and quicker elimination of stranded costs[14].

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14 CFO Insights: Divestitures and carve-outs: Becoming a prepared seller, Deloitte, 2010