The serial divestiture journey

Navigating serial divestitures to rebalance portfolios for growth

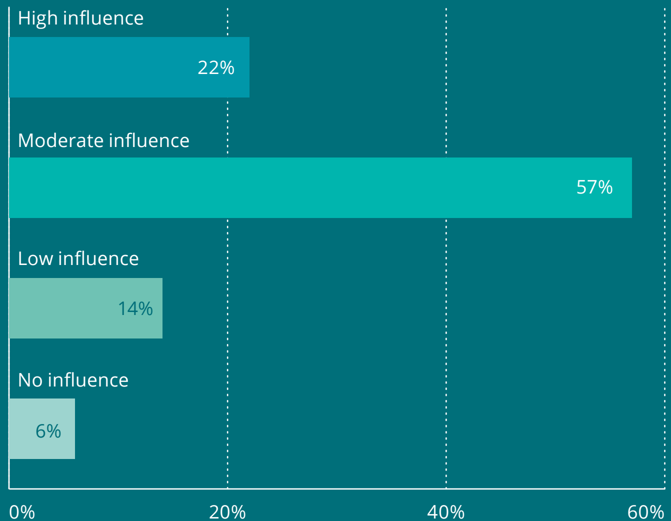
Embracing opportunity

Any company that aims to outperform its peers over the long run should continuously evaluate and pivot its business model and asset mix. Our research indicates that those who frequently do so also achieve higher returns on their M&A transactions.[1]

While businesses have mostly had a favorable backdrop for expansion after the dust settled from the Great Recession,[2] market dynamics have rapidly changed recently. Unprecedented supply chain delays and prolonged disruptions persist, interest rates are rising as policymakers battle inflation, and the economy continues to adjust to shifts and ripple effects caused by the pandemic (figure 1). For larger companies with diverse portfolios, now is the time to examine how economic and market disruptions may be affecting specific businesses and permanently altering their return profiles (figure 2).

Figure 1: Pandemic influence on divestiture strategy

Seventy-nine percent of respondents reported the pandemic had a moderate to high influence on their sell-side strategy; organizations with $5B+ in annual revenue indicated "high influence" compared to other organizational sizes.

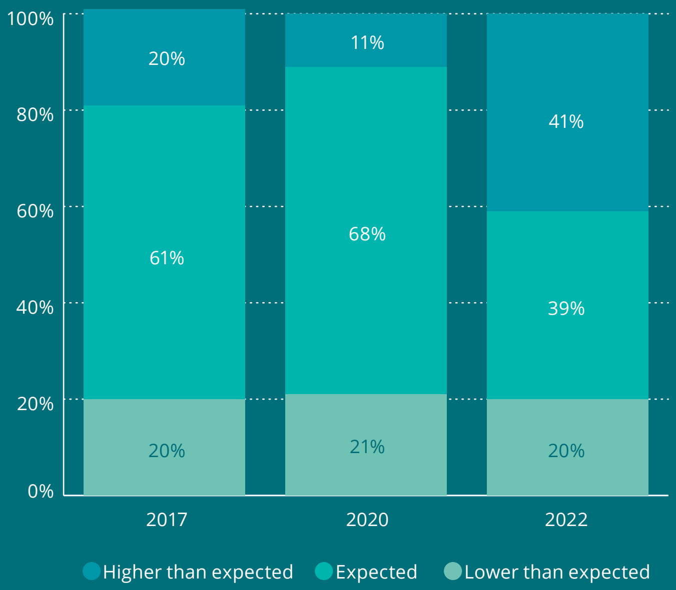


Note: N=500; Does not total to 100% due to rounding.

Source: Deloitte 2022 Global Divestiture Survey

Figure 2: Impact to divestiture value

In late 2021, many sellers still saw M&A markets as seller friendly, with 41% of survey respondents receiving a higher deal value than expected.



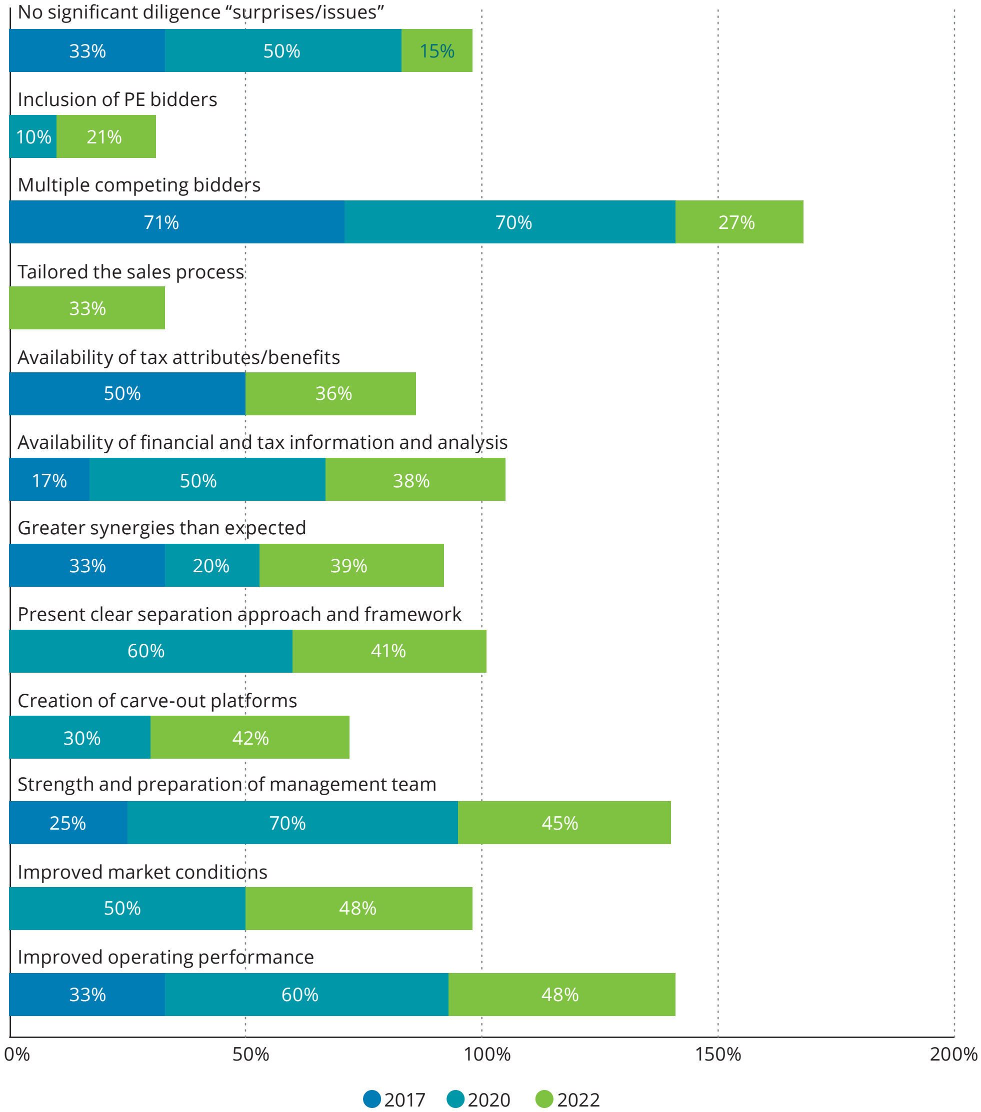
Note: 2022 N=500, 2020 N=100, 2017 N=100; "Don't know" responses have been removed; Does not total to 100% due to rounding.

Source: Deloitte 2022 Global Divestiture Survey

While mergers often receive a disproportionate share of media attention, divestitures, spin-offs, and asset sales have the opportunity to generate tremendous value. Organizations that conduct a well-designed portfolio review can more effectively identify and prepare businesses for divestiture. This process can enable the identified businesses to thrive by unlocking the resources, focus, and entrepreneurial energy available in a stand-alone company or as part of a smaller organization. Divesting these businesses can free up capital and other resources to allow the remaining company to pursue investment opportunities that more closely align with its overarching strategy and mission (figure 3).

Figure 3: Higher-deal-value drivers

Improved operating performance was the driver of higher deal value for 48% of respondents that had received higher deal value than expected.



Note: 2022 N = 205; "Inclusion of PE bidders," "Present clear separation approach and framework," "Creation of carve-out platform," and "Improved market conditions" responses were not available to select as answers in 2017; "Availability of tax attributes/benefits" response was not available in 2020; "Tailored the sales process" response was not available in 2017 or 2020.

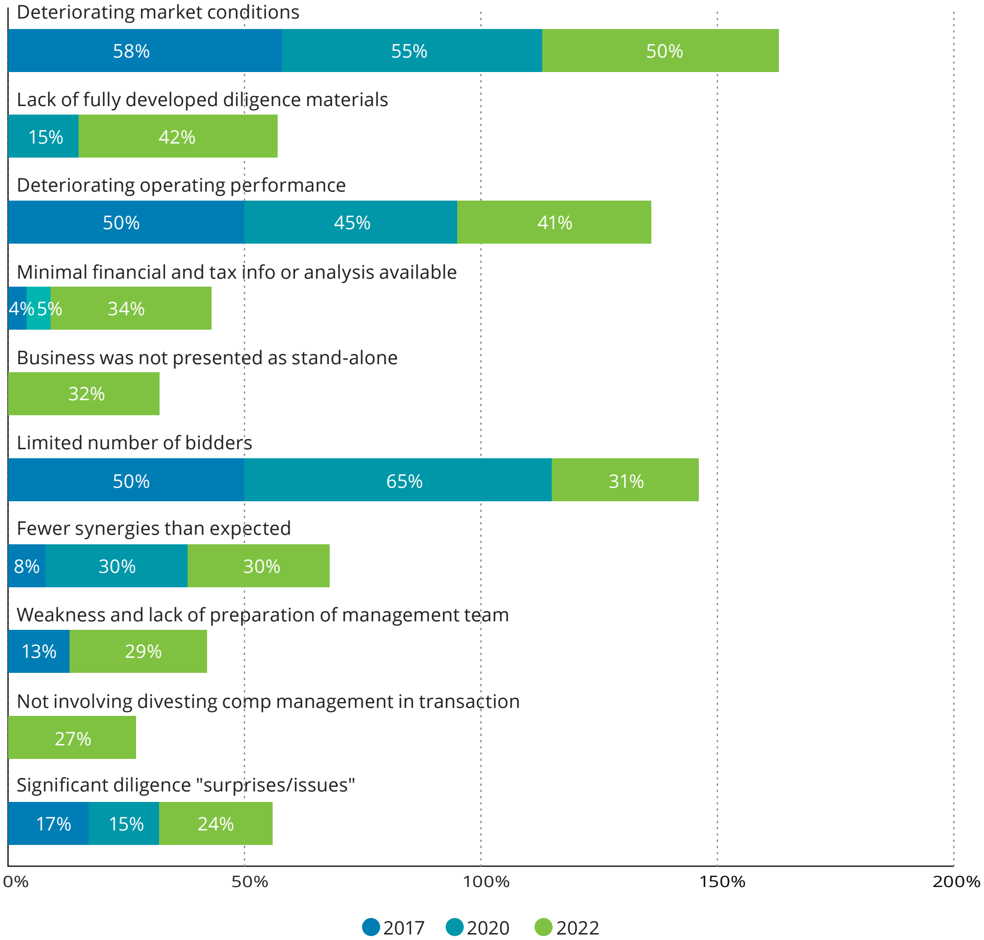
Source: Deloitte 2022 Global Divestiture Survey

To get the most out of portfolio management, our research shows that more frequent portfolio reviews lead to higher value out of divestitures.[3] For larger companies, portfolio reviews should place attention and focus on managing complex interdependencies, sequencing, and similar aspects that impact the ability to maximize total value from serial divestitures.

That said, portfolio management and separation strategy are only the beginning of the serial divestiture process. The execution of each divestiture should be prepared and managed effectively, while recognizing how the individual risks and execution hurdles that interfere with value creation and deal success will compound when evaluating several divestitures at the same time (figure 4). A successful strategy to maximize shareholder returns will take time to define the scope of each divested asset (or "deal perimeter") thoroughly and sequence specific deals in the series of divestitures to position each individual asset as part of a broader value creation strategy (figure 5). Value will be optimized when assets are bundled properly, separation complexities are addressed and mitigated upfront, and separations are properly sequenced.

Figure 4: Reasons for lower deal value

For companies receiving a lower deal value than expected, 42% saw lack of fully developed diligence materials as one of the most important drivers of lower deal value.

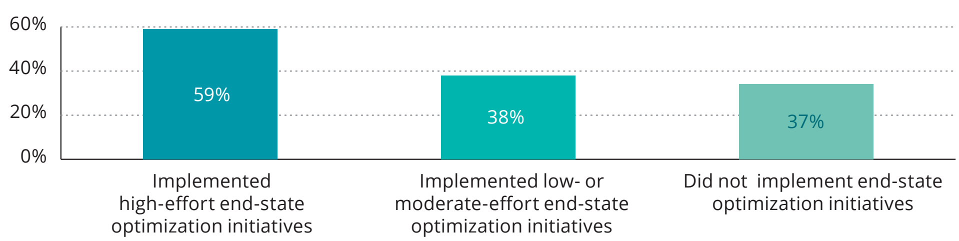


Note: 2022 N=101; "Lack of fully developed diligence materials" response was not available to select as an answer in 2017; "Weakness and lack of preparation of management team" response was not available in 2020; "Business was not presented as stand-alone" and "Not involving divesting company management in the transaction process" responses were not available in 2017 or 2020.

Source: Deloitte 2022 Global Divestiture Survey

Figure 5: Impact to divestiture value

While only 16% of respondents indicated they implemented high-effort end-state optimization initiatives, those who did were significantly more likely to achieve a higher value than expected.



Note: 2022 N=500, 2020 N=100. Source: Deloitte 2022 Global Divestiture Survey

Establishing effective portfolio review criteria

Whether it is from acquiring small, unrelated assets in a large acquisition or due to changing business conditions, large companies should consistently and proactively review their assets to help distinguish between core and non-core assets.

In our work with clients, we often encounter organizations that do not have a regular and effective portfolio review process, which we have found to be one of the key predictors to value creation through divestitures. Indeed, a recent Deloitte survey[4] identified a potential link between the frequency of corporate portfolio reviews (potentially indicating maturity) and value achieved in divestiture transactions. Respondents indicating they conduct more frequent portfolio reviews more often indicated achieving higher-than-expected value on their most recent divestiture. Noteworthily, companies seem to be starting to turn a corner on portfolio reviews. In 2020, we observed that only 17% of respondents conducted a portfolio review more than once per year. In 2022, this figure had risen to 54%.

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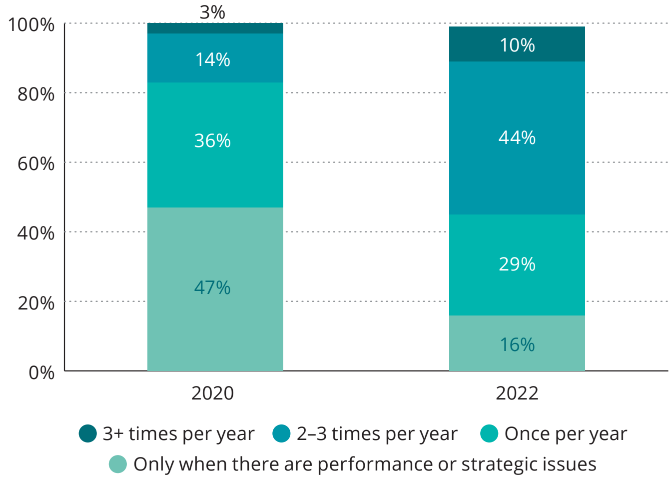
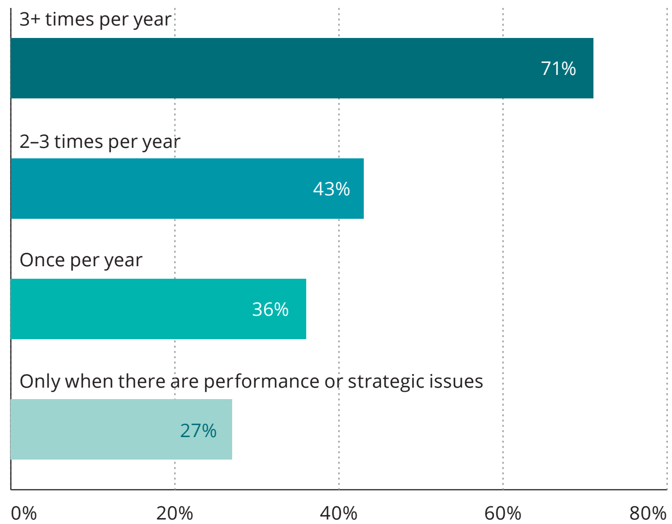
Figure 6: How often does your company strategically evaluate individual businesses to determine whether the business should continue to be owned or divested?



Note: 2022 N=500, 2020 N=100; Does not total to 100% due to rounding.
Source: Deloitte 2022 Global Divestiture Survey

Figure 7: Of respondents that selected each response, percent that indicate achieving a higher value than expected on their most recent divestiture



Source: Deloitte 2022 Global Divestiture Survey

To optimize its portfolio review process, a company should focus on establishing a regular review cadence as well as consistent review metrics and criteria to increase the likelihood of meeting its strategic goals. This review process helps buttress the risk of getting caught flatfooted during changing market conditions, and it also helps companies act decisively when the time is ripe to divest or double down on certain assets.

We believe companies should use an "invest," "harvest," or "divest" framework that contemplates the following questions:

- Is there a path for this asset to achieve market leadership? Is there sufficient runway/market opportunity to earn positive incremental returns on invested capital for this asset?
- Is the value of this asset optimized under our company's ownership? Is it accretive/dilutive to our overall multiple? Are there other owners who can better maximize the value of this asset?
- What do valuations look like for comparable assets in similar spaces? Do the financial and resourcing costs of separating the asset justify the value that would be created for shareholders? If not, is there a way to optimize this business for return on capital/cash flow?

With the application of an effective portfolio evaluation process, it becomes possible to make regular assessments of how a particular asset aligns to core business objectives. It is highly unlikely that all possible quantitative and qualitative factors will be relevant across all organizations, but it is critical that companies create their own framework and cadence to address their specific needs. A robust evaluation framework will help a company weigh the risks and benefits associated with grouping assets for divestiture.

That said, if the decision is made to divest a certain business or asset, the review process will assist a company to develop insights into how assets should be grouped for maximum value to potential buyers.

Asset bundling

One key consideration is to have a proper level of specificity when bundling assets for divestiture. Factors including, but not limited to, manufacturing (dis)synergies, commercial contracting, tax implications, and regulatory considerations all fall into this bucket of considerations when evaluating asset grouping. Overly granular product classifications may obscure synergies that can create value. There may be network effects that justify grouping assets that are not immediately obvious. For instance, a product that is not a market leader might nonetheless enable another product that dominates a category and has strong market position.

Being clear on what "success" looks like and having the right key performance indicators (KPIs) to measure success is important. This can sometimes be a hurdle for portfolio review efforts, but we often advise our clients to establish proxy metrics that can help address this fundamental step. Seeking out both quantitative financial data related to such metrics as market size or profitability and qualitative scales such as intellectual property strength can help in ranking assets.

Ultimately, an organization needs to be flexible. As we will discuss later in this paper, bundles of asset combinations for divestiture can often be dependent on the buyer universe. It is critical to have a "base case" bundle to begin the overall divestiture program, but companies often find it necessary to alter that asset bundle as it moves through the divestiture process.

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Optimizing for serial divestitures

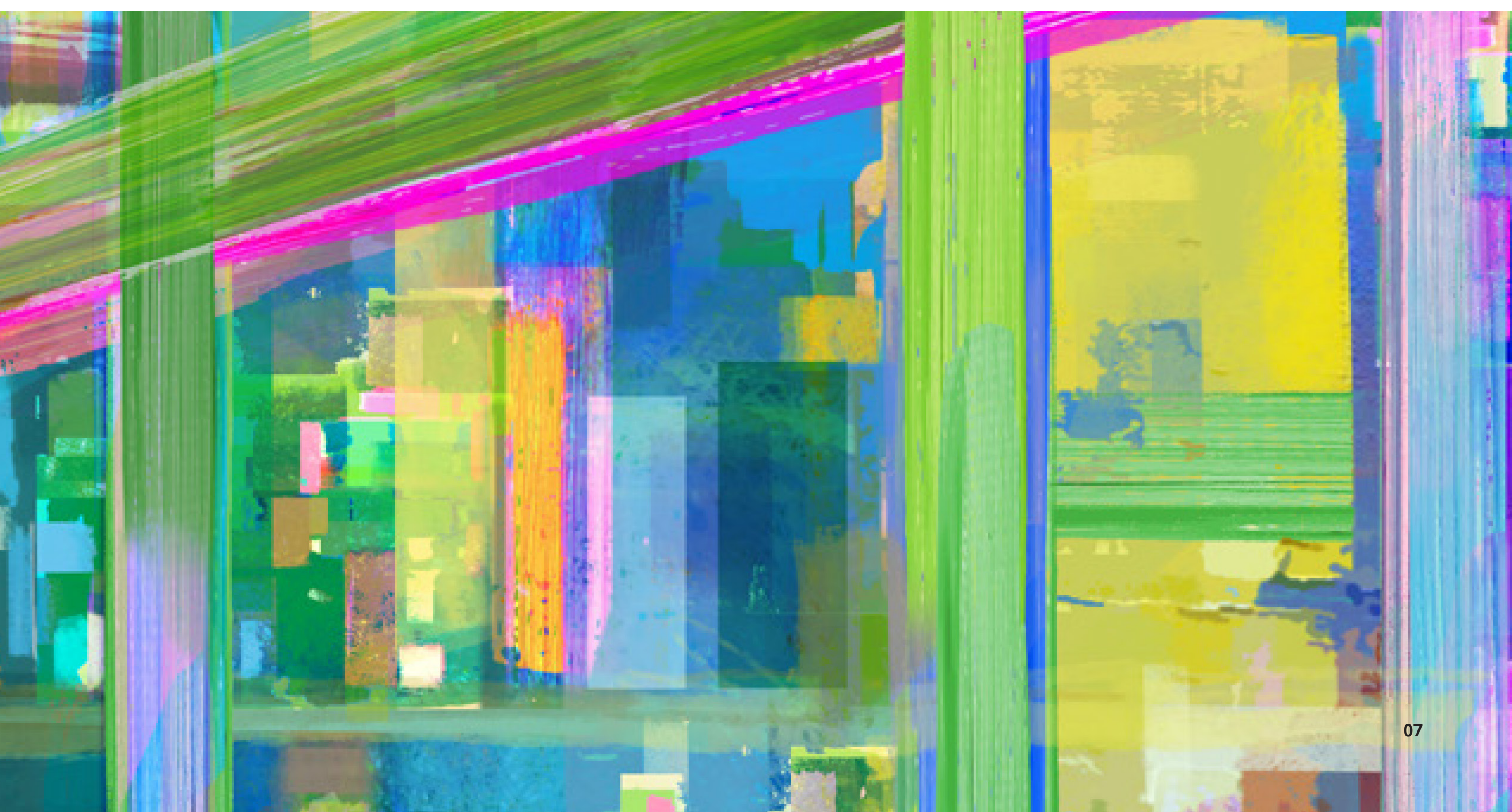
After undergoing a thorough portfolio review process, a company may decide that is has multiple divestitures it wants to execute. When an organization queues up multiple divestitures, its separation strategy should address interdependencies across transactions and how those interdependencies may ultimately impact deal value. The interactions among deals may be complex and may shift over time. In addition, operational separation risks tend to compound when there are multiple divestiture programs being executed simultaneously.

From our experience, we tend to see several common problems with serial divestitures:

- A lack of clarity on divestiture objectives
- Shifting deal perimeters and changing deal structures
- Separation “fatigue” and Transition Service Agreement (TSA) convolution

All the aforementioned factors often prolong or undermine divestiture programs, creating significant value leakage and a loss of momentum. Based on our experience, we suggest the following practices to help navigate these persistent challenges:

- Program governance and guiding principles
- Pre-sale diligence on the buyer universe and deal perimeter
- Divestiture sequencing strategy



Program governance and guiding principles

While it is key to any successful divestiture program to have robust governance, it is even more critical for managing serial divestitures. We find that companies with strong divestiture program governance tend to minimize several of the risks experienced by companies that run projects in silos.

Some of the key benefits of program governance that we regularly see are:

- Insight into functional bandwidth/priorities and capacity management
- Superior cross-deal interdependency management
- Enhanced issue/problem resolution
- Consistency in TSA approach/philosophy

In addition to governance, we recommend that serial divestiture programs have clear guiding principles. The adage in M&A is that time kills deals, and we consistently see that a program lacking guiding principles lacks sufficient organizational alignment to decentralize decision-making. Inevitably, there will be trade-offs in any divestiture transaction, and all project leaders should know what overarching strategic goals, imperatives, and non-negotiables they are marching toward. This can shorten decision-making time and improve alignment across the organization, particularly if there are key separation items like TSA that a company may want to apply consistently across divestitures.

Pre-sale diligence on the buyer universe and deal perimeters

One of the often underappreciated aspects of any divestiture process, let alone a serial divestiture program, is a deeper understanding of the buyer universe, as well as the deal perimeter of different assets. Companies can gain a considerable advantage in execution timing by understanding the universe of potential buyers before launching a sale process. This can help the company proactively prepare analysis and data requests that can help streamline the diligence process for buyers. Additionally, companies can potentially change the scope/perimeter of a deal if it knows that divesting assets to certain buyers may negatively affect its remaining operations.

With this in mind, it is critical for companies to thoroughly understand deal perimeters. This enables the ability to change a grouping of assets more dynamically to potentially appeal to different sets of buyers or to find the right "home" for assets within different asset bundles. Further, it will help the organization shape its separation and TSA philosophy—two factors that often delay the sale process and prolong operational entanglements.

Sequencing strategy

There are innumerable factors that may ultimately have an impact on a company's approach to sequencing serial divestitures, including tax consequences, regulatory review time periods, financial reporting impacts, investor communications, and TSA duration. We commonly see value leakage when a company does not thoughtfully sequence its divestitures.

Aligning sequencing to the overall objectives of the divestiture program can help minimize value leakage, but more importantly, prevent timing delays that can put one or more individual divestitures at risk. Companies are often tempted to go as quickly as possible, but the impact of not thinking through the right order of operations can undermine the value of a divestiture program. Evaluating the impact of sequencing on the divestiture program ahead of initiating the divestiture process can help mitigate problems in the future.

Some considerations that shape an initial sequencing strategy may be:

- Are there overriding objectives that influence our sequencing? (e.g., a timeline for specific financial targets)?
- Are there macroeconomic concerns, industry cyclicality, or operating issues that influence the ideal time to sell?
- How experienced and comfortable are we with divestitures? Should we start with something easier and less complex if we are more inexperienced?
- What bidder types are we targeting for each divestiture? Are we prepared for potentially more demanding private equity investors?
- What does our internal resourcing capacity look like, and how would we supplement?

Conclusion: A proactive approach maximizes value and minimizes pain

Although no divestiture program is easy, serial divestitures both compound the impact of problems generally encountered through a single divestiture program and create their own unique set of issues that can create value leakage and ultimately inhibit companies from executing a successful proactive portfolio management strategy.

Companies can take the following steps to proactively manage serial divestitures and optimize value from their portfolio management process:

- Establish a proactive, regular portfolio review process with clearly defined KPIs
- Create a "base case" asset bundle, knowing that it may need to change over time
- Establish robust divestiture program governance and clear guiding principles
- Perform due diligence on the potential buyer universe and deal perimeter
- Perform a sequencing analysis prior to inform the timing of each divestiture/sale

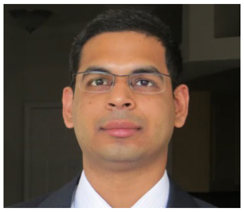
Implementing the above steps will help organizations prepare for and navigate the often-choppy waters that accompany serial divestitures.

Companies can gain a considerable advantage in execution timing by understanding the universe of potential buyers as well as possible before launching a sale process.

Contacts

Will Engelbrecht
Principal
Deloitte Consulting LLP
wiengelbrecht@deloitte.com

Varun Budhiraja
Principal
Deloitte Consulting LLP
vbudhiraja@deloitte.com



Kushan Biswas
Senior Manager
Deloitte Consulting LLP
kbiswas@deloitte.com

Henning Buchholz
Senior Manager
Deloitte Consulting LLP
hbuchholz@deloitte.com

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Endnotes

1. Deloitte 2022 Global Divestiture Survey: c. 70% of respondents who evaluated their portfolios three or more times per year indicated they achieved higher-than-expected value on their most recent divestiture.
2. We refer to the Great Recession as a period of global market declines between December 2007 and June 2009.
3. Deloitte 2022 Global Divestiture Survey.
4. Ibid.