Will you set the divestment pace, or try to keep up with it?

India Corporate Divestment Study 2019

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Our perspective

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Indian corporate boardrooms are increasingly facing critical issues that directly impact their business strategies and future directions. Shifting customer expectations, regulatory and tax changes, along with geopolitical and global macroeconomic changes, will all affect how businesses operate in the future. Companies are now streamlining operating models and focusing on core business fundamentals to capitalize on the growth opportunities presented in India. Fueling this growth agenda requires capital, and divestments are an effective source for funding investments in technology, products, markets and geographies.

This report highlights that 81% of surveyed companies in India are planning to divest in the next two years. Companies continue to divest non-core businesses in order to streamline their operating models. A constant review of business portfolios helps organizations build trust with their stakeholders, thus generating greater shareholder value.

The decision to divest is only the beginning of the process and our experience shows that sellers often underestimate the effort required to execute a successful separation. The first edition of the EY *India Corporate Divestment Study* aims to help companies understand the steps required for increasing divestment success, such as identifying the impact of different deal structures, understanding regulatory and tax requirements, conducting adequate diligence, addressing interdependencies across their businesses and developing a comprehensive value proposition for the buyer.

Sellers also need to be prepared to engage with the ever-widening pool of buyers — from private equity to cross-sector businesses. Leveraging analytics, aligning leadership around deal perimeters and building stand-alone operating models creates confidence in buyers that the business has been properly prepared for separation, thus making it easier for buyers to take control of the target post-deal.

All of these critical divestment steps can help companies accelerate their pace of transformation, reposition the remaining business for future growth, and ultimately drive total shareholder value.

About this study

The EY *Corporate Divestment Study* focuses on how companies should approach portfolio strategy, improve divestment execution and future-proof their remaining business.

The 2019 India study results are based on interviews with 43 Indian senior executives. The survey was conducted between September and November 2018 by Acuris.

- Executives are from companies across India and from varied sectors.
- Eighty-eight percent of the respondent companies are publicly listed.
- Executives have knowledge of or direct hands-on experience with their company's portfolio review process and have been involved in at least one major divestment in the last three years.
- Thirty-five percent of corporate executives represent companies with annual revenues of US$1b–US$5b.
- Thirty percent represent companies with revenues that exceed US$5b.

Key findings

81% of companies surveyed plan to divest within the next two years.

Increasingly, corporates are using divestments as a strategic option to unlock significant value. Evolving customer preferences, macroeconomic uncertainties, technological change, shareholder pressure and geopolitical instability are driving corporates to consider divestments.

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Why are so many companies divesting?

63%

say streamlining operating models will factor into their divestment plans over the next 12 months.

23%

identify financial distress of the parent or target as a major reason for divestment.

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How can you operationalize a divestment for success?

77%

say their divestment was delayed or deferred because they didn't fully understand regulatory requirements.

63%

say they held onto assets too long when they should have divested them.

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How can you maximize value from the next wave of buyers?

40%

say working with a PE buyer led to an increase in purchase price.

56%

say that PE involvement in the sale process led to an increase in multiple for the business.

Lessons learned

Streamline operating models for better agility and sharper focus

Re-focus on core business

Geopolitical shifts are a constant variable in the divestment equation

Active portfolio management tempers opportunistic divestments

Weigh the merits of different deal structures

Always be divestment-ready

Make tax a top consideration

Understand work stream interdependencies

Anticipate regulatory hurdles

Don't hold onto assets too long

Expect wide price gaps

Leverage the power of private equity

Use analytics in the sales process

Build value through stand-alone operating models

Align on deal perimeter

1 Why are so many companies divesting?

Eighty-one percent of the companies surveyed are planning to divest in the next two years. This is largely driven by the companies looking to deleverage their balance sheets. The evolving regulations (e.g., Insolvency and Bankruptcy Code (IBC)) and business environment in India are adding pressure on corporates to streamline their business models. Shareholders are becoming increasingly aggressive, which is driving corporates to place divestments at the core of their growth and transformation strategy.

Macroeconomic uncertainty, along with regulatory and technological changes, are causing unprecedented business disruption globally. In India the drive for resolution of non-performing assets and shareholder pressure are making corporates confront an important issue: how do they best deploy their resources to stay competitive in an evolving market?

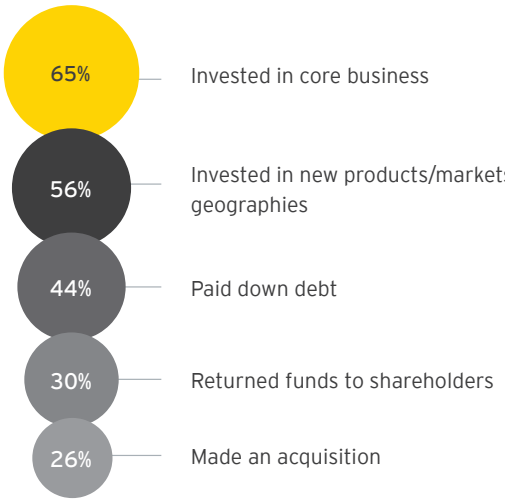
Re-focus on core business

During the record credit growth between 2004–09, many Indian corporates diversified their business into emerging industries such as infrastructure (highways, power, etc.). However, in the past decade, regulatory changes and business cycles have forced corporates to reassess their business and capital allocation strategies. Some of the capital allocation challenges that companies face today are:

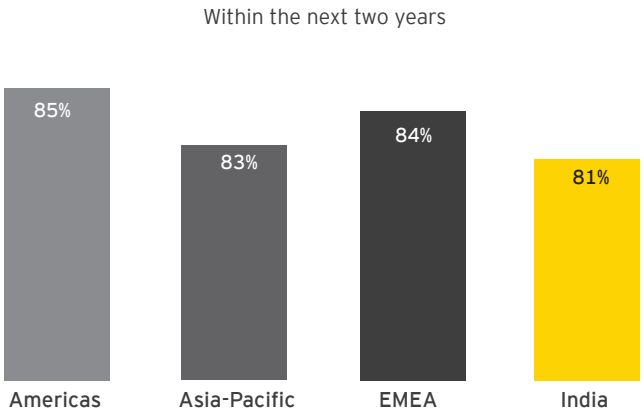
1. What, where and when to divest?
2. When should they dispose of part of the business that no longer fits into the future strategy?
3. How do they raise sufficient capital to invest in new technologies, markets and sectors?

EY research shows that 65% agree that they used the proceeds of their last divestment to re-invest in their core business.

Q What did you do with the funds raised from your most recent divestment? Select all that apply.



Q When do you expect to initiate your next divestment?



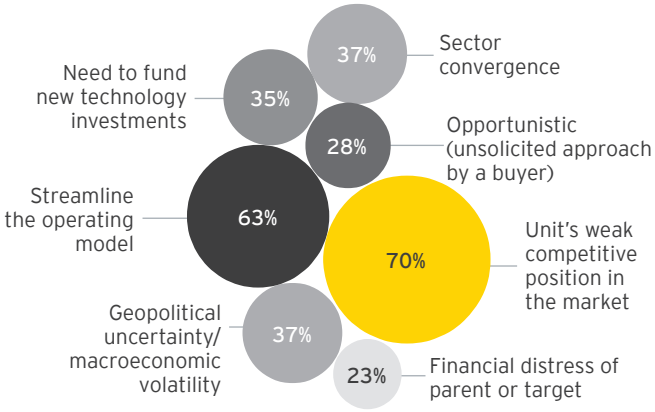
The IBC has led to distressed assets becoming available to buyers at potentially attractive valuations. Further, sectoral convergence trends are also widening the pool of potential buyers. Seventy-four percent of executives surveyed expect to see divestments related to industry consolidation over the next 12 months and 40% of the potential buyers are expected to be outside the seller's sector.

Streamline operating model

Faced with evolving sector landscapes, businesses are continually evaluating their growth strategies. Corporates need to be agile and have access to capital for investment. Seventy percent of surveyed companies divested assets because they needed to generate more capital.

The result is a streamlined operating model that gives companies the ability to quickly execute their capital agendas. Our survey shows that 63% of companies identified the need to streamline their business model as one of the primary drivers for their recent divestment. Further, 86% of the respondents believe that this will continue to be the reason for divestment in the coming years.

Q Which triggers prompted your most recent major divestment? Select all that apply.



More than half the executives surveyed (56%) say that proceeds from the last divestment were used to fund investments in new products, markets and geographies.

> "We need expansion capital and we have a set of non-core assets that have served us well, but if the projections are right, we will go ahead with the planned divestment."
>
> A CFO of a media and entertainment company

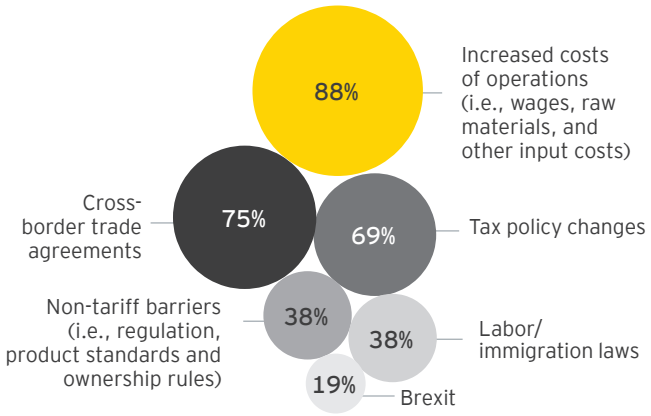
Geopolitical shifts: a constant variable in the divestment equation

Despite uncertainty within global markets, whether driven by tariffs or trading costs, companies must continue to diligently review their portfolios. Recent events such as changes in global foreign trade policies, Brexit and immigration matters add to the complexities of making strategic portfolio decisions.

Fifty-eight percent of companies feel that macroeconomic and geopolitical triggers will play into divestment decisions next year. These factors must be taken into consideration when finalizing financial forecasts for companies operating in the affected markets.

Almost all companies (88%) expect these geopolitical shifts to push operating costs higher, while 75% are unsure whether they can depend on existing cross-border trade agreements remaining in force. They will have to factor these rising costs into their divestment strategy and timing. Whether these factors can otherwise be addressed through vendor negotiations, price increases or cost reductions may factor into whether a company decides to divest a unit that is affected by tariffs, trade disputes or geopolitical uncertainty.

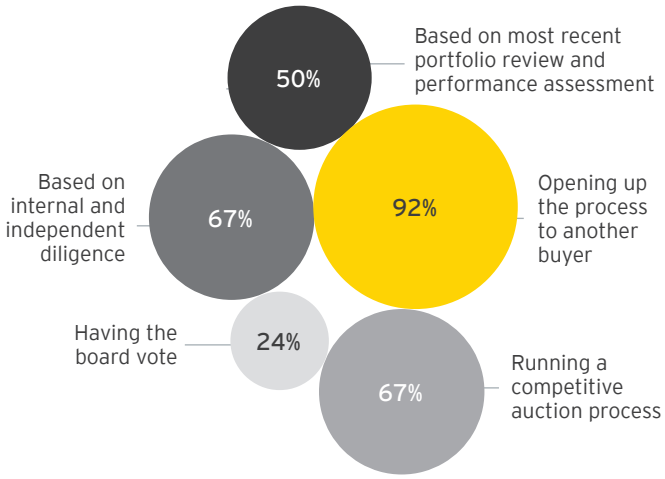
Q Which of the following geopolitical shifts may affect your plans to divest? Select all that apply.



Portfolio management tempers opportunistic divestments

In the current market, while companies are looking to divest to focus on their core business, only 5% of respondents say that their last divestment was opportunistic. Fifty percent of the respondents say that an unsolicited approach by a buyer will be a key factor in making a business decision in the next year.

Q How did you determine whether the price being offered was reasonable for your opportunistic divestment? Select all that apply.



50% of those reporting an opportunistic divestment say they had already started considering a sale and, therefore, had some level of preparation when the unsolicited bid was made. They were also four times more likely than their counterparts to meet or exceed their expectations for both price and timing of the divestment, demonstrating that preparation for a possible divestment as a result of portfolio reviews pays off when the asset is divested.

67% of respondents confirm that they are not confident in their ability to value their business if they were to receive an unsolicited bid today. This highlights the need for companies to conduct regular portfolio reviews with an eye toward the value of a business to different types of potential buyers.

92% of companies opened their opportunistic divestment process up to at least one other buyer to create competitive tension and validate the price offered.

Even when opportunistic divestments present themselves, success is by no means guaranteed. Unplanned divestments provide leverage to buyers to define deal perimeters, value and buying price. This can also negatively impact the valuation of the remaining company.

With a more active approach to portfolio management, companies can begin to prepare a compelling story for an increasingly diversified pool of buyers. This is an essential step in closing the widening price gap between buyers and sellers.

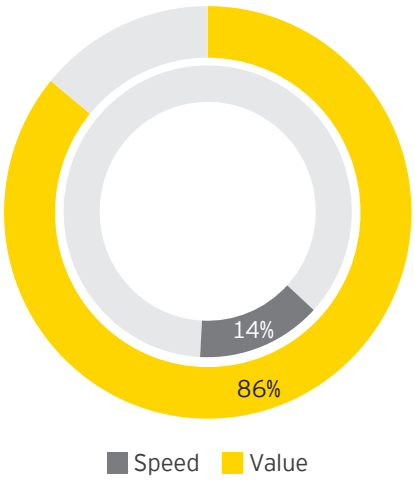
2 How can you operationalize a divestment for success?

In a constantly evolving environment, companies need to regularly assess all aspects of their business to ensure that they remain competitive. A majority of the survey respondents say that shortcomings in their portfolio review process have sometimes resulted in failure to achieve the intended divestment results.

Speed vs. value

Companies surveyed are more concerned about creating value from the divestment rather than the speed of the transaction. Of those companies who say their focus has shifted from speed to value in the past three years, 75% report a better understanding of the sale process based on previous failures. Thirty-seven percent of respondents believe a critical element to enhancing sale value is to operationally separate the asset partially or fully.

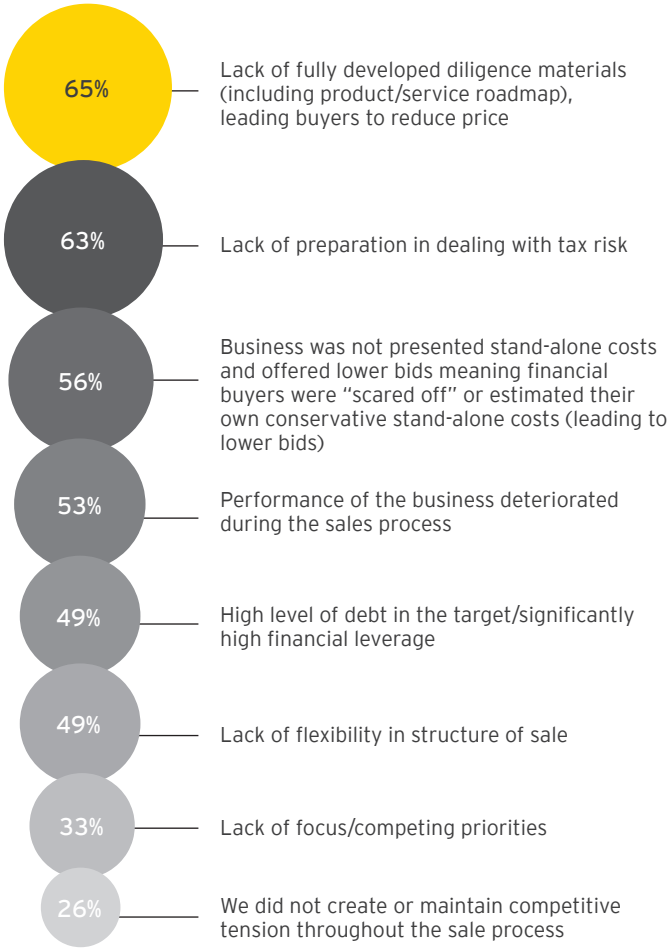
Q What was your main priority in your last divestment? Select one.



While in their most recent divestment, most companies prioritized securing the best price over speed of execution, achieving that expected value can be a significant challenge. Strengthening the business to be divested, developing the equity story and executing a seamless separation process should be the highest priority for any seller.

Many companies miss out on opportunities to improve value in their divestment process. For example, 65% of companies believe that they commonly lose value by not fully developing diligence materials and by not being flexible with the sale structure. Fifty-six percent of respondents also say that by not presenting the business as a stand-alone entity, they scared off potential buyers or it prompted them to estimate more conservative stand-alone costs and offer lower bids.

Q What do you see as the causes of value erosion in your last divestment? Select all that apply.



Case study: Preparing ahead to maximize sale value

Preparing ahead of the transaction is one of the key prerequisites for a smooth and successful process. Many companies and investment bankers get vendor due diligence done to cover various aspects of a business such as finance, tax, legal and markets. In our experience, vendor due diligence has become a market practice for transactions exceeding US$50m.

The EY organization was appointed as a sell-side transaction diligence advisor for a large packaging company with multiple operating facilities. The EY Transaction Diligence Team provided vendor due diligence services including financial, tax, markets and sales and purchase agreement advice. Vendor due diligence helped the company and the investment banker smoothly handle multiple buyer due diligences in a timely manner. Vendor due diligence also helped in constructing a consistent and cohesive story behind the numbers, which played an important role in the success of the transaction.

Weigh the merits of different structures

Eighty percent of executives say their most recent divestment was a carve-out of the business unit. Companies should also explore other deal structures (e.g., JV, partial divestment, etc.) that can sometimes support greater return to shareholders.

As the regulatory environment evolves, sellers must stay agile in their approach to divestments (e.g., tax policy changes, cross-border trade issues, etc.). They should remain flexible about the deal structure, keeping in mind a buyer's interest and minimizing tax liability (e.g., asset sale versus a share sale).

On a recent divestiture, an Indian steel company chose to form a JV with a foreign partner for some of its divisions. This allowed the seller to raise capital to pare down debt as well as provide them with access to global markets. The buyer in turn was able to diversify geographically while remaining in the same sector. The JV structure helped minimize investment risks for the buyer and provided tax benefits to the seller.

Always be divestment-ready

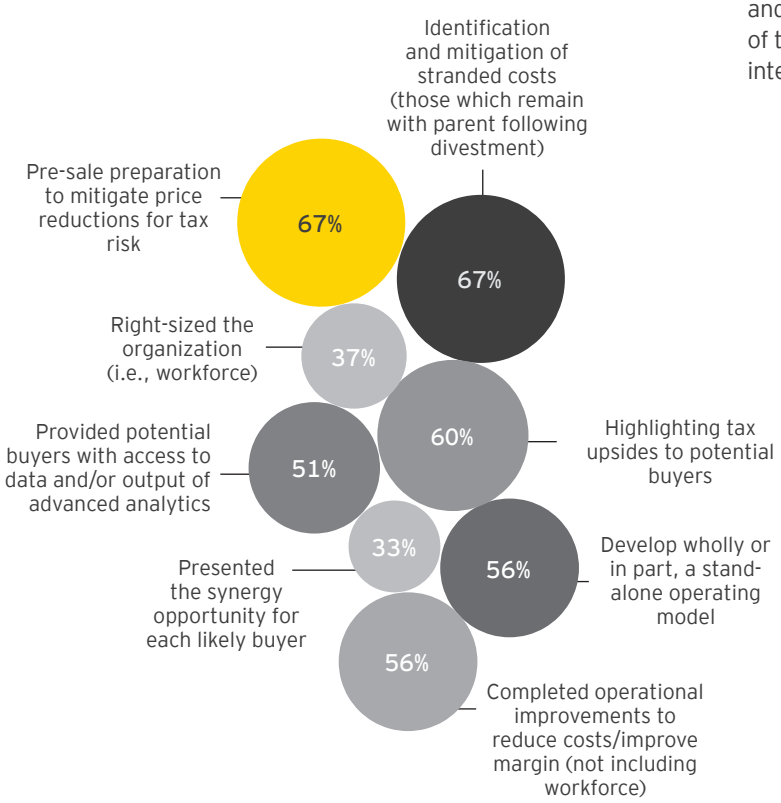
Companies today are generally better at identifying assets that should be divested, but are increasingly slower in launching the process. In fact, 63% of companies say they held onto assets too long. A well-defined portfolio strategy, coupled with the right resources and expertise to manage divestments, should give companies more confidence in their ability to act when the time is right.

Companies underestimate the impact a lack of preparation has on the deal timeline and shareholder return. The majority (63%) of companies report that their divestment took five months or longer from signing to closing, far beyond the three month closing timeline that shareholders have come to expect. Deferred closings, increased transitional service agreements (TSAs) and other obligations can plague the remaining organization when appropriate time is not invested in preparing the business for sale.

Companies are increasingly pursuing a "carve-out platform" approach to make businesses divestment-ready. Under this approach, systems, processes and even legal entity separation work begins before the deal process starts. Initiating this work before a buyer is known helps accelerate the separation and stand-alone timeline and minimize TSAs. For example, 37% of companies reported that an optimized legal structure was the most important step in enhancing sale value.

Complete tax assessment early

Q **Which of the following steps did you undertake before putting the business up for sale? Please select all that apply.**



A seller should proactively complete the tax assessment and provide its analysis to the buyers before they have a chance to develop their own model. For example, a seller can highlight the tax efficiencies associated with the manufacturing process, such as any tax holidays, which enhance the value of the asset. In the survey, 44% of executives indicated that over the last 12 months, highlighting tax upsides to purchasers helped them to drive value. Companies can take the following approach:

- Complete a comprehensive tax review of the target, understand tax implications of divestment and identify tax data that will be required from a buyer's perspective
- Create a point of view on tax risks to address concerns of potentially skeptical buyers
- Emphasize the upside by building out a buyer's potential tax benefits

The Indian tax environment has undergone significant changes in the past three years and this adds an additional layer of complexity which needs to be addressed during the divestment process.

Interdependencies between business units

Many business processes and functions such as HR, finance, IT, etc., are shared across an organization, which adds an additional layer of risk. While divesting, the seller needs to clearly identify these interdependent processes and functions and adequately plan for separation. Sixty-nine percent of the respondents say that inadequate understanding of interdependencies delayed or derailed the deal close.

How can you resolve interdependencies?

Key activities	Description
Appoint functional leaders	Establish clear roles, responsibilities and lines of communication. Implement a governance structure to enable monitoring and reporting.
Broad business review	Complete a broad review of the business units. Identify all business processes impacted by the decision to divest.
Identify interdependencies	Identify the common business processes across all business units. Assess the effort required to support processes that will be divested.
Resolve interdependencies	Assess importance of business processes to parent company. Define to-be business processes (both interim and end-state). Develop and help implement solutions to address gaps and achieve the to-be state.
Complete financials	Identify financial impact of resolving interdependencies and finalize stand-alone financials. Share the financials with the buyer to help ensure the baseline is consistent across all stakeholders.

Areas with a high degree of interdependencies that consistently cause divestment delays:

- **IT** – shared ERP, applications, infrastructure and network have long lead times and are expensive to separate
- **Shared business activities** – common business activity such as shared customers and vendors, require communications and/or negotiations that can be disruptive if not properly handled
- **Shared services** – centralization of business processes means commingled transaction processing and data that can be difficult to identify and require separation

Mapping out interdependencies early and creating an ongoing dialogue between cross-functional teams drives transaction governance and value. During a recent divestment, the seller conducted a detailed assessment to understand the interdependencies between the various legal entities and prepared a divestment blueprint. This enabled them to establish the financial, operational and commercial implications for both the target and the parent company. This allowed the seller to make informed decisions on the structure and valuation of the business to be divested.

Transitional Service Agreements

Transitional Service Agreements (TSAs) are put in place by the seller to support the divested business post-close. This provides the buyer with sufficient time to create a stand-alone independent organization.

TSAs are often implemented for HR, finance, IT and other back-office functions, which are provided by the parent as shared services to the unit being divested. However, there are other less obvious interdependencies, such as intellectual property rights or shared customer and vendor agreements which are overlooked in TSAs. In addition, TSAs should also include services, agreements, or assets provided by the divested business unit that are used by the remaining seller organization.

To help manage the TSA process, it is recommended that companies take the following steps:

1. Develop operating models for divesting assets
2. Identify potential services needed under a TSA
3. Review completeness and accuracy of services
4. Determine pricing, duration and service levels
5. Complete TSA documentation and schedules
6. Design TSA operating and governance models

When required, companies should price TSAs at cost-plus, add escalation clauses, cap them at 12 months and manage them in relation to stranded costs. One company that divested part of its business agreed with the PE buyer to implement TSAs prior to transaction close. This enabled the buyer to have operational stability on day one, and gave it sufficient time to undertake fresh enterprise resource planning (ERP) implementation to create a stand-alone entity. The seller in return had sufficient time to ramp down its resources, thus avoiding stranded costs post-TSA exit.

Mitigate stranded costs

Sellers need to identify potential stranded costs early and develop mitigation plans. Companies often minimize the effort required as we often hear from sellers, "This can only be done close to closing," or, "We know the costs included in the deal, so this will be easy." However, many costs in the deal are often shared or allocated in nature.

Companies need to examine shared costs across business units, including those charged to the carved-out entity. Corporate allocations, business charge-ins and charge-outs, services provided with no, under, or over-allocated costs, shared people and facilities are all key inputs relative to stranded costs. There are several sources of stranded costs and related key considerations and knowing these can save precious time, while preserving value going forward for the seller.

Cost type	Seller considerations
Allocated cost: Amount currently allocated to entity considered for separation	Mapping these allocations to the actual costs to be ultimately transferred is paramount. They often represent fractional time for people, facilities, research and development, sales and marketing.
One-time or transition costs: Costs related to the transfer of operations (e.g., cloning a computer system)	Knowing that while these costs are typically borne by the seller, they are often subject to negotiation.
TSA cost recovery: Some of the stranded costs can be covered, for a time, by charging for ongoing services under TSAs	Minimizing TSAs, particularly given that they often defer the ultimate mitigation of stranded costs. TSA exit terms and conditions could impact the stranded cost mitigation plans (e.g., early termination of services) and should be considered when developing TSA pricing methodology.
Loss of leverage costs: Additional costs incurred under vendor contracts due to lost volume or other incentives	Assessing the potential impact from vendor and other agreements as soon as practical in order to be able to begin negotiations well before the separation date.

Pre-empt regulatory hurdles

To set clear timelines sellers need to identify regulatory requirements in every jurisdiction. Seventy-seven percent of companies say their divestment was delayed or deferred because they didn't fully understand regulatory requirements.

Widely varying country-specific requirements, along with insufficient time to capitalize and operationalize a legal entity, can delay the buyer from being able to effectively operate in a jurisdiction. Forty-four percent of sellers say it was a challenge to capitalize and operationalize a legal entity in their most recent divestment. In many countries, sellers may face a 60-, 90-, or 120-day review requirement to be met before they can put capital into a local entity.

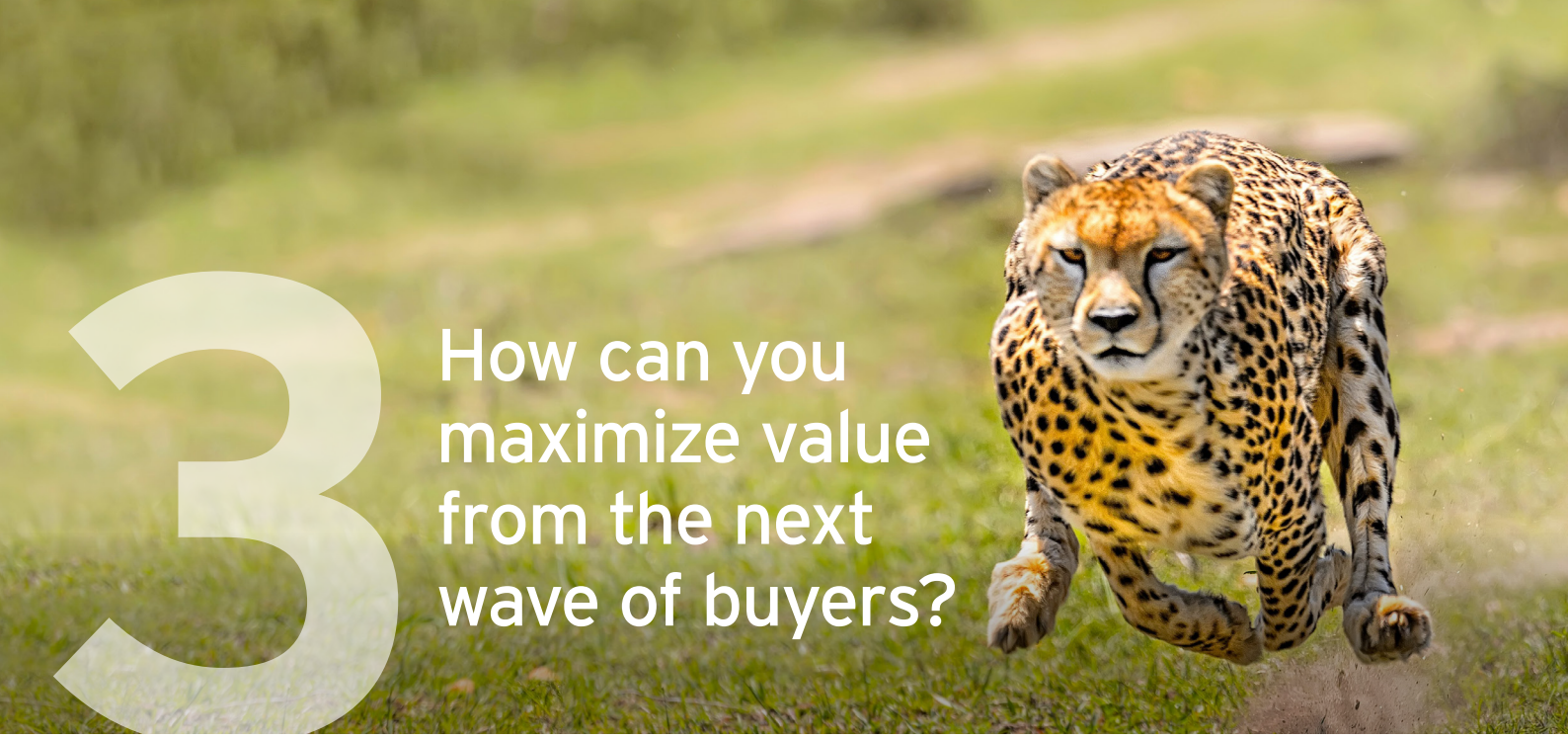
Regulatory requirements can include antitrust approvals, business licenses, capitalization of new legal entities, registration of products, labor requirements and obtaining various tax IDs. Many of these activities must occur in a specific sequence, can be lengthy and can change based on rule-making bodies in each country and locality.

A delayed post-close poses operational and administrative burdens to sellers post-close and often delays their receipt of cash. They also delay the buyer from implementing the changes required to achieve value capture goals. Overall, these issues are suboptimal for buyers and sellers.

Actions taken in successful divestments include:

- Identifying key regulatory requirements in every current and anticipated jurisdiction, by leveraging local subject matter experts
- Prioritizing the countries of significant importance based on a combination of size and importance to the day one operating model (i.e., location of key facilities)
- Building out the proper timeline to address activities such as product registration, product labeling, business licenses, tax IDs, labor requirements and contracting with third-party service providers

In summary, identifying long lead-time regulatory requirements early in the divestiture process and developing country-specific plans to minimize delays and transition cost overruns results in significant savings of time and effort.



3 How can you maximize value from the next wave of buyers?

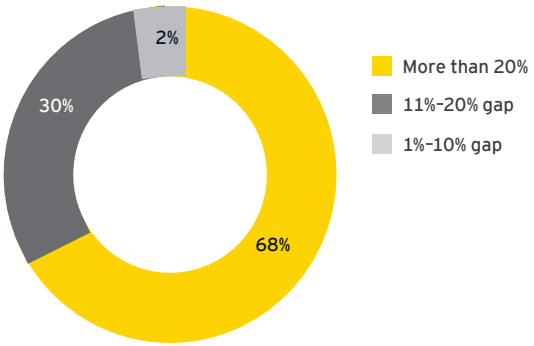
In a marketplace driven by high valuation expectations, sector convergence and technological disruption, who will be your next buyer? How will you anticipate the needs of different buyers and maintain competitive tension? How do you maximize value?

Price gaps are increasing

There is an increasingly large gap between buyer and seller expectations that needs to be bridged. Sellers often value assets through a combination of improvements and projected earnings, while buyers are inclined to calibrate against historical earnings to discount for short-term or unquantified risks, while balancing their desire to stay in the deal process.

Two-thirds (67%) of respondents say the price gap between a seller's expectation and a buyer's willingness to pay is greater than 20%. Hence, it is critical for sellers to build a credible value story with supporting data and start preparation early to realize their desired valuation.

Q **In today's marketplace, how wide do you consider the price gap between what sellers expect versus what buyers are offering?**



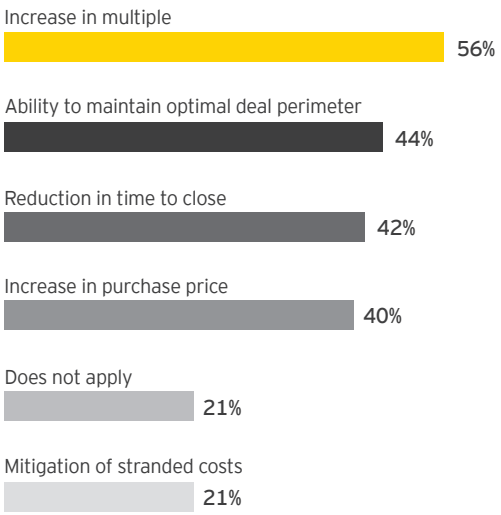
The research shows that 65% of the respondents believe that a lack of fully developed diligence materials (including product or service roadmap), led the buyers to reduce their price. A well-managed divestment process, with timely conclusion of sell-side functional diligence (financial, operational, etc.), enables the seller to be better prepared by:

1. Identifying, analyzing and preparing critical target data
2. Identifying critical issues which when resolved can increase sale price
3. Helping management understand all the operational and financial nuances of the business and be better prepared for buy-side diligence
4. Creating a level playing field and information symmetry for all buyers at the start of the sale process

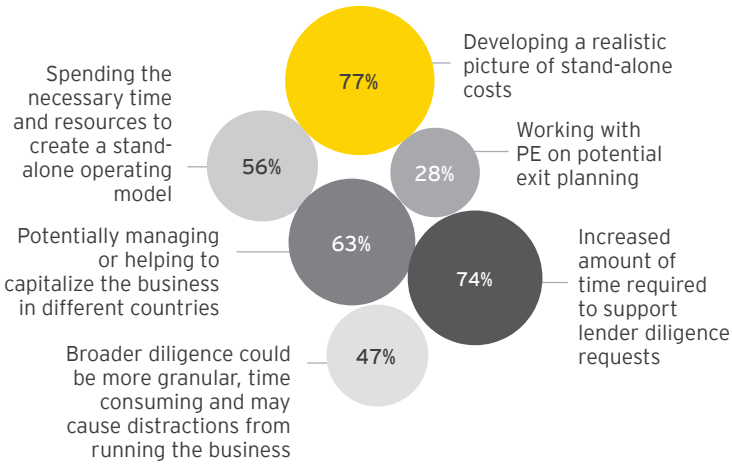
Leverage the power of private equity (PE)

Appealing to private equity buyers sometimes requires significant time and effort, but these bidders also bring increased competition and sharper focus on the business value. Critically, PE involvement potentially brings an increase in multiples during divestiture, which 56% of the executives confirm.

Q In what ways did you experience an increase in value based on PE's involvement in your divestiture? Please select all that apply.



Q What do you see as your biggest challenges in working with PE as a potential buyer? Select all that apply.



Unlike corporate buyers, PE buyers may not necessarily have a portfolio company with which to integrate the business being sold. That's why sellers may find PE diligence demands to be more granular and therefore time consuming.

Forty percent of companies expect the number of buyers outside of their sector to increase (e.g., PE buyers). Presenting detailed stand-alone costs is one of the top ways sellers say they created value in their last divestment.

Sellers must combine the necessary sector and technical expertise to put themselves in buyers' shoes – particularly those in another sector – to understand the benefits of the acquisition.

Forty-two percent of sellers say that a PE buyer's involvement in the divestment led to a reduced time to close. Some of the reasons for faster closing may be:

- PE firms require fewer regulatory disclosures.
- They may already have expertise relative to a particular business based on ownership experience with an existing portfolio company.
- Their clarity relative to the exit strategy and related time sensitivity speeds up the process.

There are other benefits to working with a PE buyer: 40% of those surveyed say doing so led to an increase in purchase price.

Sellers should take the following steps to maximize PE participation in a competitive process:

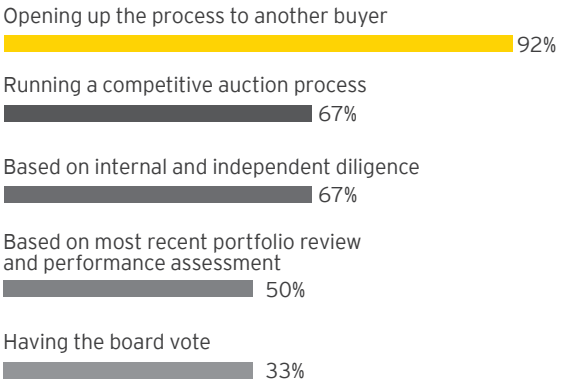
- **Build a compelling picture of the asset as a stand-alone business:** PE firms say a well-thought-out, stand-alone case and related cost model are key to keeping them in the sales process. Sellers may need greater flexibility in financial reporting systems as a first step in developing an accurate picture.
- **Keep an eye on operational performance:** Missed forecasts concern potential buyers, particularly if the business misses forecasted performance outlined in marketing materials. Thirty percent of private equity bidders cite this as the most likely reason they would drop their price or walk away.
- **Help PE "see" the exit strategy:** The nature and timing of an exit is of ultimate importance to PE. Sellers should articulate their perspective around potential monetization strategies early in the process.

- **Be prepared to generate granular data:** Nearly half of the PE firms say access to granular data was a key factor in their decision about whether or not to stay in an auction process. The seller may need to have monthly historical and projected information down to transactional and SKU-level detail.
- **Tell a consistent story:** Sellers need to have a clear sense of financial forecasts, growth opportunities, capital requirements, the management team and overall business strategy going forward. These are focus areas for PE, as they drive the financial and operational business models as well as the exit strategy.

Keeping potential PE buyers engaged in the process can be vital to a successful deal, as it increases competition between buyers. Twenty-six percent of the respondents say that not creating or maintaining competition between the buyers throughout the sale process was one of the reasons they lost value in their last divestment.

Creating competition also helps the sellers to move the buyer's focus from the historic financials to evaluating future potential in the business.

Q How did you determine whether the price being offered was reasonable? Select all that apply.



Use analytics to maximize value

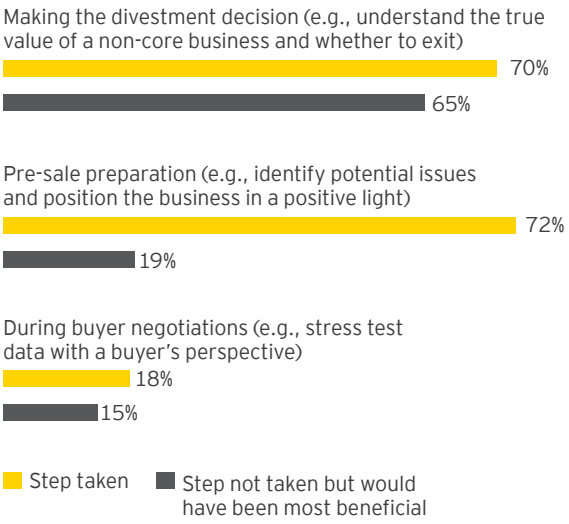
The research indicates that in India only 33% of the companies surveyed continued to create value in the business unit before divestment. This is in marked contrast to the Americas (64%) and Europe (55%).

Analytics can help companies create value before a sale. Sellers who leveraged analytics in their pre-sale preparation say that analytics assisted them more than anything else in making the divestment decision. Sixty-five percent of sellers now believe that advanced analytics would create even more value when used during buyer negotiation. For example, analytics can be used to help the buyer identify growth opportunities for the business. This could include identifying opportunities to grow revenue, such as new customers or markets; improving operations to deliver better margins or rightsizing or outsourcing the workforce.

Case study: Using analytical tools for insightful analysis

The EY organization was appointed as the sell-side transaction diligence advisor for a mid-size general insurance company. Given the volume of data involved, leveraging analytics was key to efficiently manage the assignment within the timelines. The Transaction Diligence team used analytics and data visualization tools to analyze premiums, claims and commissions. This significantly reduced the time required to identify data gaps and create deep insights.

Q In which of the following areas of your most recent divestment did you leverage analytics? And where would it have been most beneficial?



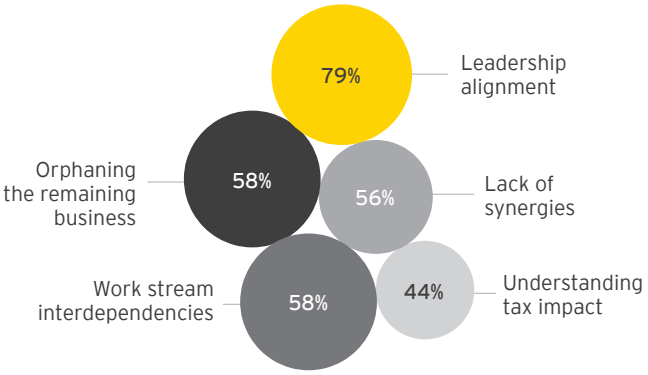
Build value through stand-alone operating models

In carve-outs, buyers may recognize greater value when sellers present a stand-alone operating model. Buyers have confidence in the operating model and know that the business has been properly prepared for sale, with a comprehensive separation plan. Seventy-one percent of the companies surveyed mentioned that they took detailed steps to create the stand-alone business and provide a clear picture to the buyer.

The benefits also extend to sellers by:

- Help enabling them to easily understand the impact of potential deal perimeter changes in "real time" – to make the business more attractive to a buyer
- Assisting with TSAs, one-time costs and stranded cost remediation, which impacts the deal model for both the buyer and seller
- Serving as key input into and aligning with the stand-alone cost model that drives deal economics
- Building the foundation for the seller's separation planning and the buyer's integration planning, both of which will be greatly accelerated
- Allowing for proper planning relative to capitalization and regulatory requirements, which avoids delayed or deferred closings

Q What are some of the biggest challenges you've faced in developing the deal perimeter? Select all that apply.



Align on deal perimeter

The business to be divested is often defined differently by executives and functions within the organization. Too often, deal models are prepared utilizing historically-generated system data that contains improperly allocated costs, excludes certain costs and does not reflect the business to be ultimately transferred.

Importantly, the seller needs to identify areas where the deal perimeter can be changed or modified to maximize deal value. Accordingly, alignment on the deal perimeter across all functional areas, with a clear line of sight to the deal model for each buyer, is key to maximizing sale value.

In the EY survey, 54% of the executives indicated that a lack of flexibility in changing the deal perimeter either scared buyers off or delayed the closing. In addition, leadership alignment around the deal perimeter – across the remaining company and the target – is essential, but this is a challenge for 79% of companies.

One common deal perimeter issue for sellers is deciding on the disposition of commingled manufacturing and production facilities. For example, an auto component manufacturing company was looking to carve out a manufacturing unit from its integrated production facilities. The seller conducted a detailed analysis of the operational interdependencies to make informed decisions on the deal perimeter (i.e., what to keep and what to divest). Most importantly, there was complete alignment between corporate and local leadership which provided the flexibility to change the deal perimeter during buyer negotiations, creating a win-win situation.

Conclusion

If you are one of the 81% of companies planning to divest within the next two years, what steps should you take now to maximize shareholder value?

Streamline for agility

Divestments can provide capital for companies to streamline their operating model and invest in their core competencies, thus helping them remain competitive. Evolving regulations, macroeconomic conditions, technological changes and geopolitical forces mean that companies must undertake regular portfolio reviews to identify under-invested or non-core assets for divestments.

Be prepared yet flexible

Early preparations can help sellers identify potential issues to be addressed which will help to maximize sale value. Sellers should prepare diligence materials, identify functional interdependencies, address regulatory and tax issues, understand TSA requirements and develop stranded cost mitigations to create a comprehensive value proposition. This enables the seller to be flexible with regards to different deal structures in order to close the transactions.

Develop a value story for all potential buyers

Sellers should understand the needs of a widening range of buyers. This breadth of buyers, including PE firms, drives competition and a potential increase in purchase price. Sellers also require detailed information to understand the stand-alone requirements and build a credible exit story. Sellers must continue to create value during the divestment and put together a compelling value story for the buyers.

How EY can help

Our dedicated, multifunctional divestment professionals work with corporate and private equity clients on sales of the entire company, carve-outs, spin-offs and joint ventures. We help companies evaluate their strategy, manage the portfolio, improve divestment value and grow their remaining business.

Evaluate corporate strategy and help manage the portfolio:

- Identify strategic opportunities to help drive growth
- Understand business performance compared with peers and contribution to the rest of the portfolio, including assessing the quality of information and developing more reliable data for the evaluation
- Evaluate priorities around which businesses to divest, and when
- Stress test divestiture hypotheses, evaluating different deal perimeters and estimating impact to EBITDA and operations
- Understand dis-synergies and one-time costs that may result from a potential divestment
- Help determine where capital can be released and reallocated toward growth and digital innovation

Improve divestment value:

- Identify and help execute opportunities to help create value in the assets to be divested
- Become an informed negotiator through use of advanced analytics
- Support the development of a clear value story and help guide you through preparation and execution – removing any potential bumps in the road before buyers get involved
- Assist in designing a tax structure to benefit buyer and seller, to help optimize working capital, design a communication plan, evaluate forecasted performance or provide a complex global separation and stand-up plan

Grow the remaining business:

- Understand the remaining company's cost structure, and help identify opportunities for the company to invest in the core business with a focus on top-line growth
- Identify areas of leverage to improve working capital or return value to shareholders

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Whether you're preserving, optimizing, raising or investing, our Connected Capital Solutions can help you drive competitive advantage and increased returns through improved decisions across all aspects of your Capital Agenda.

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Enabling better decisions around financing and funding capital expansion and efficiency

Enabling strategic growth through better-integrated and operationalized acquisitions, joint ventures and alliances

Enabling strategic portfolio management, and better divestments to help you maximize value from a sale

Helping you transform or restructure your organization for a better future by enabling business-critical and capital investment decisions

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