How can divesting fuel your future growth?

Life sciences

Global Corporate Divestment Study 2018

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A note from
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Technological change is having a profound effect on the divestment strategies of leading life sciences companies. First, the digital transformation of health care requires life sciences executives to reconsider whether their portfolio of businesses and therapeutic areas is optimal for future growth. Second, technology, data and analytics are helping many businesses to make much better divestment decisions, maximizing value and efficiency as they execute transactions.

With the shift towards a digitally-enabled, patient-centric approach to products and services, life sciences companies are scrambling to position themselves. Eighty-three percent expect to make divestments within the next two years, very often as they seek to free up capital for technology investments or to dispose of assets that are a poor fit with the evolving environment.

Technology, not only a driver of divestments, can be an enabler of deal value. Life sciences businesses confident in their ability to shift towards a more data-centered divestment strategy report superior results from their portfolio reviews and transaction outcomes. Analytics tools underpin an increasingly structured and systematic approach to divestment.

Such discipline will be crucial as more life sciences companies pursue divestments to amass firepower[1] and jettison underperforming and non-core assets. Alongside the challenges of technology transformation, life sciences executives continue to confront ongoing pricing pressures, market access challenges and increasing competition in all of their key markets.

[1] The EY Firepower Index tracks a group of life sciences companies and their "firepower," which EY defines as a company's ability to do M&A based on the strength of its balance sheet – see *EY 2018 M&A Firepower Report: Life Sciences Deals and Data*.

About this study

The EY *Global Corporate Divestment Study* focuses on how companies should approach portfolio strategy, improve divestment execution and future-proof their remaining business amid rapid technological change. The 2018 study results are based on 1,000 interviews with 900 senior corporate executives (including 180 from life sciences) and 100 private equity executives. The survey was conducted between October and December 2017 by FT Remark, the research and publishing arm of the *Financial Times Group*.

- Executives are from companies across the Americas, Asia-Pacific, Europe, the Middle East and Africa.
- CEOs, CFOs or other C-suite-level executives make up 85% of executives surveyed.
- 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.
- While 10 industry sectors are represented, the study primarily focuses on consumer products, financial services, life sciences and technology.
- Just over a quarter of corporate executives represent companies with annual revenues of US$1b–US$5b, and 42% represent companies with revenues that exceed US$5b.

Key insights
Life sciences

Technology is driving divestment

74%

of life sciences executives are pursuing divestments to allow them to invest in or acquire assets in new areas and businesses – up from 56% in the previous study.

46%

see the need to fund new technology investments.

See page 4

Divest with a technology-driven, patient-centric world in mind

57%

of life sciences companies are divesting businesses that will not help them build competitive advantage in a patient-centric world.

See page 6

Consider contingent compensation to secure deal value

2%

of life sciences companies now say they would not accept contingent considerations in a transaction, compared to 22% in 2015 and 13% in 2016.

61%

cite R&D technical success as a potential milestone criterion for contingent compensation – up from 33% in 2014 to 50% and 60% in 2015 and 2016, respectively.

See page 7

Monetize R&D projects with alternative divestments

90%

of life sciences companies say they are prepared to consider expressions of interest from third parties seeking to acquire or license R&D assets.

See page 7

Insights from across all sectors on pages 9-28

Market overview: fast and furious

Competitive threats continue to rise in the life sciences sector from non-traditional players, including technology giants. The determination of payers to bear down on costs remains fierce. Technological transformation is putting pressure on industry players from biotech to medical devices and pharmaceuticals to innovate their business models.

Executives are rethinking their strategies and pursuing new inorganic growth opportunities. EY's 2018 *Firepower Report* suggests that in most areas of life sciences, the conditions are now ripe for a surge in mergers and acquisitions (M&A) activity in 2018, based in large part on clarity around corporate tax reform in the US.

This is encouraging for the many life sciences companies expecting to divest. According to our latest Global Corporate Divestment Study, 83% of life sciences executives say they are planning a divestment within the next 2 years; the majority expect to do so in the next 12 months.

There are clear drivers behind these transactions:

- Desire to focus the business and the therapeutic portfolio is evident, with certain segments, such as diagnostics and imaging, more likely to be divested.
- Shift towards therapeutic areas where companies can secure first-mover advantage. This will likely continue as payers, including insurers and public health plan sponsors, demand new pricing models – in particular, a shift towards performance-related pay centered on patient outcomes.
- Rationalization of the portfolio through divestments is a compelling option for life sciences companies trying to build a better value story. Activist investors continue to challenge executive teams on strategic direction and capital allocation.

Technology is driving divestment

The need to fund new technology investments was a trigger for the last divestment made by 46% of life sciences companies, with biotech businesses (52%) particularly likely to cite this option compared to biopharmaceutical (48%) and medical device businesses (38%).

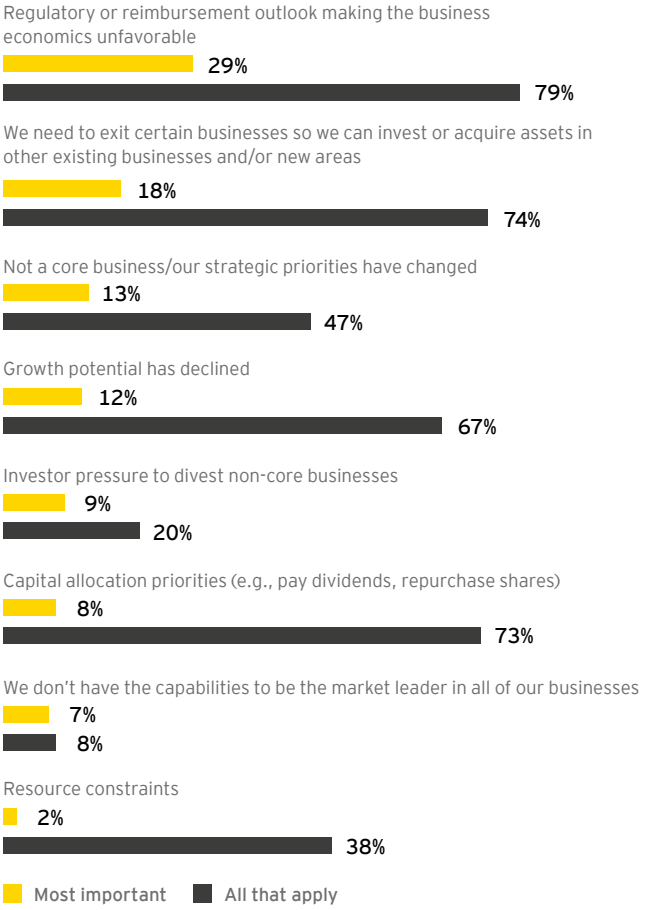
This imperative continues: 46% of life sciences executives surveyed say the need to fund new technology investments is making it more likely they will make divestments over the next year; that figure rises to 50% among biopharmas.

The potential payoff is enticing. According to our global study, businesses across all sectors that understand how technology affects their value are 15% more likely to achieve a sale price above expectations and 12% more likely to achieve a higher valuation of the remaining business post-divestment. However, life sciences businesses can't afford to wait. Competitors are now overhauling their portfolios and the threat of new entrants from other sectors — especially the tech industry — look to disrupt the life sciences supply chain.

Such pressures weigh heavily on life sciences executives. Almost three-quarters (74%) say their companies feel compelled to exit certain businesses so they can reinvest, often in new areas. Close to half (47%) report that their strategic priorities have changed and that they are divesting non-core businesses.

Other factors driving divestments will continue to be important: 79% of executives point to a deterioration of the regulatory or reimbursement outlook; 73% are addressing capital allocation priorities such as dividend payments or share buybacks; and 67% worry about declining growth potential.

Q From a life sciences perspective, what are the major reasons you plan to narrow your company's portfolio? Select all that apply and the most important.



Analytics can generate better divestment results

Life sciences companies are turning increasingly to analytics to bring data-driven discipline to their portfolio reviews and divestment execution.

Descriptive (performance) analytics, which focuses on historical performance; predictive (applied) analytics, offering insight into likely future performance of the business and its marketplace; and prescriptive (dynamic decision modeling) analytics, which can generate operational decisions based on predictive scenarios – all have a crucial role to play in divestments.

According to our global findings of businesses surveyed, those that apply consistent data-driven analytics to drive decision-making in their portfolio reviews are 33% more likely to achieve a sale price above expectations than those that do not.

In addition, all companies surveyed that consider their predictive analytics capabilities to be effective in making portfolio decisions are 81% more likely to achieve a sale price above expectations and 35% more likely to complete their exit sooner than expected. They are also twice as likely to achieve a higher valuation than expected for the business that is not sold.

The better the data, the better the output

Achieving those gains relies on access to accurate, timely and sufficiently granular data to unlock value through portfolio optimization. This is a challenge for life sciences, given its often complex IT infrastructure.

For example, cost allocation can be inaccurate, making it difficult to assess profitability at a stock keeping unit (SKU) level. Insights gleaned from more detailed data analytics can provide insights to divestment teams to address any inaccuracies in capital allocation.

This trend will continue as more life sciences companies embed analytics in their divestment process, building decision-making platforms that provide regular feedback at every stage of the transaction life cycle.

Improvements in reporting, with customizable dashboards and user interfaces accessible to executives outside of IT, offer further benefits — but only to life sciences companies that continue to invest in their data.

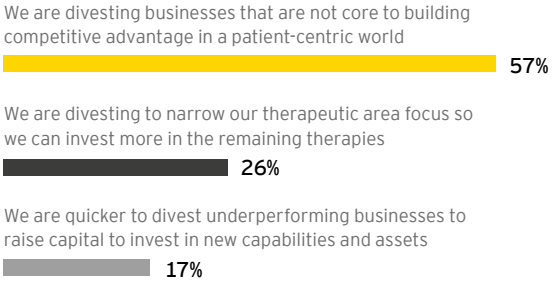
Divest with a technology-driven, patient-centric world in mind

This is the dawn of the health care platform: marketplaces where patients can connect with manufacturers, payers and even policymakers to find products and services tailored to their individual needs – drugs, devices and therapies sourced from multiple providers.

More than half of life sciences executives (57%) say this patient-centric shift has been the biggest driver of their latest divestment planning. A quarter (26%) are narrowing their therapeutic focus to devote greater resources to assets with the greatest prospects for success in the platform economy.

And as emerging technologies continue to shape health care in unpredictable ways, a wait-and-see approach is likely to fail. Already, 17% of executives say they are quicker to divest underperforming businesses than in the past to free up capital for more productive use elsewhere.

Q What is the biggest effect that technology-driven sector convergence and digitalization are having on your divestment planning? Select one.



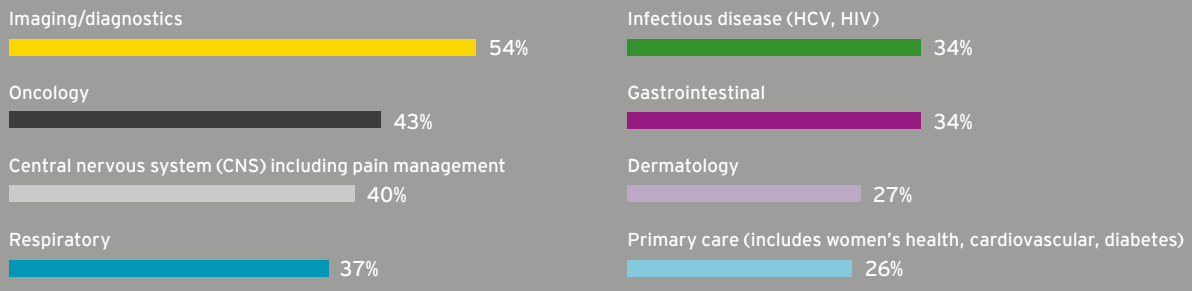
Imaging and diagnostics still in question

Changing payer and provider trends, as well as broader pricing issues, are prompting many in life sciences to reconsider their divestment plans. More than half (54%) of the executives in this survey anticipate the potential disposing of an imaging and diagnostic business from their portfolio or from their peers — a marked increase on last year's figure of 15%.

While this reflects their general sentiment for the industry, the increase highlights the recent reimbursement changes that continue to affect the diagnostics and imaging businesses. Medicare reimbursement for imaging has been repeatedly cut back over the past decade, and federal policies such as increased deductibles have no doubt diminished appetite for assets in this area. The temporary Medical Device Excise Tax setback appears to have had a lingering effect.

In the realm of IVD (in vitro diagnostics), the Protecting Access to Medicare Act (PAMA) was released at the end of 2017 and its rollout over a period of several years is expected to have more impact on core diagnostics and less on diagnostics tied directly to targeted drugs or novel molecular diagnostics which payers see as positively affecting patient outcomes and overall plan economics. Diagnostics and imaging businesses have always been more challenging business divisions to operate, and we expect continued consolidation of these businesses into large diagnostics companies who can weather these challenges and invest appropriately.

Considering payer and provider consolidation trends and pricing issues, percentage of companies that are more likely to consider divesting specific types of assets.

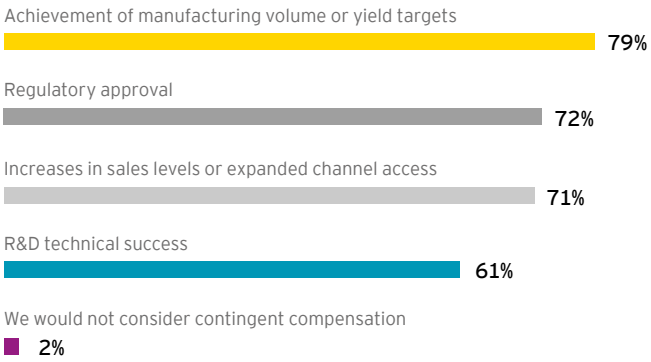


Consider contingent compensation to secure deal value

In an uncertain market environment – most obviously in the US, where health care reform remains divisive – making any kind of revenue projection is challenging. Instead, sellers are seeking new ways to bridge the value gap, accepting they must share some of the risk with buyers if they want to maximize revenues.

As a result, contingent compensation has become a mainstream deal feature. In 2015, 22% of executives said they would not accept contingent features in a transaction; in 2016, this figure fell to 13% and it now stands at just 2%.

Q When planning and structuring a divestment, which of the following milestone criteria would you consider for contingent compensation? Select all that apply.



The nature of the contingency varies from deal to deal. Manufacturing volume or yield targets, regulatory approvals and sales are all popular milestone criteria. For example, the deal between Merck and AstraZeneca last year to jointly commercialize the latter's Lynparza cancer therapies involved Merck agreeing to a US$8.5b consideration, of which US$6.15b was contingent upon successful achievement of future regulatory and sales milestones[2].

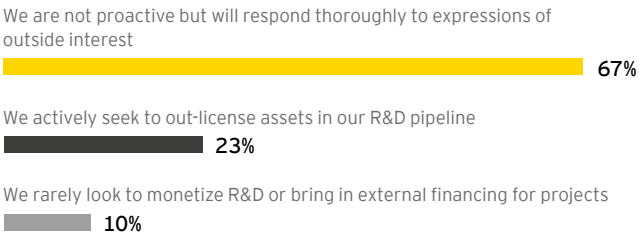
Research and development (R&D) technical success is an increasingly common contingency in drug development, ever a key risk for buyers. In recent years, the number of life sciences businesses prepared to accept this as the basis for contingent compensation has steadily increased, from 33% in 2014 to 50% and 60% in 2015 and 2016, respectively, reaching 61% in the latest study. As sellers seek to justify higher valuations, they will need to address buyers' caution. If deal rationale is built on innovation and R&D, this form of contingency may be needed to secure a higher price.

Be prepared to monetize R&D projects

Increasing numbers of life sciences companies now see their R&D pipeline as a potential source of hidden value. While not necessarily proactive about it, 67% of executives say they will respond thoroughly to third parties interested in licensing R&D assets. Almost a quarter (23%) actively seek to out-license their R&D.

Life sciences companies are regularly under pressure to commercialize their pipelines and identify the next drivers of business growth. The temptation may be to hold on to as broad a range of R&D assets as possible. However, companies risk losing out on its potentially greater value to third parties. Executives should assess their R&D assets for hidden value. Unlocking that value, through some form of traditional divestment, joint venture or other more creative collaborations, may prove to be the right strategic decision.

Q What is your approach to monetizing R&D projects or securing third-party financing?



Exploit technology to improve R&D efficiency

When assessing and managing the value of their R&D, life sciences companies should consider any efficiency improvements that emerging technologies, including artificial intelligence (AI) and 3D printing, might offer.

A range of new tools is changing the nature of R&D in the sector. AI's analytics and predictive simulations can help reduce drug development failures and improve the efficiency of clinical trials. Another exciting tool is additive manufacturing and its role in creating biological materials. This technology could eventually print materials for use in the human body – if not complete organ transplants.

These printed tissues may also offer a convenient option for testing drugs, improving R&D outcomes while reducing costs. And as costs of new technologies fall, this will alter the calculations made by businesses considering divestments and other M&A activity.

[2] https://www.astrazeneca.com/media-centre/press-releases/2017/astrazeneca-and-merck-establish-strategic-oncology-collaboration-27072017.html

Conclusion

Focus on technology to drive divestment value

After a year of peak life sciences M&A activity in 2016, 2017 was relatively subdued – particularly for biopharma – but it still ranked within the top five annual M&A performances of all time. The total value of M&A in the sector is expected to surpass US$200b in 2018, particularly as US Tax reform offers some certainty for those companies considering divestments and acquisitions.

A number of large biopharma companies are considering divestments in 2018. Pfizer and Merck KGaA are examining strategic alternatives for their respective consumer health businesses[3] with Eli Lilly reviewing options for their Elanco Animal Health business[4]. Securing value from divestments – by making the right portfolio choices at the right times, as well as getting a good price for the deal – will be as important as ever.

Technology holds an important key: the race is on for life sciences companies to reposition themselves for an era of digital transformation. They will need to focus on assets that will prove competitive on the emerging health care platforms of tomorrow. Analytics, meanwhile, provide the means to plan and execute divestments more successfully.

Further insights

For more insights on key business issues affecting life sciences companies, please go to ey.com/VitalSigns.

2018 M&A Firepower Report: Life Sciences Deals and Data

Life sciences companies are using their firepower to create competitive advantages and M&A is essential, especially as technology and non-traditional players threaten current business models

ey.com/firepowerindex

Is your growth strategy a big deal? Bolt-ons outperform in the latest EY Life Sciences research

EY's research investigated whether transaction type has an impact on creating differential shareholder value.

ey.com/gl/en/services/transactions/ey-choose-your-deal-strategy-wisely

[3] https://investors.pfizer.com/investor-news/press-release-details/2017/Pfizer-Reviewing-Strategic-Alternatives-for-Consumer-Healthcare-Business/default.aspx and https://www.merckgroup.com/en/news/consumer-health-strategic-options-05-09-2017.html

[4] https://investor.lilly.com/releasedetail.cfm?ReleaseID=1045060

Insights from across all sectors

Global Corporate Divestment Study

Our perspective

Paul Hammes
EY Global
Divestment Leader

It's been another turbulent year — from an improving, synchronized global economy to ongoing political disruption — making boardroom discussions more complex. But one theme stands out in our latest *Global Corporate Divestment Study*: digital transformation. It's one of the biggest influences on the C-suite in 2018, both in terms of capital strategy and operating model decisions. Digital disruption, transformational shifts in customer preferences and sector convergence are forcing companies to make bets on future technology now.

The result of this focus is a significant increase in companies divesting assets to fund digital growth strategies. And those that understand how evolving technology will affect their business over the next 12 months, are three times more likely to achieve an above-expectation valuation multiple on their remaining business post-divestment.

Companies should understand what is changing in their sector. If you can't articulate that story, how can you decide whether to hold on to that business? And if you can't demonstrate value to potential buyers, you risk leaving money on the table. And that story depends on data — specifically, the ability to distill large amounts of data and create a detailed picture of your portfolio. This data-led approach is essential, whether you're divesting for bottom-line cost efficiencies or pursuing technology driven top-line opportunities.

As always, we produce the *Global Corporate Divestment Study* to provide suggestions of how your company can maintain a competitive advantage. This year especially, that means using analytics to maintain a persistent view on your portfolio. It also means understanding potential changes to tax implications — especially in light of US tax reform — as well as bringing your functional areas together to build a strong value story and developing an operational separation plan early.

All of these critical steps will ultimately improve divestment decisions, maximize sale value and help transform your company — here and now — into what you want it to look like tomorrow.

Key findings

87%
of companies plan to divest within the next two years.

Our annual *Global Corporate Divestment Study* reveals that divestments are now a strategic imperative for senior corporate executives in every sector, and that technology – both as threat and an opportunity – is influencing their thinking.

Market forces

Page 12

74%
say the changing technology landscape is directly influencing their divestment plans.

80%
say tax policy changes are a geopolitical driver in their plans to divest.

Lessons learned:

- Consider how technology is changing your business model
- Divest to get a competitive edge
- Understand tax implications

Strategic reviews

Page 16

56%
say they held onto assets too long when they should have divested.

64%
struggle to identify a team with the right analytics and technical skills to drive portfolio reviews.

Lessons learned:

- Develop an always-on approach
- Build a decision analytics platform
- Ramp up analytics skills

Divestment planning and execution

Page 20

60%
continued to create value in a business they planned to divest.

42%
say not presenting the business as stand-alone "scared off" buyers or prompted lower bids.

Lessons learned:

- Create value ahead of the sale process
- Tailor the synergy opportunity
- Prepare for separation early
- Improve communication

1 What is driving the appetite for divestments?

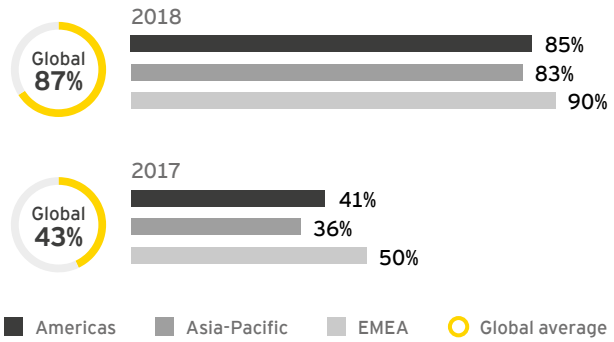
A record number (87%) of companies are planning to divest in the next two years – strikingly higher than the 43% reported in our 2017 study. Companies are facing intense pressure to evolve their business models using rapidly advancing technology. And they continue to navigate ongoing macroeconomic and geopolitical issues like the recent US tax reform and Brexit. All of these pressures are placing divestments at the core of their growth and transformation strategy.

Technology is evolving business models

As new technologies power innovation, business models in almost every industry look starkly different than they did just a few years ago. Cloud computing is prompting a wholesale shift to the platform economy, where the "as-a-service" model now dominates. Digital technologies such as social and mobile have significantly changed the way consumers interact with many businesses. In manufacturing, 3D printing promises to transform supply chain and logistics practices, negating the need to ship parts that can simply be printed on-site. And automated processing is driving efficiency savings in every part of the service economy.

As companies revisit their business model, around three-quarters (74%) of executives agree that the changing technology landscape is directly influencing their divestment plans, up from 55% in 2017. The challenge today's companies face is deciding what, where and when to divest. When should they dispose of a business that no longer fits into the future business model? Do they need capital to invest in new technology? Should divestment proceeds be invested in a different sector to enhance their product line or operating model?

Companies that expect to initiate their next divestment within the next two years



Sector convergence trends may widen the pool of potential buyers, but it also creates more competitive tension among sellers. Sixty-five percent of companies expect to see divestments related to industry consolidation over the next 12 months.

As a result, sellers should take an outside-in perspective of their business portfolio – understanding shifts in customer expectations, future revenue models and growth trajectories, as well as competitive positioning.

Divest to get a competitive edge

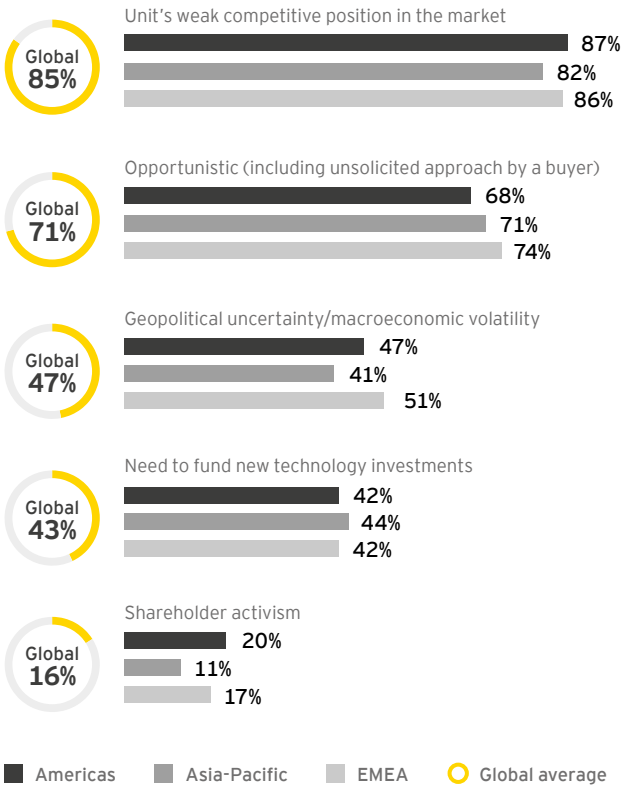
The key divestment driver continues to be a business unit's relative weakness in competitive position in its marketplace – cited by 85% of companies in the latest findings, up from 49% in 2017. Half of companies (50%) planning a divestment say they intend to use the proceeds to fund investment in new technology.

Companies who divest in order to focus on top-performing assets, particularly where new technology can provide a competitive edge, are 21% more likely to achieve an above-expectation sale price than opportunistic divestments. Companies that divest to fund new technology investments are 48% likelier to achieve a higher valuation multiple on the remaining business post-divestment than those that divest opportunistically.

Those companies divesting to fund technological change are primarily looking to improve operating efficiency (82%) and address changing customer needs (80%) in their remaining businesses. However, investment in technology that will deliver product innovation – currently a focus for only 43% of companies – may deliver greater long-term value.

For example, one Fortune 500 company recently divested a non-core business unit to invest in a start-up business with technologies that would increase the company's direct relationship with the patient, both in and out of the hospital. In less than two years, the company increased its revenues by more than 12% via cross-selling opportunities enabled by the acquisition.

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



> "In addition to supporting our R&D activities, we continue to look for additional opportunities for innovation through business development which remains a priority for [the company] going forward … along with driving value."
>
> **CEO, large health care company**

Drive innovation through alternative deal structures

Another way companies are addressing the need to compete, and making up for technology shortcomings, is by taking a more creative approach to divestments. As businesses pursue new technology-driven opportunities, more companies are considering cross-sector deals and alternative structures. Almost half of companies (46%) recently opted for alternative structures, including partial divestments, joint ventures, and revenue sharing and collaboration agreements, nearly twice as many as in our 2017 study. Such approaches are often driven by the need to invest in emerging technologies resident in young, innovative companies with little market presence but with the potential to transform a buyer's business model.

Companies that divest to fund new technology investments are

48% likelier to achieve a higher valuation multiple on the remaining business post-divestment than those that divest opportunistically.

Expect macroeconomic and geopolitical issues to persist

While the pace of technological change affects every sector and market, 62% of companies say that macroeconomic and geopolitical triggers are driving their divestment decisions. But these companies were less likely to achieve the valuation multiple they anticipated on the remaining business, or complete the deal within the expected time frame.

A staggering 86% of companies cite labor and immigration laws as a geopolitical trigger affecting their future divestment plans. The recent populist movement away from foreign labor to local workers is leading to policy shifts, particularly in the US, UK and Australia. This presents uncertainty for companies around how to best manage foreign investments and the key labor and workforce planning behind it. Coupled with the potential impact of cross-border trade negotiations from TPP-11 to NAFTA, divestments may be a viable option for companies that have not factored new policies into their strategy.

Potential sellers in this environment should be cautious, as buyers will take a similar view of these macroeconomic and geopolitical risks. Accordingly, sellers need to evaluate whether the time is right to divest. To minimize negative impacts on price, sellers can screen likely buyers and target those less concerned about macroeconomic and geopolitical impacts. These buyers may be direct competitors or companies already operating in the relevant geography. A broad auction may also help retain pricing tension in the divestment process.

Understand tax reform's ripple effect

More than ever, tax is affecting sellers' ability to achieve desired results. Tax policy can make divestment plans less viable or, alternatively, offer new opportunities to improve value. Eighty percent of companies highlighted tax policy changes as one of the most significant geopolitical shifts that may affect their plans to divest. New policies are reshaping the tax profile of businesses, from US tax reform to the OECD/G20 Base Erosion and Profit Shifting (BEPS) project cascading through Europe.

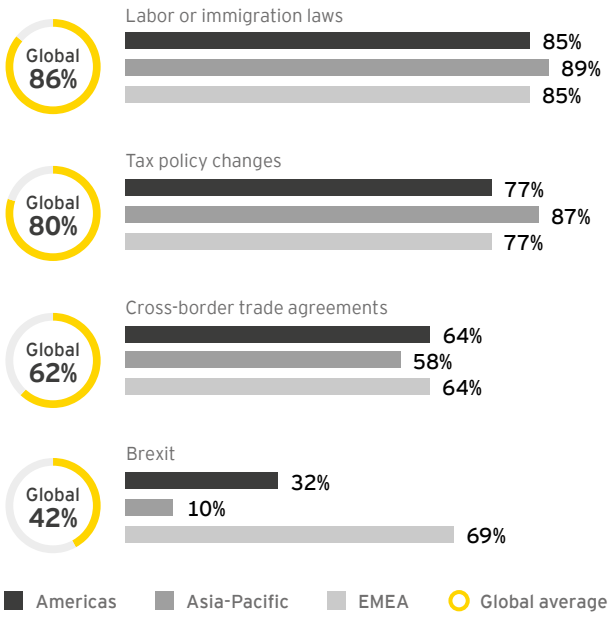
While 31% of companies claim tax changes are making it more difficult to execute deals, certain policy changes – such as the reduction in US corporate rates passed at the end of 2017 – offer US corporate sellers the opportunity to significantly increase after-tax cash proceeds. For all these reasons, understanding tax dynamics is increasingly becoming essential to the strategic decision of whether and how to divest in the first place, rather than a detail handled during execution after the decision to divest has been made.

Opportunistic divestments on the rise

In an M&A environment fueled by record levels of private equity dry powder and large corporate war chests, companies report that 71% of divestments are prompted by opportunistic, unsolicited bids – up from just 20% in 2014. Therefore, sellers must have a continuous and deep understanding of even the smallest assets in their portfolio. It's easy to get caught up in the excitement of an unsolicited offer that exceeds what you think the business is worth. But how can companies determine whether an unexpected offer stacks up? And how can you prove to stakeholders that you've agreed to a fair price?

For example, a Fortune 500 company received an unsolicited approach for one of its businesses, with an indication of value at US$5 billion. The company debated whether to accept the offer and negotiate solely with this buyer or initiate a full sales process. The company hired an investment banker and determined the attractiveness of the asset to both corporate and private equity buyers. Ultimately, the company elected to conduct a full auction process, generating significant competitive tension and negotiated a sales price 20% higher than the initial valuation.

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



36%

of Chinese companies have made **three or more** divestments in the past three years.

China as a hotspot

Global companies that built or aquired businesses during China's high-growth period are revisiting their portfolios to focus on their core strength due to competition from local Chinese companies. These global companies are therefore divesting in China, often to local operators, and investing capital in new growth markets. In addition, State-owned enterprises are under a Chinese government mandate to push for a more mixed ownership and competitive business landscape. This means attracting private capital, and disposing or shutting down non-performing or non-core businesses.

At the same time, privately-owned enterprises who have greater flexibility in ownership structure are revisiting portfolio strategy. They have their own incentives for disposing non-core businesses – to free up capital for new investment, and to cope with disruption from technology and sector convergence.

36%

of Japanese companies have made **three or more** divestments in the past three years.

Japan divests

The corporate governance reform led by Prime Minister Shinzo Abe has been a major driver of divestment activity in Japan. Large, traditional Japanese companies are under mandate to appoint external directors and auditors in their board of directors meetings. This change has brought increased pressure on internal directors to identify non-core and low-profitability businesses. The trend is expected to persist, as Japanese trading houses, with similar business characteristics of traditional companies already under reform, will likely follow suit.

In addition, since the financial crisis Japanese companies have actively expanded outside Japan through organic growth or M&A transactions. Many Japanese companies have had mixed success in their overseas expansion, prompting management teams to consider divesting operations that are performing below expectations or facing financial distress.

28%

of UK companies have made **three or more** divestments in the past three years.

UK: wait and see

During this period of political, economic and regulatory uncertainty that is unlikely to change before 2019, 81% of UK companies expect Brexit to affect their plans to both invest and divest. For many companies, Brexit is an existential risk that is hard to quantify or model; the only certainty to date is it has lowered the value of the pound sterling. Some sectors, such as financial services, airlines and pharmaceuticals, have had to move even before the terms of a Brexit deal are known. Either their existing current corporate structures no longer work, or a waiting game is not possible; options must be generated to enable trading to continue.

Watch for increased divestments of global groups' holdings of UK manufacturing and consumer goods businesses that rely on UK customers. They will seek to channel capital to other sectors or geographies that deliver shorter-term margin and volume aspirations. Conversely, capital within the UK will look to the country's natural global competitive advantages: financial services, high tech and health care assets are likely to be the most active sectors.

2 How do you make the decision to divest?

Especially in this fast-moving market, companies need a portfolio review process that makes them ready to act. Those that conduct portfolio reviews annually are twice as likely to exceed performance expectations for divesting "at the right time." However, many businesses are at risk of acting too slowly – our survey finds 56% of companies indicating they have held onto assets too long.

This may be in part because more than two-thirds (69%) of companies find it a challenge to make portfolio reviews a strategic imperative, indicating the need for a more formalized approach. And many don't regard divestments as a catalyst for growth, or want to admit "failure" in one of their business units.

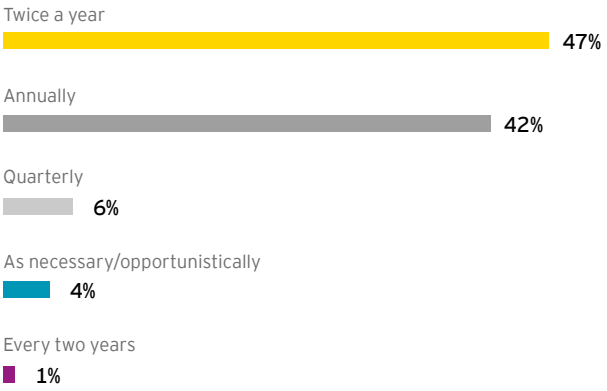
Look at the big picture

Companies should start their review process with the following questions:

- Do we have the right capital structure to meet our strategic priorities?
- What is the best way for our company to grow – and is it aligned with our core businesses?
- What steps can we take to enhance our portfolio's performance?
- How can we improve the performance of our assets?
- Are we the best owner of certain assets?

The answers will help companies develop their divestment road map. This gives the board and the strategy team a framework for further discussion – and action.

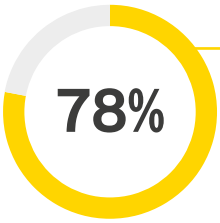
Q How frequently do you assess your portfolio to determine business units or brands to grow or divest? Select one.



> "You have to be very thoughtful about the type of assets you're buying and when you decide to sell other assets you own … When major changes are afoot, it's not quite business as usual."
>
> **CEO, private equity firm**

Lead with a data-driven story

Companies should start by assessing their proprietary financial and operational data alongside relevant external data. This combined view supports their ability to understand current valuation, manage company growth objectives, assess the impact of various scenarios, and allocate and manage the return on capital.



of companies leveraged advanced analytics to understand the true value of a non-core asset in their last divestment.

In their approach, companies must define what they want to accomplish through portfolio review: Do they need to evaluate at a business unit or geographic level? Or do they need to dive deeper, looking at the category or brand level? What will be the key metrics used to make decisions?

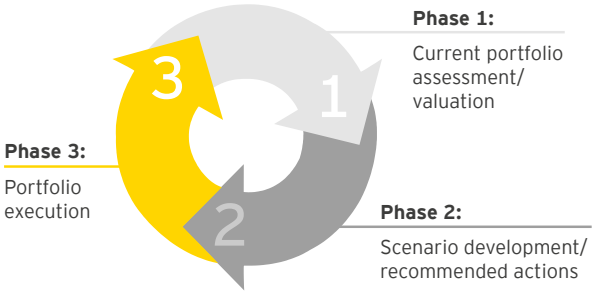
Once a business has applied data to the agreed upon metrics, it can then take an unbiased perspective of its assets. This provides greater confidence in divestment decisions, as well as better results.

Companies that apply data-driven analytics consistently to drive decision-making are 33% likelier to exceed price expectations in their divestments.

Build an "always-on" review process

Businesses that assess their portfolios to determine business units or brands to grow or divest twice a year – rather than on an opportunistic basis – are 41% likelier to achieve a sale price above expectations. They are also three times more likely to complete an exit sooner than expected.

But, with regular reviews now the norm, the future of portfolio reviews is a real-time process that captures the exponentially increasing amount of external data available to companies and their competitors. Portfolio optimization requires timely and frequent feedback through a decision analytics platform that transforms data into insight. Ideally, this "always on" approach should be results driven and include the ability to manage tactics throughout each phase of portfolio optimization.



This always-on review process should be supported by three types of analytics: performance (descriptive), applied (predictive) and decision modeling (prescriptive) analytics.

	Key steps of the portfolio review	Analytics to support your portfolio decisions
Phase 1	Define your strategic objectives Develop key metrics Agree on ratings and weightings for metrics Collect and analyze data Develop base-case valuation and dashboard	**Performance (descriptive) analytics** focuses on the base business and its historical performance, including strategic, financial and operational levers.
Phase 2	Build or customize scenario model Assign business units to preliminary buckets: grow, exit, fix, sustain Evaluate standalone impact of potential actions Combine actions into plausible scenarios for value assessment Evaluate *pro forma* range of metrics Recommend portfolio strategy and execution plan	**Applied (predictive) analytics** provides insight into the likely future performance of the business and helps optimize decision-making – based on predictions and other broader market factors. **Dynamic decision-modeling (prescriptive) analytics** helps make strategic and operational decisions based on predictive scenarios to optimize portfolio performance – including divestment decisions.
Phase 3	Execution through divestments, acquisitions, joint ventures, tax structurings, margin enhancements and enterprise cost reductions	

Automating decisions

A large pension fund with key investments in life sciences, retail, business services, technology and energy needed to create an automated review process to better understand industry convergence and remove management bias from historical performance.

The fund created a real-time platform that combined industry benchmarks, public domain data (e.g., news feeds), syndicated data, financial filings and a comprehensive set of financial/operational data with machine learning based algorithms.

As a result, they can predict performance of the overall portfolio and a subset of companies, drive the capital allocation process and measure return on invested capital. The fund is also able to simulate growth-related scenarios to stress test any investment thesis. By identifying underperforming parts of the portfolio earlier in the process, the fund is able to provide adequate time to resolve issues or prepare for divestment.

Ramp up analytic skills

Nearly two-thirds (64%) of companies struggle to find people with the right blend of technical and analytics skills to lead a data-driven portfolio review process.

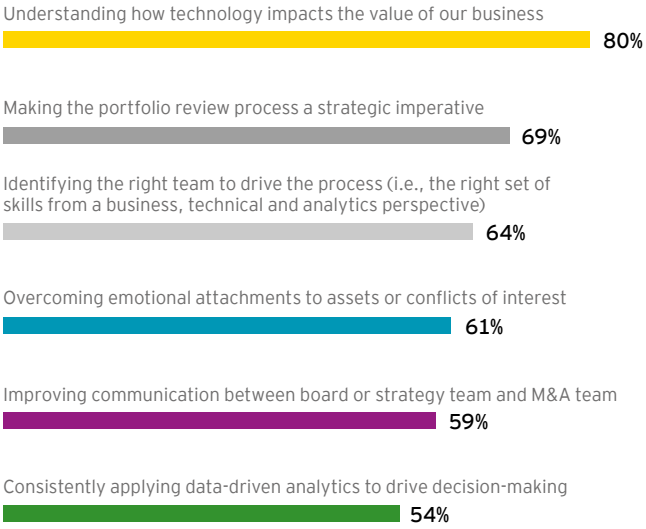
Given that a complete set of these skills is rarely found in one person, we recommend building teams with a mix of deep business knowledge, specialized functional skills (e.g., strategy, finance, marketing, supply chain) and analytics skills, including data management, modeling and visualization. With analytics skills in particular, companies will need to consider all options in finding the right talent. Do you hire? Acquire a company with the expertise? Outsource? Retrain your workforce? Companies should consider a combination of these options based on timeline, budget and sector-specific requirements.

Scrutinize your business levers with performance analytics

Performance, or descriptive, analytics can summarize a company's historical data to unearth critical, value-driving insights. Performance analytics enables companies to learn from past behaviors - whether around customers, cash flow, logistics or workforce - and understand how they may affect future outcomes. For example, companies can analyze historical customer buying patterns to determine product preferences, which can be used to streamline the sales cycle.

Performance analytics and visualization tools can also be applied to portfolio decisions, helping to define divestment parameters and presenting them clearly and efficiently to the board and the strategy team. Companies that use these tools are 24% likelier to achieve a sale price above expectations, and 20% likelier to complete the deal faster than expected.

Q What do you consider a challenge associated with your portfolio reviews? Select all that apply.



Consider applied analytics as no longer optional

Strategy teams are making greater use of applied, or predictive, analytics capabilities in their portfolio reviews.

In particular, they are using applied analytics to:

- Understand impact on various divestment scenarios in real time
- Help identify incremental investments or operational improvements to position the business for sale
- Identify how to re-invest capital generated by the divestment and measure its impact on growth

Companies with effective predictive analytics capabilities are 81% likelier to achieve a sale price that exceeds their expectations and 35% likelier to close their deals ahead of schedule.

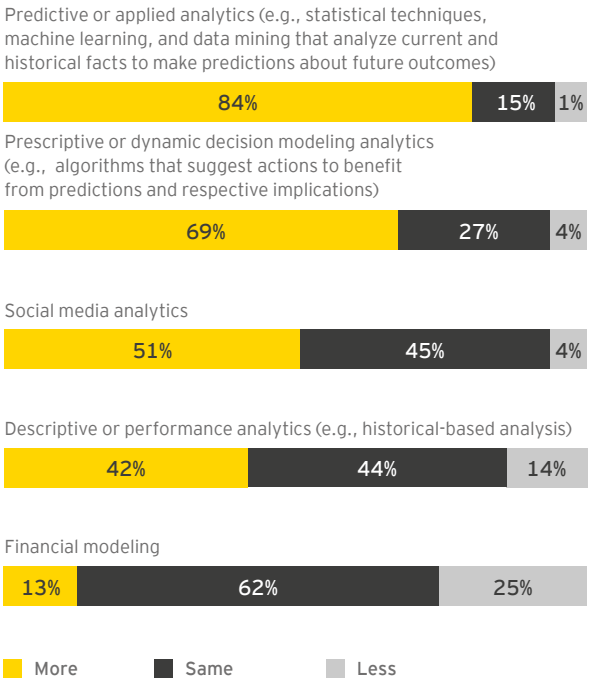
Optimize performance with dynamic decision modeling analytics

Dynamic decision-modeling, or prescriptive, analytics can help companies determine how to optimize performance across their portfolios, by taking action on operational data outputs and feeding results back into the model.

Companies should use prescriptive analytics to understand their current portfolio's performance and valuation, and how to best allocate and raise capital. For example, prescriptive analytics can help identify where to make investments as well as potential divestments, and where the capital raised can be reinvested in the portfolio to drive growth.

In our survey, more than two-thirds (69%) of sellers say they expect to make greater use of prescriptive analytics for portfolio decisions over the next two years. Those that use these analytics are 76% likelier to achieve a higher than expected price for the business being sold.

Q Within the next two years, will you use the following more, less or same?



Dynamic performance boost

A technology company decided to divest several product lines in its hardware business. It then applied dynamic decision-modeling analytics to identify actions that could improve the overall performance of the divested assets pre-sale, to increase its value. These included changing suppliers to optimize the supply chain, and using new distribution channels to reduce overall cost. These actions not only helped the seller improve the performance of its hardware business, they helped determine how to best combine products from various product categories to generate value and interest from buyers. The seller obtained a higher-than-expected price and positioned the remaining business for increased profitability.

Seek out social metrics

Social media is often overlooked as a vital source of data, despite its potential value to companies – especially those with a strong connection to consumers. Social media can reveal market sentiment, key stakeholder perceptions and trends that may not be evident from internal data. For example, what are customers, suppliers and employees saying about the company's reputation? What product or pricing strategy is generating positive feedback from customers and the media?

Just over half (51%) of companies expect to make greater use of social media analytics in the future – more than double the number in our 2017 survey. Removing functional silos between a company's marketing teams that may be managing social tools, and the strategy team that can benefit from access to the data, will unlock the value of social media in portfolio decisions.

Sweet smell of success

A luxury brand company was preparing to divest several fragrance product lines. It used social media metrics in pre-sale preparation to analyze the volumes, sources, sentiments, demographics and geographic footprint of conversations for key fragrance brands and their competitors. The analysis included 2.3 million posts over 24 months, showing that the brands being divested had the highest net positive sentiment, but that a main competitor had a much higher share of voice. In advance of the divestment, the company activated a targeted social media campaign. The result was additional product sales, an increased share of voice, and overall improvement in the value of the assets ahead of the sale process.

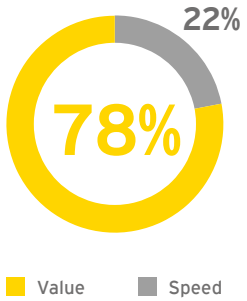
3 Do you have the right tools and talent to maximize your divestment outcome?

While most companies (78%) prioritized securing the best price over speed of execution in their most recent divestment, achieving that expected value can be a significant challenge. Most sellers think the price gap between buyer and seller expectations is between 11% and 20%.

Strengthening the business to be divested, developing the equity story and executing a seamless separation process should be the highest priority for any seller. However, many companies fail to address key value drivers.

In this section, we'll address how companies should think differently about how to maximize divestment value.

Q What was your main priority in your last divestment?



Executives often tell us:

"Why should we invest in a business that we are going to sell?"

"There's little benefit to tax planning when we don't know who the buyer is."

"It doesn't make sense to begin separation planning until we know the buyer."

"We can't involve many people in the sales process – we don't want employees to panic, or customers to find out the business is for sale."

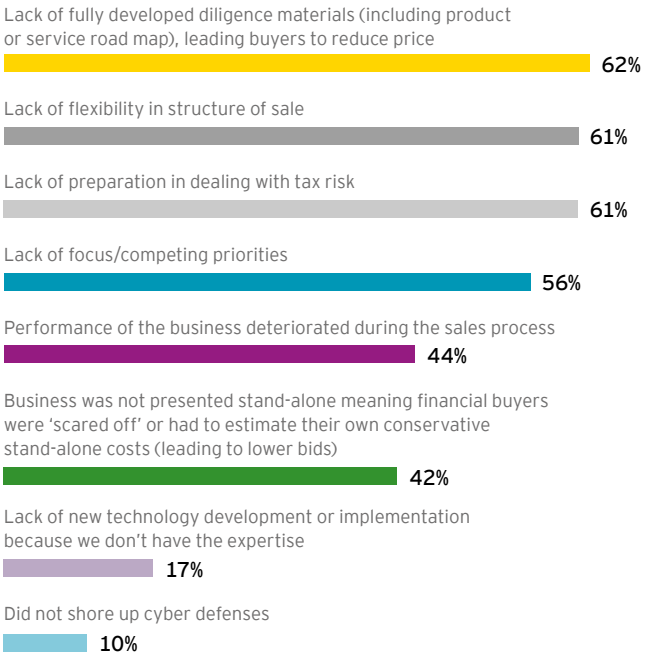
Value can be lost as quickly as found

Many companies miss out on opportunities to improve value in their divestment process. For example, 62% of companies commonly lose value by not fully developing diligence materials and not being flexible with the sale structure. And 42% say that not presenting the business as stand-alone entity 'scared off' potential buyers, or it prompted them to estimate more conservative stand-alone costs and offer lower bids.

Companies that continue to create value in a business they intend to sell are

27% more likely to beat their sale price expectations.

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



Make improvements before you start the sale process

Companies that continue to create value in a business they intend to sell are 27% likelier to beat their sale price expectations, highlighting the importance of showing sustained improvements to the business before buyer diligence begins. Analytics can also help companies create value pre-sale. Those sellers that leveraged analytics in their pre-sale preparation were 59% likelier to achieve a sale price above expectations. For 21% of sellers, the initiative that created the most value was providing potential buyers with the output of their advanced analytics; it enables buyers to identify growth opportunities that support higher valuations.

Analytics can also help companies shorten the diligence period, minimize the need for transitional service agreements (TSAs) and demonstrate the business has been capitalized, operationalized, and properly prepared for sale. By using analytics pre-sale, companies help buyers identify where they can generate future growth opportunities. 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.

Food for thought

As part of divestment planning, a food delivery company used analytics to uncover key insights into its profitability by days of the week. They found their lowest-demand day was Tuesday, when they often operated at a loss. By restructuring the driver workforce to reflect this lower demand, rather than keeping the same staffing levels as the other days, the company improved productivity and drove three incremental points in margin, resulting in a stronger valuation.

Splitting for strength

When a medical device company decided to divest a business, its first step was to get a clear picture of what the workforce would look like post-separation. The company then used analytics to complete operational improvements: synthesizing financial reporting, benchmarks and operational information to increase EBITDA. In doing so, the company was able to capture a sale price 18% above expectations for the business.

Tailor the synergy opportunity

Presenting synergy opportunities is one of the top ways sellers say they created value in their last divestment, and buyers from other sectors are part of that equation. With 41% of companies expecting the number of buyers outside of their sector to increase, how can you make the most compelling case to the widest potential pool of buyers?

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. Sellers can increase deal value by identifying:

- Customer overlap and related cross-sell opportunities
- Supplier alignment to highlight potential purchasing synergies
- Operational footprint and cost base to identify potential rationalization opportunities and ultimately cost savings

Potential buyers expect detailed information on business value drivers — so sellers should determine what data is needed and share it. Only 57% of sellers presented synergy opportunities to buyers, but this was the activity that the largest group of sellers we surveyed (26%) say created the most value.

Prepare for separation early

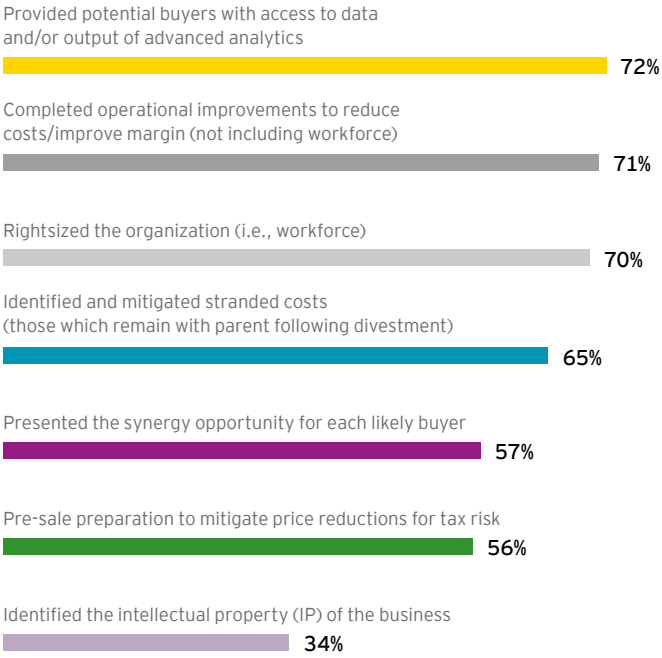
Creating a clear vision of a post-sale stand-alone business is vital to deal value: 42% of companies say failing to do so was a source of value erosion in their last divestment. Here we outline common separation mistakes and why it's so critical to take the right separation approach.

Different buyers, different perspectives

A diversified products company leveraged analytics to position a carve-out of its technology-based medical device business to buyers across the health care, life sciences and technology industries. Combining financial and operational data from the carve-out with different types of industry data, the seller was able to develop two different deal perimeters. One aligned to the software sector, with industry-specific key performance indicators (KPIs), and the other aligned to the health care/life sciences space, with associated medical device KPIs. Through this flexible, data-driven approach, the seller was able to attract a larger and more diversified pool of buyers, keep them interested longer and ultimately drive a higher sale price than initially expected.

Common seller missteps	Why it is critical to do this right
Not preparing a detailed view of stand-alone costs for key functions (e.g., IT), with variations by buyer type/platform	Stand-alone cost estimates allow sellers to prepare to negotiate the incremental cost based on buyer type and platform. Left to their own estimates, buyers generally take a conservative view that decreases valuations.
Failing to be clear about the scope of assets included in the deal	By developing a bespoke, optimized operating model for a business and highlighting potential synergies, sellers can articulate its value in the hands of a new owner.
Not preparing an estimate of one-time separation costs	In carve-outs, companies that take this step are 21% likelier to achieve a sale price above expectations. Buyers often overestimate one-time costs and therefore decrease their valuation.
Not starting separation planning early, with consideration to both the transaction perimeter and the transition of the business	Early separation planning helps identify potential areas of entanglement that affect the TSA framework (services, pricing, etc.), the magnitude of stranded costs and the buyer integration model. Long lead-time activities can delay closing for months if not appropriately addressed.
Underestimating the legal and regulatory requirements to close	Certain countries require long lead times to close, due to extra steps demanded by complex regulatory environments (e.g., operationalizing legal entities, setting up product registration, marketing authorizations). Unexpected delays may require implementation of different Day 1 models in different geographies that will be ready at later dates.
Not contemplating the financial information needs of different buyers	Buyers may need audited carve-out financials early to obtain financing, as well as deal-basis financials that align to the deal perimeter. Buyers also need to get comfortable with what they would be inheriting on Day 1, and sellers must address these information needs to show the business in the best light.

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



71% of companies who completed a carve-out created a stand-alone operating model to reflect the buyer pool.

47% provided an estimate of one-time separation costs.

Move quickly on tax assessment

Sellers should complete their tax assessment before the buyer develops its own quantified model. For example, a seller can highlight tax efficiencies and opportunities associated with the supply chain structure (e.g., reduced-rate principal structures or tax holidays) to enhance value in the buyer's eyes. In our survey, 35% of executives indicated that over the last 12 months highlighting tax upsides to purchasers better enabled them to drive value. We recommend that companies take the following approach:

- Conduct exit workshops to identify potential buyer types and any tax data they may require, before a buyer is identified
- Present both tax challenges and upsides – early, and in detail – to make buyers more enthusiastic about the potential of the purchase and less likely to propose a conservative price
- Assign resources to assess tax exposures across multiple work streams and geographies
- Understand how the tax operating model and effective tax rate associated with the business's supply-chain structure will affect a buyer's effective rate and cash flow post-transaction, on both income taxes and indirect taxes (e.g., VAT, sales tax, customs)
- Investigate the largest jurisdictions that are material to the deal when resources or time is tight
- Emphasize the upside by building out a buyer's potential tax benefits

In light of recent global tax policy changes, sellers must stay agile in their approach to divestments. In particular, companies should remain flexible about deal structure, keeping the buyer's tax position in mind (e.g., asset sale versus a stock purchase) to mitigate tax risk and secure superior value.

Improve execution through communication

Nearly one-third of sellers say they need better communication strategies during deal execution. Communication fosters greater collaboration and performance across functions, from tax to human resources to corporate development.

Create a stakeholder communication plan

Only 53% of companies say they created a stakeholder communications plan. This should be a universal feature of the divestment process – preparing communications for all constituencies, including investors, staff, management, customers, suppliers and the market in general. Sellers must consider that confidentiality, timing and content will be different for each constituent. Overall, companies should:

- Clear the right people early to make timely decisions
- Establish protocols to continue communication with stakeholders of any divested assets after the deal is done
- Couple communications with other strategies, such as incentives that reward executives on various measures of transaction success
- Consider your audience and use channels (e.g., social media) that align to their communication preferences

Focus on the management team

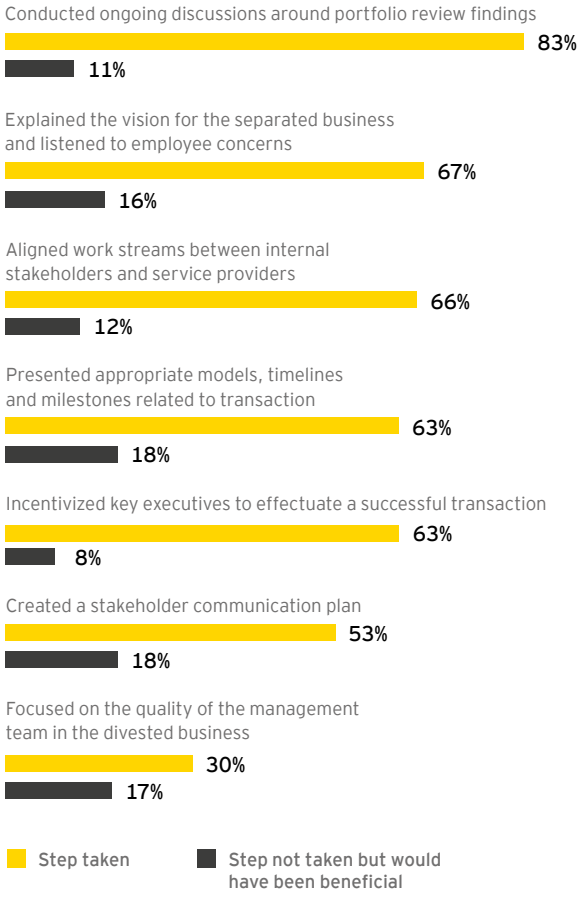
Surprisingly, another area where a majority (70%) of companies say they have fallen behind is in the quality of the management team in the divested business.

In selecting management teams, sellers should consider their:

- Deep familiarity and track record with the business and its competitive positioning
- Key customer relationships
- Vested interests, and the potential for reinvigoration of these leaders by the potential sale (i.e., a unit that has been underinvested or micromanaged, may offer new "freedom" to the management team)
- Ability to develop the go-forward strategy and passionately and credibly present it, with a clear linkage to the forecast
- Willingness to go with the business upon sale and be locked up for an appropriate time period

Once a buyer is identified, the management team's allegiances will naturally begin to shift toward the buyer. Companies should have governance in place to ensure those aligned to the divested business are not acting in a manner inappropriate to the seller.

Q In your last major divestment, which of the following internal communication strategies did you undertake? Select all that apply.



Key communications during a divestment

Pre-announcement:

- Create a compelling and clear vision of the desired end-state
- Develop communications on team structure, strategy and targeted messaging for seller audiences
- Prepare for announcement, including development of press releases and website messaging

Post-announcement:

- Identify labor requirements and implement a localized communications approach
- Prepare the seller's customers, suppliers and vendors for Day 1
- Develop and execute a talent retention plan
- Focus on engaging leadership in two-way conversations with employees

Conclusion

If you are part of the 87% of companies planning to divest within the next two years, what steps should you take now to maximize shareholder value? Here's what our data and experience suggest:

Consider how technology affects your core business

Technology is both a divestment driver and a lever in accelerating top- and bottom-line growth. Sellers who understand how evolving technology affects their business are more likely to beat expectations on the valuation multiple of their remaining business. It's a fast-moving market, so don't wait too long to accept that a business may be better off in the hands of another owner.

Take an "always-on" approach to strategic reviews

Data and analytics capabilities enable an "always-on" approach to strategic reviews and more informed decisions about your growth strategy. Companies that invest in tools to extract and process data, and people with the skills to manage a data-driven decision process, are more likely to extract value from their divestments — including opportunistic deals or those driven by macroeconomic or geopolitical shifts.

Focus on critical value drivers in divestment planning and execution

Companies are more likely to exceed expectations on divestment performance when they spend time up-front to properly capitalize and operationalize the business for potential buyers. Sellers can improve negotiations through greater transparency and using analytics to avoid learning something from the buyer about their business that they should already know. In addition to preparing a strong value story, creating an effective stakeholder communication plan and focusing on a quality management team can improve divestment speed and value.

How EY can help

EY's dedicated, multifunctional divestment professionals can help you improve portfolio management, divestment strategy and execution. Our work with corporate and private equity clients includes a variety of divestments, including sales of the entire company, carve-outs, spin-offs and joint ventures.

Portfolio strategy

Using advanced analytics, we first help you understand your business performance compared to that of your peers and its contribution to the rest of the portfolio, including assessing the quality of information and developing more reliable data for the evaluation. We advise on which businesses are worth investing in and which may be worth more to others. We then collaborate with you to determine where capital can be released and reallocated toward growth and digital innovation. And we help you understand dis-synergies and one-time costs which may result from a potential divestment. Our sector-focused teams can also help you understand the effect a divestment could have on your remaining company's growth, brand and stakeholders.

Improve sale value

Next, we work with you to prepare for a divestment and become an informed negotiator. We can help you improve transaction value by articulating a clear value story and guiding you through preparation and execution – removing any potential bumps in the road before buyers get involved. Whether it be the preparation of financial statements and related deal-basis information, designing a tax structure to benefit buyer and seller, helping to optimize working capital, designing a communication plan, evaluating forecasted performance or providing a complex global separation and stand-up plan, our dedicated divestment professionals will work with you along the journey.

Finally, we assist with negotiations and Day One readiness, and advise on managing your remaining cost structure so you can focus on future growth.

Increase success with EY's divestment platform

EY's real-time divestment data and analytics platform provides a broad view of your transaction life cycle. It helps companies to collaborate across three often siloed functional areas: project management, finance and operations; and it alleviates the need for data reconciliation. In particular, our technology can help you:

- Conduct ongoing portfolio reviews via a structured framework that removes management bias
- Create deal-basis financial statements based on multiple deal perimeters within tight transaction timelines
- Identify tax structuring opportunities by integrating financial and tax data
- Seamlessly operationalize legal entities across the globe by tracking sequential milestones and country and regulatory requirements
- Manage day-to-day interdependencies and milestones with real-time reporting in order to quickly resolve issues

In summary, our technology drives better decisions, a quicker time to close and reduces business disruption throughout the divestment lifecycle.

Read our sector-specific *Global Corporate Divestment Study* reports

ey.com/divest

- Consumer products and retail
- Financial services
- Life sciences
- Private equity
- Technology

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How you manage your capital agenda today will define your competitive position tomorrow. We work with clients to create social and economic value by helping them make better, more-informed decisions about strategically managing capital and transactions in fast-changing markets. Whether you're preserving, optimizing, raising or investing capital, EY's Transaction Advisory Services combine a set of skills, insight and experience to deliver focused advice. We can help you drive competitive advantage and increased returns through improved decisions across all aspects of your capital agenda.

EYG no. 01139-184GBL
BSC No. 1710-2438834
ED None

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