At a glance

The recent trend toward separation or break-up of businesses, with a view to unlocking value or focusing on higher growth opportunities, has brought divestiture strategy and execution back into focus.

An interactive roundtable of corporate business development executives discussed divestiture themes such as: the basis for divestment decisions; structures; buyers; planning and preparation; speed vs. control and key housekeeping matters to consider.

A consensus was reached on the top considerations for successful divestitures.
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Introduction

The current environment of worldwide economic uncertainty, combined with high levels of volatility in the capital markets, has escalated the complexities that corporate management teams and corporate board members are facing as they reassess their strategic direction for 2012 and beyond.

Increasingly, we have seen a trend toward separation or break-up of large-scale businesses, with a view to ‘unlocking value’ or focusing on higher growth opportunities in specific sectors or markets. This is evidenced by announcements such as the break-up of conglomerate business models like ITT Corp and Tyco International, as well as the divestiture of large business units such as GE’s divestment of NBC Universal.

About the roundtable

PwC’s Transaction Services group recently hosted an interactive roundtable for leading corporate development executives in the New York Metro region. This session was a continuation of a series of bi-annual roundtables that feature timely topics and enable peer networking.

The topic of this session was divestitures. Participants from a wide variety of sectors candidly shared best practices and lessons learned, with a focus on disposal strategies, keys to success, and pitfalls to anticipate and avoid.

Participating in this interactive discussion were:

Vinay Bassi
Avaya

Brian Buchert
Church & Dwight

Duncan O’Brien
General Electric

Brian Cook
Honeywell

Michael Lorch
MasterCard

Mark Armstrong
Tyco International

And, from PwC:

Nigel Smith, Moderator

We wish to express our gratitude to our participants for their candor in sharing their views, experiences and lessons learned with us—and, through this summary, with you.
Executive Summary

This Corporate Development Roundtable focused on divestiture strategies and structures – looking into key considerations in managing a successful divestiture process — be it a sale or a spin off. Our participants candidly shared their views on how their companies are exploring and successfully executing divestitures, as well as the trade-offs, risks, rewards and other factors that have prompted them to pursue a divestment strategy. The discussion spanned the challenges their respective organizations have faced across the lifecycle of a divestiture — from exploring the possibilities and initiating the deal all the way through to signing and close.

Some key takeaways emerged:

- **The basis for the divestiture decision needs to be clearly understood.** Disciplined sellers have a structured process to identify candidates for disposal, and the basis for the divestiture decision is validated outside of the business unit through a corporate lens. Before moving forward, significant time is invested up front to define and understand the business being considered for divestiture and develop a detailed divestment strategy. Being able to articulate a robust story and basis for the divestiture before approaching potential buyers is key.

- **A variety of strategies and structures must be considered.** In any divestiture, it is important to evaluate a variety of strategies and to weigh the key considerations associated with each option, be it a full sale, a business alliance such as a JV or retained minority interest, a spin-off or an IPO. There are a number of risks and rewards associated with each option, and it is important for sellers to identify the best fit for their organization’s unique circumstances.

- **Sellers need to evaluate the various potential buyers and understand their motives and as well as their demonstrated ability to close a deal.** The consensus was that selling to PEs is often more difficult than selling to a corporate, in that the process is demanding and valuations are generally lower due to limited value ascribed to synergies and a discipline imposed by accountability to financiers and credit committees. That said, PEs can move quickly. They have the ability to navigate complex issues and are open to very creative structures and ideas. Foreign buyers are often cash rich but, more often than not, they carry the burden of a risk-averse corporate bureaucracy that can slow execution speed and increase uncertainty.
• **Thorough planning and preparation is the key ingredient for a successful divestment.** That means doing the homework to define the business for sale and to develop a comprehensive understanding of how the business interacts with the selling parent – as these inter-linkages have a legal impact, an operational impact and a financial impact.

Building a robust appreciation for the boundary lines of the business allows the seller to have confidence in what is being sold and the completeness of the deal financials, which leads to a more informed negotiation later in the deal. Lessons learned from prior carve-outs or spin-offs should also be folded into this preparation, as they will inform the seller’s decision making around the divestiture. In short, preparation minimizes avoidable surprises and facilitates success.

• **Control versus speed; there is always a balancing act when going to market with a divestment plan.** Robust preparation allows the divestment process to gather momentum over time. This is especially the case around transition service arrangements and synergy / stand-alone cost assessments, where an informed seller can set the pace of negotiations. The roundtable agreed that control and speed go hand in hand, so if the seller is unprepared and must start researching buyer data requests and questions when received, rather than responding, then the buyer has assumed an element of control in the interactions. Speed and momentum stall, and the risk of value leakage rises. A competitive auction process facilitates speed and allows management to better control data flows and navigate difficult issues. Panelists pointed out the need for a seller to have a focused team of in-house specialists (both function and industry) to support the disposal process and ensure management allegiance does not switch to the buyer too early in the process.

The following pages reflect a summary of the participants’ discussion on these key topics, along with select quotes that reinforce the summary and some observations from PwC.
The basis for a divestiture – Determining whether to move forward

Corporate Development executives speak out...

The roundtable began with a discussion on the basis for a divestment decision, the tools and approaches companies utilize to evaluate their portfolios for potential divestiture candidates, and the factors that come into a divestment decision.

The panelists generally agreed that divestment decisions would typically stem from annual and quarterly strategic reviews, which are typically robust business unit reviews presented by management to corporate and BU executives. The most effective reviews present a consistently applied, metric-based assessment of business unit performance that highlights overall performance and market dynamics.

The factors typically qualifying a business for careful consideration as a divestiture candidate are:
- Poor performance with declining market share and profitability
- Commoditizing of the business model
- Cyclicality of revenue and profitability
- Lack of historical capital investment that needs to be re-addressed in the near term
- Loss resulting in businesses no longer being deemed critical to other aspects of the portfolio
- Risk profile of an industry or business no longer consistent with the balance of the enterprises portfolio
- Non-core business inherited as part of a larger acquisition
- Unsolicited or persistent bidders with the means to execute a favorably priced deal, and to do so quickly

When performing any assessment of an individual business for divestment, a key factor for all panelists is the extent of linkages to other parts of the enterprise’s business model. How critical is the business to the rest of the portfolio, and how complicated and distracting would any sales process be for all stakeholders?
Other questions and considerations panelists pointed to in any divestment assessment include:

- Is there an easily identified potential buyer(s)?
- Would a sale process be a competitive auction with multiple bidders?
- Is this the right time in the business cycle to divest the business?
- Could macro events outside of the seller’s control have a material impact on how the process might actually play out?
- Are there any contingent liabilities that could materialize?
- Is the business critical to another part of the corporation? Can it be carved out?
- What is the long-term impact of the divestiture?

Challenges include ensuring that a divestment decision is well founded and is not due to the difficulties an underperforming management team may be experiencing. Panelists all experienced instances where management wanted to divest a problem, rather than expend the time and effort to fix it. They also pointed to situations where management objected to divestments for selfish reasons, such as lost revenue and earnings that would need to be recouped at the BU level, sometimes without the BU receiving all the redeployed capital. Furthermore, all agreed that sales processes are very disruptive to the core businesses – so any divestment decision should not be taken lightly. Significant planning, preparation and packaging of the business must be undertaken to mitigate any execution risk associated with a sale.

In the voice of our Participants...

Frameworks that form the basis for identifying a divestiture candidate “We go through our annual strategic planning process and also have quarterly updates throughout the year. When the business units are presenting, they are also updating on their strategy. Depending on where a particular unit fits, we will try to see what’s going on and whether or not it makes sense to invest in or divest that particular unit.”

“We ask ourselves, ‘Is the underperforming business in a good industry? Is it profitable, and is it growing? Do we just have a bad position in a good industry, or do we have a bad team that’s not executing?’”

“When the business units say they want to sell a business, often it’s because it’s underperforming and they’re getting beat up because of the results. We look first at the strategic fit of the business within the portfolio to see if there is a way to fix the business going forward. And, if it really doesn’t fit strategically for whatever reason, then we start the divestiture process.”

“A key theme at our organization is: ‘Great position in good industries.’ That’s how we start the decision making process around a divestiture”
**Triggers for a disposal**

“Maybe we haven’t invested money in the business for one reason or another, so we do some analysis around “what if” scenarios. What if we eliminated this product line and invested money here? What if we had a different position in this industry that otherwise looks to be strong?”

“A very competitive process can make a relatively ugly asset look pretty. If financing is available, and there is competition for the asset there can be a perfect deal in almost any business cycle.”

“**If you only have one potential buyer and he’s not going to lift a finger until you give him an exclusive up front, you’re in trouble. Tread carefully!”**

“An early signal that something should be considered for divestiture is when we are not willing to invest meaningful money in it. Declining EBITDA and a lack of investment money are usually related.”

**Market timing:**

“We tried to sell a fairly cyclical business and the market cratered. We held onto it for a number of years, the market came back, buyers appeared, and that’s when we sold it. Strategically, it was always known that it was not a fit and it would be sold when the time was right.”

“We knew we’d be going public when we were at the peak of the cycle or at least starting to get into the peak. Just when we thought we’d timed everything perfectly, Hurricanes Katrina and Rita wiped out all the facilities down on the Gulf Coast, destroying our process overnight. We didn’t have a plan for that!”

“I would say that most of our really outstanding divestitures have been driven more by competitive dynamics than by perfection of timing.”
PwC Observations:

There are many different triggers and frameworks that can initiate a divestiture. Whatever the catalyst for a divestiture decision, it is critical that a corporation perform significant homework up front to determine whether selling a particular business is the best option for the organization, or whether it makes more sense to invest the necessary capital and resources to fix the underperforming business and keep it in the portfolio.

Before embarking on a divestiture, first ask yourselves these key questions:

- Why is this business underperforming, and is it worthwhile trying to fix the problem rather than divest? Can we invest in the business and expect return on the capital deployed?
- What macro factors are driving the need to divest, and how is that different from last year?
- Do we have the right management team in place?
- How critical is this business to the rest of the organization. Do we fully understand the interdependencies and their impact on key stakeholders in the company (customers, suppliers, etc.)?
- How big is the business — could we spin it off or is the best option to look to sell?
- What level and form of proceeds can we expect to receive if we go forward with a divestiture — cash vs. stock vs. minority stake?
- Can the business be easily carved out? How will this impact the core company operations?
- Will there be any material stranded costs left for the seller to absorb?
- Can we achieve a clean exit from the business without long-standing obligations such as transition services?
- Do we have a sense for any contingencies that may be linked to the business, and what is the probability these will materialize?
- Would we need to, or be willing to, retain a minority interest?
- What are the potential tax benefits or consequences?
- What resources will we need to execute the divestiture? Do we have the experience and processes necessary to manage and complete the divestiture?
- Is this the best time to act?
- What are the human capital impacts to the seller? How will they impact valuation?

Having a clearly understood basis for the divestiture will allow management to plan, prepare, present and position accordingly—and, should the facts and market circumstances change, management will have the flexibility and wherewithal to revisit the basis for the divestiture.
Structuring a divestiture – Considering the alternatives

Corporate Development executives speak out...

Often a trade sale is not realistic or may not be the preferred option in a divestment exercise. A spin-off may be preferred to allow existing shareholders to continue to participate as owners, or the business may not lend itself to a sale process, thereby making more creative structures necessary in order to achieve an exit.

Panelists agreed that one of the first things they would do in any divestiture process is to look at the industry structure and the capital market structure to determine the most realistic exit strategy and approach.

Market forces may mean that one or more options are available at any given moment. There was consensus around the critical factors to be assessed when considering the most favorable strategy for the divestment of a business:

- Size of the business and market share
- Industry and company growth rates
- Cyclicality of the industry
- Availability of financing in the capital markets

The most commonly used approaches were carve-out sales, spin-offs, and JV structures – some of which allowed for a step divestment over a period of time and a sharing of the up (and down) side.

The panelists agreed that while a step divestment framework can help to get the deal done, the put / call buy-out mechanisms are almost always messy and need to be carefully crafted to avoid becoming a future distraction for the organization.

There was also discussion on situations when sellers would like to divest a business but still retain a commercial supply / licensing type relationship. These situations make negotiations on valuation and supply terms very difficult, as there are value transfers in the sale price as well as the supply contract pricing. Further complexity arises if the partners don’t have alignment on long-term strategy, service levels and exit plans.
**In the voice of our participants...**

**When contemplating an IPO / spin vs. sale:** “If you’re considering an IPO or spin, you would ask yourselves:

1. Is the market eager for a pure play in this space?
2. Who are the other participants and what are they trading at?
3. How much leverage can I get before I spin or IPO it?

You’re then going to marry an IPO valuation up against what you could expect if you sold outright, you’d ask:

1. What’s my LBO valuation?
2. How much leverage can the PE sponsors get on the business in this market?
3. Is there a logical trade buyer and, if so, could they close a deal?

We would go through that analysis around determining divestiture structure.”

“We announced that we were going to spin a particular business but, at the same time, we started a process to divest it because – due to where the credit markets were at that time – we knew that we could sell it to a private equity and get a reasonable price. We considered the risks in timing the IPO market and then the whole cost of putting a spin together – putting management teams and public-company infrastructure in place, etc. We felt there was more certainty if we undertook a direct sale and it would be easier to execute.”

**Retaining a minority position in order to achieve an exit:**

“We recently sold a business into a JV. We actually started down the process of trying to spin it out, but then we had to change tack. The business never got any attention from anyone because it was buried within a much larger entity. When we dug in and saw that the business had extreme levels of cyclical volatility, it became clear that it didn’t fit our overall structure and, furthermore, it was not suitable in the public company model. Historically, this business never had two consecutive years of EBITDA growth over the last 20 years. For 20 straight years it was up one year and down the next! That made it a poor spin candidate and very difficult sale. The JV negotiation was a joy!”

**Using a step sale to allow sellers to participate in any upside:**

“Bids in a recent sale of ours were well below what we thought was the intrinsic value of the business, due to a combination of all time lows in pricing in what was a very cyclical business and a lack of financing for buyers. We decided to do a step divestiture – holding a stake for another three to five years because we believed the market would turn around and we could exit closer to our view on value.”

“In any spin scenario, we have our own reputation to consider. We have to be sure the business will be viable as a public company.”
PwC Observations:

Sophisticated sellers take sufficient time up front to consider the pros and cons of each structure and the alternative options – carve-out sale, spin-off, alliance or joint venture – linking each to the strategic imperatives and management’s expectations as to value and timing.

Every divestiture plan should have several scenarios baked into it so that the seller does not get trapped into executing a bad deal. Looking at each option, ask yourselves:

- Are there any overriding factors that will make this exit strategy impractical—size, growth, cyclicality?
- What are the tax implications?
- What are the public company costs, e.g., SEC, reporting and financing implications?
- What cross-dependencies and competing demands might we encounter in undertaking this particular strategy?
- What operational separation complexities must we plan for?
- Are there any factors that will potentially lead to value leakage?
- What regulatory requirements and related compliance issues might there be?
- What are the deal-execution costs?
- What reputational risks could impact our organization after the deal closes?
- Can the seller present an alternate asset/liability mix in the carve-out to maximize the market ability of the business?

The seller should weigh these factors and form a view on which structure has the right balance of acceptable execution risk and the highest realizable valuation. Then, comparing this outcome to what a potential bidder would prefer, bridge the difference in anticipation of a negotiation discussion.

Answering these and similar questions before moving forward is the key to success during and beyond the divestiture.
Evaluating the buyer mix – Planning for a successful sale

Corporate Development executives speak out...

The panelists discussed the characteristics of the various buyers they encounter in their divestment processes and the strengths and weaknesses of each. There was a consensus that corporate buyers were preferred because of fit and style, but that PEs play a very important role given their creativity, ability to move at speed and willingness to close a deal. It was also clear the panelists see foreign buyers as important players who have strategic ambitions in the US and a willingness to pay a premium for the right assets – but they also bring unique cultural and business practices and traits that need to be incorporated within any robust divestment process.

When discussing the most preferred buyer, the panelists were unanimous in their views that they follow the money – whether it comes from PE or corporate. While there are trade-offs to be made around timing and execution risk, money talks, and the panelists all acknowledged that a premium price will always command attention, no matter how complex the proposed structure and terms might be.

Consistent themes associated with the types of potential buyers were:

**Corporate buyers (Domestic):**
- More recognizable behaviors make for an easier cultural fit
- Knowledgeable of industry issues and challenges that can speed due diligence
- Willing to bid based on their expected synergies
- Sometimes inexperienced and unsophisticated in M&A

**Private equity buyers:**
- Move at speed
- Flexible and willing to take risk
- Creative deal makers
- Detailed and comprehensive due diligence process due to likelihood that business will be resold in 3-7 year timetable
- Experienced M&A executors with advisors who work with them very regularly
- Ruthless negotiators

**Foreign buyers (Corporate and sovereign wealth funds):**
- Significant cultural differences (Asia v EMEA v LATAM)
- Can be unknown to the marketplace in the US
- Bureaucratic decision making with more stakeholders
- Slower, more deliberate process
- Cash rich, and often have exchange rate benefits depending on the business cycle

The panelists noted an important role for each buyer group in M&A activities. They expressed a willingness to work with anyone who invests time and resources in a sales process and has a demonstrated ability to negotiate and close a deal.
**In the voice of our participants...**

**The ideal buyer:** “From our standpoint, go far and go wide at the outset of the process and then give yourselves options as you go forward.”

“When you have a business to sell, my bias is always to put it out there in lights, attracting all comers... ‘Hey, I’m selling the business!’ You can never be assured that you’ll fully understand everybody else’s strategy, so why make that decision up front?”

“If the capital markets are working well, PEs can be a great stimulator of value in a competitive process. But, given a choice, I prefer to sell to a strategic buyer. It is not necessarily easier, but I think the behavioral patterns are more easily recognized. There is a cultural aspect that is very important—the negotiating style, behavior patterns and way of doing diligence. Strategic and private equity players have a very different take on things.”

“There’s a speed element, and private equity can complete their analysis and get to a competitive bid very quickly – and they won’t invest their time unless they’re serious.”

“In a sale to a PE, you typically have to do extra work because they bring in their experts—consultants—who know each domain but who often don’t know how everything should work together. You might prepare a lot up front, but it’s a constant negotiation going back and forth, back and forth.”

“The PE community can do very creative things that a corporate won’t try.”

“In terms of process, it’s usually more difficult to sell to private equity. Your preparation and readiness of the sale process has to be much tighter, as they will be much more aggressive depending on what sort of diligence issues they find.”

**Private equity buyers make a huge contribution:** “The private equity structure is such that when all the financial markets are open, they can step up and do very creative things.”

“When we have a divestment of size, our leadership team always wants to know what the PE is going to do when we sell the business, and why we can’t do that ourselves. And almost always, the answer is that PEs can restructure much more aggressively without worrying about the impact on quarterly earnings...”
"As sellers we always consider what a PE fund will do – we need some sense of what their value-creation paradigm would be versus what we could do, and whether selling is the right thing. PEs have the ability to do things that are much harder to do in the public-company environment."

"The private equity industry is now a mature business. They have deep industry insight and a strong point of view."

**Corporate buyers focus their efforts on different areas than PE buyers:** "If you have a sophisticated corporate buyer on the other side, you can sidestep a lot of the industry issues. PEs have gotten a lot better, but with the smaller PE guys, you typically have to start at the beginning of the story."

**Anti-trust factors:** "When selling to a competitor, by the time we have to go to the DOJ and navigate the anti-trust process we have already negotiated and signed a deal. So, if we then figure out the buyer can’t close unless they divest a particular product line, there will likely be a negative value impact for the buyer. But if I have done my homework, then I should already have prepared and ensured the contract is watertight and the buyer can’t walk from the deal."

**Nuances to consider when dealing with foreign buyers:** "If you’re doing a divestiture in India, there is a much more difficult and different negotiating style than if you’re doing it in China, and it is still different if you are doing it in Brazil or Israel. How foreign buyers position themselves and how they think is very different from a typical US company."

"Foreign buyers can be great players in the process, but they typically have a corporate governance structure that is more structured and bureaucratic than that of a US company in terms of approvals and the processes they have to go through. You can get surprised. You just have to create a little more time in your process to work through it."

You’re looking for the CEO that goes to his board and says, ‘if I don’t do this deal, I’m out of this business. I’m dead.’ No PE firm is going to tell its investment committee that!"

"Strategic buyers can become irrational at times, and that’s what we’re looking for ...... I want them to be irrational when I’m selling a business (and they want me to be irrational when I’m buying a business)."

"In China, it’s not clear to me that there is any pace at all until they have decided they’re ready to do something."
“When you do cross-border transactions—make sure your buyer is educated as to where they’re doing business. There’s culture, and then there’s market practice, and these can both be problematic if buyers and sellers are not well informed.”

“In Asia, it is more common for them to want the senior executive to make the call every time, and to always be available. It takes time to get comfortable with the people who they will be working with on a daily basis.”

“As a negotiation dynamic, the rules of the road in the US and Western Europe feel relatively well established – but when you get beyond those places, the practices change. People may make agreements that end up not being agreements. It changes the dynamic a bit from a negotiation perspective. You have a process and a path of discovery.”

“I’ve found that some foreign buyers, if they get interested in a US business, are really valuable buyers, i.e., it’s good to have them in a process because they can help to move the price up for you, often they are willing to pay up for a US footprint.”
PwC Observations:

Factors to consider when selling to...

...Private equity buyers today have invested significant resources getting to know an industry and have teams and funds dedicated to specific industries. Furthermore, they draw upon the knowledge and experience of a large team of specialized deal executors – typically comprising top lawyers, accountants, strategy consultants, M&A environmental advisors, benefits-plan strategists and others – to gain a firm grasp of the industry and the potential business to be acquired. PE firms have a different investment time horizon, meaning that they focus on different areas in structuring – doing their diligence and then negotiating a deal. With a scarcity of opportunities in the marketplace, PE firms are proving themselves to be very creative and aggressive buyers who are often more willing than strategic buyers to do difficult deals. Focus areas for a PE buyer include:

- Ways to leverage the business
- Value creation through top-line growth, cost reductions and co-sourcing within their portfolio, as well as liquidation of surplus or non-core assets
- Exit strategies
- Management team (experience, creativity, quality and capability)
- Capital requirements (short-term working capital, capex for growth and maintenance spend)

...Strategic buyers typically have strong knowledge of the industry issues and are motivated as buyers by more macro or longer-term strategic factors such as market footprint, horizontal and/or vertical integration, or critical technology or components that they can leverage in other aspects of their business. As a result, they can sometimes be more willing to buy at a higher valuation, but this can come with higher execution risk. Focus areas for a strategic buyer include:

- Synergy identification and quantification
- Anti-trust constraints
- Strategic fit
- Compliance and any regulatory implications such as FCPA
- Income focus vs. PE who are more interested in EBITDA and cash flow

...Foreign buyers, like corporate buyers in the US, are typically well versed in the industry issues and come with the same focus areas – synergies, regulatory compliance, strategic imperatives and growth. However, there are cultural factors that must be considered and anticipated, but not used to dismiss a buyer. These include language, negotiation style, speed and decision-making authority.

Irrespective of whether there is a financial or strategic buyer in the process, sellers should recognize that culture and style likely presents the major barrier to navigate in any divestment discussions. Once each party understands how the others operate and determines what they need to be able to work through in the transaction, then most things will fall into place.
Plan, Prepare, Position and Present — Informing the Seller

Corporate Development executives speak out...

There was a consensus that a robust and insightful planning and preparation process is the essential ingredient that facilitates an accelerated negotiation and a smoother path to a closed sale.

Critical aspects of such a plan were:

- **Defining the business for sale.** Panelists concurred that it is not enough to agree to sell a business; the key is to define what that business is and what it is not. All agreed that the most complex scenario is typically a carve-out where there can often be a spider’s-web of linkages back to the mother ship through shared assets, IP, inter-linked customer and supplier contracts, shared cost centers, people, infrastructure and services. Others observed that there are sometimes long-standing and critical operational dependencies such as inter-company supply and sales contracts. These linkages all need to be identified, documented and quantified.

- **Building out the deal team** – The discussion around who were the essential players underneath the BD team to prepare and plan a divestiture centered around: M&A lawyers and tax-structuring experts to help frame the deal structure, an HR specialist who could advise on retention and incentive plans as well as potential C-suite overlaps, and an operational person (outside of the business for sale) who really knows and understands the business and can act as a counterweight to BU management (who may change loyalties and are sometimes not part of the initial deal team until a definitive sale process is set in motion). The panel pointed out a variety of circumstances that dictate when to bring BU management into the process, but agreed that the best practice was on an ‘as-needed’ basis. All the panelists use trusted advisors to supplement their deal teams as they tackle the heavy workload associated with the preparation.

- **Obtaining agreement from the key internal stakeholders.** Internal stakeholders must agree on the definition of the business for sale. Panelists concurred that stakeholders need to have an understanding of the impact of the disposal on all aspects of the company businesses. This involves gathering the population of intra-company linkages and educating the businesses and functions on the impact (such as potential stranded costs or new legal frameworks that will need to be put in place) and acknowledging as much.
Savvy sellers have a process to monitor and learn from previous deals, part of which involves making sure that they understand where preparation and planning might have fallen short in past deals. Panelists pointed out that a common area for improvement is usually the inter-dependencies and linkages between the parent and the business units. Given that carve-out businesses have not typically been operated or organized in anticipation of a divestment, there is always going to be a potentially long list of linkages and considerations to frame and reflect in the deal financial statements.

Items called out by the panel as typically challenging preparedness for a divestiture include:

- Trading activities with the parent company businesses – and quantifying the arms length financial impact
- Incomplete or arbitrary allocations (sometimes can mean free-of-charge situations; other times can mean cross-subsidization and charges levied without basis)
- Transition Services Arrangements (TSAs) and licensing agreements
- One-time separation costs and change-of-control penalty or re-assignment payments
- Stranded costs left with the seller (unabsorbed fixed costs, contract-breakage penalties etc.)
- Branding and perpetual licensing of proprietary IP

Any surprises – be they under performance of the business, data gaps or changes to the deal structure – allow buyers to take the upper hand. This usually slows the process, scares off certain buyers and, more often than not, erodes value. Given the huge disruption of a sale on the business, it is a constant struggle to avoid surprises over the course of a divestiture process. Panelists made this point regularly throughout the session and pointed to thorough preparation and use of advisors as a means of mitigating the risk of nasty surprises late in the negotiation.

All agreed it was a big mistake to assume that one size fits all. Flexibility and adaptability are very important in a divestiture. If the buyers are able to understand where their value opportunities might lie, a well-prepared seller who has properly planned ahead will almost always be able to ensure that buyers will stay involved in a competitive auction process. To that end, the panelists called out synergies and stand-alone costs as an area where sellers can anticipate a specific buyer’s focus areas and provide data that will enable a more complete understanding and valuation of synergy opportunities available to individual bidders.

Defining success in a divestiture is always a challenge, but the roundtable agreed that it is important to manage internal expectations around valuation and timing – the most common yardsticks for success. Another important success factor identified in the conversation is a clean exit, with satisfied customers, suppliers and regulators, as well as minimal long-term ties between buyer and seller. The challenge with any sale is the fact the timetable is often dictated by the nature of the buyer and their ability to navigate regulatory approvals and filings along with any financing needs. Also, once complete, the lasting legacy of a divestiture is the valuation – meaning that the headline price is always a key benchmark of success.
In the voice of our participants...

**Define the business for sale:**
"You decide to sell a business, ‘Okay, we’re getting out of this,’ but having everybody agree on what ‘this’ is and how that impacts the core business always takes a lot of time and effort, and every decision has a significant bearing on the financials for the deal."

"You start with a business definition. You draw charts — you know, supplier to this business over here, customer over there. You have a supply agreement and a customer agreement that you have to provide. You have back-office functions, IP agreements, etc. Getting all of that right up front is step one. Step two is getting it reflected in the financial statements."

**Ensure that there is internal buy-in for the sale:**
“It’s not just the business unit that is selling a business, it’s the company. It maybe that there is a business unit in another part of our company that’s a customer of that business, or a supplier.”

"...You have to make sure that the people selling the business understand what it’s actually going to mean to get rid of that business — that you are out and likely can’t get back into it.”

**Build out a team carefully when doing divestitures**
"BD sits at the center, quarterbacking the deal team. Our M&A lawyer will be heavily involved in structuring and negotiating the deal — a real partner in the process — and typically the legal structure is driven by tax issues, so getting the tax attorney on the team up front is also very important. We need a savvy HR person because getting separation agreements, incentive arrangements and retention arrangements outlined early on is critical. I suggest you do that before you start talking to management teams that prepare the business for sale.”

"You find that everybody wants to work on an acquisition. It’s fun. It’s dynamic, and you’re growing the business. But it’s the divestiture where you find you’re standing in the room by yourself!”

"Often, if it’s a complex carve-out, we’ll look to put somebody on the team who has some knowledge of the business – someone who has spent time in the business but isn’t going to be in the business going forward, who can help us identify and administer some of the separation issues.”
“In most of our disposals we know if the CFO of the BU is critical, so we will bring the CFO under the tent early, but we won’t necessarily tell the general manager. It’s hard for that CFO, but sometimes we have to do that to protect the business unit until a definitive go/no-go decision is made. Once we have the ability to tell the executives, and we explain it, people are pretty comfortable.”

“I would say this is one of the places where advisors like PwC have been a real asset to us, because everybody involved in these processes has a ‘day’ job. We need some extra resources that really know what the end game is and what it needs to look like.”

**Prepare for every scenario:**
“Prepare for every scenario:
“If you put yourself in the buyer’s shoes, that mindset will help you to figure out whether the story hangs together with the numbers.”

“Historically we really didn’t know where all the linkages were. We figured it out over time, but it ended up being a discovery process and a negotiation – which is not the way to do it.”

**Understand the linkages and intra-company activities:**
“The businesses in our company haven’t been run with an idea that we’re going to sell it someday. So, concepts such as change of control, and documented commercial contracts are not always things that have been part of the commercial organization. We have to sort all of that out. The IP is everywhere and nowhere at the same time.”

“I think the place where we struggle the most is trying to figure out all of the linkages between a business or a business unit and the rest of the company, and then to figure out, on an arm’s-length basis, what it’s going to cost – first to break it apart, second to provide the transitional services, and third whether there are any stranded costs at the parent.”

“Prepare for every scenario, I like to be as close to being done as possible once I’m on the phone with XYZ buyer.”

“The devil is in the details. You really have to focus on intra-company charges and allocations that occur, because some of them are for value, some are free and others are debatable. You have to be able to sort all of that out – and it’s typically not straight forward.”

**Provide clarity for buyers:**
“Know the buyer you are dealing with, and then present the business in a way that allows the industry participant to see where the synergies are and the PE firm to assess the stand-alone costs. They’re going to show up with a point of view and, of course, they’re going to downplay the synergies and overlay the costs. You need to have a firm grasp and a well-founded viewpoint.”

**Manage internal expectations:**
“Setting the barometer of success is a real challenge. When do you have a clear enough picture to set a headline price— and how does that number start getting some stickiness? Once discussed, it quickly becomes the measuring stick in terms of success. If you get that right, you do well; if you miss it, it’s a failure.”
PwC Observations:

The seller needs to have a rationale for the divestment and a very crisp story as to how and why the divested business can perform better under new ownership. To craft such a story, the planning and preparation needs to tackle a number of internal issues up front, items such as:

- Defining what is being sold, including navigating what are often complex internal issues and controversial items that are usually dismissed until the end of the process - items like patents and IP licenses, branding and logo’s, etc.
- Obtaining agreement early on that the proposed structure can work and will be supported by the key stakeholders in the rest of the company who will be affected by the disposal
- Identifying and building a disposal team that can manage the preparation and analysis of the business for sale and then transform into a smaller negotiation team that has authority and sponsorship.
- Setting expectations around value and defining success

Developing the rationale and story behind the sale also requires a seller to take an external perspective and challenge internal status quo and views on what is essential to the activities of the business being divested. External advisors can add valuable perspectives on:

- Market size, growth opportunity and competitive positioning
- Insights into what is constraining the business today
- Unusual factors that may constrain the anticipated profitability of the business
- Infrastructure required for the divested business and the adequacy of the cost base included in the deal financials (allocations vs. stand-alone assumptions)
- Valuation factors relevant to a variety of potential buyers (scenario planning for PE, local / foreign competitors, or major customers / suppliers

Completeness is crucial - An important benefit of robust planning and preparation is that it allows the seller to feel confident in the story they are communicating and that the financial information they are delivering to potential buyers reflects the business being sold. It also informs the sellers as to where there is risk and softness in their data and allows them to prepare or proactively present information to respond to anticipated questions and concerns of the buyers.

Other considerations around the planning and assessment phase of a divestiture process include:

- Has a detailed plan, timeline and deal team been established?
- Has a chain of command been established to facilitate decision-making throughout the deal process? Who is "under the hood?" Do we have the right people?
- What controls, functions or processes exist to ensure quality of information and data throughout the sales process – especially as it relates to documents and data provided to potential bidders?
- What advisors are required, and when should they be engaged?
- Have contingency plans been considered in the event of a failed sales process?

In our experience, those sellers who do the most preparation up front are the ones who avoid surprises that impact value and they manage to consistently complete transactions in less time. Conversely, if the seller is not prepared to deal with issues the prospective buyers bring up, loss of credibility can occur, the process can slow down or even grind to a halt, and value can plummet.
Going to market – Maintaining control and speed

Corporate Development executives speak out...

There are a myriad of factors to evaluate in the execution phase of a transaction. The panelists discussed a number of judgmental areas that they have encountered in the execution window of a divestiture process:

- **Seller messaging to the market on the intention to sell** - The approach taken often says a great deal about the seller’s conviction to sell and willingness to hold onto the business if the price is not right. Making bold statements that a business is for sale is an open call for bids, but it begs questions around strategy and price expectations. These must be handled carefully so as to avoid putting a ceiling price on negotiations and creating potential uncertainty for customers, suppliers, employees and other stakeholders in the business. Panelists also noted the importance of sustaining performance of the business to be sold or spun off throughout the divestment process, and that communications around the intention to sell must anticipate and mitigate anything that might compromise performance.

*Speed to market* – This is a real challenge, as moving too fast exposes the seller to oversights and mistakes in the preparation that may derail the transaction, while moving too slow suggests there is not a competitive auction or willingness to sell. Panelists also noted that a drawn-out process is much more challenging for the management team who have to run the business and maintain morale while navigating due diligence from the various bidders. Speed and control go hand in hand. If the seller becomes reactionary to buyer demands, then a certain amount of control transitions to the buyer and speed is lost. The panel unanimously agreed that speed and momentum needs to gather through the life of the process – with thorough preparation facilitating a more aggressive timetable from buyer due diligence through to contract negotiation.
Information flow - A competitive process allows a seller to manage the release of information and highlights on the deal to bidders in a way that piques interest but also limits the volume of confidential information that may be in the marketplace until there is a population of very serious bidders. The panel observed that if the bidder is a direct competitor, then the level and nature of information shared needs to be very carefully monitored and managed. It was also noted that confidentiality is a challenge for all sellers, and the panelists shared their approaches to maintaining confidentiality and experiences – highlighting the fact leaks are hard to recover from and regaining control of ‘the marketing story’ is difficult. All agreed that confidentiality is an even greater challenge in today’s modern business world, where blogs, twitter and message boards quickly spread leaks and inflame rumors.

Management’s role - Management must know ‘the story’ and have a detailed understanding of any deal financials prepared by BD to reflect the business for sale. Panelists noted that, more often than not, the business team in a carve-out situation does not recognize the financial statements presented to buyers due to the various contributed assets and pro forma adjustments for allocations that may have been included in the historical results. While all interactions with bidders are handled by BD and corporate executives, the BD team does need to carefully prepare and script the business unit management for management presentations and due diligence calls. The entire team needs to be capable of delivering decisive responses to bidders – having anticipated the buyer questions and information requests and prepared their answers in advance. There is no such thing as too much prep, as ‘it always pays off 10 times over.’ Panelists delivered this message over and over again during the session.

Customers, suppliers and other key stakeholders - Stakeholders often receive mixed messages around a transaction, which, depending on the situation, can be very damaging to the underlying business if not proactively managed. Panelists had different approaches as to when and how the various stakeholders were informed of a pending transaction and the basis for the divestment, but all concurred that it is important to ensure that these stakeholders hear direct from the seller rather than the rumor-mill.
Conveying the intention to divest a business: “Here are a couple of considerations: Are you prepared to sell the business at any price and take a loss if you need to? If so, then go ahead and announce it. On the flipside, are you prepared to retain it if you can’t find a buyer? You have to consider the damage it does to the business if you have announced that you are trying to sell it but then you end up having to own it for a period of time.”

“Putting a for-sale sign up in bright lights is a bold move. You have to have anticipated the impact on all stakeholders in your business. It’s high risk if you aren’t prepared to move fast and with conviction.”

Deciding when and how to disseminate the necessary information: “We like to be prepared, but sometimes the sharing of the information is done in tranches because we’re dealing with a competitor – giving them enough for negotiation purposes, but not so much that we lose a lot of confidential information if they walk away. That’s the balance.”

“Information is power, and unless you have put a box around all of the critical information, you lose. You lose power. You lose leverage. And you ultimately lose proceeds.”

“There’s no right or wrong way— it’s just providing adequate information to enable bidders to prepare a robust bid and come forward as a negotiator with every intention of moving toward signing a deal.”

“Under really sensitive contract conditions, where we might be selling to a competitor, we either won’t share the information or we’ll do it in some sort of a clean room, and that has to be done prior to signing.”

Don’t jump the gun: “Once the decision is made to move forward, there is real pressure to move quickly. It’s a balance. You use all available time to prepare, and you try to get all the big things, but if speed is of the essence, you are going to miss a few things. It’s a big risk to take, especially in a buyer’s market”
“There’s a little message box at the bottom of our best practices for divestitures that says, ‘Start slow to finish fast.’ And that’s not where we were as a company five years ago – we’ve learned.”

“You might get the books out in two weeks as opposed to three months, but your diligence when you get the books out in two weeks takes six or eight months versus a four-week period if you invest the time up front...”

“I always take the beating that I’m moving too slowly, but I will take that beating all day long rather than get out over my skis and fall on my face. I will not promise anything, but I’ll try to convince them that they are going to end up with the right answer at the end.”

Don’t allow a buyer to wrestle away your control of the process: “We wanted to sell a business. It took us four months just to get ready to go to market. That seemed like an interminable period. By the time we got to market, the financial crisis started to break. Most of the big players were already starting to have trouble. By September the world had fallen apart. We had one buyer left, and they were being very aggressive. We decided not to sell, and today it’s a very profitable business in our company.”

Confidentiality is a challenge: “In terms of confidentiality, I’ve found it to be really difficult to keep things quiet. I’m getting questions from people who shouldn’t have any idea that there was something going on, and who don’t really need to know. So we instituted a confidentiality agreement and have people sign them on significant deals. This works to some extent, because people take it seriously, but it doesn’t work perfectly.”

“One of the ways to approach confidentiality is to adopt a culture where you become comfortable telling people who don’t need to know ‘there’s no reason you have to know, and we’re just not going to tell you.’”

“The confidentiality issues we have are not typically deal-team related or management-team related. It’s somebody at the senior level somewhere at a staff meeting or at an external meeting who says something that it would be better if he or she had not said, and then chat boards and blogs pick it up and accelerate the leak or rumor.”
Management’s role in the sales process: “You have the management team that’s going with the business, and clarifying that up front is critical. But in terms of the deal team, that is going to be led by someone from corporate, and we’ll call the shots from a day-to-day perspective.”

Managing interactions with buyers: “In terms of how we interact with bidders in the process, there’s a well-established process that is tightly managed. BD controls the conversation. We would never put target management in the room for this discussion. It’s probably not something you should ever do.”

“We coach the management team well and script what they’re going to say, and then we try to keep them on script.”

“How buyers act in a process right from the very first meeting has a huge impact on how the management team behaves as the sales process rolls forward. In one instance, there were distinct differences between three players who really mattered. There were profoundly different views in the management team as to where they really wanted to go versus where they did not want to go. In the final analysis, people act professionally – but there’s a real human element to manage.”

Customers and suppliers need to be carefully managed: “We proactively communicate about a potential transaction with our customers and key suppliers just so that they have a clear message from us. They don’t always hear the facts behind the sale. If they don’t understand, it will hurt us in the longer term.”
PwC Observations:

Flexibility and adaptability are key success factors in a divestment process. Going to market on the back of robust planning, preparation and packaging of a business for sale allows a seller to understand the challenges that are likely to exist in the marketplace, and the attractiveness of the asset in question.

Keep flexibility and adaptability in mind as you go to market – making sure that you understand your readiness in terms of the following:

- What is your likely buyer population? Are you prepared to potentially respond to a PE or a foreign buyer? Can you articulate a crisp story around the business and the opportunity?
- Has the appropriate amount of time and analysis been spent up front to assess the value of the business so that realistic expectations are set for negotiations?
- Can you define the necessary TSA services and standards, and is this consistent with the basis for the arm’s-length stand-alone and stranded-cost assessments that you have undertaken?
- Did the up-front sell side diligence on the business surface any large risks, deal issues, or roadblocks to the sale that must be identified and addressed early on, prior to meeting with potential buyers?
- Have you identified the right internal resources to tackle these?
- What controls, functions or processes exist to ensure consistent quality of information and data throughout the sales process – especially in the buyer due diligence phase?
- Can you support the bidders as they work to quantify synergies? Do you have your own view on the achievability of each synergy, and can you help to frame the buyer’s view?
- Does the management team "buy into" to the forecasts presented to the bidders? How confidently can they defend the plan under buyer scrutiny?

Sellers should have a clear view of the way they want to position and negotiate deal issues. They should set out their expectations early and communicate their position using the terms and conditions included in their initial draft Sale & Purchase Agreement (SPA) – thereby beginning any negotiation from a position most favorable to them, rather than leaving issues open to a discussion with the buyer, which could result in an unsatisfactory compromise.

It is important to have mechanisms to ensure management is working for the sellers, and that allegiances have not switched if there is an obvious buyer. To keep management honest in the course of the deal, the seller’s team needs to include an operational person who is not going with the deal.

Be confident in the preparatory work you have performed, and do not make on-the-spot decisions in the negotiation process. Reference and leverage the team supporting the divestment process.
Housekeeping is critical at close

Corporate Development executives speak out...

The roundtable also spent time talking through critical housekeeping matters that all agreed were essential to facilitate a smooth path to a closed deal – areas that, if not properly considered and evaluated, can cause a deal to unravel or can result in significant value leakage. The main topics covered were:

- **Audited financial statements** - Panelists agreed that it was sensible to perform an audit, assuming it is warranted given the size of the deal and mix of buyers. Not having an audit when a buyer needs one to obtain financing or SEC reporting requirements can unnecessarily delay a signing or closing. The discussion warned that, in certain circumstances, a set of audited financial statements could be quite different from the deal financial statements presented by the corporate development teams, making it important to have a robust bridge in this situation. Factors to weigh include:
  - Buyer mix (small corporate and PE often need an audit)
  - Size of deal (materiality for SEC registrant (3-05 rules)
  - Capital markets expectation (buyer undertaking 144A offering or SEC filing)
  - Speed - an audit allows flexibility and avoids hold-ups at close (no buyers excluded)

- **Transition services type agreements with the seller** - Panelists noted the importance in a carve-out transaction of documenting all services provided by the parent group of companies to the business being divested – including IP and brand licensing types of arrangements – to ensure that the nature of the services are understood and that there is clarity around the extent to which the cost of each service is captured in the carve-out financial statements. At a minimum, the seller should ensure that there is an agreed-upon framework setting out the nature and quality of services to be provided, as well as the related cost and timeframe post close. Panelists agreed that there is a value trade-off, to the extent that the cost charged for the services does not reflect the market value of the services.

- **Closing mechanics** - The seller must carefully evaluate any purchase price adjustment mechanism so as to understand factors such as seasonality and changes in the business cycle that may result in value leakage between signing and close. The preparation work should anticipate a detailed request from buyers – especially PEs, who are more focused on closing mechanisms – as they focus on day-one capital funding requirements, value loopholes and leakage opportunities.
In the voice of our participants...

Need an audit? “If we think that financial buyers are going to be a big player or if the business meets a size threshold then we get an audit done. Too often in the past, an audit was a gaiting issue holding up a close.”

“Need an audit?” “If we sell a small business to a corporate buyer, typically they don’t need audited financial statements. They get comfortable in diligence so it is seldom a valuation matter. Buyers will deal with it in signing the reps of the agreement.”

“There are the audited financial statements, but then there are deal financial statements... the reality.”

“If we sell a small business to a corporate buyer, typically they don’t need audited financial statements. They get comfortable in diligence so it is seldom a valuation matter. Buyers will deal with it in signing the reps of the agreement.”

Anticipate and prepare TSA arrangements: “It’s important to make sure that your legal team papers the economic proposals that you’ve set forth, and the buyer assumed in their valuation, as soon as possible – ideally when you present the purchase agreements. All too often, you’re killing each other for months over the supply agreement, or the customer contract, or the non-compete.”

“Anticipate and prepare TSA arrangements: “It’s important to make sure that your legal team papers the economic proposals that you’ve set forth, and the buyer assumed in their valuation, as soon as possible – ideally when you present the purchase agreements. All too often, you’re killing each other for months over the supply agreement, or the customer contract, or the non-compete.”

“Putting numbers around the value of transitional services and a lot of the softer costs of the corporate infrastructure is tough. You are ultimately going have to defend those numbers, and that’s not always so easy to do.”

“To avoid last-minute hiccups at closing, it is critical that management plan and resource the post-closing execution at the same level of detail and foresight as the pre-closing efforts.”

Purchase Price Adjustment mechanism considerations: “Make sure that the divestiture plan considers all the various aspects of the closing mechanics of the deal. If not, serious value erosion can occur in negotiations prior to signing and value leakage can occur, which could result in a significant post-closing purchase-price adjustment.”

“If the PPA doesn’t properly contemplate the business cycles, or the potential for management interference pre closing, significant value transfers can occur.”
PwC Observations:

Among the many steps to complete prior to closing any transaction, there are typically a small number that are critical, given their impact on value and ability of the buyer to obtain financing or comply with regulatory filing rules. Commonly included as conditions of close, these include the provision of audited financial statements and completion of transition service agreement documentation.

- The need to perform an audit largely depends on the size of the business being sold and buyer mix. Typically the best practice is to have a carve-out business audited, as this provides the seller with flexibility and a commonly understood basis for data presented to the bidders in the auction process. While the complexities of carve-out audits sometimes result in financial statements that do not reflect the business being sold, the differences can typically be explained and understood by the buyer community.

- TSAs can result in value transfer pricing, depending on the pricing of the services being provided and the quality and extent of the services being provided – so the earlier in the process these key terms and conditions can be negotiated and documented, the less likelihood there is for TSAs to become a roadblock to closure.

Using their initial draft of SPA terms and conditions presented to bidders is an effective way for sellers to communicate their position on key deal issues and it sets their expectations early in the negotiation process. It also ensures that the seller begins the negotiation from a position most favorable to themselves, rather than leaving issues open to a discussion with the buyer which may result in an unsatisfactory compromise.

Any seller that does not adequately prepare for a purchase-price adjustment mechanism negotiation can be embarrassed after the completion of the deal. Buyers (especially PEs) will spend a significant amount of time in the due diligence process understanding factors such as seasonality and lumpiness of cash flows over the fiscal year. Such analysis is important not only for buyers to understand their financing needs, but also to be informed as to how to negotiate a purchase-price adjustment mechanism. Often, by the end of due diligence, it is the buyers that have a more thorough analysis of working capital trends and drivers. The end result can mean value transferring from the seller to the buyer, which is a scenario that all sellers want to avoid.
Conclusion

There was a general consensus among the roundtable participants on the following points:

1. Companies that employ a regular and detailed metric-based assessment of their portfolio of businesses are likely to be more sophisticated sellers with a more consistently applied process and review discipline to inform the team and model assumptions. The basis for a disposal is more easily determined and defined.

2. A key to success in any divestiture is planning and preparation – investing significant resources, time and effort up front before going to market. Whether the buyer be private equity or corporate, foreign or domestic, it is essential to understand the underlying business drivers and present information that the buyer will need in order to sign and close the sale.

3. In carve-out transactions, the linkages and inter-dependencies between the parent and the business unit are often highly complicated and require careful analysis and assessment so as to understand the allocated costs included in the carve-out financial statements and the expected stand-alone and stranded costs associated with the parent company.

4. PE buyers are more demanding in the due diligence process, but they are very innovative with structures and strategies – allowing them to execute difficult and messy deals a corporate may not contemplate. 

5. Management needs to focus on operating the core business and ensuring that the year-to-date performance does not underwhelm, in that valuations will be negatively affected and certain bidders will walk from the sale process if performance declines.

6. Several factors can dictate the most attractive divestment structure – these include size, industry cyclicality and volatility, growth-rates, the population of potential buyers, and demand in the capital markets for a pure play / IPO business.

7. Control and speed are critical to the success of a divestment process. If control is forfeit to buyers, then speed inevitably slows as the bidder seeks information to help substantiate a valuation adjustment.
Acknowledgements

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