Forced divestment or strategic opportunity?

A carve-out can maximize deal value and business advantage through focused approach and extensive planning

The better the question. The better the answer. The better the world works.

Building a better working world

Corporate divestment is a complex process of carving out the target entity from the parent, especially where there are significant interdependencies between the entity being divested and the parent, or the divesting entity. Companies can drive significant value by adopting a systematic approach to identify all interdependencies and develop and implement a robust carve-out action plan.

Corporate divestment as a strategic option for stakeholder value creation

The practice of corporates using divestments as a strategic option to unlock significant value on a global scale is becoming more commonplace. Furthermore evolving customer preferences, macro-economic uncertainties, technological change, shareholder pressure and geopolitical instability are driving corporates to consider divestments. A global study by EY reveals that:

43%

of companies are planning to divest in the next two years

55%

say changes to the technology landscape are influencing divestment plans

47%

say lack of focus and resourcing caused value erosion in the last divestment

Organizations are realizing that divestments can be a growth tool and can be used to re-allocate assets and resources to focus on core competencies and strengths. Some of the key benefits that corporates achieve from divestment are:

- Increase in shareholder returns
- Focus on value propositions that are closer to the core competencies of the firm
- Prioritize resource allocation based on business requirements
- Divest a non-performing asset(s) and/or reduce debt
- Address any shareholder and market concerns
- Meet regulatory and compliance requirements

Corporate divestments in India[2]

Keeping pace with the global trend, Indian corporates have undertaken significant divestments over the past three years. Approximately 300 divestments have been concluded in India since January 2015, where many deals had valuations over US$100m.

Sector*	Number of divestments from January 2015 to August 2017
TMT	66
Manufacturing	56
Infrastructure	31
Lifesciences	31
Services	31
Real estate, hospitality and leisure	25
Financial services	19
Retail and consumer products	17
Others	22
Grand total	**298**

*Sector classification according to EY umbrella sectors | Source: M&A database (ThomasOne, Mergermarket, CapitalIQ)

1 EY study in collaboration with Financial Times and Mergermarket; Participants from Mergermarket panel of 900+ corporate executives surveyed between October and December 2016; Companies from 60 countries and 10 industry sectors; 78% CEOs, CFOs or other C-level executives

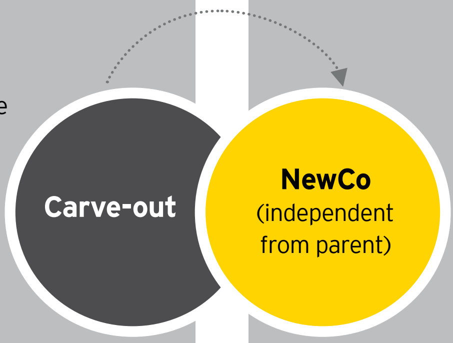
2 Data source: M&A database (ThomasOne, Mergermarket, CapitalIQ); Dataset includes only strategic transactions (i.e. not having financial buyers/sellers) and those in which 100% ownership is divested by the parent. Further, all transactions have India as at least one of the locations of the divested entity

The key to success or failure of a carve-out is dependent on the level of preparation and readiness of the stakeholders from both the buy-side and sell-side

Key considerations for buy side and sell side for a successful carve-out:

Sellers objectives

- Maximize value in the deal
- Package the business effectively for sale
- Reduce disposal costs
- Optimize TSA structure
- Accelerate transition to stand-alone and mitigate stranded costs
- Limit warranties and indemnifications



Buyers objectives

- Confirmation that the stand-alone business is sustainable
- Understand and mitigate separation risks, business continuity on Day 1
- Limit TSA and separation costs
- Balance exclusivity and break-frees
- Clarity on how to drive stand-alone value post acquisition

Both-seller and buyer

- Smooth transfer on Day 1, control uncertainty
- Quick transition to a stand-alone, maintain credibility and enhance reputation
- Minimal separation costs and risk
- Preserve value

Irrespective of the type of buyer, i.e., strategic or financial, the key to success or failure of a carve-out is dependent on the level of preparation and readiness of the stakeholders from both the buy-side and sell-side. A focus on value drivers early on in the transaction, combined with a disciplined, agile and sustainable carve-out approach increases the likelihood of success.

A good deal is made even better when the organizations ask and answer key questions during the formulation of a carve-out plan. For instance:

- Has the transaction perimeter been clearly defined, i.e., which of the people, assets, systems, contracts, etc. are part of the deal?
- Are all the critical stakeholders (internal and external) identified?
- What are the key interdependencies between the carved-out entity and the parent/remaining company?
- What is the incremental impact on operating expenses as a result of the carve-out?
- Have the one-off carve-out costs been identified and quantified? Is there an impact of the carve-out costs on the valuation?
- Has a timeline been defined for the carve-out? Does the timeline take into account the key regulatory and compliance activities?
- Has a robust governance structure been implemented to provide oversight to the carve-out process?
- Have the post close target operating models across functions been finalized?

EY's 5-step approach to a successful carve-out

EY has a tried and tested five step methodology which is designed to maximize deal value during carve outs. We assist clients in conducting due diligence, identifying all the dependencies, drafting an execution roadmap and setting up a program management office to execute the carve-out efficiently and effectively.

1 Identify interdependencies

- Identify critical people shared across business processes
- Identify shared technology resources (e.g., applications, data, etc.)
- Develop strategy for shared business processes
- Identify tangible and intangible assets shared with seller entities
- Assess impact of all shared contracts

2 Quantify impacts

- Identify one-off separation costs, incremental operational costs and stranded costs for the seller
- Quantify any capital expenditures required
- Estimate cost of separation for shared resources
- Quantify additional technology investments needed (e.g., licenses, infrastructure, etc.)

3 Proactive planning

- Prepare detailed Day 1 activity plan to identify critical project path
- Identify risks and issues and develop mitigating actions
- Develop a communications strategy for all stakeholders
- Define end state business and IT operating model

4 Manage transition services

- Identify transition services agreements (TSAs) between buyer and seller
- Finalize governance, timeline and cost for TSA management
- Draft TSAs and reverse TSAs for services with defined scope, cost and duration of services

5 Execute the carve-out

- Implement project governance to oversee and report progress on separation of business and IT processes
- Conduct kick-off workshop to align stakeholders
- Monitor risks and issues to enable early resolution
- Distribute communication to enable employee transition

How EY can help in your carve-out

EY provides end to end support to clients across all the stages of a carve-out lifecycle. We leverage our deep sector and functional expertise which has been built through multiple engagements across sectors to bring significant value to our clients.

Strategy and search		Due diligence		Bid and negotiation	Day 1 preparation		TSA support and exit
Transaction perimeter	Issue teaser	Issue IM	Data room and VDD	SPA/BTA	TSA drafting/ negotiations	Functional carve-out support	Support TSA, conditions subsequent

	1 Carve-out assessment	2 Carve-out planning and execution	3 TSA governance and exit
Objectives	▸ Understand carve-out perimeter ▸ Understand financial and operational implications of carve-out on seller and buyer ▸ Identify time and effort involved in the carve-out	▸ Understand seller obligations between signing and closing ▸ Understand implications of TSAs needed ▸ Effective management of carve-out process	▸ Effective management of TSAs with buyer(s)
Key activities	▸ Define carve-out perimeter at business and function level ▸ Identify operational dependencies across business and functions (people, process, assets, systems and contracts) ▸ Prepare carve-out financials for target(s) ▸ Develop carve-out options	▸ Establish a governance and review mechanism to manage carve-out execution till legal Day 1 ▸ Develop detailed carve-out plan (activities, accountabilities, timelines) ▸ Identify support services (IT, finance, etc.) and develop TSA(s)	▸ Establish TSA governance mechanism to manage transition services provided to buyer(s)
Deliverables	▸ Carve-out perimeter defining target(s) and Remain Co ▸ Interdependencies map across business and functions ▸ Pro-forma financials for target(s) and Remain Co, including potential incremental opex costs ▸ High level estimate of carve-out timelines and costs	▸ Carve-out governance structure ▸ Detailed carve-out plan with buyer and seller accountabilities, stakeholders, and timelines ▸ TSAs for key services along with commercials and SLAs ▸ Reporting dashboards, risk and issues log for tracking carve-out progress vs. plan	▸ TSA governance framework (issue escalation, change request, review cadence, etc.) ▸ Reporting trackers (TSA, SLA) for monitoring service delivery and readiness for exit

Select case studies:

Case study 1

We provided carve-out and TSA support to a PE fund acquiring a consumer products company

Transaction overview and objectives

- Consumer electrical business was being carved out of a large listed parent
- PE buyer appointed EY to undertake carve out review for the target business, with focus on evaluating IT and operational dependencies on parent and supporting PE buyer in TSA negotiations and planning
- Another key objective of the exercise was to understand requirements for establishing an independent IT function within 18 months of carve out, with limited opex and capex requirements

How EY helped

- Completed a detailed interdependency analysis
- Quantified costs and time required for standalone IT operations post TSA period
- Estimated standalone one-time and on-going operational costs
- Supported preparation of detailed TSA documentation, including costs, timing and governance

Value delivered

- Successful deal signing including agreement on TSA and support for establishing standalone operations
- Successful completion of TSA and carve-out execution
- Completed carve-out of IT systems

Case study 2

We managed the end-to-end carve-out and integration of an Indian technology business with that of a US based technology business

Transaction overview and objectives

- An ITES business was being acquired by a US based company. The target assets were being carved out from its parent and integrated with the acquiring company
- EY was engaged by the client to complete a seamless operational carve-out and enable a disruption free legal Day 1

How EY helped

- Aligned stakeholders regarding objective, scope and timeline via a kick-off workshop
- Identified and tracked key milestones with interdependencies mapped across workstreams
- Updated leadership about project progress and to escalate risks early to enable resolution
- Recommended operational/technological changes to achieve integration objectives
- Identified potential synergies and aligned key stakeholders to achieve synergy targets

Value delivered

- Minimized business disruption on Day 1
- Timely achievement of project milestones and pre and post close activities
- Supported the acquirer to implement a detailed TSA agreement with seller
- Identified operational synergies through rationalization of key business applications

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