

ACQUISITIONS MONTHLY

Hein Marais, partner, PricewaterhouseCoopers LLP discusses how to maximise value from the sale of non-core assets in the current downturn.

Return on divestment

Current economic conditions may force corporates to refocus on their core businesses and look to realise value from underperforming or non-core assets. In doing so, they will need to apply a more thorough approach to the divestment planning process than was necessary in the past.

During the “growth years” vendors focused on completing deals and realising value quickly, often leading them to compromise on robust divestment planning or on defining a “fit for purpose” operating structure.

In hotly contested auctions, there was little pressure on vendors to think through and demonstrate how the business being sold could operate successfully as a standalone entity, despite losing the benefit of the parent’s support functions, such as IT, finance, shared services or supply chains. Often, higher value was also extracted through competitive tension rather than through demonstrating efficiency opportunities for the divested business.

In today’s market, the corporate sales process is changing, largely driven by less available financing and the resultant fewer bidders. In the past six months, where transactions have been considered, financing banks have been applying a higher level of scrutiny to separation issues, specifically the viability of separating the divestment from its parent without any disruption to its business operations.

This is a marked change. Twelve months ago, many financing banks would not have even been present at the table when separation issues were discussed. Now, it is not unusual for them to be present and often leading the conversation aimed at getting comfort over the separation plans.

For vendors, this means that achieving a divestment requires much more thorough preparation. In order to facilitate deal completion, they need to indicate how separation risks can be addressed and how value can be added in the divested business.

To maximise sale value, they need to identify and quantify the upsides for acquirers and articulate these clearly in the divestment plan – providing a costed operating model setting out, function by function, the necessary headcount and other support costs likely to be incurred, or that can be saved. Vendors may even consider demonstrating the viability of the divestment plan by putting some elements into practice and achieving “quick wins”.

It is often assumed that the costs associated with a division will increase once it has to operate as a standalone business because of lost synergies and benefits of scale. This is not necessarily the case. By challenging assumptions about the levels of support needed by the divested business to operate on a standalone basis, cost and efficiency savings can be achieved.

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ing and financial reporting systems used by the division of a large group are typically tailored to meet the group’s needs – not the division’s. This usually means a higher degree of complexity than otherwise required. For example, when enabling a division to operate on a standalone basis, a comprehensive ERP system can often be replaced by a lower specification, off-the-shelf solution with little tailoring required.

In management reporting terms, divisions often have to compile detailed month-end reports to meet the needs of their parent. However, in order to run the business, divisional management will often focus on a far more concise set of key performance indicators. Often, the majority of the data reported to the group are not used by divisional management at all.

Thus, reducing the scope and complexity of financial reporting systems and focusing on cash management, an area often neglected but of critical importance under private equity ownership, can deliver a relatively simple “quick win” to reassure acquirers about the operational viability of the divested entity on a cost-effective basis.

Another potential “quick win” can often be achieved in procurement activity. A popular assumption is that a division separated from its group will lose most purchasing power benefits. This is not necessarily true.

Suppliers are under competitive pressure and keen to main-

tain sales volumes. Hence, deals can still be negotiated. In addition, group purchasing departments may have focused on a few key spend categories. Applying the same focus across all categories in the division, including smaller items, can achieve significant additional savings.

If this level of detailed preparation seems excessive, it is not. Vendors should plan for the most demanding scenario – the business being acquired by a purchaser with no existing support infrastructure, such as a private equity buyer with no portfolio to which the divestment can be bolted on.

Providing a plan that can convince such a buyer of the standalone entity’s viability has two advantages. First, it ensures maximum competition for the divested opportunity, between both private equity funds and corporates. Second, the greater challenge means that the vendor is likely to uncover more opportunities for achieving value in the business.

Aspiring vendors can use the coming months to apply such a private equity lens to their divestment planning activity. By preparing during the market “low”, vendors will ensure that their divestment is well positioned with bidders to better highlight upside opportunities and to demonstrate that the implementation of the separation does not present any unexpected risk.

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