



Can divesting help you capitalize on disruption?

Global Corporate Divestment Study 2017

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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 massive market disruptions. The 2017 study results are based on more than 900 interviews with corporate executives between October and December 2016 conducted 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 78% 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 nine industry sectors are represented, the study primarily focuses on consumer products, financial services, life sciences and technology.
- ▶ About 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.

Our perspective



Paul Hammes
EY Global
Divestment Leader

This is an especially timely *Global Corporate Divestment Study*. Unprecedented geopolitical uncertainty and technological change are making portfolio and divestment strategy more vital than ever.

Faced with these dynamics, our clients are trying to figure out where it is profitable to maintain a geographic footprint versus when it is time to focus on different markets – and how much it would cost to make a move. They're also considering how to free up capital to invest in innovation.

We are seeing many companies flee geographies because of short-term fears and wind up with suboptimal valuations on their businesses. We also are seeing companies enamored of new technology without fully considering its effect on the entire portfolio of businesses. But the basis of such transformative decisions must always be a company's long-term strategy.

So, how should successful companies use divestments to underpin their portfolio strategy? Our survey finds that nearly half of companies plan to divest in the next two years. A divestment can empower a company to put capital to better use, enable a leaner operating model and enhance shareholder value.

This year's *Global Corporate Divestment Study* suggests ways your company can thrive amid disruptive market forces: understanding how they affect valuation, efficiently executing a divestment and future-proofing your remaining organization.



Steve Krouskos
EY Global Vice Chair,
Transaction Advisory
Services

With mergers and acquisitions near record levels in 2016 and a dynamic deal market anticipated in 2017, M&A is a cornerstone of today's corporate route to growth. And where there is a buyer there is a seller; companies reshaping themselves for the future are not only acquiring but also divesting.

As technology transforms business models – blurring sector lines and spurring change in consumer preferences – buying rather than building innovation is often the preferred strategic path to success. In tandem, successful companies are strategically divesting non-core or underperforming businesses in order to fund growth. They are selling assets to refocus and re-energize their core business.

Market fundamentals will likely fuel further recycling of assets. Economic growth is modest and uneven globally and geopolitics has entered a new, uncertain phase. And in a world where product innovation happens daily, executives are perpetually setting new strategic directions. Against this backdrop, those that use divestments to strategically change what is in their control will become the disruptors, rather than the disrupted.

Key findings

Our annual *Global Corporate Divestment Study* reveals a deal-making environment faced with disruptive challenges and senior executives craving an information advantage. Divestment is a fundamental tool for many of those surveyed. Even those not planning to divest in the next two years are evaluating their portfolios more rigorously. Here is what the data tells us leads to divestment success.

Why divest?



76%

say their most recent divestment created long-term value.

Lessons learned:

Understand implications of technology as a disruptive force

Page 9

Better manage your geographic footprint

Page 10

Consider tax, an increasingly disruptive factor

Page 11

Divest with strategic intent

Page 11



55%

say changes to the technology landscape are influencing divestment plans.

Portfolio review



88%

more companies have successful divestments when they understand disruptive forces affecting their sector.

Lessons learned:

Focus on achieving your full potential

Page 12

Don't wait until it's too late

Page 13

Embed analytics into portfolio management

Page 13



88%

say improved analytics capabilities would help make faster, better divestment decisions.

74%

more companies achieve a sale price above expectations when they divest because of technology change versus geopolitical uncertainty.

Strategic divestments, including those used to fund new technology, have a positive impact on company value. However, reacting hastily to external forces such as geopolitics can negatively affect sale price. Regardless of transaction rationale, sellers should thoroughly prepare and consider how proceeds will support growth.

Deal execution



63%

more companies generate a sale price above expectations when they highlight tax upsides to purchasers.

Lessons learned:

Dedicate the right resources

Page 16

Establish a governance model

Page 17

Conduct commercial diligence

Page 17

Remain flexible on the perimeter

Page 18

Communicate tax upsides to buyers

Page 19



55%

more companies generate a sale price above expectations when they conduct commercial diligence.

Becoming more agile



66%

plan to better align investment team and operational management roles.

Lessons learned:

Align investment team and operational management goals

Page 20

Develop a lean and agile operating model

Page 21

Invest in emerging technology platforms

Page 22



48%

are becoming more disciplined about creating value pre-sale.



1

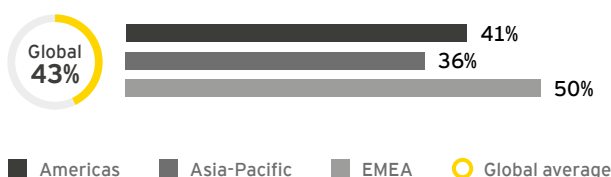
Are you divesting based on strategic reasons or disruptive forces?

Macroeconomic uncertainty, geopolitical instability and technological change are creating unprecedented business disruption. These dynamics, coupled with a low-growth environment, increasing shareholder pressure and changing consumer preferences are prompting a critical decision: how best to allocate capital to gain competitive advantage.

Divestments are a fundamental part of portfolio strategy, especially in a volatile and disruptive environment. Companies are selling non-core and slow-growth businesses to fund investments in their core portfolios. They are putting the capital to good use: from making acquisitions and investments in digital capabilities to expanding product ranges and geographic footprint.

Nearly half of companies globally (43%) plan to divest in the next two years. But what is the “right” reason to exit – how much should you base your divestment decision on strategic rationale versus external market forces? And how should your transaction rationale factor into how you prepare for a divestment?

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



Our data overwhelmingly shows that divestments pursued primarily in response to macroeconomic and geopolitical instability result in suboptimal outcomes. The data also reveals that companies are feeling pressured to move quickly, often because of these unpredictable market forces. But prioritizing speed often results in a divestment that does not achieve sellers’ expectations.

Conversely, divestments triggered by technology-related opportunities or risks often yield outcomes that exceed expectations.

While companies must always consider how external forces may affect performance, a long-term strategy, rather than short-term influences, should drive the decision to buy, reshape or sell a business.

External forces increasingly drive divestments ... but should they?

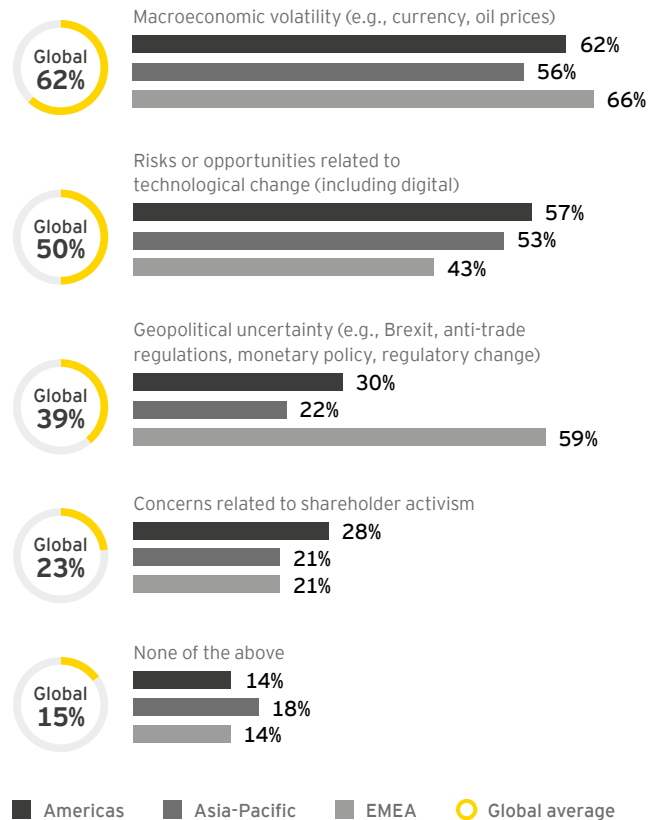
Sixty percent of companies say that external forces prompted their most recent divestment. Macroeconomic volatility – in oil prices and exchange rates, for example – is the biggest external market force driving companies' most recent major divestments (62%). Risks or opportunities related to technological change (50%) and geopolitical uncertainty (39%) are other key drivers.

Since the Brexit decision in June 2016, the US elections in November 2016 and the rise of populism around the globe continuing into 2017, many companies are thinking differently about how political changes could affect global trade and corporate growth.

These disruptive forces are expected to have a major impact on future divestment plans, with many companies selling to manage risk.

However, many do so without having access to all information needed to understand the impact these forces could have on their growth strategies. In fact, 53% say understanding the business impact of new disruptive forces is among their key portfolio review challenges – and most say it is their biggest challenge. (See page 13.)

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



Percentage of companies that say those external forces will increase their likelihood of divesting over the next year



76%

Macroeconomic volatility



67%

Risks or opportunities related to technological change



56%

Geopolitical uncertainty



38%

Shareholder activism

Geopolitics' negative impact on divestment outcomes

Companies that divest because of geopolitical uncertainty are 31% less likely to achieve a sale price above expectations. Those that divest because of macroeconomic volatility are 20% less likely to deliver a favorable valuation.

Our data shows that compared with other parts of the world, companies in Europe, the Middle East and Africa (EMEA) are more likely to divest because of geopolitical or macroeconomic reasons. They are also most likely to prioritize speed over value in a deal – often leading to a lower sale price. Further, 38% of EMEA executives say that their divestment did not create long-term value. This compares to 24% globally.

Conversely, companies that divest because of risks and opportunities prompted by technological change are 21% more likely to achieve a higher sale price than expected.

Overall, companies that divest in response to technological change – rather than geopolitical uncertainty – are 74% more likely to achieve a sale price above expectations. There are four key reasons for this:

- ▶ While technological change happens quickly, companies often take time to observe how competitors' innovations unfold.
- ▶ Technological change that reduces an asset's competitiveness under one owner could be of value to another.
- ▶ Divestments strategically pursued to respond to – or get ahead of – technology advances can better enable the company to fund future innovation.
- ▶ Since the seller is likely to have a clear divestment rationale, the market response is likely to be more positive than a geopolitically driven sale that may not be clearly articulated to the market.

“We incurred more legal costs than expected, and the deal took a lot longer, because we had not taken into consideration changes in the regulatory system. This could have been avoided if we knew how to prioritize these issues and had resolved them more quickly.”

Executive at a Germany-based life sciences company

Likelihood of achieving a sale price above expectations

31% less ▼

when companies divest because of geopolitical uncertainty

20% less ▼

when companies divest because of macroeconomic volatility

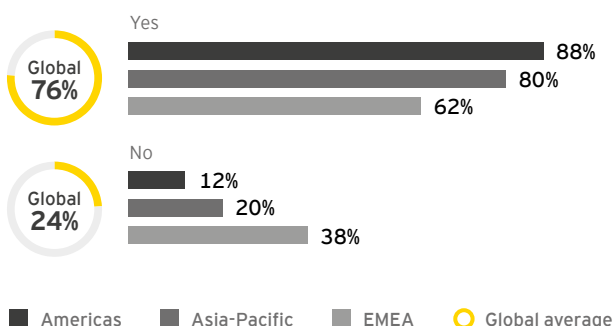
21% more ▲

when companies divest because of technological change

74%

more companies achieve a sale price above expectations when they divest because of technology versus geopolitics.

Q Do you think the cost of divestment paid off (i.e., do you think it created long-term value)?



Understand the constant disruptive market force: technology

Digital strategy used to be largely the responsibility of the chief marketing officer and chief information officer. But with the entire value chain being disrupted – from procurement through production, recruitment and go-to-market – “digital transformation” has become a major focus for the entire C-suite. Leading organizations are talking less about “digital strategy” and more about “business strategy in a digital world.”

Similarly, 43% of companies plan to use divestment proceeds to invest in digital capabilities. And 55% say changes to the digital landscape, and therefore the competitive landscape, are directly influencing their divestment plans.

Digital disruption forces organizations to take a holistic view of their capital decisions, including divestments. Specifically, companies should:

Consider how to use market factors to create value

Understand which new business models are driving material growth, how customer priorities are changing and where scalable growth can be driven. Also identify the non-traditional competitors that might impede competitive advantage.

Invest in your strengths

Identify where the organization has momentum in place and brand recognition. Companies should determine the right balance of organic versus inorganic capital investment and strategically use divestments to fuel capital re-allocation. For example, divestments can fund digital enablement and growth in nascent businesses.

Divesting a non-core business to invest in technology

A global health care company recently divested a non-core business. The company used the proceeds to buy digital capabilities that would enable it to generate revenue across more areas of a patient’s health care continuum. Instead of helping patients only in the hospital, the technology and data-capture capabilities enabled the company to transfer its client relationship to the home.

Result: The company earned a premium valuation, enabling it to fund technological investments. It was able to maximize sale price by carefully preparing carve-out financial statements, designing an efficient tax structure and conducting operational separation work early.

43%

of companies plan to use divestment proceeds to invest in digital capabilities.



Strategically manage your geographic footprint

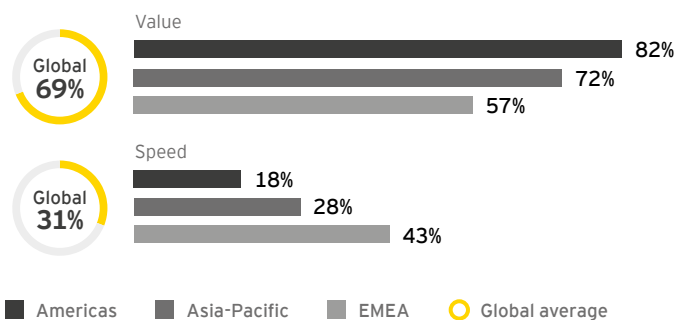
Capital re-allocation has always been a challenge. The difficulty of deciding what and how to sell is now exacerbated by increased geopolitical and economic uncertainty. Companies faced with this situation could consider the following guidelines:

Don't speed

When faced with potential political or regulatory changes, companies often feel pressured to exit quickly. For example, 43% of companies in Europe, the Middle East and Africa prioritized speed over value (compared with only 18% in the Americas, where companies are less likely to divest because of macroeconomic or geopolitical reasons).

However, speed does not translate into a higher sale price. Sellers that prioritize value over speed are 63% more likely to achieve a sale price above expectations and even complete the deal sooner than those who prioritized speed. Companies should take the time to plan for various scenarios, develop a compelling and credible value story when it's time to sell, and identify the best buyer pool.

Q What was your main priority in your last divestment?



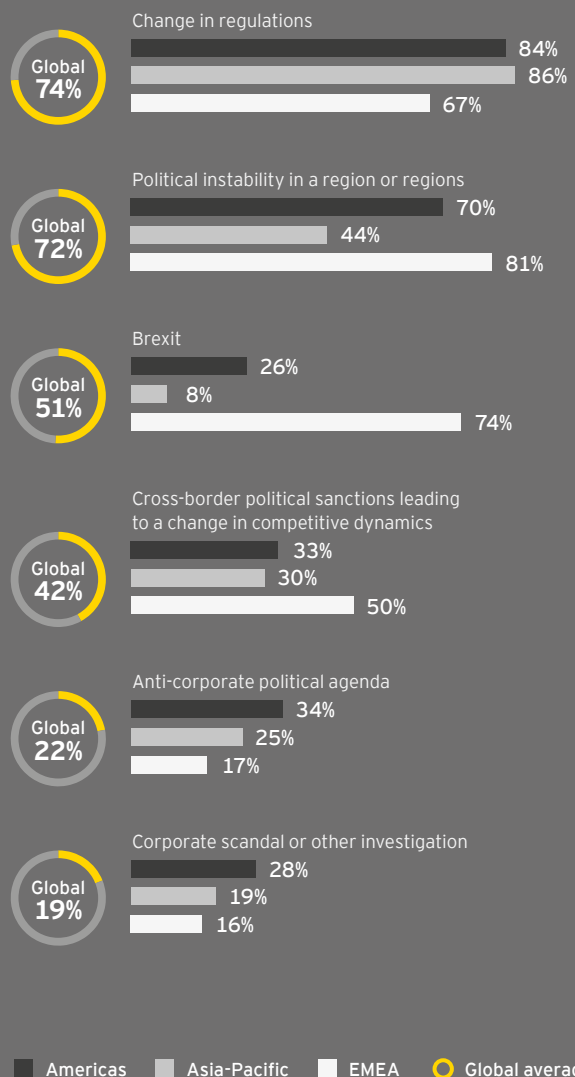
Set appropriate value expectations

Sellers should understand appropriate comparable valuations, have a clear basis for their expectations and seek third-party advice. If a market or geography no longer seems favorable for you, buyers may feel the same way. Sellers also need to evaluate the opportunity costs of not divesting at all – which may mean that the business becomes further starved of investment and creates a drag on the rest of the business.

Geopolitical divestment drivers by region

Geopolitical uncertainty is often cited as a major divestment factor in EMEA (59%), compared with only 30% in the Americas and 22% in Asia-Pacific. Of those companies in EMEA that divested for geopolitical reasons, 81% say the core reason was regional political instability, with 74% saying it was because of Brexit specifically. By contrast, in the Americas and Asia-Pacific, regulatory change is by far the most frequently cited reason for divestment (84% and 86%, respectively).

Q Did any of the following geopolitical issues impact your decision to divest? Select all that apply.



Consider a broader set of buyers

Valuation may be an issue in an unfavorable market environment regardless of buyer pool. However, looking for less traditional buyers in adjacent sectors or private equity buyers can increase your chances of a better sale price. Less traditional buyers, in a different market or geography, may be willing to pay more for an asset based on different goals or synergy assumptions. And a bigger buyer pool will increase competitive tension.

Evaluate alternative transaction structures

Companies should remain flexible on the assets for sale. For example, sellers can consider retaining certain assets so the buyer can avoid anti-trust issues, or including intellectual property in the deal through an interest-free license to enhance longer-term value. Further, companies that understand the value of alternative structures to potential buyers are 95% more likely to achieve a sale price above expectations. Conversely, 48% say lack of flexibility in structure of sale is a significant source of value erosion.

Consider tax, an increasingly disruptive factor

A growing aspect of geopolitics is tax policy, which often affects a divestment decision. Recent tax changes globally and expected upcoming reforms are making it more complex than ever to assess the potential tax risk of selling a business. This is confirmed by 48% of companies, for which tax has become a bigger challenge to divestment execution over the last year.

In the US, the prospect of tax reform, including lower corporate tax rates, is having a material impact on taxpayer behavior (e.g., accelerating tax deductions and deferring revenue). And the prospect of investing more in domestic infrastructure projects and border security will lead to inorganic growth, producing a favorable environment for business divestment in those market segments.

Further, divestments of operations have accelerated in such formerly high-growth economies as China, Brazil and India. Tax complexity is contributing to divestments in these countries.

The tax impact on divestment decisions and processes is often underestimated. Early identification of tax complexities is key.

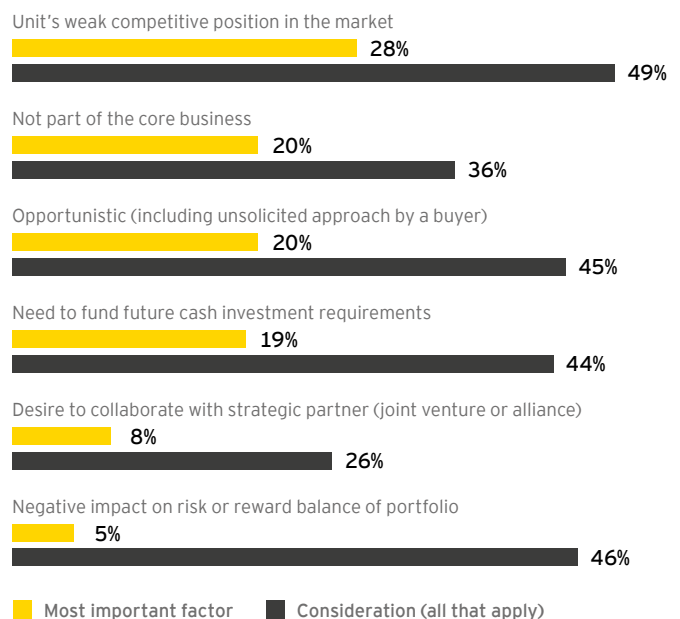
Divest with strategic intent

External disruptions may trigger tactical change, but the most important focus should always be long-term strategy and business fundamentals. Companies that divest because of performance issues that signal long-term value erosion are 25% more likely to have a successful divestment than those that divest because of external forces.

Executives say the most important strategic reason for their last major divestment is a unit's weak competitive position in the market (28%), followed by opportunistic rationale, including an unsolicited buyer approach (20%), and a business not being considered core (20%).

Despite the prevalence of opportunistic divestments, companies that divest because they need to fund future cash investment requirements are 51% more likely to have a higher valuation multiple post-sale. And those that divest non-core assets are 48% more likely to have a higher valuation multiple. We see these results because markets value companies that have a clear vision and are seen to be acting on that strategy.

Q What strategic triggers prompted your most recent major divestment? (Select the most important factor and all key considerations.)





Do you know what will change your valuation tomorrow?

Do you fully understand the opportunities and threats arising from rapidly changing market dynamics and how they affect the future valuation of your business? Do you have enough information about your portfolio to be able to pivot quickly? A company that understands the disruptive forces affecting its sector and business is 88% more likely to receive a higher-than-expected sale price and is twice as likely to boost its post-divestment valuation multiple.

Most companies (53%) say understanding market dynamics is their biggest portfolio challenge. However, they are having a tough time identifying the criteria they need to benchmark their future performance – and those benchmarks are changing quickly.

As a result, 39% of companies say that shortcomings in their portfolio review process have resulted in failure to achieve intended divestment results.

Focus on achieving your full potential

More than half (55%) of companies say their biggest challenge is making portfolio review a strategic imperative. Particularly with geopolitical, macroeconomic and technological change, company leadership must dedicate time and resources to understanding the gaps between where they are today and how to reach their full potential. Our Full Potential Paradigm™ framework outlines fundamental questions to address these gaps:

Performance gap

- ▶ Are we operating our current businesses as well as possible?
- ▶ Are we earning appropriate margins from each of our businesses based on our relative market share (RMS)?
- ▶ Are we achieving appropriate cost reduction through learning and experience?
- ▶ Are we achieving optimal pricing given the elasticity of the market and our RMS?

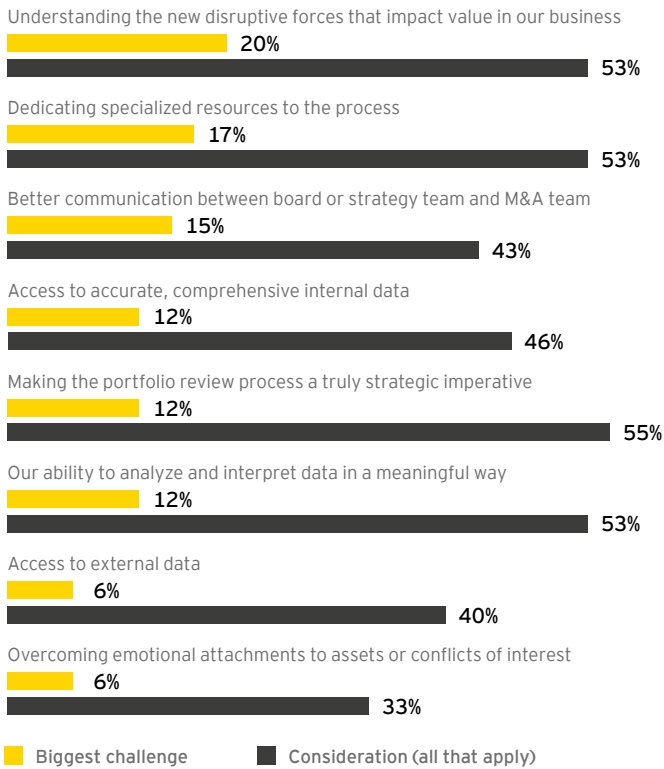
Opportunity gap

- ▶ Which businesses should be in our portfolio, and how should we deploy capital across them?
- ▶ Are we keeping pace with market growth in each of our businesses?
- ▶ Where can we invest in organic growth within our current portfolio?
- ▶ Where can we consolidate our current markets, or enter new markets, through acquisition?

Perception gap

- ▶ Are we getting full credit from investors for the value of our portfolio?
- ▶ Are our strategic decisions aligned with how investors value our business?
- ▶ Could we improve investors' perception by better articulating our operating or growth initiatives?

Q Which of the below do you consider a challenge associated with your portfolio reviews? (Select the biggest challenge and all key considerations.)



Don't wait until it's too late

Forty-one percent of global companies say they have held on to assets too long. Companies also need to take a data-driven, on-demand approach to portfolio review in order to generate buyer interest for assets and act confidently if the imperative to divest becomes unavoidable.

Review your portfolio frequently

- ▶ Conduct an in-depth portfolio review once or twice a year
- ▶ Review performance quarterly to understand where you are against plan, market dynamics and competitor actions
- ▶ Use analytics to constantly interpret internal and external data

Systemically embed analytics in the portfolio management process

How can you better understand divestment success criteria? How can you choose what to sell and how to structure the deal – and remove the human bias from decision-making? Analytics is key to leveraging disruption to gain competitive advantage.

Executives understand that they need analytics to make better portfolio and divestment decisions. But they also know they have not yet spent time working through their data challenges or putting the right set of algorithms in place to improve insight. Most executives (88%) agree that advanced analytical tools would help them make faster, better divestment decisions and improve divestment preparation.

Companies that apply analytics outperform peers

- ▶ While only 18% of executives cite effective prescriptive analytics capabilities during their portfolio review, 46% of top performers (those with a higher-than-expected valuation multiple on the remaining business) cite the same.
- ▶ While only 21% of executives cite effective prescriptive analytics capabilities during the divestment process, 49% of top performers cite the same.

What “analytics” really means

We define analytics as the transformation of strategic, financial or operational algorithms combined with complex data sets into information, enabling better, faster and more decisive actions. This definition is significantly more complex than modeling in a spreadsheet. Rather, it includes incorporating advanced analysis, algorithm development, and a full range of relevant structured and unstructured data from other company financial and operational data. It also incorporates a variety of external sources, including governments, reporting agencies, weather centers, traffic data centers and social platforms.

The benefits of analytics

Type	Why it's important
Descriptive analytics and visualization (e.g., historical value-based analysis)	<ul style="list-style-type: none"> ▸ Describes the base business and its historical performance, taking into account strategic, financial and operational dimension and levers ▸ Helps the seller define assets to be included in the deal perimeter
Predictive analytics (e.g., future outcome and business impact analysis)	<p>Helps identify:</p> <ul style="list-style-type: none"> ▸ Issues early, allowing the seller time to remedy the issues or prepare in advance for a divestment before it becomes critical ▸ Opportunities to manage top-line synergies through cross-sell and up-sell, based on a mix of mutual and new customers ▸ Cost synergy opportunities ▸ A forecast for future business performance under a new buyer's control, thereby helping define specific areas for synergies and support more rapid synergy realization
Prescriptive analytics (e.g., operationalization of predictive scenarios)	<p>Helps:</p> <ul style="list-style-type: none"> ▸ Optimize portfolio performance and enable decisions as to whether to fix an impaired or non-strategic business or sell it, and when ▸ Assess how to optimize the financial and operational performance of a business given the overall company strategy ▸ Define how to leverage the predicted future performance without compromising other priorities
Social media	<ul style="list-style-type: none"> ▸ Helps identify and describe market sentiment about an asset or a transaction ▸ Helps identify customer, supplier, employee and other stakeholder sentiment about the company, brand, products and services ▸ Provides insights to rapidly recognize synergies ▸ Identifies trends that are not evident in internal data and which might affect transaction value
Other technologies (e.g., robotic process automation, machine learning, artificial intelligence)	<ul style="list-style-type: none"> ▸ Automates data gathering, data processing and information generation processes ▸ Provides more rapid and on-demand analytics, enabling better and more confident decisions

While many executives say their capabilities in descriptive and predictive analytics are effective, most say more advanced analytics capabilities, such as prescriptive analytics, robotics, machine learning and artificial intelligence, are less effective. However, these same executives expect to significantly increase use of all forms of analytics as part of the portfolio review process over the next two years.

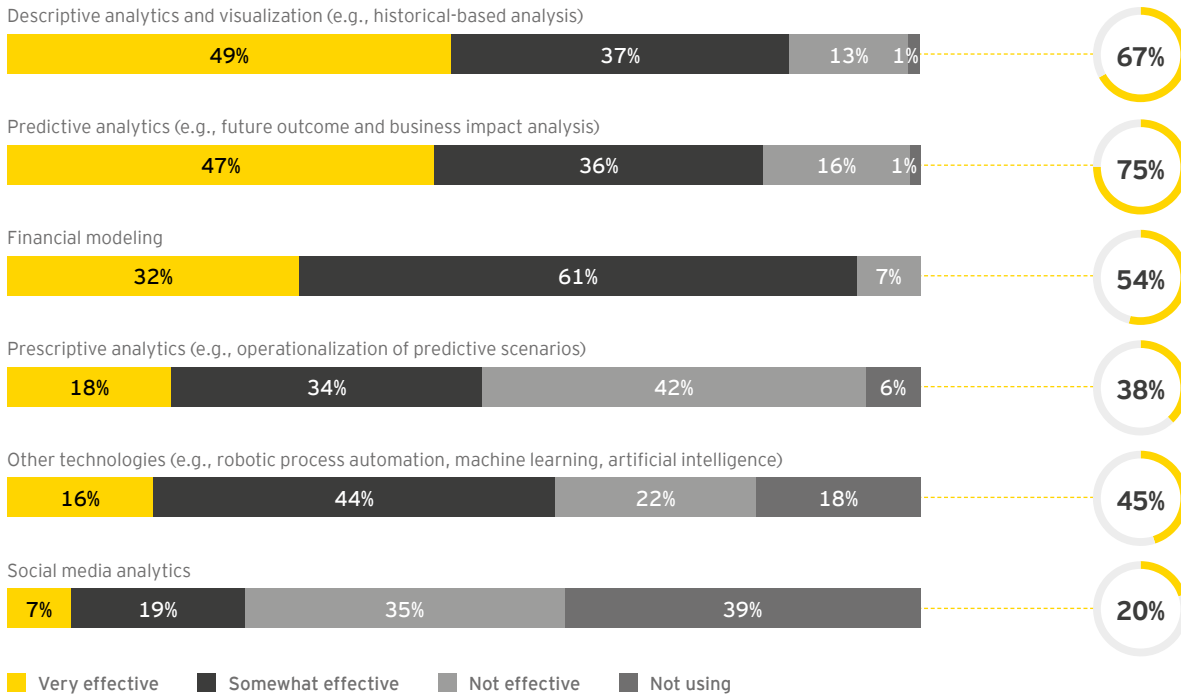
Descriptive analytics help explain performance gap in technology company

In preparation for a carve-out, a middle-market technology company had been unsuccessfully applying traditional analysis to understand why a set of products had been consistently underperforming. The company then applied descriptive analytics to a three-year transactional data set, combined with third-party demand data and demographic data. Specifically, the company analyzed pricing performance at a stock-keeping unit (SKU) level, taking into account market conditions.

Result: The data revealed that the underperformance was related to a specific set of pricing programs that were used at the discretion of sales representatives. The company immediately changed pricing guidelines and improved performance. The company was also able to proactively, and more credibly, communicate the past performance and recent improvements to potential buyers.

Q How effective are your capabilities related to making portfolio decisions?

Percentage of companies that plan to use these analytics more in the next two years



How to incorporate analytics into your portfolio review process

Start by leveraging descriptive analytics that focus on historical performance and key business trends for the portfolio and the individual business. Analytics should be automated and available to executives on demand to support decision-making at any point and to evaluate their business portfolio for divestment candidates.

Companies can use these same kinds of analytics to:

- ▶ Better describe historical performance and key business trends for a specific divestment. For example, analytics can identify which deal attributes might attract a broader pool of owners willing to pay more for an asset.
- ▶ Build a data-driven business case from the lens of the buyer, allowing for easier modeling of different structures to generate the most interest from buyers
- ▶ Remove management bias from the process

Predictive analytics can be utilized to better forecast market conditions and demand, anticipate future revenue streams and project cost synergies. More advanced analytics, such as prescriptive analytics, should be applied only after adopting descriptive and predictive analytics.

Analytics is driving the future of portfolio reviews

Companies are increasingly leveraging analytics across the transaction life cycle to make divestment decisions. For example, executives say they leverage analytics to:

46% Instill greater confidence in divestment decisions

45% More rapidly execute diligence and closing

39% Obtain greater insight into value drivers, performance and risk

37% Obtain more insight into diligence

32% Better manage risk and post-close valuation

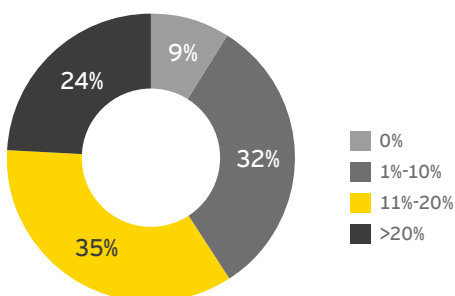


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How should you take action in disrupted markets?

How can you maximize sale price and long-term value once you decide to do a deal? Since last year's study, value realization has become more challenging: 76% of companies believe their most recent major divestment created long-term value, down from 84% last year. And senior executives perceive that the price gap – between what sellers expect and what buyers are offering – is growing. So it's more important than ever to develop a strong value story. Here we summarize some leading practices to improve your divestment outcome.

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



Dedicate the right resources

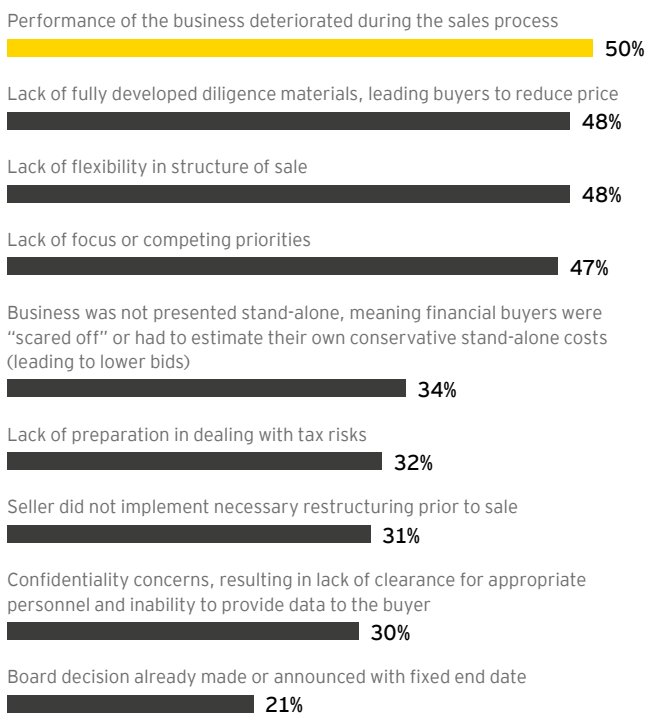
Companies often overestimate the attractiveness of their assets. A frequent, critical mistake is that sellers don't focus enough on separation planning and diligence materials. Nearly half (47%) say lack of focus and resourcing was a cause of value erosion in their most recent divestment, and 48% say lack of fully developed diligence materials led buyers to reduce their offer. Similarly, companies often regard preparation as a supplement to an employee's day that can be performed "after hours." This lack of focus results in loss of buyer interest, value leakage, or even broken processes or failed auctions. Worse yet, during buyer diligence, management often becomes distracted from running the business. They often end up frantically scrambling to respond to buyer questions or challenges to the perimeter that should have been planned for well before diligence.

Establish a governance model

Don't underestimate the importance of executing these seemingly routine tasks:

- ▶ Define a plan and form a transaction team that represents all key functional areas; communicate team objectives to kick off the transaction efficiently and avoid a slow start
- ▶ Decide which internal and external stakeholders should know about the transaction and strategic plans before they are public, and develop messaging accordingly
- ▶ Set targets, and delegate and monitor progress through reporting, in order to manage divestment complexity and maintain accountability
- ▶ Define the timeline and align work streams to key deadlines and milestones to maintain momentum, track progress and target the desired close date – while allowing for long-tail items, such as regulatory matters, order-to-cash establishment, etc.

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



Conduct commercial diligence

Fewer than half of companies (46%) say their commercial diligence capabilities are very effective. However, companies that do this well are 55% more likely to achieve a sale price above expectations. Today, commercial diligence is much more than just market and competitor diligence. Rather, it should demonstrate the business upside for a potential buyer, challenge the business plan that management prepared, and identify areas for improvement or weaknesses in assumptions. In particular, it examines:

- ▶ The business's product portfolio and routes to market to assess whether they are keeping pace with digital innovation
- ▶ Which markets are susceptible to geopolitical disruption
- ▶ Customer perception – whether feedback supports the seller value story, and whether issues are being addressed
- ▶ What synergies might be available for a potential buyer
- ▶ Opportunities to remove cost, improve the supply chain, or expand the offerings or customer base

What happens when you don't prepare

A Fortune 100 company marketed a global business representing 25% of its revenues. The assets had experienced constant revenue and earnings growth, and so management did not devote proper time for sale preparation. More than 35 indications of interest were received, but only five management presentations resulted and all parties ended up dropping out of diligence. In the end, the company pulled the assets off the market, even after management had devoted significant time to the process during a critical period for the business.

Result: Revenue required 18 months to recover. A process that should have taken less than 12 months took more than two years, and the ultimate valuation was 20% under management's targeted range. What can you do to avoid this scenario?

55%

more companies achieve a sale price above expectations when they conduct commercial diligence.

Remain flexible on the perimeter of assets for sale

Sellers take a view on which assets are for sale – the perimeter of the deal – but they should also consider whether additional assets could be included or excluded from the deal to make it more attractive to a buyer. Some key considerations include the following.

Deal perimeter implications

- ▶ Ongoing earnings power of the business post-closing
- ▶ Transition services agreements (TSAs) and reverse TSAs
- ▶ Tax-efficient acquisition structure for the buyer
- ▶ Separation-related requirements, including operationalizing the specific countries in association with the closing
- ▶ Talent (e.g., works councils, benefits legally required to transfer)
- ▶ Regulatory requirements and related time frames
- ▶ Supply agreements
- ▶ Stand-alone and one-time costs

Appropriate level of separation planning

It is vital to find a balance between too much and too little. Potential buyers should have a clear sense that the business has been properly prepared for sale across the board: in the Confidential Information Memorandum, at management presentations and in due diligence.

Buyer considerations relative to the desired perimeter

These may include antitrust considerations, the buyer's existing infrastructure and legal entities, tax attributes, manufacturing locations and relative capacity, funding relative to select liabilities and settlement processes relative to commingled accounts (e.g., accounts receivable and accounts payable).

Scenario-driven analytics

These are not simple spreadsheets. A proper set of analytics employs data relative to the potential transaction that allows for modeling various scenarios and the impact of these scenarios on revenue, EBITDA and working capital. Scenario-driven analytics allow for streamlined deal-basis financial statements and deal model reporting. They also provide the deal team with appropriate data relative to the deal and the remaining organization, and they enable the team to present the impact of the various scenarios proposed by multiple buyers to the C-suite and board of directors.

Q In your last major divestment, how would you rate the effectiveness of each of the following steps?

Conducting commercial diligence (e.g., market and competitor diligence)



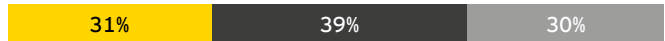
Focus on the quality of the management team in the divested business



Continuing to create value in a business even though you intend to sell it



Identification and mitigation of stranded costs (those which remain with parent following divestment)



Understanding the value of alternative structures to buyers



Pre-sale preparation to mitigate price reductions for tax risks



Very effective Somewhat effective Not effective

Conduct cyber diligence

No organization is immune from cyber attacks. These attacks can damage transaction value. And data breaches and other attacks are expensive and time-consuming.

When it comes to divestment candidates ("DivestCo") and cyber threats, some ways to maximize value include:

- ▶ Identifying the biggest threats and plans to mitigate them before you engage buyers
- ▶ Monitoring avenues of attack against DivestCo that could open up when companies separate
- ▶ Developing defensible support for DivestCo's valuation that considers the potential cyber-event impact on a range of factors – sales, brand and reputation, litigation costs and competitive impact from loss of intellectual property

As for the remaining business ("RemainCo"), some ways to mitigate threats include:

- ▶ Identifying internal security monitoring gaps and closing potential avenues of attack against RemainCo that could open post-separation
- ▶ Making sure RemainCo's critical assets, such as intellectual property, are not inadvertently transferred to DivestCo
- ▶ Closing gaps among RemainCo's team members and risk control governance structure caused by separation
- ▶ Supplementing security monitoring teams, which are often overwhelmed during the transaction

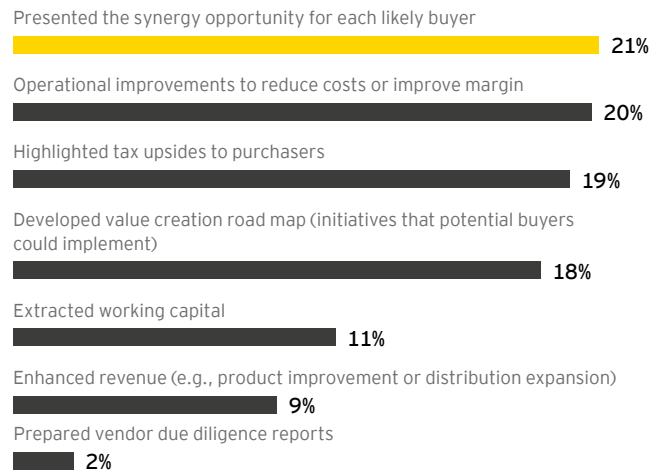
Communicate tax upside to buyers

Given widespread flux in tax laws across the globe, it is difficult for buyers to identify tax value and opportunities, especially from the outside. The most successful sellers look at their business through the eyes of a buyer and proactively highlight potential tax upsides. Sixty-three percent of executives say that they highlighted tax upsides to purchasers during their most recent divestment – among the most important steps they took to enhance value. Better yet, 48% of executives say it has become easier to offer flexibility in sales structures over the past year. But it’s still not an easy task, and there is still room for improvement. Only 28% of companies say their pre-sale preparation to mitigate price reductions for tax risk is very effective. And of all the pre-sale steps companies say they did not take but should have, highlighting tax upsides tops the list.

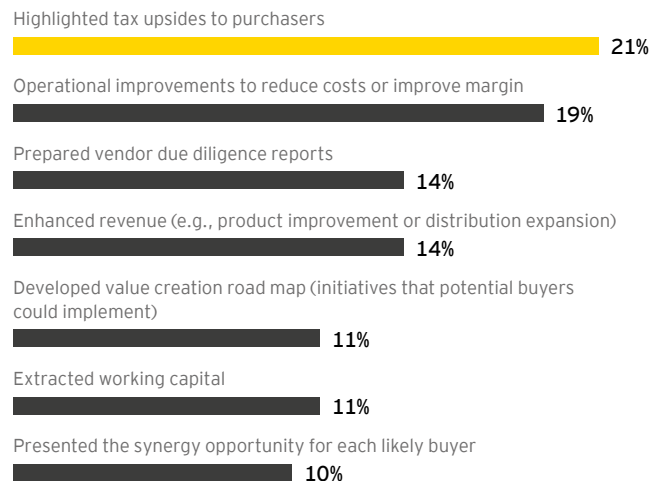
When it comes to communicating tax upside, where relevant, sellers should:

- ▶ Understand the benefits to buyers of different sale structures
- ▶ Provide a detailed tax model to illustrate when tax losses and other attributes will offset cash taxes
- ▶ Review historical tax advice and the trail of why positions were taken
- ▶ Illustrate the capacity for tax-deductible debt, country by country
- ▶ Seek to agree on open tax points with tax authorities where possible
- ▶ Highlight tax incentives that could be available
- ▶ Outline tax efficiencies that have been considered but not yet implemented

Q Which initiative was most important for enhancing sale value?



Q Which step did you not do but now feel you would have benefited from the most?



“For the unit that was considered for sale, we always maintained the balance in our operations between continuing to create value and preparing for the sale. We started well in advance so we could look into details before completing the transaction. This allowed us to determine the right value, enhance that value to suit buyers’ requirements and make sure regulatory and compliance aspects were intact. We also kept our operations very transparent, which enabled the buyer to apply their strategies without having to face integration challenges and delays.”

Executive at a US-based financial services company

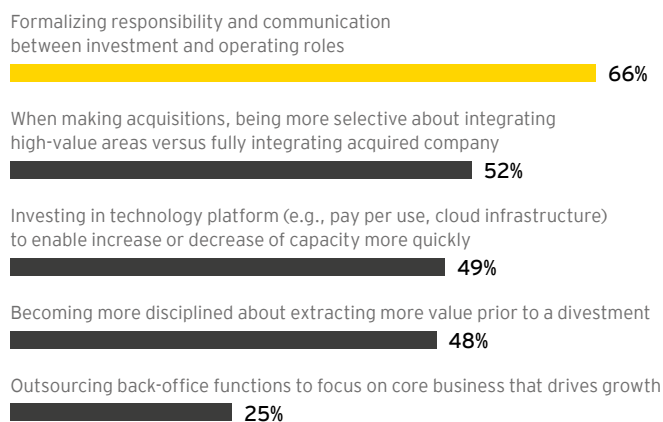


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How can you improve the agility of your remaining business in the new digital economy?

Once you have divested, how can you develop a flexible operating model that enables your remaining company to move businesses in and out more quickly, efficiently and cost-effectively in the new digital economy? Leading companies are creating greater optionality in a world of frequent portfolio turnover and disruption.

Q Which of the following operating model changes are you planning to implement in the next year in order to make a future divestment process more efficient? Select all that apply.



Take a holistic approach – align investment team and operational management goals

Most companies (66%) say they plan to formalize the responsibility and communication between the investment (M&A) and operational roles. This step is critical because their key performance indicators (KPIs) are often different and conflicting. For example, the relevant M&A KPI may be to achieve maximum value. However, if an asset sale, in isolation, removes scale and therefore utilization from a production facility, this could adversely affect an operational KPI based on capacity utilization or return on assets employed.

In addition to normalizing operational KPIs for M&A, companies can consider these key ways to accomplish a more holistic, rounded approach to goal-setting:

- ▶ Communicate the M&A strategy in detail and involve operations teams in the strategic thinking around operational footprint before launching a divestment process

- ▶ Instead of thinking about a divestment as a single event, factor in broader thinking about how the operational footprint will develop over time – consider structuring the sale as an enabler of a broader facility-consolidating plan
- ▶ Rather than regarding a divestment as an immediate separation, consider whether a softer approach, such as a longer-term manufacturing agreement, can ease the impact of the separation for both buyer and seller
- ▶ Set a mixture of operational and M&A-driven KPIs, including dynamic KPIs specifically linked to the impacts of the separation
- ▶ Refine the future operating model to increase business agility and reduce divestment cost and time

Reassess your operating model to become lean and agile

You should not be doing what you don't want to do. In disrupted markets, a company may want to consider a fundamental rethink of its operating model. Companies should consider selling what's non-core (e.g., infrastructure and other back-office assets) and focus on what truly drives growth. This could start anywhere, from outsourcing particular administration functions right up to reimagining the business with everything outsourced. The fundamental premise is to make the cost base as flexible and variable as possible by separating the business model from a fixed cost base.

In addition to replacing some contracts with cloud providers, outsourcing routine business processes and commodity IT services, creating a mobile workforce is an emerging trend that enables a new way of working. Companies are considering what intellectual capital is critical to maintain in-house versus what could be outsourced, especially back-office functions that have enormous benefits of scale.

Only 25% of companies are planning to outsource back-office functions to focus on the core business activities that drive growth. There is clearly room for improvement here. We see large companies, in particular, starting to commission carve-out offices from third-party service providers. These offices serve as a transition point between the seller and the new owner of a divested asset. The carve-out office assumes all back-office functions and can mitigate or completely avoid stranded costs at the seller while also making it much quicker for the new owner to assume responsibility. This not only increases efficiency but can also reduce the time between sign and close.

Questions companies need to answer to develop a tailored operating model strategy

- ▶ Are portfolio and divestment decisions affected by concerns about lost capacity?
- ▶ Which functions are critical for the business to "own"? Which add to the intellectual capital of the business?
- ▶ Is the current supply chain still the optimal way to get products to market?
- ▶ Does the operational and employee footprint mesh accurately into the markets in which the business competes?
- ▶ Could an alternative transaction structure (e.g., partnership, joint venture) make exiting a business less painful and potentially add more value?

66%

of companies plan to formalize responsibility and communication between investment and operating roles.

Invest in emerging technology platforms and innovative companies

Just under half of executives (49%) say they plan to invest in more agile technology platforms (e.g., pay-per-use, cloud infrastructure) to enable a quicker increase or decrease of capacity. In light of recent technology advances, this percentage should be higher.

To increase competitive advantage, companies must take advantage of new ways to reduce costs and enable growth. Particularly as companies consider divestments, some technologies can greatly reduce stranded costs and the need to right-size the business post-sale. For example:

- ▶ **Robotics:** automation of manual, rules-driven tasks (e.g., financial reporting, processes of order to cash, payments)
- ▶ **Artificial intelligence:** self-learning technologies that provide deeper insights across organizational and customer behavior as they acquire additional data
- ▶ **Software as a service (SaaS) and cloud infrastructure:** capacity enablers that scale up or down quickly based on usage, enabling easier separation and lowering fixed costs
- ▶ **Digital supply chain and Internet of Things:** tools that help companies track goods, inventory and quality of assets within the supply chain to increase efficiency

How companies can benefit from SaaS

A global consumer food manufacturing company implemented various SaaS solutions across its organization. The result was that the company increased efficiencies and agility across the back office, such as human resources and commercial functions, to better meet the needs of the business. SaaS is an alternative to the standard software installation in the business environment where a user has to build the server, install the applications and configure it. Using SaaS, the company does not pay for the software itself. Instead, it works like a rental – the company incurs lower costs, it requires less maintenance, and the company easily scales capacity up and down.

49%

of companies plan to invest in agile technology platforms.

Conclusion

If you're reading this study – or you're just trying to stay competitive in 2017 – chances are you're considering a divestment. So what should you do about it, based on the data in our study? Let's recap our four questions.

Are you divesting based on strategic reasons or disruptive forces?

In the face of both market disruption and impatient shareholders, the best approach is to review your portfolio more frequently and use analytics to make more effective, quick decisions. But companies also need to take the time to prepare a business for sale – or the likelihood of failure increases.

Do you know what will change your valuation tomorrow?

Perhaps the most value-damaging action a company can take is holding on to an asset too long. Understanding your performance, opportunity and perception gaps through rigorous portfolio reviews is the best protection against value erosion. These reviews should be fortified through descriptive, predictive and prescriptive analytics.

How should you take action in disrupted markets?

It's never been more true: thinking like a buyer is critical to divestment success. Sale preparation is vital, even for the best-performing unit. And especially in disrupted industries, flexibility around the deal perimeter and structure can be the ultimate path to success.

How can you improve the agility of your remaining business in the new digital economy?

Even after a successful divestment, disrupted markets provide significant opportunities and risks for enhancing the value of the remaining business. It is essential to optimize the remaining company's operating model and invest in agile technology platforms to make it easier to transact going forward.

How EY can help

EY's dedicated, multifunctional divestment professionals can help you improve portfolio management, divestment strategy and execution.

Using advanced analytics, we first help you understand your business performance compared to that of your peers and the rest of the portfolio, including assessing the quality of information and developing more reliable data for the evaluation process. We then help you decide where capital can be released from underperforming or non-core activities and reallocated toward higher-growth areas and digital innovation.

Next, we work with you to prepare for a divestment and become an informed negotiator. 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.

For carve-outs in particular, we advise on which businesses are worth investing in and which may be worth more to another owner. Our sector-focused teams can also help you understand the effect a divestment could have on your remaining company's growth, brand and stakeholders. Further, we can help maximize transaction value by guiding you through preparation and execution and removing any potential bumps in the road before buyers get involved. For example, we can help create a compelling value story by analyzing the growth opportunity; assessing underlying trends; and identifying hidden value in earnings, corporate allocations, real estate, working capital, human resources, IT, operations and tax.

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



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