



Specific consideration in cross-border divestitures

- 1**  **Determining what's really for sale**
 - Geographies to be included
 - Which shared country assets and resources are part of the transaction
- 2**  **Compiling the financials and considering the deal structure**
 - US GAAP vs IFRS
 - Tax regime and consequence of asset vs stock deal
- 3**  **Knowing the laws at home and abroad**
 - Government intervention
 - Foreign Corrupt Practices Act
 - Regulatory filing process
- 4**  **Marketing the business and adapting to foreign buyers**
 - Cultural differences
 - Time zones
- 5**  **Planning for the separation**
 - Entry rights and visa issues
 - Pension, healthcare, and insurance liabilities

Carve-outs and divestitures are a vital means of advancing corporate strategy. They are also complex—and are likely becoming more so as sellers increasingly adopt a global perspective in an effort to attract more bidders and generate higher value. US companies have historically preferred selling to domestic buyers; however, this preference appears to be eroding, with the percentage of executives preferring a domestic corporate buyer dropping from 70% in 2010 to 59% in 2012, according to the Deloitte 2013 Divestiture Survey.¹

Although certain preparations are leading practice regardless of the geographic scope of the transaction, there are some specific considerations in a cross-border divestiture (summarized to the right) that may significantly impact whether or not the seller can effectively execute the transaction and obtain their desired price.

Due to these and other considerations, sellers should be mindful that a cross-border divestiture usually takes more preparation and patience than anticipated.

¹ Deloitte 2013 Divestiture Survey, "Sharpening your strategy," January 2013, "<http://www.deloitte.com/us/ma/divestiture-survey-2013>" www.deloitte.com/us/ma/divestiture-survey-2013 as per source

1



Determining what's really for sale

What exactly are you selling? The answer might seem obvious at first glance, but determining which assets are for sale can be difficult, especially when the team at the Corporate Headquarters does not have much in-country knowledge. Oftentimes in international companies, key assets, as well as managers, are shared among multiple business units but are often housed in one legal entity. Deciding which of these assets and people stay with the parent and which ones go with the sale can be complicated and expensive, particularly if economies of scale will be lost, factories are shared, or repatriating employees is being considered. Not knowing what infrastructure the buyer has in place can make this component even more stressful. In cross-border carve-outs, it is fairly

common for buyers and sellers to argue over what is included in the transaction well into the final stages of the deal negotiation.

This challenge is often amplified by the complexities of operating in multiple tax jurisdictions. A country-by-country analysis is usually required to effectively evaluate how to segregate assets that are to be retained versus sold, and how to transfer those earmarked for sale in a tax efficient manner. In addition, transfer taxes and “de-grouping” charges are very common in many foreign countries, so the seller should be prepared to incur them. From a US tax perspective, different types of transactions can affect the company’s ability to claim foreign tax credits, and thus impact its effective tax rate.

These potential implications argue for careful analysis and structuring of the assets for sale. They also call for assembling the appropriate team early in the deal process. To be effective, this team should be multi-disciplinary, have extensive M&A experience, and be intimately familiar with local customs and business practices. For many companies, this means engaging experienced external advisors who can help to streamline the process early on before it becomes overwhelming. Well-qualified external advisors may be able to help accelerate deal close and value realization by guiding the company through the intricacies of doing a cross-border deal.



Compiling consistent underlying financial data facilitates cross-border due diligence.

Situation:

A global automotive parts manufacturer headquartered in the US divested a multinational business unit to another automotive parts manufacturer headquartered in Asia. The business unit operated within several different geographies. These operations were maintained within legal entities that also housed operations for some of the seller’s other business units, resulting in commingled financial and operating information. Standalone income statements and balance sheets for the business unit did not exist for the majority of these entities. In addition, the underlying supporting data for the financial results of these entities was not available centrally or in a consistent format. Changing deal assumptions and tax considerations resulted in frequent modifications to the transaction scope, which complicated the task of performing seller diligence and assembling standalone financials for the businesses being divested.

Result:

Pro-forma income statements and balance sheets were created for each of the entities to be included in the transaction. These were modified throughout the diligence process as the deal structure changed to include or exclude certain entities and geographies. Having a diligence team working in a centralized location facilitated a more streamlined approach to the creation and continuous modification of these standalone financial statements. Overall, compiling consistent underlying supporting data for the financial statements facilitated the seller diligence process. Of note, structural planning prior to the divestiture, with minor changes to accommodate a potential buyer’s structure, can expedite the diligence process and lead to a faster close by avoiding such a high degree of complexity.

2



Compiling the financials and considering the deal structure

There are two types of financial statements that can be compiled as part of a carve-out transaction: (i) The Deal Financial Statements prepared to help value the business to be sold, and (ii) those prepared under US GAAP or IFRS for Audit purposes, which may be required by the seller as part of the terms of closing. While the two types overlap, the Deal Financial Statements include forward-looking projections, whereas the Audited Financial Statements do not. The Deal Financial Statements also include more detailed analysis of shared costs and standalone profitability, assets and liabilities than the Audited Financial Statements.

Both types of financial statements will need to be adjusted to account for costs shared by the parent company and the division to be sold, while the Deal Financial Statements will factor in forward-looking costs associated with the transition.

For instance, the carve-out may incur additional costs once it splits off from the parent. These costs could include new management positions, back-office services that were previously the responsibility of the parent, and higher prices for materials, insurance, and professional services as a result of decreased purchasing leverage. Transition service agreements (TSAs) may also be necessary, which require time, effort and negotiations to set up. In comparison to a domestic transaction, these types of costs could be larger in a cross-border deal since a foreign buyer may not have existing facilities and staff in the countries where the carve-out operates.

Valuing a carve-out, however, isn't only about assessing the costs. On the flip side, positive synergies could be generated such as price or volume increases, facility and staffing rationalization, and other

cost savings. In addition, brands and expertise could be transferred to the buyer, which could be utilized elsewhere. The extent to which the seller is able to help a buyer understand and quantify these synergies can largely determine the price they are willing to pay.

Tax consequences should also be considered in structuring the deal, since they are omnipresent in settling or transferring intercompany payables and receivables in a cross-border divestiture. As such, the seller should evaluate these consequences in an effort to propose a tax-efficient solution. This solution usually includes a tax-efficient way to repatriate cash from the entity to be sold, and it requires the seller to gather information related to intercompany cash balances and distributable reserves. Additionally, the seller will need to determine if there is "trapped cash" in the system.



Coordinate early and often for better financials and a smoother sales process.

Situation:

A multinational pharmaceutical company divested a US-based business unit with operations in various foreign jurisdictions. The parent company, along with their buy-side investment banker, brought several bidders to the table.

Result:

In order to effectively deal with language barriers and cultural differences, a broad diligence team was assembled that put "boots on the ground" in each of the relevant jurisdictions. This team was governed by a single operating leadership group, which served as the project management office. Through early coordination with the buy-side investment bankers, the sell-side diligence team was able to confirm that the financial information to be included in the Confidential Information Memorandum (CIM) was consistent with the information in the data-room, and it was reconcilable to the company's accounting book of record. Consequently, very few reconciliation issues arose regarding the financial data provided to potential buyers, and management was well prepared to answer fluctuation questions. By averting financial surprises, this upfront coordination facilitated a smooth sales process, which culminated in a very effective auction.

3



Knowing the laws at home and abroad

Legal violations and government intervention can potentially derail a deal. In cross-border situations, these factors can be even more important to consider. On one hand, selling to a foreign buyer can present fewer antitrust issues if the buyer does not have a presence in the market. On the other hand, national security concerns can trigger government intervention. For example, a state-owned Dubai company dropped out of a transaction that would have allowed it to manage some terminal operations at American ports due to resistance from the US House Appropriations Committee and pressure from its own government, which became fearful of the public relations implications of the deal on the international stage.²

For US companies, as well as foreign issuers of securities traded in the US, the Foreign Corrupt Practices Act (FCPA) also comes into play. Enactment and enforcement of anti-bribery laws appear to be increasing throughout the world. Given the prevalence of these laws, companies engaging in cross-border M&A transactions should consider expanding their due diligence efforts to include a forensic component aimed at uncovering possible practices that could be considered problematic under applicable laws before proceeding too far with a prospective buyer.

The complexity of the regulatory filing process poses another potential impediment when divesting a business in a foreign

jurisdiction. In many cases, this process is lengthier than in the US and filing thresholds are lower, making it necessary to file for approval on much smaller deals.

Local differences regarding the preparation and presentation of the carve-out's financial statements should also be considered, such as the number of periods required to be included therein and conversion considerations between US GAAP and IFRS or local GAAP. Accordingly, the seller may need to provide additional financial information to the buyer to help meet these requirements in a cross-border transaction.

²“Under Pressure, Dubai Company Drops Port Deal,” The New York Times, March 10, 2006, http://www.nytimes.com/2006/03/10/politics/10ports.html?pagewanted=all&_r=0



Local knowledge is crucial in a cross-border deal.

Situation:

A global manufacturing business headquartered in the US divested a majority-owned joint venture to its joint-venture partner, a global manufacturing business based in Asia. A unique tax law applicable to related party transactions required each of the businesses being divested to be valued for tax purposes using a non-traditional valuation approach. During the negotiation process, tax considerations became a key element of the discussions concerning the overall transaction structure.

Result:

The sell-side diligence team enlisted both US and local South Korean tax professionals. Having local professionals on the team was essential because they not only knew the tax rules and valuation methodology but they were also familiar with the local language and cultural norms. The blended team expedited the diligence process, helped the buyer and seller to arrive at a mutually beneficial deal structure, and enabled the seller to preserve deal value in negotiations with its joint-venture partner.

4

Marketing the business and adapting to foreign buyers

Sellers should be aware of different cultural norms and expectations when working with foreign buyers. These cultural differences can affect many aspects of the sale, from negotiations through closing and transition management. From the outset, foreign buyers may have corporate governance structures that are more rigid and bureaucratic than those of US businesses. This may translate into more approvals, a longer process for obtaining sign-offs, and consequently, more time to complete the transaction. Negotiation dynamics too will likely differ from a domestic deal, especially when language barriers are an issue.

Selling to buyers in certain regions will likely also require a heightened level of management involvement. Some foreign buyers eschew e-mail and electronic document exchange in favor of phone conversations and face-to-face meetings. There can also be an expectation that senior executives will be available at any time to attend meetings and answer the buyer's questions. These requirements can place unexpected demands on the seller's organization, but being able to work through these cultural differences can allow for a broader pool of potential buyers and, ultimately, potential to increase sale price. If the seller is able to engage in-country leadership or at least

regional leadership in the process, then this can add local knowledge and experience to more efficiently answer the buyer's questions.

Throughout the marketing process, prepared sellers should be willing to adapt their tactics accordingly in an effort to maximize value and maximize deal terms. This includes remembering that carve-outs are often underperforming businesses with potential. Non-core businesses located far from headquarters are sometimes undermanaged since senior company leaders lack the bandwidth to focus on them. In many of these situations, the prevailing sentiment becomes: "We believe this can be a great business in someone else's hands." While there's a lot of validity in that statement, it's important for the seller to adequately communicate the turnaround opportunity to foreign buyers, without making it seem overwhelming. This can often be accomplished by highlighting the strength of the current business along with suggestions for improvement.



5



Planning for the separation

Assembling the appropriate team

Putting “boots on the ground” in the buyer’s country is a significant consideration when assembling the separation team. Being able to work face-to-face, in the same time zone, and speaking the same language is often an underestimated and overlooked aspect of assembling the team. The benefits are not without their challenges—entry rights to some countries can be hard to obtain and maintaining them can involve a good amount of effort. However, providing local points of contact to the buyer’s team can often help in avoiding delays related to work-hour differences and language barriers.

Being a prepared seller

Understanding the buyer’s motivations, capabilities, and integration strategy (e.g., bolt-on, full integration, etc.) can help the seller to scope their effort and plan the governance model appropriately. For example, if the buyer is entering new markets or geographies through the acquisition, the seller should be prepared to play an active role in planning, and even executing, the integration. This can include supporting the buyer in a variety of activities, such as identifying action items with long lead times, filling capability gaps, and collaborating on integration and separation plans.

Being a prepared seller in a cross-border transaction also means not using TSAs as a crutch to get the deal done, especially since delivery of services can expose the seller to significant value-added tax (VAT) liabilities, and the negotiation and review of service contracts can require government approvals in some countries. Plus, IT vendors may restrict the buyer from accessing the seller’s systems in certain markets, adding yet another layer of complexity to service delivery. Prepared sellers should have a firm grasp of the potential implications of relying on TSAs too heavily, and instead develop a process that drives separation and deal objectives.

Sellers should additionally be poised to manage special accounting requirements when selling to a foreign buyer. For instance, the sale of a US business to a foreign buyer will often create accounting considerations for the legacy business, such as how to comply with SEC reporting requirements and how to account for discontinued operations.

Managing the employee experience

Understanding and managing the people-side of the separation doesn’t typically get corporate development teams excited, but ignoring the needs of employees, customers and suppliers can have devastating effects on the deal itself as well as on the retained business. The public relations impact of

selling to a foreign buyer, for instance, can greatly affect employee morale as well as decrease the value of the retained business if factories/offices are closed and jobs are lost in the home country.

In addition, employees in some foreign jurisdictions can wield considerable power and in some countries can even block a deal. Sellers should be aware of the different human resources and legal considerations with regard to gaining the consent of works councils and unions and to be mindful of the required notification periods. The pension laws in the U.K. provide a good example. There, buyers may be required to fund pension deficits associated with the carve-out, which can be significant. Pension trustees and pension regulators also have significant influence and can potentially block a transaction if it is not in the interests of the pension plan members.

Healthcare liabilities can raise similar concerns since the buyer may be expected to fund employee health insurance programs, and employees and regulators can have considerable say in whether or not proposed solutions are acceptable. Again, this situation can vary greatly throughout the world depending upon whether the country has a national healthcare system or if it relies on private health insurance as in the US.

Cross-border divestitures often require more—of everything.



Situation:

A US-based manufacturing business sought to carve-out and sell a multinational business involving several plants, regional distribution centers and 50+ sales organizations. Each applicable reporting unit was responsible for providing several years of information, which required heightened levels of organization and analysis. Reporting formats and accounting systems were also inconsistent among the different countries and regions. Seller involvement was additionally limited, leading to bottlenecks in obtaining the required information.

Result:

The transaction team developed standardized, yet adaptable, templates to facilitate information gathering and to define a consistent reporting format across countries. Additionally, each region was assigned a single point person who was responsible for coordinating and managing data flow. An e-room was also established for convenience in working across borders and time zones. To help alleviate data collection bottlenecks, the team enlisted the assistance of a senior leader within the parent company to help manage the process and hold employees accountable for submitting information on-time. Progress was monitored through regular status meetings and frequent follow-up. Largely due to these efforts, the carve-out was effectively sold to a Brazilian subsidiary.

Conclusion

Carve-outs in general are challenging; working across borders can make them even more so. Cross-border divestitures, nonetheless, are becoming more and more common in an increasingly globalized economy. In comparison to domestic deals, these transactions often require more of everything, including greater due diligence, ability to navigate different financial and tax reporting structures to identify what is being sold, and extra time to prepare the financials. Understanding a foreign buyer's culture and ways of doing business can also be vital to facilitating the transaction closing and help avoid costly delays.

How Deloitte can help

M&A experience

Deloitte has supported hundreds of divestitures across the entire transaction lifecycle for companies in nearly every industry and geography. We offer more than just general knowledge; we offer practical, hands-on support rooted in experience with deals just like the one you may be facing.

Our services include:

- Portfolio strategy assessment
- Buy-side and sell-side advisory support
- Carve-out financial statement development
- Organizational separation and reorganization strategies
- Transition service agreement development and optimization
- Day-1 planning and readiness preparation
- Stranded cost identification and elimination

Global M&A footprint

Deloitte has access to a network of more than 100 offices around the world, and a deep understanding of leading practices in each of the BIC countries (i.e., 11 offices in Brazil, 15 offices in India, and 16 offices in China). Through this global reach, we can put M&A specialists with local language and business skills on the ground wherever you need them with an understanding of local culture and business environments.

Contacts

Greg Gong**Managing Director**

Deloitte Tax LLP

gregong@deloitte.com

+1 212 436 5602

Joe Fritz**Principal**

Deloitte Consulting LLP

Joefritz@deloitte.com

+1 612 659 2963



This material was developed in 2014.

This publication contains general information only and Deloitte is not, by means of this publication, rendering accounting, business, financial, investment, legal, tax, or other professional advice or services. This publication is not a substitute for such professional advice or services, nor should it be used as a basis for any decision or action that may affect your business. Before making any decision or taking any action that may affect your business, you should consult a qualified professional advisor. Deloitte, its affiliates, and related entities shall not be responsible for any loss sustained by any person who relies on this publication.

Deloitte Corporate Finance LLC ("DCF"), member FINRA, is an indirect wholly-owned subsidiary of Deloitte Financial Advisory Services LLP and affiliate of Deloitte Transactions and Business Analytics LLP. Investment banking products and services within the United States are offered exclusively through DCF.

About Deloitte

Deloitte refers to one or more of Deloitte Touche Tohmatsu Limited, a UK private company limited by guarantee ("DTTL"), its network of member firms, and their related entities. DTTL and each of its member firms are legally separate and independent entities. DTTL (also referred to as "Deloitte Global") does not provide services to clients. In the United States, Deloitte refers to one or more of the US member firms of DTTL, their related entities that operate using the "Deloitte" name in the United States and their respective affiliates. Certain services may not be available to attest clients under the rules and regulations of public accounting. Please see www.deloitte.com/about to learn more about our global network of member firms.