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Upfront in brief

Divestments: Creating shareholder value

IDEA IN BRIEF

- Divestments are set to play an increasingly large role in company strategies as they seek to realign their business models for growth.
- With divestments likely to become an increasingly used tactic within corporate arsenals, Deloitte assessed how they can create shareholder value for both buyers and sellers by studying the short- and long-term share price performance. Our findings suggest that divestments can create greater shareholder returns for both buyers and sellers.
- Our analysis indicates that both the buyers and sellers of divestments out-perform their relative index 33 per cent of the time, while in only 11 per cent of the deals both underperform.
- Deloitte notes that there is often a thin line between success and failure and isolated a number of best practices, and pitfalls to avoid. These include a proactive approach to divesting, thinking big but executing small, focusing on core assets and the importance of human capital.
- Divestments can create shareholder value for both buyers and sellers, if done with clarity of purpose on both sides.

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Since September 2008, companies worldwide have divested more than $415 billion-worth of assets. As companies reposition themselves to achieve growth in the new economic landscape, large-scale divestments will form an important part of this realignment. Analysis by Deloitte indicates that divestments can create greater shareholder returns. While the share price of both sellers and buyers tends to outperform their relative index, there is a thin line between success and failure. We examined large-scale divestments since 2005 and identified what successful companies did to increase their shareholder returns.

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Divestments undertaken during periods of recovery can create greater shareholder returns.

Changing nature of divestments

Since the onset of the financial crisis in 2008 we have seen a shift in the sectors, objectives and geographies of divestment activity. This change has been fuelled by a drive to raise capital and realign for growth in a volatile and changing landscape.

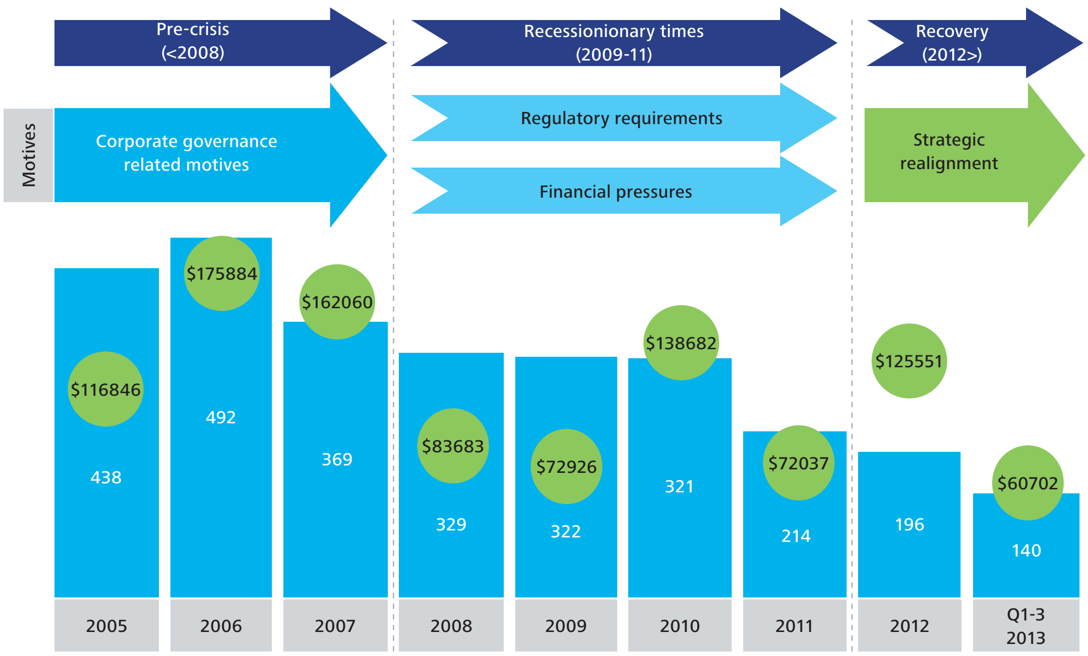
From conglomerate discount to strategic realignment

Before the financial crisis of 2008, most divestments were carried out as a matter of good corporate governance. However, post crisis the majority have been due either to regulatory requirements or financial pressures. Part of the reason for this is the changing make up of corporate boards: since 2008 the number of FTSE 100 CEOs with a financial background has increased by two-thirds.[1] These corporate leaders undertook large-scale divestment programmes to augment the financial austerity. As a result many companies now have record cash reserves.

Regulatory requirements have been shaping divestments in the financial service industry in particular. Here the sharp increase is due partly to the capital adequacy and risk compliance requirements contained in Basel III, Target 2 and Solvency II regulations.

In the future we expect more CEOs to focus on the growth agenda and make more strategic divestments. Such companies will be actively evaluating their portfolios and disposing of non-core assets to refocus on their core businesses to build a platform for growth. Markets react quite favourably to such announcements as they allow companies to create a more focused business model (Figure 1).

Figure 1. Motives behind divestments with volumes and values (USD millions)



Source: Mergermarket, Thomson Reuters, Deloitte analysis

Europe is the preferred target area for buyers. Europe accounted for 65 per cent of divestments post crisis, the UK alone accounted for 20 per cent of divestment deal volumes.

BRICs leading the charge

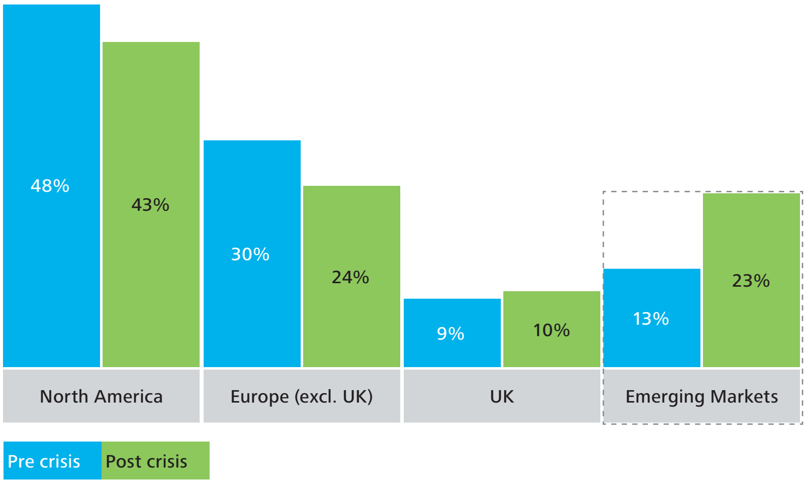
One of the more significant changes in the post crisis world has been a sharp increase in the number of buyers from BRIC countries. Historically, assets were exchanged across the Atlantic between European and North American buyers. Post crisis, the share of acquisitions by emerging market companies has risen from 13 per cent to 23 per cent over the past six years, with the four BRIC nations leading the charge (Figure 2).

Europe is the preferred target area for these buyers. Before the crisis Europe accounted for 46 per cent of all global divestments. After the crisis, its share jumped to 65 per cent, a reflection of the degree of corporate realignment and distress that has taken place in Europe. Of these, the UK alone accounts for 20 per cent of deal volumes (Figure 3).

Financial services industry dominates

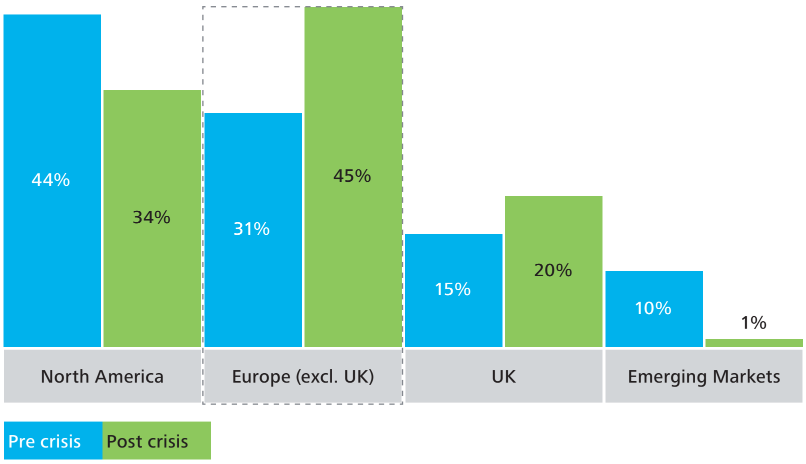
There has also been a sharp contrast in the industries where most divestments are occurring. Before the crisis, consumer business, manufacturing and energy and resources companies divested heavily.
Since the crisis, divestments in the consumer business and manufacturing sector have decreased, while divestments by the financial services industry and the energy sector have increased. They now account for 30 per cent and 28 per cent respectively, primarily due to distressed sales and industry-wide consolidation (Figure 4).

Figure 2. Deal distribution by region for buyers



Source: Mergermarket, Deloitte analysis

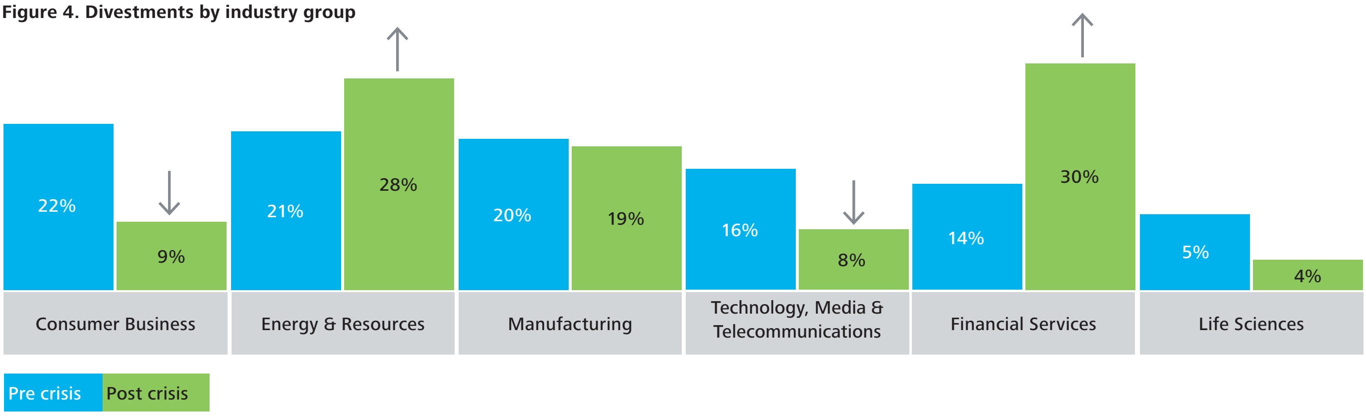
Figure 3. Deal distribution by region for sellers



Source: Mergermarket, Deloitte analysis

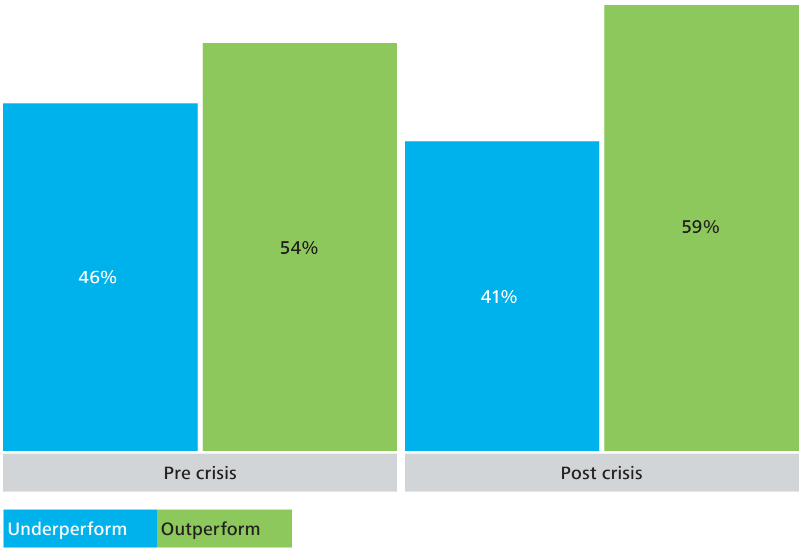
… markets tend to reward smaller, well planned divestments.

Figure 4. Divestments by industry group



Source: Mergermarket, Deloitte analysis

Figure 5. Short-term sellers performance



Source: Mergermarket, Deloitte analysis

Shareholder value creation through divestments

To understand how divestments can create shareholder value for buyers and sellers, Deloitte considered all divestment deals worth more than $500 million that took place between 2005 and 2011. We used the collapse of Lehman Brothers as the bellwether, providing us with two distinct economic environments to compare: pre- and post-crisis.

A company's share price movement, relative to the index where the company is listed, is an indicator of how the market perceives the deal. We measured both the buyers' and sellers' share price movements over a seven-day period – from three days prior to and three days after the announcement – to determine whether the divestment was successful. The seller's share price one year after the announcement is an indicator of how well it has executed the divestment. To analyse the long-term impact, we calculated the average stock price of the seller and its relative index between 30 and 60 days prior to the announcement (T-60, T-30) and compared it to the average stock price of the seller and its relative index 12 and 13 months (T365, T395) after the divestment announcement.

Europe was the most rewarding target market for buyers where 60 per cent of deals done outperformed.

Deloitte's analysis of these divestments shows that they are more likely to lead to a favourable performance in the share price of both sellers and buyers. This is particularly the case during recessionary times.

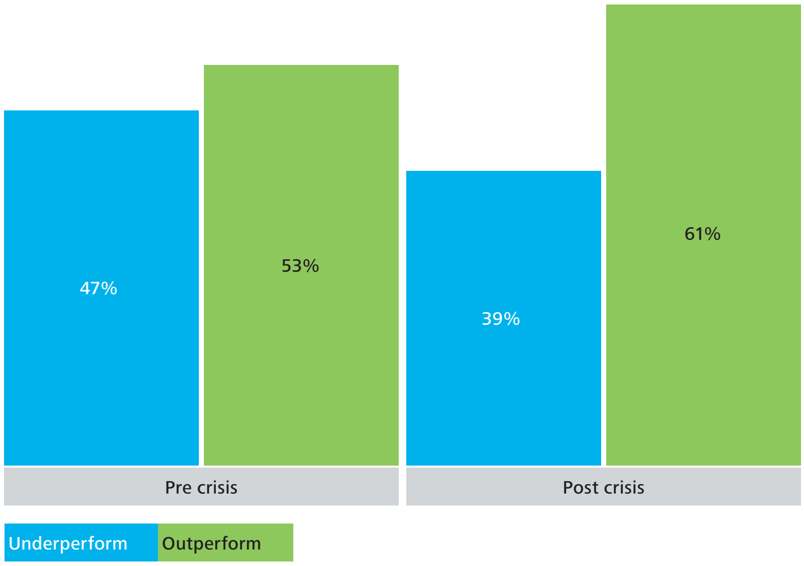
Short-term seller performance

The analysis found that 59 per cent of post-crisis sellers saw a relative increase in their share price, compared to 54 per cent of sellers before the crisis. There was a marked improvement in share price movements for divestments worth $500 million to $1 billion. Two-thirds of such deals outperformed the relative index, compared with 56 per cent of those valued at above $1 billion. This is a clear indication that the market tends to reward smaller, well-planned divestments (Figure 5).

In the post-crisis period, 62 per cent of sellers from continental Europe and 62 per cent of those from North America outperformed the market, whereas only 52 per cent of sellers in the UK saw similarly favourable returns. This can be partly explained by the fact that the majority of divestments in the UK were in the financial sector, which had a number of distressed deals that the market viewed unfavourably.

The consumer business sector had the most favourable returns. Despite the number of divestments in the sector almost halving, some 67 per cent of the deals out-performed the relative index. Among the outperformers was Sara Lee Corporation which sold its global body care and European detergent businesses to Unilever plc to refocus on its core businesses.[2,3] Strategic divestments that realign businesses to focus on their core have been generally rewarded in the post-crisis environment.

Figure 6. Short-term buyer performance



Source: Mergermarket, Deloitte analysis

Short-term buyer performance

Our analysis found that 61 per cent of the buyers of divested assets outperformed during periods of recession. As with the sellers, this superior performance is even more pronounced for smaller purchases: 74 per cent of the buyers of assets worth between $500 million and $1 billion outperformed their relative index (Figure 6).

Europe was the most rewarding target market for buyers where 60 per cent of deals done outperformed. Within the financial services industry, 63 per cent of buyers outperformed. This can be explained by the numerous distressed divestments, which, arguably were often sold at below par valuations. The market rewarded the buyers for getting prized assets at a keen discount.

While there were not many deals in emerging markets, 69 per cent of the companies that bought divested assets in those markets outperformed and the market seems to be rewarding these buyers for tapping into the growth potential of the emerging markets.

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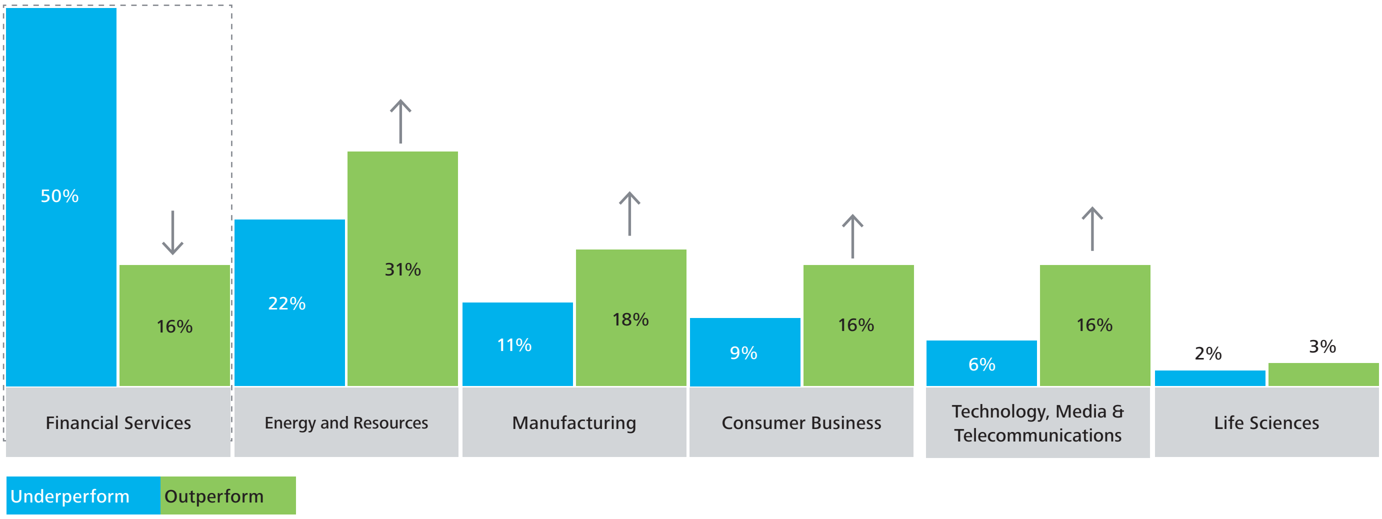
Figure 7. Post crisis long-term performance of sellers



Source: Mergermarket, Deloitte analysis

Post crisis long-term performance of sellers

When Deloitte considered the share price one year after the divestment of assets, we found that apart from financial services, the majority of companies in other industries also outperformed the market in the long term. Many of these divestments were for strategic or financial reasons where companies were looking to reposition or deleverage. As a result, they attracted a positive response from the market.

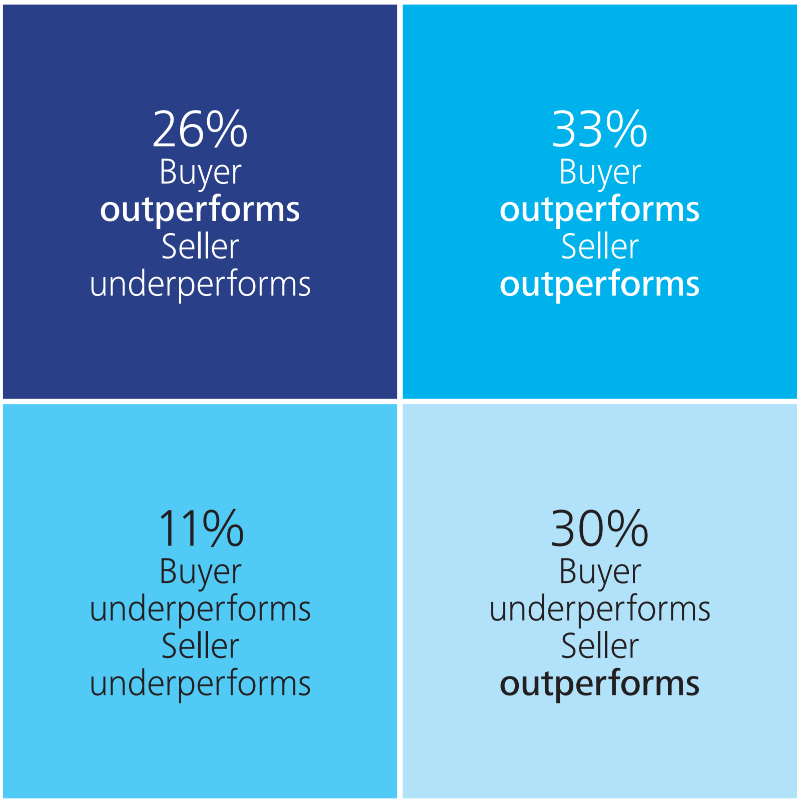
With financial services companies, we found that four out of every five companies that divested had negative shareholder returns. While divesting distressed assets might temporarily help to ease short-term financial pressures, it does not alleviate market concerns surrounding the depressed growth prospects of the seller, hence the long-term underperformance (Figure 7).

In volatile times focusing on core business allows companies to communicate a clear and decisive growth story to the markets.

Post crisis performance for sellers and buyers

Our analysis suggests in periods of recession, both the buyers and sellers of divestments out-perform 33 per cent of the time, while in only 11 per cent of the deals both underperform. In 30 per cent of divestments the sellers outperform while buyers underperform and the buyer outperforms while the seller underperforms in 26 per cent of deals. This suggests overall it is beneficial for sellers to divest, as in 63 per cent of the instances they out-perform (Figure 8).

Figure 8. Post crisis numbers of instances where sellers and buyers outperform and/or underperform



< **Lessons for maximising shareholder value**

There is often a thin line between success and failure when divesting assets, hence we considered the deals where both sellers and buyers either outperformed or underperformed to understand what works and what pitfalls need to be avoided.

Be proactive, not reactive

One of the lessons learnt from the under-performance of many financial services companies is that distressed and unplanned divestments create neither short- nor long-term shareholder value for sellers. The markets consistently penalise such deals. This is because the markets believe that the sale price does not reflect the intrinsic value of the divestment. At the same time, the markets reward astute buyers who pick up assets at a discount.

When Intesa Sanpaolo SPA sold its securities custody unit to State Street Corporation for $1.87 billion, not only did it manage to exit from its non-core custody business, it also got a fair valuation for its division, which included goodwill of $932 million.[4] This was not a distressed sale and was part of a planned divestment programme to bolster its Tier I capital. On the other hand it allowed State Street to consolidate its position as one of the world's largest custody businesses. The share price of both companies jumped when the deal was announced in 2009.

What works: It is important to have a proactive divestment strategy and companies should review their portfolio of assets frequently, so they are in state of preparedness for divestment opportunities. The markets reward companies that have a clear outline of their future growth and an ambitious, but realistic strategy.

Think big, but execute small

Deloitte analysis shows that the most successful divestiture programmes are ones where there are a number of smaller divestments rather than one big blockbuster sale. We observed that when companies carried out their divestment programmes in bite-sized chunks they were rewarded by investors. Often when these companies sold an asset their share prices increased signalling approval for this strategy.

What works: The markets reward both sellers and buyers of smaller divestments, both in the short and long-term. This is because in times of asset volatility, such deals give investors confidence that both the seller and the buyer can go through with the deal without becoming over-leveraged and/or enduring a long and difficult period of integration.

In major corporate events, people are often the most crucial part and leaders must therefore give them clarity of purpose in their actions to maintain motivation.

Focus on the core

Markets reward both buyers and sellers who focus on their core businesses. In volatile times, they are looking for a clear focus and well defined growth plan.

In October 2009, Ameriprise Financial Inc., a listed US-based, financial-planning firm, bought the long-term asset management business of US-based Columbia Management Group, from Bank of America Corporation for $1 billion.[5] The price was lower than the market had expected. However, the acquisition provided Ameriprise with product distribution opportunities as well as investment talent and economies of scale to help serve a broad range of investors. Buying assets at low prices to strengthen its core business pushed the share price of Ameriprise Financial up by 17 per cent in a seven-day timeframe.

What works: Focusing on core businesses allows companies to communicate a clear and decisive growth story and to focus on their key strengths. Companies should always review which of their businesses would be worth more in another firm's portfolio, and then divest accordingly.

People matter the most

Large-scale divestments are significant events in the corporate lifecycle. This can create a tremendous amount of uncertainty for staff and cause disruption to the process. Keeping people motivated throughout the process is therefore key to success.

AIG went through what is arguably one of the largest and most complicated divestment programmes in the financial services sector. To get everyone behind the task, the CEO first made it clear to all that their immediate goal was to repay the US government and restore the company to private ownership.

Secondly, the leadership made efforts to communicate to staff that the divestments was not the completion of the strategy and there was life beyond these events. They emphasised the new skills people were developing through the divestment process. These actions motivated people behind a common goal.

What works: In major corporate events, people are often the most crucial part and leaders must therefore give them clarity of purpose in their actions to maintain motivation.

Bottom line

Divestments are becoming an increasingly important part of every company's strategic growth plans. If done with clarity of purpose on both sides they can create shareholder value for buyers and sellers.

Notes

1. http://www.financialdirector.co.uk/financial-director/feature/2078033/rise-strategic-fd
2. http://www.unilever.com/mediacentre/pressreleases/2009/UnilevertoacquirethepersonalcarebusinessofSaraLee.aspx
3. http://www.saralee.com/~/media/SaraLeeCorp/Corporate/Files/PDF/NewsReleases/2009/HBC%20Unilever%20Press%20Release%20%20%20FINAL%20pdf.ashx
4. http://pr.statestreet.com/us/en/20091222_1.html http://www.secinfo.com/d14D5a.q6F7a.15.htm
5. http://www.ft.com/cms/s/0/c2b68f14-ae22-11de-87e7-00144feabdc0.html#axzz1xTrVwIk9

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About the research
Upfront is the global flagship M&A report published by Deloitte UK. The insights are based on primary analysis, secondary research and interviews conducted with our clients.

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Designed and produced by The Creative Studio at Deloitte, London. 30481A