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Divestments

The importance of preparing the operational aspects early

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Realising value in a fast-paced market

Divestments are an effective way to drive value. Thorough preparation and execution is essential to achieve the full value potential of the transaction.

The decision to divest

The extensive post-COVID and geopolitical changes in the marketplace over the last years have spurred companies to conduct portfolio reviews more often. According to our 2024 Global Divestiture Survey[1], 46% of companies strategically evaluate their portfolio with a focus on potential divestitures 2-3 times per year, which is a sharp increase from 13% in 2020.

We see this trend reflected in the number of divestitures in the market. Since 2020, organisations have been steadily increasing their divestiture deal volume, 82% reporting over three divestitures closed in the past 36 months in 2024, up from 32% in 2020. While changes in the competitive environment and re-focusing on the core were driving divestments in the immediate post-pandemic world, more recently companies cite an opportunistic approach from third parties, fund raising, and changes in the tax and regulatory environment as key divestment catalysts.

Divestitures offer an effective solution to preserve and create value. When executed properly, a divestment can reduce complexity in the organisation and focus its resources on the most value-creating business lines, while also freeing up funds which can be invested in core areas of the business.

Maximising deal value

Divestitures are complex and require thorough preparation to secure the expected value. Respondents in our 2024 Global Divestiture Survey[1] reported preparation and execution of value creation opportunities as significant reasons leading to higher deal values, emphasising the importance of both adequate planning and successful execution for divestitures.

Value creation and optimisation possibilities can only be identified after thoroughly assessing the divestment business, and yet many companies rush to the market without the required preparation in place. A common pitfall is initiating the due diligence phase without clearly defining the deal perimeter. It is crucial that all stakeholders are aligned on what is to be divested, as it is the basis for all the work that follows—from preparing carve-out financials and valuation to stand-alone blueprint and business plan to negotiating SPA and other agreements (including TSAs, MSAs etc.) and preparing the business for standalone operations on Day 1 and 2. Secondly, it is critical to understand the interdependencies between the parent organisation and the divestment business, as these can lead to a myriad of execution challenges and value loss post-closing.

The following pages include guidance on how to prepare for the successful operational execution of a divestment. First, we explain the impact thorough preparation has on the key objectives of the transaction. Second, we outline the key steps every seller should take to prepare their business for a carve-out.

Figure 1

What were the most significant internal reasons that your company received more value than expected in a divestment?

Source: 2024 Global Divestiture Survey

[1] 2024 Global Divestiture Survey, Deloitte Global 2024

The impact of thorough preparation

A well-defined separation approach set out at the start of the transaction process can enhance the asset value, attract more buyers, shorten transaction time, and facilitate smoother execution after closing.

Objectives of a separation approach

The separation approach needs to address several key topics. First, it needs to clearly describe the detailed perimeter of the transaction.

Next, it needs to outline how the divested organisation will operate once it is separated from the parent, and clearly state the costs involved in making it stand-alone. Last, it should highlight the areas which will be most complex to separate and include a plan on how to minimise potential risks arising from the separation.

It is imperative that these topics are addressed right after the decision to divest has been made and before exploring potential buyers, as they will affect multiple elements of the transaction process. A solid separation strategy can enhance the asset value, attract more buyers, decrease buyer due diligence time, and facilitate smoother execution once the deal has closed.

1. Enhance the asset value

The stand-alone operating cost of the divested business is difficult to estimate without a thorough (operational) analysis. As it directly impacts valuation, it is often subject to detailed scrutiny by the buyer and prolonged negotiation discussions. Rooting the stand-alone cost in a thorough operational assessment allows sellers to remain in control of the pricing discussion and minimise lengthy negotiation with buyers.

Having a clearly defined perimeter and a solid grasp of the to-be operating model and its associated costs will ensure the business value is assessed correctly and will minimise the amount of rework needed in the preparation stage.

Valuation is performed on a set of carve-out financials, which need to be created to portray the performance of the divested entity. These financial statements consider not only costs related to the divestment perimeter, but also any additional costs that will be incurred while operating the perimeter on a stand-alone basis.

These costs often arise from dis-synergies created during the separation, such as the need to hire more people in areas where support was previously provided by the parent or an increase in costs following contract renegotiations.

Furthermore, having a detailed understanding of the to-be operating model and costs enables the sellers to identify potential value creation opportunities in the divestment business, as well as assess any business optimisation needs (such as legal entity structuring, system or data separation…) which can make the asset more attractive to the buyers.

2. Attract more buyers

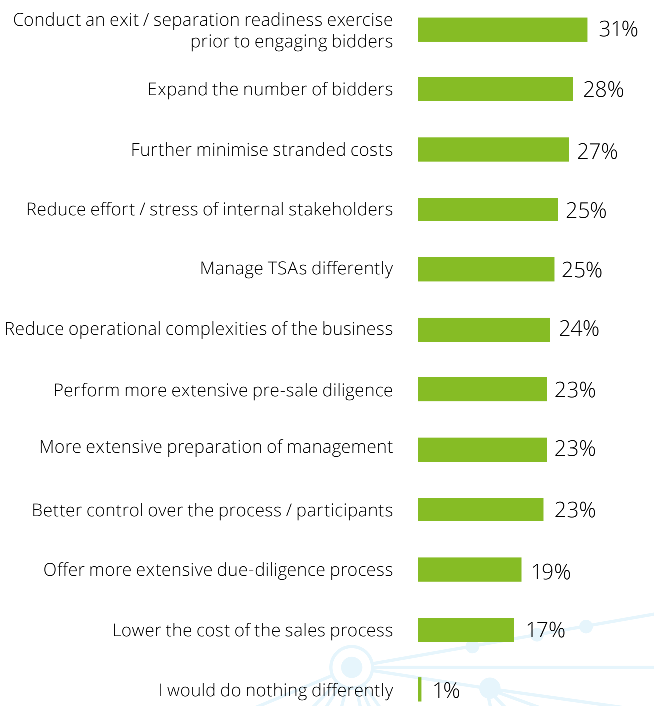
Historically, broadening the bidder pool has been considered a successful strategy to maximise the transaction price.

While financial buyers (e.g. private equity firms) typically look for stand-alone operating businesses with a solid equity story supporting their exit within a few years' time, strategic buyers (corporates) will likely integrate the business, and therefore will focus on potential synergies to be gained.

Understanding how the divested business unit will operate stand-alone will shed light on the potential buyers for whom the asset will be most interesting from a strategic point of view. Furthermore, providing transparent information upfront will enable bidders to thoroughly evaluate the asset against their objectives, which will minimise their perceived transaction risk - hence increasing transaction value - and ensure they stay engaged in the process.

Figure 2

If you could execute your company's last divestment / spin-off again, what would you try to do differently?



Source: 2024 Global Divestiture Survey

Starting preparations early enables sellers to foresee and address potential operational, regulatory, and structural risks to ensure the transaction process and execution run smoothly.

3. Shorten the transaction time

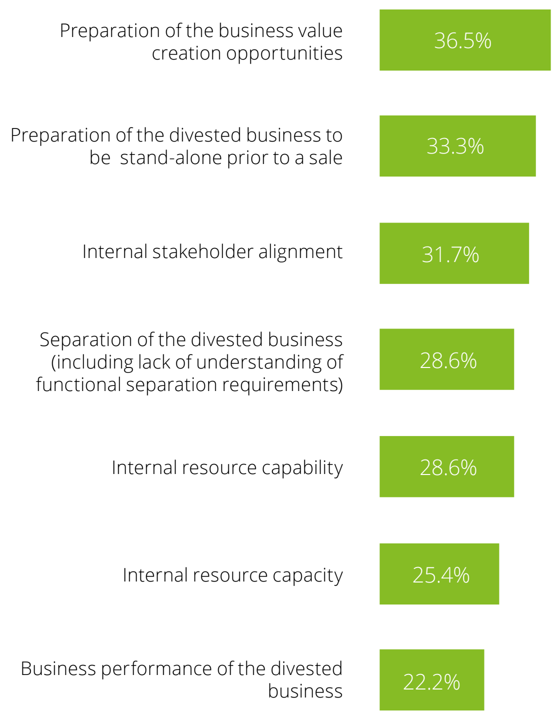
Among the internal factors, a lack of preparation—in both business value creation and stand-alone readiness—was a key element leading to divestitures taking longer than expected. Lack of preparation often stems from the seller underestimating the extent of entanglement of the divestment business within the rest of the organisation, as well as inadequate involvement of and alignment between key stakeholders.

Lack of preparation can have adverse effects on other aspects of the transaction. During a divestment, buyers' objective is to clearly understand the financial and operational performance of the transaction perimeter to ensure it is valued correctly. Changes to the divestment perimeter or lack of clarity regarding required cost adjustments will lead to significant reworks and delays, and potentially delays in negotiations of the transaction documentation.

Furthermore, overlooking regulatory implications of operational and legal entanglements, such as the need for new legal entities and market authorisations, can lead to delays in obtaining regulatory approvals.

Figure 3

What were the primary reasons that your company's most recent divestiture required more time to complete than expected?



Source: 2024 Global Divestiture Survey

4. Prepare for smooth execution

After a lengthy deal process, closing the transaction is rarely the end of the story. In fact, all divestitures face continuing challenges after closing. Our survey highlights TSAs, talent retention, and tax and legal complexities as the biggest continuing challenges.

These are challenges that typically can be relatively easily remedied. The key lies in the early identification of crucial interdependencies between the parent (RemainCo) and the divestment company (NewCo). This allows the sellers to proactively prepare a comprehensive separation plan, which will not only minimise any critical operational disruption during the separation process but also empower sellers to mitigate any stranded costs that the RemainCo may inevitably encounter.

This proactive approach lays the groundwork for a smoother transition, minimising friction and ensuring continuity in operations. Sellers can navigate potential pitfalls with confidence, safeguarding against unforeseen liabilities and streamlining the post-closure landscape.

Figure 4

After closing your company's most recent divestiture, what was the biggest continuing challenge?

Source: 2024 Global Divestiture Survey

Preparing for success

Getting the deal perimeter right is crucial, and the tricky decisions need to be addressed upfront. Failure to comprehensively cover all the required bases can lead to mistakes in valuation, significant rework, and prolonged negotiation.

Before you begin

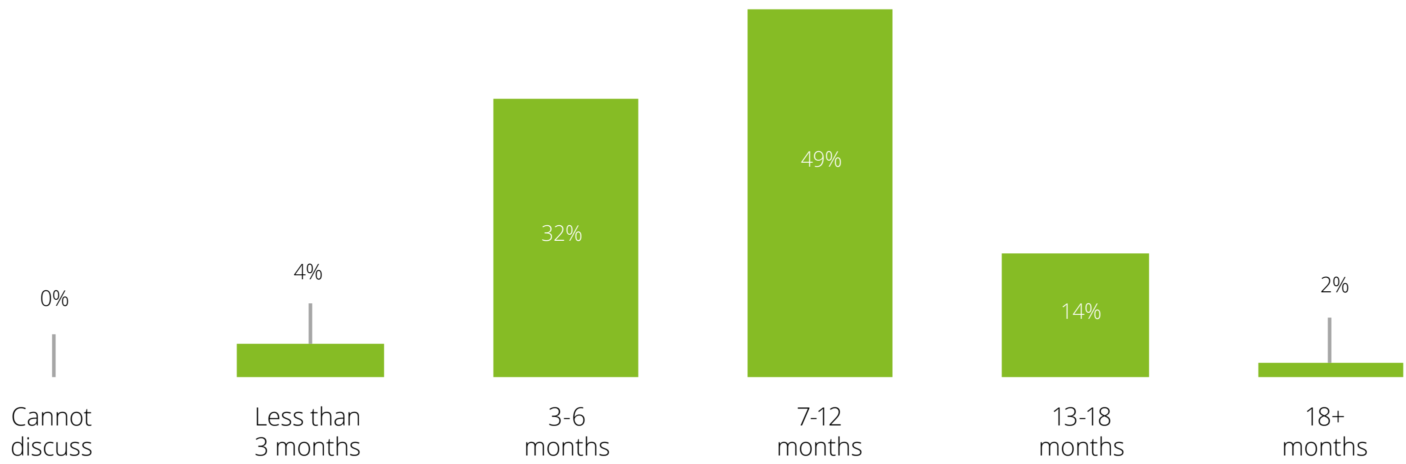
It takes most sellers 7-12 months to sign the deal after they've taken the decision to divest, and an additional 3-6 months to complete the deal, with the complexity of executing the separation often being the key driver.

Separations touch upon all aspects of the organisation, which is why it is critical to set up a decision-making committee which will oversee the separation from the decision to sell, through separation design to closing. This committee needs to have the power and ability to make strategic decisions regarding the transaction perimeter and timeline, as well as be able to understand the operational consequences on the RemainCo.

Getting an early buy-in from both parent organisation and the divestment company stakeholders is critical and will ensure you meet the desired timelines and make critical decisions efficiently.

Figure 5

What was the time period between the decision to sell and execution of the purchase agreements?



Source: 2024 Global Divestiture Survey

Step 1: Define the perimeter

Getting the deal perimeter right is crucial. There are three key elements you need to consider: 1) the product or services you are selling—including geographies, business units or service lines, 2) the assets—both tangible, such as factories and equipment, and intangible, including patents or brands, and 3) the most difficult, the people who will transfer with the perimeter. Given that the perimeter is at the heart of the transaction, the tricky decisions need to be addressed upfront. Failure to comprehensively cover all the required bases can lead to wrong expectations, mistakes in valuation, significant rework, and prolonged negotiation.

Defining a to-be operating model will confirm the operational viability of the perimeter to the buyers, facilitate building a transparent stand-alone cost model, and highlight areas in need of TSAs.

Step 2: Map out the functional interdependencies

Functional interdependencies will exist between the divestment perimeter and the parent organisation. Understanding them will enable you to take key decisions regarding to-be operations in both the divestment business and the parent organisation and facilitate quantification of related costs.

Taking a structured approach ensures all bases are covered. Each functional area of the divestment business, such as commercial operations, supply chain and support functions, can be analysed across five pillars—people, process, technology, assets, and contracts—to highlight any interdependencies with the parent organisation. Operational understanding of the functional areas is key. Therefore, it is important to balance the need for confidentiality with involving the right stakeholders early on.

Figure 6

Functional interdependency framework

Separation affects all areas of business operations:

People

Are there any employees supporting NewCo and RemainCo activities? Will these employees transfer?

Will new employees need to be hired to cover capability gaps?

Process

How will support function (finance, HR, IT...) processes work in the NewCo?

Are business-critical processes part of the transaction, or will they be retained in the RemainCo?

Technology

Will the NewCo have an independent infrastructure?

How will we separate critical applications needed for day-to-day operations?

Contracts

How will this impact the customer portfolio?

Will pricing with critical suppliers be affected by change in volume?

Assets

Can the NewCo utilise the current brand, or will a rebrand be needed?

Do the employees need to move to a new office?

Source: 2024 Global Divestiture Survey

Step 3: Define the stand-alone operating model

Each interdependency area needs a solution. Will extra staff need to be hired, or will the RemainCo provide support via a TSA? Are there suppliers whose contracts will need to be renegotiated? Which processes will be part of the NewCo and which ones will come from a third party? Will additional licenses for critical applications need to be purchased?

Answering these questions benefits the seller three-fold. First, they confirm the operational viability of the perimeter, which provides potential buyers with confidence and decreases their perceived risk. Second, it will facilitate building a bottom-up overview of costs required to make the perimeter operate on a stand-alone basis. Third, it will point out areas which might require TSAs and provide a framework to determine the appropriate costing mechanism.

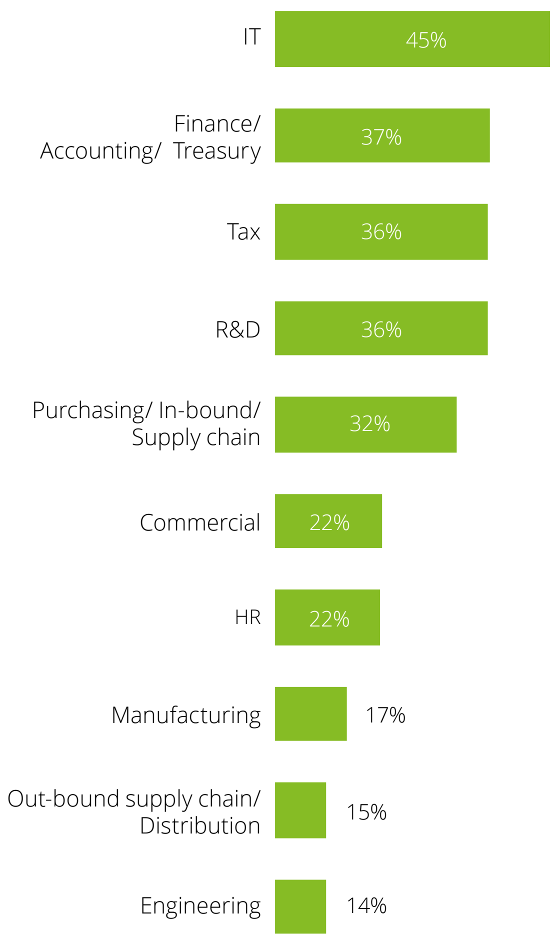
Defining a stand-alone cost model as well as one-off costs rooted in actual operations is an essential step in driving value of the divestment.

Step 4: Define TSAs

While TSAs are an effective way of managing separation costs, they are the most common challenge continuing after closing. This is likely because most TSAs are offered in functions which are most complex to separate, such as IT, R&D and functions that heavily rely on viable reporting systems, like finance or quality control. Having a clear view on the entanglement and the to-be model can help you avoid this trap and further challenges post-closing.

Figure 7

When your company pursues a TSA, which functional area does your company typically provide TSA services for?



Source: 2024 Global Divestiture Survey

Step 5: Quantify the costs involved

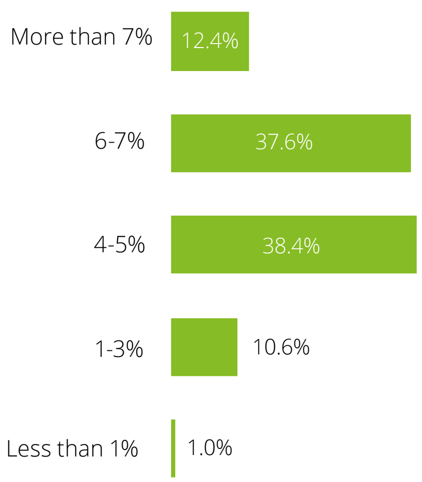
Defining the stand-alone cost of the carve-out perimeter can be tricky due to the large number of assumptions that are in play. At the same time, it is imperative that it is assessed correctly as it has a direct impact on the build-up of carve-out financials, as well as on the valuation of the asset. Having defined the steps that need to be taken to make the perimeter operate stand-alone enables sellers to cost each action accordingly, therefore building a cost model which is rooted in actual operations.

Secondly, taking a methodical approach enables sellers to identify related one-off separation costs. In 2024, 76% of sellers claim one-off costs amounted to 4-7% of the revenue of the divested business.

Lastly, having a thorough stand-alone cost assessment provides a solid baseline to identify and evaluate potential value creation options for the divestment perimeter, allowing sellers to maximise their transaction value.

Figure 8

How significant was the (one-off) cost of preparing for and executing the divestment and 'tidying up' the retained business post divestment, as a percentage of the sold business revenue?



Source: 2024 Global Divestiture Survey

Step 6: Clear road ahead

Understanding key separation touchpoints and costs involved brings clear focus to separation planning. In this phase, it is recommended to involve functional experts to understand detailed steps that need to be taken to impact the separation, the timing involved, and map out any interdependencies between the steps. Having prepared the separation approach in detail, the execution is likely to have minimal effect on operations and be completed on time and within budget.

Key lessons learnt

1

Define and align on the transaction perimeter

It is critical to have a clear deal rationale and define which parts of the business are in scope (and which ones are out of scope).

2

Set the separation principles

Clear separation principles expedite the separation process and help to make decisions. Examples of principles: no stranded costs, minimise dis-synergies, what belongs to a business moves with that business, minimum number of TSAs....

3

Start early

Plan well but start the execution sooner rather than later—you can easily lose time planning, and the plan will need revising when you encounter implementation issues.

4

Resource workstreams

Resource each separation workstream with a company veteran to ensure relevant functional knowledge. Backfill the day-to-day positions of these people to ensure that they can support the separation effectively.

5

Recognise the role of central

Central design, local implementation—you cannot oversee all issues and limitations that may occur at a local level centrally, but central needs to determine the direction and pace.

6

Stick to your decisions

Make decisions once, document them well, and do not go back on them—it triggers too much rework, especially given all interdependencies.

7

Manage interdependencies

Manage interdependencies within a function, but especially between functions (treasury, finance, IT, HR). They all need to work together to make the transaction work.

8

Underpin projections and potential cost savings

Projections and potential cost savings need to be well-underpinned (detailed and granular) or bidders will discount them. Also, the historical track record of cost-saving programmes should be considered to establish credibility in the management's ability to deliver.

9

Avoid shortcuts

No shortcuts—you will regret them later. Work through the required details with rigour.

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