

ASK THE EXPERTS WEBINAR

Navigating a Successful Divestiture

June 18, 2020

KEY REMINDERS

- ▶ Riveron webcasts – past and upcoming
- ▶ 4 polling questions must be answered to obtain CPE
- ▶ If you have questions, feel free to ask in Q&A option in Zoom
- ▶ Webinar evaluation form & CPE certificate will be emailed to you
- ▶ On demand video is not eligible for CPE
- ▶ You will receive a follow up email including:
 - ▶ Access to this webinar recording and deck
 - ▶ The ability to join our Webinars Mailing list to receive future invites
 - ▶ Presenter contact info

PRESENTERS



Josh Bier

MANAGING DIRECTOR

Expert Areas: Carve-outs and divestitures, from strategy through closing, and implementation and financial diligence



Ryan Gamble

MANAGING DIRECTOR

Expert Areas: Carve-outs and divestitures, structuring, business combinations and IPO readiness



Michelle Gross Kuhr

MANAGING DIRECTOR

Expert Areas: Valuation, financial reporting, financial modeling, and merger integration



Sasha Morozova

MANAGING DIRECTOR

Expert Areas: Carve-out and pro forma financial statements, business combination and divestiture matters, IPO readiness, GAAP change and conversions



Adrian Sawczuk

MANAGING DIRECTOR

Expert Areas: Corporate performance management, merger integration and divestitures

AGENDA

M&A OUTLOOK

STRATEGY AND DEAL EXECUTION

CARVE-OUT FINANCIAL STATEMENTS

SEPARATION ACTIVITIES

Q&A

Polling Question #1

Does your current near or mid-term strategy include executing a divestiture of a portion of your business?

- A. Yes
- B. Potentially
- C. No
- D. Prefer not to disclose

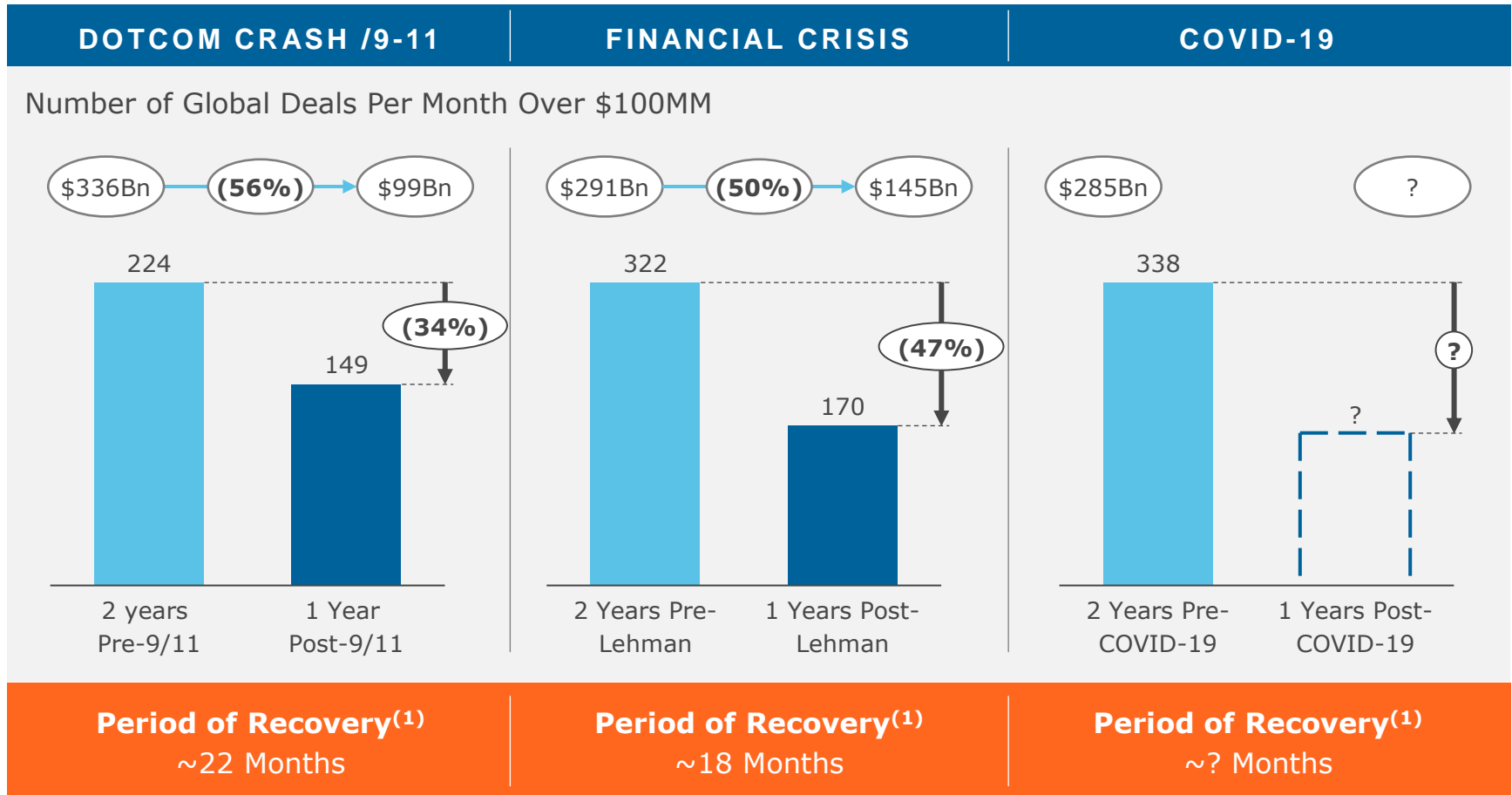


The slide features a dark blue geometric background on the left and a lighter blue geometric background on the right. A thin orange line extends from the bottom of the dark blue area towards the center. The text 'M&A OUTLOOK' is centered in white, bold, uppercase letters.

M&A OUTLOOK

ACTIVITY RECOVERY FOLLOWING PRIOR RECESSIONS

Following market shocks, M&A volume typically declines by 30-50%, subsequently recovering over 18-24 months



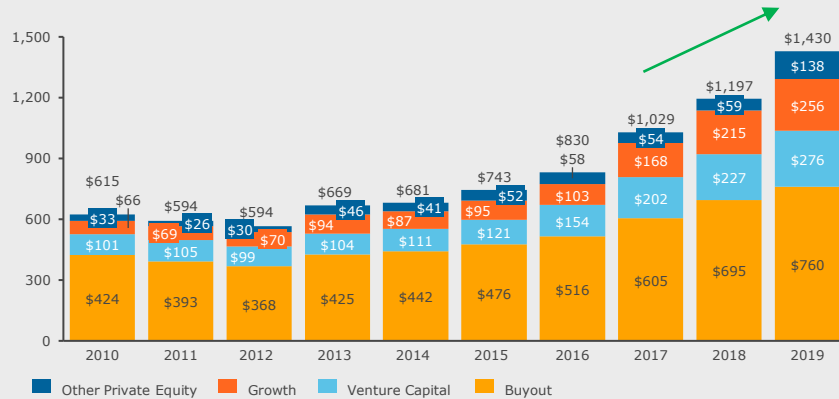
○ Average Monthly Deal Value (\$Bn)

Sources: Morgan Stanley, Reuters

PRIVATE EQUITY IMPACT

Aggregate Private Equity "DRY POWDER" by fund Type

\$ in Billion

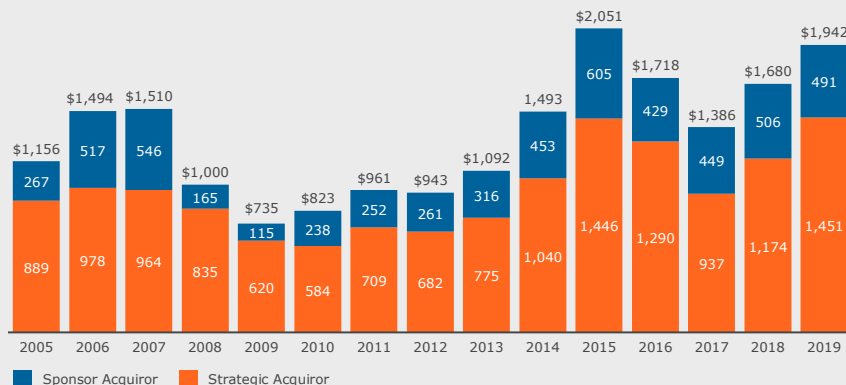


KEY TAKEAWAYS

- ▶ Record level of "dry powder" - \$1.4T - held by investment funds
- ▶ Strong growth in M&A activity over the last 3 years with ~25% sponsor based and 75% strategic

Strategic and Sponsor M&A Activity

\$ in Billion



POSITIVE MOMENTUM [AT A DISCOUNT]

Completed Transactions



\$100B

COMBINED MARKET CAP



\$42B

COMBINED MARKET CAP



\$17B

ACQUISITION

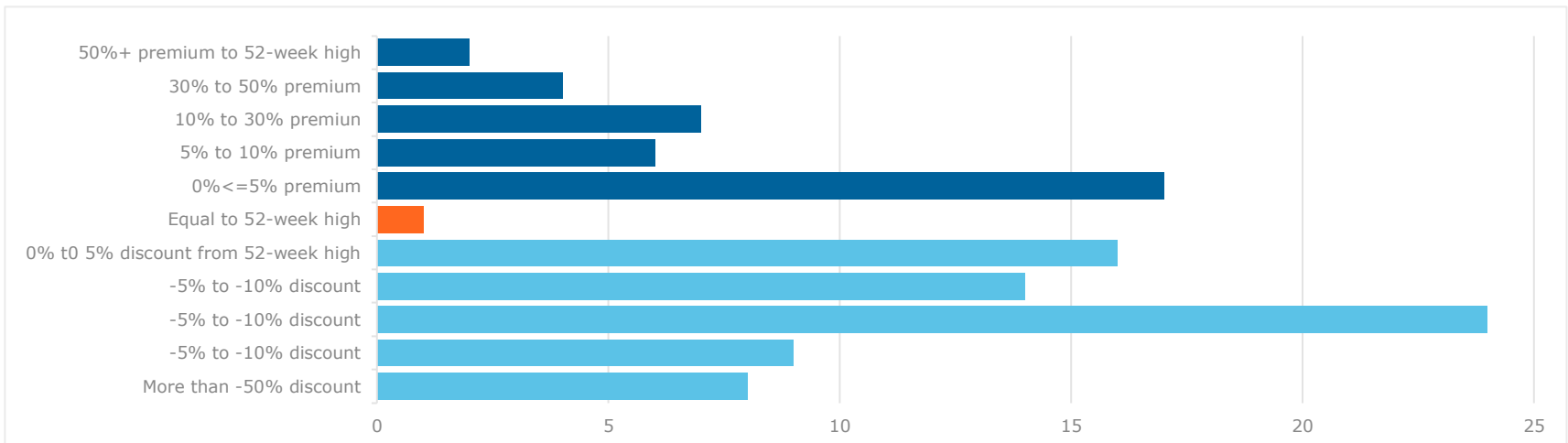


\$7B

ACQUISITION




In the last 12 months, more than 60 percent of U.S. companies acquired at a valuation of more than \$100 million agreed to deals that priced their **shares at or above a discount of no more than 10% to their 52-week high**




OPTIMISM FOR 2H 2020


Depending on the timing and sequencing of reopening the global economy, **pent-up demand and massive accumulations of undeployed capital** will increase activity as we emerge from the crisis



Although demand for strategic acquisitions may ebb, much of that **deal flow may be replaced with divestitures**, secondary seed rounds and other investment vehicles



Even in stable macro conditions, between **70 and 90% of mergers and acquisitions fail to realize the investment thesis goals**; given current climate, comprehensive integrated diligence and robust stand-up or integration planning is critical



Polling Question #2

How have the prevailing macroeconomic conditions impacted your Company's deal appetite?

- A. Delayed or renegotiated deals in progress
- B. Extended due diligence on existing deals
- C. Pause in active pursuits to preserve liquidity
- D. No impact
- E. Prefer not to disclose





STRATEGY AND DEAL EXECUTION

KEY FACTORS DRIVING CARVE-OUTS

Carve-outs can be a key tool for businesses dealing with the challenges presented by COVID



RENEWED FOCUS ON
CORE BUSINESS



CONCERNS ABOUT
UNDER-PERFORMING
DIVISIONS



COMPANIES SEEKING
WAYS TO OBTAIN
LIQUIDITY



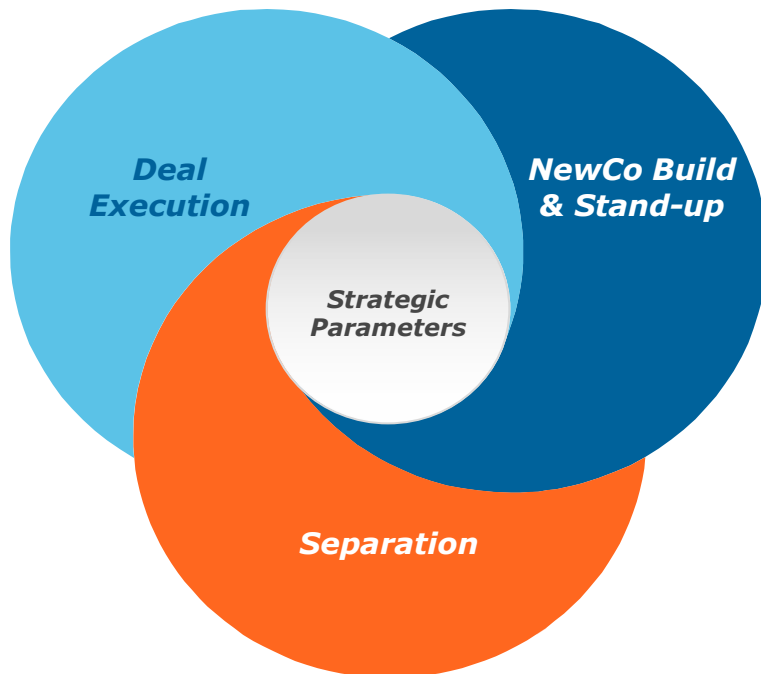
THE SUM OF THE PARTS
ARE GREATER THAN
THE WHOLE



STRATEGIC PRIORITIES DRIVE VALUE IN A CARVE-OUT

Strategic parameters

- ▶ Value vs. speed
- ▶ Stakeholder interests
- ▶ Don't disturb ongoing, core business
- ▶ Market conditions



Deal execution

- ▶ Define the transaction perimeter of NewCo and maintain optionality for changes in deal structure
- ▶ Deal financial information (e.g., QoE)
- ▶ Structure for the transaction

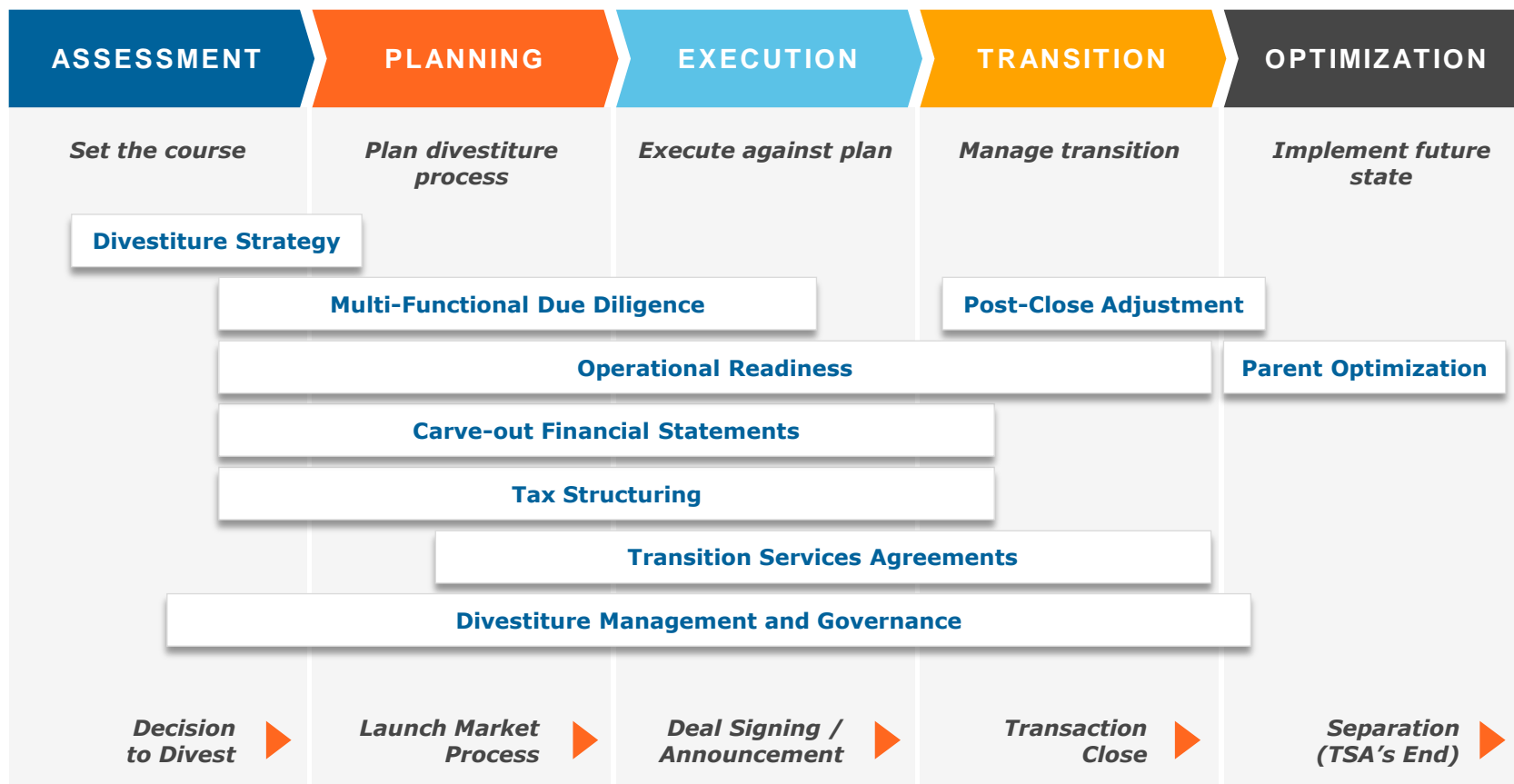
Separation

- ▶ Inventory and separate operations (e.g., TSAs, legal entities, tax matters, etc.)
- ▶ Define one-time transformation costs
- ▶ Optimize Parent operating model & cost structure (e.g., stranded costs)

NewCo build & stand-up

- ▶ Design NewCo operating model & cost structure
- ▶ Design NewCo governance
- ▶ Set & transition TSA services from Parent
- ▶ Plan for building new capabilities and services that are required for growth

MANAGING THE DIVESTITURE PROCESS



DIVESTITURES AND TAXES – VALUE PRESERVATION OR EROSION?

Key Tax Considerations to Preserve Value

1. Sell-Side planning, risk mitigation and maximizing opportunities.
 - ▶ Identifying imbedded tax risks in advance of the acquiror and either quantifying the risks or taking steps to mitigate
 - ▶ Harvesting tax opportunities which could be lost post-transaction (i.e., NOLs, tax credits, tax incentives, etc.)
2. Pre-sale structuring and maintaining flexibility.
 - ▶ Determining the optimal divestiture structure for purposes of the seller while maintaining flexibility to adapt to often competing priorities of the acquiror
3. Unintended tax consequences of post-sale operating model and/or structure.
 - ▶ Analyzing and modeling the post-transaction structure and financial projections of both parties to determine changes to tax footprint and posture
 - ▶ Considering operating model changes within each organization particularly as they related to the finance and tax functions

Polling Question #3

Which alternative investment structures has your company considered to preserve growth momentum while conserving capital?

- A. Special purpose entities
- B. Carve-out
- C. Joint venture
- D. Licensing arrangements
- E. None
- F. Prefer not to disclose





CARVE-OUT FINANCIAL STATEMENTS

WHEN GAAP CARVE-OUT FINANCIAL STATEMENTS ARE REQUIRED

The different uses of carve-out financial statements depend largely on the transaction.

PUBLIC COMPANY	NON-PUBLIC COMPANY	FINANCIAL
3-05 Financial Statements (1 – 2 years)	Based on financing (0 - 2 years)	IPO, 144A (2 – 5 years)

- ▶ A carve-out audit (for 1-2 fiscal years) may be **required** if.....
 - ▶ the ultimate acquirer is a public company, and
 - ▶ the transaction is deemed to be **'significant'** to the acquirer
 - ▶ new rules on significance are in effect
- ▶ A carve-out audit or review may be strongly **requested** by.....
 - ▶ (a) an acquirer for **additional comfort** around the historical results and balances, and/or
 - ▶ (b) an acquirer's lenders in order to provide **debt financing** (typically 1-2 years).

GAAP CARVE-FS COMPLEXITIES

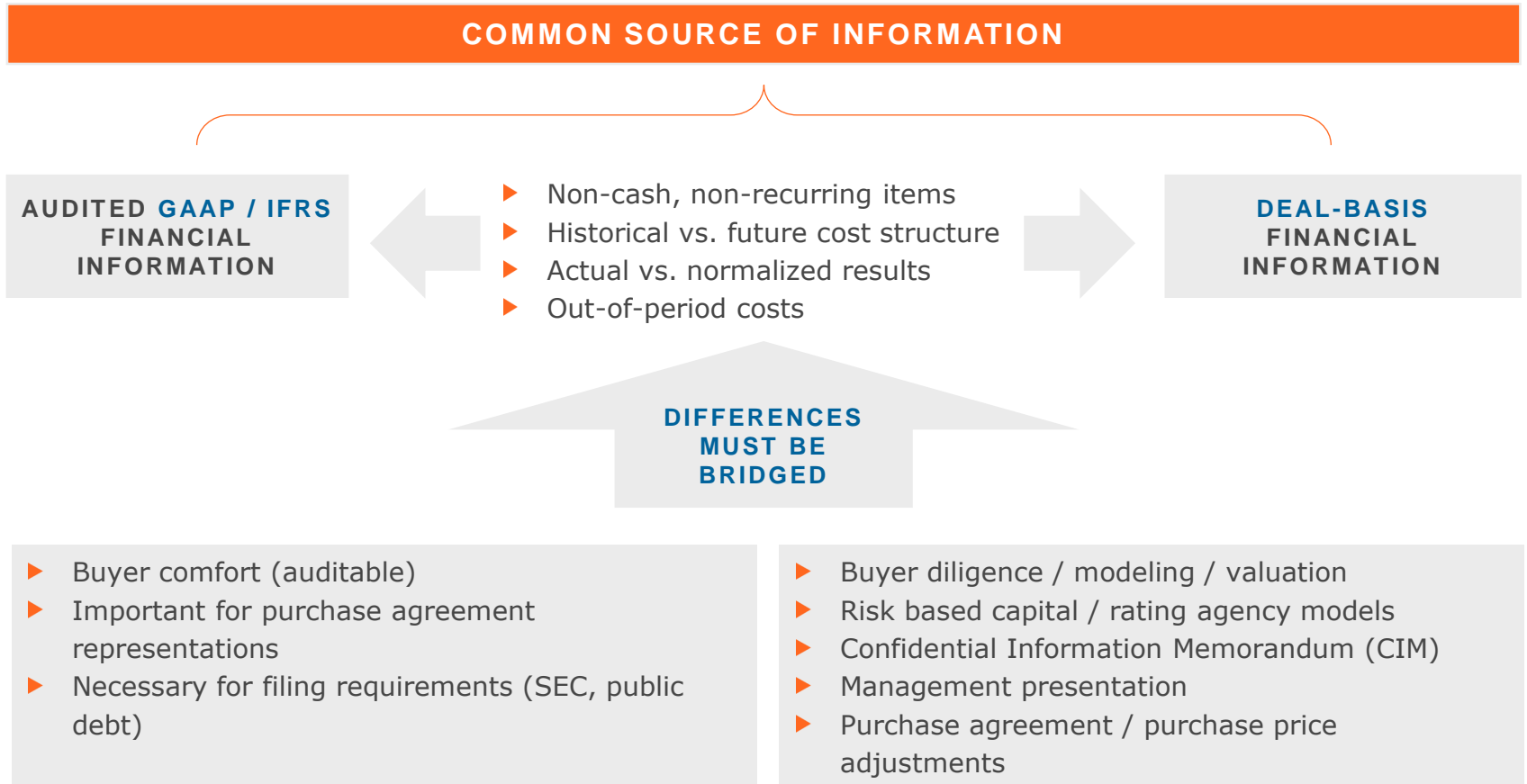
ENVIRONMENTAL COMPLEXITY

- ▶ **LE structure**
 - ▶ Shared vs. dedicated
 - ▶ “True” carve-out vs. extraction
 - ▶ Ability to leverage cost centers?
- ▶ **Global footprint**
 - ▶ # of countries/ local capabilities and/or bandwidth
- ▶ **Audit landscape**
 - ▶ What stat audits have been performed that can be leveraged?
- ▶ **ERP environment**

ACCOUNT LEVEL COMPLEXITY

- ▶ **Basis of presentation:** What’s in/out?
- ▶ **Comingled assets and liabilities:** Stock takes and rollbacks
- ▶ **Goodwill:** Stand-alone testing
- ▶ **Net Parent Investment:** Assets/liabilities outside of the business’s LE structure (intangibles?)
- ▶ **Overhead allocations:** Several layers (Tier I HQ, GOF, Fairfield) + impact of internal reorganizations
- ▶ **Income taxes:** Separate return method
- ▶ **Intercompany:** Factoring, cash pooling
- ▶ **Materiality:** Separately assessed

COORDINATED EFFORT TO BRIDGE BETWEEN GAAP AND DEAL BASIS FINANCIAL INFORMATION



Polling Question #4

What have your challenges been in executing a divestiture?

- A. Insufficient planning
- B. Poor synergy capture
- C. Change management
- D. Lack of communication
- E. Other
- F. N/A





SEPARATION ACTIVITIES

LEADING PRACTICES AND CONSIDERATIONS



1

MAXIMIZING DEAL VALUE

- ▶ Identify sources of lost value and mitigate risks
- ▶ Maximizing deal value by managing costs and entanglements
- ▶ Establish a Project Management Office, functional and cross-functional workstreams



2

MANAGING HUMAN CAPITAL

- ▶ Manage employee costs and liabilities
- ▶ Maintain business operations
- ▶ Enable a smooth transition
- ▶ Retain key talent and drive the right behaviors throughout the organization



3

LEGAL, COMMERCIAL AND OPERATIONAL CONSIDERATIONS

- ▶ Legal
- ▶ Commercial
- ▶ Finance & IT
- ▶ Supply Chain & Operations



MAXIMIZING DEAL VALUE

RUN-RATE COSTS	Post deal costs on a stand-alone basis excluding one-time costs
ALLOCATIONS AND REPLACEMENT COSTS	Corporate allocations and services need to be replaced and how
SEPARATION COSTS (ONE-TIME)	Costs to segregate the business from the remaining operations
TRANSITION SERVICES AGREEMENT (TSA) COSTS	Cost to provide temporary functions needed by the buyer
STRANDED COSTS	Costs that cannot be conveyed to the buyer / divestiture entity which remain with parent, negatively impacting seller operating margin
CONTRACT MANAGEMENT	Change in customer and vendor volumes negatively impact unit pricing
PURCHASE AGREEMENTS	Change in customer and vendor volumes negatively impact unit pricing



MANAGING HUMAN CAPITAL

MANAGE EMPLOYEE COSTS AND LIABILITIES	MAINTAIN BUSINESS OPERATIONS	ENABLE A SMOOTH TRANSITION	RETAIN KEY TALENT AND DRIVE BEHAVIORS ACROSS THE BUSINESS
<ul style="list-style-type: none"> ▶ Understand true stand-alone costs and liabilities related to in-scope employees to be transferred rather than corporate cost allocation ▶ Treatment of equity grants and tax / accounting implications of replacement programs ▶ Ensure balance sheet accurately reflects true nature of financial obligations (pensions, bonuses, PTO, vacation, CBAs) ▶ Failure to budget for concessions that may be triggered by transactions (e.g. employee transfer related severance) 	<ul style="list-style-type: none"> ▶ Avoid underestimating TSA support requirements and your limitations ▶ Develop a solid labor relations strategy and discipline around executing labor union and work council consultations ▶ Establish a plan or process for managing retention, transfers, and redundancies ▶ Strategically realign and design relevant functions to reflect the new reality 	<ul style="list-style-type: none"> ▶ Understand the state of labor relations ▶ Understand legal requirements, regulatory aspects and implications in each jurisdiction ▶ Understand the sequence of HR activities and inter-dependencies ▶ Execute the deal with the right resources (HR, legal counsel, etc.) an manage dependencies ▶ Establish a common approach to knowledge transfer and workforce transition 	<ul style="list-style-type: none"> ▶ Identify in-scope employees early and have a plan in place to ensure employee performance and productivity is not disrupted ▶ Communicate effectively with employees and ensure retention of key talent ▶ Proactively manage and address employee concerns ▶ Ensure leadership and managers understand their role in the divestment, employee engagement and retention



LEGAL, COMMERCIAL, AND OPERATIONAL CONSIDERATIONS

FUNCTION	WHAT TO PLAN FOR
LEGAL ENTITY	<ul style="list-style-type: none"> ▶ Establishing expected separation timelines ▶ Aligning country operating models with the buyer ▶ Coordinating efforts between cross-functional, global teams ▶ Synchronizing legal entity separation and required name change activities
COMMERCIAL	<ul style="list-style-type: none"> ▶ Marketing / brand considerations ▶ Customer transition – communications, contracts, service levels ▶ Sales & customer care – support and transition
FINANCE	<ul style="list-style-type: none"> ▶ Interim and end-state operating models including identification of day-one requirements ▶ Review of go-forward processes, work volumes and staffing requirements ▶ End state finance organizational structure, skillsets and budget
IT	<ul style="list-style-type: none"> ▶ Day-one disposition and license requirements; ownership of proprietary systems ▶ Access to historical financial data ▶ Ownership of physical assets, day-one ▶ Timelines for managing intermediate employee moves and day-one transfers
SUPPLY CHAIN/ OPERATIONS	<ul style="list-style-type: none"> ▶ Supplier transition – contracts, purchase orders; volume and discount implications ▶ Separation of 'shared' resources – procurement, demand planning, logistics ▶ Segregation of physical resources – plants, warehouses, offices
TRANSITION SERVICE AGREEMENTS	<ul style="list-style-type: none"> ▶ Scope, costs and level of resources required to support TSAs ▶ Billing, payment and escalation processes ▶ Alignment with yearly budget process for ParentCo and NewCo



Q&A

ADDITIONAL RESOURCES

Related Thought Leadership

[Navigating M&A During Macro Uncertainty](#)

View additional insights [HERE](#)

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