Article 6 of 6 of The Race to Recapitalise
Disposals – how to take control and avoid the fire sale

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Danny A. Davis has more than 20 years' experience in M&A integration and carve outs, having planned and run both small and large transactions of up to £6bn in deal size. He is a guest speaker at London Business School, has been on the Experts Panel of the Chartered Management Institute, and literally wrote the book on "M&A Integration: How To Do It". We are grateful to Danny for co-authoring this article.

The Race to Recapitalise has started, and companies are determining how their financing and corporate structures may have to change, to address the long-term impact of the crisis. In our series of articles on the "Race to Recapitalise" we are illustrating some of the key issues to consider to win the Race.

Many companies are considering non-core disposals as part of their response. However, the risk of the vendor being viewed as a distressed seller will be elevated, particularly if the company already has listed securities and may therefore have to keep the market updated on their current situation. In this article, we discuss the key internal execution factors that will allow the vendor to take control of the disposal process to maximise the likely valuation, while also retaining maximum benefit within the core group.

1. Prepping for Sale – internally confidential or not?

The first execution choice will be whether to announce the carveout process internally. Having the spinoff management team aware of the likely separation, could make the process simpler to execute especially if there are complex untangling decisions or major costs to be incurred. However, this could also distract management, staff and even clients, which might impact EBITDA and therefore realised valuation.

One useful test to consider is whether the knowing – or not knowing – will impact the pathway to cost reduction. Will the decision make the process more expensive, either in incurred costs or in rolling out cost reduction plans?

This decision could be even more important if the seller has decided to sell several assets, and will need to consider how to avoid being perceived as a distressed seller.

2. Defining the perimeter – assets, people, customers, IP

Like a car, the asset should be "Sold as Seen". Bidders need to see exactly what is on offer from legal, operational, and asset viewpoints. These cannot be changed halfway through the process without cost. The sale preparation should therefore start with a dispassionate view on what is strictly necessary to maximising valuation – or put another way, a clear look at what will put the asset in the best light and therefore get the best price.

Decide up front on what assets, people, customers, or even shared business initiatives should be shown in the perimeter. This sounds easy – however even in relatively small groups, there are decisions to be made on the tradeoffs. Are the current management team the right team to lead the business through a sale process and into new ownership? Are some employees internally seconded? What about graduate schemes?

Decide early on the split of material data, customers, accounts, and products, especially if a major customer is internal. If it's external, does it belong to the parent, or to the spinoff? If it's internal, Is the relationship at arm's length? These decisions affect EBITDA so are not just operational questions. A good discipline may be understanding the split of revenue generation, and how this affects buyer and seller motivation. Be prepared to reflect this with reciprocal agreements in the SPA or other documents.

Central functions may need to be duplicated, where they cannot be provided at arm's length (perhaps during a transition period). This may cause the seller to revisit the question of which people to include in the perimeter. And if financing relies on an explicit or implied parent guarantee, will the separation process increase funding costs on a standalone basis and what might this imply for buyers?

3. What is "Business As Usual" expense?

Once a decision to sell has been taken, the seller should reduce all costs that aren't essential to that asset or the sale. Consider planned capex which may no longer be required, as it is driven by parent company requirements (e.g. freeze on new IT spend, halting of new reporting systems rollout).

At the same time, there could be additional costs and programmes involved in getting ready for the separation. Can these be planned into a normal capex cycle? This could help with the decision in 1. above, of whether to keep the sale confidential.

It is also worth considering the positive advantages of splitting the business decisions between parent and asset. For instance, can the revenue of the asset be improved, perhaps by increasing the sales budget in the runup to sale, which will pay for itself in multiples of generated EBITDA?

4. Consider implications for the remaining business units

A separation is not a standalone decision. The remaining business units could also be impacted and existing incentive structures distorted. For instance, are certain group fixed costs shared across business units by headcount? Could the sale have the perverse effect of *reducing* margin for the remaining businesses by increasing the per-head costs of employees? Might this then make the management team of that business reduce key operational spending such as marketing, so they can continue to meet expected budget?

5. Tailoring a great separation plan for the likely buyers

Maximising the value of a sale doesn't stop at closing. If the asset is well prepared the asset to be integrated and/or refinanced, the valuation that a bidder will pay could be increased.

In thinking about the separation plans and implementation, the seller should take into account the different buyers and what they might want to do with the newly acquired business. A management team that can clearly communicate a good separation plan to each type of buyer, or at least a good person to work with them, will create a more appealing business for bidders.

6. Put yourself in the bidder's shoes

Think through what a buyer wants to achieve with the business *after the sale*. Maintain a view on the competitive landscape and what this implies for the sale valuation. Synergies are more than a headline – they impact the price that a bidder will be willing to pay. In plain English, could a particular bidder use the asset as the core management/systems/IP to unlock value from the rest of its business? Knowing that, will realise a higher valuation than a vanilla bolt-on sale.

[Watch the video accompanying this article here]

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About The Deal Team and the Race to Recapitalise series

The Deal Team is the first professional transaction manager for public equity and debt capital markets transactions and M&A, providing dedicated Deal Captains to project manage transactions within existing management teams. Based in London and working across Europe, we know how to maximise the speed and efficiency of execution for deals such as rights issues, high yield bonds, and M&A disposals, among others.

In 2Q 2020, we have published weekly articles on the internal execution steps a company should consider in order to win the Race to Recapitalise. This is the final article in the series:

1. The key lessons of crisis management
2. Getting to an answer fast: Financials and Forecasting
3. Tapping your shareholders: Rights issues best practice
4. Managing the details: best practices for due diligence and data room management
5. Preparing for the first listed bond
6. *Disposals – how to take control and avoid the fire sale*

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