

## **Streamlining your acquisition through strategic divestitures**

An acquisition may be the foundation of your company's strategic growth strategy. So the last thing you're probably thinking about is selling off your newly acquired assets. That could be a mistake.

Sloughing units, product lines or divisions that underperform, deviate from your core goals or demand too much management time or financial resources may be the most profitable decision you make. To maximize the value of your M&A deal, start thinking about what you can sell before you even complete the initial purchase.

### **Making a dent**

The benefits of making divestitures may not be obvious at first. But financial models that evaluate the future impact of the sale on your company's revenue, product mix, gross profit margins, selling costs and overhead can help you better visualize them.

While it's easy to identify the forgone sales and direct cost reductions that will result from the divestiture, it may be more difficult to fully calculate the amount of overhead that will be saved. The sale of a unit, for example, may increase other units' overhead. Your financial model must also consider contingent receipts such as your original seller's earnout payments — deferred payments that are contingent on the company achieving certain milestones.

### **Foreseeing challenges**

In addition to assessing possible benefits, it's important to consider potential challenges a divestiture could raise. For example, you need to understand the supply chain and sales channel of your ongoing business and the division being sold. If the divested operation is a significant link to your supply or distribution chain — either because you continue to use it as a source or because it remains a distribution channel for other products — conflicts are more likely to arise after the transaction is complete. Further, if important intellectual property is used in the divested business, you may need to negotiate complicated licensing arrangements to close the deal.

If you're selling a troubled unit, you face particular challenges. To mitigate risk, a buyer may stipulate as part of the deal that you retain an equity stake in it or provide partial financing. This has advantages and disadvantages: If your underperforming division produces better results for a more efficient owner, you get to participate in its success. But, if it remains troubled, it may become a drag on your balance sheet.

### **Preparing for the sale**

To successfully accomplish your divestitures, start by assembling timelines, lists of likely buyers and a team of M&A professionals to assist you. You'll also need to communicate your plans to employees. The news of a divestiture can be especially sensitive, as many

employees will already be reeling from the idea of the merger — let alone an additional sale. Consider which employees you'd like to retain and offer incentives to keep them in place.

When selling a unit, you'll need to create a carve-out statement — a discrete set of financial statements for the division you are divesting when it has no separate historical financial statements. Identifying sales and direct costs is usually easy, but allocating overhead costs that involve marketing, accounting, information services and human resources means making some judgment calls. This process is usually necessary, however, because buyers require carve-out statements to value the entity.

### **Staying involved — or not**

Sometimes, sellers sever all ties with the unit after the divestiture is complete. In many cases, however, sellers retain some involvement in the divested division, such as by handling routine administrative functions during the transition stage or through:

- Complex sublease arrangements,
- Seller financing,
- Retained equity stakes, and
- Royalties due from licensing or service commitments.

Post-transaction seller involvement often depends on whether the buyer is strategic or financial. Financial buyers may plan to use the acquisition as a platform for entering a new industry and require a service contract from the seller to perform certain administrative activities for a time.

Strategic buyers, on the other hand, may be less likely to require transitional support or ongoing service arrangements. These buyers typically try to integrate their acquisition's operations with their own as quickly as possible to capture business synergies.

### **Consider strategic goals**

The best time to think about selling unwanted business units is when you're still evaluating a potential acquisition. Review your target company's assets in relation to your strategic business plan. If they don't all fit, divesting your company of these units can make it a leaner, meaner, more competitive machine.