MorganFranklin
CONSULTING

8 STEPS TO SURVIVING A CARVE-OUT

A Guidebook For Your Next Complex Transformation

While the major steps may seem straightforward, complexities will arise. Be ready.

Is your organization considering a carve-out?

Engaging an experienced divestiture partner from inception to completion can help navigate the convoluted intricacies of successfully carving out a subsidiary, product, or service line.

Short- and long-term success hinge on understanding the desired future-state relationship between the separate entities and any ongoing involvement in the carved-out subsidiary's future operations. Focusing on the key carve-out considerations early in the overall transaction process will guide the structure of the transaction and mitigate post-transaction complications.

Divestitures Strategy

Spinning off or selling a business unit, product, or service line can provide cash, improve earnings stability, and increase your focus on key assets.

Experienced and thoughtful evaluation is a critical step toward knowing whether this strategy will provide the best path to value. A comprehensive portfolio assessment process is necessary to evaluate your entire portfolio of business lines against both strategic importance and current performance relative to the competition.

By objectively reviewing and ranking each business line, you will understand their competitive position, as well as the

COMMON COMPLICATIONS TO CONSIDER

Based on our experience helping clients, we summarize frequent challenges and related solutions to help you achieve carve-out success.

CONFLICTING VISIONS

Post-transaction, different parties will be vying to achieve their individual objectives. By clearly defining the transaction vision and structure, any ambiguity can quickly be cleared to secure an optimal result.

INTERTWINED & COMPLEX CONNECTIONS

Following years of ERP efforts, companies are more interconnected than ever. The interrelated activities blur the performance of individual entities potentially impacting the profitability determination and more importantly profit sustainability. In addition to impacts on profitability, process and systems should be considered.

HAMPERED BUSINESS OPERATIONS

Due to the time commitment related to carve-outs, in addition to the company-wide dedication required for a smooth transaction, the normal day-to-day operation of the business may be negatively impacted. Staffing appropriately will help each business maintain focus on its routine activities.

CARVE-OUT & DEAL FINANCIAL STATEMENTS

Sellers should use a model to aggregate historical data, prepare financial statements, and facilitate diligence & potentially an audit. Direct and indirect costs must be reflected in the historical carve-out financials. The deal terms do not dictate accounting treatment. Insufficient planning and preparation can lead to delays.

shareholder value impact of potential actions for each business. Business lines that don't align with core strategies may deserve a closer look. Even if your company isn't actively considering a deal, this assessment can reveal a potential divestiture opportunity.

How to Survive a Carve-Out

1 DEFINE THE VISION

Clearly define the transaction structure to guide the necessary strategic planning for ultimate execution. Be sure to define the vision in a way that maintains the ability to govern and potentially change the structure as constraints or obstacles arise during the transaction life cycle. Establish escalation procedures as well as a governance team that can assemble quickly and make decisions regarding the transaction structure. The initial vision will likely change as the transaction process matures—and effective decision makers and expedited turnaround times will prevent delays in execution.

> MorganFranklin provides hands-on expertise to successfully formulate and execute your carve-out strategy. We add value by leveraging our collective experience to help clients through complex transactions.

2 UNDERSTAND THE BUSINESS MODEL

Assessing the current-state business model and developing a clear vision of the future state will dictate how the parent company should monetize the subsidiary and validate the viability of the approach. Determine if the profitability of each entity is realistic and, more importantly, sustainable under the proposed transaction structure. Where concerns arise, consider revising the go-to-market approach and, potentially, the transaction structure.

3 BUILD TEAM & ESTABLISH TIMELINE

Successful carve-outs take time. Build the carve-out team with individuals who can focus on the carve-out plan and execution without hindering day-to-day operations. Preparing the business for the transaction is a collaborative effort spanning the entire organization. Prepare and execute non-disclosure agreements (NDAs) for the carve-out team, and scale the team based on the organization's size and the complexity of existing integrations. Identify milestones and leave ample time for execution.

- Leave time to shop. Look for interested buyers if selling, or banks if going public or auctioning.
- Build an advisory team that includes management consultants, legal advisors, investment bankers, tax attorneys, etc.
- Develop business and key resource retention strategies and leadership plans.

4 ASSESS FUTURE-STATE OPERATIONS

Model how the parent and divested businesses will operate and implement optimization plans post-separation. Examine the various integration points between the individual businesses as they operate together instead of independently. Determining the level of integration from both a process and system perspective is critical for developing any temporary or ongoing agreements and, ultimately, the timeline to reach Day 1. Assess stand-alone, one-time, and stranded costs and provide scenarios that increase the value of the carve-out business and reduce transaction and restructuring costs. Provide functional expertise to enable enterprise-wide tactical execution of transition requirements and long-term separation plans.

- Think through all business functions and how they will operate post-transaction.
- Determine back-office organizational structures for the parent and carved-out entity—who will be staying and going—to decide if there are adequate resources to execute shared services.
- Think through facilities, fixed assets, contracts, and systems across the companies.

5 EVALUATE FINANCIAL STATEMENT REQUIREMENTS OF EACH ENTITY

The carve-out team is in place, a timeline has been established, and separation of the business processes has been initiated. Now it is time to address the historical and deal-basis financial statement needs. Preparing financial information for the business to be divested is one of the most complex issues in the execution of a sale or spin-off. Carve-out GAAP financial statements typically reflects the historical operations of the carve-out entity and all costs of doing business as if the carve-out entity operated on a stand-alone basis. These carve-out GAAP financial statements may be used for an SEC filing, to satisfy financing requirements of the buyer, or to provide additional comfort to the buyer. Deal basis financial statements and other diligence materials should reflect the business operations being divested, which may be different than the historical operations of the carve-out entity. These are critical documents to support an IPO, spin-off, or sale transaction.

6 DEVELOP A 90-DAY CHECKLIST

Legal Day 1 is rapidly approaching. Processes and integration are unwinding as desired, pro forma financial statements are under a microscope, and investors are swarming (hopefully)—but will everything be ready for Day 1? Gather the carve-out team leaders, consultants, and advisory team and prioritize what is critical for Day 1 separation vs. what can be solidified 30 or 90 days after separating before the first required reporting and disclosure cycle. Develop a comprehensive and customized communications plan for different constituents (e.g., employees, vendors/suppliers, customers, and other stakeholder groups), and plan on initiating legally necessary communications prior to transaction execution. While cost reduction opportunities and other optimization efforts may be identified (and even executed), maintain a clear focus on Day 1 readiness.

7 PLAN FOR OPTIMIZATION

As the carve-out team continues to push toward Legal Day 1, future-state optimization planning should begin. The team has detailed current-state processes, captured system architecture, and isolated financials. Leveraging all these artifacts, begin a comprehensive assessment of the business and identify opportunities to automate procedures and streamline business processes. While identifying all licensing and other agreements, consider if it is time to renegotiate. After reviewing numerous reports surrounding financials and operations, determine the level of satisfaction with existing reporting capabilities. Revisit the business model and build new strategic roadmaps. Reflect on the underlying systems and the data received for planning the carve-out. Was it enough? What is the level of confidence in data accuracy? Can the control procedures across the firm be trusted? A carve-out may be just the thing the organization needs to refocus on streamlining future operations.

8 LOOK BACK

Now that the transaction has ended and operations have returned to business as usual, did the transaction meet the desired objectives? This may not be the organization's last transaction, so discussing lessons learned and modifying the playbook are key to ensuring course correction and the success of future transactions.

MorganFranklin Takes Strategy to Execution

STRATEGY

- Facilitate development of a comprehensive carve-out plan and roadmap with milestones and interdependencies.
- Define the end-state for both companies and create and facilitate processes to execute transition service agreements (TSAs).
- Identify cost-reduction opportunities and align the business with new strategies.
- Document and evaluate the design effectiveness of end-to-end processes.
- Identify unmitigated risks and recommend controls.
- Establish a Divestiture Management Office (DMO).

ENABLEMENT

- Prepare deal-basis financial statements.
- Perform financial and operational diligence.
- Develop TSAs and detailed delivery over execution against shared resources.
- Map technology resources against performance of post-separation activities.
- Design and implement systems to perform all required activities for both businesses.

EXECUTION

- Prepare GAAP financial statements.
- Support stakeholder communications to reduce uncertainty and plan a retention strategy.
- Execute change management to reduce the learning curve for post-separation business activities.
- Perform separation efforts in alignment with contractual agreements (e.g., TSAs, software licenses, and unique deal terms).
- Evaluate risks and implement controls for new processes.
- Remediate conflicts of interest and proper segregation of duties. ■

Questions? Contact carve-out@morganfranklin.com.

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