EXECUTIVE INTERIM PARTNERS

WHEN FAILURE IS NOT AN OPTION

EIP INTERIM NEWS

Boosting Corporate Value Through Professional Carve-Out Management

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Boosting corporate value through professional carve-out management: The Interim executive as an experienced conductor in complex carve-out transactions

"Companies often revert to carve-outs to improve their competitive position and boost company value. While carve-outs are not the most glamorous corporate transactions, they are among the most complex. Yet, masterfully prepared and executed, they increase the value of the parent and the divested company. EIP interim managers focus solely on creating value and possess all skills to lead carve-outs to success."

Markus Nicolaus, Partner, Executive Interim Partners GmbH

The number of carve-outs and similar divestments is expected to increase in 2021

M&A experts anticipate that numerous corporations, forced or motivated by the Corona crisis's economic impact, will put their business model and portfolios to the test in the coming months. The private equity community shares this assessment, which is why 75% of the panel participants in the FINANCE Private Equity Panel Q2/2020 see excellent investment opportunities in carved-out assets for 2021[1)]. In Europe, record dry powder held by private equity funds is forecasted to boost carve-out activity in 2021. The finance information service PitchBook also expects carve-out activity to pick up quickly this year as public and private companies seek to offload non-performing assets to raise liquidity amid the pandemic turmoil[2)]. US companies are facing a similar situation, which can put more pressure on them to sell non-core assets[3)]. As desired, these carve-outs will serve to generate capital from assets to compensate for the falling cash flows from the decline in sales in the recent months and in particular, to increase corporate values.

Exhibit 1 – publicly announced corporate carve-out and divestment plans

Company	Details	Timeline
TechnipFMC plc	Ongoing spin of majority stake in Technip Energies	Q1/2021
SAP SE	Divestment of sales and market research software Qualtrics ongoing	Q1/2021
IAC/InterActiveCorp.	Approved plan to spin off video software company Vimeo	Q2/2021
Merck & Co., Inc.	Spin of women's health, legacy brands and biosimilars	H1/2021
IBM Corp.	Announced to spin-off of managed infrastructure services	Q4/2021
Bausch Health Inc.	Announced intention to spin off eye health business	H2/2021
Sanofi S.A.	Announced to spin off pharmaceutical ingredients business	2022
Continental AG	Delayed spin of powertrain business Vitesco Technologies	Uncertain
Thyssenkrupp AG	Considers to divest of troubled steel business	Uncertain
adidas AG	Currently exploring sale of Reebok brand, decision by end of Q1/2021	Uncertain

Source: http://thezenofinvesting.com; www.stockspinoffs.com; Financial Times; company websites

A primary objective of a carve-out is to increase a company's value

Carve-outs, spin-offs and split-offs are different transactions that companies typically use to divest of certain assets such as business units, subsidiaries and other company parts. The objective of these transactions is usually to increase the enterprise value of the parent corporation and the carved-out company.

In a **carve-out** event, the parent company sells the asset either directly to a strategic investor or financial investor or indirectly to several investors as part of an IPO. Through the sale the investors become new (co-)owners of the carved-out company. Simultaneously, the parent company receives additional financial resources, often one of the primary motivations for this transaction.

In the case of a **spin-off**, a listed parent company distributes the shares in a spun-off subsidiary proportionally to its previous shareholders in the form of a special dividend. After the spin-off, the shareholders hold the shares of two separate companies. However, the parent company does not receive any cash from the spin-off. The same applies to the **split-off**. The parent company shareholders have to decide whether to hold shares in the subsidiary or continue to keep those of the parent company.

Companies revert to carve-outs particularly to improve their financial position

The Corona crisis's economic impact forces many corporations to divest parts of the company by carve-out quickly. With the resulting capital inflow, they can improve their financial position and contribute to the company's survival. On the other hand, a study by Deloitte[4)] shows that under normal circumstances companies typically divest and sell parts of their company to:

1) focus on their core business
2) pursue a long-term growth strategy
3) react to significant market changes
4) address a shortage of adequate staff for further growth

They are thus more likely to focus on long-term strategic objectives to increase the company's value successfully. This also applies, if the funds derived from the carve-out are invested in the parent's company strategic growth and not just used for mere survival. Regardless of whether the carve-out intends to serve strategic development or improve its financial position, the company executive management asks how the carve-out will achieve a maximum cash inflow for the parent company.

Carefully prepared and executed carve-outs achieve higher sales prices

Carve-outs are incredibly complex transactions that require meticulous planning and excellent execution to be successful. The carve-out's professional preparation and implementation typically have a very positive effect on the targeted sales price.

The results of a survey of 150 executives who are regularly involved in corporate divestments show that in 85% of the cases the sales price achieved matched or even exceeded the seller's expectations[4)]. The particularly beneficial factors were:

1) sale by bidding procedure with several competing bidders
2) well-prepared and robust management of the parent company and the carve-out business
3) more significant synergies with the buyer than initially expected by the seller
4) no big surprises or deviations in the buyer due diligence
5) availability of reliable financial data and analyses on the business to be carved out

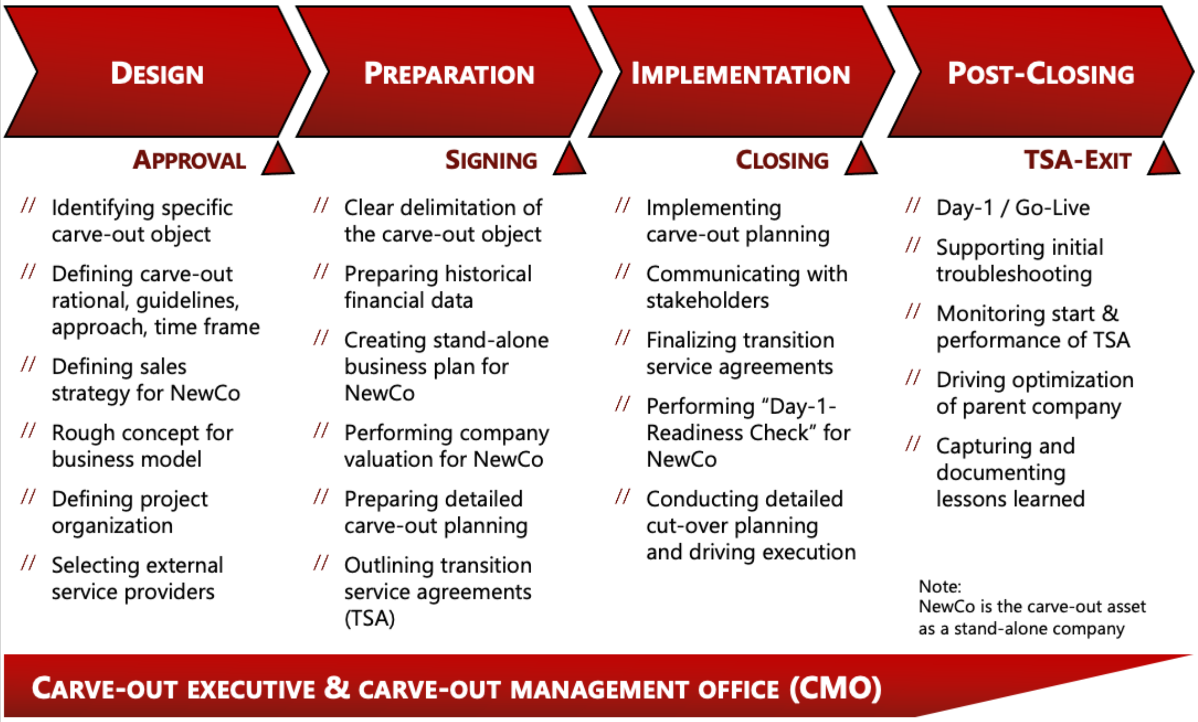
In particular, the scope and reliability of the information provided about the company's part considered for divestment and well-prepared management promote the confidence of potential buyers in the carve-out property's intrinsic and stable value. As a result, the potential buyers typically apply lower risk discounts on the enterprise value and the purchase price. These factors also promote trouble-free negotiations between buyers and sellers, which lead to a faster conclusion of a contract for the sale. For most corporations and their management, the sale of parts of the company is a unique situation. Executive leadership has to figure out how the intended carve-out can be carefully planned and professionally prepared to achieve a swift sale with the desired success.

Carve-outs are complex – in both planning and operational implementation

In principle, we can divide carve-outs into four phases (see exhibit 2: carve-out process).

1) In the **DESIGN PHASE**, the most critical parameters for the carve-out need to be determined and defined. Additionally, to identify the carve-out object (NewCo), the rationale for the planned divestiture and which carve-out approach (see Exhibit 3: carve-out approach) and timeframe the sale and the carve-out need to complete is defined. Furthermore, identifying potential buyers, the preferred sales strategy, and necessary project guidelines are defined. As another essential part of the design phase, the rough concept for the company's future business model and the appropriate transfer process (see Exhibit 4: transfer process) for NewCo are also defined. In addition to setting up a project organization, that is still lean at first, assigning responsibilities and selecting external service providers, it is recommended to appoint a carve-out executive manager and establish a dedicated carve-out management office (CMO). The carve-out executive works closely with the M&A team and instills his extensive operational carve-out experience across all phases of the entire carve-out transaction.

Exhibit 2 – carve-out process



2) In the **PREPARATION PHASE**, a multitude of activities takes place before potential buyers are contacted. The most critical tasks in preparing for a successful carve-out include:

a) clearly delimiting the carve-out asset

b) preparing financial reports & analyses

c) creating a stand-alone business plan

d) calculating NewCo's company value

e) creating a detailed carve-out plan

a) Delimiting the carve-out object: The parent company's management must have clarity as to what is to be carved out and sold in concrete terms. We can quickly identify it in the case of a subsidiary that operates 100% independently and with which there are no extensive operational, personnel, financial or legal links. It becomes challenging when there are close ties and dependencies between the parent company and the carve-out property. Often parts of the company use the same IT, HR, procurement, finance and controlling infrastructure as well as a variety of other resources from the central functions of the parent company. Usually, the same applies to real estate, patents, rights of use, suppliers, customers, service providers, employees, etc. For the clear definition of the company part planned to be carved out, it must be specified in detail what is part of the carve-out scope and what will remain with the parent company. Finally, the buyer also wants to know what he is acquiring by purchasing the carve-out object.

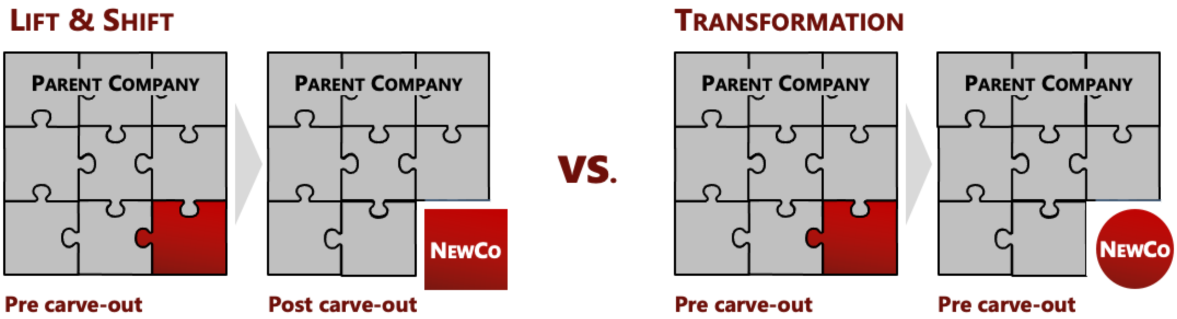
b) Financial reports and analyses: Regularly there are no or only insufficient financial data and reports available of the company part being divested. The same applies to financial analyses, which potential buyers urgently need to make their calculations on the company's profitability and enterprise value. This is due to the fact that the carve-out object is often not an independent business with corresponding reporting obligations. Furthermore, there are often allocations and intercompany settlements of the parent company for centrally provided services, which usually do not correspond to market prices. Comprehensive and reliable historical financial reports and analyses must be prepared with auditors and other consultants' help.

c) Stand-alone business planning: For a successful sale, a separate stand-alone business planning of the company's part to be carved out is indispensable. This should preferably be created with potential buyers in mind and consider potentials in the market, competitors, customers, suppliers and other synergies. Business planning must also reflect that there will no longer be any links and dependencies with the parent company in the future. Contrary to planning for purely internal purposes, a particular challenge is that potential buyers have high expectations regarding the stand-alone business planning reliability. If these expectations are not met, trust in the seller's credibility decreases, the sales process gets delayed and the sales price typically decreases. Against this background, the stand-alone business planning for the next three to five financial years becomes a highly complex challenge, which can often not be mastered without independent professional service providers' active support.

d) Company value: The business planning created is also used as a basis for valuation of the carve-out property from a seller's point of view. Using different scenarios and valuation methods such as discounted cash flows, EBITDA or sales multiples, etc. the carve-out property's value is usually calculated with the support of M&A consultants. For the first time, the parent company receives a well-founded indicator of a possible sales price for the carve-out property.

e) Detailed carve-out planning: With careful carve-out planning, the carve-outs property transfer from the current state to the future business model or the target state is mapped out. The aim is to eliminate any potential or existing ambiguities and create transparency on the operational procedure, the resources required, the costs incurred, the investments needed and the timeframe for the implementation of the carve-out. Also, business furthermore needs transition service agreements (TSA) during the transitional period until the complete decoupling from the parent company is completed.

Exhibit 3 – carve-out approach



Lift & Shift

- // Focus is on speed for a quick carve-out
- // Plain vanilla carve-out, as a realignment of the carve-out business will be carried out only after its separation from the parent company
- // Lower costs and personnel expenditure for the carve-out on the seller's side (parent company)
- // Realignment of the carved-out business after completion of the divestment drives higher initial costs for NewCo

Transformation

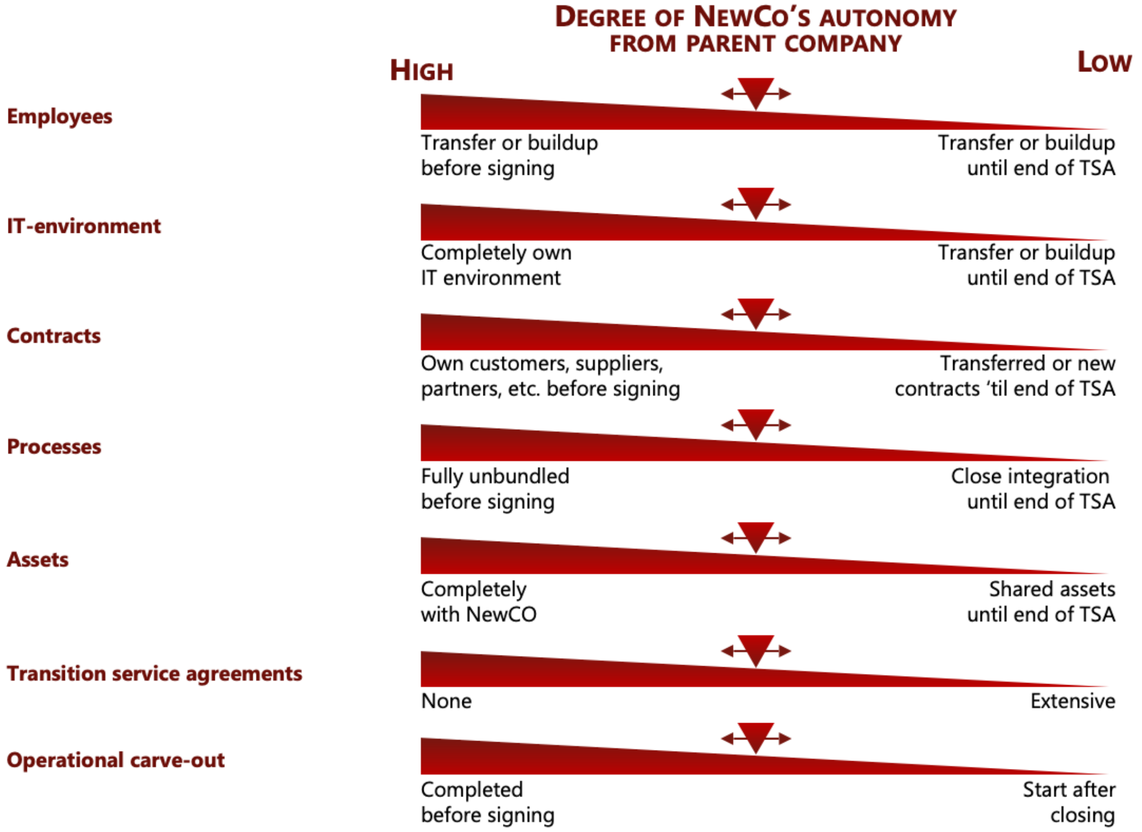
- // Using the opportunity to realign NewCo's business before or during the carve-out
- // Realignment of NewCo requires longer carve-out preparation and implementation timeframe
- // Realignment leads to higher costs and personnel expenditure for the seller (parent company)
- // NewCo does not have to bear any additional costs for its realignment after finalization of the carve-out

Before these measures and other preparatory activities for the operational carve-out, the project team must be named, the project organization to be set up and the necessary communication rules to be established. The carve-out executive is primarily responsible for these tasks getting hands-on support from the carve-out management office (CMO).

3) The **IMPLEMENTATION PHASE** begins with the conclusion of the contract (signing) between buyer and seller. This is when the operational implementation of the carve-out usually begins. In this phase, it is essential to implement all steps of the detailed carve-out planning. As a rule, all parent company employees and the company's part to be carve-out are informed about the sale and the carve-out at the time of signing. To keep the employees involved, and motivated, the messages concerning the sale and carve-out must be carefully prepared and communicated. Measures and incentives to secure high motivation of all performers involved are usually prepared and, if necessary, communicated already early in the carve-out preparation phase. Such measures should now also be considered for other employees depending on the situation. Transparent communication on the purpose and benefits of the carve-out and showing opportunities for future personal development and perspectives are significant important measures in this context.

If not already done during the preparation phase, the transition service agreements' content must be drawn up and negotiated in detail with the buyer. The parent company must take appropriate precautionary measures to effectively provide the agreed services after the operational carve-out has been completed.

Exhibit 4 – transfer process



In preparation for the final handover of the carve-out property, a "Day-1 Readiness Check" must be carried out well in advance. The check verifies whether all areas are adequately prepared for Day-1 or Go-Live. The review includes, among other things, all TSA, the necessary communication with suppliers, customers, service providers, public bodies, banks and other business partners as well as the testing of the IT infrastructure and applications. The "Day-1 Readiness Check" often brings up unexpected challenges that can usually still be eliminated due to sufficient lead time and with a focused approach.

The handover (cut-over) for Day-1 or Go-Live must be planned in detail. However, due to changing framework conditions, unexpectedly arising new challenges, eventualities and circumstances, necessary deviations from the original cut-over planning may occur. In such cases, quick and precise decisions on how to proceed are essential for carve-out success. This is where the carve-out executive proves his worth. He/She usually takes the necessary decisions himself promptly and, with the CMO's support, can also evaluate their effects on the entire carve-out.

4) The **POST-CLOSING PHASE** starts with Day-1 or Go-Live, with which the operational carve-out is mostly completed. The parent company essentially ends the project work after the carve-out transaction has been completed. However, for a short period following the completion, it is advisable to maintain access to the project team and have the CMO still available for coordinating activities. Experience has shown that unexpected challenges arise in the weeks after the Go-Live, which have to be mastered quickly in the sense of a "trouble-shooting". Here access to the carve-out executive, the CMO and the project team is usually beneficial. The carve-out executive and the CMO should also continue to be involved in the knowledge transfer to optimize the parent company's business and in monitoring the smooth start and the quality of the TSA provision.

Critical key factors for a successful carve-out

Carve-Outs are a veritable unique situation for companies. They demand skills, experience, and expertise from management and employees that go far beyond managing day-to-day business. Even minor discrepancies can lead to a loss of confidence among potential buyers and small delays can lead to the postponement of the carve-out. At worst, such events even lead to the cancellation of the entire carve-out.

In addition to the conditions and parameters described above, the following framework conditions and measures are critical factors for successful carve-out transactions:

1) availability of sufficient, adequate staff
2) effective governance model in place
3) early decisions on critical IT systems
4) employee transfer and retention plans
5) transition service agreements
6) operational readiness from Day-1

1) Availability of adequate staff: Sufficient suitable employees with adequate free capacity must be available for the carve-out. Day-to-day business and the carve-out activities must be managed successfully in parallel. This puts many companies and their employees regularly to the test. The carve-out executive and the CMO can ideally be staffed with external experts for capacity expansion and methodical support to relieve the company from any existing or potential bottlenecks.

2) Effective governance model: Clear responsibilities, short decision-making paths, high transparency and effective communication at all times promote quick decisions and smooth processes in the context of the carve-out. Figuratively speaking, all those involved in the carve-out are to be understood as members of a large symphony orchestra who perform a virtuoso concert under the guidance of an experienced conductor. A carve-out is simply too complex to be carried out successfully in a decentralized structure without clear guidelines and rules of the game.

3) Early decisions on critical IT systems: In the case of close IT interdependencies and entanglements between the carve-out property and its parent company, it must be decided early on in which IT environment the NewCo should work in the future. This requires developing a clear IT strategy, establishing the necessary IT environment, and detailed transfer planning for all IT-relevant data, processes and applications. Experience from numerous carve-outs shows that IT is permanently at risk of becoming a critical bottleneck in a carve-out.

4) Employee transfer and retention plans: For the affected employees, a carve-out is often a stressful situation with great uncertainty in addition to an operational ordeal. It is usually not clear whether their position will even exist in the future for many of them. Also, they are mostly in the dark about what their role and area of responsibility will look like in the future and how the carve-out will change their daily workflow. With innovative transfer plans, clarity can be created early on about which employees will take on tasks at NewCo. The affected top performers at NewCo as well as the parent company must also be given clarity at an early stage of the carve-out about their future areas of responsibility and tasks through job descriptions. Often selected employees can also be motivated to continue to demonstrate high performance during the carve-out and in the following years, by being offered special incentives or employee retention plans.

5) Transition service agreements: Often the time required to unbundle the carve-out business from its parent company exceeds the time frame available for the operational carve-out. To avoid significant delays in the sales and carve-out processes, usually transition service agreements are used as inevitable makeshift solutions that virtually enable operations of NewCo from Day-1. However, since neither the parent company nor NewCo has experience in rendering commercial services, transition service agreements are often problematic, which is why their number and duration should be limited to an absolute minimum.

6) Operational readiness from Day-1: A successful carve-out depends mainly on the level of performance of NewCo in the market. One of the biggest challenges in this regard is retaining existing and attracting new customers. Great attention must be paid to operational readiness from Day-1, especially in direct customer contact such as order acceptance, order processing, customer service, etc. For this, it is advisable to appoint a dedicated team that identifies the essential processes, tests and verifies their smooth performance using simulations, and certifies their full operational readiness for Day-1. Only in case that all critical processes are fully functional, tested and approved shall NewCo go operational.

Carve-out executives free up executive management to focus on their core business

Executive management can actively increase the value and improve the financial position of their respective company through divesting assets in carve-out transactions. In addition to extensive carve-out experience, these transactions' extraordinary complexity requires professional carve-out management skills to achieve a high sales prices from the divestment and an uninterrupted, trouble-free separation from the parent company. An experienced carve-out executive backed by a strong operational carve-out management office (CMO) supports or even frees up company executive management from the time consuming carve-out preparation as well as execution. Thus, sufficient room to maneuver for executive management and company staff is created to fully focus on the core business of the parent company, unlock untapped potential and spur further profitable growth. Equally, the top management and staff of NewCo get sufficient leeway to focus on establishing the new company in the market successfully. Our EIP interim managers focus solely on creating value and possess all skills needed to lead carve-outs to success, for the parent corporation and the carved-out entity.

Sources:
1) FINANCE, Private Equity Panel Fall 2020
2) PITCHBOOK, European PE Breakdown 2020 Annual
3) Petiole Asset Management, Unlocking Value through Corporate Carve-Outs
4) Deloitte, Perspectives on driving divestiture and carve-out value
5) The Zen of Investing: http://thezenofinvesting.com
6) Stock Spinoffs: www.stockspinoffs.com
7) The Financial Times
8) Company websites

How our EIP interim managers can support you in a carve-out transaction

- ✓ Immediate provision of an experienced carve-out executive as interim
  – Chief Transformation Officer
  – Chief Operating Officer
  – Chief Executive Officer
  – Chief Financial Officer or
  – Program Officer
- ✓ Avoidance of an impending delay / the impending termination of an ongoing carve-out by initiating and implementing immediate improvement measures
- ✓ Support with the realignment, reorganization or performance improvement program of a part of the company during or in advance to a future carve-out transaction
- ✓ Support in identifying and addressing potential buyers for the purchase of the carve-out object by using our EIP network
- ✓ Support in the selection and coordination of external service providers for the preparation and implementation of the sales and carve-out processes, e.g. auditors, M&A, tax and management consultants, law firms etc.
- ✓ Bridging vacancies in the top management or on the board of directors as well as other vacant executive positions of the parent company or the carve-out object

About Executive Interim Partners

Executive Interim Partners GmbH was founded in Munich-Gruenwald in February 2005.

The partners of Executive Interim Partners support you and your company as interim managers or consultants, especially in special situations that require immediate entrepreneurial action, such as

- Restructuring and turnarounds
- Transformations and realignments
- Company sale and carve-out transactions
- Company acquisition and post-merger integration
- Management crises or a management vacuum
- Digitalization and digital transformation

Our partner team is characterized by long and extensive entrepreneurial and operational management experience as senior managers, entrepreneurs, and investors.

We convince through extensive operational experience as board members, managing directors or advisory and supervisory board members in the conception and implementation of strategic realignments, performance improvements, and operational and financial restructuring of medium-sized companies and corporations from Germany and abroad.

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About the author

Markus Nicolaus is a partner of Executive Interim Partners and has more than 20 years of international experience as interim manager, top management consultant and managing director in the consumer goods, capital goods and services industries.

He has supported numerous carve-out, post-merger integration and M&A transactions in various functions in an operational and advisory capacity. As Interim Chief Operating Officer, Markus was responsible for the carve-out and post-merger integration of a division of a leading global sports and lifestyle company. He coordinated the preparations for further carve-outs at various subsidiaries of the DAX company.

In the industrial sector, Markus has prepared and coordinated the carve-outs of various business and functional areas of an international high-tech conglomerate. He has supported the post-merger integration of different energy companies in an advisory capacity. As an employee, he was part of a post-merger integration after a NASDAQ-listed digital agency had acquired the rapidly scaling internet start-up consultancy he co-founded.

Before his freelance work as interim manager and senior advisor, Markus served as Managing Director, being responsible for the European business and the international key account business of the Rodenstock Group, a leading global manufacturer of high-quality consumer goods.

As Vice President of Siemens, he headed the strategy, marketing and communication division of the global power plant business. He advised Siemens' top management as a project manager in critical projects on strategic and operational challenges.

Markus began his professional career in top management consulting at A.T. Kearney. He moved on to become Director of Sapient Inc. supporting start-ups, medium-sized companies and international corporations in carve-outs, post-merger integrations and M&A transactions, amongst other things.