

SLAUGHTER AND MAY /

CARVING IT UP

Practical tips to maximise the value of a carve-out

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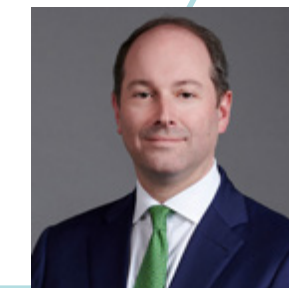
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INTRODUCTION

Carve-outs have become ever more popular in recent years, as market players seek different ways to raise or return cash, maximise shareholder / fundholder value, optimise a company’s operations or change the strategic direction of a group. While there has been a lull in recent months, we expect shareholder and LP pressure, along with the well-expected deployment of private capital to come, will see corporate carve-outs back with a bang.

With that in mind, we have drawn together in this publication some practical tips and tricks (and traps to watch out for) from our recent experience of carve-outs across the globe.



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GETTING IT RIGHT: PRACTICAL TIPS TO MINIMISE VALUE LEAKAGE

1



DON'T BREAK THE "BAU"

It might seem obvious, but this is the largest area of value leakage. Planning and implementing a carve-out is hugely time intensive and inevitably will result in less focus on maintaining business performance during that process. Using temporary resource (including advisers) in the right areas at the right time can lighten the project management load and help bring experience in particular areas. Bear in mind though that when it comes to detailed operational planning, there can be no substitute for first-hand knowledge of the business in question.

2



GET ON THE FRONT FOOT WITH A PLAN

Present a potential buyer or investor with an accessible, detailed and costed plan of separation steps and transitional services that you are willing to stand behind. This plan should be realistic from the outset – a separation plan for a heavily integrated business that offers up three months of transitional servicing or even expects a clean-break from completion is only going to spook a potential buyer. The more confidence you can give a buyer, the less likely they are to build in a price discount for separation risk or, worse still, walk away for fear of a painful and unconstructive separation process.

3



STRUCTURE FLEXIBLY – WATCH OUT FOR STRANDED COSTS

Planning is important, but be strategic about implementing too early. That can leave significant sunk "stranded costs" with the carved-out or remaining business which go directly to value, especially if an acquirer has a different view of the world to your proposed plan.

4



ARE THINGS RIGHT SIZED? DON'T NECESSARILY STICK WITH STATUS QUO

Don't just plan for a "lift and shift". Contracts, functions and processes that are appropriate for the combined business may not necessarily be right for smaller carved-out or remaining businesses and could leave unnecessary ongoing overheads. The carve-out can also provide a chance to enhance and improve things that haven't worked so well previously.

5



PEOPLE ARE KEY AND IT STARTS FROM THE TOP

Having the right leaders for the carved-out and remaining business in place early, incentivised in the right way and with the right messages behind them is essential to bringing everyone else. Without that, you may end up with half the carved-out (or remaining) business that you were expecting. Keeping the "best" people in the retained business can also be a tripwire, as buyers (and people within the carved-out business) will be alive to that.

6



COMMS CAN MAKE OR BREAK IT

As well as employees, carve-outs can create uncertainty and instability with investors, customers, suppliers and partners, and risk them looking elsewhere. Confident, tailored and clear communications about what is happening, when it will happen, what the impact will be and why "it is all going to be even better than it was" are critical to a successful carve-out.

BUYER BEWARE: OUR 6 TOP THINGS TO FOCUS ON

1



BRIDGING THE INFORMATION GAP – AM I GETTING WHAT I NEED?

A buyer is inherently at a disadvantage in a carve-out, as they have less ability to know whether a carve-out is being done well and what the impact on the carved-out business will be. Expert adviser support in diligence and contractual protection can help to some extent. But the best tool is to be clear about the value impact if you don't get the information you need or an issue is not resolved. Nothing focuses a seller's mind more than highlighting the direct correlation to purchase price or ability to do the deal.

2



CREATE ALIGNED INCENTIVE FOR BOTH SIDES

Having the selling business retain a stake in the carved-out business may create complexity, but ongoing exposure can incentivise a seller to ensure the carve-out is done well. Earn-out or deferred purchase price can also have the same effect, in a less complex manner, if it is structured in the right way.

3



AM I GETTING THE RIGHT PEOPLE AND WILL THEY STAY?

As a buyer, you need to be particularly alive to whether you have too many (or not enough) people, whether they are the right people and whether they will stay. Insist on meetings with senior managers of the carved-out business (without the seller, if possible) to help close the information gap, give comfort you have the right people (and identify where you need new hires) and help you craft effective incentivisation and retention arrangements to keep them. Investing time to work with the seller on employee comms can help make sure that people are enthused about the future and let you focus post-completion on moving forward, not fixing miscommunications from the past.

4



INTEGRATION ISSUES?

If failure to implement a carve-out well is near the top of the list of value-destroyers in a M&A transaction, then failure to implement an integration must be at the same level or even higher up. So if you are looking to integrate the carved-out business, focus on how you will do that at the time of acquisition and as part of your diligence, before it is too late. Similarly, be realistic about synergies and make sure to diligence potential blockers to those (e.g. exclusivity commitments in contracts).

5



IT WON'T ALWAYS BE PERFECT

A buyer will need to accept in any carve-out that there will inevitably be plenty of rough edges. The key thing is to make sure that the separation actions that go to the heart of the business's value are done correctly (and that you have appropriate levels of involvement in those) and you are well protected for risk if they have not been.

6



CAN CONTRACTUAL COVERAGE SOLVE THE ISSUE?

Creative contractual coverage can bridge value gaps on carve-outs and you need your lawyers to focus on possible solutions along these lines when identifying potential diligence issues. That might be warranties over having what you need to run the business following a separation, undertakings that separation will be implemented in accordance with an agreed plan, indemnities for specific separation risks or even bespoke milestone payments for separation actions. Amidst the urgency and noise of sale negotiations, the temptation may be to defer detailed separation discussions to post-signing – but a buyer should push to agree key separation matters upfront alongside the deal terms rather than relying on mere “agreements to agree” from a position of reduced leverage.

MAKING IT WORK: A CASE STUDY OF A COMPLEX CARVE-OUT IN PRACTICE

DEAL STATS

- DEAL VALUE** £2bn+
- SELLER** Large multinational corporate
- BUYER** APAC-based private equity investor
- TRANSACTION** Carve-out and sale of product segment, including manufacturing, supply chain and sales channels across 5 different countries spanning Asia and Europe

NAVIGATING THE ISSUES

- SHARING THE BRAND**
Crafted a complex perpetual and exclusive brand licence for the carved-out business that still allowed the seller to use and protect the value of the brand across the rest of the world, whilst addressing co-existence considerations to reduce brand dilution and confusion.
- WEB OF SERVICES ARRANGEMENTS**
Bespoke mix of transitional services, long-term manufacturing and supply arrangements and cross-border partnerships. Creative pricing and synergy mechanics added value for both sides.
- WORKS COUNCIL WORRIES**
Navigated a delicate mandatory works council process in Europe, alongside positive employee engagement more broadly across the globe.
- ROUTE THROUGH REGULATORY**
Created a tailored deal structure and package of contractual protection to plot a viable route to obtaining approvals from antitrust, foreign investment and product regulatory authorities, along with the “split” of various licences and approvals so that both ongoing businesses had what they needed.
- LITIGATION LIABILITIES**
Apportioned liabilities for ongoing litigation through a tailored indemnity package, alongside provisions to allow both parties the input they need into the conduct and conclusion of that litigation.
- RESTRUCTURING THE REMAINDER**
Diligenced, designed and implemented a new corporate and financing structure to get everything on the right “side of the fence” and ensure the carved-out and existing businesses had right-sized and appropriate financing packages going forward.
- AND A JV ON TOP**
A new TopCo was put in place in which the seller retained a minority interest. Ongoing governance, funding and exit mechanisms aligned incentives for both parties.

OUR EXPERIENCE

Global carve-out transactions require a depth of multi-specialist experience across many areas, including as corporate, intellectual property, technology, outsourcing and commercial contracting, regulatory and financing paths cross. That is where we excel.

Sellside experience

- Ageas Insurance Limited** – on the sale of its UK commercial lines front book business to AXA Insurance UK plc
- Aviva** – on the disposals of its businesses in France, Poland, Hong Kong, Indonesia, Singapore and Vietnam
- Bunzl** – on the disposal of its healthcare business to Mediq
- Bupa** – on the divestment of part of its UK care home business to HC One and to Advinia Healthcare, involving highly complex carve-outs of 144 care homes from the existing operating Bupa companies
- Centrica** – on the £2.85bn sale of its North American energy supply, services and trading business to NRG
- Essentra** – on the disposals of its packaging and filters divisions by way of auction sales
- Ferrovial** – on the divestment of the Amey group, including on the prior carve-out of certain business divisions

- GSK** – on various transactions including the demerger of its consumer health business to form Haleon
- Hibu Group** – on the sale of its US business to an affiliate of H.I.G. Capital
- Interserve** – on the carve-out disposal of its Support Services division to Mitie
- John Wood** – on the sale of its Built Environment consulting business to WSP Global, Inc.
- Johnson Matthey** – on the sale of its diagnostic services business to Sullivan Street Partners
- Just Eat Takeaway.com** – on the sale of its stake in iFood to Prosus
- Marston's** – on the merger of its brewing business with Carlsberg to create the Carlsberg Marston's Brewing Company
- Prudential and M&G** – on the demerger by Prudential of its UK business, M&G
- Reckitt** – on the sale of its Infant Formula and Child Nutrition business in China to Primavera Capital Group and the disposal of its Scholl footcare products business to Yellow Wood Partners

- The Restaurant Group** – on the proposed sale of its leisure business
- TOKIN Corporation** – on the sale of its electro-mechanical devices business to NTJ Holdings I Ltd
- Viridor Waste Management Limited** – on the disposal of its collections business and certain recycling assets to Biffa plc
- Vodafone** – on various transactions, including the proposed merger of its UK business with Three and the sale of Vodafone Hungary

Buyside experience

- Credit Karma** – on the acquisition of Noddle from Call Credit
- Drax** – on the acquisition of Scottish Power's portfolio of pumped storage, hydro and gas-fired generation assets
- Equinix** – on the purchase of UK data centre operating business from IO
- Investindustrial** – on its acquisition of CSM's ingredients business in Europe and China and subsequent bolt-on of Hi-Foods in Italy
- Markerstudy** – a portfolio company of Pollen Street Capital – on its acquisition of BGL Insurance from BGL Group
- Midlothian Capital Partners Limited and Hattington Capital LLP** – on the acquisition of Dobbies Garden Centres Limited from Tesco Holdings Limited
- M&G** – on the acquisition from Royal London Group of Ascentric, a digital wrap and wealth management platform for UK independent financial advisers
- Ovo Energy** – on its purchase of SSE plc's GB household energy and services business
- Schroders** – on its acquisition of River and Mercantile Group's solutions business
- Swire Beverages** – on its acquisition of the Coca-Cola bottling operations in Vietnam and Cambodia
- Virgin Group** – on Virgin Active's acquisition of the nutrition assets of South Africa's Real Foods Group
- Vodafone** – on the acquisition of Liberty Global's German and Central and Eastern European business

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