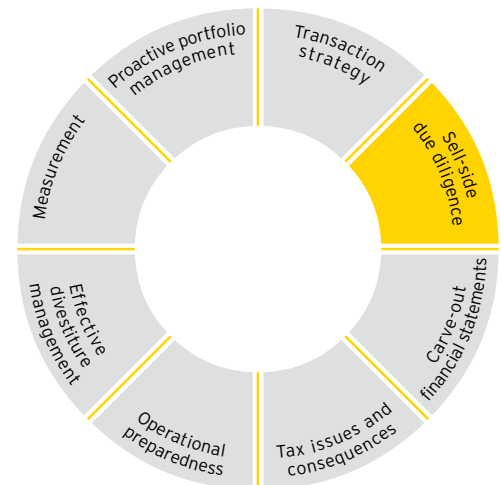


Sell-side due diligence

Sell-side due diligence is a cornerstone of divestiture strategy, enhancing seller credibility and deal value for both buyer and seller.

by Paul Hammes, Doug Campbell and Kevin Magee



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Key points:

- ▶ Conduct sell-side due diligence to build a strong value case for the deal and avoid costly surprises
 - ▶ Define due diligence broadly, to include tax, accounting, compliance, transition and synergy issues
 - ▶ Establish an electronic data room, supplied with transparent, consistent information
 - ▶ Build a “synergies story”
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It has become a staple of the divestiture process. Done right, sell-side due diligence proactively identifies and addresses potential buyers’ issues. It plans for aggressive questioning by buyers and their lenders, helps eliminate costly surprises and identifies trouble spots before they become deal breakers. Prepared sellers may reduce disruption to the business, increase tax benefits from the sale, improve operational separation and experience a faster and smoother close.

Sell-side due diligence should look at the transaction through a buyer’s eyes. It is essential to understand the likely pool of buyers and their different views and needs. It’s also up to the seller to uncover any untapped value, such as potential synergies, excessive corporate overhead or underinvestment in key markets.

Today’s market skepticism means buyers and their lenders look for issues that could result in a purchase price reduction or the need for more capital investment. If information is incomplete, poorly presented or not timely, potential buyers are likely to walk.

Focus areas

Sell-side due diligence should be broad and deep, addressing such factors as historical financial results, pro forma and forecast financial results, the specific assets involved in the deal and implications for the seller's remaining businesses including stranded costs/ corporate overhang and discontinued businesses. All one-time, transition and residual costs, as well as any transition service or supply arrangements required by buyer or seller should be taken into account. In addition, sellers should develop a stand-alone business model for the entity being divested.

Accounting issues have become increasingly important to due diligence, as sophisticated global buyers will

often ask whether a spun-off or carved-out entity is ready to implement International Financial Reporting Standards (IFRS). Sellers can expect questions about compliance with other regulations, such as Section 404 of the Sarbanes-Oxley Act of 2002, and will want to clearly understand related compliance costs.

Tax issues belong on the list. Sellers can do considerable advance work with respect to planning and structure, potentially adding millions of dollars in value to the deal for both buyer and seller.

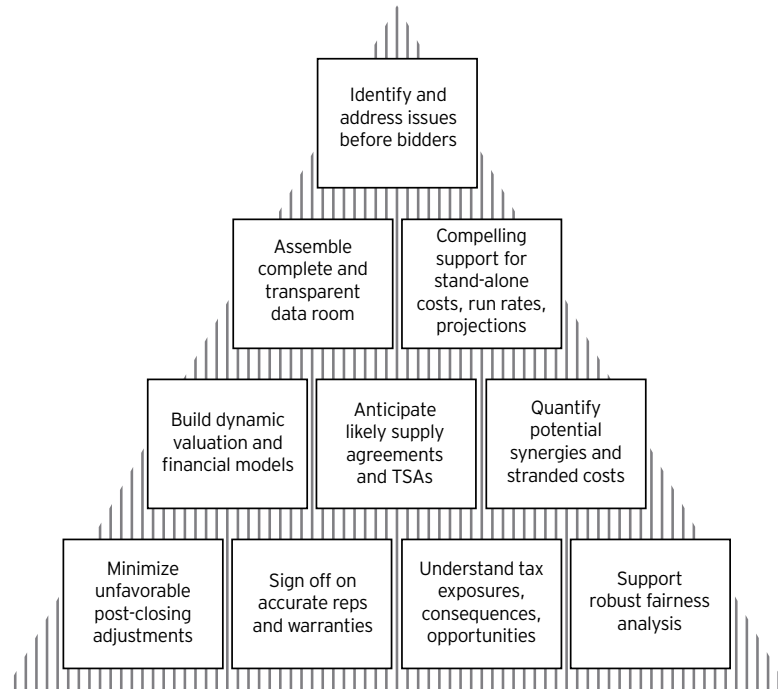
To execute sell-side due diligence, sellers should assemble a skilled, multi-disciplinary transaction team under executive sponsorship.

Data rooms

Perhaps the most important task associated with sell-side due diligence is the establishment of a complete and transparent electronic data room - usually an online repository of information the seller makes available to buyers via a third-party provider.

The data room should offer documentation consistent with any information already provided to potential buyers. In deciding what information to make available, sellers should consider buyer needs while keeping in mind their own goals and strategies. They also should consider today's more rigorous lender demands for financial and operational facts.

Seller diligence forms the foundation



Although “complete and robust data” is the guiding principle of data room construction, it is not always in a seller’s interest to provide everything buyers may want.

Typically, buyers will require historical pro forma and forecasted financial statements and information on tax, HR, legal matters, real estate and operations. Full disclosure often makes sense for a seller working with a single buyer. But sellers seeking to create competitive tension among a group of buyers may want to release information selectively or in phases. In a complex transaction, particularly if there are no competitive intelligence issues, giving buyers more information speeds their due diligence and can keep more buyers in the game.

Buyers also vary from one deal to the next and use different guidelines or metrics to establish value. Compared to a financial buyer, a strategic buyer may more easily determine the value of business based on its own experience and integration plans. The financial buyer may need more fulsome data to make the value case for buying the business.

When potential buyers are direct competitors, customers or suppliers, sellers may worry that revealing information about pricing, customers or other proprietary matters might put the seller or the business at a disadvantage if the deal falls through. Decisions about how much to share must be made at the highest levels of accountability. The best data rooms allow sellers to assign different levels of access to different buyers at different stages of the deal.

It is crucial that the information in the data room be aligned with the financial information in the offering

memorandum. If a buyer spots inconsistencies or becomes concerned with the overall control and reporting environment, the deal can fall apart. Subjecting the data room information to a complete review of alignment with information provided historically can help avoid such a situation. It is also crucial that senior management, especially the CFO or controller, be intimately familiar with the information loaded into the data room.

Synergies

One little-appreciated aspect of sell-side due diligence is building a compelling “synergies story” for those strategic buyers who need help grasping the full value of the deal. Some corporate buyers will have clear synergies in mind and won’t care much about the seller’s view. Others may envision modest synergies based on slightly different expense projections. In some cases, though, a convincing presentation of likely synergies could increase the chance of a good sale. A management team’s credibility is enhanced by its ability to identify likely synergies and operational priorities. ▼

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Essentials for your data room

- ▶ Adequate information to support a controlled question-and-answer process
- ▶ Full information on commercial and legal matters
- ▶ Location and use of corporate real estate (owned, leased, ventures)
- ▶ Validation of key valuation assumptions
- ▶ Alignment of data room with financial reporting structures
- ▶ Audited financial statements
- ▶ Presentation of normalized stand-alone financials
- ▶ Compelling support for stand-alone costs, run rates and projections

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