



# Increasing value from disposals

## Investing in divesting

ADVISORY

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# Introduction

Disposals are an integral part of the strategy of many corporate organizations and all private equity firms – but disposals are rarely given the same priority as mergers and acquisitions. Our findings suggest that corporates and, to a lesser extent, private equity firms should put more focus on their disposals processes if they want to:

- maximize the value of bids
- reduce the erosion of value, in particular after the deal completes
- reduce disruption to the seller and business being sold
- increase the speed of execution and maintain control of the process
- manage expectations of stakeholders.

In mergers and acquisitions (M&A), it has always been more glamorous to buy than to sell, but for every acquisition there must be a disposal! While acquisitions grab the headlines, disposals are just as important when it comes to creating – or destroying – value.

This is the second KPMG International disposals survey. In 2004, KPMG International published research looking at the disposals process called *Increasing Value From Disposals: A Case For Professionalizing the Sell Side*. The survey's findings provided a clear signal to both corporates and private equity firms (PE firms) that they should focus on their disposals process to respond to the increasingly sophisticated approach of purchasers.

The research has now been repeated on a larger scale, broadening the scope to look at differences in the approach and success of corporates and PE firms. This survey covers Europe, the U.S. and Asia Pacific to see what lessons can be learned. Since our original report, have sellers become more professional?

The answer is yes – but it comes with a huge caveat – there is still plenty of room for improvement. Almost half of the corporates interviewed, and a quarter of the PE firms, felt they had not maximized the value on their latest disposal.

The M&A market is booming and now is a great time to be selling businesses. There are numerous potential buyers in the market and prices are high and rising. This research provides insight into how sellers can put themselves in the best possible position to extract maximum value from disposals.

In our view both corporates and PE firms could benefit from further investment in their disposals process.

# Key insights

“It will happen (value leakage) around things that you didn’t know about ...it will happen around misunderstandings, it will happen around warranties and it will sometimes happen around management’s attitude... and management’s agenda.”  
PE firm

## Sellers are not maximizing value in their disposals

It is a seller’s market, however almost half of the corporates interviewed, and a quarter of the PE firms, felt they had not maximized the value on their latest disposal.

## Value leakage remains a big issue, in particular once the deal completes

Over two thirds of sellers are experiencing post completion issues, especially warranty and indemnity claims and completion accounts disputes.

## Increasing liquidity and the rise of private equity

The buyer landscape has been changing fast with the increase in liquidity and the rising influence of PE firms. Corporate sellers need to be prepared for the more challenging due diligence enquiries from PE firms.

## Achieving financial and strategic advantage – the importance of planning

Sellers now believe that the greatest advantage is to be gained from advance planning and preparation. Both corporates and PE firms agree that planning and successful disposals go hand in hand.

“We get surprised, but we want the surprises to be in-house.”  
Corporate, Director of M&A

## Disposals take time

Over three quarters of sellers report that it normally takes more than six months to sell a business, and almost one in five say it normally takes more than one year. Although the timeframe for disposals is generally perceived to have been stable in the past few years a significant minority believe that the timeframes have lengthened.

## Future trends

It is likely that the disposal process will continue to become more professional. But until corporates place as much strategic emphasis on selling as buying businesses, they will lag behind PE firms in maximizing value from disposals.

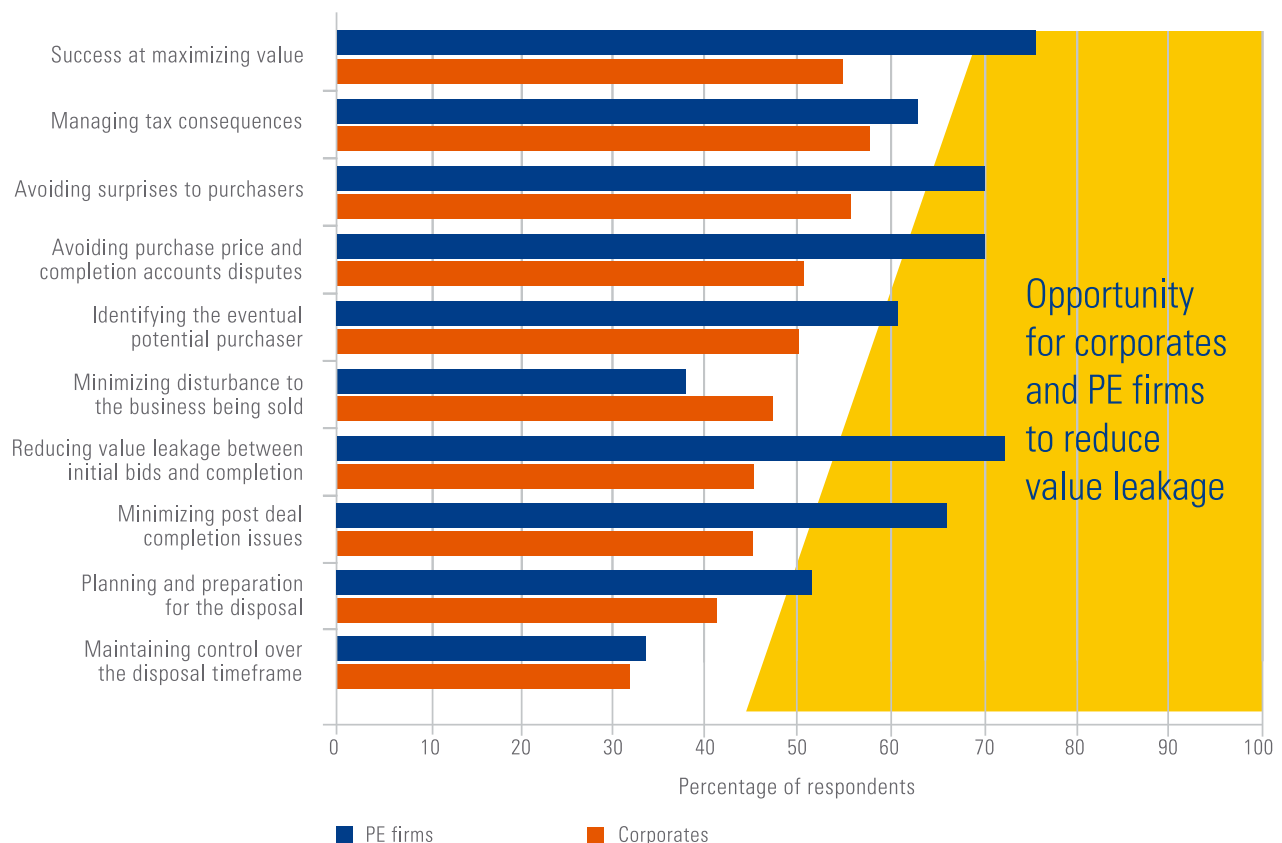
# Disposal values

It is a seller’s market however, almost half of the corporates interviewed, and a quarter of the PE firms, felt they had not maximized the value on their latest disposal.

Interestingly, for those corporates who rated their disposals as not being successful, the majority noted that the value was lost by the time a preferred bidder had been chosen – this means that the disposal process has to be right from the start.

We asked how successful our corporate and PE respondents felt they had been in their last disposal in maximizing value and in achieving certain other goals.

## Corporates and PE firms claiming success for the following goals in their last disposal



Source: KPMG International

The corporate sellers who rated their last disposal as being *unsuccessful* felt that the main factors behind the lack of success were:

- Purchase price and completion accounts disputes
- Post deal completion issues
- Losing control over the disposal timeframe.

By contrast, the corporate sellers who rated their last disposal as being *successful* felt that they were most successful in:

- Avoiding purchase price and completion account disputes
- Avoiding surprises to purchasers
- Managing tax consequences.

Overall a greater proportion of PE firms felt that they had been successful in all goals except for minimizing disturbance to the business being sold. Good planning and preparation and setting a realistic timeframe for the disposal can limit the level of disruption to the day to day operation of the business.

Both PE firms and corporates felt that they were least successful in managing the deal timetable. Sellers are typically keen to shorten disposal timeframes because too long a process can prove distracting for the business being sold and its management, leading to business under-performance and value leakage. However, aggressive timetables can limit the opportunity for the necessary planning and preparation which many sellers now realize they need to invest in. Sellers need to recognize that disposals can take a significant period of time and therefore need to be realistic when setting their disposal timetable.

From experience we see sellers becoming more sophisticated and professionalizing their approach to the disposals process. Indeed the balance of power has been moving to the seller since the last survey.

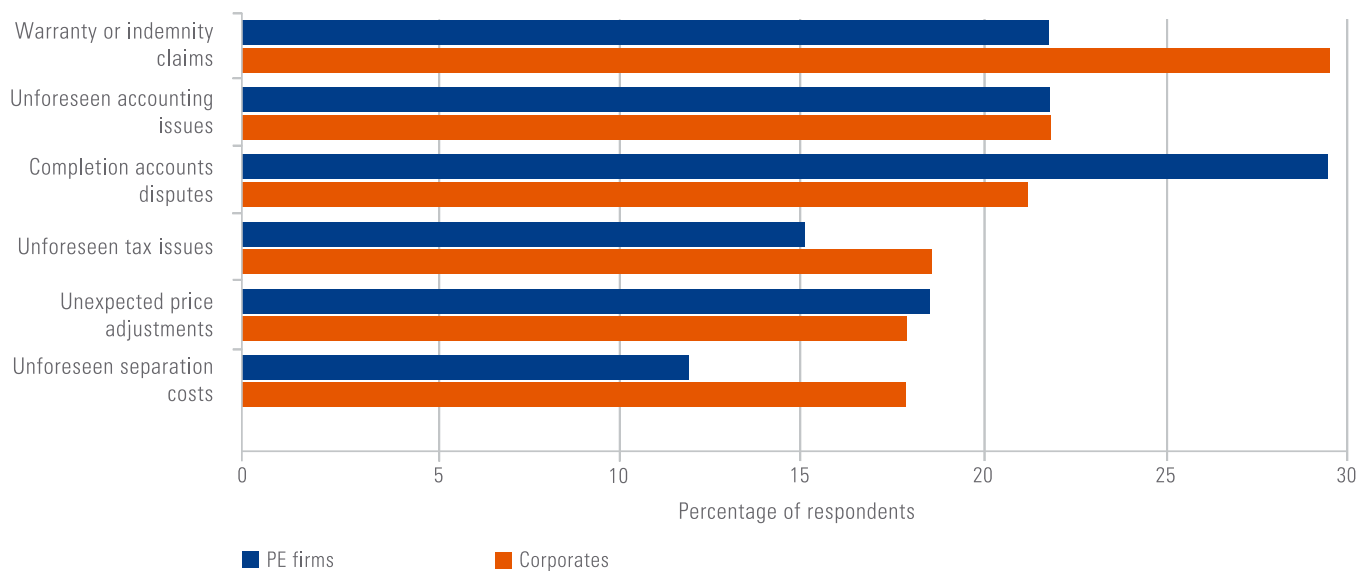
However, based on the responses on the previous page it is clear that there is significant opportunity for corporates and PE firms to reduce value leakage during the disposals process.

# Value leakage

Value leakage remains a big issue, in particular once the deal completes. Over two thirds of sellers are experiencing post completion issues, especially warranty and indemnity claims and completion accounts disputes.

Sellers are still experiencing a wide range of issues post completion which typically results in value leakage. And the increasing competition for assets means some buyers are being more aggressive at clawing back value after the completion of the deal.

## Main issues experienced by sellers once the deal completes



Source: KPMG International

While corporates and PE firms are facing similar post-completion issues, there is a marked difference in their experience of warranty or indemnity claims, completion accounts disputes, and unforeseen separation costs, all of which may reduce the value of the disposal to the seller.

## Warranty or indemnity claims

Nearly one third of corporate respondents have experienced unforeseen warranty or indemnity claims, which is similar to the findings in the last survey.

By contrast the percentage of PE firms experiencing warranty or indemnity claims has fallen from 30 percent to 21 percent. We believe this decline can be attributed to two factors. Typically PE firms are selling standalone businesses and it is easier for them to provide appropriate information and disclosures to purchasers. PE firms have also been increasingly successful in limiting the warranties and indemnities that they give, or managing to avoid giving them at all, and while buyers continue to greatly outnumber sellers this trend can be expected to continue.

It is more difficult for corporate sellers to limit or avoid warranties and indemnities. However corporates can reduce the risk by carrying out sufficient pre-sale due diligence to help ensure an increased understanding of the business, by providing sufficient information and adequate disclosures to prospective purchasers, and by ensuring that warranties and indemnities are tightly drafted. It is better to spend time identifying potential issues in advance, and resolving them before the sale or in negotiation with the purchaser. The alternative can be a long, costly and distracting dispute process.

## Completion accounts disputes

A greater proportion of PE firms than corporates experience issues with completion accounts disputes.

To reduce the risk of value leakage the completion accounts process needs to be very well defined and carefully drafted into the sale & purchase agreement. Most respondents recognize that the seller's lawyers and accountants need to work closely together on this aspect of the transaction, in particular in determining the accounting policies to be used and how they are applied when drafting the completion accounts.

There are many advantages to the well established completion accounts process, but there are also disadvantages. For the seller the process introduces uncertainty and the risk of price adjustment, and for the purchaser it can be an unwanted distraction in those vital weeks and months following completion when the new purchaser wants to focus on the acquired business. Sellers are seeking to avoid the need for a completion accounts process by using an agreed

pre-completion 'effective date' balance sheet as the reference point for the transaction, as opposed to a post-completion balance sheet (this is sometimes referred to as a "locked box" mechanism). For this approach to work there needs to be a robust reference date balance sheet to price the deal, and the practical ability to ring fence and protect the business' assets – to lock the box – from the balance sheet date to legal completion.

## Unforeseen separation costs

As may be expected, a higher proportion of corporate sellers experienced unforeseen separation costs than PE firms. But less expected was the finding that as many as 12 percent of PE firms have experienced this issue.

In order to mitigate this risk a greater number of corporate sellers are focusing on more detailed separation planning and more detailed assessment of the impact of the disposal on the seller's retained business prior to marketing the business. Much more work, for example, is going into the preparation and pricing of transitional service, supply and other agreements in advance. Historically some sellers have left the drafting of transitional service agreements until after the signing of the sale & purchase agreement and even after completion.

# Buyer landscape

The buyer landscape has been changing fast with the increase in liquidity and rising influence of PE firms. Corporate sellers need to be prepared for more challenging due diligence enquiries from PE firms.

There have been big changes in the type and number of buyers since the last survey; in particular the presence of the private equity sector is now well recognized. 70 percent of sellers report more financial buyers in the market, 20 percent report more trade buyers and 10 percent report more international buyers.

The biggest factor is the rise of private equity. PE firms raised US\$160 billion in 2004 and more than US\$400 billion in 2006. Debt is freely available, both from banks and institutional investors, and cheap.

Although it is a seller's market, the increasing number and sophistication of buyers is creating a growing challenge for sellers to manage within the disposal process. The sales process now has to be designed to take into account the needs of multiple domestic and international trade buyers and financial buyers. Sellers are increasingly aware of this.

"We don't necessarily know who the buyer is going to be... so we try and prepare for as broad an audience as possible."

Corporate, Director of M&A

The survey respondents provided numerous comments on the pros and cons of trade vs. financial buyers. The pros of the corporate buyer are mainly around them having a greater understanding of the business and consequently fewer concerns around liabilities. The pros of the private equity buyer are around the speed of decision making and deal execution.

"What I've found is that in selling to private equity vs. trade...private equity goes to a deeper level of materiality...the private equity buyer always worries about contingent liabilities, whereas the trade buyer assumes that those are really no different from the same difficulties they have in their own business."

Corporate, Director of M&A

“Financial buyers are much quicker decision makers than companies... they do a lot of deals, they know how to do them and they are able, in an auction process, once they have got their finance lined up, to move very quickly...and one of the things you can do is you can make sure the due diligence is set up in a way that they can do financial due diligence very fast...or you can actually offer a finance package alongside as part of your sale.”

Corporate, Head of M&A

“It’s just the efficiency of the dialogue...if I have a financial buyer, they rely on third parties...industry experts...there is not the efficiency of dialogue...a trade buyer obviously knows the business as well as you do...can price the liabilities much more efficiently...so they are less apprehensive about numerous liabilities.”

Corporate, Director of M&A

While sellers are becoming more comfortable with meeting the needs of the two types of buyer, the market is already moving on. PE firms and corporates are now teaming up as consortia to acquire businesses, and the combination of skills and experience creates a formidable acquirer. We expect to see this trend continuing.

“In some ways...you combine the industrial, operational approach with the thorough buying process/M&A skills of private equity players...”

PE firm

We are also seeing PE firms coming together to make joint bids, often referred to as “club deals”. This approach can facilitate bids that would not otherwise be made. However, club deals reduce the number of bidders and so limit the competitive nature of an auction. As a reaction to this some sellers have prohibited joint bids by PE firms.

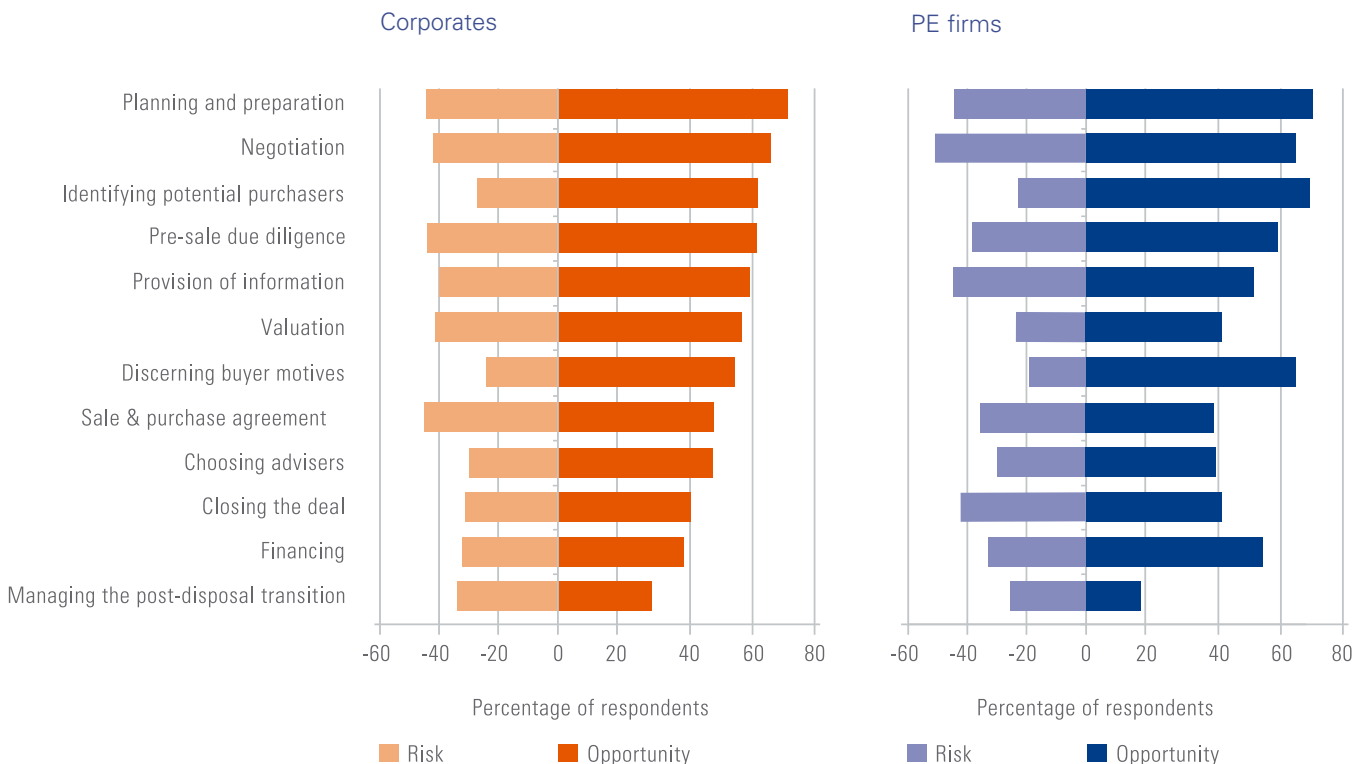
# Achieving financial/strategic advantage

Sellers now believe that the greatest advantage is to be gained from advance planning and preparation. Both corporates and PE firms agree that planning and successful disposals go hand in hand.

The survey participants were asked to identify which activities in the disposal process present an opportunity for financial or strategic advantage, i.e an opportunity to enhance one’s ability to achieve the best price, and which activity represented a risk.

The tables below show that both corporates and PE firms believe that the greatest opportunity in the disposal process is in planning and preparation. Interestingly this is also seen by corporates and PE firms as one of the most likely areas of risk. If you get your planning and preparation right it can lead to a successful disposal; if you get it wrong there is a higher risk the disposal will not be successful.

## Opportunity and risks in the selling process

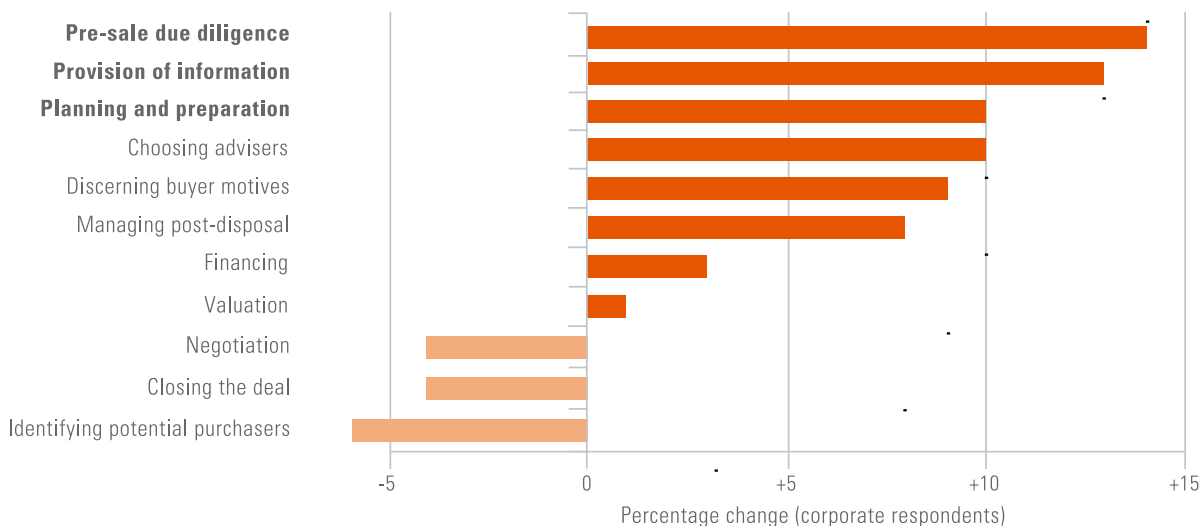


Source: KPMG International

## How has this changed since our last survey?

When compared with the findings from our previous survey there have been some significant changes in how corporates view the financial and strategic advantage to be gained from different aspects of the disposal process. The change in view from PE firms is less marked.

### Change in emphasis since our last survey



Source: KPMG International

### Pre-sale due diligence, provision of information, planning and preparation

Corporates are putting significantly greater focus on planning and preparation which indicates that corporates are catching up with PE firms who have typically put greater focus on these aspects of the disposals process.

The survey shows that corporate sellers are recognizing the need to have a detailed understanding of the business being sold. This is consistent with our experience as we are seeing an increasing amount of pre-sale due diligence being carried out by both in-house teams and by external advisers.

“Within our company, we believe the one time we know most about our business is the day prior to sale.”

Corporate, Director of M&A

Insufficient preparation can result in an uncomfortable experience for sellers and their advisers as even small issues can cause chaos in a disposal process. It is difficult being on the back foot during sale negotiations and being faced with awkward surprises because a prospective purchaser has carried out its own extensive due diligence and developed a better understanding of the business and the value drivers.

Sellers also need to consider the impact of a disposal on the whole of the business i.e beyond just the business being sold, to ensure central costs that can no longer be allocated to the disposed business are identified and reduced accordingly.

Preparatory work is also being carried out at an earlier stage in the process; the earlier it is done, the more time the seller has to develop potential upsides and to address downside issues in advance of the transaction.

“The worst thing in the sale process is when things creep out of the woodwork or you have a bit of an Achilles heel...I think in today’s environment you have to assume that every buyer, be it trade or financial, is very sophisticated and does lots of due diligence and you can’t hope that they won’t notice...it’s much better to say we do have a few gaps here, let’s make sure we address those gaps before we go through the sales process.”

PE firm

Another aspect of pre-sale due diligence is the increasing use of “vendor due diligence” by corporate and PE firms across Europe. This is where the seller commissions an independent due diligence assessment of the business being sold and the resulting report (the “vendor due diligence report”) is provided to potential purchasers. We are beginning to see this approach being used in the U.S. and Asia.

“Our vendor due diligence is more extensive than it was...it’s underpinned by the significance of private equity...and their need for quality financial information with which to raise debt.”

Corporate, Director of M&A

“I think it (vendor due diligence) used to be seen as just an extended IM...and there is still some cynicism around that...but in a competitive market it is a useful tool...the other place it can be very useful is if you have got questions yourself about the business...it’s quite a good way of knowing what you are selling in a lot more detail.”

PE firm

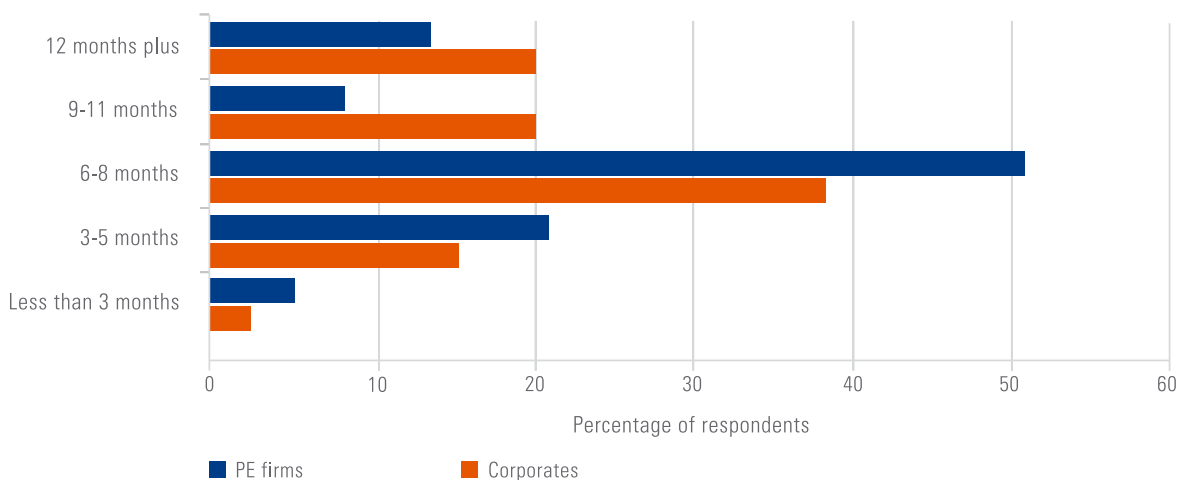
# Timescales

Disposals take time. Over three quarters of sellers report that it normally takes more than six months to sell a business, and almost one in five say it normally takes more than one year.

Sellers need to recognize that disposals can take a significant period of time and therefore need to be realistic when setting their disposals timetable. There is a perception that a quick disposal is better, but the survey found no correlation between the perception of success and the time taken to sell.

Aggressive timetables can limit the opportunity for necessary planning and preparation particularly for corporates, which has been identified as one of the main keys to delivering a successful disposal. In our experience PE firms tend to be more realistic about disposal timetables; they know the deal process, what lies ahead, and tend to be better prepared for it.

## Time taken to sell



Source: KPMG International

Many corporate disposals can take longer due to separation issues and implications on the retained business. In corporates, it is also not unusual for the strategic decision to dispose to be made by senior management, while the responsibility for execution is delegated to individuals with limited disposal experience or authority to control the resources required.

The majority of corporate sellers stated that the timeframes for completing disposals has not changed during the past five years. However almost one third of PE firms stated that they thought that timeframes had lengthened, which they attributed to increased regulation, greater levels of due diligence and the need to provide more information to buyers.

Sellers are keen to shorten disposal timeframes. Long disposal processes are a distraction for the business being sold and for its management, which can often lead to underperformance of the business and value leakage. Sellers referred to several factors that have helped to shorten disposal timeframes. The controllable factors included: 'learning from previous experience', 'sufficient attention devoted to planning and preparation', 'earlier and greater use of external advisers', and 'use of vendor due diligence'.

"The biggest factor is our readiness to undertake the sale...that our strategic thinking is fully baked, that our knowledge of the business is complete...some of the transactions that we were involved in last year...involved us selling businesses that we didn't know very well...which meant that we had to spend a lot more time preparing for the sale...and the sales process itself took longer because we were not in a position to respond as quickly to certain factors as they came up."

Corporate, Director of M&A

"The longer a deal takes the more value we lose...there are a couple of places where there is value leakage...many businesses we have had to try and sell are businesses that are not operating at their maximum...sometimes they are actually losing money...and then there are business risks that get managed differently through the sale process than they would normally get managed. I am a firm believer that, as a rule, the longer the process takes the more value is destroyed...and it comes from the fact that the business is just not managed for its maximum through the sale process."

Corporate, Director of M&A

# Future trends – and increasing value from disposals

We believe that the disposal process will continue to become more professional. But until corporates place as much strategic emphasis on selling as buying businesses, they will lag behind PE firms in maximizing value from disposals.

As noted in this survey over half of the corporate respondents and a quarter of the PE firms believed that they had failed to maximize value from their latest disposal. It is perhaps surprising therefore that over two thirds of corporates and PE firms that were interviewed stated that they were not very likely to change their approach to disposals over the next five years.

In practice we are seeing continuing development in the disposal process, for example accelerated auctions, the rapid increase in the deployment of electronic data rooms, and the emerging use of the “dual track disposal process” (simultaneously running an auction process with an IPO process, and deciding which route to take at the last practical moment).

Key actions for sellers to consider during their next disposal are listed below:

## What are the options for the business?

- Validate the disposal opportunity
- Evaluate the different disposal options – disposal, joint venture, buy-out, IPO
- Consider the impact of the sale on the remaining business
- Prepare an initial valuation
- Consider use of external advisers.

## Initial planning steps

- Assign overall responsibility for the process to a senior executive
- Agree internal decision making process
- Carry out a disposal workshop
- Identify potential purchasers and tailor the disposal process to meet their needs
- Identify potential transaction issues
- Set a realistic timetable, and keep tight control of internal teams and external advisors
- Carefully manage internal and external communications.

## What are you selling?

- Carry out sufficient pre-sale due diligence, and have a detailed understanding of the business being sold
- Identify potential upsides, hidden value and issues
- Develop business plans and implement performance improvement quick wins
- Assess working capital requirements of the business
- Identify optimal deal structure.

## How do you maximize the price paid?

- Prepare a compelling selling message
- Create a competitive sales process
- Provide as much information as possible to potential purchasers, allowing for commercial sensitivities, to allow bidders to understand risks and to put a value on potential upsides and synergies
- Provide a useful data room clearly focused on the key value drivers, commercial and legal matters, and purchasers' anticipated areas of concern
- Ensure all the information provided to potential purchasers is consistent and robust
- Prepare an appropriate sales & purchase agreement
- Prepare a separation plan and identify related separation costs
- Provide a constructive Q&A process to assist purchasers
- In an auction process achieve genuine competition in the disposal process, and keep as many bidders active in the process for as long as possible, giving exclusivity at the last possible moment
- Manage purchasers' direct access to the business
- Encourage and facilitate pre-emptive offers.

## How do you limit value leakage post completion?

- Minimize the level of warranties and indemnities, and tightly draft the wording
- Carry out a rigorous disclosure process
- Design a robust purchase price adjustment and completion accounts mechanism
- Implement the separation plan.

# Survey methodology

KPMG International extends its thanks to all who have taken the time to participate in this survey.

This is the second KPMG disposal survey. It is broader in scope than the first, which was published in 2004, and includes a wider sample of corporate entities and PE firms, as well as a broader geographical focus. The overall purpose of this survey was to identify developing trends in the disposals process and the factors which help deliver successful disposals. No distinction was made between carve-outs and disposals of whole businesses as the principles are the same.

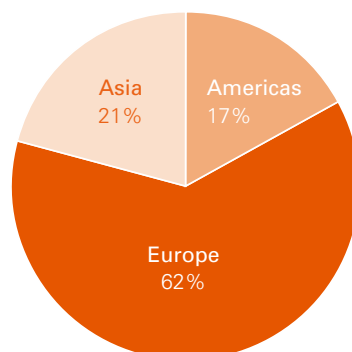
The survey's findings are based on telephone interviews with M&A decision makers in 358 corporate organizations, comprising both large and mid-market companies based in Europe, North America and Asia. 61 PE firms were also interviewed with a similar geographical spread. The countries covered by the survey were China (and Hong Kong), France, Germany, India, Ireland, Italy, Japan, Korea, Netherlands, Poland, Russia, Spain, Sweden, Switzerland, Singapore, U.K. and the U.S.

The core research was supplemented with a selection of in-depth qualitative interviews.

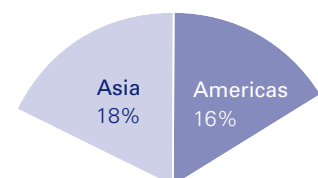
To preserve the confidentiality and anonymity of survey respondents (and in accordance with standard market research guidelines) the survey was carried out by TNS Financial & Professional Services and not by KPMG International or KPMG member firms.

## Geography of respondents

Corporates



PE firms



Source: KPMG International

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