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Considering the Acquisition of a Business Unit of a Large Company? Part One

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Unique Issues Regarding Carve-Outs

In the course of assisting our clients in evaluating potential acquisitions, target companies are typically 'stand-alone' entities that lend themselves to a fairly direct analysis. However, in numerous instances, our clients have contemplated the purchase of individual business units that were part of larger corporate organizations. These types of transactions are referred to as carve-outs.

The evaluation of a carve-out presents unique challenges and other considerations that need to be identified and addressed. We have highlighted several important items that we have observed during our work on carve-out acquisitions.

- *Understanding the real reasons for divestiture.* The biggest reasons for a corporation's desire to carve-out a business unit or subsidiary include:
  - The business unit is no longer aligned with the core mission of the parent;
  - Prospects of financial growth of the business unit are a drag on overall growth levels; and
  - The disposal of significant actual or potential liabilities.
- *Importance of brand recognition and customer relationships.* We assisted with the evaluation of a business unit of a health-care supply company that manufactured automated delivery equipment. The health-care supply entity's parent company's name and relationships with customers provided the subsidiary with a high level of visibility and cache within its industry. We helped our client to assess the downside risk relative to the loss of the parent company's brand recognition and customer relationships and the impact on the valuation for negotiation purposes.
- *Key business processes and systems.* This evaluation first involves the identification of processes that are stand-alone and those that are intertwined with the parent company.The stand-alone business and processes are less problematic and can usually be more easily addressed. For processes that are combined with a parent company, the acquirer must determine the manner in which the carve-out can effectively be managed on Day One after the transaction.This often involves the negotiation of a separate service agreement where the acquirer is able to utilize the seller's systems for a certain period of time after the transaction. It is also important that the buyer has a well-designed plan to transition from the seller's systems in a timely manner onto a platform where the business can be effectively managed. Obviously, these related costs must also be included in the underlying valuation for negotiation purposes.

The items above are some of the more important items for consideration. However, there are other key issues for evaluation when contemplating the purchase of a corporate subsidiary or business unit. We will highlight several of these in the near future.

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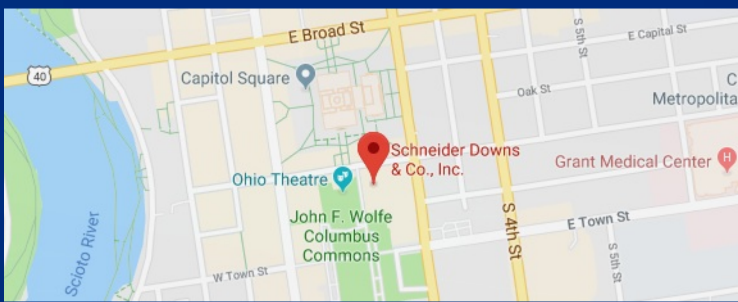

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