

Corporate carve-outs.

UNLOCKING HIDDEN VALUE



Unlocking hidden value

Financial sponsors are increasingly looking to carve-outs as a way to deploy capital outside highly competitive auction processes. Carve-outs also provide opportunities to unlock hidden value from an underperforming, undervalued or unloved business unit. We anticipate that during and following the Covid-19 crisis larger businesses will be looking to shore up balance sheets and so these transactions may become even more common in the coming 12 months.

Whilst the opportunities are considerable, carve-out deals present a unique set of challenges which need careful management to ensure that you acquire the business you want, without hidden costs or risks.



We set a very ambitious timetable and the Travers Smith team delivered, offering sound commercial advice whilst never losing sight of the bigger picture. An outstanding performance from a team that have delivered for TA time and time again. They are truly market leading.

Chris Parkin, Partner, TA Associates

(Travers Smith advised TA Associates on the acquisition of the single strategy asset management business of Old Mutual Wealth)

Transaction perimeter

What are you buying, how will you protect its value and what are you leaving behind?

You need to make sure that you acquire all of the assets required to operate the target business without assuming unwanted or unforeseen risks and liabilities. Certain types of liability (e.g. some environmental liabilities and DB pension scheme issues) cannot be left behind and, where relevant, specific protections will be needed in order to mitigate these risks.



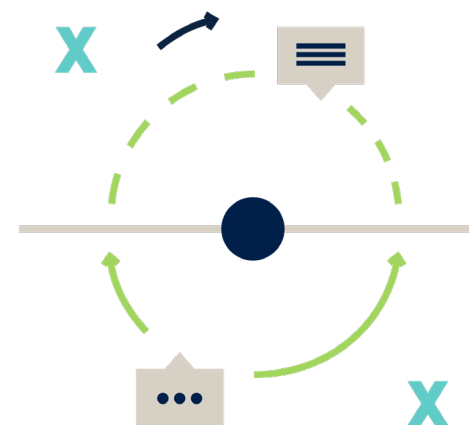
Detailed information and diligence will be required to make sure you have sufficient clarity on the transaction perimeter.

Does the target business have stand-alone accounts to diligence?

If not, special purpose accounts will be needed to form the basis of locked box accounts or to set the targets for completion accounts. A completion accounts mechanism may be preferable (particularly where there are inter-company loans, trading balances or other intra-group positions which make it hard to 'lock the box' around the target business).

Intra-group positions

It is important to distinguish between (i) inter-company balances arising from arm's length trading arrangements (on the other); and (ii) balances which arise from the recharge of central costs and / or intra-group funding balances between the target business and the retained group (on the other). Whilst the former might be treated as genuine third party trading balances, the latter will need to be unwound. In both cases, careful consideration is required to dovetail with a locked box.



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The Travers Smith team skilfully dealt with the complexities and multi-jurisdictional nature of our investment in Estera, and successfully delivered to a challenging time frame. These are exactly the attributes we look for in our advisers and ones Travers Smith have demonstrated time and time again.

William Paul, Head of Financial Services, Bridgepoint

Separation

Understanding how you will separate the target business from the retained group (and what that will cost) is key.

Is the target business prepped for sale?

Ideally the Seller will have undertaken a pre-sale exercise (with input from external advisers) to ensure that the assets, contracts, IP, employees etc. which comprise the target business have been (or can be) separated from the retained business pre-completion.

If not, a detailed exercise will be required to establish a separation plan. If not well progressed as part of the pre-transaction preparations, this is likely to have significant cost/timing implications for the transaction. From the outset, you will need to agree who is bearing the cost of any reorganisation.

Day 1 operations

It is vital that the target business can be fully operational on a stand-alone basis from Day 1. Key things to consider include:

Working capital

- Will the target business have sufficient working capital to allow it to operate on Day 1 (e.g. following any cash sweeping/pooling by the retained group, repayment of intra-group balances and/or the target business ceasing to benefit from group wide working capital management schemes such as invoice discounting/supplier finance arrangements).

Transitional services

- What key central/group wide services/resources will need to be accessed on an interim basis under a transitional services agreement (TSA)? Early access to, and engagement with the target's management, is key to understanding what will be needed.
- Will any services need to be provided by target business back to the retained group?

Employee benefits/incentives

- It is likely that the target business' employees will cease to qualify for the retained group's benefit schemes (e.g. pensions, medical, life and/or permanent health insurance). Appropriate replacement schemes will need to be in place from completion.
- If employees of the target business are members of a share incentive (or similar) scheme operated by the retained group, it will need to be agreed how this will be dealt with on/after completion.

Property

- If properties need to be moved in or out of the target business, landlords will often require a parent company guarantee or an authorised guarantee agreement (AGA) as a condition of their consent to assign.
- Where this is required, these provisions will often need to be backed to backed in the purchase agreement to ensure the liabilities sit in the right place.

Tax

- Tax issues arising on a separation will depend on the structure of the transaction (e.g. whether it is a share or asset sale and whether a pre-sale reorganisation is required). It is important to get tax advisers involved early to steer around any pitfalls.
- It is also important to ensure that the target business has everything it needs from a tax perspective in place in order to continue to trade efficiently post carve-out, in particular VAT registrations and payroll capabilities.

Insurance

- What new stand-alone policies will be needed and what period should they cover (i.e. is some element of cover required for historic issues or can you rely on the retained group's policies?).
- What access is required to the retained group's existing insurance policies (e.g. in respect of prior claims periods and/or ongoing claims).

Wrong pockets

- The transaction documents should provide for pass through arrangements in respect of cash ending up in the wrong place for accounts receivable (e.g. payments from customers).

Third party involvement

Separating the target business from the retained group is likely to trigger third party consents. Examples include:

- Shareholder approvals for the retained group (particularly where the retained group is listed and the deal is a Class 1 transaction).
- Consent to change of control/assignment under key customer/supplier contracts (including key leases). For non-key contracts or where a business is contract heavy, formal consent to transfer will not be practical – but there are established approaches to addressing this.
- Regulatory approvals and/or the need to apply for new licences where these were previously held on a group wide basis.
- Guarantees given by the retained group (e.g. parent company guarantees given in favour of a supplier or landlord) which need to be replaced. These can often cause particular difficulties (as third parties are often reluctant to give up the benefit of a parent company guarantee without securing some additional leverage).

Communications

Communications will help to facilitate a smooth separation.

Key issues to consider include:

Employees – making sure that the separation (including the arrangements for the continuation of key benefits) and what this means for employees is relayed sensitively will help to make sure that the target workforce remains engaged and motivated post-completion. If employees are being transferred under TUPE, this will need to be wrapped up with the required TUPE notifications.

Customers/suppliers – notifying trading partners can be a useful way of making sure that accounts receivable and inbound enquiries are redirected to the correct target business entities quickly post-closing as well as forming part of a bulk contract assignment process post-closing.



The service provided by the Travers Smith team was first class. Their ability to provide and coordinate highly technical advice across multiple disciplines, combined with a truly commercial approach and ever impressive response times, was critical to delivering a complex transaction under very tight time pressure.

Joe Chambers, Senior Managing Director, Evercore
(Corporate Finance Advisor to TA Associates on their acquisition of Old Mutual)

Selected highlights



Advised TA Associates on the carve-out of the Single Strategy asset management business from Old Mutual Wealth.



Advised Inflexion, on the carve-out acquisition of Marley, a UK-based roofing specialist.



Advised Bridgepoint and other selling shareholders on the carve-out of the Estera fiduciary services business from Appleby law firm.



Advised Cambridge Education Group on the separation and subsequent sale of its CATS Colleges division.



Advised Bridgepoint Development Capital on the de-merger of HKA Global from Hill International.



Advised Equistone on the carve-out of Bulgin from Elektron Technology plc.

Key contacts



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