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Insights

Value recovery in the automotive industry

Maximising value from non-core assets

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Introduction

THE AUTOMOTIVE INDUSTRY will look back upon the time of the COVID-19 pandemic as a watershed. This is not only because of the economic downturn it has caused but more because of the way the crisis has accelerated already evident disruptive trends to the point that a radically different value chain is emerging faster than could have been anticipated. Automobile companies that want to remain relevant and to capitalise on this development need to take bold, transformative action now.

Experience shows that both down cycles and major systemic shocks – such as the sector is experiencing – can present unique opportunities to change the direction of a business. This report outlines how companies can identify and capitalise on assets that will not be part of their core business in the coming decade. Further, it explains how this repositioning can make a company more agile and flexible to take advantage of the wide range of high-growth opportunities that are likely to emerge during the post-pandemic recovery.

This report outlines how companies can identify and capitalise on assets that will not be part of their core business in the coming decade.

Automotive non-core assets in the spotlight

A RADICALLY DIFFERENT VALUE CHAIN is emerging in the automotive industry where mobility is purchased as a flexible service and vehicles are connected, autonomous and electric. This is the opposite of the traditional automotive business model where privately purchased, hardware-focused, human-driven vehicles powered by internal combustion engine (ICE) are the norm.

The speed and scale of this change differs across the value chain and different geographies. It is also too simple to say there is a traditional model and a future model with clear winners and losers. Emerging disruptive forces present a spectrum of impacts for organisations from positive to negative, and from rapid revolutionary market changes to slower evolution over decades. An example is regional nuances in the adoption of electric vehicles (EVs), which is anticipated to be much faster across Asia and Europe compared to the United States.

While the speed and route to a future automotive value chain will vary, we believe the ultimate destination is common. To prepare your organisation for this change, you need to take decisive action around what your future strategy and operational configuration looks like.

As part of these considerations, companies (including dealers, original equipment manufacturers (OEMs), suppliers and service providers) will likely identify within their organisation a technology, product line and/or division that needs to be reviewed and potentially given a new direction. This is because continuing with the same strategy that benefitted from the strong automotive market of the past is unlikely to optimise returns in this evolving market. Particular attention needs to be paid towards areas that will not be part of your core strategy over the next decade and beyond.

Assets identified as 'non-core' will differ in scale. For some companies such assets are a small part of the overall business. For others, a desire to leverage previous investments will mean they constitute a larger portion. Some companies (particularly suppliers and dealers) may face stark decisions – their whole business may fall into the non-core category and require strategic review.

Managing non-core assets to deliver value

WE PRESENT FOUR potential responses (figure 1) to help business leaders, management teams and shareholders understand the options when considering how to manage non-core assets.

The responses presented in the non-core asset value recovery matrix consider the intensity of the transformation required and the focus on where your transformation needs to take place:

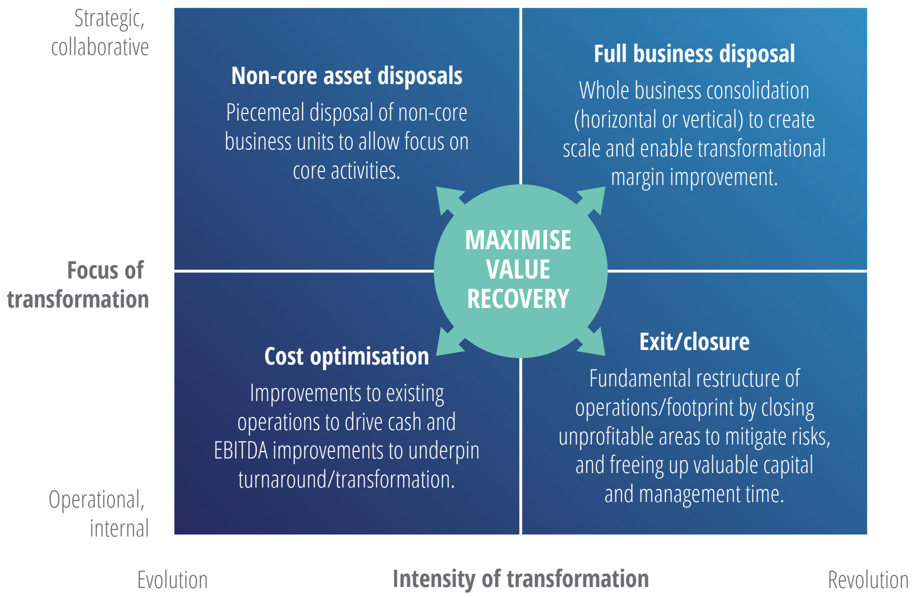
- **Intensity of transformation:** How fundamental and how intense is the transformation of your business model? Is the transformation evolutionary with incremental gains sought by rearranging the existing business, or is the transformation more revolutionary with previously entrenched positions, ideas and strategies abandoned and replaced with new ones?
- **Focus of transformation:** Is the business model transformation internally focused under the existing ownership structure or does it involve new ownership for the non-core asset to unlock transformation otherwise not possible?

No single response is the preferred or only option for a business. Each response suits different situations and aligns differently to overarching strategic priorities. A combination of approaches will likely be needed to deal with different non-core assets, according to their characteristics and position/prospects.

The purpose of this report is twofold. First, we explore factors associated with each response and the potential business impact. Second, we provide guidance on best practice behaviours associated with implementing the response to help businesses maximise the value created through transforming their non-core assets.

FIGURE 1

Non-core asset value recovery matrix



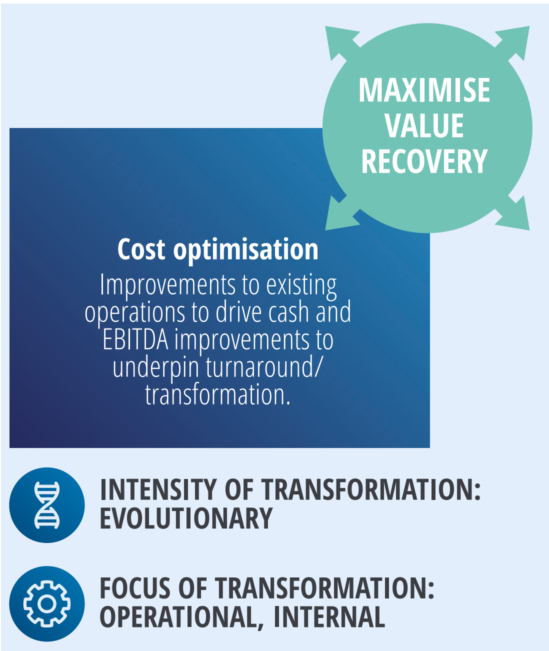
Source: Deloitte analysis, 2020.

Part 1: Assessing the most appropriate response

MANAGEMENT TEAMS AND shareholders need to identify the non-core assets of the business and the scale of transformation needed to bring the most benefit from each asset in the short and medium term. Understanding the details of each possible response helps management teams frame their deliberations and prioritise value recovery actions.

Internal improvement and restructuring

COST OPTIMISATION



The principle objective of a cost optimisation project is to maximise business productivity through increased efficiency and effectiveness across the value chain to drive profit and cash flow improvements.

Three areas of focus in a cost optimisation project are:

1. **Process improvement:** Assessing business processes to identify areas to drive greater efficiency and effectiveness.
2. **Resource allocation:** Identifying functional areas of misalignment in resource investment and allocation to improve productivity and return.
3. **Infrastructure and technology enablement:** Capturing opportunities to enable greater productivity across the business by optimising infrastructure, systems and technology.

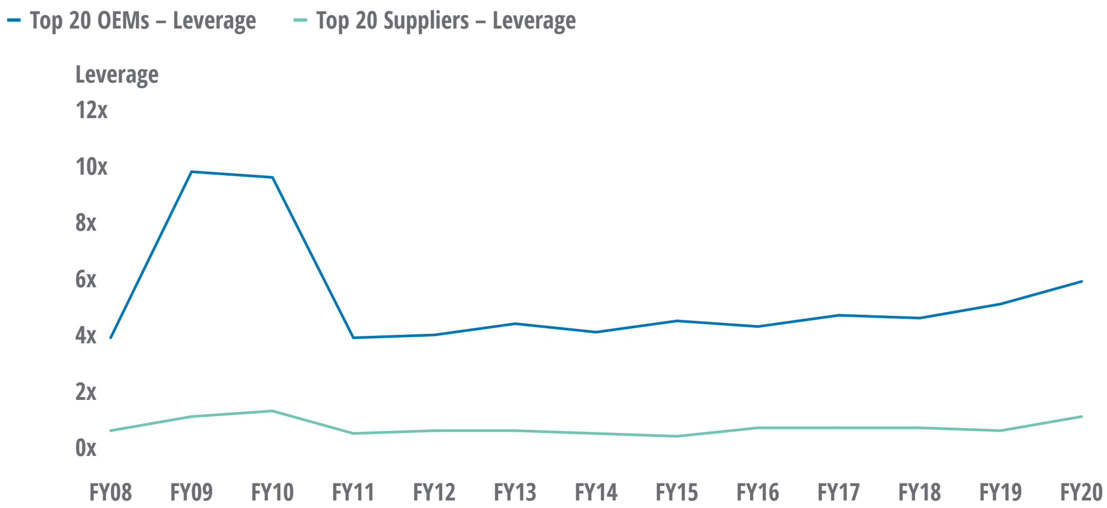
In dealing with distressed assets, cost optimisation projects are often more useful than narrow-focused cost-out programmes. But delivering a cost optimisation project in the current climate is a challenge. COVID-19 has already driven businesses to cut costs with examples in the automotive industry including, but not limited to, reduction of inventory levels, renegotiation of key contracts, review or delay of capex investments, stopping or reducing performance rewards and a temporary freeze on new hires. However, cost optimisation will be needed to provide businesses with the flexibility and agility they need to capitalise on any potential market recovery.

Flexibility is particularly important in the context of the leverage levels within the largest 20 OEMs and largest 20 tier-1 suppliers, which were higher pre-COVID than directly before the global financial crisis (see figure 2). In the post-COVID recovery period, companies will need to focus on cash flow to support covenant compliance and to service debt repayments and interest costs.

FIGURE 2

Automotive industry leverage

Leverage (net debt/EBITDA)

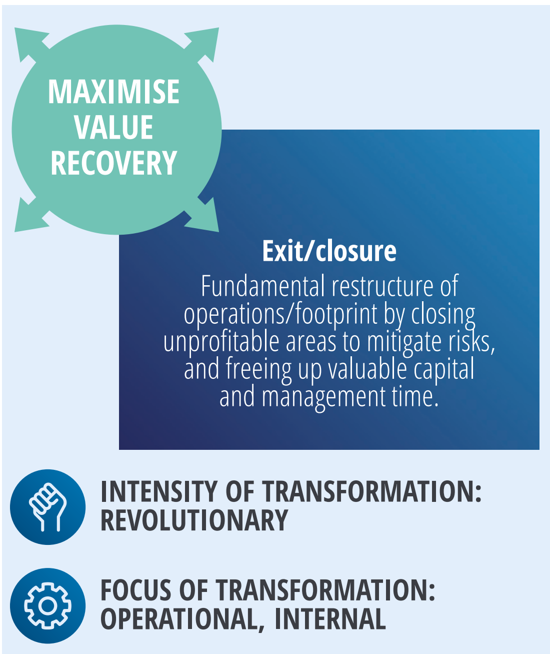


Source: Deloitte analysis, 2020.

While short-term cost-reduction initiatives have been necessary, a more structured and strategic reflection on the cost base will be required to boost recovery and prepare businesses to thrive during uncertain times. At a minimum, this will include assessing the financial impact of cost reduction and optimisation measures from both a functional and end-to-end process perspective (that is, order to cash, procure to pay, etc.) to understand the cost and the potential value created.

If a robust performance improvement process does not deliver anticipated benefits or is not considered a viable option, the optimum strategy may be an exit from the underperforming subsidiary or business unit through a managed wind-down and closure.

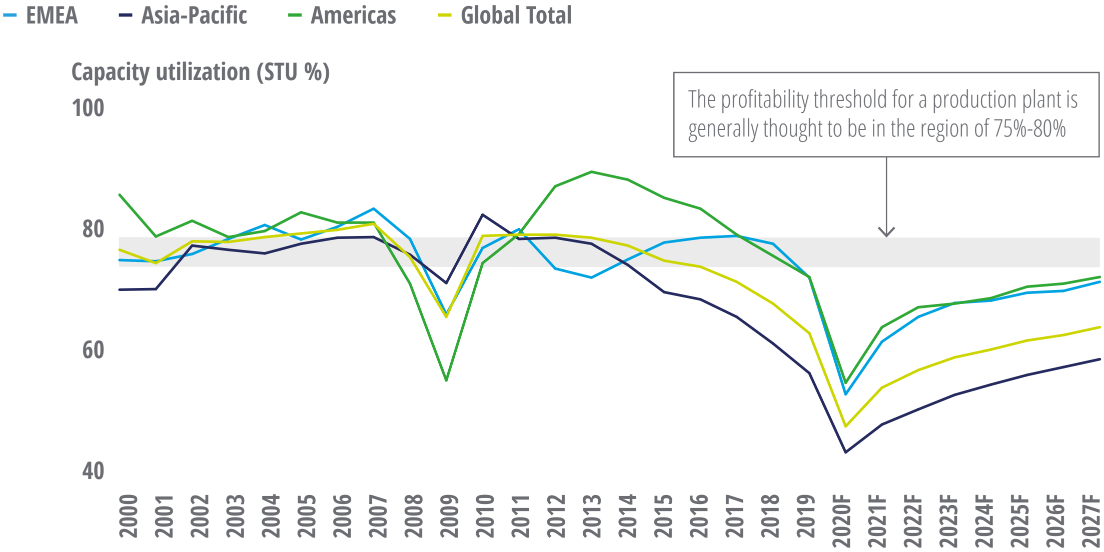
EXIT/CLOSURE



If a robust performance improvement process does not deliver anticipated benefits or is not considered a viable option, the optimum strategy may be an exit from the underperforming subsidiary or business unit through a managed wind-down and closure. This response is likely to be seen in organisations facing material and potentially permanent structural

FIGURE 3

Light vehicle capacity utilisation – by region (2000-2027 forecasted)



Note: Straight-time capacity utilisation (STU) is calculated based on individual plant crew structure (i.e., number of shifts), excluding overtime.

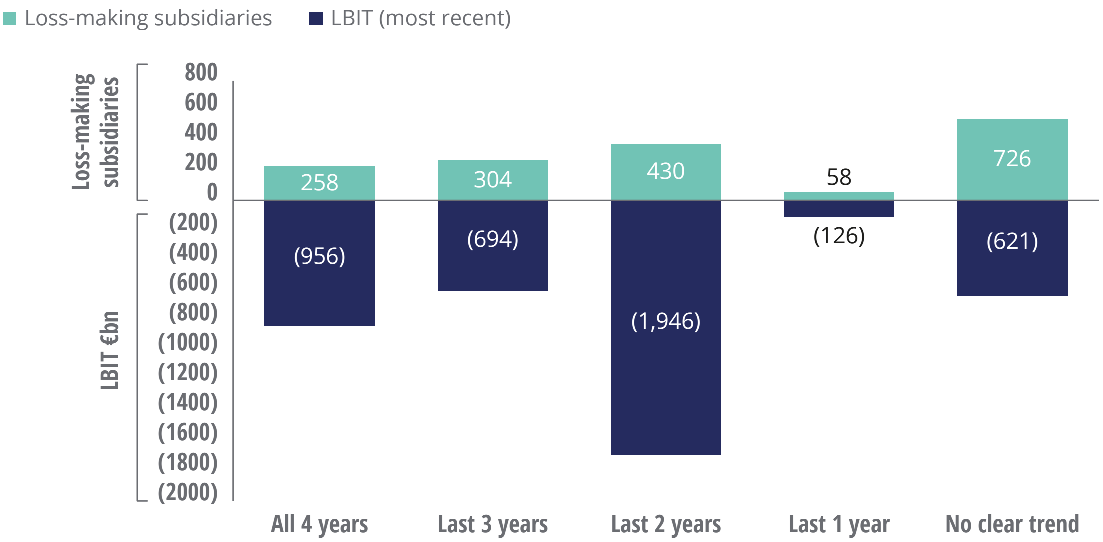
Source: IHS Markit, 2020.

challenges as a result of long-term declining demand for ICE products, as well as suffering from the short- to medium-term impact of COVID-19.

One of the visible impacts of COVID-19 was the closure of factories as measures to protect public health. These actions, combined with depressed demand, have pushed factory utilisation to historic lows with capacity utilisation falling well below normal profitability thresholds (figure 3). Without reductions in capacity, utilisation is expected to recover gradually. Post COVID-19, businesses could be expected to close non-core assets with greater frequency, although this will be dictated by specific market dynamics.

FIGURE 4

Loss-making automotive subsidiaries (Europe)



Source: Mint, 2020.

An analysis of European loss-making subsidiaries indicates the scale of leakage of operating profit over the past four years (see figure 4). Last year, a total loss before interest and taxes (LBIT) of €4.3 billion was incurred. While there may be a strategic rationale for retaining each business contributing to this figure, and while a proportion will return to profitability through a turnaround process, closure may be the best option for the remainder given other pressures being exerted on the industry.

Closing a distressed asset assumes that a financial restructuring or turnaround is not viable. In many cases, this is because even with a revised capital structure, the forecast P&L cannot effectively service the capital structure. Therefore, financial restructuring would 'kick the can down the road' rather than offer a long-term solution.

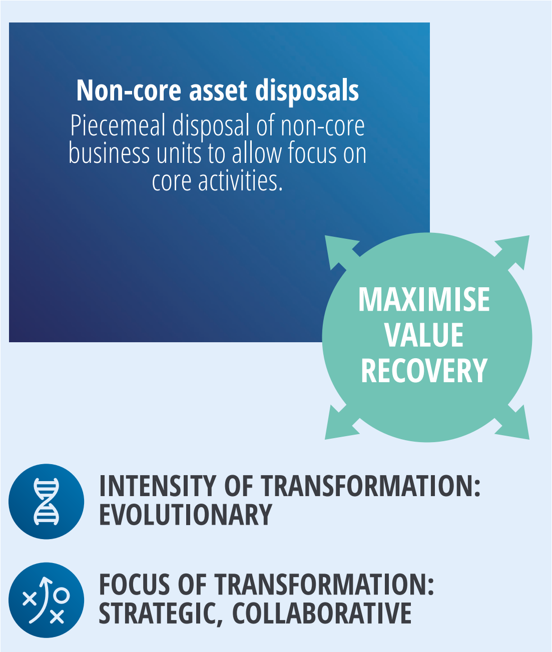
If a financial restructuring is preferred, the initiative must be coupled with a robust turnaround plan, with a focus on profitability improvements and cash generation. Failure to do so means there will be inevitably a similar situation of financial underperformance and potential liquidity pressure in the future.

Ultimately, a managed wind-down and closure of a non-performing asset can improve the performance and viability of the overall operations. It can also reduce exposure to non-core businesses or markets, mitigate risks and free up valuable capital and management time.

Divestment

The internal improvement and restructuring programmes identified in this report are commonly the first approach adopted by management teams looking to transform a non-core asset. However, the other main consideration is if the business could thrive under different ownership.

NON-CORE ASSET DISPOSALS



From a seller's perspective, one of the benefits to disposing of (rather than 'fixing') a non-core asset is the ability to enact a rapid solution. Disposing of a whole business, division or product line deals with the issue of being invested in a market that is no longer attractive or core in the medium to long term. This response is decisive and conclusive.

The disposal of units that require extensive carving out from a financial and operational perspective are more complex and take longer than whole business disposal. However, disposal typically allows faster progress than the extensive time and management attention a turnaround improvement programme requires.

Another benefit of asset disposal is the realisation of value. However, this depends on the asset. The existence of a buyer pool for the asset and a level of competition among bidders is a determinant of the possible value, and this depends on several factors:

- current profitability of the business and the attractiveness of existing commercial contracts with customers (for example, the exclusive distribution contracts dealers have with OEMs, or the contracted position suppliers have on key OEM platforms/models)
- nature of the underpinning technology and whether this has a level of IP protection that will help defend margins, or is commoditised and therefore has margins prone to low-cost competition
- ease of enacting the carve-out (as well as the re-integration for corporate buyers)
- scale of potential efficiency improvement opportunities based on:
  - size (turnover and cost base)
  - geographical footprint
  - potential synergies with a buyer's existing business.

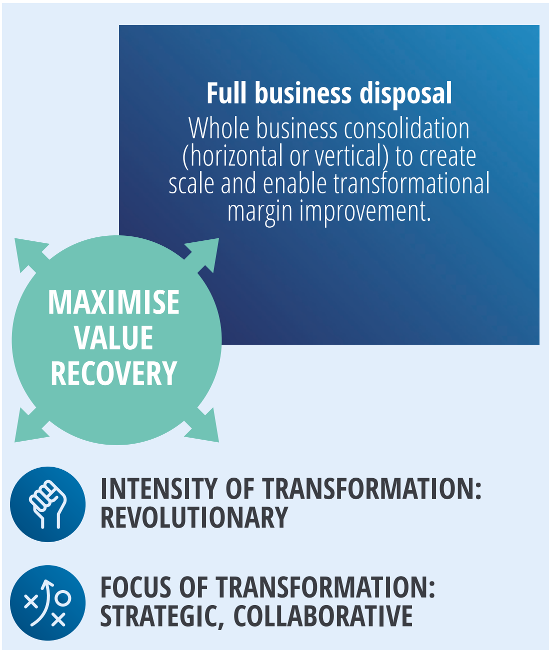
Unprofitable, traditional technology-based businesses facing a shrinking market and requiring extensive effort around carve-out and synergy capture will attract less attention and, therefore, a lower price.

When an attractive price cannot be negotiated, disposal at a low (or even negative) price could still be in the interests of the seller if the disposal eliminates the need for significant R&D expenditure related to older technologies, mitigates the need for a costly and bandwidth-consuming restructuring programme (including the negative PR impact of redundancy programmes) and/or avoids future operating losses as the market contracts.

Under such conditions, giving away the non-core asset (even with a dowry) can be a good deal for the seller over the medium to long term.

Linked to this is an increasing trend towards executing non-core asset disposals by joint venture (JV) formation or separate listing/ring-fencing. While this does not deal fully (or at all) with the vendors' exposure to the current and future performance of the asset, it does have benefits. The upfront carve-out required to get the business on a stand-alone basis makes future disposal easier and enables the remaining business to focus on core strategy execution. If structured correctly, it can also isolate financial liabilities.

FULL BUSINESS DISPOSAL



Many of the benefits, challenges and features associated with the carve-out and disposal of individual business units/divisions equally apply to the disposal of a whole business. However, there are considerations specific to whole business consolidation.

Full disposals are commonly associated with horizontal consolidation, which has been a feature of M&A in the sector in recent years. Examples are OEMs operating in the same customer segments, suppliers focusing on the delivery of similar parts/modules or dealer networks serving the same geographies.

The resulting larger businesses will be better placed to maximise value capture from non-core assets by combining income streams and more efficiently utilising their asset and cost bases in the face of lower market volumes.

However, it is also anticipated that the sector could see a new consolidation dynamic: vertical consolidation. This would be a reversal of well-developed procurement strategies at OEMs and large tier-1 suppliers. For more than a decade, the trend has been for OEMs to outsource complex and invaluable modules (from instrument panels and powertrain modules to HVAC systems and door modules) to tier-1 suppliers.

The OEM manufacturing process has increasingly become an assembly operation, with the manufacture of modules and parts handled by suppliers. Accordingly, tier-1 suppliers have outsourced detailed parts manufacturing to sub-tier suppliers located across a complex, integrated global supply chain.

Two emerging pressures have led to this changing dynamic: First, COVID-19 was a shock to the hyper-efficient 'just in time' supply chains refined to be as close to real time as possible. As the pandemic impacted automotive factories, production halted as parts could not be manufactured or delivered in sufficient time or quantity.

This has brought in to question the resiliency of automotive supply chains and whether the pursuit of ever-increasing efficiency has gone too far. OEMs and tier-1 suppliers are considering bringing production of critical parts/components back in-house to secure supply and avoid significant disruption in the future. Vertical consolidation around specific geographies is also a solution being considered to enable increased resilience. This means creating larger supply bases with enhanced capabilities through mergers and that reduce logistics risks by being closer to the OEM factory gates.

Second, vertical consolidation is being viewed as a tool to help stabilise profit levels in the face of lower volumes. Companies are trying to make more income from each vehicle to make up for the gap left by lower volumes. The focus has been on complementing product sales with service sales, particularly around digitally enabled mobility solutions. However, capturing additional margin from each vehicle by expanding the level of value-add content 'owned' on each one, whether at the OEM or supplier level, is a feature of vertical consolidation being explored by industry executives.

The current market environment presents a unique opportunity to change the direction of a business, and sell-side M&A can be an effective tool for companies looking to reinvent themselves. However, creating maximum value through divestiture can be challenging. During the industry consolidation expected to emerge – whether by acquisition of non-core divisions, or consolidation of whole businesses horizontally or vertically – it will likely be a buyer's market in the near future.

The cost of executing a value-creation strategy through buying, combining and rationalising automotive companies is currently low due to the disruption impacting the market, which is depressing deal prices and creating opportunities around stressed and distressed assets. Simultaneously, the potential for profitability improvement is high, due to these same issues. This means that the potential for creating value is there for buyers up for a challenge. Private equity investors (PEIs) are well-placed to capitalise on this opportunity. According to recent research, the top 400+ PEIs active in the automotive industry are estimated to have more than US$1.2 trillion of unallocated "dry powder" as of September 2020.[1]

Part 2: Implementing your response

HAVING CONSIDERED WHAT parts of the business require transformation and which of the four value recovery responses is best suited to delivering maximum value from that transformation, management teams must quickly execute. By nature, a restructuring programme or disposal project is complex and typically outside the day-to-day core skill set of the organisation.

As a result, such projects carry significant risks. A poorly planned project can lead to milestones being missed, cost overruns and value leakage.

Implementing cost optimisation

Cost optimisation should be targeted at maximising efficiency and effectiveness across the value chain and driving flexibility. Three strategies should be put into action to derive the most value:

1. **Be bold.** Translate strategic goals into a bold yet realistic transformation programme with executive buy-in. It requires courage to pull the right structural levers and look declining performance directly in the eye!

2. **Focus on value.** Be explicit about how you intend to create value and focus on driving execution. There are unlikely to be shortcuts in this process.

3. **Reinforce agility and flexibility.** Implement an agile approach that delivers quick wins through an iterative process.

The best programmes have clear goals and priorities that increase resilience to the existing challenges a company faces and act as an enabler for strategic priorities. It is important to lay a solid foundation for any cost optimisation exercise by determining your addressable baseline and assessing the potential impact across all cost levers available to your business.

DETERMINE YOUR ADDRESSABLE BASELINE

The first step is to assess financial and organisational baselines to establish a starting point of your cost optimisation. This baseline typically consists of four costs:

1. **Indirect spend** – Costs related to the purchase of goods and services that allow the organisation to operate but are not linked to the manufacturing of its goods or delivery of its services.

2. **Extended workforce** – Costs related to off-balance-sheet workforce including contingent workers and external providers.

3. **Labour** – Direct costs linked to the compensation of on-balance-sheet employees (permanent and fixed term).

4. **Materials** – Direct costs linked to the purchase of raw materials/products as part of the manufacturing process or delivery of services.

EXPLORE THE DIFFERENT COST LEVERS

Having determined your addressable baseline, your organisation can consider cost improvement initiatives by scanning the baseline through six different cost functions. The purpose is to develop tactical and strategic transformative improvement initiatives, as shown in figure 5.

FIGURE 5

Tactical and strategic transformative improvement initiatives

Function/area	Transformative improvement initiatives
01 ORGANISATION STRUCTURE	• Assess cost structure across geographies, business units and channels. • Review key roles and responsibilities particularly between centre and business units.
02 OPERATIONS	• Perform benchmarking of portfolio companies in similar sectors (including operational, cost and working capital KPIs), and identify improvement levers. • Assess footprint optimisation potential.
03 IT/TECHNOLOGY	• Provide an efficient and scalable platform, and optimise IT applications and infrastructure. • Assess IT projects and test completeness and robustness of business cases including benefits.
04 FINANCE AND HR	• Assess repetition in work and additional organisational overhead due to fragmented processes with various teams seemingly undertaking similar activities.
05 THIRD-PARTY SPEND	• Assess controls over third-party spend, including delegated authority and approvals levels.
06 CAPITAL PROJECTS	• Review business cases for ongoing or planned capital projects, including assessing whether there is a clear line of sight on costs to deliver and proposed benefits are properly identified and realistic.

Deloitte analysis, 2020.

MAKE YOUR PERFORMANCE IMPROVEMENT A SUCCESS

When implementing a cost optimisation project through one or a combination of tactical and strategic initiatives, there are six success factors that will help you maximise success:

1. **Stakeholder ownership:** Accountability is key, so a designated owner must be assigned to each initiative.

2. **Actionable initiatives:** Identify actionable initiatives – no 'theory talks'. Consider the 'agility' of your organisation, and focus on bite-sized initiatives.

3. **Fact-based, data-driven approach:** Define a clear current-state cost base detailed enough to withstand challenges.

4. **Cost programme command centre:** Establish a dedicated cost-reduction team to monitor costs and benefit realisation and to initiate corrective measures should the need arise.

5. **Communication:** Realigning the cost base can be hard on employees and potentially amplified given the increased prevalence of remote working. Make use of virtual forums for employees to share concerns and for leaders to provide transparency.

6. **Resiliency:** A cost optimisation project should not be a stand-alone, one-off exercise. The project should build resilience into your business so that you are prepared for the next crisis/challenge. This means making your cost baseline transparent, flexible and scalable and putting measures in place to monitor and report on cost performance.

Implementing exit/closure

Implementing an exit without a well-thought-out and structured plan can negatively affect financial performance and reputation. For some businesses and management teams, the exit is a defining moment, one that can release tangible benefits to the bottom line. However, it must be presented as a transition to the future to avoid a sense of failure in the retained operations.

A well-managed closure should follow three steps:

1. **Options analysis** – An organisation must consider if closure is the correct approach to deliver value to stakeholders. Would a performance improvement programme or non-core asset disposal deliver more value?

2. **Implementation planning** – Detailed planning of the exit process is key to meeting objectives and avoiding common pitfalls that erode the potential benefits to the remaining business.

3. **Implementation** – It is imperative that organisations execute their plan and achieve their objectives using robust project management disciplines to avoid slippage and value leakage from the process.

Implementation planning and implementation are the most important parts of a managed wind-down or closure. To conduct an options analysis, an organisation should consider not just whether to exit a business but how they exit, while mitigating risk and maximising the return to the core business. A comprehensive options analysis answers if there is a:

- requirement for a 'clean break' from non-core business

- need to stem losses in an underperforming business unit to avoid a material adverse impact on the wider business

- plan to minimise the impact on remaining core business operations – freeing up management time and available capital to be invested in growth areas

- plan in place to protect the core business reputation and stakeholder relationship

- viable business for the future or whether closure is the best option.

In many cases, a managed wind-down and closure will be the option that will deliver the most value to shareholders and have the most significant and positive impact on the business. This holds true even if a dowry payment is needed to avoid future investment and distractions from core operations made on management's time.

Implementing non-core asset/full disposal

Best-practice behaviour for disposing of an automotive asset is broadly the same for non-core assets (response 3) and full disposals (response 4). Substantial differences in best practices commonly emerge after the sale in post-deal integration and value optimisation programmes. However, in 'getting the deal done' there are more similarities than differences.

PREPARATION TO ESTABLISH, ENHANCE AND DEFEND VALUE

The key to executing a disposal is preparation. Preparation of the underpinning value story behind the sale and preparation of the business to enhance and defend that value (figure 6).

FIGURE 6

Establishing, enhancing and defending value through comprehensive preparation

Preparing the value story and preparing the asset for sale

ESTABLISH VALUE

01 **Through transaction planning** – buyer identification, clear perimeter definition, go-to-market strategy.

02 **Compelling value story** – clarity on where the business sits in the changing market in terms of customer relationships, product technology, trend exposure.

03 **Performance improvement potential** – clear path to additional value from operational improvements (profit and cash conversion).

04 **Detailed and robust financials** – historical underlying track record and projections that support the value story.

ENHANCE VALUE

05 **Pre-deal business optimisation** – implementation of improvement plans to full extent possible before going to market (working capital, balance sheet, operations).

06 **Pre-deal synergy planning** – clear articulation of potential synergies, with supporting analysis/planning, to highlight additional value opportunities.

07 **Separation planning** – development of a detailed separation plan to clarify the actions required and reduce uncertainty for buyers, particularly around the manufacturing footprint, IT infrastructure and back-office TSAs required.

DEFEND VALUE

08 **Avoid value leakage** – early identification of risks/liabilities, to either layout detail for buyers and/or mitigate exposure: a 'no surprises' approach.

09 **Tax optimisation** – tax structuring work to minimise tax impact of the divestment (for the seller and buyer).

10 **Comprehensive stakeholder management plan** – thorough and coordinated communication with key stakeholders in the business.

Deloitte analysis, 2020.

Executing a disposal is fraught with risk, especially in the current market environment, which can lead to valuation expectation gaps. While agreements can be completed close to signing, sellers would do well to prepare, align them internally and build a supporting narrative or investment hypothesis well in advance.

According to cross-industry research, changes in the market environment and corporate strategy aside, the largest hurdles to divestitures anticipated this year include changes in operating performance (36%), inability to negotiate acceptable deal terms (35%) and inability to obtain acceptable value for assets (33%).[2] In the automotive sector, there are additional factors, such as uncertainty around market volumes, the transition to EVs and a rapidly changing regulatory environment, that all make the creation of an investment hypothesis that stands up to scrutiny increasingly difficult, but completely necessary.

Sellers must now expend significantly more effort helping potential buyers build the hypothesis, making it easy for them to see the value that can be created and to have confidence that uncertainty can be mitigated (or even leveraged).

PREPARATION OF THE VALUE STORY

A clear and consistent value story must be communicated to buyers:

- What is the position of the business in the market in terms of strengths and weaknesses?
- Which market trends is the business exposed to?
- How well aligned are operations to the current and future automotive market?
- What technology underpins its products?
- Where is the value that can be created for a new owner?
- What is required to access it in terms of effort and investment?

If the value story resonates with buyers, then a carefully coordinated go-to-market strategy will pique buyer interest and drive competitive tension.

As it is likely to be a buyer's market for the foreseeable future, getting the value story right and keeping it consistent is crucial to help buyers determine that your asset has value. In particular, having that view as to how value can be created will enable the right buyer(s) to be identified.
Vendors therefore need to identify what would make their assets attractive even if no longer additive to themselves. What makes an asset attractive might not be immediately obvious, especially if it is linked to location, intellectual property or some other intangible asset. The 'right' buyer is someone who understands the asset and its potential, while also being able to justify investing the optimum value sought by the seller.
Businesses embarking on the disposal of non-core assets without a vision that sells will find it harder to attract buyers and convince them to meet price expectations.

A clear value story is also important in ensuring that stakeholders are aligned to the approach.
The expectations and concerns of customers, employees, labour organisations, local and national government, suppliers and other groups will need to be managed. Having a clear rationale behind the transaction, shared with different stakeholders at the appropriate times, will help build acceptance and/or support and avoid damaging relationships or delays that will ultimately impact value.
Once a clear and cohesive value story has been established, the focus needs to shift to the sale.

PREPARATION OF THE BUSINESS FOR SALE

Preparing a business or non-core asset for sale involves a combination of enhancing the potential value and/or defending against value leakage throughout the M&A process. This is delivered primarily through comprehensive sell-side materials. Crucial to a successful deal is to carefully compile and manage the information flow to support buyer targeting, positioning of the business, buy-side due diligence and deal structuring.

Skilled sellers start divestiture planning early. According to recent research, 75 per cent start planning between 4 and 12 months in advance of the sale, with most opting for the high end of that range. Only 8 per cent start separation planning within 3 months.[3]

This is important because the more the information package is prepared, the easier it is for buyers to get and stay interested. And the easier a seller makes it for a buyer to see the potential value in a business, the better chance the seller has of a successful disposal. *The Deloitte 2020 Global Divestiture Survey* identifies five priorities for sellers in preparing a deal for market:

- developing carve-out financial statements (60% of respondents)
- performing a detailed valuation analysis (57%)
- analysing potential deal structures (50%)
- considering tax and legal structure (41%)
- establishing an incentive plan for target management (39%).

Current uncertainty and risk in the sector have the potential to put investors off, so any additional uncertainty arising from poor materials will be difficult to overcome. A thorough process of preparing business and sell-side materials also enables risks and issues to be identified early and avoided or mitigated. This includes defending against value leakage in areas such as off-balance-sheet/contingent liabilities, outstanding liabilities, pension liabilities and tax.

Materials can take different forms, but typically fall into three categories, along with a supporting populated virtual data room:

- **Commercial/financial:** Teaser, Information Memorandum, Vendor Assist or Vendor Due Diligence report(s)
- **Legal:** Vendor Due Diligence or disclosure package, draft sale and purchase agreement
- **Operational:** Day one separation plan (including IT), draft Transitional Service Agreements (TSAs), draft synergy plans.

A thorough process of preparing business and sell-side materials also enables risks and issues to be identified early and avoided or mitigated. This includes defending against value leakage in areas such as off-balance-sheet/contingent liabilities, outstanding liabilities, pension liabilities and tax.

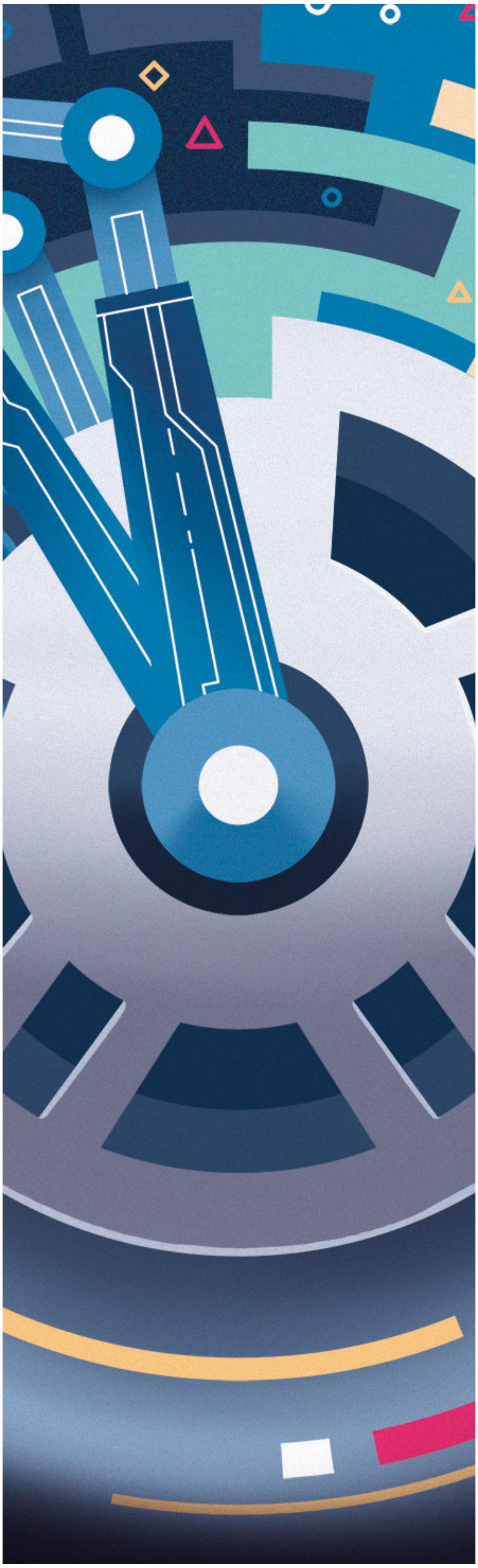
There are two overarching features essential for the package of sell-side materials:

1. **Ensuring alignment:** Every document needs to be aligned to the overarching story articulated to buyers around the value of the business. Any difficult truths should be dealt with at this stage, as issues cause more damage to value if they surface late in the process. The credibility of the materials is paramount. If this slips on one document, it can damage the whole package and destabilise the overall process.

2. **Dealing with complexities:** Sell-side materials need to deal with the complexities of the business and/or the execution of the transaction. All deals are unique, but the following areas are where complexities typically arise:

   - **Definition of the transaction perimeter, particularly on carve-out deals.** Detailing exactly what is included in the target business is critical, especially when the situation is more complex than the disposal of ring-fenced legal entities. This is even more important where the non-core asset being sold is a group of products rather than an existing division or parts (but not all) of several different legal entities. Once the process has started, any confusion risks damaging the credibility of the process.

   - **Availability of financial information aligned to the transaction perimeter.** Often the business/division being sold has a historical record of performance. In these circumstances, a financial forecast will typically be available (at least for the current year). However, in more complex non-core asset carve-outs, the business may form a group of products/operations that have never had financial results separately prepared. This is increasingly common when the disposal perimeters are around product technology, rather than traditional reporting lines such as geography or end market. In this situation, a track record for the target plus a corresponding set of forecast financials will need to be created.



- **Level of operational entanglement the target business has with the parent group.** The extent to which a unit relies on the back-office functions, management team, manufacturing facilities and sales/supplies of the parent company are drivers of carve-out disposals. Potential buyers need to understand these entanglements both practically and financially. In particular, the quantum and details/terms of intra-group trading and costs recharges will be scrutinised. A detailed separation plan is needed for disentanglement to allow confidence that practical steps can be achieved in the required time frame and that costs are understood, as well as the impact on the underlying profitability of the target.
All these ‘clarity’ requirements can be addressed in pre-prepared sell-side documents. As with the financial package, this package can show buyers a path to value. A detailed plan can help turn a complex and expensive disentanglement into an achievable project (with quantified, albeit estimated, costs).

- **IT infrastructure.** IT tends to be one of the largest costs of separating a business and/or integrating it into a new one. Understanding the IT infrastructure within the target business and how it is entangled with the parent group is key to estimating what time, effort and/or expenditure it will take to complete an IT migration. Early understanding of what this will entail means that there are no surprises later on.

Complexity in disposals can concern a buyer and is therefore a risk to value. Time spent preparing sell-side materials before launching a process directly affects the smoothness of a disposal process and ultimately the value obtained. Understanding and documenting these areas, especially if they are complex, gives a seller a bigger chance of attracting potential buyers and keeping them interested.

Now is the time for action on non-core assets

Companies need to make bold decisions about non-core parts of the business focused on the traditional automotive business model. While these parts may not have been in the spotlight recently – as the industry is focused on the rapid pace of technology and market changes – now is the time to pay them attention and maximise the value delivered by them. Faced with this non-core challenge, there are critical questions that you as a business leader need to ask yourself:

Have you undertaken an open and honest assessment of all parts of your business, and where, how and why they fit in to your future strategy?

- Which parts should dominate capital allocation at the expense of other non-core areas?
- Given the scale and pace of change in the market, is your business flexible enough to deliver on your future strategy?

For business parts identified as non-core – whether they be product lines, business units or divisions – have you developed a strategy for maximising value from them?

- Can these assets have cash flows maximised to benefit investment in future capabilities, or should they be sold to free up capital?
- Can these assets benefit from pre-sale performance improvement programmes to maximise value if a sale option is considered?
- What 'no regrets' actions can be taken to release value trapped in working capital?
- Have you considered a broad cost optimisation plan, rather than a simple cost-out programme?
- Have you addressed your cost base in a flexible and dynamic way so you can respond to the post-COVID-19 recovery?
- Have you undertaken detailed scenario planning, flexing assumptions for a range of potential market recovery profiles?

If disposal is an option for non-core assets, have you considered:

- What planning and preparation is required to maximise the likelihood and value of a transaction?
- What would the baseline cost of closure be as an alternative?
- How integrated is the non-core asset with the wider business – can it be sold as a stand-alone business or is a managed wind-down a potential scenario?

Endnotes

1. John Roop, Steve Boyette and Trent LaFrano, "What can we learn from the last recession? Preparing for a new wave of M&A in the automotive sector", Deloitte Insights, October 20, 2020.

2. Anna Y. Lea Doyle and Iain Macmillan, "2020 Global Divestiture Survey: Perspectives on sell-side activity and recent divestitures", Deloitte, 2020.

3. Ibid.

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Contact us

Our insights can help you take advantage of change. If you're looking for fresh ideas to address your challenges, we should talk.

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