



Divesting in difficult times: guidelines for asset management firms

by Susan Prior

In this turbulent economic environment, the asset management industry – traditionally viewed as a source of stable, dependable earnings and cash flows – is subject to significant troubles. With earnings slammed by both falling asset values and growing demands for withdrawals and redemptions, asset managers are coming under increasing pressure to rationalize or retool their investment product offerings, maintain liquidity and implement rapid, sustainable cost reductions. Furthermore, they must also devote more attention to risk management while strengthening their investment management talent and improving their overall performance.

These difficulties could result in a major industry-wide consolidation in the coming months. Various scenarios are possible. Organizations such as banks and insurance companies that are subject to stress and facing liquidity challenges may decide to divest their asset management arms to raise capital. Organizations with captive asset management businesses may wish to monetize them so they can channel their focus and resources back to their core business. Other firms may seek transactions to achieve the scale and diversified product offerings needed to drive enhanced returns.

Many organizations are undertaking a rigorous review of their portfolios and weeding out parts of the business determined to be noncore or simply underperforming. Optimizing the corporate portfolio will be the ultimate key to survival. Keeping this in mind, some players in the industry may be able to take advantage of the turmoil, pouncing on weaker participants and engaging in transactions that allow them to achieve scale, access talent and relationships, widen their product portfolios or attain a level of critical mass they could not have achieved organically.

Four principles of successful transactions

For those organizations likely to sell their asset management businesses, the secret to a successful transaction lies in rigorous preparation. It is no longer a seller's market, where even the most unattractive of assets would be pursued by hordes of bidders. In today's environment, a planned, structured and thoughtful approach to divestitures is critical to maximize value or even just to close the deal.

That said, the key drivers or principles of a winning transaction haven't changed. Four critical guidelines still govern successful divestitures:

- ▶ Maximize value
- ▶ Maintain control
- ▶ Mitigate risk
- ▶ Focus on speed

Maximize value. Sellers must be able to establish the value of the business they are putting on the block and communicate it to bidders clearly and precisely. At the same time, they must preserve the value of what they're selling by attending to stakeholders – clients, employees (including key relationship and investment managers) and regulators – safeguarding performance and profitability and otherwise ensuring stability. All this is not always easy to do when management begins to focus on a divestiture, particularly in this time of extreme market disruption and general economic instability.

Maintain control. It is in the interests of the seller to maintain control for as long as possible over both the business being sold and the divestiture process. The key is to ensure that management remains focused on continued performance and that the seller has control over the release of information and the confidence that there will be no surprises arising from the bidder's diligence. This requires the seller to complete a thorough preparatory diligence exercise that anticipates the questions and concerns likely

to be raised by all types of bidders, including corporate and financial ones.

Mitigate risk. Risk has two dimensions, often referred to as transaction risk and business risk.

Transaction risk, sometimes called closing risk, is the possibility that the deal will collapse before it is completed. Given the rapidly changing marketplace, this is a significant risk. It can be mitigated chiefly by an effort to decrease the time that passes between the signing and closing of a transaction. Delays can often result from unforeseen circumstances, involving either the buyer and seller and/or the financing and regulatory parties. Typically, delays to the closing process can be lessened through early identification of critical path items, including the timely preparation of interim financial data and financial data for inclusion as exhibits to purchase and sales agreements. A recent transaction was placed in jeopardy when an underprepared seller was slow to provide the documents requested to enable the buyer to complete its financing arrangements. During this delay, the market conditions changed drastically, and the seller was forced to renegotiate a less attractive transaction with another party.

Another way to accelerate the closing process includes identifying and addressing specific circumstances that could delay a clean exit of the business. In another example, the seller anticipated the buyer's need for transition services arrangements. The seller identified the specific processes that would need to be considered and developed a strategy with respect to related costs. This proactive approach facilitated an accelerated transaction timeline. Thorough preparation is therefore key to early identification of risks and ultimately to abbreviating the timeline to close the transaction.

The second dimension is risk to the business itself. This stems in part from possible

damage to the seller's reputation during the divestiture, as well as from risks associated with divulging proprietary information to bidders who may also be industry competitors. Again, appropriate preparation by the seller is a key element in mitigating both of these risks. In a recent transaction, a seller had clearly prepared to remain focused on the operations of the business throughout the transaction process. The seller accurately identified and addressed transaction-related issues in advance, including the development of a well-supported transaction rationale, thorough understanding of the potential buyer pool, robust analyses of financial performance and potential operational impacts of a transaction.

Focus on speed. Time is always of the essence, but in the current climate, the need for speed has become disproportionately great. In a moment of economic uncertainty, with many organizations seeking to raise capital and divesting similar businesses, it is advantageous to be quick to market and quick to close. Moreover, the asset management industry relies heavily on intangible assets such as its people, brand, trust and reputation – all of which take years to build but can evaporate quickly. Therefore, firms must move fast to preserve value. Asset managers that want to sell must conduct disposals rapidly – but sensibly – and on their own terms.

These four principles apply to buyers as well as sellers in any transaction. But selling is generally acknowledged to be harder than buying, particularly as the transaction process speeds up. Sellers must make decisions more quickly than they are accustomed to doing and often need to deal with the demands and challenges of competing bidders. In addition, sellers must negotiate more adroitly the inevitable tradeoffs between speed and value and between control and risk.



Getting “bid-ready”

Once sellers understand how the four principles apply to their assets, they must address the requirement for data to establish and support their asking price. Sellers with consistent and detailed documentation have a much better chance of closing deals promptly *and* at the price they want. The critical criterion here is how much control sellers maintain over transaction details. They must be so well prepared that there is little risk of unpleasant surprises surfacing as the deal unfolds. This is known as being “bid-ready.”

Being bid-ready is closely tied to the numerous operational decisions a seller makes around an impending sale. When selling a business or business unit, every decision related to operational separation – which staff will stay or go, which IT systems are kept or discarded, arrangements for the transition and operational disentanglement – will ultimately affect the financial information a seller presents to bidders. Moreover, each of these decisions has consequences. Successful sellers must be able to articulate the pros and cons of those decisions if bidders are to accept the seller’s view of value.

Successful sellers will also be able to communicate how they plan to transfer the business as a fully functioning stand-alone entity. This point is crucial. Although some buyers will have an existing platform to support the acquired business, acquirers that are not in the target company’s industry will likely need extensive transition arrangements. In particular, private equity funds, even those whose managers usually invest in industries they know, will need additional infrastructure to operate the target business seamlessly through a transition period and beyond. Functions such as human resources, legal, treasury, internal audit and finance may require extensive support from sellers for some period of transition after the deal is closed.

Asset management firms face an additional layer of complexity due to the potential regulatory considerations in many transactions. They should communicate early and often with the regulatory agencies that will have jurisdiction over the acquired business post-transaction or that currently have jurisdiction over the existing business.

Preserving brand trust

The top priority for sellers is (or should be) protecting the inherent value of the business being sold. This means ensuring that stakeholders continue to feel trust and confidence in the business. In some cases, the loss of key investment and/or relationship advisors and clients in a run-up to the sale can destroy the value of an asset management franchise. This is all too commonplace in transactions that are poorly managed.

Indeed, preserving brand trust is one of management’s top jobs during the transaction. In fact, in any disposal of businesses, management has three full-time jobs: staying focused on the current business, managing the concerns of stakeholders affected by the transaction and finally, preparing for and assisting with the transaction process.

Devoting the necessary level of resources to execute and preserve brand trust is a significant challenge, but the outcome is certainly well worth the effort. Sellers that manage the risks effectively will be rewarded with a transaction that maximizes shareholder value and minimizes disruption to the business being divested.

Susan Prior is a professional in the Transaction Advisory Services practice of Ernst & Young LLP. Susan is based in New York and can be reached at +1 212 773 7974 or susan.prior@ey.com.

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