



# When a Parent is Involved:



# BUYER

M&A insiders anticipate a spike in subsidiary sell-offs as the economy deteriorates

By | Diana Drake

With mentions of the “R” word (whispered “Recession”) all too frequent these days, M&A advisors have started to plan in terms of the “D” word, or divestitures. The economic slowdown promises to hit different sectors of M&A in different ways (*see story, page 4*). Many agree, however, that hard times for businesses will most likely result in a spike in divestitures, the selling off of company subsidiaries and divisions. Companies will be looking to get rid of non-core businesses and underperforming businesses and reduce their debt burden. Industry insiders expect to see some interesting acquisition opportunities in the coming months as divestiture plans are implemented. It may well keep M&A activity going as companies restructure and try to fix themselves.

“Lots of companies today are over-leveraged in the current markets,” explains John Aiello, chair of the corporate securities and law department at Giordano, Halleran & Ciesla in Middletown. “They borrowed money in order to go out and acquire companies and became very highly leveraged. They are now confronted with having to service that debt, pay the interest and the principle. They’re considering taking some part of their business that might not be as critical as another part and selling it off to another purchaser so they can reduce their debt with the proceeds.”

Aiello has come up with some specific advice for the buyer of a division or subsidiary. “There are several issues that are unique to the acquisition of a subsidiary or division that warrant special consideration,” suggests Aiello. These are:



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# Beware!

## 1. SEPARATE STATEMENTS

It's important that the buyer get separate company financial statements for the subsidiary he is purchasing. What's more, he should also urge the seller to have those statements audited. "The

there's software that the parent company has after it divests a subsidiary that once you've bought the subsidiary you really need?" he says. "Business people generally don't spend the time necessary to understand what assets are required to allow the acquired business to run on a standalone basis. They

ments are in place that will allow the acquired business to run autonomously after the deal closes. "The buyer should identify interrelationships and assess their financial impact," explains Aiello. "For example, if the seller is getting certain goods and services at cost or below cost and the buyer will have to buy the

goods and services after the closing from third parties at higher prices, the buyer will want to know this up front and may adjust the purchase price." Consider drafting a transition agreement that will dictate the specifics of the buyer transitioning to other vendors on the other side of the deal. | M&A

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John Aiello *Attorney, Giordano Halleran & Ciesla*

seller will resist a request for audited statements and will complain about the cost, expense and possible time delay," says Aiello. No matter. Audited statements will equip the buyer with information about shared expenses and overhead between the parent company and division; intercompany charges such as management fees; and intercompany payments for goods and services. "The buyer will be in a better position to evaluate both the historic and prospective profitability and cash flow of the acquired business unit on a standalone basis and be able to determine how dependent it is on the parent," explains Aiello.

## 2. ASSET IDENTIFICATION

It's very likely that a subsidiary is integrated with its parent company and its assets are shared by other parts of the organization. So what happens if it needs assets that it doesn't have title to after it is divested? This, notes Aiello, must be dealt with up front. "Say

would rather focus their attention on the economics of the operation." Pay special attention to contract terms, related negotiations, and due diligence.

## 3. PROTECTION FROM PARENT COMPETITORS

Non-compete covenants have new meaning in divestiture transactions. A seller may insist that the non-compete be narrow in scope and even request a provision that will allow it to acquire a company that competes with the divested business. "The buyer should be very careful about letting the seller carve out exceptions to a non-compete that will erode the protection against competition to which the buyer is entitled," explains Aiello.

## 4. A CLEAN BREAK

Are we ever truly free of a parent's grip? That is the goal in a divestiture transaction. Buyers need to be sure that arrange-

## THE DEVIL IS IN THE DEAL DETAIL

Integra LifeSciences, a medical device company in Plainsboro, has for many years employed an M&A growth strategy of three-to-five acquisitions a year. Maria Platsis, vice president of corporate development, recalls the intricacies of buying Burlington, Mass.-based Radionics in 2002, which at the time was a division of Tyco Healthcare Group:

"It was a complex deal because the division of Radionics was not distinct in Tyco," explained Platsis in a 2006 interview with NJBIZ. "It used manufacturing capabilities in plants that manufacture products that they were not selling in the deal. It used distribution capabilities of Tyco International that we weren't buying in the deal. We had to craft a way to buy these assets out of Tyco and transition them into Integra when we weren't buying all the assets that Tyco used to run the business. We had an acquisition agreement and then a transition agreement. We had to imagine the difficulties going forward of transitioning Radionics fully into Integra and turn it into an agreement that was not too detailed because you don't know exactly what you're going to run into, but that was detailed enough to make sure we got the support we needed while we were transitioning the business. You should consider if you need to build up other areas of your organization, figure out if there is a third party to do it for you, or figure out how long and how much help you need from the seller after the deal closes."

