

The Journal

Asset Disaggregation: A Strategy to Facilitate Acquisitions and Exits

By Richard L. Kaye
Hilco

Acquisitions, whether the target is accretive to an existing business or represents a strategic venture into a new industry or market segment, almost always involve expendable assets regarded as surplus, duplicative, underperforming, or not synergistic with the strategic direction of the go-forward business. Closing these transactions can challenge even the most astute negotiators. Many a deal has fallen through simply because buyer and seller can't come to terms on how to handle the unwanted assets.

Now comes "Asset Disaggregation," a concept from Hilco, a global provider of asset monetization services, that is being employed by corporate development executives, private equity groups and investment bankers to systematically remove troublesome assets that otherwise might be a major obstacle to getting deals done.

Briefly, the asset disaggregation strategy involves a structured sale of undesired assets to a third party (i.e., Hilco or a similar buyer), typically at the time the transaction closes or immediately thereafter. The third party then takes control of the assets and monetizes them through various disposition methodologies. The spread between what the third party paid for the assets and what they are able to recover, net of expenses, represents the return on investment. The effect of this strategy is to short-cut the disposition process, take the problem out of the hands of the acquiring company's management, and realize acceptable value for assets and operations that could be of use to other businesses.

The third party assumes a relatively high level of risk in an asset disaggregation deal. But this is the reason that both buyers and sellers find the format attractive. They have come to understand the inherent hard and soft costs associated with the ►

asset disposition process and recognize the benefits of conveying the work and risk to others.

This article explains in general terms how the asset disaggregation strategy can be applied in an acquisition and how a properly structured transaction can benefit all parties. This strategy, moreover, can be applied in a merger, where duplicative assets are identified. The strategy can also be especially helpful when the deal is at risk of violating certain anti-trust regulations and a government agency demands that certain operations be divested as a condition for clearing a merger deal.

Asset Disaggregation – Pulling Apart Assets

Within the context of a corporate merger or acquisition, the term asset disaggregation denotes the pulling apart or separation of a compendium of business assets into two major categories: “what’s wanted” and “what’s not wanted.” The nature of the transaction usually drives the disaggregation process.

When the buyer intends to maintain a continuing business through acquisition, albeit with certain strategic or operational changes, unwanted assets typically are characterized as underperforming or non-synergistic with the intended business platform. Take a multi-line industrial products manufacturer, for example. The buyer sees an opportunity to make strategic changes by eliminating several product lines. Asset disaggregation can be employed to sell off these products and their associated assets.

If the deal is a merger involving two competing firms, unwanted assets are typically characterized as duplicative or surplus. An obvious example is the merger of two companies that manufacture the same commodity product. Duplicative assets could include manufacturing facilities, selected machinery and equipment, inventory, distribution centers, real estate, and intellectual property such as trade names. Surplus assets might include raw materials, work-in-process or finished goods inventory, leased or owned office space, or rolling stock such as trucks and rail cars.

In a merger of retailers, redundant or overlapping store locations and associated leasehold obligations, as well as in-store inventory, are common issues that need to be addressed.

Unwanted Assets – An Acquisition or Exit Impediment

Undesired assets can hinder a merger, acquisition or divestiture in two ways. For openers, there are the problems in valuing the assets and subsequently building that value into a deal’s financial structure. Second, even if acceptable values can be established and a transaction can be completed, considerable time and expense can be incurred after closing to dispose of the assets, and perhaps divert the management from the core goal of making the combination work.

In an acquisition or an exit, the buyer would be inclined to significantly discount, if not place a zero or even negative value, on non-synergistic assets. As a result, the buyer would drive down the bid price to a point where it might not be an acceptable offer to the seller, who seeks full value for all assets.

In yet another scenario, the buyer might insist it doesn’t want to purchase expendable assets, leaving the seller with the unpalatable choice of walking from ►

the deal or accepting a partial sale and being left to shed relatively worthless bits and pieces.

If the buyer absorbs another company via merger, target shareholders could experience significant dilution if duplicative assets are valued on the basis of their worth to the seller instead of as dispensable assets in the combined business.

In both scenarios, the burden falls on senior executives and support staff—all of whom should be focused on managing the business going forward—to dispose of the unwanted assets, or at least manage a complex process that could involve multiple outside advisers. This time and effort could be better spent on building the combined venture.

Asset Disaggregation – Music to a Retailer’s Ears

An historical example of how asset disaggregation helped make a deal happen involved the purchase by a private equity firm of a music retailer (“ABC”) that was to be an add-on to an existing portfolio company (“XYZ”).

XYZ’s owner sought to acquire the 100+ store ABC chain for \$41.0 million. However, XYZ’s executives determined there were a total of 34 underperforming ABC stores and overlapping locations they didn’t want. Armed with this information, XYZ teamed with Hilco. At closing, Hilco purchased the 34 unwanted ABC stores and later disposed of the inventory and mitigated the lease obligations.

From the XYZ perspective, they were required to purchase only those locations they wanted. They wrote a smaller equity check and required less leverage. Furthermore, their executives had no worries about closing the unwanted stores, selling the assets and dealing with leases. Hilco did all that.

From the ABC perspective, they received full value for the entire company, not just the locations desired by XYZ.

Four Keys to a Successful Asset Disaggregation Strategy

Whether you are a financial or strategic buyer, or your target is a competitor or an upstream or downstream member of the supply chain, the key to successful asset disaggregation is early involvement with a qualified disaggregation partner.

Qualifications include:

- capital to invest in unwanted assets;
- internal asset valuation capabilities across the entire spectrum of business assets, including enterprise valuation;
- proven asset disposition capabilities across all asset categories— but particularly physical assets such as machinery and equipment, inventory, and real estate—along with know-how in winding down operations; and
- demonstrable deal structuring experience.

The effective use of asset disaggregation can facilitate the successful completion of a difficult merger, acquisition or divestiture, both on the domestic front and in cross-border deals. ■

About the Author

Richard L. Kaye
Executive Vice President



Richard L. Kaye is Hilco's Executive Vice President and Chief Marketing Officer. Prior to joining Hilco, he was a consultant to the company and, prior thereto, owned and managed a platform of three companies that provided strategic marketing consulting and business communications services to manufacturers, service companies and financial institutions. Kaye has authored over 20 trade and academic papers and articles on strategic marketing, and has become an authority on successful techniques for marketing professional services.

This article is one in a series of contributions by ACG Chicago's Sponsors and was taken from ACG Chicago's publication, *The Journal*, April 2010 issue. We appreciate Hilco's support.

Hilco (Hilco Trading, LLC) is a diversified financial and operational services firm whose principal competency is understanding and monetizing the value of business assets, including retail, consumer and industrial inventory, machinery and equipment, real estate, accounts receivable and intellectual property. Through an integrated platform of more than 20 business units in North America and Europe, Hilco helps companies and their professional advisors derive the maximum value for said assets through appraisals, asset disposition and acquisition services, private equity investment and consulting services. Hilco serves retailers, wholesalers, distributors, manufacturers, private equity firms, hedge funds, investment banks, law firms, turnaround professionals, accounting professionals, bankruptcy trustees and receivers. www.hilcotrading.com