THE 2021 M&A REPORT

Mastering the Art of Breaking Up

October 2021

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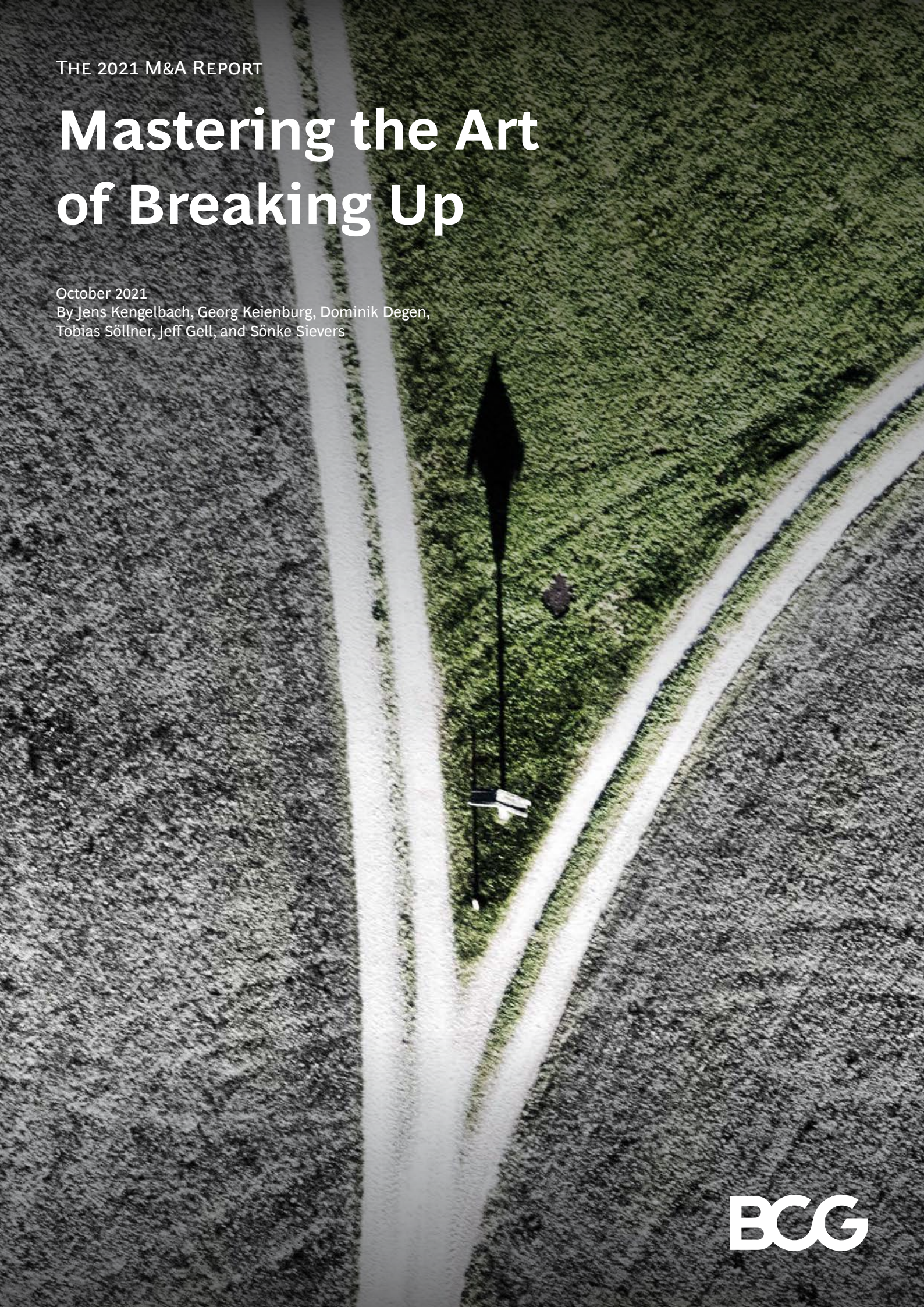

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Executive Summary

The 2021 M&A Report examines the value creation potential of divestitures and how companies can capture the benefits while managing the costs of these often-complex transactions. As companies respond to the impact of the COVID-19 pandemic, divestitures continue to be important tools to raise cash, optimize portfolios, and achieve a variety of other corporate objectives.

After 2020's rocky ride, the M&A market has been booming in 2021. By midyear, deal values returned to the elevated levels seen before the pandemic and takeover premiums reverted back toward pre-crisis levels. Looking ahead, dealmaking will be promoted by numerous factors—including abundant capital, favorable economic conditions, portfolio restructurings, industry and regional consolidations, and sustainability.

Many companies believe this environment makes it the right time to divest non-core businesses. Are they likely to achieve their goals for value creation? What is the best path to success? To find the answers, we leveraged BCG's M&A database of more than 840,000 deals covering the period January 1980 through June 2021.

The message from our research is clear: periodic portfolio reshufflings and divestitures of non-core assets can create substantial value for shareholders. Two measures of value creation with different time horizons—cumulative abnormal returns (CAR) around the announcement date and relative total shareholder returns (RTSR) during the two years after a divestiture—have both trended strongly upward, on average, since 2016.

However, averages mask significant variances in performance and returns. For example, although CARs are positive for all industries, they vary substantially—from near zero for telecommunications companies to more than 1% for media and entertainment companies. RTSRs, in contrast, are negative in some industries, including high tech, health care, and consumer products. The highest RTSRs are seen in utility industries, such as energy and power and telecommunications, as well as financial services. As another example, the median two-year RTSR for spinoff transactions is close to zero, but top-quartile performers can generate stellar RTSRs of more than 50%.

To get on the good side of this performance gulf, sellers need to prepare for every divestiture from start to finish—from thinking deeply about what, when, and how to divest to getting the asset ready and rigorously executing the process through closing. The central element of this preparation process is typically carving out the divested business—that is, separating it operationally and financially from its parent company. This includes getting an early start on minimizing stranded costs. We conclude this report by exploring the complexity of carve-outs and the key success factors for delivering the intended value.

M&A had a rocky ride in 2020.

- Deal value and the number of deals fell by 13.2% and 8.3%, respectively, in 2020 compared with 2019.
- The number of deals fell in all regions, while deal value fell everywhere but Europe (reflecting low value in 2019). Deal volume declined in almost all sectors in the first half of 2020 but then grew significantly in the second half.
- Technology and health care megadeals (deals with a value greater than $10 billion) propelled deal value upward in the second half of 2020. For the full year, the technology, media, and telecommunications sector and the health care sector dominated the five largest deals.

Dealmaking has been booming in 2021.

- Deal value in the first half of this year was 22% higher than in the second half of 2020 and an astonishing 136% higher than in the first half of last year. Deal volume is up by 6% compared with the second half of 2020 and by 32% compared with the first half.
- In North America, deal value reached a record high in the first half of 2021, marking a 35.0% increase compared with the second half of 2020. In contrast, deal value grew by only 4.7% in Europe and declined by 46.0% in China. Deal volume in the first half of 2021 grew strongly compared with the second half of 2020 in most regions.
- The three sectors with the strongest deal flow in 2021 (through mid-September) are media and entertainment, industrials, and energy and utilities.
- As of the end of September, there had been 38 megadeals in 2021, 24 of which were announced in the first half. This compares with only 26 megadeals during all of 2020.
- The year to date has seen a high volume of deals involving minority stakes, in absolute terms and relative to those involving majority stakes.
- Private equity (PE) and venture capital (VC) investments recovered quickly from the pandemic pullback as firms sought to invest the large amount of dry powder available. PE firms have also shown a strong interest in acquiring corporate divestments, especially assets that have extended potential for value creation as standalone businesses.
- In 2021, sellers' CARs around the announcement date spiked to a median of 0.7%. For buyers, CARs were negative in 2020 but ticked upward during the first half of 2021 to a median of 0.2%.

Trends point to a positive M&A outlook.

- The general uptick in economic activity resulting from a variety of factors—including pent-up demand and government assistance to individuals and businesses—should promote M&A activity.
- The demand side of the M&A market is flush with capital. In addition to PE and VC firms having record amounts of dry powder, many companies have plenty of cash on hand. And many well-capitalized "special-purpose acquisition companies" (SPACs) will be looking for targets during the next 12 to 18 months.
- Over the longer term, companies adversely affected by the pandemic will use divestments to raise cash for paying down their high debt burdens. Additionally, higher tax rates, if they materialize, may accelerate corporate decisions to spin off assets.
- In some industries (such as steel), companies will continue to use M&A to reduce overcapacity or to consolidate. In other cases, M&A will be a valuable tool for addressing the convergence of industry sectors, such as mobility and technology.
- The need for global or regional scale will promote cross-border M&A in industries such as semiconductors and media, while industries such as automotive will turn to acquisitions to build international supply chains.
- Some companies (such as those in the energy and oil and gas industries) will likely use acquisitions and divestitures to make their portfolios more appealing from a sustainability perspective.

Against this backdrop, companies will continue to divest businesses to achieve strategic objectives. We distinguish three types of divestitures.

- Trade sales, in which corporate owners or financial investors sell companies (including carved-out businesses) in private deals, peaked most recently in 2017 at almost 15,000 deals.
- Subsidiary IPOs, which involve the listing of a subsidiary held by a corporate or financial owner, reached record levels in 2020 as more than 600 IPOs generated total proceeds exceeding $150 billion.
- Spinoffs, in which a corporate owner issues separate shares in a subsidiary to its existing shareholders, have seen deal volumes decline from their peak of approximately 150 in 2011 to just north of 100 in 2020.

Companies use divestitures to promote a variety of objectives.

- The leading objective, from a corporate owner's perspective, is focusing the portfolio on the core business. An analysis of more than 2,000 news stories and other publications using the machine intelligence "discovery tool" Quid found that "focus on the core" was the most frequently recurring theme for divestitures in 2015 and 2020, the two years we compared.
- Another frequent motive, especially in downturns, is raising cash. Our Quid analysis of publications showed that many companies needed to "cut debt," respond to "debt pressures," or improve "financial flexibility" as cash evaporated and debt levels ballooned in 2020.
- Depending on the asset (or the direness of the situation), generating cash from a sale may not even be possible. In such cases, the primary motivation for selling an asset is to avert the need for future cash-outs.
- Realizing value is another cash-focused motivation, but with more positive connotations. In some cases, the opportunity to reap a cash windfall has enticed owners to sell what is arguably a core business.
- Other motivations include tax effects, increased regulatory burdens, or succession issues in family-owned businesses.
- Activists and other engaged shareholders may demand that companies make divestitures to pursue one or more of these strategic objectives, especially to focus on specific businesses and escape from a conglomerate discount.

Divestitures create value for sellers' shareholders, on average.

- Short-term CARs have shot up from a trough of 0.23% in 2016 to 0.74% in the first half of 2021.
- Two-year relative RTSR increased from roughly 1.5% for deals announced in 2014 to 4% for those announced in 2019.
- High CARs in flashy industries such as high tech and media and entertainment go together with low or even negative RTSRs, whereas the relationship is inverse for more staid industries. It appears that, in some cases, investors initially cheer the shedding of corporate "fat" but later think that the divestiture cut into value-creating "muscle."

The right choices for what, when, and how to sell can promote higher returns.

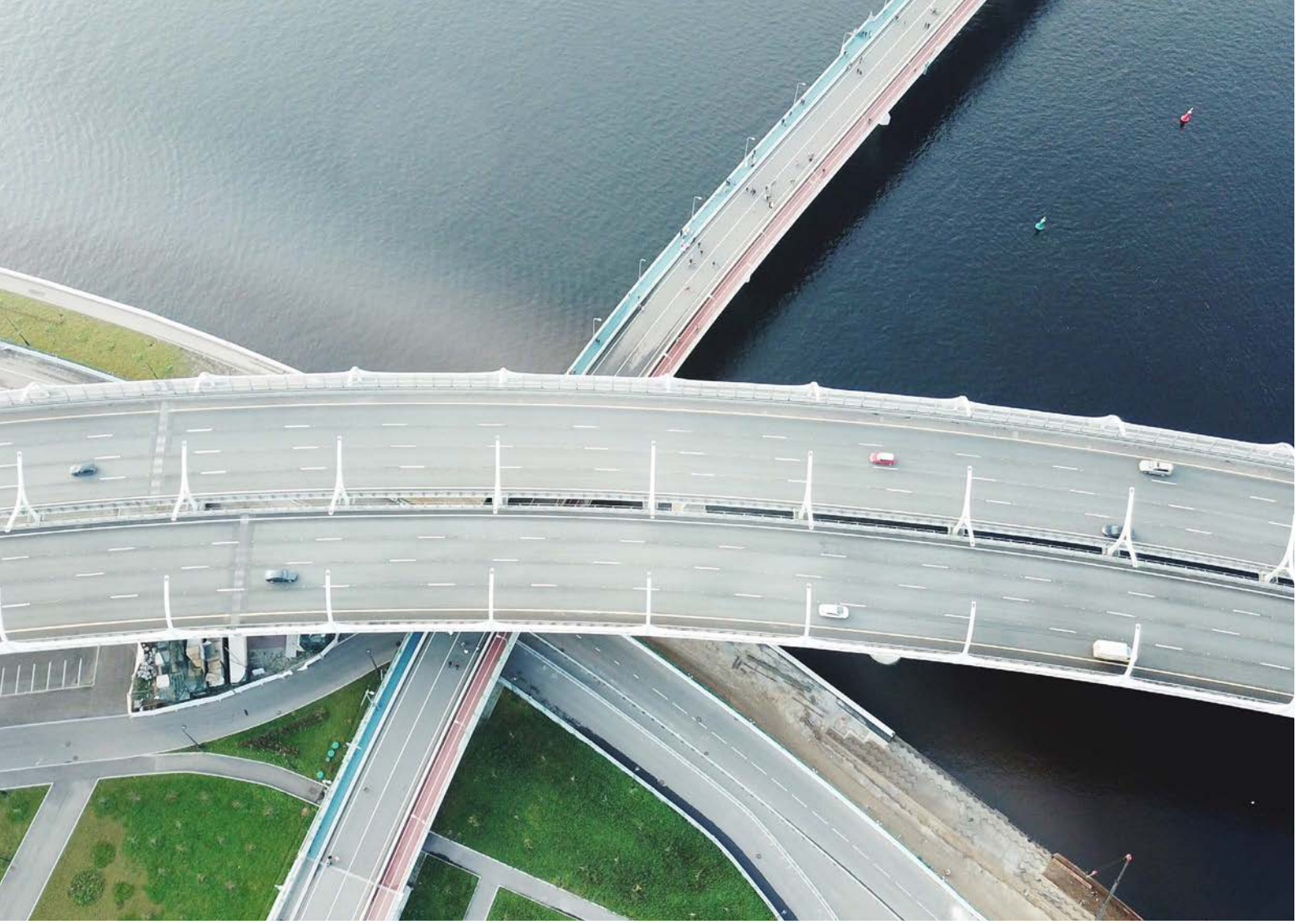
- Selling non-core assets and/or underperforming assets generates the highest RTSR. These sales free up cash, reduce complexity, and improve the growth and margin profile.
- Not surprisingly, returns are higher from divestitures made when market conditions promote better economic prospects and give sellers more negotiating power. We also found that RTSR increases with a company's level of debt, because investors like to see that the seller can put the cash to good use.
- In terms of two-year RTSR, spinoffs are the most attractive exit route, followed by trade sales and IPOs. The complexity and inherently higher risk of spinoffs lead decision makers to devote a high level of scrutiny to these transactions, which, in turn, promotes a greater chance of success when finally carried out. Trade sales to corporate buyers generate higher returns than those to financial investors because corporate buyers are more willing to pay for synergies.
- Companies that sell assets relatively frequently generate higher RTSRs than less-experienced sellers.

Complex carve-outs are resource intensive and costly.

- Before a divestiture can become a success story, sellers must prepare the business for a sale by separating it from—that is, carving it out of—the parent company.
- In recent years, more than 50% of large carve-out companies have required support from their former parent via transitional service agreements, including agreements involving core functions, and continued sharing production sites and other facilities.
- Achieving a clean break is challenging because complex carve-outs require significant internal and external manpower and entail a variety of costs beyond the highly visible advisor fees.
- Cumulative one-time and transition-services costs can range from approximately 1% to 5% of the divested business's revenues. There is a substantial difference between the most efficient and the costliest carve-outs relative to deal size, with costs ranging from less than 0.5% to more than 15% of deal value.
- Stranded costs regularly amount to 3% to 7% of a carve-out company's revenues. A significant restructuring effort is often needed to eliminate or reduce them.
- According to a recent BCG survey of leading M&A and carve-out practitioners, the top three reasons why carve-outs fail are unclear strategic design; capacity constraints and loss of critical talent; and a mismatch between sellers' design plans and buyers' integration needs.

To succeed, companies must follow a variety of imperatives.

- Focus on creating maximum value from the overall transaction.
- Don't overlook the details—an 80:20 approach is likely insufficient.
- Closely manage people issues and the overall change and communications process.
- Even while focusing on the carve-out process, keep the business running and help it to further develop and grow.
- Ensure that the project organization is lean and composed of experienced staff with sufficient seniority and weight in the organization.
- Comprehensively plan the carve-out budget and then rigorously track and manage it throughout the process.
- Tackle stranded costs early and rigorously, potentially also using the exercise to challenge the parent company's operating model and reset the cost structure.



Dealmaking During the Pandemic

In March 2020, M&A activity stopped in its tracks as the COVID-19 pandemic spread around the world. The sudden global health crisis caused an unprecedented economic shock. But, although the health crisis has persisted, the impact on dealmaking was temporary. Corporate decision makers, investors, and dealmakers adjusted rapidly, enabling M&A activity to rebound strongly.

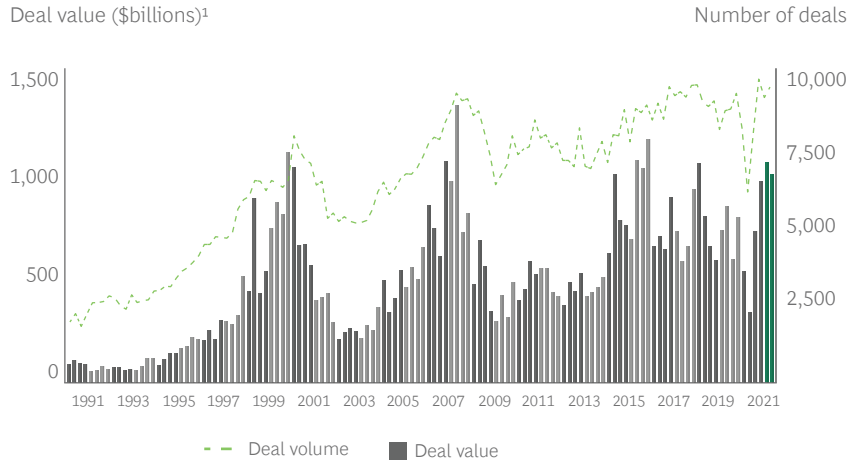
Looking Back at 2020's Rocky Ride

In normal times, the M&A activity in 2020 would be considered disappointing; deal value and volume fell by 13.2% and 8.3%, respectively, compared with 2019. (See Exhibit 1.)

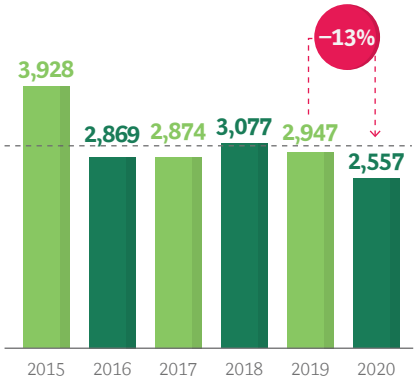
Deal volume fell in all regions, but not uniformly. Europe and Asia Pacific saw declines of approximately 13.5%. Japan bucked the trend in Asia Pacific with a volume increase of 8.7%. In North America, volume declined by only 1.1%, although the region's decline in deal activity in the second quarter was the steepest globally.

Exhibit 1 - Global M&A Activity Recovered Fast and Stayed Strong

The sharp rebound in activity in the second half of 2020 persisted in the first half of 2021...



...but, for the full year, 2020 saw a decline



Sources: Refinitiv; BCG Transaction Center.

Note: The total of 808,406 M&A transactions comprises pending, partly completed, completed, unconditional, and withdrawn deals announced between January 1, 1990, and June 30, 2021, with no transaction-size threshold. Self-tenders, recapitalizations, exchange offers, repurchases, acquisitions of remaining interest, minority stake purchases, privatizations, and spinoffs were excluded.

[1]Deal value includes assumed liabilities.

The regional story was different for deal value. Although value in Europe soared by 31.8%, this reflects, to some extent, the low value in 2019. North America and Asia Pacific saw declines of 26.4% and 6.2%, respectively. The worst declines occurred in the Middle East (–61.3%) and Japan (–45.7%).

From an industry perspective, 2020 was a tale of two half years. In the first half, deal volume declined in almost all sectors (retail was a notable exception). In contrast, the second half saw significant volume growth in almost all sectors (consumer staples and real estate stood out as decliners).

Although the health crisis has persisted, the impact on dealmaking was temporary.

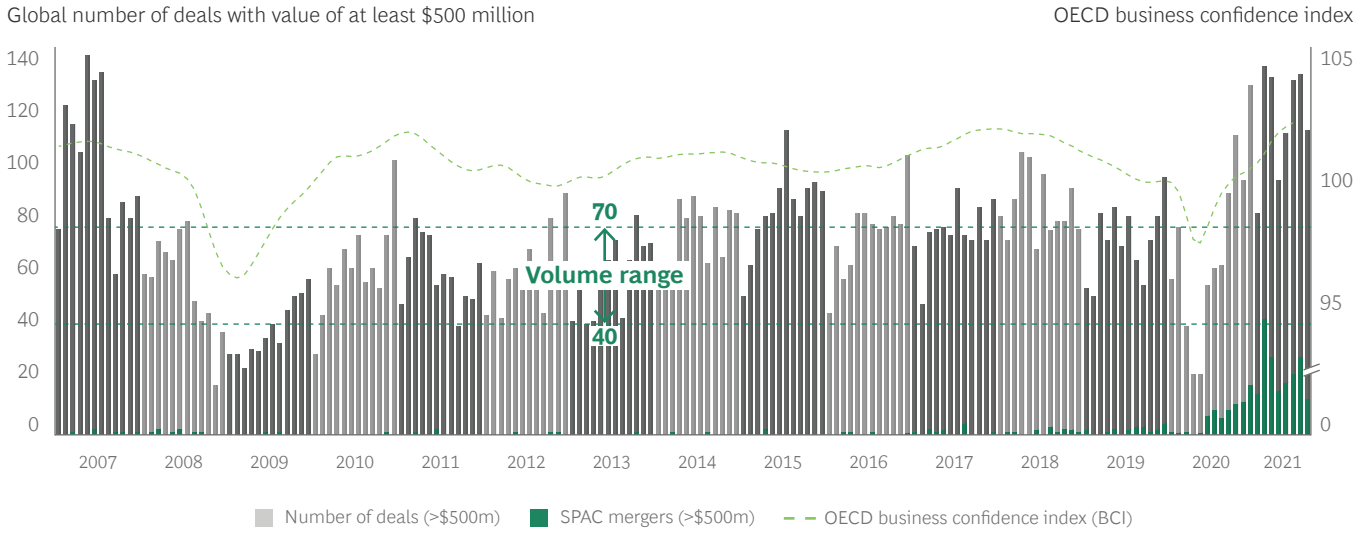
The only sectors that experienced higher deal value in the first half of 2020 were consumer staples and telecommunications. One large deal was responsible for the positive performance in telecommunications: Liberty Global and Telefonica announced plans to combine their UK subsidiaries—cable operator Virgin Media and mobile carrier O2—in a joint venture valued at $12.6 billion. In the second half of 2020, technology and health care megadeals (deals with a value greater than $10 billion) propelled deal value upward.

For the full year, the technology, media, and telecommunications (TMT) sector and the health care sector dominated the five largest deals:

- Dell Technologies spun off its 81% share (valued at $52.2 billion) in VMWare, a virtualization software company.
- S&P Global announced its acquisition of IHS Markit, a UK-based market data and research company, in an all-stock deal valued at $43.5 billion.
- Nippon Telegraph and Telephone acquired the publicly held shares (33.8%) of its subsidiary NTT Docomo, Japan's largest mobile carrier, thereby taking it private.
- Nvidia announced its takeover of British chip designer Arm, valued at $40.0 billion.
- AstraZeneca announced its acquisition of Alexion Pharmaceuticals for $39.3 billion.

Large deals (deals with a value exceeding $500 million) followed the same pattern as overall M&A activity, with a sharp decline followed by a strong rebound. (See Exhibit 2.) After a short breather, the volume of large deals came roaring back beginning in August 2020. The momentum in the second half of 2020 has continued unabated in 2021.

Exhibit 2 - Large Deals, Including SPAC Mergers, Rebounded to New Highs



Sources: Refinitiv; OECD; BCG Transaction Center.

Note: The total of 12,270 M&A transactions comprises pending, partly completed, completed, unconditional, and withdrawn majority deals announced between January 1, 2007, and August 30, 2021, with deal values greater than or equal to $500 million. Deal values include assumed liabilities. SPAC = Special-purpose acquisition company.

Taking Stock of 2021's Dealmaking Bonanza

M&A activity has been booming in 2021, at levels comparable to the 2007 frenzy.

Deal value in the first half of this year was 22% higher than in the second half of 2020 and an astonishing 136% higher than the first half of last year. Deal volume is up by 6% compared with the second half of 2020 and by 32% compared with the first half. (See Exhibit 3.)

In North America, deal value reached a record high in the first half of 2021, marking a 35.0% increase compared with the second half of 2020. The Middle East, Southeast Asia, and Australia-New Zealand also reached record levels of deal value and saw the highest growth relative to the second half of last year. In contrast, Europe saw only 4.7% growth for deal value, while deal value declined in China (–46.0%) and Japan (–20.8%).

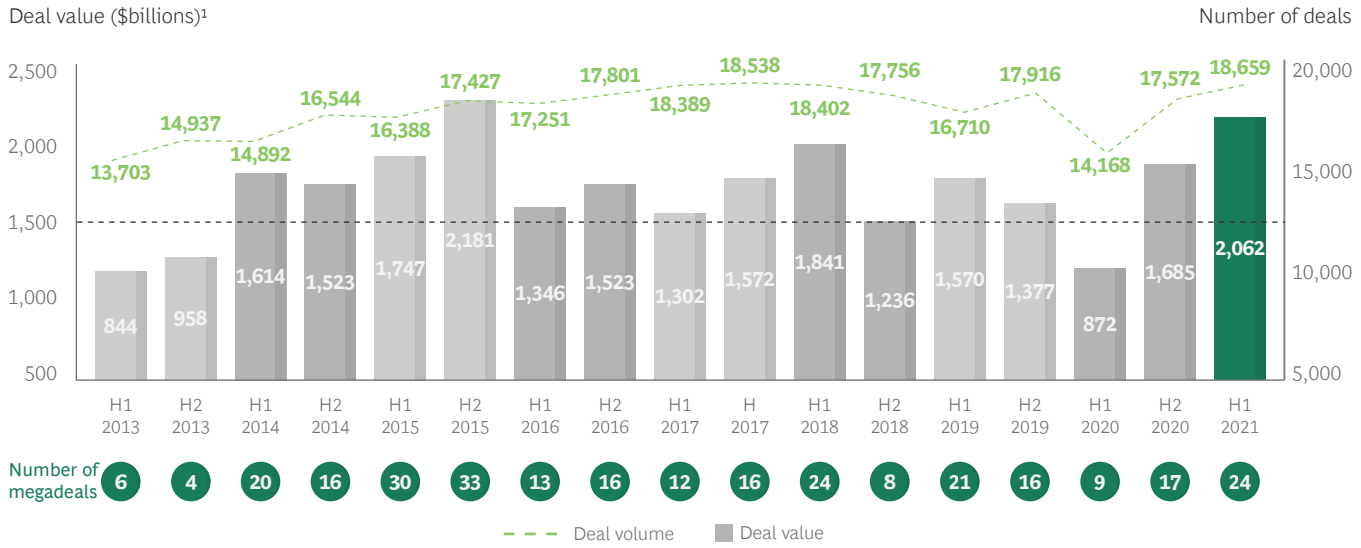
Deal volume in the first half of 2021 grew strongly compared with the second half of 2020 in most regions. The Middle East led the way with a 32.0% increase. Deal volume also grew in Europe (16.7%), Africa (12.9%), and North America (9.2%). However, the global trend was not evident in Japan (2.3% increase) or China (15.0% decline).

M&A activity has been booming in 2021, at levels comparable to the 2007 frenzy.

The two sectors with the strongest deal flow in 2021 (through September) are media and entertainment and energy and utilities. There were several notable deals:

- AT&T announced the merger of Warner Media with Discovery, a deal valued at $65.3 billion.
- Vivendi spun off 60% of Universal Music Group in a deal valued at $32 billion.
- Rogers Communications, a Canadian communications and media company, bid for its industry rival Shaw Communications in a transaction valued at $21.9 billion.
- UK-based National Grid acquired electric power distributor Western Power Distribution from US-based electric services company PPL for $20.1 billion.
- Suez and Veolia Environment, two French companies, agreed to merge in a deal valued at $10.7 billion.

Exhibit 3 - Deal Activity Approached Record Levels in the First Half of 2021



Sources: Refinitiv; BCG analysis.

Note: The total of 287,051 M&A transactions comprises pending, partly completed, completed, unconditional, and withdrawn deals announced between January 1, 2013, and June 30, 2021, with no transaction-size threshold. Self-tenders, recapitalizations, exchange offers, repurchases, acquisitions of remaining interest, minority stake purchases, privatizations, and spinoffs were excluded. Megadeals are deals with a value above $10 billion.

[1]Deal value includes assumed liabilities.

Megadeals (deals with a value greater than $10 billion) are often a sign that dealmakers are confident. As of late September, there were 38 megadeals in 2021, 24 of which were announced in the first half. This compares with only 26 megadeals during all of 2020. AT&T's announced sale of Warner Media to Discovery for $65.3 billion has been the largest deal of 2021 so far. Through late September, the next four largest deals in 2021 were:

- Singapore-based Grab's merger with Altimeter Growth, a US-listed special-purpose acquisition company (SPAC), valued at $34.3 billion
- The ongoing takeover battle for Kansas City Southern (Canadian National Railway submitted a bid valued at $33.5 billion to outbid Canadian Pacific's offer of $31.2 billion, but the latter still seems to be the frontrunner because of regulatory concerns.)
- MSP Recovery's announced merger with Lionheart Acquisition Corporation II, a SPAC, valued at $32.5 billion
- General Electric's sale of GE Capital Aviation Services to AerCap for an announced deal value of $31.2 billion

SPACs have played prominent roles in recent large deal activity.

As this list indicates, SPACs have played prominent roles in recent large deal activity. The number of SPAC IPOs skyrocketed in 2020 and then peaked in the first quarter of 2021. So far in 2021, approximately 190 SPAC business combinations ("de-SPAC" transactions) have been announced. While the average SPAC IPO raises proceeds of approximately $300 million, year to date, the average deal value for de-SPAC transactions is $2.2 billion. As of September 2021, approximately 430 listed SPACs (each one with more than $100 million in IPO proceeds) are looking for targets. Because SPACs typically need to find a merger target within 18 to 24 months after their IPO, we expect that they will continue to boost the number of M&A deals in the coming months. Recently, however, the SPAC frenzy has cooled off, which could have longer-term implications for M&A. (See the sidebar "Is the SPAC Frenzy Over?")

Is the SPAC Frenzy Over?

SPACs (special-purpose acquisition companies) were the star players in equity capital markets during 2020 and 2021. They are listed shell companies whose sole purpose is to acquire or merge with a private operating company within 18 to 24 months after their IPOs. In addition to offering shares to public investors, SPACs invite institutional investors to buy shares through "private investment in public equity" (PIPE), simultaneously with the SPAC merger.

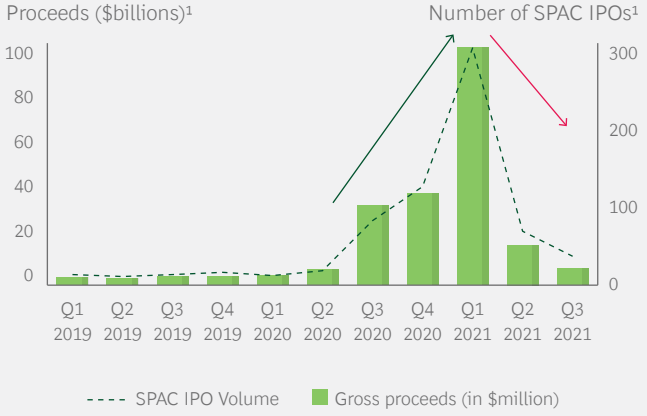
A SPAC's founders, or "sponsors," are usually experienced executives with a background in an industry or in finance (such as in PE or VC). Some sponsors, such as Chamath Palihapitiya (a Silicon Valley entrepreneur and investor) and Michael Klein (a banker and dealmaker), have launched several SPACs in recent years. Celebrities have also sponsored SPACs. Although there are exceptions, SPACs typically focus on the broader tech sectors, including gaming, health and biotech, and especially new mobility and transportation, from electric vehicles to space travel.

These "blank check companies" are not a new concept—they have existed since at least the 1990s. The recent surge in popularity began in 2019. An early marquee transaction during this wave was the merger between Social Capital Hedosophia (a SPAC founded by Palihapitiya) and Virgin Galactic (Richard Branson's space travel company).

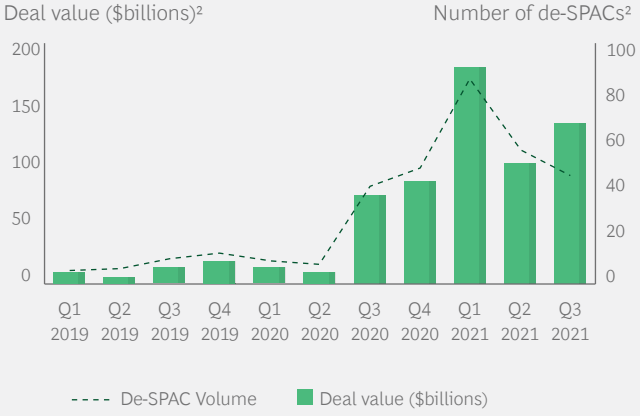
So far, 2021 has seen 441 SPAC IPOs with proceeds greater than $100 million, two-thirds of them in the first quarter. This already represents an annual record, compared with 230 in 2020 and 53 in 2019. (See the exhibit.) The frenzy reflects high-growth companies' desire to go public even if the traditional IPO route may not be suitable because of their limited financial and/or operating histories. And investors have been eager to place bets on these riskier companies despite the absence of a track record.

SPAC Activity Is Cooling Off

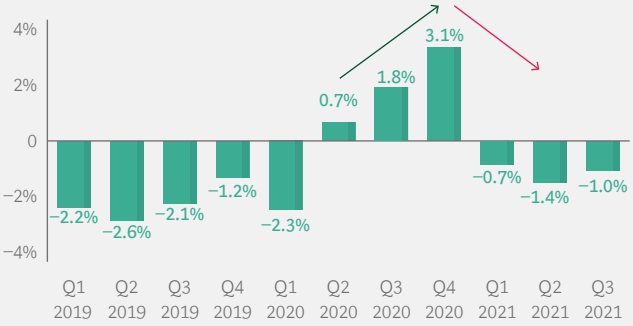
SPAC IPOs[1]



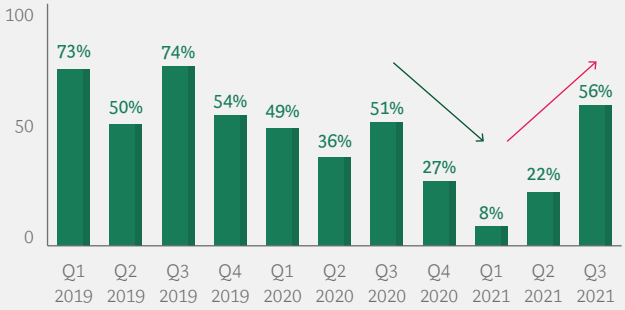
De-SPAC transactions[2]



Average first-day pop (%)[1]



Average redemption rate (%)[1,2]



Sources: S&P Capital IQ; SPACinsider; BCG Transaction Center.

[1]Includes SPAC IPOs with proceeds of at least $100 million.
[2]Includes de-SPAC transactions with a deal value of at least $100 million.

There are signs that the two-year SPAC frenzy is winding down, however; retail investors are showing less interest in SPAC IPOs. This is evident in the "first-day pop"—the stock price increase on the first trading day—which started to decrease significantly in April 2021 after soaring from November 2020 through March 2021. In addition, the rate of public investors' share redemptions before a merger has recently increased. The rise in redemption rates demonstrates the importance of PIPE financing to ensure that enough capital is available.

Investors' waning interest may reflect their understanding that, when it comes to SPACs, there can be too much of a good thing. As more SPACs chase a finite number of targets, the shareholders of potential acquirees have gained bargaining power with respect to deal terms—which had previously been set predominantly by, and quite favorable to, SPAC sponsors and investors.

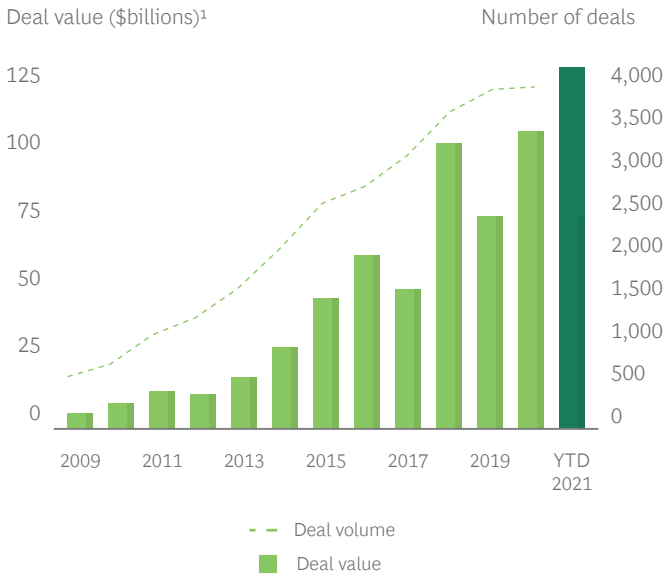
Moreover, sponsors' and investors' enthusiasm has been dampened by public statements of the US Securities and Exchange Commission. The regulators raised concerns about the classification and accounting for the warrants issued by SPACs, as well as investor protection issues. It is also noteworthy that short sellers leveled allegations of fraud against some SPACs in 2020 and 2021. Companies listed after a de-SPAC transaction could be attractive targets for short sellers. Because these companies often have high projected revenues and earnings but low or nonexistent current profits, betting against some of them might produce a handsome return. Operating companies that are planning to go public through a SPAC should take this into account.

The year to date has seen a high volume of deals involving minority stakes, in absolute terms and relative to those involving majority stakes. This follows a significant increase in minority deals last year, as private equity (PE) firms and other investors offered minority investments to companies during the crisis. Minority deals have also been promoted by companies' increasing appetite to provide corporate venture capital (VC) to startups and growth companies—a trend that continued despite the pandemic. Indeed, corporate VC investments are capturing an ever-increasing share of the VC market. (See Exhibit 4.)

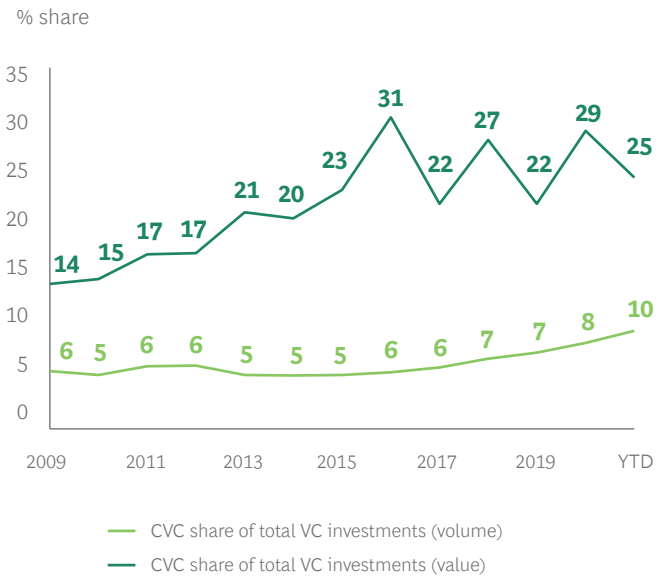
Generally, PE and VC investments recovered quickly from the pandemic pullback as firms sought to invest the large amount of dry powder available. (See Exhibit 5.) PE firms have also shown a strong interest in acquiring corporate divestments, especially carved-out businesses that are considered non-core assets by the seller and have the potential for significant value creation on a standalone basis.

Exhibit 4 - Corporate Venture Capital Activity Has Increased Steadily

The number and total value of CVC deals rose over the past decade…



…and these deals now represent about one-quarter of the total venture capital invested

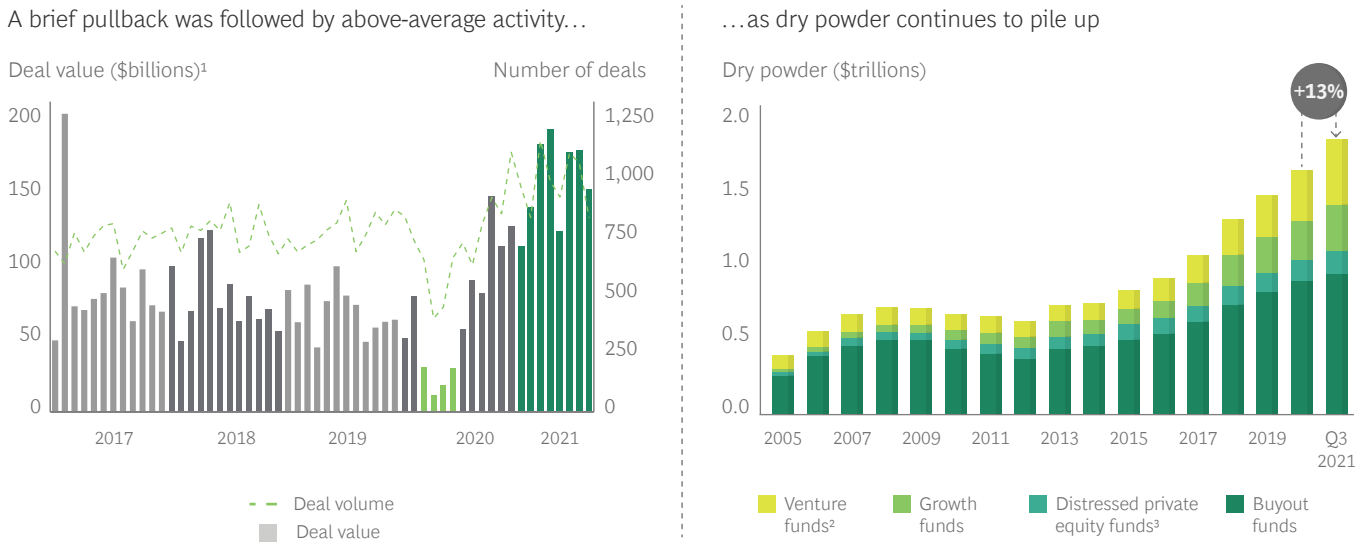


Sources: Pitchbook; BCG analysis.

Note: CVC = Corporate venture capital; YTD as of September 29, 2021.

[1]Deal value includes assumed liabilities.

Exhibit 5 - Fueled by Dry Powder, Private Equity Deals Soared to New Highs



Sources: Refinitiv; Preqin; BCG analysis.

Note: PE deal activity includes buy-side and sell-side involvements of financial sponsors.

[1]Deal value includes assumed liabilities.
[2]Venture funds include all venture-capital stages.
[3]Distressed funds include those focusing on distressed debt, special situations, and turnarounds.

Deal prices and takeover premiums have seesawed since the pandemic's onset. From early to mid-2020, uncertainty about the pandemic's effects pushed deal valuations significantly lower while takeover premiums rose. A reversal began in the summer of 2020. By mid-2021, deal values had returned to elevated levels and takeover premiums plunged back to their low, pre-pandemic levels. (See Exhibit 6.)

To better gauge how public investors perceive deal announcements, we analyzed cumulative abnormal returns (CARs) for public acquirers and sellers during the period starting three days before the announcement of a transaction and ending three days after it. (See Exhibit 7.) For the past 30 years, investors have generally reacted positively to divestiture announcements. In 2020 and 2021, sellers' CARs spiked to a median of 0.7%—the highest level seen this century. In contrast, buyers' CARs have tended to be negative since 1990, often significantly so prior to 2010. The past decade has been a mixed picture, with shallower downturns and periods of positive CARs. The most recent downturn in CARs occurred from 2018 through 2020. CARs ticked upward during the first half of 2021, with a median of 0.2%.

For the past 30 years, investors have generally reacted positively to divestiture announcements.

Trends Point to a Positive M&A Outlook

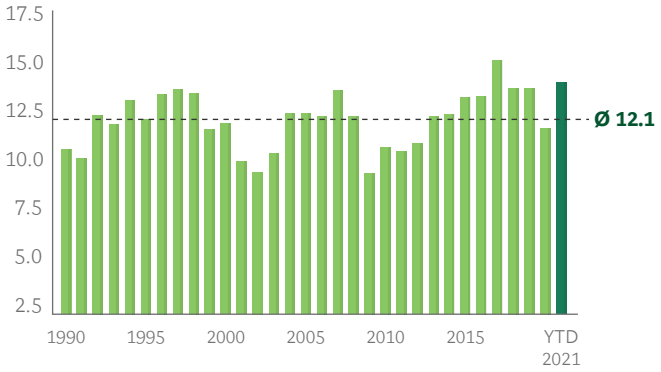
Against this backdrop, several trends are promoting a positive outlook for M&A in the years ahead.

- **Favorable Macroeconomic Conditions.** In the short term, the general uptick in economic activity resulting from a variety of factors—including pent-up demand and government assistance to individuals and businesses—should also promote M&A activity, especially in hard-hit sectors. At the same time, low interest rates and favorable capital market conditions support deal financing (and generally lower the cost of capital). Although the currently high valuations make some deals less attractive, the rich and stable capital markets make equity financing easier and help acquirers that want to use their stock to pay for a takeover. This stability also supports a broader return of shareholder activism because reduced volatility makes it easier for activists to buy and sell shares and decreases the cost of risk management.

Exhibit 6 - Deal Valuations and Takeover Premiums Seesawed During the Pandemic

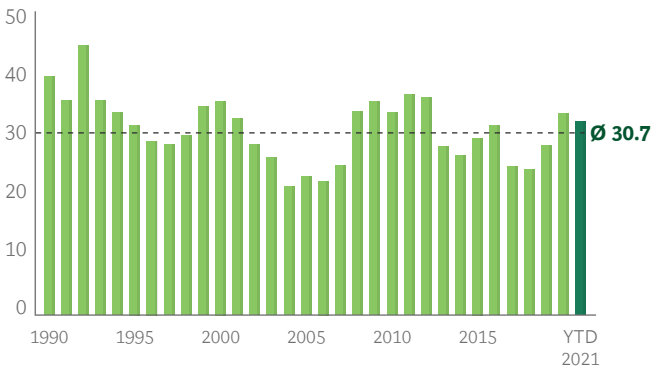
Deal valuation levels recovered quickly from the pandemic shock…

Median EV/EBITDA acquisition multiple (x)



…while takeover premiums fell below the average level

Median one-week deal premium (%)



Sources: Refinitiv; BCG analysis.

Note: The total of 12,775 M&A transactions comprises completed, unconditional, and pending deals announced between January 1, 1990, and September 28, 2021, with transaction values of at least $25 million and at least a 75% share transfer. Self-tenders, recapitalizations, exchange offers, repurchases, acquisitions of remaining interest, minority stake purchases, privatizations, and spinoffs were excluded. Only deals with a disclosed value were considered.

- **Abundant Capital.** An imbalance between supply and demand persists in the M&A market, with more and more players (PE and VC funds as well as SPACs and other relatively new participants) chasing a limited number of potential targets. As noted, the demand side of the M&A market is flush with capital. In addition to the record amounts of PE and VC dry powder cited above, many SPACs have recently entered the market and will be looking for targets during the next 12 to 18 months. And many companies, especially those whose resilience promoted strong performance during the pandemic, have plenty of cash on hand.

- **A Focus on Balance Sheets and Portfolio Restructuring.** Unprecedented government support and monetary policies will likely prevent a large uptick in distressed deals, at least in the short term. Over the longer term, the need to repay a portion of the government assistance could compel some companies to sell assets. It is quite likely that companies adversely affected by the pandemic will use divestments to raise cash for paying down their high debt burdens. We have already seen instances of this. High valuation levels are another factor making it attractive to pursue divestments. Finally, if governments raise tax rates to fund their higher expenses stemming from the pandemic, corporate leaders may accelerate their decisions to spin off assets.

  As companies regain their footing in the new reality, they need to closely review their corporate portfolio and growth strategy to see whether it needs to be adjusted. Some companies will decide to restructure their portfolio and divest non-core assets. Others will make acquisitions to accelerate growth, gain scale, or digitize their businesses. Digitization and technological disruption of industries will likely remain important reasons for companies to make deals aimed at corporate transformation or acquisition of capabilities, technology, and talent.

- **Industry and Regional Considerations.** In some industries (such as steel), companies will continue to use M&A to reduce overcapacity or consolidate. In other cases, M&A will be a valuable tool for addressing the convergence of industry sectors, such as mobility and technology.

  A resurgence of cross-border deal activity is on the horizon. This will be driven, in part, by the restoration of international travel after the pandemic. Moreover, the need for global or regional scale will promote cross-border M&A in industries such as semiconductors and media, while industries such as automotive will likely turn to acquisitions to build international supply chains.

The time is right for companies to capture the value of divestitures.

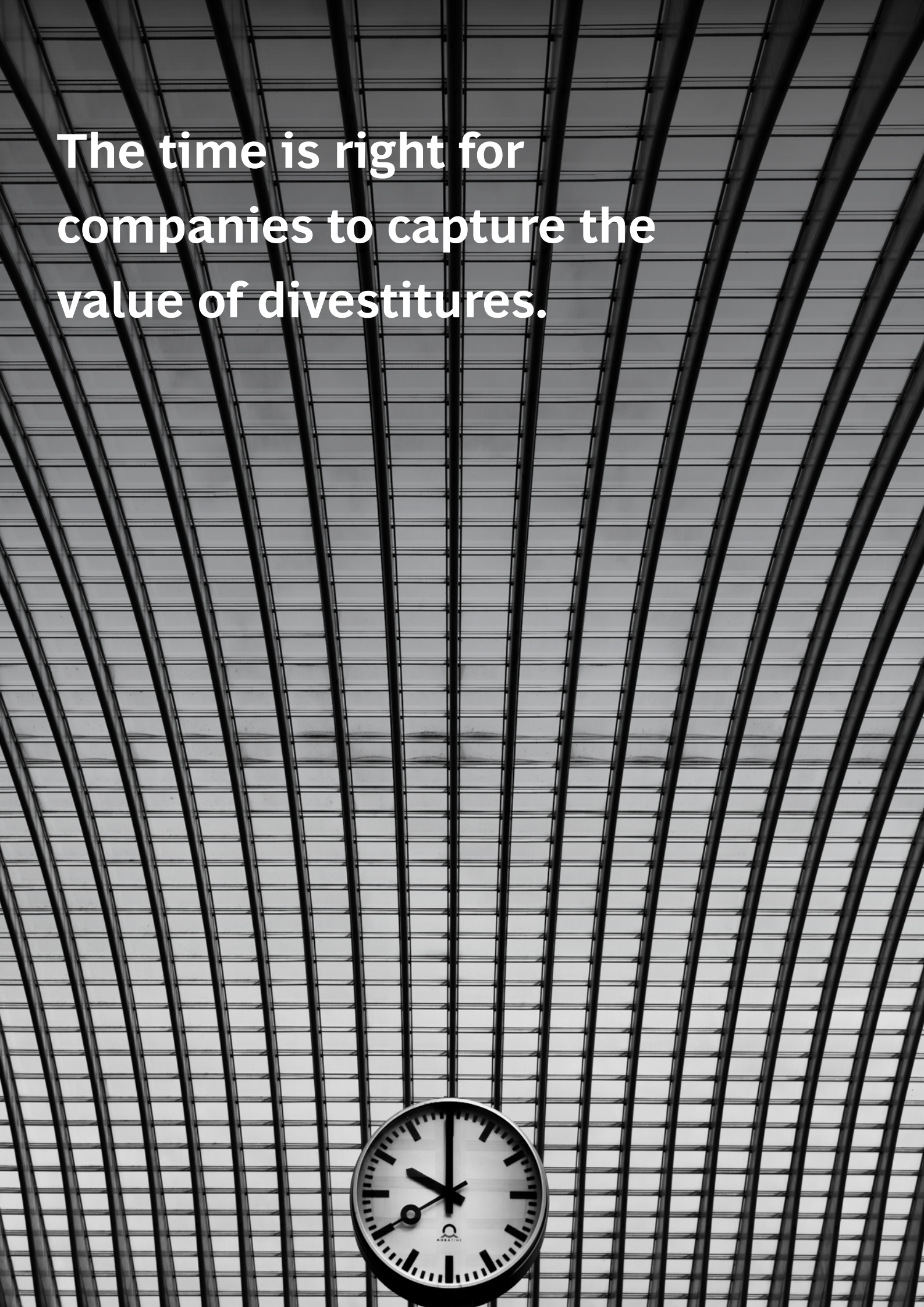
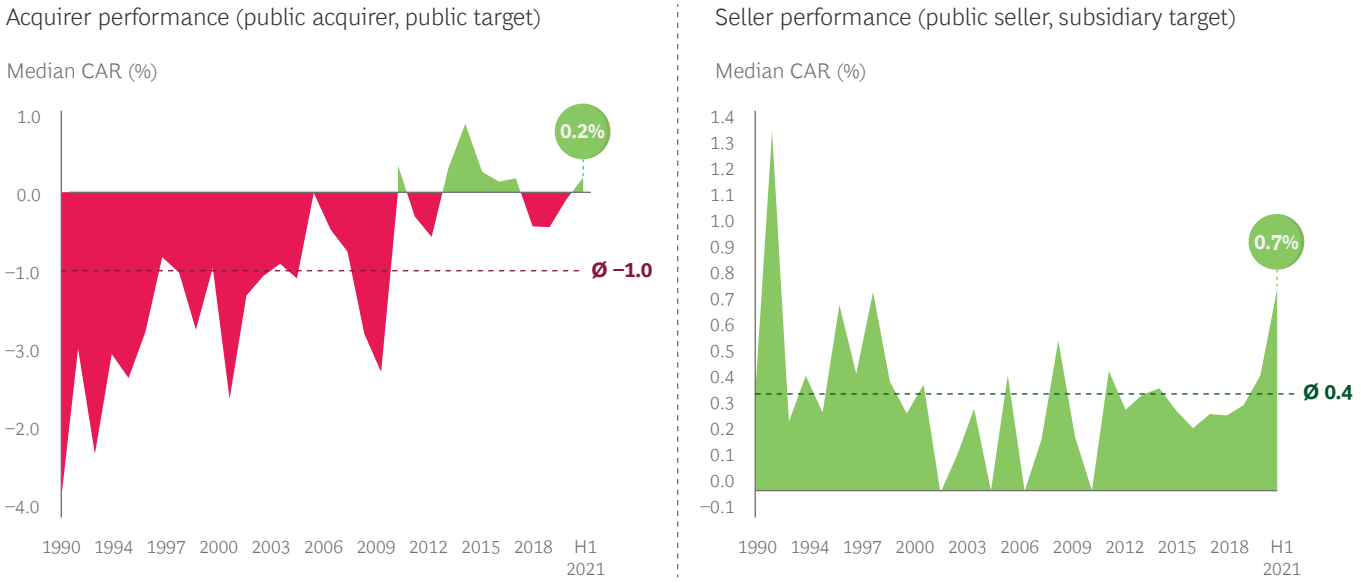


Exhibit 7 - Announcement Returns Turned Positive Again for Acquirers and Reached Record Highs for Sellers



Sources: Refinitiv; Datastream; BCG analysis.

Note: The total of 8,706 M&A transactions comprises completed, unconditional, and pending public-to-public deals or deals with public sellers announced between January 1990 and June 2021 with transactions of at least $250 million and at least a 50% share transfer. Self-tenders, recapitalizations, exchange offers, repurchases, acquisitions of remaining interest, minority stake purchases, privatizations, and spinoffs were excluded. Only deals with a disclosed value were considered. CAR = Cumulative abnormal return.

- **Sustainability.** Last but not least, sustainability topics (known as environmental, social, and governance factors or ESG) are an increasingly important consideration for investors. Companies have responded by evaluating their strategies and portfolios through an ESG lens. Some companies will likely use acquisitions and divestitures to adjust their portfolios in ways that make them more appealing to investors. Companies in the energy and oil and gas sectors face especially high scrutiny and will most likely actively manage their portfolios to achieve better ESG ratings.

Many companies are currently considering divestitures to raise cash, optimize their portfolios, and achieve a variety of other corporate objectives.

Overall, the M&A market seems to be in excellent shape with deal activity at record levels—however, the market could already be at the peak or quite close to the end of a cycle. To take advantage of this environment, many companies are considering divestitures to raise cash, optimize their portfolios, and achieve a variety of other corporate objectives. The remainder of this report explores whether they are likely to achieve their goals for value creation and discusses how they can promote success.

Divestitures Promote Value Creation

As noted in the previous section, M&A activity is booming again after the brief COVID-19-induced trough in 2020. Companies, private equity funds and other alternative investors, and SPACs (the relatively new kids on the block) are vying for attractive deals, and public markets are scaling ever greater heights.

This plethora of willing buyers requires an equal number of eager sellers. And the numbers indicate that the buyers and sellers have found each other: the volume (along with the value) of divestitures has risen steadily over the past 30 years. Downturns such as the dot-com bust, the Great Recession, and the euro crisis of 2012 only briefly tapped the brakes on divestment activity.

Three Types of Divestitures

We distinguish three types of divestitures. (See Exhibit 8.)

- Trade sales, in which corporate owners or financial investors sell companies (including carved-out businesses) in private deals
- Subsidiary IPOs, which involve the listing of a subsidiary held by a corporate or financial owner (in contrast to startup IPOs)
- Spinoffs (also called "de-mergers"), in which a corporate owner issues separate shares in a subsidiary to its existing shareholders

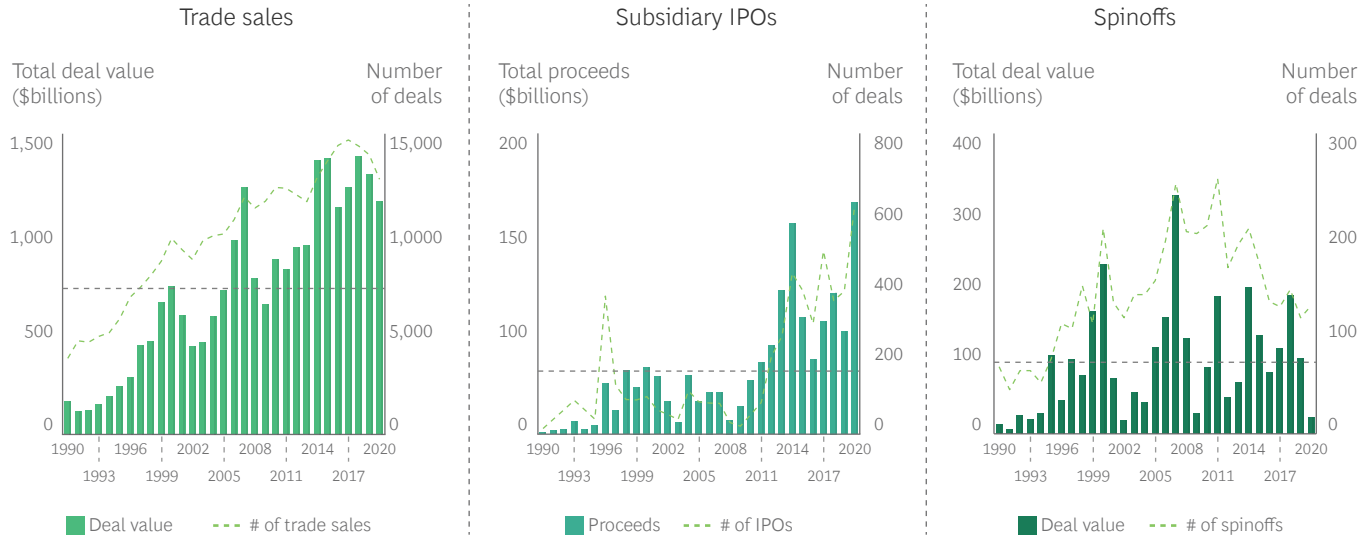
Trade sales peaked most recently in 2017 in terms of deal volume and in 2018 in terms of deal value. Volume and value declined substantially in 2020 as markets were essentially frozen for a few months in spring and early summer. However, trade sales continue to be the primary divestiture route in terms of volume and value. And they are ever more attractive for financial investors sitting on mounds of dry powder; the share of PE buyers of corporate divestitures has risen from 10% in 2010 to more than 20% in the first half of 2021.

Trade sales have lost some ground to IPOs, at least as a matter of public perception. In 2020, more than 600 IPOs generated total proceeds exceeding $150 billion. These figures—both all-time records—reflect IPOs' renewed prominence as an attractive exit route. Some corporate owners prefer IPOs over trade sales (which typically entail selling a majority stake) because they can retain control of the asset while taking advantage of favorable market conditions to maximize cash proceeds (referred to as "crystalizing value"). IPOs' attractiveness has also been promoted by record stock market valuations and strategic buyers' decreased willingness to pay for synergies in trade sales. Even so, the absolute number of trade sales is still substantially higher than the number of IPOs.

Trade sales continue to be the primary divestiture route in terms of both volume and value.

The picture for spinoffs is more mixed; deal volumes declined from their peak of approximately 250 in 2011 to just north of 100 in 2020. This volatility is not entirely surprising, given that spinoffs are rarely used outside the US and are often at least partly motivated by tax considerations (which may change as the tax code is amended). Moreover, neither companies nor their shareholders receive funds from these transactions.

Exhibit 8 - Divestiture Activity Remains Strong, Despite Some Volatility



Sources: Refinitiv; BCG Transaction Center.

Even with this dynamic picture, there is a clear overall trend toward increased use of divestitures—and for good reason, given the many strategic motivations and the value creation potential.

Why Divest a Business?

Companies can use divestitures to promote a variety of strategic objectives:

- **Focusing on the Core Business.** The most prominent reason for divesting a business—from a corporate owner's perspective—is focusing the corporate portfolio on the core business. This is still the case two decades after corporate strategy orthodoxy started shifting from diversification to focus, at least in Western countries. The importance of this motive is evident from a large-scale analysis of more than 2,000 news stories and other publications using the machine intelligence "discovery tool" Quid: "focus on the core" emerged as the most frequently recurring theme for divestitures in 2015 and 2020, the two years we compared. Divesting non-core businesses not only generates cash but also, less tangibly perhaps, frees up management and organizational capacity to be invested in and dedicated to the growth of core activities. For example, Daimler recently split its passenger car and truck businesses into two separate companies via a spinoff transaction. Although not done to generate cash, the spinoff created two entities—each with a distinct identity. This allowed management to define and pursue a unique strategy for each business. We expect this motive to continue to play a major role, especially now that many companies will want to reshuffle their portfolios coming out of the crisis.

- **Raising Cash.** Another frequent motive for divestitures, especially in downturns, is the need to raise cash, either to "repair" the balance sheet by bringing down net debt levels or, often more urgently, to meet upcoming financing obligations such as the repayment of a loan or bond. Not surprisingly, this theme became much more prominent in 2020. Our Quid analysis of publications showed that many companies mentioned the need to "cut debt," to respond to "debt pressures," or to improve "financial flexibility" as cash evaporated and debt ballooned. A case in point is the airline industry. It was among the sectors hit hardest by the pandemic and many companies needed government support and private capital infusions, typically in the form of loans. To raise cash to repay these loans and restore their healthy balance sheets, some companies are resorting to selling non-core parts of their business.

- **Stopping the Bleeding.** Depending on the asset (or the direness of the situation), generating cash from a sale may not even be possible. In such cases, the primary motivation for selling an asset is to avert the need for future cash-outs.

- **Realizing Value.** Crystalizing value is another cash-focused motivation, but with more positive connotations. Lofty valuation levels have fueled many trade sales and IPOs over the past few years and can also color decisions on what is deemed a "core business." In some cases, the opportunity to reap a cash windfall entices owners to sell what is arguably a core business. This may have motivated Deutsche Telekom's divestment of T-Mobile Netherlands or eBay's sale of its classifieds business. Companies also realize value through a partial exit (that is, selling a minority stake in a business). Recent examples include Alphabet's sale of stakes in its autonomous driving startup Waymo to financial and strategic investors and SAP's IPO of its subsidiary Qualtrics.

- **Other Motivations.** Beyond these main reasons for divestitures there can be many other motives. For example, tax effects often motivate corporate spinoffs, which can be corporate tax neutral in some jurisdictions. Some divestments are intended to reduce the regulatory scrutiny that often intensifies as companies grow and gain competitive advantages. Additionally, family-owned businesses may break up to address succession issues.

> **Divesting non-core businesses generates cash and frees up management and organizational capacity to focus on the growth of core activities.**

Activists and other engaged shareholders may demand that companies make divestitures to pursue one or more of these strategic objectives. In particular, they may want a company to focus or refocus on specific businesses in order to escape from a conglomerate discount (in which the company's market value is less than the aggregated value of its businesses).

Ultimately, the "why" of a divestiture, as in other major business decisions, is specific to owners and executives, their strategic considerations, or the pressures they face. But the impact on shareholders is generally more clear-cut, as we explore next.

Shareholders Capture Substantial Value

To determine whether divestitures create value for sellers' shareholders we looked at two indicators with different time horizons. (See Appendix I for details.)

- CAR over a period starting three days before the announcement of a transaction and ending three days after it.
- Relative total shareholder return (RTSR) as a measure of outperformance or underperformance of a seller's value creation compared with its benchmark index during the two years after a divestiture.

Overall, both measures are encouraging for would-be sellers; they have trended strongly upward since 2016. Short-term CARs, in particular, have shot up from a trough of 0.23% in 2016 to 0.74% in the first half of 2021. This may be expected, given the revival of markets' "animal spirits" following the unprecedented government stimulus measures in 2020 and strong economic recoveries across the globe this year. But the same trend can be observed in two-year RTSRs, which increased from approximately 1.5% for deals announced in 2014 to 4% for those announced in 2019. And looking specifically at spinoffs confirms the broader impression: companies included in Bloomberg's Spin-Off Index have consistently outperformed companies in the S&P 500 since 2003, with total returns about twice those of the benchmark index.[1]

> **Periodic portfolio reshuffling and divestitures of non-core assets can create substantial value for shareholders.**

Going one level deeper to look at value creation at an industry level provides a more nuanced picture. CARs for all industries are positive, but they vary substantially—from almost zero for telecommunications companies to more than 1% for media and entertainment companies. RTSRs, in contrast, are negative in some industries, including high tech, health care, and consumer products. The highest RTSRs are seen in utility industries, such as energy and power and telecommunications, as well as financial services. This points to an interesting correlation: high CARs in flashy industries such as high tech and media and entertainment go hand in hand with low or even negative RTSRs, whereas the relationship is inverse for more staid industries. Presumably, the initial buzz in the stock market frequently turns into a hangover as investors realize that, rather than shedding corporate "fat," companies may have actually cut into value-creating "muscle."

But overall, the message is clear: periodic portfolio reshufflings and divestitures of non-core assets can create substantial value for shareholders, in the short and medium term. This also makes sense from a market perspective: investors and analysts often subject complex corporate structures to a conglomerate discount because they struggle to distinguish brass from gold in a company's portfolio and question the synergies between what may be highly heterogeneous divisions. Academic research supports the market perspective, showing that conglomerate (or diversification) discounts are economically and statistically significant, albeit lower than initially estimated in the late 1990s.[2]

The Right Choices Promote Higher Returns

In considering the sale of a business, owners typically focus on three main issues: what, when, and how to sell. Delving into the data related to each of these issues, we identified the choices that promote higher RTSRs. (See Exhibit 9.)

- **What to Sell.** Confirming the conventional wisdom voiced in business schools and board rooms across the globe, owners generate the highest RTSRs by selling non-core and/or underperforming assets. This frees up cash, reduces complexity, and improves the growth and margin profile.
- **When to Sell.** Not surprisingly, returns are higher from divestitures made in favorable market conditions. Better economic prospects improve valuation levels and give sellers more negotiating power than in a fire sale during a downturn. As another factor related to timing, we found that RTSRs increase with a company's level of debt. Investors like to see that the seller needs the cash and can put it to good use.
- **How to Sell.** The choice of exit route also affects returns. In terms of two-year RTSR, spinoffs are most attractive, followed by trade sales and IPOs. This might be because spinoffs are usually quite sizeable transactions, sometimes with complex tax considerations, that provide no cash proceeds to the seller. The complexity and inherently higher risk lead decision makers to devote a high level of scrutiny before announcing a spinoff, which, in turn, promotes a greater chance of success. Historically, the value added by trade sales has been more than twice that of IPOs. The availability of forward-looking financials in trade sales (versus only historical financials in an IPO) and the sharing of synergies promote higher returns. Among trade sales, selling to corporate buyers generates more value than selling to financial investors, because the latter have few, if any, ways to realize synergies within their portfolio.

1. The Bloomberg Spin-Off Index tracks US companies spun off from their parent over the first three years after the spin-off date.
2. See, for example, Ammann, Hoechle, and Schmid, "Is there Really No Conglomerate Discount?", *Journal of Business Finance & Accounting* (2012).

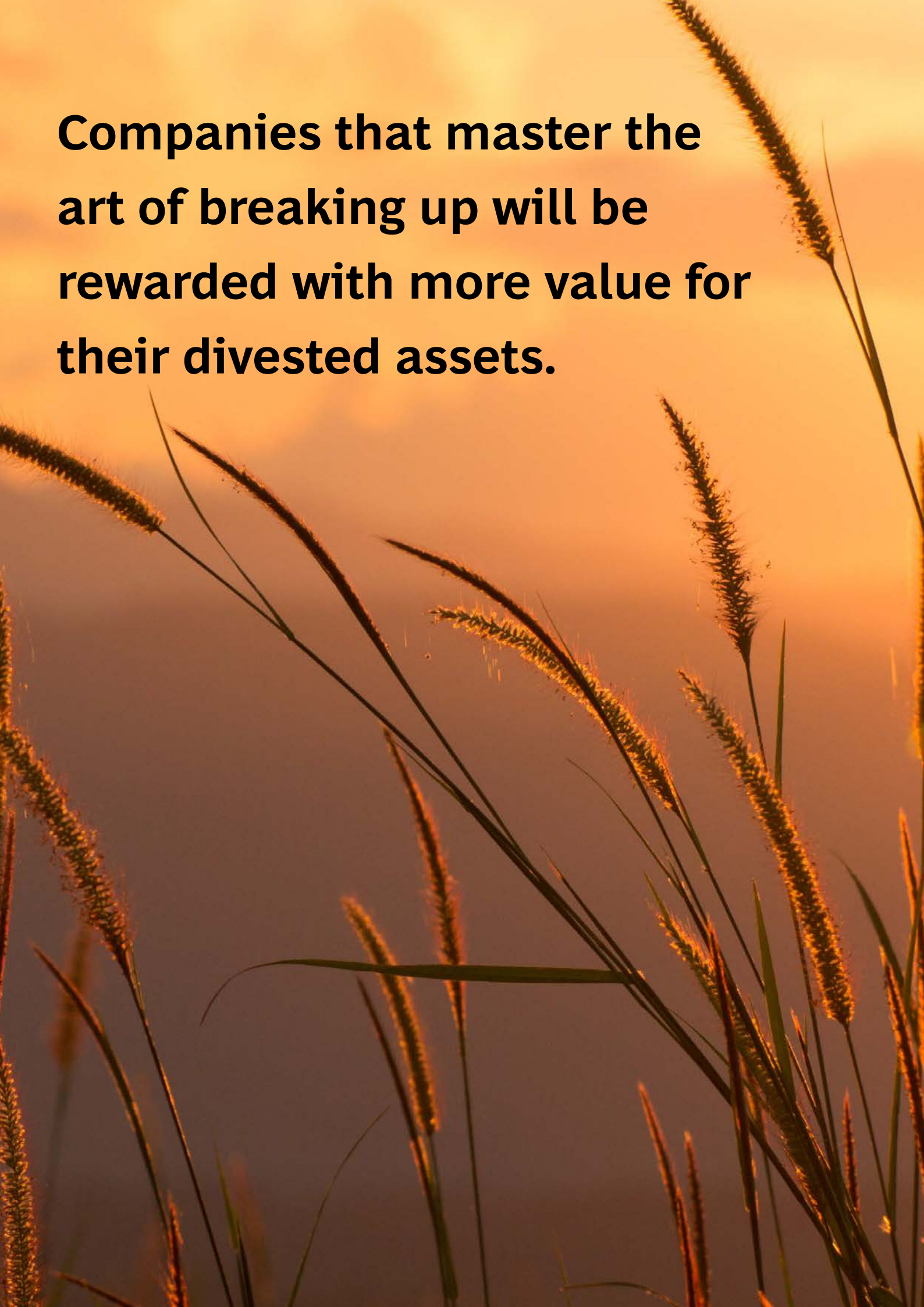
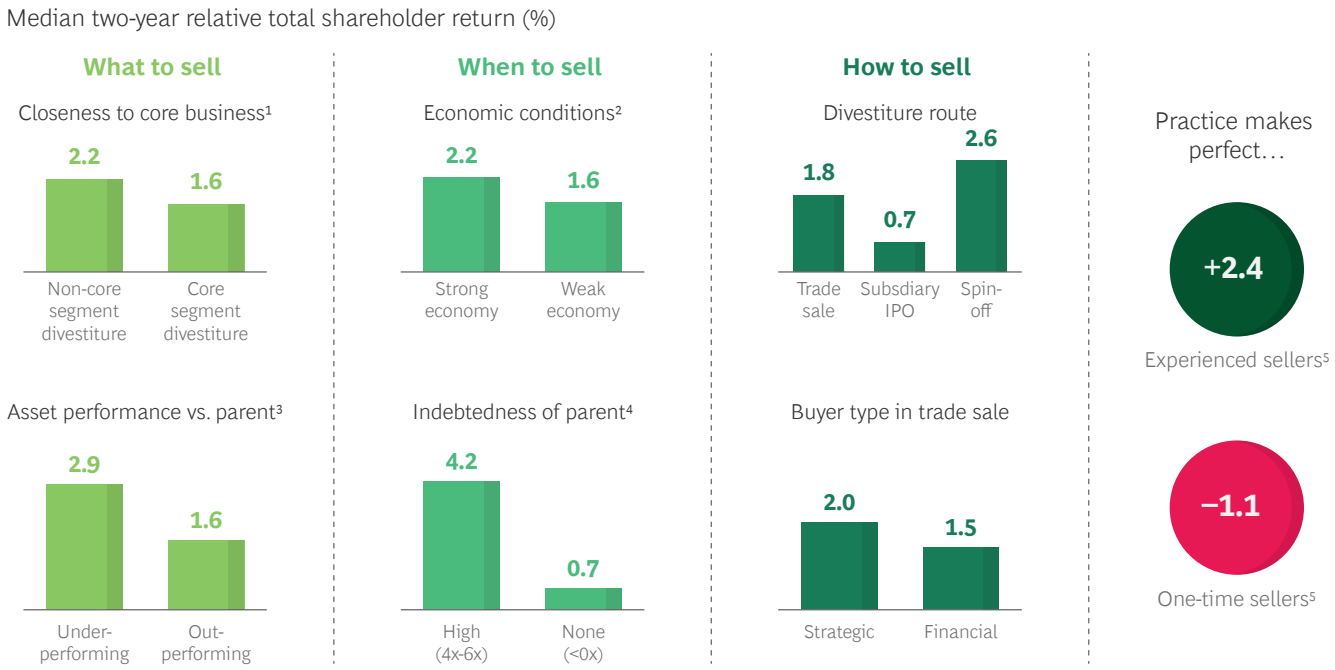

Companies that master the art of breaking up will be rewarded with more value for their divested assets.

Exhibit 9 - Deaveraging the Performance of Divestitures



Sources: Refinitiv; Datastream; BCG analysis.

[1]A core segment acquisition is one in which the primary two-digit Standard Industrial Classification codes of the target and the seller are identical.
[2]Strong-economy (weak-economy) years are those in which the respective global real GDP growth rate is in the top (bottom) third of all growth rates in our observation period.
[3]EBITDA margin of the asset relative to the parent company serves as proxy for performance.
[4]Indebtedness is measured as Net debt/EBITDA.
[5]Experienced" sellers completed at least three transactions in the data sample.

Last but not least, stock market analysts appreciate the adage that practice makes perfect. Companies that sell assets relatively frequently generate higher RTSRs than less-experienced sellers. The effect could partly be due to frequent sales being evidence of superior management practices. But it also matches our previous research on frequent acquirers, which showed a clear correlation between deal experience and returns for buy-side transactions.

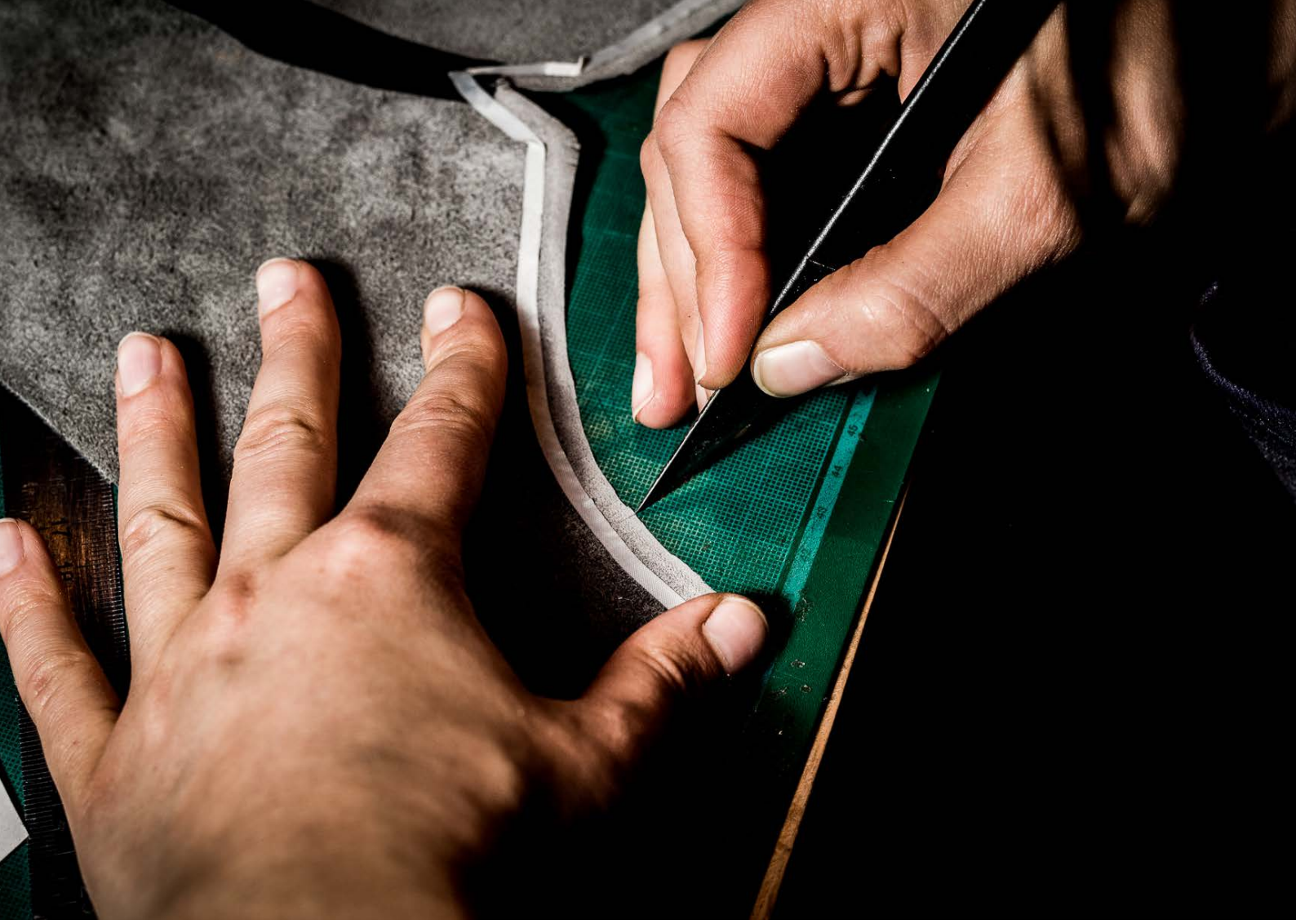
Preparation Lays the Groundwork

As we have outlined, divestitures can create substantial value for shareholders, and sellers can promote this value by following certain best practices. But averages can mask significant variances in performance and returns. De-averaging spinoff returns, for example, shows that top performers in the first quartile can indeed generate stellar RTSRs of more than 50% over a two-year period. The median, however, is closer to zero because underperformers drag it down.

Sellers can get to the good side of this gulf in performance by adequately preparing for every divestiture from start to finish—from thinking deeply about what, when, and how to divest to getting the asset ready and rigorously executing the process through closing. While a stringent preparation process is not a panacea—market conditions can deteriorate unexpectedly, for example—it minimizes risks and lays the groundwork for a successful deal.

> **A stringent preparation process minimizes risks and lays the groundwork for a successful deal.**

The central element of this preparation process is typically carving out the divested business—that is, separating it operationally and financially from its parent company. In the final section, we explore the complexity of carve-outs and how to undertake them successfully.



How to Create Value Through Carve-Outs

Divestitures are clearly on the rise, and, in many cases, they prove to be value-creating for the seller—if done right. But before a divestiture can become a success story, sellers must climb a hill that is often steeper than expected: preparing the business for a sale by separating it from—that is, carving it out of—the parent company.

Exploring the Complexity of Carve-Outs

A carve-out is one of the most complex and consequential projects a company and its executive team can undertake. The operations of the parent company and the divested business (the "carve-out company") must continue without disruptions while the process proceeds. Extensive and intricate carve-outs require long-running transitional service agreements (TSAs) and other constructs to ensure business continuity starting on "day 1"—the first day of operating under the wing of a new owner.

In many cases, deep levels of entanglement between the carve-out company and its parent that could not be (or were not) fully resolved during the carve-out process make it hard to achieve a clean break. Primarily, the degree of entanglement reflects the extent to which the entities share IT (especially enterprise resource planning systems), production sites, supply chains (including warehouses), and internal processes.

In reviewing BCG's database of carve-outs occurring in recent years, we found that more than 50% of large carve-outs (those with a value greater than $300 million) require post-day-1 support from their former parent via TSAs, including agreements involving core functions such as finance, IT, and HR. They may even continue sharing production sites and other facilities. (See Exhibit 10.) Indeed, we see a growing proportion of carve-out companies remain significantly dependent on the parent company after day 1. This reflects how the current high valuation multiples have motivated companies to divest businesses that are relatively complex and highly entangled.

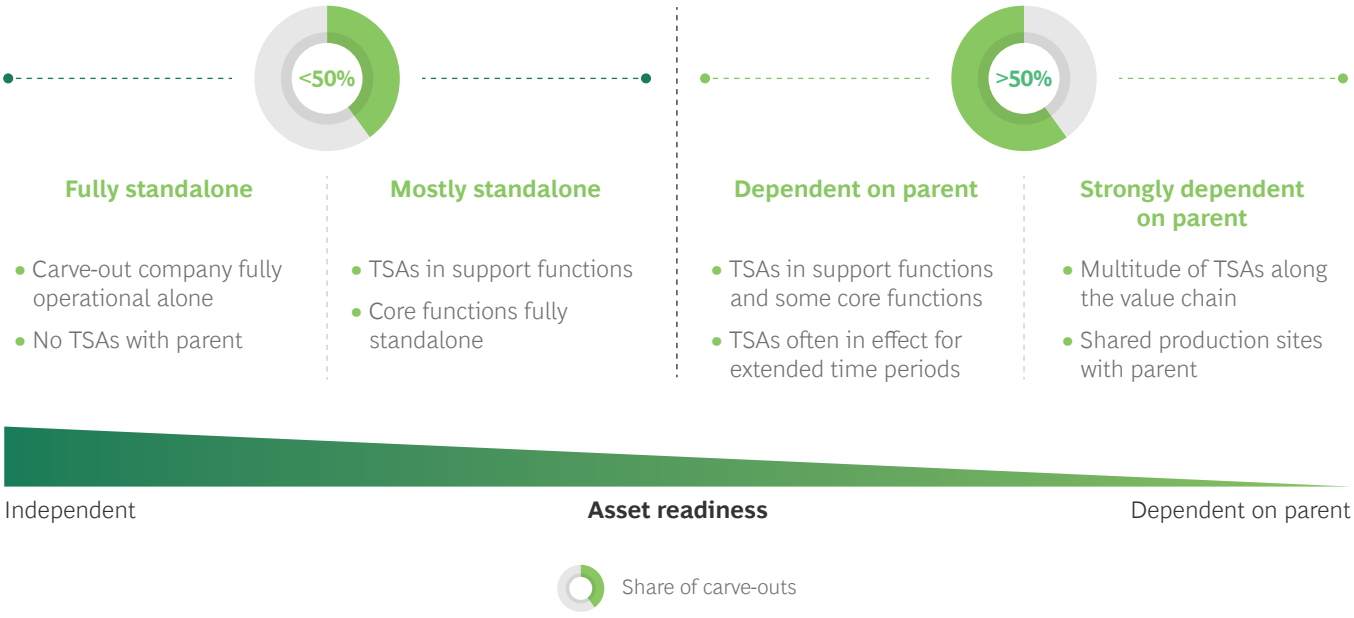
Making a clean break is challenging because companies need to invest significant resources and money in a complex carve-out. Executives of parent companies are understandably reluctant to make these investments upfront—before bringing the asset to market and finding out what it is worth. However, considering today's consistently high exit multiples, many companies are now willing to start preparing for a complex carve-out before offering an asset for sale.

> **A carve-out is one of the most complex and consequential projects a company and its executive team can undertake.**

Regardless of when companies initiate the carve-out process, they need an in-depth and accurate understanding of the resource and cost requirements.

Resources. Executives often underestimate the need for significant manpower—both internal and external. The gap between estimates and real resource requirements can be substantial and have harmful consequences for the carve-out and parent companies down the road.

Exhibit 10 - Large Carve-Outs Typically Remain Dependent on Their Parent



Sources: BCG carve-out database and expert interviews.

Note: Core functions include, for example, IT, manufacturing/production, supply chain, and sales. TSA = Transitional service agreement.

Resource requirements for large-scale carve-outs start small and then build to a global effort. Strategic planning typically requires a small team comprising only the project leader, top management, and key functional leaders. Once the preparation phase begins, however, the effort requires local teams to drive the overall carve-out execution. Although central functions coordinate and guide the execution, regional and country organizations ultimately perform the bulk of the work.

In the month before closing and during the immediate aftermath, staffing levels often reach 200 or more FTEs for complex multi-country carve-outs (with the effort spread among approximately 500 employees). In such cases, a significant share of the company's entire workforce is involved in the operational aspects of the transaction. Clearly, a failure to plan for this complexity can be highly disruptive to business processes at both the carve-out and the parent and result in costly delays.

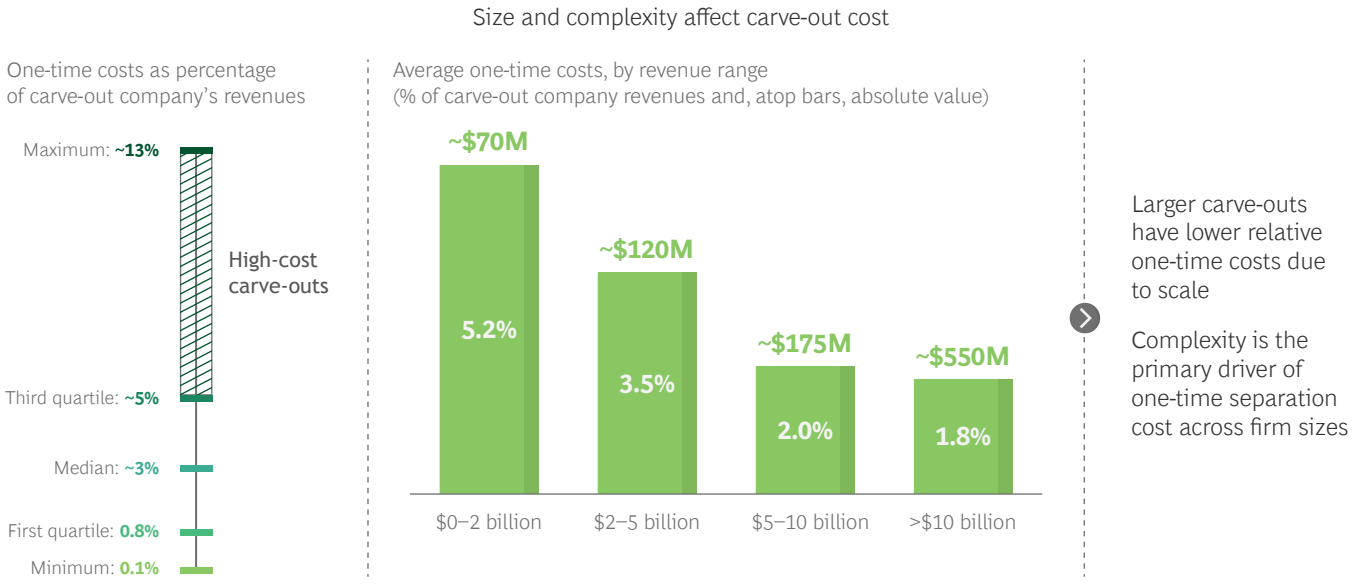
Costs. Companies can incur substantial costs to carve out personnel, assets, technology, and contracts from the parent company. If the divested asset or business has already been operating as a distinct subsidiary, the separation can be fairly straightforward and entail relatively low separation costs. However, if the entity is heavily entangled with the parent company's core business, the separation can be very demanding on the organization and expensive to deliver.

Carve-outs are notably more expensive in some industries. In health care, for instance, the main contributors to high costs are long separation timelines and the need for regulatory compliance. Similar restrictions apply to other highly regulated industries, such as financial institutions. Across industries, the size of the divested business, the number of legal entities involved, and IT and supply chain entanglements are important factors as well.

Companies incur substantial costs to carve out personnel, assets, technology, and contracts from the parent.

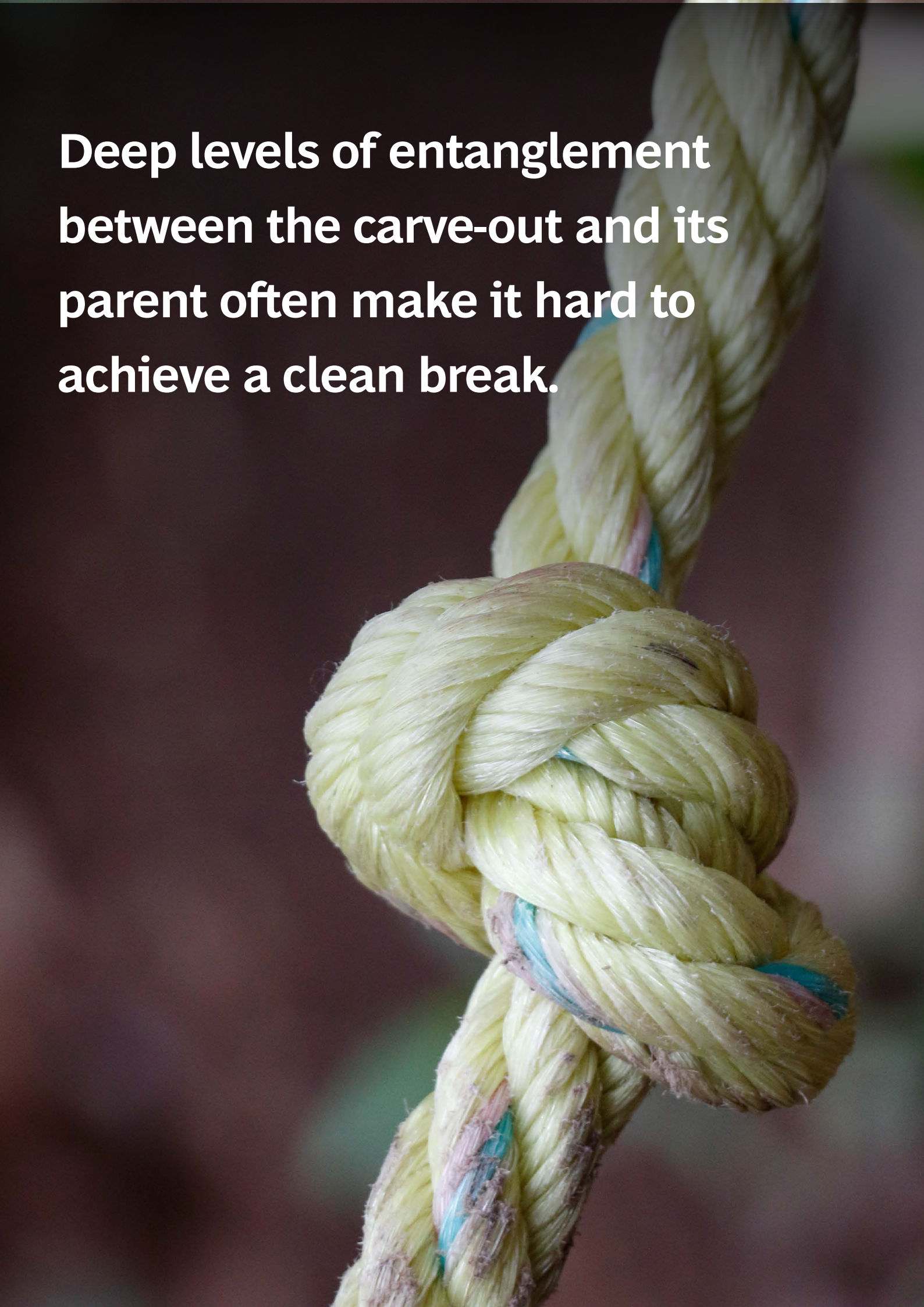
In a recent study, we analyzed direct carve-out costs—one-time costs and TSA costs—across 59 divestments with deal values greater than $1 billion, mostly in Europe and North America. (See Exhibit 11.) We found that these costs can range from approximately 1% to 5% of the divested business's revenues (with a median of approximately 3%.), translating into tens or hundreds of millions of dollars in absolute costs. In some large and complex carve-outs, these costs reach up to 13% of revenue. As expected, because the effort and costs to separate a business are often similar regardless of deal size, it is common to see lower one-time costs (as a percentage of revenues) for larger divested businesses.

Exhibit 11 - Separation Costs Can Be High, Especially for Complex Deals



Sources: Annual reports; public information; BCG Transaction Center.

Note: Sample of 59 divestments with deal value greater than $1 billion; includes transaction costs.


Deep levels of entanglement between the carve-out and its parent often make it hard to achieve a clean break.

At a region level, relative costs were similar in Europe and North America. But at an industry level, clear differences emerged. We saw the largest one-off costs in health care and financial services, as well as in manufacturing industries where production and supply chain assets required a separation.

Beyond regional or industry variation, the high-level data masks a substantial difference between the most efficient and the costliest carve-outs relative to deal size, with costs ranging from less than 0.5% to more than 15% of deal value. This difference is driven partly by deal size and the levels of entanglement across IT and the supply chain. At the same time, execution skills matter: companies that execute the carve-out well—with an experienced team, a clear process drumbeat, and consistently applied best practices—emerge from the process with lower costs as a percentage of deal value.

In addition to the direct costs of a carve-out, sellers also need to consider stranded costs: a parent company's cost structure often includes expenses that are linked to the operations of the divested business but are not transferred and cannot easily be eliminated after the carve-out. Stranded costs can be substantial, regularly amounting to 3% to 7% of a carve-out company's revenues. Some of these costs will be necessary to support the TSAs, at least for the duration of the contracts. For instance, in large carve-outs with highly entangled companies, sellers often must provide comprehensive TSAs that can amount to more than $100 million a year and include hundreds of people providing services to the carve-out company. Here, sellers need to consider how to deal with stranded costs after TSA exit in their future operating model. And they must also deal with stranded costs unrelated to TSAs, which can be substantial.

Because stranded costs are often hard to identify and take time to eliminate, sellers should get an early start pinpointing and quantifying them. This requires rigorous baselining and cost allocation, followed by clear target setting (based on benchmarks, for example) and the definition of cost reduction measures. Such an exercise should be managed centrally in a dedicated process, with sufficient resources provided. The potentially large value of stranded costs makes it imperative to have a strategy in place to address them. This requires thinking creatively about how to work more efficiently in the context of a smaller organization.

The high-level data masks a substantial difference between the most efficient and the costliest carve-outs relative to deal size.

Why Do Some Carve-Outs Fail?

To better understand how companies can succeed with carve-outs, we recently looked at the issue from the opposite side—that is, we asked M&A and carve-out experts participating in a BCG-hosted conference for their perspectives on the key reasons carve-outs can fail. (See Exhibit 12.)

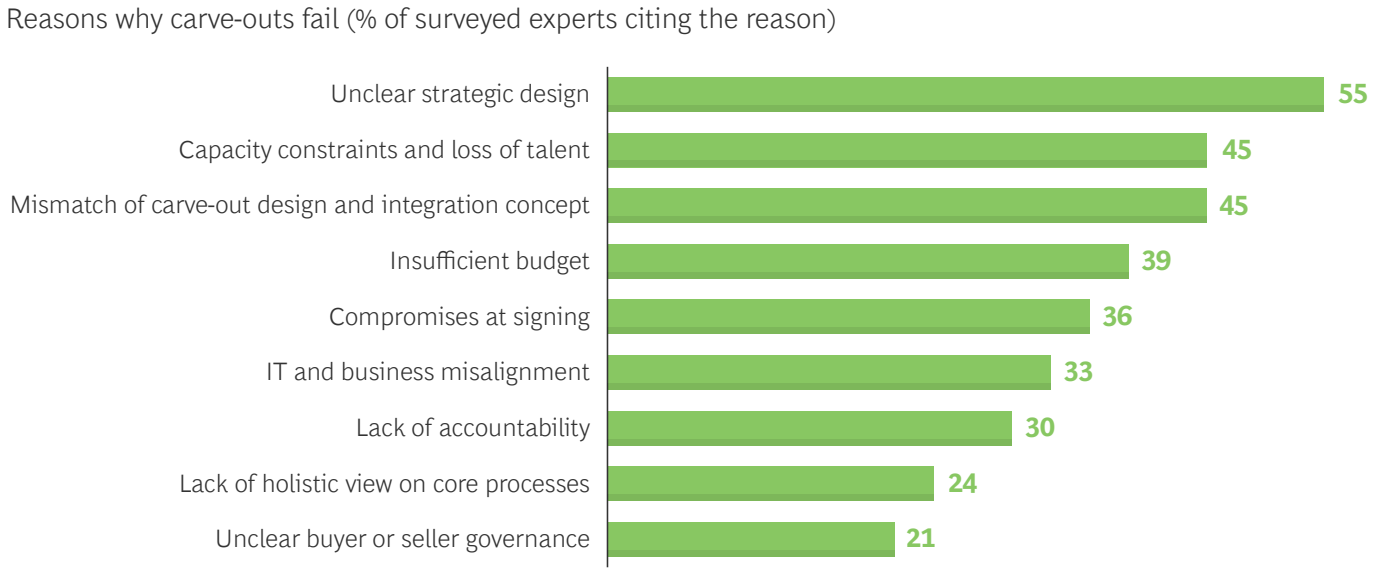
- **Unclear Strategic Design.** Many carve-outs suffer from underinvestment in the strategic planning stage of the process. Companies often make an exit decision in the context of a longer-term strategic review. However, they usually do not comprehensively consider the strategic design: Will the asset be a fully standalone company, prepared for an IPO, a minimally viable company tailor-made for a strategic buyer, or sold piecemeal in a series of deals? A lack of clarity here is the root cause of significant complexity further down the road toward day 1.

- **Capacity Constraints and Loss of Critical Talent.** As discussed above, carve-outs are long-term projects that require significant extra work from many key stakeholders and functional experts. This is not a sprint but a transformational project that can easily take 12 to 18 months from the start of preparation to day 1. If companies do not establish the right incentives for their key people and institute a strong communication and change program, morale is likely to suffer. In the worst case, companies risk losing key people along the way.

- **Mismatch Between Design Plans and Integration Needs.** Often, the seller's design plan for the carve-out process does not match the prospective buyer's integration concept and requirements. Recognizing the need for alignment, some sellers are now involving buyers much more intensively in the design phase. (See the sidebar "The Timing of Carve-Outs is Shifting Later.")

Survey participants also pointed to unclear or insufficient budgets, reflecting an underestimation of the high costs discussed above. Other reasons cited for failure include compromises made at signing, a misalignment between business and IT processes, the absence of a holistic view on core processes, and unclear governance.

Exhibit 12 - Carve-Outs Fail for a Wide Variety of Reasons



Sources: BCG expert interviews; BCG survey of 76 M&A and carve-out practitioners.

The Key Success Factors

To avoid these pitfalls and truly create value from a carve-out, leading companies follow a variety of imperatives:

Focus on value creation. A carve-out is a significant technical, operational, and project-management challenge. But it should not be treated as a purely mechanical separation exercise that is limited to shifting assets and processes. Ultimately, it is about creating maximum value from the overall transaction. This should be the yardstick against which each scoping decision, action taken (or not taken), and staff allocation is assessed.

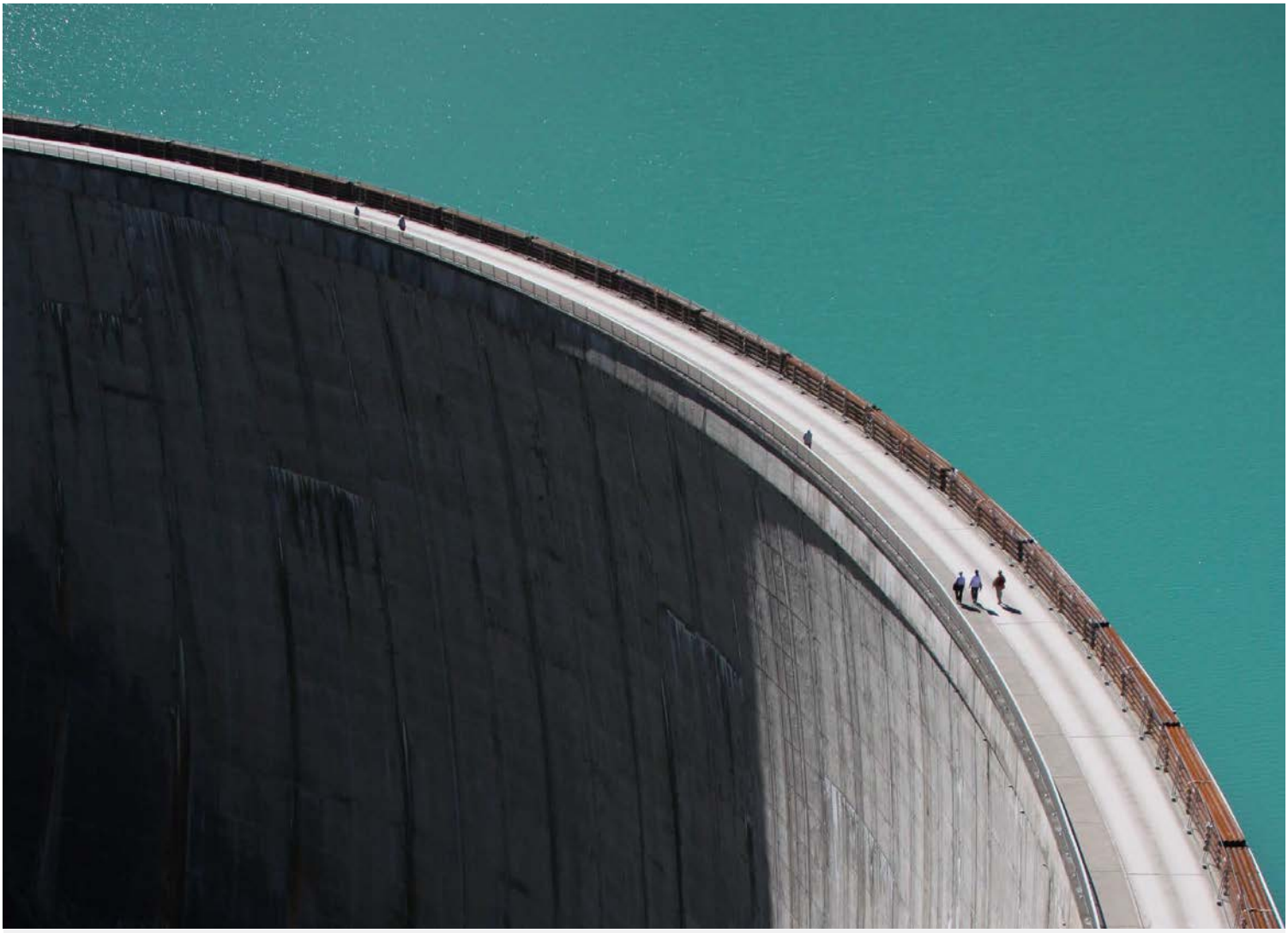
Don't overlook the details. The tasks are myriad, and the process is long, so it may be tempting to use an 80:20 approach in implementation—which is typically necessary and sufficient in most complex situations. But this may not be enough to ensure business continuity in a carve-out; the devil can be in the details.

Keep everyone on board. Operational separation is the prerequisite for a successful carve-out. But it is not sufficient. Even the most smooth-running project can fail if the people responsible for making the carve-out company a standalone success do not support the effort. This makes it essential to closely manage people issues and the overall change and communications process.

> **Even the most smooth-running project can fail if people do not support the effort.**

Don't forget the business. Even as executives devote a disproportionate share of their time and attention to the carve-out process, they need to not only keep the business running but also help it to further develop and grow. Fulfilling these obligations requires taking actions from the outset to maintain business momentum. This includes setting up a dedicated project team to monitor performance and ensure that executives and teams on the ground have sufficient time to focus on their primary task: promoting the success of the carve-out company and its former parent.

Staff the team with the right people. As in any large transformation project, operational managers (and their superiors) may be reluctant to contribute key people to an undertaking that is likely to last months or even years. But companies need to ensure that the project team is lean and that it comprises experienced staff with sufficient seniority and "weight" in the organization. This makes it paramount to fill key roles—especially the project leader, the carve-out leader, and regional leaders—with the right people at 100% capacity.



The Timing of Carve-Outs is Shifting Later

The timing of the carve-out process relative to the transaction process has changed substantially during the past few years. Historically, owners often stood up an asset as a fully standalone entity before they initiated the process of selling it. More recently, companies typically complete only the setup, design, and planning phases before launching the transaction process, while timing the implementation phase to coincide with a targeted signing date. This approach shifts a significant share of the carve-out work into the transaction process itself, which provides more flexibility. Today, we see this approach used most frequently for large deals.

The newest development in timing, however, goes even further: rather than providing potential buyers with an (almost) executed carve-out, owners increasingly do only the planning work before signing, and make the execution specific to the successful bidder and its requirements. In some cases, they put off planning until after signing. This has several implications for would-be buyers of carve-outs, whether corporate or financial investors:

- **Involvement.** Buyers are closely involved in many day-to-day and strategic carve-out decisions. This gives them substantial influence over the outcome and value creation. However, it also requires significant resources and expertise, both internal and external.

- **Timeline.** With the bulk of the carve-out work starting at signing, deals will naturally take longer to complete—potentially twice as long or more compared with traditional carve-out approaches.

- **Costs.** Along with the need for more resources, buyers also face higher costs for the internal staff that they need to reserve and for external support, because these costs are no longer covered exclusively by the seller.

The additional sweat and tears has a clear upside, of course: it allows buyers to tailor the carve-out to their strategic plans and potentially improve the process. So, we expect this new approach to become more popular over the coming years, especially in deals involving financial investors.

Plan your budget and stick to it. As we have shown, carve-out costs can be much higher than expected. So, think carefully—and broadly—about the budget you need for the carve-out. Consider cash requirements and internal costs at the outset, and then rigorously track and manage the budget throughout the process. And do not underestimate the importance of IT costs, which typically account for 50% or more of the total budget.

Tackle stranded costs early and rigorously. Prioritize the elimination of stranded costs and get an early start addressing them. Stranded costs are often a significant lever to unlock the full value of a divestiture. The exercise can also be used as a catalyst to challenge the parent company's operating model and reset the cost structure. Tools such as zero-based budgeting can facilitate the effort.

> **Companies must apply best practices to ensure that high costs do not undermine the value realized.**

The time is right for companies to capture the value of divestitures. With numerous trends favoring a continuation of today's robust M&A market, sellers are likely to find strong demand for their assets. Moreover, our analyses reveal that divestitures can create substantial value for shareholders in the short and medium terms. But strong returns are not guaranteed. Companies need to sell the right assets at the right time and select the best divestment channel. They also must recognize the complexity of carving out the divested asset and apply best practices to ensure that high costs do not undermine the value realized. Companies that master the art of breaking up will be rewarded with more value for their divested assets and, ultimately, a stronger portfolio of businesses.

Appendix I

Data and Methodology

The research that underpins this report was conducted by BCG's Transaction Center during the first nine months of 2021.

Data Sets

The data set used for the analyses in BCG's M&A research (the "M&A database") comprises approximately 842,000 M&A deals covering the period January 1980 through June 2021. In assessing general market trends, we analyzed reported M&A transactions from 1990 through the first half of 2021. For the analysis of deal values and volumes, we excluded transactions marked as repurchases, exchange offers, recapitalizations, or spinoffs.

For the analyses of seller performance, we looked at a subsample of approximately 5,500 transactions that were classified as divestitures by Refinitiv. We further restricted the sample to deals with a value of at least $250 million, a transfer of majority (greater than 50%) stake, and a public seller.

In addition to our proprietary data and analytics, we collected and collated financial data and relied on information from a variety of data providers, including Refinitiv's Thomson One, Eikon, and Datastream, as well as S&P Capital IQ, Pitchbook, Crunchbase, Mergermarket, and Bloomberg.

Short-Term Value Creation

Although distinct samples were required to analyze different issues, all return analyses employed the same econometric methodology. For any given company i and day t, the abnormal (that is, unexpected) returns (ARi,t) were calculated as the deviation of the observed returns E(Ri,t). Abnormal returns are the difference between actual stock returns and those predicted by the market model. (See Equation 1.)

EQUATION 1

$$AR_{i,t} = R_{i,t} - E(R_{i,t})$$

Following the most commonly used approach, we employed a market model estimation to calculate expected returns.[1] (See Equation 2.)

EQUATION 2

$$ER_{i,t} = \alpha_i + \beta_i R_{m,t} + E_{i,t}$$

The derived alpha (αi) and beta (αi) factors were combined with the observed market returns ($R_{m,t}$). (See Equation 3.)

EQUATION 3

$$AR_{i,t} = R_{i,t} - \beta_i R_{m,t} + (\alpha_i + \beta_i R_{m,t})$$

To determine the "announcement return," we derived the cumulative abnormal return, or CAR, by aggregating the abnormal returns day by day, starting three days before the announcement date and ending three days after it. (See Equation 4.)

EQUATION 4

$$CAR_{i,t} = \sum_{t=-3}^{+3} - \beta_i (R_{i,t} - E(R_{i,t}))$$

Long-Term Value Creation

For M&A deals, we track the stock market performance of the acquirers or the sellers over periods of different length following the acquisition announcement. Note that we cannot track the targets because, in most cases, they are delisted from the public-equity markets.

First, we measure the total shareholder return (TSR) generated by the acquirer or seller over a time period with length t. (See Equation 5.)

EQUATION 5

$$TSR_{i,t} = (P_{i,t} / P_{i,o})^{(1/t)} - 1$$

Second, we subtract from the TSR the return made by a benchmark index over the same period in order to find the relative total shareholder return (RTSR) generated by the acquirer or the seller—in other words, the return in excess of the benchmark return.[2] (See Equation 6.)

EQUATION 6

$$TSR_{index,i,t} = (P_{index,i,t} / P_{index,i,o})^{(1/t)} - 1$$

$$RTSR_{i,t} = (TSR_{i,t} / TSR_{index,i,t}) - 1$$

Note that we could not include all deals in this analysis because the time elapsed since the announcement was too short to calculate the returns for some deals.

Statistical Significance of Our Results

We applied common-practice statistical significance tests to all of our quantitative results in this report. To assess whether means are statistically different from zero, we used one-sample t-tests, and—where appropriate—we used two-sample t-tests to determine whether the difference between means is significantly different from zero—that is, whether two groups do in fact have different means.

1. See Eugene F. Fama, Lawrence Fisher, Michael C. Jensen, and Richard Roll, "The Adjustment of Stock Prices to New Information," *International Economic Review* 10, February 1969; and Stephen J. Brown and Jerold B. Warner, "Using Daily Stock Returns: The Case of Event Studies," *Journal of Financial Economics* 14, 1985.
2. The benchmark indexes we apply are the relevant worldwide Refinitiv (formerly Thomson Reuters) indexes.

Appendix II

Selected BCG-Supported Transactions, 2021, 2020, and 2019

2021

Reckitt Benckiser

Selling its footcare brand Dr. Scholl to

Yellow Wood Partners

Strategic advisor to the seller

Value not disclosed

BCG

2021

steag

Selling its power minerals subsidiary to

EP Power Europe

Strategic advisor to the seller

Value not disclosed

BCG

2021

ZIM

Strategic advisor on IPO

$250M

BCG

2021

HITACHI

Selling its metal business to

BainCapital

JIP

Japan Industrial Solutions

Strategic advisor to the seller

$3.5B

BCG

2020

Worldline

ingenico GROUP

Strategic advisor on PMI

$8.5B

BCG

2020

Lufthansa

Selling its European airline catering subsidiary to

gategroup

Strategic advisor to the seller

Value not disclosed

BCG

2020

Caisse des Dépôts Groupe

pbb Deutsche Pfandbriefbank

CAPVERIANT

Strategic advisor to the seller

Value not disclosed

BCG

2020

SIEMENS Healthineers

VARIAN medical systems

Strategic advisor on PMI

$16B

BCG

2020

avaloq

sold by Warburg Pincus to

NEC

Strategic advisor to the seller

$2.2B

BCG

2020

7-Eleven

Speedway

Strategic advisor on PMI

$21B

BCG

2020

Chevron

noble energy

Strategic advisor on PMI

$5.0B

BCG

2020

Allied Universal

There for you.

G4S

Strategic advisor to the buyer

$5.1B

BCG

2020

Woolworths Group

PFD Foodservices

Strategic advisor to the buyer

$332M

BCG

2020

Triton

leadec Industrial Services

Diversified Automation

Strategic advisor to the buyer

Value not disclosed

BCG

2020

etex

Selling its building material subsidiary to

TERREAL

Strategic advisor to the seller

Value not disclosed

BCG

2020

Generali

Nationwide

N2G

Strategic advisor in JV transaction

Value not disclosed

BCG

2020

Bridgepoint

PharmaZell GROUP

Strategic advisor to the buyer

Value not disclosed

BCG

2020

ucb

Ra Pharma

Strategic advisor on PMI

$2.3B

BCG

2020

NORDIC CAPITAL

SpaMedica

Strategic advisor to the buyer

$370M

BCG

2020

BAVARIAN NORDIC

buying travel vaccine brands Rabipur and Encepur from

gsk

Strategic advisor on PMI

$890M

BCG

2020

thyssenkrupp

selling its elevator business to a consortium

Cinven

Advent International

RAGSTIFTUNG

Strategic advisor to the seller

€17.2B

BCG

2020

COMCAST

sky

Strategic advisor on PMI

$39.9B

BCG

2020

OAKTREE

MBE

MAIL BOXES ETC.

Strategic advisor to the buyer

Value not disclosed

BCG

2020

BBVA

Allianz

Strategic advisor in JV of non-life insurance

€270M

BCG

2019

EQT

ANTAS

Strategic advisor to the buyer

Value not disclosed

BCG

2019

ارامكو السعودية
Saudi Aramco

Strategic advisor on IPO

$29.4B

BCG

2019

Sumitomo Corporation
Enriching lives and the world

QPARK

Strategic advisor to the buyer

Value not disclosed

BCG

2019

SENVION

selling its European onshore service business to

SIEMENS Gamesa
RENEWABLE ENERGY

Strategic advisor to the seller

€200M

BCG

2019

PERMIRA

FLIXmobility

Strategic advisor to the investor

Value not disclosed

BCG

2019

AGFA

selling AGFA HealthCare to

Dedalus

Strategic advisor to the seller

$1.1B

BCG

2019

charles SCHWAB

TD Ameritrade

Strategic advisor on PMI

$28B

BCG

2019

BAYER

selling its animal health business to

Elanco

Strategic advisor to the seller

$7.6B

BCG

2019

ARDIAN

CELLI group
The sustainable drinking experience

Strategic advisor
to the buyer

Value not disclosed

BCG

2019

Fonterra
Dairy for life

selling its 50% stake in DFE Pharma to

CVC
Capital Partners

Strategic advisor
to the seller

NZ$633M

BCG

2019

MILLICOM

Telefónica
Móviles

Telefonia Celular
de Nicaragua

Strategic advisor
on PMI

$1.6B

BCG

2019

Sipchem
EXCELLENCE everywhere

sahara petrochemicals

Strategic advisor
on PMI

$2.2B

BCG

2019

BRIDGESTONE

TOMTOM
TELEMATICS

Strategic advisor
to the buyer

€910M

BCG

2019

gsk

PHYSIOGEL
HYPOALLERGENIC

Strategic advisor
to the seller

Value not disclosed

BCG

2019

omnicare

EQUISTONE

Strategic advisor
to the seller

Value not disclosed

BCG

For Further Reading

The Boston Consulting Group publishes many reports and articles on corporate development and finance, M&A, and PMI that may be of interest to senior executives. The following are some recent examples.

Don't Let Carve-Out Cost Compromise Value Creation
An article by Boston Consulting Group, June 2021

Does Your IPO Need an Anchor or Cornerstone Investor?
An article by Boston Consulting Group, June 2021

Dispel These Myths to Maximize Value in Small and Midsize Biopharma M&A
An article by Boston Consulting Group, June 2021

Don't Settle for Anything Less Than Full-Potential PMI
An article by Boston Consulting Group, April 2020

Decoding the Competitive Software M&A Market
An article by Boston Consulting Group, March 2020

The 2020 M&A Report: Alternative Deals Gain Traction
A report by Boston Consulting Group, September 2020

Keeping M&A Deals on Track During the Downturn
An article by Boston Consulting Group, September 2020

Taking the Stress Out of Distressed Carve-Outs
An article by Boston Consulting Group, September 2020

Building Beachheads in the US Defense Market Through M&A
An article by Boston Consulting Group, July 2020

What's Next for US Banking Consolidation in the Post-COVID-19 World?
An article by Boston Consulting Group, June 2020

The Asia-Pacific M&A Report: Dealmaking in Turbulent Times
A report by Boston Consulting Group, June 2020

Navigating Merger Clearance During the Crisis
An article by Boston Consulting Group, May 2020

COVID-19's Impact on Global M&A
An article by Boston Consulting Group, March 2020

IPO Performance and the Quest for Capital
An article by Boston Consulting Group, December 2019

How to Nail M&A in Engineering and Construction
An article by Boston Consulting Group, December 2019

The 2019 M&A Report: Downturns Are a Better Time For Deal Hunting
A report by Boston Consulting Group, September 2019

As Tech Transforms Auto, Deals Are Booming
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How Bold CEOs Succeed at M&A Turnarounds
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As Global M&A Slows, Investor Activism Is on the Move
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After the Honeymoon Ends: Making Corporate-Startup Relationships Work
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The 2019 Value Creators Rankings
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Riding the M&A Wave in Consumer Goods
An article by Boston Consulting Group, April 2019

The M&A Way into Distributed Energy
A report by Boston Consulting Group, March 2019

Cracking the Code of Digital M&A
A report by Boston Consulting Group, February 2019

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BCG Transaction Center

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Paderborn University

The authors are grateful for the support provided by Paderborn University, the University for the Information Society, which has a strong foundation in computer science and its applications. Paderborn's Chair of International Accounting, Sönke Sievers, focuses on research related to information processing in financial markets and valuation. Since 2019, he is a principal investigator in two projects of the TRR 266 Accounting for Transparency (https://accounting-for-transparency.de/), which is a transregional collaborative research center funded by the German Research Foundation (Deutsche Forschungsgemeinschaft – DFG). In addition to academic research, he intensively collaborates with business partners to advance knowledge in the fields of corporate finance, accounting, and mergers and acquisitions. For more information, please visit www.upb.de/accounting.

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For Further Contact

This report is a product of BCG's Transaction & Integration Excellence practice, which works with its clients to deliver solutions to the challenges identified in this report. If you would like to discuss insights drawn from this report or learn more about the firm's capabilities in M&A, please contact one of the authors.

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