Corporate Carve Outs: A Strategic Growth Tool for Turbulent Times

When challenges arise in the economic environment, businesses become much less interested in discretionary acquisitions—particularly larger deals or at higher multiples, creating a need for dealmaking alternatives.

The result is an uptick in corporate carve out transactions.

In H1 2023, the percentage of private equity (PE) deal value and volume for corporate carve out transactions trended higher than the value and volume seen at the same time last year, accounting for **10.3% of PE deal value and 8.2% of deal volume in Europe**, versus 8.8% of PE deal value and 7.4% of deal volume, respectively, a year prior.

PE total deal activity relating to corporate carve outs has also increased significantly in recent years.

In 2022, PE firms invested a record $2.3 trillion in corporate carve outs, up from $1.4 trillion in 2021. As PE firms seek to capitalize on the growing number of corporate carve outs, this trend is expected to continue in 2023.

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This trend is being driven by several factors, including financial distress, risk and regulatory pressures; environmental, social and governance (ESG) risk and reporting and the influence of shareholders.

Financial Distress

Macroeconomic factors can compel a parent company to focus on core business functions—and / or shed less profitable business units—and attempt to raise capital from the sale of business units not in the business's future plans.

Risk and Regulatory Pressures

In response to existing and evolving regulations, carve outs can help reduce risk by separating the parent company from a business segment, presenting a compliance burden.

Additionally, ESG risk and reporting have taken on greater importance in strategic planning and in dealmaking, as seen in 2022 with the energy transition catalyzing substantial carve out activity.

Influence of Shareholders

Intensifying shareholder and activist pressures have added new considerations for boards and management, which can prompt the decision to carve out a specific division to accommodate these stakeholders.

Given PE's expertise in business planning and value creation, they have substantial experience with these kinds of deals, making them a helpful resource for corporates looking to create value during ongoing economic uncertainty.

Keeping in mind the slowdown in dealmaking, PE players have accumulated considerable dry powder that they need to deploy before the end of the year.

Looking ahead into 2024, we expect to see corporates increasingly considering carve outs to address strategic challenges while supporting growth opportunities outside of buyouts.

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Lincoln Perspective

With a renewed focus on core business operations and the need to improve environmental credentials, industrials players and big service organizations are seeing the most opportunity for carve outs in 2023.

Opportunities for carve out transactions are plentiful and increasingly attractive investments for PE dollars, from improving green credentials by spinning off carbon-heavy assets to monetizing a non-core element of the business.

Corporates should consider carve outs as a way to get leaner during times of economic uncertainty while maximizing cash and improving agility for when market activity returns.

While carve outs are attractive within the present economic landscape, some factors make these processes complex, like management fit, close scrutiny on financials post-split, etc.

The value of pre-transaction planning and the need for a strong advisory partner cannot be overstated. The timing and process of a carve out should be customized to meet the parent company's objectives.

Lincoln International's positioning in the market, deep industry and advisory expertise and experience with complex carve-out transactions present a strong partner for these processes.

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