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Will you set the divestment pace, or try to keep up with it?

Global Corporate Divestment Study 2019
Spotlight on Europe

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The better the question. The better the answer. The better the world works.

While geopolitical uncertainty dominates the headlines – from tariffs to trade wars, Brexit to border control – European companies are embracing divestment to strengthen their competitive edge and execute on their transformation agenda. Divesting non-core businesses is seen as a priority to secure a more nimble operating model that enables execution on their capital agendas.

> “Convergence is a real challenge in all sectors as well as an important driver for divestment decisions. Take the automotive sector for example – it's currently reshaped by such disruptors as hybrid engines, autonomous vehicles, AI-driven manufacturing and predictive maintenance systems.”
>
> **Carsten Kniephoff**
> EY EMEIA Divestment Leader

With 84% of European companies surveyed intending to divest within the next two years (the majority planning to do so in the coming 12 months), executives are streamlining operating models for better agility. Accelerating corporate strategies to adapt to technology-driven business models is helping companies reposition themselves for future growth opportunities.

Digital disruption is fast-forwarding the pace of transformation. Seventy-four percent of European executives say that changes to the technology landscape are directly influencing their divestment plans. Executives predict that the number of tech-driven divestments will rise by 81% in the coming 12 months – 50 percentage points up from last year, with 4 out of 10 respondents aiming to fund new technology investments from a divestment.

79% of companies say streamlining the operating model will factor into their divestment plans over the next 12 months.

Executives divest to future-proof growth

Companies are increasing their rigor around portfolio management and sharpening their focus on building a growth strategy around core profitable operations.

With this, more companies are divesting for strategic reasons as opposed to shortcomings or failures in a business: European companies that cite a unit's weak competitive advantage as a driver in their latest divestment fell to 68%, down from 87% the previous year.

The second highest-rated driver for divestment is streamlining the operating model (65%), giving companies the ability to execute more nimbly on their capital agendas. Part of this equation is reinvesting the funds from a divestment to effectively strengthen a company's competitive edge. Sixty-one percent of European executives are prioritizing investing sale funds in new products, markets or geographies, with 58% investing back in the core business.

75% of European companies say their most recent divestment took the form of a carve-out sale.

Building the foundation to divestment success

Businesses increasingly realize that there are crucial steps in achieving a successful sale. Preparation is paramount. Regular portfolio reviews and use of analytics tools provide clarity of vision around an asset's state of health and divestment readiness.

The following are essential activities to pave the way for a successful divestment:

- Weighing the merits of different deal structures to deliver optimum value. A carve-out is the preferred approach for the vast majority of European respondents (75%), up from 48% last year. Alternative structures, such as partial divestments or joint ventures, were in second place (20%), down from 46%. This decrease may reflect the governance challenges that businesses can face when they partner with another company, particularly a previous competitor.
- Understanding and managing work stream interdependencies. This proved to be one of the biggest challenges for six out of 10 of respondents in developing their deal perimeter with more focus needed on highly-entangled areas such as IT, shared legal entities and shared services.
- Pre-empting regulatory hurdles. Sellers must identify regulatory requirements in every jurisdiction to set clear work stream timelines. Non-tariff barriers to success, including regulation, product standards and ownership rules, is cited by 45% of respondents as affecting their divestment plans.

Executives name a number of other pre-sale activities to help unlock maximum value from a divestment. These include identifying and mitigating stranded costs and highlighting tax upsides to potential buyers, completing operational improvements to reduce costs or improve margins and preparation to mitigate price reductions for tax risk.

Maximizing value by minimizing fatal flaws

The price gap between what buyers and sellers expect has widened significantly. Two-thirds (67%) of respondents report a gap of more than 20% between sellers' expectations and buyers' offers, up from 22% of respondents last year. And more than one-third (37%) say that their most recent divestment did not meet their price expectations, up from 14%.

The lack of alignment in expectations may explain why opportunistic offers were a trigger for just 49% of divestments, down from 73% last year. If sellers are to avoid joining the 57% of respondents who admit to holding onto assets for too long, it is even more important to build a credible value story tailored to meet the needs and interests of all potential buyers.

To maximize value sellers should:

- Bring analytics into buyer negotiations. Although 79% of respondents used analytics in making their investment decision, the number using analytics to stress test data from a buyer's perspective fell to 44% from 70% last year. Over half of respondents (54%) who didn't use analytics in buyer negotiations admitted that they wished they had.
- Offer potential buyers the reassurance of stand-alone operating models. Forty-one percent of respondents recognized that their failure to capitalize and operationalize stand-alone entities delayed or deferred asset closing.
- Demonstrate flexibility in operating models, deal perimeters and sale structures. Fifty-seven percent of respondents say that a lack of flexibility in the sale structure eroded the value of their last divestment.

67% of executives cite a gap of more than 20% between sellers' expectations and buyers' offers.

Conclusion: Bright future prospects

Despite the headwinds, just 38% of European companies now cite geopolitical uncertainty and macroeconomic volatility as the prime divestment trigger, down from 52% last year. Prospects for future deals remain bright, with prices well placed to rise again. A significant number of European respondents predict that the level of strategic sellers, unsolicited approaches, and buyers from outside their sector will increase over the next year. They also foresee a rising incidence of industry consolidation (80%, up from 67% last year) and large transformational deals (74%, up from 50% last year). To leverage these positive opportunities, sellers need to look through buyers' eyes and deliver what they want to know and see. Crucially, they should streamline their operating model for agility, prepare assets for sale before the opportunity arises, and tailor their value story for all potential buyers.

> "This study tells me that businesses have learned to become more resilient to geopolitical shock waves which are now considered the new norm."
>
> **Carsten Kniephoff**
> EY EMEIA Divestment Leader

About this study

The EY *Global Corporate Divestment Study* focuses on how companies should approach portfolio strategy, improve divestment execution and future-proof their remaining business. The 2019 study results are based on 1,030 interviews with 930 senior corporate executives and 100 private equity executives. The survey was conducted between September and November 2018 by Acuris. Europe highlights are based on interviews with 322 European executives.

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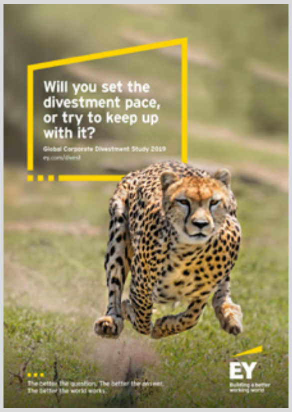

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To learn more and to have a conversation about your divestment strategy, please contact us:

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