How can divesting help build resilience and drive value beyond the crisis?

2020 Global Corporate Divestment Study

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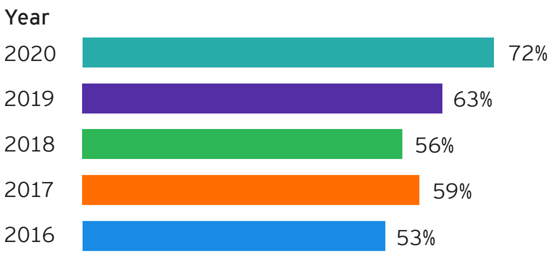
The EY *2020 Global Corporate Divestment Study* reveals divestment activity is poised for a sharp rebound as companies rebalance portfolios.

More companies than ever (72%, up from 63% in 2019) say they have held onto assets too long. At the same time, our latest survey suggests that the economic downturn is providing an impetus for sellers to take action, with more than three quarters (78%) planning a divestment.

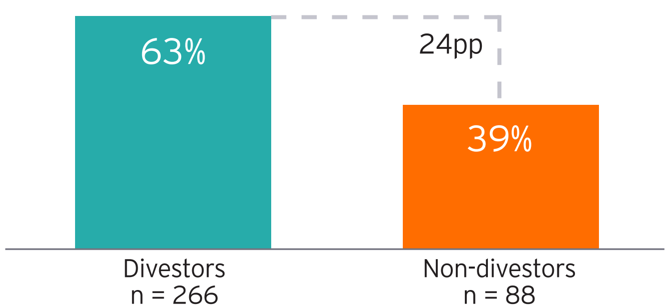
Q Companies that say they held onto assets too long when they should have divested them.



That's no surprise — in light of COVID-19, executives need to plan now for what happens next. Companies, including 65% that are rebalancing portfolios as a result of the crisis, must be willing to take action as they face even tougher capital allocation decisions. And capital investments will likely be needed now to future-proof the organization in terms of technology, automation and supply chains.

There is evidence that taking bold action now could pay off — and the most resilient and successful companies will be those that have shown discipline and focus on portfolio transformation. Lessons learned from the global financial crisis (GFC) show that active divestors outperformed non-divestors by 24 percentage points in median total shareholder return (TSR) in the 8 years following that crisis.

Q Comparing median excess returns (2010–18) of divestors and non-divestors during the period of 2008–2010[1]

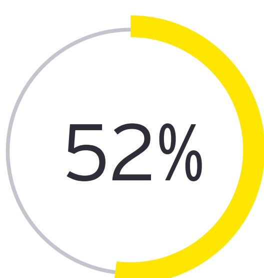


Source: EY Analysis and Dealogic

[1] *Company total shareholder return (TSR) adjusted for currency and benchmarked against global sector indices to calculate excess returns.*

This year's *Global Corporate Divestment Study* is unlike any other in its eight-year history. When we started the process for the 2020 study, it was business as usual: gathering perspectives from more than 1,000 C-suite executives across the globe on how they approach portfolio strategy and divestment execution. By the time our research concluded in January 2020, COVID-19 had begun rapidly evolving into a global crisis.

There's no doubt the financial and economic impact of the crisis has caused shifts in divestment perspectives over the last few months. Accordingly, we opened our research back up in April 2020 to retake the pulse of 300 global corporate executives.



of companies say the need to fund technology investments will make them more likely to divest in the next 12 months.

Those emerging stronger in the next phase of this current crisis will be reimagining not only their portfolios, but the very core of their business right now. Companies may not necessarily sell in the short-term, but they understand preparation is necessary in order to take action. More than half of companies (57%) say they will initiate their next divestment within a 12-month time frame, most within the next 6-12 months. The result is a long-term focus on the highest-growth aspects of the portfolio, with 67% planning to reinvest divestment proceeds in core businesses.

Q When do you expect to initiate your next divestment?

Divesting to invest in a technologically-enabled future

Capital raised from divestments can help boost cash reserves and fortify balance sheets. It will also accelerate the technology agenda - and the crisis is driving the need for more significant investments in areas such as automation.

While the pandemic has exposed cracks in some companies' ability to support remote workforces, the quickly changing demands of customers are an even bigger consideration. Forecasting value drivers beyond the crisis will precipitate different thinking now – such as developing new ecosystems of partnerships and alliances that put companies at the forefront of disruption rather than becoming the disrupted.

As such, more than half of companies (52%) say the need to fund new technology investments will make them more likely to divest over the next 12 months.

Rethinking paths to value — looking to the future while learning from the past

Our research in the wake of the GFC showing the strategic advantage of divestments may seem counterintuitive. Achievable valuations are likely to be lower in the near-term, but the analysis shows that selling in a downturn boosts total returns over the longer-term.

Divestors in the near-term will be forced to address declining transaction multiples and an ever-widening price gap between what buyers offer and sellers desire. To counter the downward turn in multiples, nearly 1 in 3 companies say they are likely to increase the scope and size of divestments post- crisis. While this may help sellers create a more valuable and attractive package of assets for buyers, this also will require even greater preparation before going to market.

Cultivating strategic partnerships to strengthen operational agility

As part of portfolio optimization and divestment strategy, companies are re-evaluating their ownership of non-core assets and considering migrating to an ecosystem of strategic partners. These partners, typically seen as better owners or managers of those assets, can help transition fixed costs to a variable cost structure, enhance company agility, shift resources to focus on core or critical capabilities, and achieve higher total shareholder return. We anticipate an increase in this trend as companies enter the recovery stage of COVID-19, and increasingly focus on supply chain resiliency.

While not necessarily new or novel, this asset light approach has been driven by several factors — the onset of digitization, economic downturn, shareholder activism and unprecedented levels of cash within private equity (US$1.5t). In fact, companies that transitioned manufacturing ahead of a sale were 17% more likely to exceed expectations on the valuation of the remaining business and were more likely to exceed expectations on the price of the divestment.

Companies that transitioned manufacturing ahead of a sale were

17%

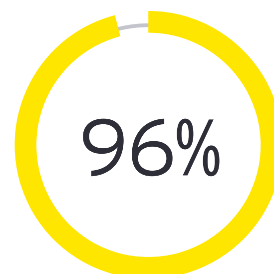
more likely to exceed expectations on the valuation multiple of the remaining business.

Activist investors — don't be surprised if they knock at the door

While shareholder activist campaigns globally have fallen 25% to 238 in the first quarter of 2020, compared to 2019, companies should not count them out. Several activists are raising funds to capitalize on market dislocation. And many, including the larger well-established firms, are thriving with large war chests and longer-term capital, compared with 2008.

EY surveyed 25 global activist investors in January 2020, and again in April 2020. The resulting data shows that the investor base will move at a faster pace, with a desire for additional portfolio focus and simplicity. And companies need to prepare now.

This is evidenced by the 96% of activists who would now, post-crisis, recommend that a target company divest non-core or underperforming businesses, up from 64% previously. Their desired timeframe has also significantly shortened. Pre-crisis, 36% of activists said the expectation was that a divestment should take place within 6 months; this has now increased to 84%. Therefore, companies should prepare for investor discussions that focus on how they are responding to the crisis, aligning the portfolio to their core strategy, and other matters such as executive compensation alignment relative to company performance.



of global activist campaigns ignited post-crisis will call for corporate carve-outs.

While we don't know exactly what's next and beyond the COVID-19 crisis, we do know that these trends are driving divestment strategy now. Strategic planning and plotting the continued course of transformation is on the agenda. So is strategically divesting to free up capital, build resilience and drive long-term value.

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EYG no. 003190-20Gbl
BSC No. 1908-3237361

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About this study

The EY *Global Corporate Divestment Study* is an annual survey of C-level executives from large companies around the world, conducted by Thought Leadership Consulting, a Euromoney Institutional Investor company.

Results are based on an online survey of 1,010 global corporate executives and 25 global activist investors pre-COVID (conducted between November 2019 and January 2020), and an online survey of 300 corporate executives and 25 global activist investors following the onset of the crisis (conducted between April and May 2020), including companies from 11 industries, with 75% of respondents holding the title of CEO, CFO or other C-level executive.

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