

How rebalancing portfolios in a downturn helps companies focus operations and recover stronger

2020 Global Corporate Divestment Study

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The EY *2020 Global Corporate Divestment Study* and lessons learned from the last crisis show how divesting can help companies accelerate out of a slowing economy.

As executives consider what comes following the crisis, they may need to make hard choices about which businesses, and type of business model, they need to capture new potential growth.

Will they embrace an asset-light model, migrating non-core assets and operations to an ecosystem of strategic partners? Will they invest in a fully automated production model combined with an artificial intelligence (AI)-enabled workforce? Or will they instead retrench in-house, with the comfort of control providing an illusion of protection against future shocks?

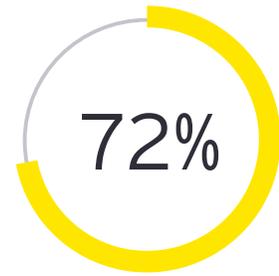
Those that leverage industry trends and combine them with lessons from the last major financial crisis stand a better chance of capitalizing on the eventual upturn.

Making bold decisions: lessons learned from the global financial crisis (GFC)

Looking at the immediate aftermath of the GFC of 2008-2010 provides insight into what may be the best route for companies to undertake as the economy begins to open up after a severe downturn.

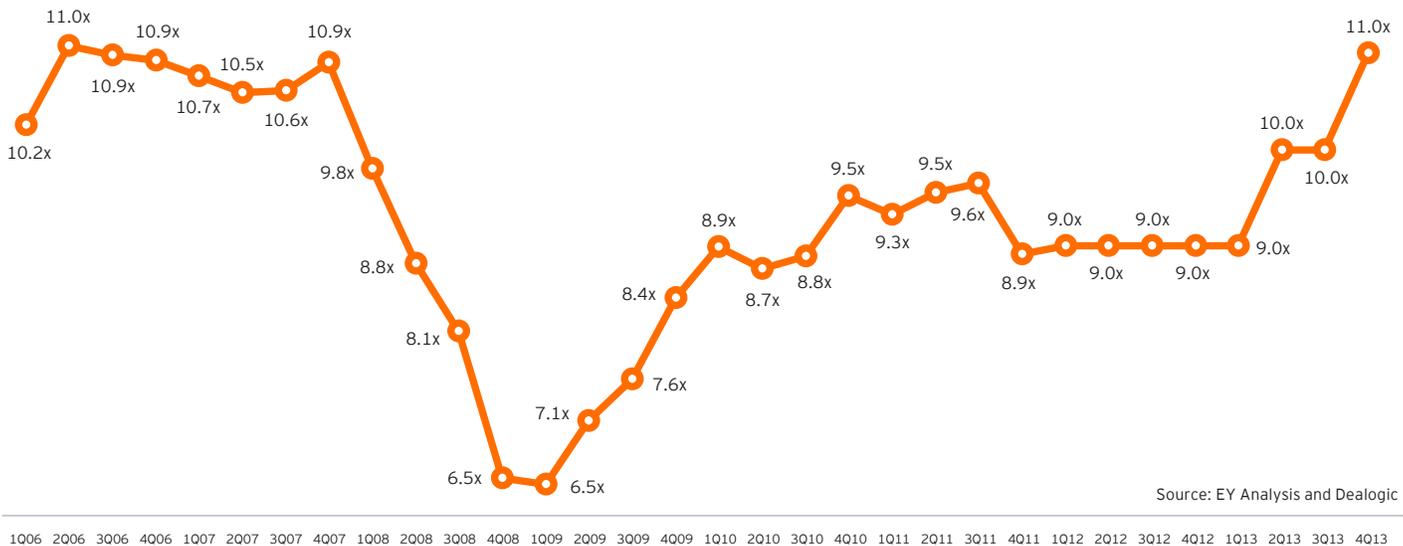
More than a decade later, many have forgotten the sharp impact of the GFC on the global economy and deal markets. As credit markets froze, many companies went into their own self-enforced lockdown. They stopped their divestiture programs, focusing instead on internal cost management and preserving cash. This led to a sharp fall in global dealmaking. Today, companies may acknowledge the potential of this failure: 72% of companies in the EY 2020 *Global Corporate Divestment Study* say they've held onto assets too long.

During the GFC, this lack of appetite to rebalance portfolios through divesting assets was mainly driven by the steep decline in valuations being paid for assets.



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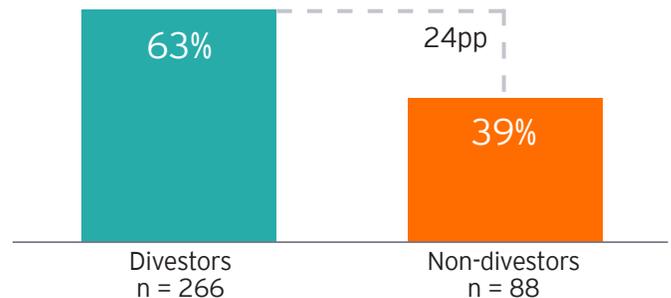
Deal multiples 2006-2013



But analysis of companies that made the bold decision to divest shows that they emerged from that crisis in a stronger position. They generated higher returns for shareholders as the economy accelerated.

Companies today need to look across their existing portfolio and make similar bold decisions about divestitures now. It can seem counter-intuitive, as achievable valuations are likely to be lower, but the evidence shows that divesting in a downturn boosts returns.¹

Comparing median excess returns (2010-18) of divestors and non-divestors during the period of 2008-2010²



¹ 354 companies with a market capitalization greater than US\$1b located in Europe and North America from the life sciences, consumer and industrials sectors. 266 companies made divestments and 88 did not.

² Company total shareholder return (TSR) adjusted for currency and benchmarked against global sector indices to calculate excess returns.

Another notable area of outperformance by companies that divested in the immediate fallout of the GFC period was in cash generation. The post-recovery period was characterized by increasing competition across sectors, as technology-driven disruption upended established business models and accelerated changing consumer preferences. The environment that companies were operating in was not an easy one. Divesting companies managed to protect their ability to generate cash better, enabling them to continue outperforming. The ability to generate capital for reinvestment in the next generation of products and services is a critical component of success in the near-to-mid-term. This is evidenced in the *EY 2020 Global Corporate Divestment Study*: 52% of companies say the need to fund new technology investments will make them more likely to divest over the next 12 months.

Today's executives have learned this lesson. More than three quarters (78%) are planning to divest within the next two years. More than half (57%) would like this to happen in the next 12 months.

Executives are aware of the potential to raise less from a divestiture in an uncertain and volatile market. But they have learned that doing nothing is a far worse strategy.

They also understand the need to focus on building resilience and agility, preparing for what lies beyond the crisis. To support this, they are looking to restructure their balance sheets and optimizing their portfolio.

For now, executives must focus on surviving this crisis and building a foundation for what comes after. Their recovery activity will need to be fast and effective. But they do need to act with purpose. Companies that have been reimagining their ecosystems for some time, and that survive the current crisis, will be best placed to accelerate beyond the pandemic.

Routes other than traditional sale to improve financial and operational efficiency

Another post-GFC analysis that reinforces the need for companies to focus on their core operations during a crisis is the performance of companies that chose to spin-off non-core operations in that downturn. Companies that spun off assets improved their excess returns against the sector, moving from underperformers to outperformers. This improvement increased over time as the increased focus on core operations improved financial and operational efficiency.

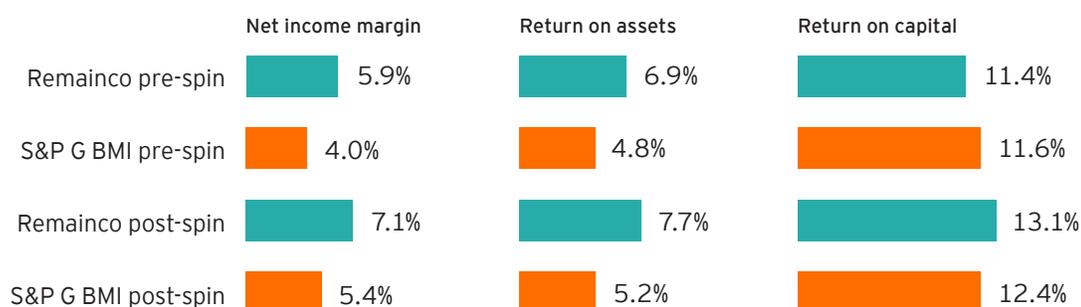
Using spin-offs to bring greater focus to the remaining business improved performance across a wide range of financial metrics, especially net income, return on assets and return on capital employed.

Both sales and spin-offs during the post-GFC period increased returns and boosted financial performance. Both are necessary tools for companies looking to lay a solid foundation for growth and to increase resilience and optionality for the future.

Executives can also consider other deal structures for assets that are either non-core or may be better managed by someone else. Joint ventures (JV), alliances or asset swaps are alternate routes for companies looking to position their portfolios for growth. In the life sciences sector, there have been a series of JVs and asset swaps – some including private equity – over the past decade that have created significant stand-alone companies. This strategy allowed one large pharma company to accelerate the pace of innovation required to bring new medicines and health care technologies to market. There have been many more examples where a JV has improved financial and non-financial performance. These often lead to a full sale or spin, with the capital raised being reinvested back into the core business.

Regardless of the route executives take to reshape their portfolio and business, there is one clear lesson from the last crisis. In order to be prepared for the next phase beyond COVID-19, executives need to take action for their companies to be best prepared for the future. Companies that focus only on making cuts in operational costs and building cash reserve may weaken their post-crisis position.

Q Comparing median pre and post-spin financial metrics for the parent company



Source: EY Analysis and S&P Capital IQ; S&P Global BMI is a broad market index of publicly traded companies. Pre spin is one year prior to announcement; post spin is one year after closing.

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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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