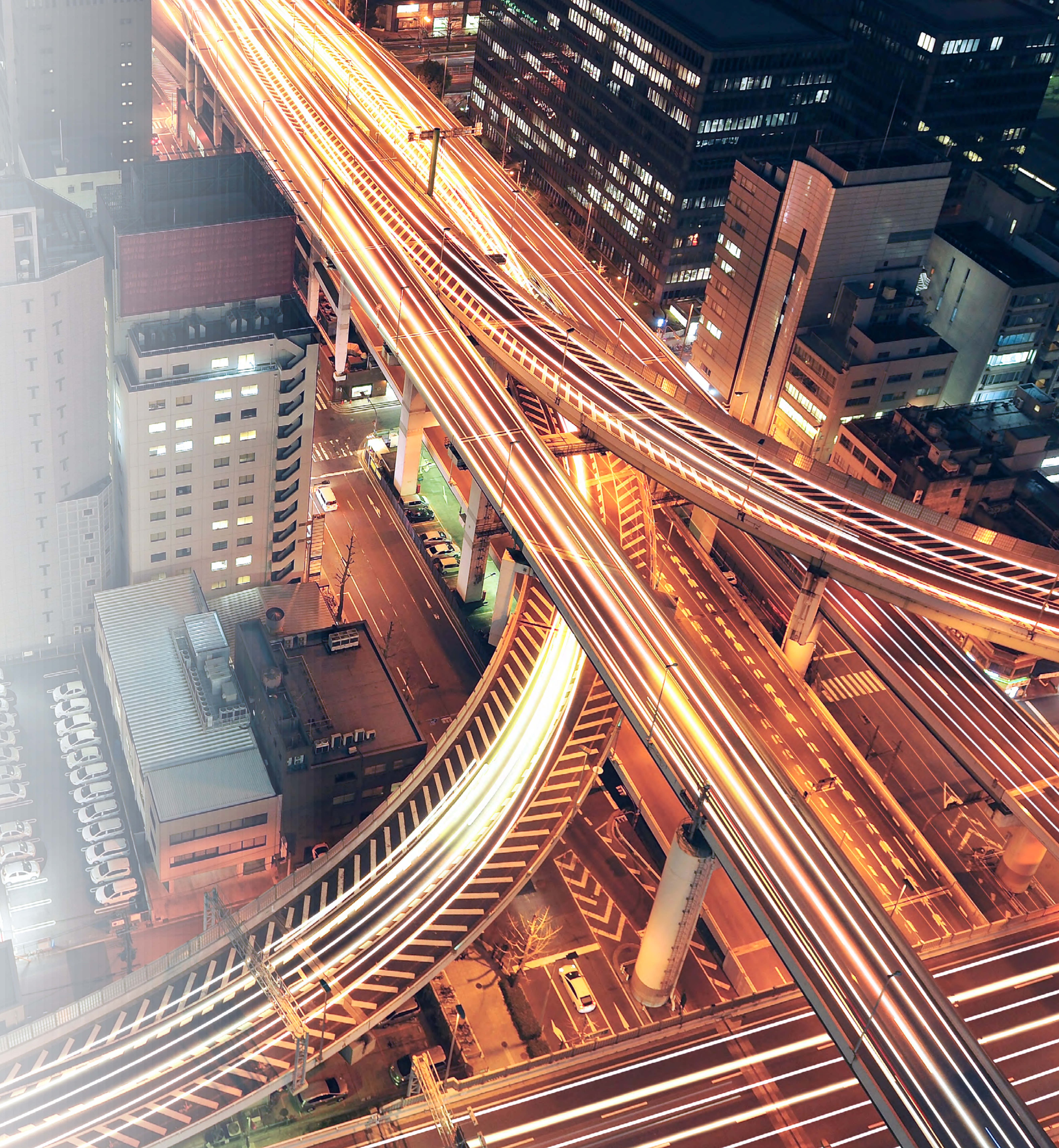
AON

Uncovering Opportunities to Realize Value

Secure Investments and Enhance Returns During M&A Carve-out Transactions



2023

Transforming Risk Into Opportunity Against Strong Headwinds

In today's rapidly evolving global business landscape, organizations constantly seek ways to adapt and maintain a competitive edge.

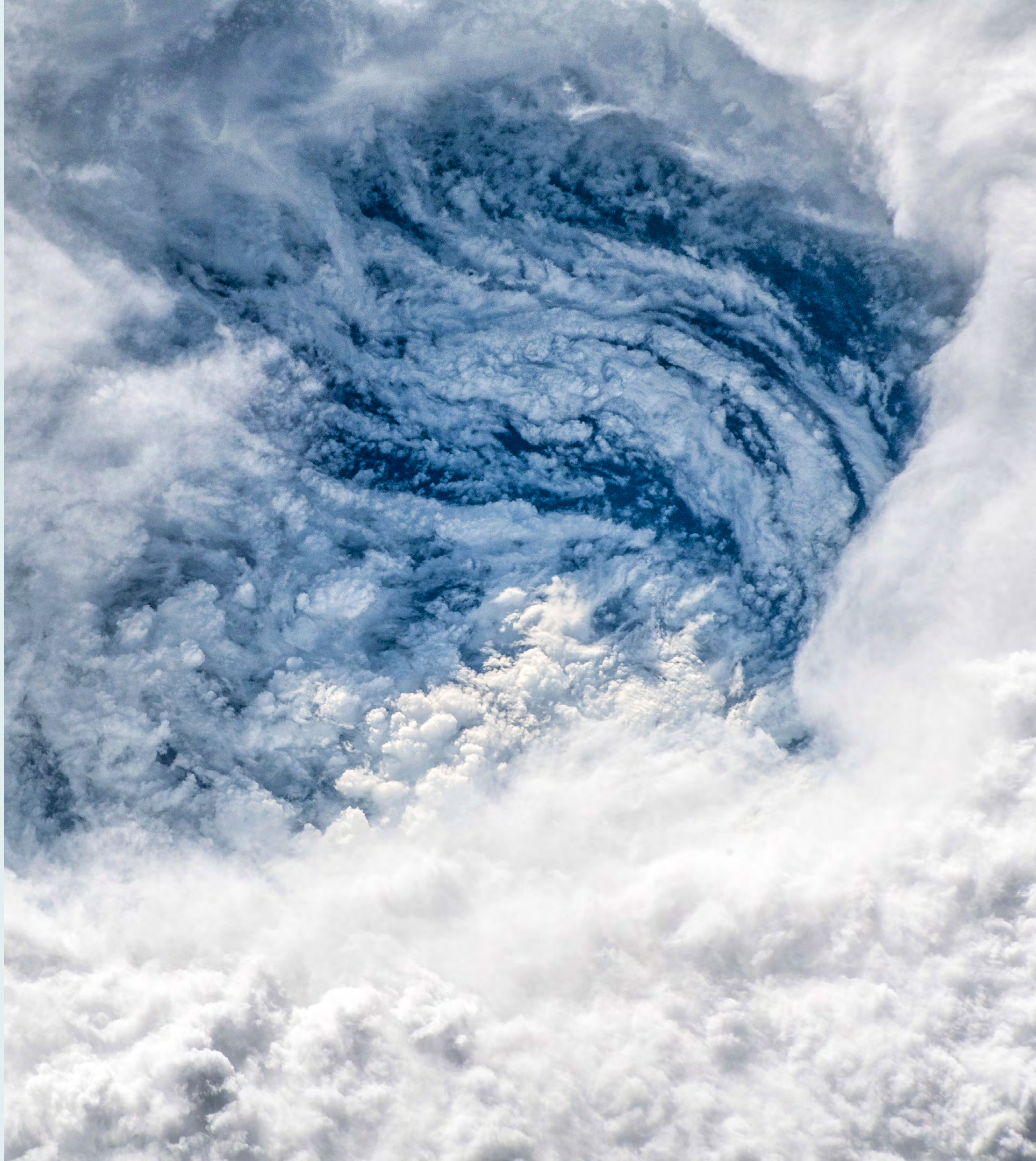
The continual swirl of challenging macroeconomic headwinds has created a turbulent environment for businesses across the globe. As organizations look to steady the ship, many find themselves assessing their growth plans and revising their strategic focus.

This shifting operating environment has spurred an increase in carve-out transactions as organizations seek to divest underperforming or non-core assets to optimize efficiency and drive value. At the same time, the market value for these assets doesn’t always reflect sellers’ demands.

A well-positioned asset with fewer variables is still attractive in the market and will likely increase its appeal as access to capital improves. However, these transactions have become increasingly complex and are fraught with challenges that can significantly impact their success. Developing a clear picture and stable standalone environment for these carve-out entities is critical to realizing the maximum value available in the market and attracting the highest number of bidders.

Here, we explore the headwinds impacting carve-out transactions and the risks and opportunities businesses can capitalize on in the current climate. We also identify the best practices and strategic recommendations for navigating these complex transactions, enabling companies to achieve their goals of improved efficiency, agility, and value creation.

Contents



1

What are the Current Headwinds Driving Carve-out Activity?

Volatility's Silver Lining?

In 2021 the carve-out market was booming, with 9,155 global transactions reported to be worth over $2.3 trillion.[1] While supply chain challenges, economic instability and geopolitical tensions in 2022 have since slowed the pace of carve-out transactions, dealmakers know that volatility also induces opportunity.

As businesses reevaluate their portfolios, streamline their operations and focus on core competencies, new opportunities emerge that both buyers and sellers can capitalize on, as evidenced by findings in Aon's M&A Risk in Review 1H 2023 that reports that 28% of our survey respondents say they are focusing on divestments and restructuring.

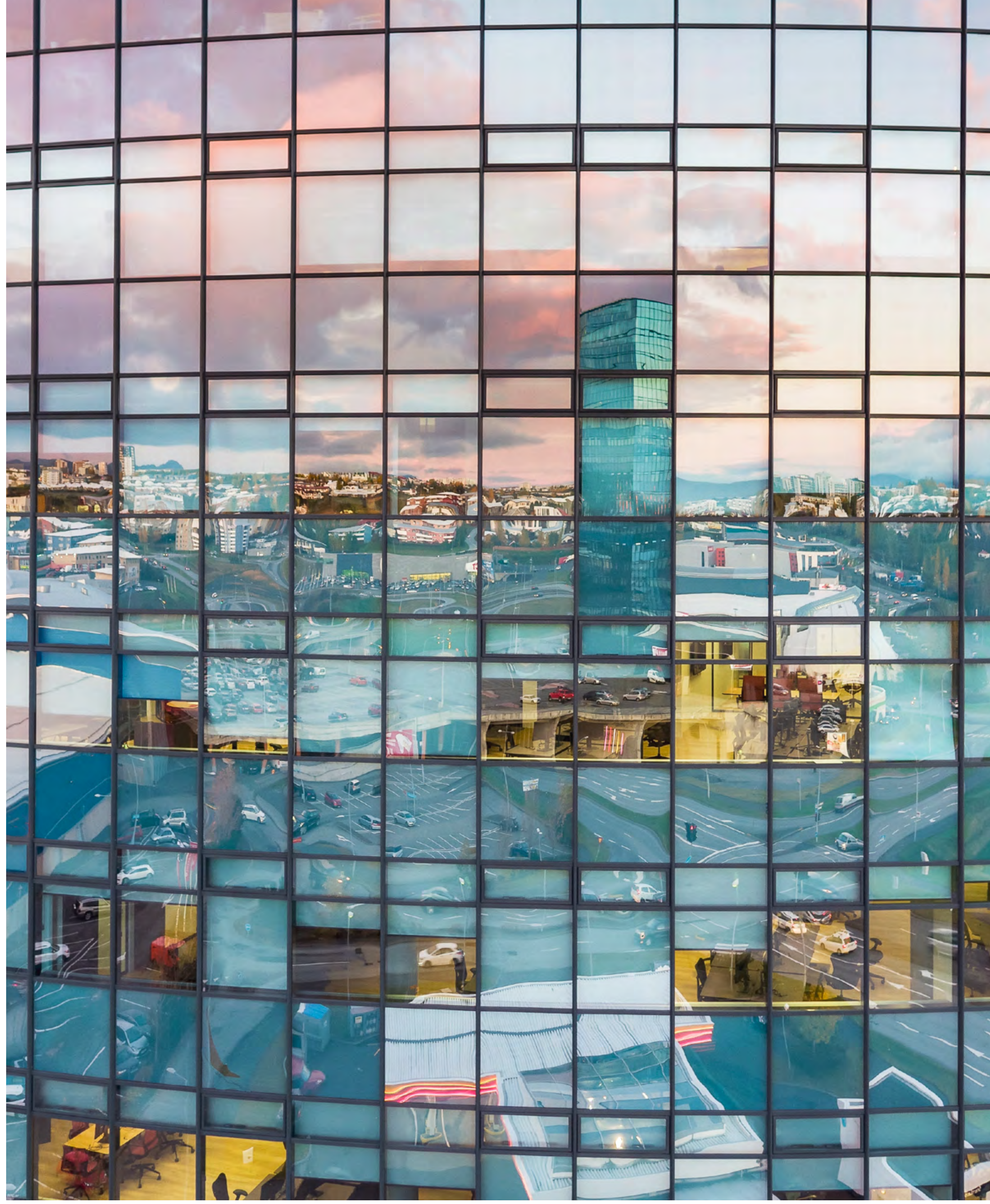
> "
>
> Sellers have the opportunity to prepare assets thoughtfully for sale — transforming risk into an opportunity to capture the maximum value in a volatile market.
>
> **— Nick Lupica**
> **Head of M&A Transaction Advisory Services EMEA, Aon**

Economic Uncertainty

In the wake of the COVID-19 pandemic and Russia's invasion of Ukraine, global economic uncertainty continues to cause market turbulence. Skyrocketing inflation, the rising cost of debt and ongoing supply chain challenges continue to sharpen strategic focus. The pressure to improve operating margins, focus on core business functions and free up cash to invest in areas of strategic growth is widening the appeal of carve-outs for businesses looking to divest non-core or underperforming assets.

Access to Capital

A tightening economic environment has significantly impacted the availability and cost of capital. However, while some dealmakers may be finding it harder to secure access to finance, those with strong balance sheets and access to capital are taking advantage of market disruptions by outmaneuvering their competition and pursuing carve-out transactions while others are unable to. At the end of 2022, global levels of dry powder waiting to be deployed by inventors approached a record-breaking $2 trillion.[2] This abundance of cash reserves, as well as access to alternative forms of capital and liquidity, is helping to buoy the market and maintain momentum amid challenging conditions.



89%

increase in private credit investment in 2022.[3]

1 Carve-outs' popularity soars as businesses pursue growth, White & Case, Aug 2022

2 Global private equity dry powder approaches $2 trillion, S&P Global, Dec 2022

3 Private credit investments surged 89% in 2022 - report, Reuters, Feb 2023

Digitalization

The rapid pace of technological advancement and digital innovation has reshaped our global economy and created conditions and opportunities that make carve-outs an increasingly appealing proposition. For example, organizations may seek to divest outdated businesses to focus on their competitive advantage and agility within the digital landscape, providing buyers with the opportunity to undergo a digital transformation and increase value.

Digital transformation can unlock as much as

$1.25 trillion

in additional market capitalization across all Fortune 500 companies.[4]

Activist Investors

Shareholder activism continues to drive activity within the carve-out market as firms embrace divestment as part of their corporate strategy. Activist investors have always concentrated on rooting out the inefficiencies that limit shareholder value, but today, investors have their lens just as keenly focused on environmental, social and governance (ESG) strategies. While sellers are keen to shed business assets that no longer align with their values, buyers are looking for transactions that will improve their ESG credentials.

> “
>
> Despite strong headwinds, carve-outs will continue to be a necessity for corporates reviewing their capital deployment strategy while coping with increasing pressure to focus on core growth areas.
>
> **— Bruno Monteiro da Silva**
> **Executive Director, M&A and Transaction Solutions, Aon**

Regulatory Pressures

From antitrust regulations to disclosures around ESG, cyber and data practices — the scrutiny and compliance pressures on businesses today are growing. In an increasingly litigious world, companies are utilizing carve-out transactions to mitigate risks or simplify operations to reduce regulatory burden.

4 Unleashing value from digital transformation: Paths and pitfalls, Deloitte, February 2023

What are the Major Challenges for Buyers and Sellers in Carve-out Transactions?

Preparedness Underpins Success

Carve-out transactions are complex, time-critical and highly specialized — even more so when combined with the current headwinds and a highly-competitive market.

Today, dealmakers must take a forensic approach to due diligence, exploring the risks beyond profit and loss (P&L), cash flow and balance sheets to evaluate a deal's unique strengths, weaknesses and value. The depth and breadth of due diligence and risk assessments needed in the current market have increased significantly. This places more emphasis than ever on the need for thorough preparation to avoid the delays and execution problems that can drive up costs and diminish value.

Proactive Preparation: A Seller's Perspective

Identifying and Carving Out the Appropriate Business Unit:

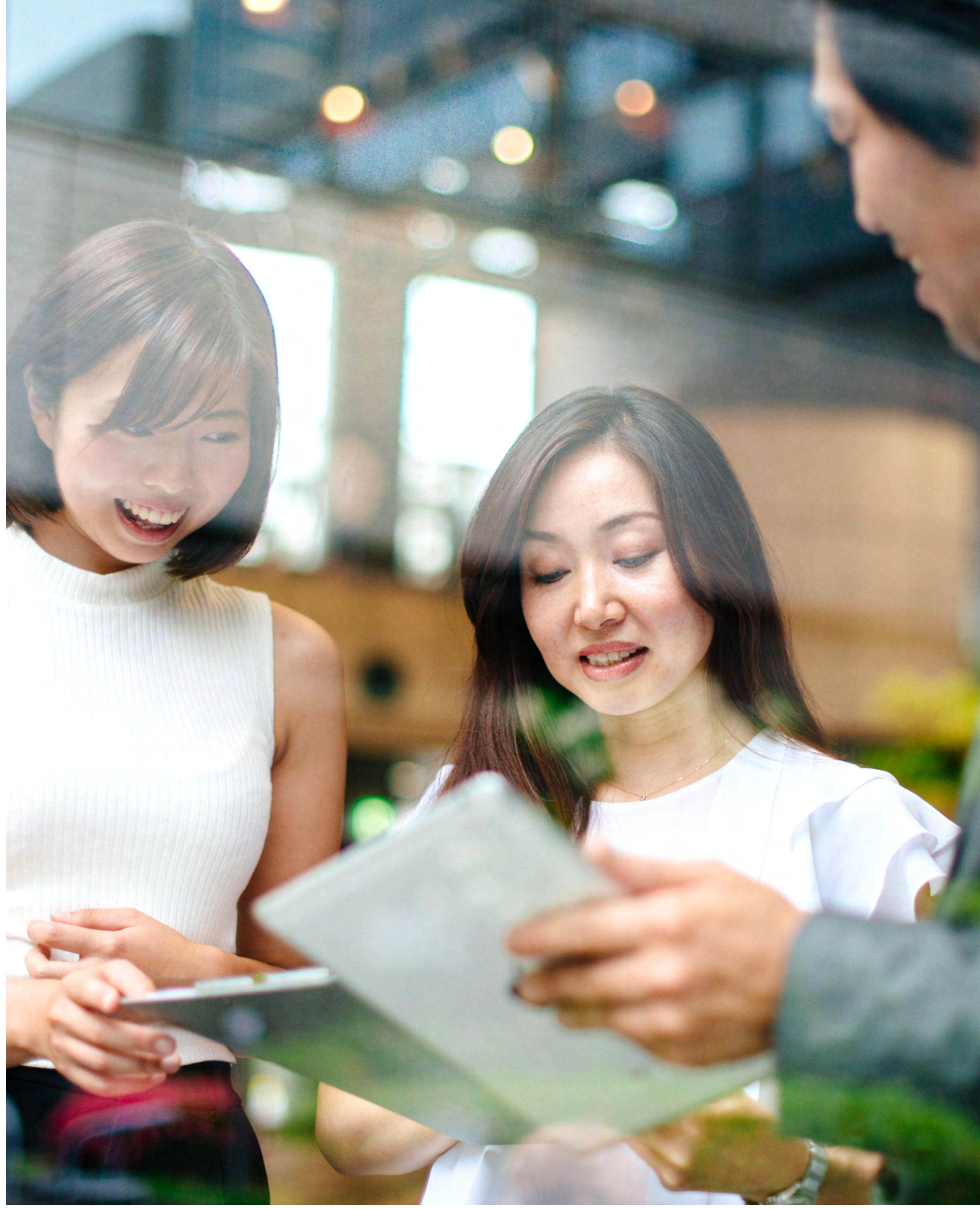
Identifying the appropriate business unit to carve out and devising an exit strategy are the first critical steps for sellers. Determining which business unit(s) can be sold without negatively impacting the rest of the organization and defining what is included in the deal requires a thorough assessment of the company's operations.

Separating the Business Unit:

Disentangling a business unit from the rest of the company is a complex and time-consuming process. Preparation is the cornerstone of successful dealmaking To capture the total value available within a deal, sellers must deliver the clarity that enables buyers to quantify and understand the risks of separating financials, IT systems, human capital platforms and other organizational functions.

19% of corporates and 24% of private equity firms said their recent carve-out deals took longer than expected.

Delays that last more than four months cost the parties an average of 16% of deal value.[5]



Maintaining Operational Continuity

During the carve-out process, sellers must define an operating strategy in their Transition Services Agreement (TSA) that ensures the acquired business unit can continue to operate smoothly. A failure to deliver satisfactory continuity of service could negatively impact reputation or customer relationships and threaten either the value of the transaction or its successful completion. Reducing the burden in thoughtful preparation can expedite this transition and reduce the post-close burden on the seller.

Achieving the Appropriate Valuation

All sellers want to receive a fair price for the sale of an asset, while buyers are on the hunt for optimum value — but there can often be a significant discrepancy between these figures. Sellers can increase competition for their assets, speed up the transaction process and achieve the maximum sale price with the proper preparedness. However, when sellers fail to conduct the appropriate analysis to establish the true value of an asset, it can result in an ambiguous value story that corrodes buyer confidence and devalues the deal.

> “
> We find buyers are much more conservative around areas of risk or uncertainty, so any clarity or certainty a seller can provide will help reduce the discrepancy.
>
> **— Nick Lupica**
> **Head of M&A Transaction Advisory Services EMEA, Aon**

5 Cross-border Carve-outs: Why one third fail and how to get them right, TMF Group, 2020

Digging Deeper: A Buyer's Perspective

Integration With the Buyer's Existing Operations:

Buyers need a clear integration plan to ensure that the acquired business unit can integrate seamlessly with their existing operations — actions contingent on having access to the correct data. Good quality data is fundamental to understanding a transaction's cost implications, operational challenges and growth opportunities. However, sellers often fail to supply adequate data about legal, tax and people risks. For example, HR and employee interactions can often fall outside initial dealmaking discussions, making it challenging for buyers to assess the risks and costs of transitioning pensions, healthcare insurance and employee benefits.

Ensuring Regulatory Compliance:

Ensuring the acquired business units comply with all relevant regulations is a complex element for buyers during carve-out transactions. While some transactions will be subject to regulatory approvals, others may need to consider regulatory compliance obligations, liability for inherited regulatory violations, and potential investments in compliance programs and processes. Getting this right will reduce the likelihood of a delayed closing.

Identifying and Mitigating Risks:

Economic, social and political volatility is increasing corporate risk for all businesses. Today, dealmakers must adopt a more holistic approach to managing increasingly complex, wide-ranging and evolving risks — from cyber threats and intellectual property to ESG. Due diligence and risk assessments must be more thorough than ever to identify and mitigate the legal, human capital, cyber and financial risks associated with a carve-out.

90%

of dealmakers are dedicating more resources than before to due diligence processes when considering a transaction.[6]

6 Aon's Better Decisions for Deal Value, 2021

Retaining Key Employees:

The success of any newly acquired asset hinges on having the right people to drive strategy and deliver growth. As well as identifying and retaining core staff, dealmakers must establish credible leadership to ensure a smooth transition, manage business continuity and deliver intended growth ambitions. The disruptive nature of the carve-out process can be a highly-unsettling period for employees, so buyers must invest time and resources into developing robust people strategies that support the retention of key employees.

Managing Cultural Differences:

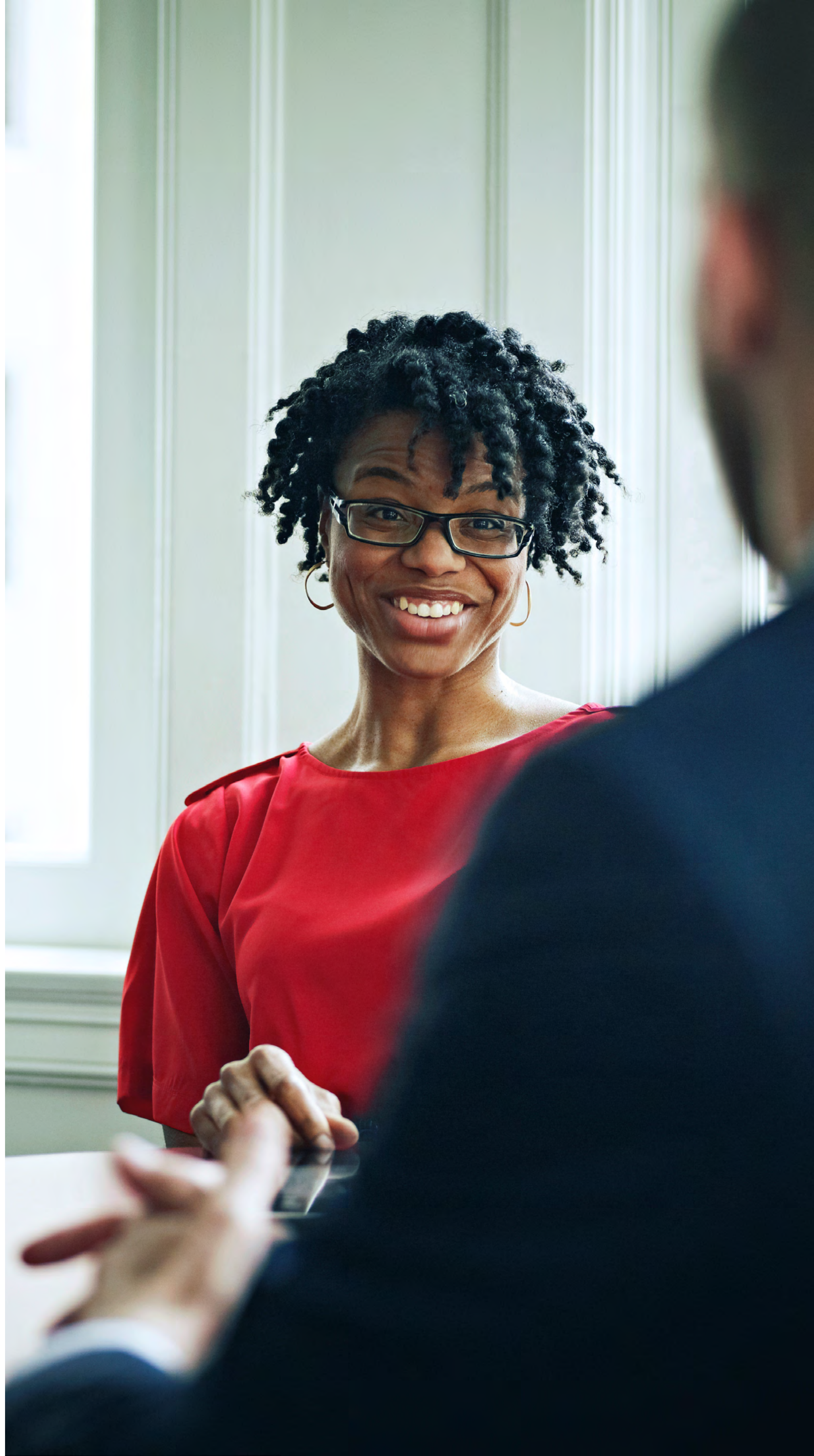
People are the greatest asset of any business — yet when deals are on the table, and technicalities are being negotiated, the full value employees bring can often be overlooked. In a rapidly shifting employee landscape, people are seeking more from their employers beyond pay and rewards. Today, the retention of employees often hinges on organizational culture. The new dawn of a carve-out can create exciting opportunities for buyers and employees. Still, a failure to align the employee value proposition (EVP) with organizational purpose and growth can create a culture war and jeopardize a successful integration.

60%

of corporate and private equity (PE) investors said they had walked away from an investment owing to ESG issues at the target.[7]

> “
>
> It is critical for buyers of a carve-out transaction to ensure that the right leadership and talent are retained and motivated. Fostering a healthy and high-performing culture requires both a comprehensive change and communication strategy. This strategy must focus on optimizing the employee experience and driving cultural alignment, while successfully retaining talent with a holistic total rewards program that drives outcomes.
>
> **— Perry Papantonis**
> **Senior Vice President/Partner & Global Leader, Human Capital Transaction Advisory Services**

7 Aon's Better Decisions for Deal Value, 2021



What Are the Opportunities for Buyers and Sellers?

Brighter, Bolder Futures

Against the rising complexity of transactions, there are considerable opportunities to capture value for those willing to reevaluate their approach to dealmaking and explore alternative routes to success.

The Hidden Value of Intellectual Property

In an increasingly digital world, intangible assets, in the form of data, source code and algorithms, have grown in both importance and value. In fact, ninety percent of the total asset value in the S&P 500 lies within intangible assets.[8] The rapid rise of artificial intelligence (AI) will only strengthen technology's grip on the markets, with global AI M&A deals increasing 64.5 percent between 2021 to 2022.[9]

Global intangible assets valued at

$74 trillion in 2021,

up 25% since 2019.[10]

Intellectual property is an afterthought in many transactions, but sellers can unlock hidden value and strengthen their value story for potential buyers with the right sell-side preparation. Positioning intellectual property as a value driver early in the M&A process has the power to shift a company's valuation by as much as 10-15%.[11]

Private Equity Firms Flush with Dry Powder

In recent years, PE players have made accelerated moves into the carve-out market. As well as having unique skills and experience that make them attractive carve-out partners, PE firms can take advantage of fewer regulatory hurdles than corporates. The abundance of dry powder available within the investment markets presents prime opportunities for M&A activity and carve-out transactions.

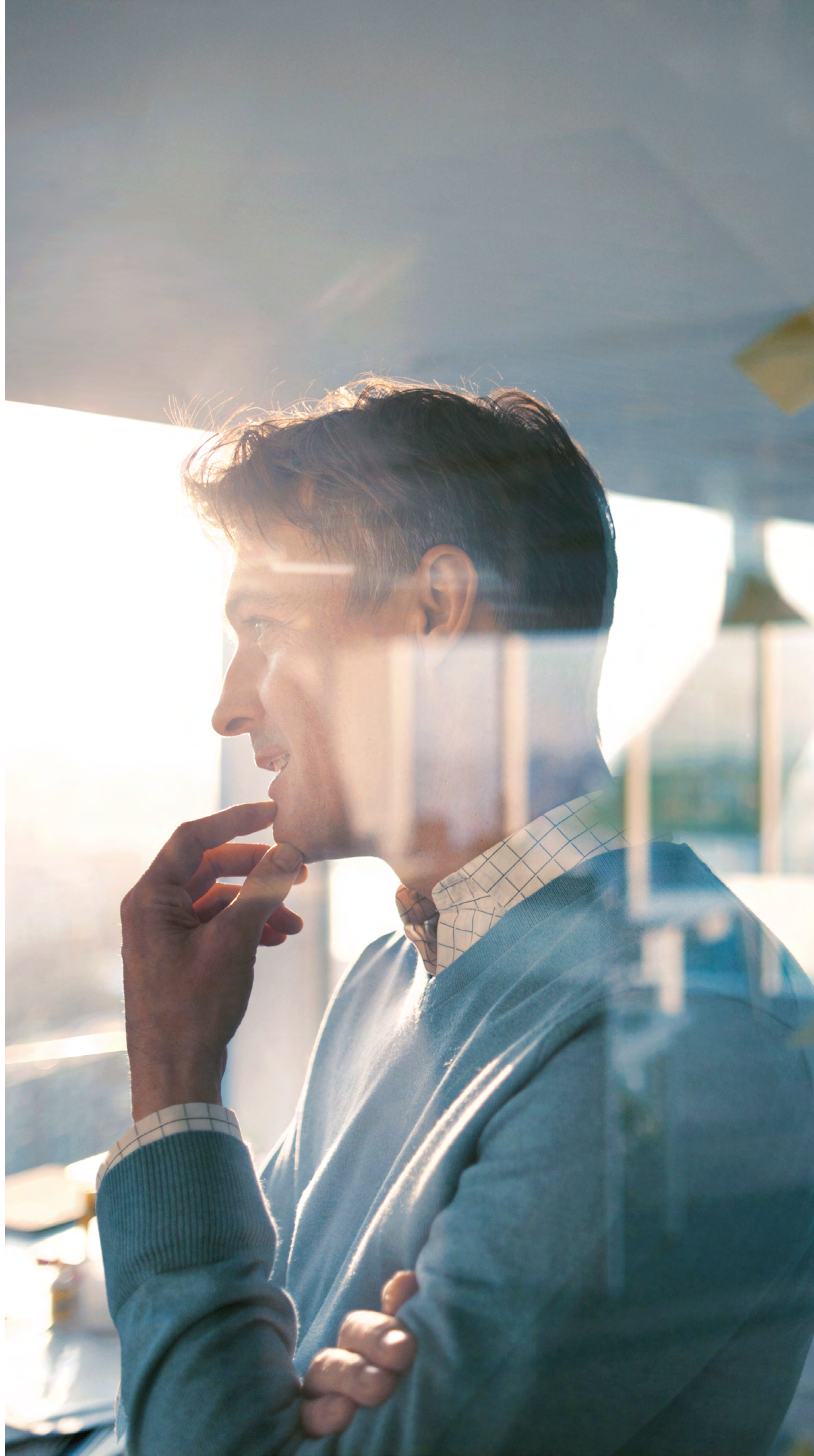
Human capital due diligence is now a critical part of any carve-out process, and today, there's a noticeable shift toward broader human capital analysis. As private equity players look to extract the most value from every deal, they are moving beyond the key performance indicators and focusing on broader issues, such as employee resilience, culture and workforce metrics.

8 Aon's Intellectual Property Transaction Solutions

9 Technology Industry Artificial Intelligence M&A Deals Total $1.7bn Globally in October 2022, Verdict, November 2022

10 Intangible Assets Owned by all Listed Companies Grew to USD 74 Trillion in 2021, Global Innovation Index, November 2022

11 Aon's Digital M&A: a Dealmaker's Digital Toolkit for Survival



A Global Drive for Good

A shift towards selling and acquiring ESG-friendly assets unsurprisingly coincides with the increasing scrutiny businesses face from consumers, employees, regulators and investors. Today, both buyers and sellers are taking a more comprehensive approach to ESG. They are more likely to dedicate time and resources to evaluating a carve-out target's ESG risks and opportunities.

Reducing an organization's carbon footprint, embracing strong equality and diversity policies and operating ethically and transparently all help enhance a company's ESG performance. Businesses that demonstrate a strong ESG strategy and performance are increasingly perceived as less risky, giving them the leverage to command higher valuations.

60%

of global investors now incorporate ESG investing into their approach.

47%

of global investors say client expectations or reputational concerns drive their approach to ESG.

50%

of global investors cite the lack of ESG data as the greatest challenge to ESG investment decision-making.[12]

12 ESG Global Study 2022, Capital Group, May 2022

4 What Action Should Buyers and Sellers Be Taking?

Transforming Transactions With Innovation and Expertise

Successful transitions are the junctures from which carved-out assets can thrive. To realize these opportunities, buyers and sellers must first navigate the intricacies of targeting, integrating and separating assets and people in a challenging climate.

To address these complexities throughout the deal lifecycle, a new breed of tools, technologies and solutions have emerged, providing unparalleled support to all parties involved in carve-out transactions. These innovative solutions harness the power of technology, data analytics, and industry expertise to deliver tailored insights and processes that de-risk and streamline the negotiation, valuation, and transition processes.

Enlisting the support of a specialist adviser at the earliest opportunity can help dealmakers to:

- Address transactional risks
- Optimize people-related programs and financials
- Identify and mitigate cyber threats
- Secure intellectual property and capture value.

Conduct the Right Level of Preparation

Sellers

Today, sellers are more proactive in preparing carve-out assets for sale. By undertaking thorough due diligence and data analytics to quantify and understand risks ahead of a sale, sellers can capture the maximum value within a deal.

Focus on:

- Providing absolute clarity about what is being sold and considering the broader sphere of risks that need to be mitigated. As well as developing robust financial statements, it is vital to understand the true value of intellectual property and make ESG an integral part of your value proposition.
- Assessing the current allocator costs for risk and insurance to guide and shape future costs for buyers.
- Understanding how to structure pre-close liabilities into Sale and Purchase Agreements (SPA).
- Understanding how Cyber Insurance will be managed post-close to protect the integration and separation of complex IT systems. Evaluate the advantages of giving access to existing cyber insurance policies to remove barriers for buyers.
- Reviewing human capital structures such as health insurance and pensions and consider how they will be moved across and structured within the new entity.

Buyers

A comprehensive view of risk and opportunity helps to secure better investments. With greater clarity and insights, buyers can more quickly identify targets that fit their business and growth goals, assess opportunities and uncover and transfer deal risks.

Focus on:

- Robust due diligence. Valuations and integration depend on the availability of data, but increasingly segmented businesses may only have limited data on some potential risks, such as the delineation of exposure and claims data. Buyers must conduct comprehensive buy-side due diligence to adequately analyze the scope of risks and opportunities to maximize value and drive deal success.
- Leveraging analytics platforms to conduct a comprehensive qualitative and quantitative analysis of intellectual property value.
- Assessing a broader range of risks. As well as traditional property and casualty risks, embrace a holistic approach and incorporate emerging risks such as cyber and human capital.

Engage With Smarter Transaction Solutions

Aon has pioneered a series of structured instruments that help dealmakers unlock value by avoiding leaving money on the table and improving deal outcomes by reducing the period from signing to closing. Aon's experienced team will work closely with the business, people and technology teams involved in the carve-out, utilizing tools and templates that dig deeper and devising solutions that steer deals toward desired outcomes.

Focus on:

- Using Representations and Warranties (R&W) Insurance and Warranties and Indemnity Insurance to help bridge the gaps between buyers and sellers.
- Assist in protecting against adverse tax rulings that can compromise the value of a transaction with Tax Insurance.
- Navigating complex legal and regulatory compliance with litigation and contingent insurance.
- Help to increase liquidity, de-risking a balance sheet and facilitating M&A deal negotiations with the support of credit and surety solutions.
- Employing Intellectual Property Insurance to robustly defend patents, trademarks and copyright or protect against patent infringement claims.

Build Meaningful Business Processes and People Programs

The right partner will do more than facilitate a sale. As well as helping organizations plan, execute and monitor the carve-out process efficiently, Aon's M&A Solutions team proactively supports constructive stakeholder communications, focuses on critical milestones, and builds processes and people programs that achieve long-term success.

Focus on:

- Human capital solutions that address a broader sphere of workforce resilience.
- Lowering the cost of capital and accessing integrated funding solutions through innovative credit and surety solutions.
- Building cyber maturity with solutions that effectively navigate digital threats through post-merger integration while also creating long-term value.

By leveraging these cutting-edge solutions, companies can more effectively navigate the complexities of the divestiture process, unlocking new opportunities for growth and success.

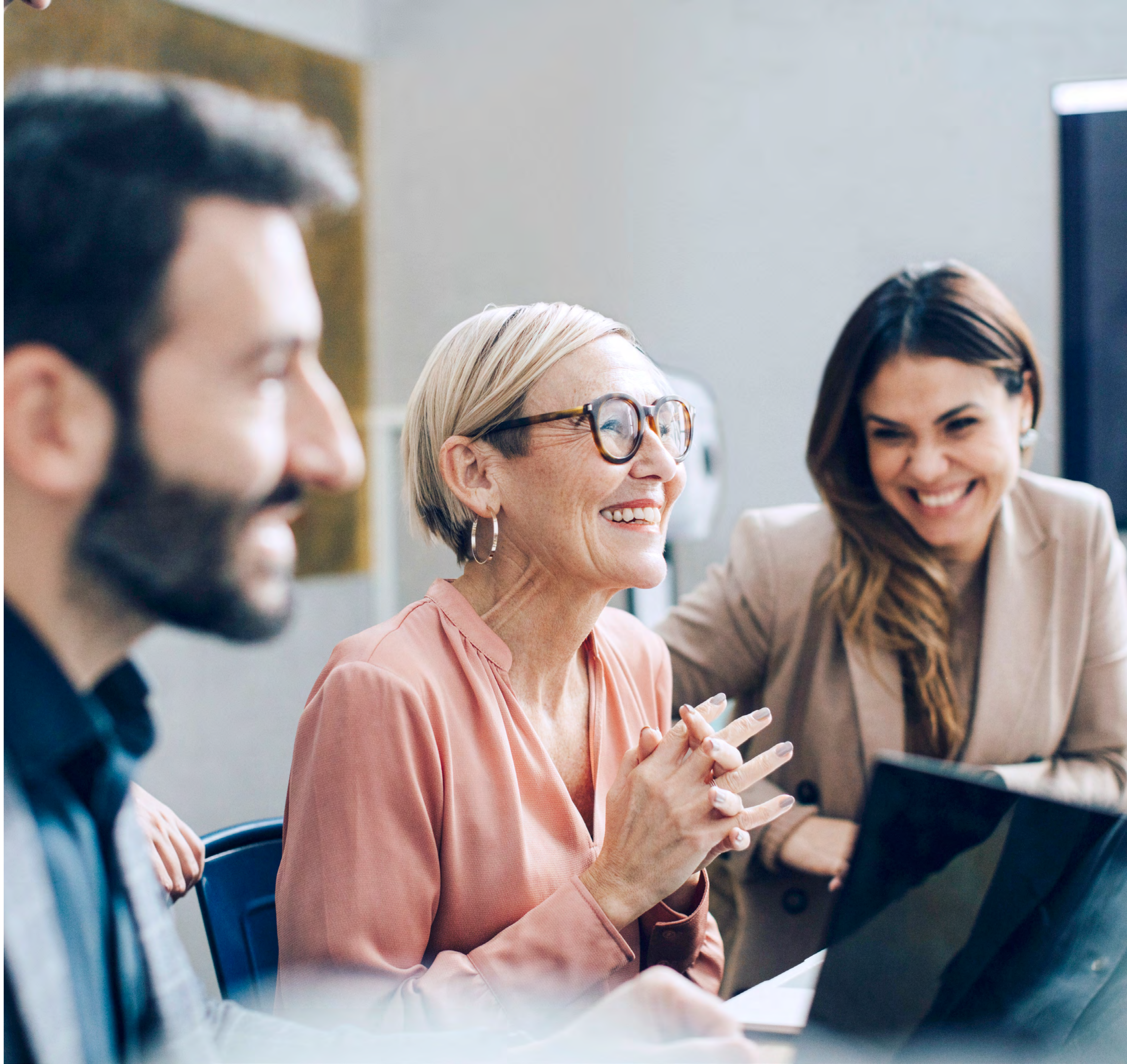
5 Clarity Has Never Mattered More

The landscape of M&A carve-outs is complex and dynamic, but untapped opportunities remain there for the taking. To seize these opportunities, both buyers and sellers must innovate and evolve, not just their strategies but their execution. While traditional transaction methods may be proven, today, they are no longer sufficient. The increasingly globalized, digitally-connected and socially-conscious world businesses now operate in demands elevated clarity, efficiency and precision.

Greater preparedness, innovative transaction solutions and more meaningful processes are the keys to unlocking this next level of M&A success. With these solutions and a revised approach to transactions, buyers and sellers can bring clarity and certainty to processes often vulnerable to complexity and unpredictability.

With the benefit of data-driven decisions and expert insights, M&A players can de-risk the transaction process and maximize value on both sides of the table. Leveraging global industry expertise, Aon supports clients to streamline the transition process, ensuring a smooth transfer of assets and operations with minimal disruption to businesses and their stakeholders.

In the high-stakes arena of M&A carve-outs, the margin for error is small, and the cost of failure is high. Embracing innovative solutions is not just a strategic advantage, it is now a necessity, and those who do will set new standards for transaction success — capturing opportunities to thrive in a rapidly evolving business landscape.



6 Further Insights

Explore the latest insights and discover emerging dealmaking trends from our leading industry experts at aon.com/m-and-a-transaction

The Aon Advantage

Aon offers a broad suite of M&A advisory solutions. We advise on thousands of transactions on an annual basis globally and have helped more firms realize deal success than any other company in the industry.

Aon's M&A and Transaction Solutions team has been leading the creation and advancement of M&A risk and insurance solutions for the industry. Comprising senior M&A and tax lawyers, senior corporate development and investment banking executives, experienced risk and insurance analysts, health and benefits professionals, and cybersecurity and intellectual property professionals, we bring a depth of knowledge and passion for developing tailored solutions to your complex deal risks that is unparalleled in this industry.

We know firsthand that the timing and sensitivity of a deal are paramount to its success, and we work closely with your deal team and our insurance providers to advise and execute solutions that improve your deal outcomes.

With our passion for developing new and creative solutions and globally coordinated teams, we can help you assess and manage deals across industries and across the globe at every stage of the deal lifecycle. Equally important, we are fully dedicated to 24/7 responsiveness for every client. We work with other stakeholders to help ensure risks are found, evaluated and protected. With Aon, you have an experienced, trusted partner to help you do what you do best — maximizing investment returns in today's rapidly evolving markets.

Thought Leadership

M&A Risk in Review 1H 2023

Digital M&A: A Dealmaker's Digital Toolkit for Survival

8 Ways to Achieve a Winning People Strategy During M&A

Why Does Workforce Resilience Matter in Mergers & Acquisitions (M&A)?

An Ever-Complex Global Tax Environment Requires Strong M&A Risk Solutions

Four Tips for a Smoother R&W Claim Recovery Process

AON

Contact Us

North America / LATAM

Tyler Adkerson
Managing Director,
Corporate and Advisory Business Development
773.401.0660
tyler.adkerson@aon.com

Elissa Etheridge
Managing Director,
Financial Sponsor Business Development
347.213.7271
elissa.etheridge@aon.com

EMEA / APAC

Bruno Monteiro da Silva
Executive Director,
M&A and Transaction Solutions, EMEA
brunomonteirodasilva@aon.com

Nick Lupica
Head of M&A Transaction Advisory Services, EMEA
nick.lupica@aon.com

About

Aon plc (NYSE: AON) exists to shape decisions for the better — to protect and enrich the lives of people around the world. Our colleagues provide our clients in over 120 countries and sovereignties with advice and solutions that give them the clarity and confidence to make better decisions to protect and grow their business.

Follow Aon on LinkedIn, Twitter, Facebook and Instagram. Stay up-to-date by visiting the Aon Newsroom and sign up for News Alerts here.

www.aon.com

©2023 Aon plc. All rights reserved.

The information contained herein and the statements expressed are of a general nature and are not intended to address the circumstances of any particular individual or entity. Although we endeavor to provide accurate and timely information and use sources we consider reliable, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

Any forecasts, estimates, projections, opinions or conclusions included in this document depend on macroeconomic conditions (including the COVID-19 pandemic) over which Aon has no control. They cannot not anticipate possible changes in conditions that could materially impact outcomes. This document is not intended to constitute advice or encouragement regarding the advisability of any investment or other strategy. Any person or business relying on any statement does so at that person's or business's own risk.