

# U.S. Mergers & Acquisitions

Q2 2019

Quarterly Insights

## Executive summary

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**This report, created by the BMO Capital Markets (“BMO”) Mergers & Acquisitions team, provides an update on selected key trends that we are observing in the public M&A markets.**



### Seth Prostic

Managing Director  
Co-Head of U.S.  
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*“Many of our sponsor clients view carve-outs as opportunities to acquire healthy businesses that have underperformed their true potential”*

*Each year, around two thousand carve-out transactions occur in the U.S. and Canada. In the context of streamlining business and positioning for growth, what trends and considerations are important as current and prospective owners contemplate carve-out segment opportunities?*

As we talk with our clients about their businesses, we often discuss the subject of divesting non-core businesses to free up capital and allow management to focus on what is most important in growing shareholder value. BMO Capital Markets has advised on 30 carve-out transactions since January 2018, with client decisions driven by the opportunity to divest less strategic or underperforming units, capitalize on an attractive M&A market while returning capital to shareholders, reinvest organically and/or via acquisition in critical areas, and focus on a more streamlined business. Many of our sponsor clients view carve-outs as opportunities to acquire healthy businesses that have underperformed their true potential due to insufficient prior investment in management talent and growth capital.

In an era with increasing activist shareholder pressures, it would seem natural for the number of carve-out transactions to have increased over the past few years. Yet actual volumes have not moved in-step with expectations. The number of carve-out transactions increased dramatically between 2009 and 2015 before beginning a gradual decline over the last four years. During this time, the number of public company transactions hasn’t changed much year-over-year, with the vast majority of the variance driven by the number of private company carve-outs.

We see a number of common factors when analyzing successful carve-out transactions. Sellers invest time and resources to enable appropriate planning and frequently employ third party consultants and accountants to create market studies and quality of earnings reports to validate market position, customer feedback, appropriate stand-alone costs and add-backs. Prior to closing, buyers carefully evaluate management talent to determine any executive positions which need to be filled and/or upgraded, and determine how aggressively to target business line expansion and specific add-on acquisitions shortly after closing.

We look forward to your reactions to the BMO M&A team’s thoughts and analysis of carve-out market trends in the enclosed report—and of course let us know if BMO can be helpful in discussing and/or advising on your next carve-out pursuit.

# North American carve-out observations

**84%**

Of surveyed firms plan to divest business within the next two years<sup>(1)</sup>

**~\$25bn**

BMO advised the Special Committee in the largest carve-out in North America since 2009 (2015 Enbridge sale of Canadian liquid pipelines business)<sup>(2)</sup>

**146**

Carve-Out transactions completed YTD 2019<sup>(2)</sup>

**30**

Carve-Out transactions completed by BMO since January 2018

**69%**

Of surveyed firms say that carve-outs are driven by the unit's competitive position<sup>(1)</sup>

**20,000+**

Carve-Out M&A transactions since January 2009<sup>(2)</sup>

**\$42mm**

Median transaction value for carve-out transactions since 2009<sup>(2)</sup>

**~\$2.5tn**

Total carve-out transaction value since January 1, 2009<sup>(2)</sup>

**80%**

Expect the number of carve-outs to increase in order to free up capital to invest in internal technology initiatives<sup>(2)</sup>

**71%**

Of surveyed firms said that transactions were prompted by opportunistic or unsolicited offers<sup>(3)</sup>

Source: EY, FactSet, market research

Note: Sample size based on U.S. and Canadian carve-out transactions from Q1 2009 through Q1 2019.

1. EY 2019 Global Corporate Divestment Studies interviews conducted between September and November 2018.

2. FactSet.

3. EY 2018 Global Corporate Divestment Studies interviews conducted between October and December 2017.

# Carve-out themes and drivers

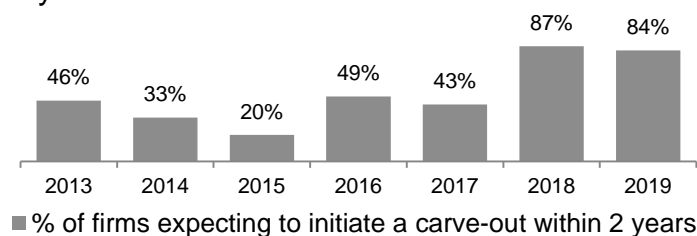
## Key themes<sup>(1)</sup>

### Desire to focus and streamline

**Active portfolio management:** Two-thirds of firms review their portfolios at least every six months

- Carve-Outs are more frequently triggered by a desire to focus on the core business
- Strategic carve-outs for superior positioning versus carve-outs of failing units

**Growing expectation of initiating carve-outs:** Expectations have grown dramatically in the last 5 years



### Structuring to improve outcomes

**Alternative tax advantaged divestitures and structures may enhance value:** Transitioning to an alternate deal structure may enhance total valuation and reduce risk to a manageable level

- In certain situations, structures including joint ventures with upside participation and Reverse Morris Trust transactions may accomplish similar goals and realize greater total value

**Evaluate critical considerations:**

Carve-Out decisions have wide-reaching tax and regulatory consequences that should be evaluated in advance

- Additional regulatory and tax impacts may delay closing and reduce value to sellers

## Key drivers<sup>(1)</sup>

### Redeployment of value

**Desire to reinvest:** Globally, firms most frequently use capital raised from carve-outs to pursue the following:

- 60%** invest in their core business
- 60%** invest in new products, markets, or geographies
- 44%** pay down debt
- 38%** make an acquisition
- 25%** return funds to shareholders

Some carve-outs have been a response from activist shareholders looking to return capital to shareholders

### Technology drives activity

**Technology to support growth:** Focus on core business growth leads to a more streamlined strategy that can be supported by divesting inefficient platforms

- Capital raised from technology-driven carve-outs is frequently redeployed into the core business
- **80%** of surveyed firms expect the number of technology-driven carve-outs to increase in the next 12 months

Source: EY, market research

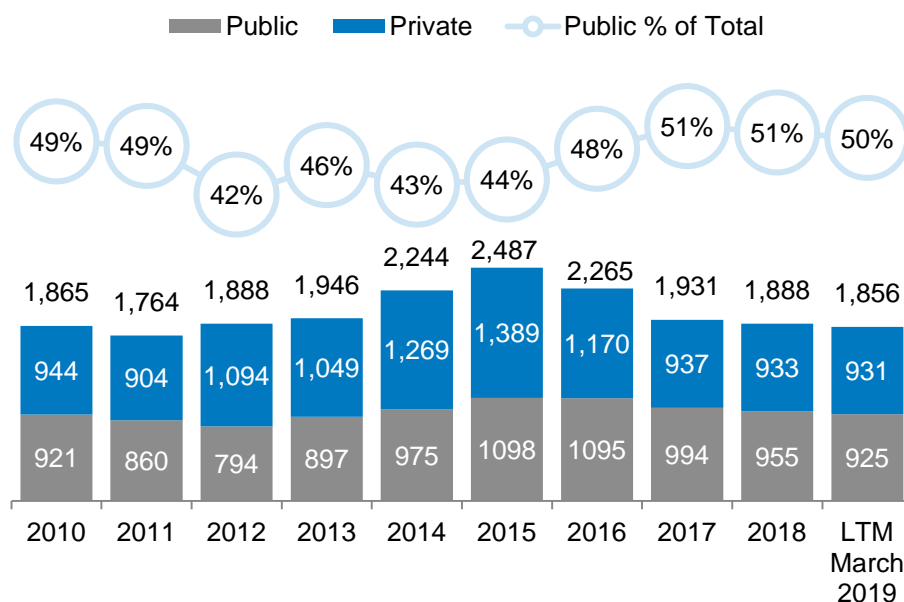
Note: Sample size based on U.S. and Canadian carve-out transactions from Q1 2009 through Q1 2019.

1. EY 2018 & 2019 Global Corporate Divestment Studies.

# North American carve-outs over time

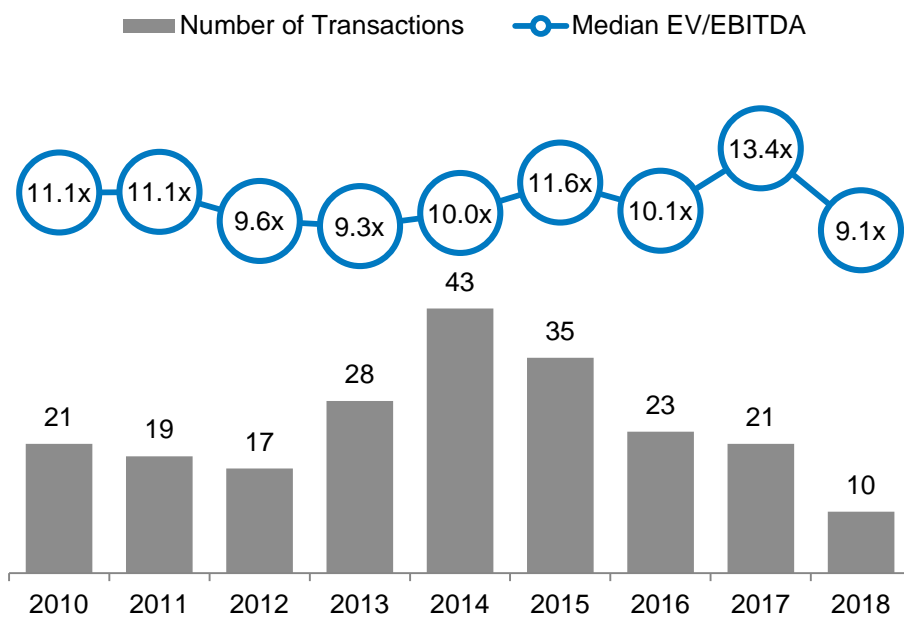
## Carve-out transactions by target classification over time<sup>(1)</sup>

Variance is driven by shifts in the number of private transactions while public transaction volume has remained consistent



## Median LTM EV/EBITDA multiples paid over time<sup>(2)</sup>

The median multiple over time has varied between ~9x and ~13x



Source: FactSet

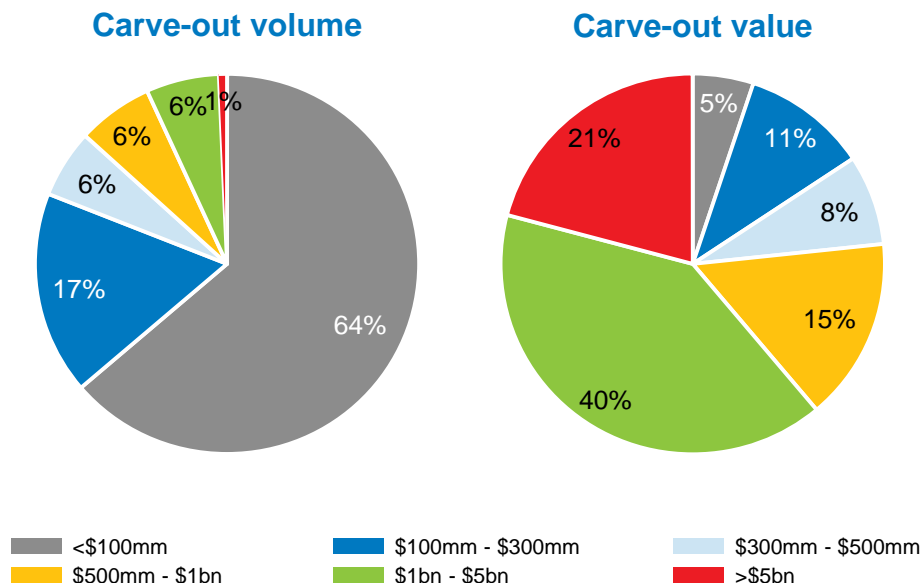
Note: Sample size based on U.S. and Canadian carve-out transactions from Q1 2009 through Q1 2019.

1. Based on public or nonpublic status of the target's ultimate parent corporation. Count based on date transaction was completed. Includes all closed transactions regardless of disclosure status.
2. Publicly disclosed multiples. Count based on announcement date of transaction. Excludes transaction multiples lower than 4.0x and greater than 40.0x.

# Carve-outs by size

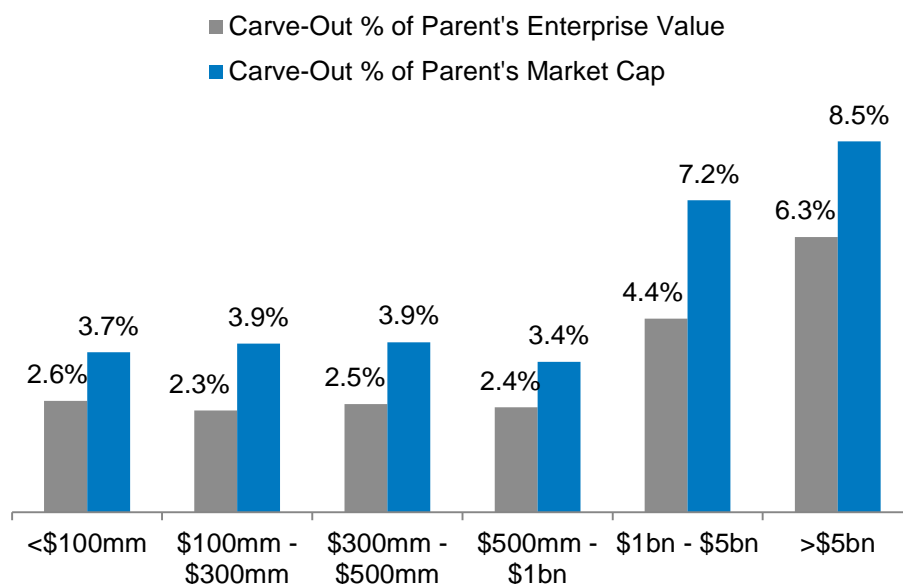
## North American carve-outs by transaction size<sup>(1)</sup>

While approximately two-thirds of carve-out volume is represented by transactions of less than \$100mm, over three-fourths of carve-out value is driven by the \$500mm+ transactions



## Carve-Out Transaction Value vs. Parent Value<sup>(2)</sup>

Greater-value transactions also tend to represent a greater portion of the parent company's enterprise value and market cap at the announcement date



Source: FactSet

Note: Sample size based on U.S. and Canadian carve-out transactions from Q1 2009 through Q1 2019; sector classification based on internal BMO methodology.

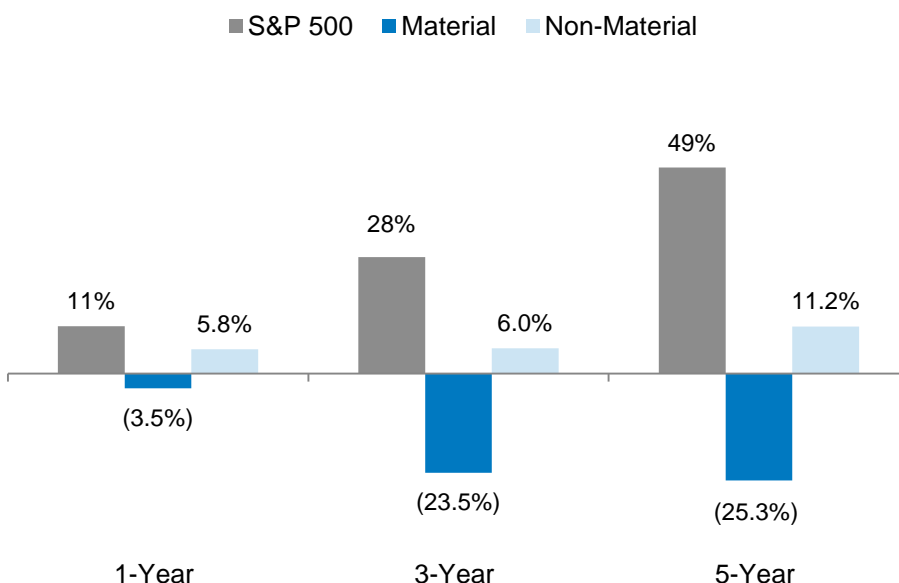
1. Includes transactions with publicly-disclosed transaction values.

2. Sample size includes parent corporations engaging in transactions with publicly-disclosed transaction values. Excludes percentages greater than 300%.

# Valuation impact

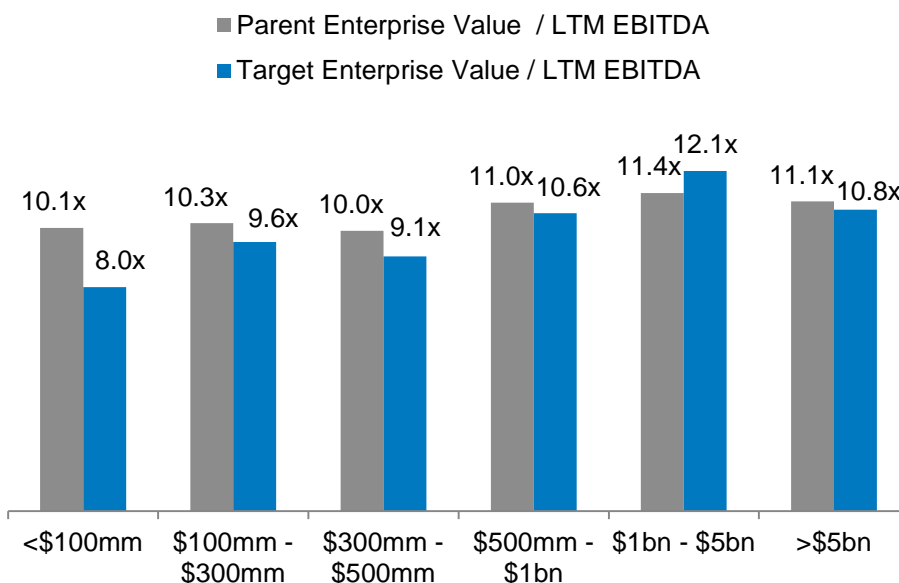
## Stock performance prior to announcement of carve-out<sup>(1)</sup>

One driver of strategic change, including selling a business unit, is stock underperformance; on average, public companies who divest businesses have tended to underperform the market prior to the carve-out – especially those selling material segments



## Carve-outs by transaction size<sup>(2)</sup>

Larger transaction sizes generally exhibit higher target and parent multiples



Source: FactSet

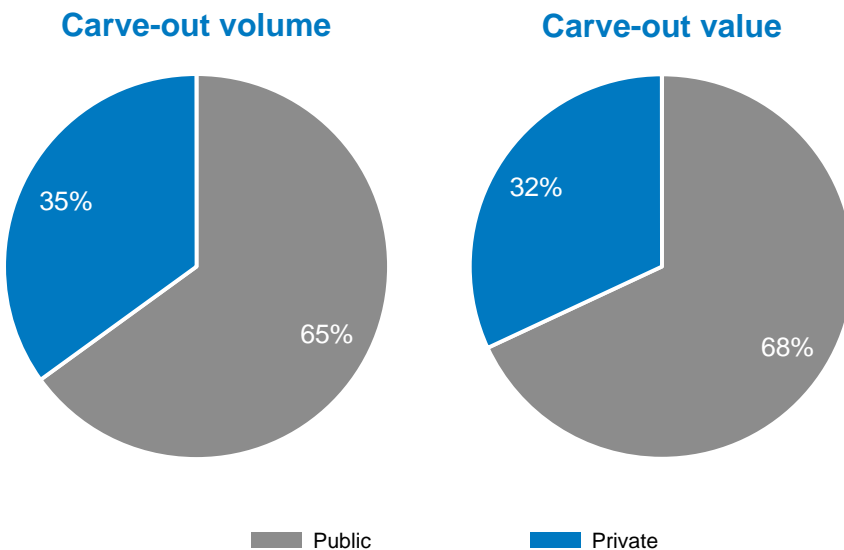
Note: Sample size based on U.S. and Canadian carve-out transactions from Q1 2009 through Q1 2019. Material carve-outs defined as transaction size greater than 10% of parent company Enterprise Value.

1. Sample size includes parent corporations engaging in transactions with publicly-disclosed transaction values. Excludes share price returns above 1000%.
2. Sample size includes parent corporations engaging in transactions with publicly-disclosed transaction values. Excludes transaction and parent multiples greater than 40.0x.

# North American carve-outs by acquirer type

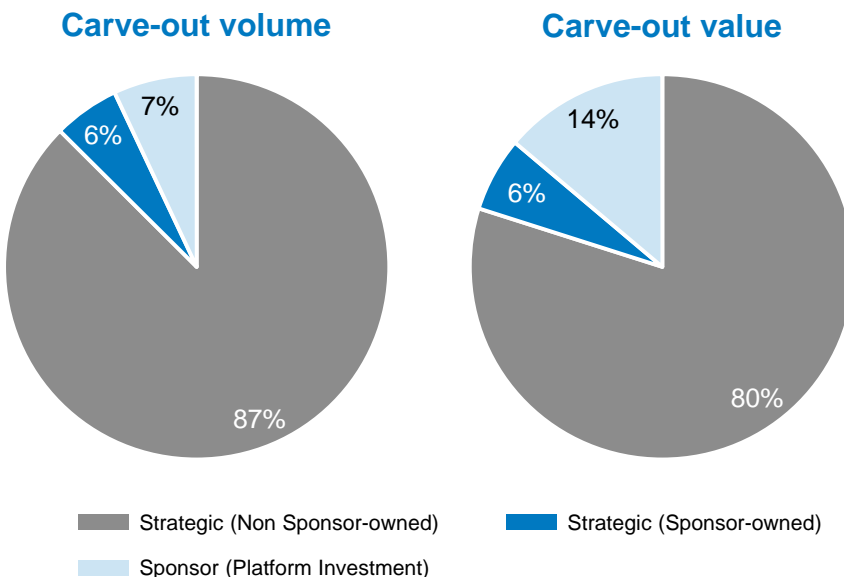
## Public vs. private acquirer by volume<sup>(1)</sup>

Roughly two-thirds of purchasers of carve-outs are public companies



## Strategic vs. sponsor acquirer by volume<sup>(1)</sup>

Sponsor acquisitions drive substantial transaction value compared to the respective deal count



Source: FactSet

Note: Sample size based on U.S. and Canadian carve-out transactions from Q1 2009 through Q1 2019.

1. Includes transactions with publicly-disclosed transaction values.



# Key carve-out challenges and considerations

Lack of access to growth capital for specific segments

Clarity and conviction around the use of proceeds from the carve-out

Execution of post-carve-out technology integration is frequently one of the most common challenges and delays to synergy realization

Internal messaging is critical as many employees fear change (compensation, health insurance, or job loss)

Pricing methodology must be carefully considered as sellers are rarely accustomed to providing services included in the Transition Services Agreement to third parties

Service levels must be clearly defined and timelines and performance standards must be realistic



Carve-Out historical and projected financial statements should account for standalone costs and growth outlook with improved investment

Companies may elect to categorize non-core holdings as discontinued operations as appropriate

Buyers require clarity and reasonableness around direct and indirect cost allocations for carve-out businesses

Customer messaging should be thoughtful to alleviate any concerns under new ownership

Note: SG&A = selling, general, and administrative expenses.

# BMO M&A expertise in carve-out transactions

## Experienced team

- Global M&A practice with ~110 M&A professionals in nine offices around the world, with ~80 M&A professionals in the U.S.
- Including over 40 Managing Directors and Directors

## Full product capabilities

- Sell-side, buy-side and cross-border advisory
- Recapitalizations and restructurings
- Fairness opinions
- Takeover defense
- Activism defense
- Leveraged and management buyouts
- Strategic alternatives review

## Proven results

- US\$404 billion<sup>(1)</sup> of transaction value in 500+ deals since 2011

## Approach

- Deep sector expertise in close alignment with BMO's industry groups
- M&A professionals partner with industry experts to drive enhanced insights and execution
- Dedicated capabilities in both large cap and middle market M&A advisory and financing

## Select recent carve-out M&A transactions

 <p>\$475 million</p> <p>Acquisition of Eagle Ford Assets from PIONEER NATURAL RESOURCES</p> <p>Financial Advisor May 2019</p>	 <p>a Subsidiary of newell BRANDS</p> <p>Sale to RHÔNE</p> <p>Financial Advisor May 2019</p>	 <p>Canadian Trucking Business</p> <p>Sale to Trimac</p> <p>Financial Advisor April 2019</p>	 <p>C\$720 million</p> <p>Sale of Cogeco Peer 1 to digitalcolony</p> <p>Financial Advisor April 2019</p>	 <p>Sale of DIAMOND CHAIN COMPANY to TIMKEN</p> <p>Financial Advisor April 2019</p>
 <p>Sale of Portfolio Company</p>  <p>Financial Advisor March 2019</p>	<p>ALTA SI PARTNERS</p> <p>\$400 million</p> <p>Acquisition of the University of St. Augustine for Health Sciences</p> <p>Financial Advisor February 2019</p>	 <p>In its acquisition of the Online Video Platform Business of OOYALA</p> <p>Financial Advisor February 2019</p>	 <p>\$325 million</p> <p>Monetization of Delaware Basin Water Infrastructure</p> <p>Financial Advisor October 2018</p>	 <p>C\$2.585 billion</p> <p>Sale of MID Financial Management (Interim) to Scotiabank</p> <p>Financial Advisor October 2018</p>
 <p>(Formerly DH Corp – DH:TSX) Portfolio Company of VISTA EQUITY PARTNERS</p> <p>Sale of DH Collateral Management Services business to TERANET Portfolio Company of OMERS</p> <p>Financial Advisor July 2018</p>	 <p>Sale of Soy Flake &amp; Flour Production Assets to Zeeland Farm Services</p> <p>Financial Advisor April 2018</p>	 <p>Fans, Silencers &amp; Systems</p> <p>Subsidiary of CECO ENVIRONMENTAL</p> <p>Sale to Cincinnati Fan a Portfolio Company of DOMINUS CAPITAL</p> <p>Financial Advisor March 2018</p>	 <p>Passion for good food</p> <p>Sale of Select Bakery Assets to Hostess and BIMBO</p> <p>Financial Advisor February 2018</p>	 <p>\$120 million</p> <p>Acquisition of FIELD ROAST</p> <p>Financial Advisor January 2018</p>

Bloomberg, Global completed deals, calendar YTD as of May 7th, 2019.

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As a member of BMO Financial Group (NYSE, TSX: BMO), we leverage the financial strength and capabilities of one of North America's leading financial services organizations

BMO Capital Markets is a single-stop provider. Depending on your needs, you may use a combination of our capabilities, or only one. Our experience and deep sector knowledge enable us to develop the solution that fits you best

## We offer a complete suite of products and services:

### Access to capital

- Initial public offerings
- Debt financing
- Equity financing
- Private equity financing
- Corporate lending
- Structured & project financing
- Securitization

### Distribution

- Institutional
  - Equity sales & trading
  - Fixed income sales & trading
- Retail
  - Direct brokerage
  - Private banking

### Strategy & growth

- Strategic advisory
- Mergers & acquisitions, including cross-border opportunities
- Valuations & fairness opinions
- Acquisition & divestitures
- Leverage buyouts
- Restructurings & recapitalizations
- Take-over & activism defense
- Share buybacks
- Joint ventures and other partnership models

### Treasury & risk management

- Commodity products
- Money markets
- Trade finance
- Cash management
- Foreign exchange

### Research

- Economics
- Commodities
- Debt
- Corporate

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Buffalo  
Calgary  
Chicago  
Denver  
Houston  
Mexico City  
Milwaukee  
Minneapolis  
Montreal  
New York  
Phoenix  
Rio de Janeiro  
San Francisco  
Seattle  
Toronto  
Vancouver  
Washington, D.C

## Europe & Middle East

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London  
Paris  
Zurich  
Abu Dhabi  
Mumbai

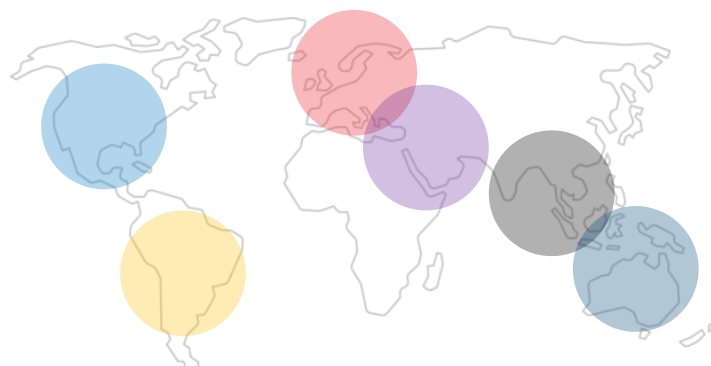
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Melbourne  
Guangzhou  
Hong Kong  
Singapore  
Shanghai  
Taipei

**2,700+**  
professionals

**33**  
locations

**5**  
continents



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