



ARTICLE

Accelerating Value Creation in Buy-side Carve-outs

Proven strategic and tactical guidance for rapidly separating
and standing up IT

For buyers, carving out an acquired business from its parent is a high-risk process that typically involves some form of business transformation in order to achieve the deal's expected value within the investment horizon. The keys to maximizing value creation in such transactions are certainty, speed and cost-effectiveness. Separating and standing up the IT components of the carved-out business can be one of the most complex, disruptive, time-consuming and costly parts of these types of transactions — making it a critical lever in the value-creation equation.

Often, the IT separation/transformation can set the critical path for the entire process. Fortunately, IT products and services have evolved to the point where — with the right knowledge and experience — IT carve-outs can be achieved far more predictably, quickly and cost-effectively than in the past, resulting in accelerated time-to-value.

Based on years of experience, here are some strategic (upfront analysis and planning) and tactical (implementation and execution) IT accelerators FTI Consulting recommends to accelerate value creation through technology.

CARVE-OUT DEAL VOLUME IS GROWING AND IS EXPECTED TO HIT AN ALL-TIME HIGH IN 2021



Data through March 31, 2021

Source: PitchBook's Q1 2021 US PE Breakdown

Strategic Carve-out Accelerators

IT Due Diligence — Perform IT due diligence early, together with financial, commercial and operational due diligence. Give careful consideration to IT operations shared with the parent company vs. the carveout's specific business processes, systems and data needs. From this, identify all of the sources of technological entanglement with the parent early. Up-front analysis of these elements, with the investment thesis in mind, will enable you to identify and quantify separation and stand-up complexity, resource requirements, timelines and costs. The knowledge gained from this analysis will allow you to negotiate and plan appropriately to address these elements as early in the transaction as possible.

IT Operating Model Design and Cost Modeling — Do it up front. At a high level, design the future-state (and potential interim-state) IT operating model(s), complete with bottom-up, one-time cost-to-achieve and run-rate costs, during or immediately following due diligence. Validate these designs and models with experienced operators and your technology advisors. Early and deliberate modeling will provide you with the knowledge needed to negotiate and close a transaction with confidence regarding how, when, and by how much IT can contribute to value creation.

IT Transition Service Agreement (TSA) Development and Negotiation — Missing or ambiguous TSA roles, responsibilities, timeframes and costs are responsible for a substantial amount of carve-out delays and cost overruns. To mitigate these surprises, ensure the TSA adequately covers both the ongoing IT operations during the transition period and the services needed to migrate off the parent's IT and onto the future-state NewCo IT. Conduct an early and thorough review of what is covered, who will provide the services, how long the services will be available and what the services will cost. Make sure there is sufficient granularity and separation between various IT services to enable you to exit some IT services early in order to shorten the transition timeline and lower TSA costs. Be sure to identify and fill any gaps or ambiguities in the TSA, and establish service-level agreements and strict governance, to avoid service, time and cost surprises or overruns.

IT Systems and Services Selection — Determine which of the ParentCo IT systems or services are suitable, or not, for the NewCo business being carved out. Occasionally a "lift-and-shift" migration approach can be taken, particularly when unique business requirements can be met rapidly by cloning select portions of the ParentCo IT systems. Often, however, the ParentCo systems or services are either overkill for the size and complexity of the NewCo, or ill-suited based on the NewCo's investment thesis or future-state operating model. When systems or services need to be selected, avoid lengthy RFP processes, particularly for commoditized IT products and services. Time is better spent up-front — during due diligence — understanding which IT products and services will or will not suit the NewCo's future-state IT operating model. Leverage experienced operators and your technology advisors to land on the best solutions in terms of capability, scalability, one-time implementation time and costs, and run-rate support efforts and costs.

Tactical Carve-out Accelerators

IT Infrastructure Deployment — Consider the carve-out as an opportunity to modernize and improve IT capabilities, reliability, security, supportability and cost of ownership by re-platforming to a modern, cloud-based infrastructure-as-a-service (IaaS) architecture. IaaS deployment accelerates the carve-out timeline, enables dynamic scaling, and reduces up-front and potential run-rate costs. The depth and breadth of capabilities, as well as implementation and support services — from the likes of AWS, Azure and others — have lifted a significant IT burden off companies at all stages of their growth cycles. Avoid replicating the ParentCo infrastructure except when absolutely necessary to temporarily host bespoke applications. When necessary, it is recommended that you employ experienced IT operators to evaluate niche IaaS alternatives.

IT Applications Implementation — Implement cloud-based software-as-a-service (SaaS) applications wherever possible. The value drivers include shorter installation and deployment timelines, more predictable and less costly implementations, and lower overall maintenance and support costs. SaaS applications are best suited for common business functions where off-the-shelf features will meet the business requirements, including functions such as e-mail, file sharing, collaboration, accounting, financial reporting, human resources, payroll, customer relationship management and supply chain management.

SaaS applications are not usually well suited for unique — company-specific — customer, product or service processes, which are often addressed by bespoke applications. For these applications it is more common to migrate the legacy applications in order to retain their unique features and capabilities. If the NewCo's future-state IT operating model calls for a combination of SaaS and bespoke applications, be sure to closely analyze and assess the application program interface (API) capabilities of the applications as well as the resources required to maintain them.

IT Support and Help Desk — Employ a third-party managed services provider (MSP) to handle basic IT support and help desk functions, such as network, desktop and mobile device management, and low-level user help desk requests. Employ in-house IT resources for higher-level user and customer help requests and escalations, custom application maintenance, project and vendor management, cybersecurity and other critical tasks. MSPs have evolved to the point where they can usually stand up a service framework and help desk very quickly and cost effectively.

Cybersecurity — Address cybersecurity with rigor, given the growing risk of an attack or breach that could halt operations, introduce unexpected costs or cause reputational harm. Cybersecurity incidents can occur any time before, during or after a carve-out. The TSA should make clear whether the parent or the NewCo has cybersecurity responsibility. Similar to MSPs, a strong recommendation is to engage a Virtual Chief Information Security Officer (vCISO) for the transition as well as for the stand-up of the NewCo. These services are run by experts in the industry who bring in best practices in cybersecurity and can provide initial risk assessments as well as the ability to build out the security processes, practices and technologies needed for a robust cybersecurity function. They can help stand up IT security offices, train support teams on best practices and bring the new CISO up to speed when a permanent individual has been identified.

PE FIRMS REPORTED THAT ROUGHLY A THIRD OF CARVE-OUT DEALS RESULTED IN COSTLY OVERRUNS OR FAILED TO DELIVER EXPECTATIONS.

24%
Costly overruns impacted the deal

34%
Failed to deliver expectations

Source: [TMF Group](#)

Conclusion

Accelerating value creation in carve-out transactions depends heavily on the degree of certainty, speed and cost-effectiveness of separating and standing up IT.

From a strategic standpoint, front-load IT activities such as identifying where and how much systems and data are entangled, clarifying any IT TSA ambiguities, developing a future-state IT operating model and pre-selecting key go-forward vendors/systems. Front-loading these IT activities will get the transaction on a strong footing in terms of what to do, when to do it, how long it will take and how much it will cost.

From a tactical standpoint, take advantage of recent advances in IaaS, SaaS, vCISO and BPO/MSP services to rapidly, predictably and cost-effectively stand up a modernized, streamlined and dynamically scalable IT infrastructure, application, security and support environment.

JOHN STIFFLER

Senior Managing Director
+1 415.283.4262
john.stiffler@fticonsulting.com

GARY JACOBS

Managing Director
+1 212.499.3640
gary.jacobs@fticonsulting.com

ERIC NELSON

Managing Director
+1 703.201.0076
eric.nelson@fticonsulting.com

Transactions

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Note: The recommendations contained here are based on successfully accelerated carve-out transactions where FTI Consulting was engaged to perform due diligence and post-close carve-out and stand-up advisory services and program management. In many cases, success was achieved in partnership with vetted IaaS, SaaS, MSP and vCISO providers that have consistently proven to be best in class.

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