Key Insights from Sun Capital’s experience in carve-out investments

- Sun Capital has built a strong reputation in the industry as a preferred buyer of corporate carve-outs.

- Our operational orientation and focus on culture help keep management positively engaged to ensure a smooth transition and business continuity throughout the transition period.

- Sun Capital has completed more than 50 carve-out transactions with leading companies, including Emerson Electric Company, General Electric, International Paper, McDonald’s Corporation, Rio Tinto PLC and Sara Lee Corporation just to name a few.

- Sun Capital applies its knowledge and expertise to efficiently conduct due diligence on even extremely complex carve-out situations—and close the deal quickly.

$1.1 b

EBITDA of 50 Sun Capital corporate carve-out investments. Increased 220% from time of acquisition to today/time of exit.
Can you describe what a corporate carve-out is and what makes them different from standard buyouts?

**Edwards:** Simply put, a corporate carve-out transaction is one where a company divests a business unit. Often this is because a decision was made that the unit is no longer core to the company’s future strategy. These businesses have often been neglected for some time, and haven’t received the attention or resources they need to reach their real potential. Over the years Sun Capital has increasingly been drawn to these types of transactions as their complexity and operational needs are a good match for our skill set.

**Liff:** In a carve-out, operational and accounting functions are fully or partially integrated with the parent organization. These interdependencies create a number of unknowns, so thorough diligence is critical to really understand what you’re buying. What assets are coming with the business, and what remains with the seller? The bottom line is it is a more complex job to understand the entire business and be ready on day one to build what’s needed.

**Garff:** The complexities can quickly become wide-ranging, so the transaction is anything but a plug-and-play endeavor. We often acquire units without financial staff, IT function/systems, and a fully-staffed sales team, etc. It takes work to think through how that could be addressed without losing a lot of momentum. These transactions are not for the faint of heart.

**Edwards:** It’s not unusual for us to know much more about the business than the parent company by the time the deal is closed because often they really haven’t looked at it as a separate business, just as a business function. We’ve seen middle market opportunities where the seller didn’t even have a P&L for the division because of the way the company was structured. We have had to help some sellers create the standalone financials in order for the deal to move forward.

How do you ensure that you do know what you’re getting in a carve-out?

**Edwards:** From the beginning, evaluating a potential transaction means bringing focus to the unfocused. Since success of the deal will ultimately hinge on the operational aspects, knowing the right questions to ask and identifying the right issues early on in the process is critical—even when you are a repeat purchaser from the same corporate parent, as we have been.

**Liff:** There are a number of questions you just don’t need to ask in a standard buyout, but that make all the difference in a carve-out. For example, it’s vital to determine whether the business’ sales have previously been bundled with other products. We’ve seen on several occasions a particular division up for consideration has had great performance metrics, but as we looked closer we noticed this revenue had largely been derivative of bundled product packages. What will happen if that bundling stops?

**Garff:** Other questions we have to ask include: Does the business have a separate sales force? Who owns the customer relationships? Who manages billing? Who owns and manages the website, email and records? Will there be a transition period with services being provided by the seller, and how long should it last? Does the intellectual property come with the business, or is it shared? All of these sorts of details must be thought out and planned up front, or you risk owning a company that can’t transact business.

**Wolfe:** Knowing what questions to ask, and how we will address potential issues, allows us to keep the sale process moving without sacrificing good diligence. We’ve done many carve-outs so we have a plan and a timeline to ensure we can get to a closing quickly and efficiently.
Garff: In a carve-out situation, the core infrastructure—both systems and people—often remain with the seller once the transaction closes. That’s why it’s important to negotiate what services the seller will continue to provide while the business transitions into a fully self-supporting entity.

Edwards: Determining the scope of the seller’s continued obligations is a key part of the dealmaking process with a carve-out. Usually the seller wants to detach itself from the divested unit as quickly as possible, so the acquirer needs to know up front what type of services will be needed, what is a fair price to pay for the services, and what it will take to build a permanent infrastructure. Ultimately, both sides must take a practical approach and take on some risk.

Liff: Once the contract is signed, you must have a fully functioning business, not just component parts. That’s where Sun Capital’s strong, in-house operating team and network of advisors gives us a significant advantage over other buyers. We can quickly develop a clear view of what’s needed and close the deal with confidence.

Edwards: Exactly. This is an area where there really is no substitute for experience. Operationally, you’ve got to be prepared to really peel the onion and truly assess the capabilities, needs and problems. People would be surprised at some of the issues we’ve spotted and had to address as part of the deal-making process. For example, in one situation where the parent company had implemented a “buy one-get one free” marketing campaign. One of those products was sold by the parent company and the other was to be provided by the unit being carved out. It could’ve gotten very ugly, very fast had we not identified and addressed the issue prior to closing.

Wolfe: Most management teams in carve-out situations have felt handcuffed in improving their businesses due to under investment, lack of authority or conflicting corporate mandates. These businesses and management teams have made lots of sacrifices as a non-core business and it is very liberating to be autonomous. This creates significant opportunities. That said, the process of separating from a parent company can also be very challenging from a cultural and operational standpoint. We work closely with the teams to effectively complete this transition using the resources we provide.

Garff: We push the strategy and plan execution right away, often getting our operating team involved pre-close so we speed execution and get early wins, which is particularly important in corporate carve-outs. It can take three to six months to get the leadership team focused and fully assembled as we fill certain skill and experience gaps, and separate the business from its former parent company. But, we have a bias for acting sooner rather than later to drive change in carve-out situations.

Wolfe: Another key component of this is the invigorating process of examining the core product or service offering of the business, and focusing on the real needs and best interests of the company going forward. Prioritizing the needs in a systematic and logical manner and establishing an appropriate time line to achieve the goals is a vital task in the early going with a carve-out.
What about things outside of the operational challenges? What gets missed?

**Edwards:** We strongly believe it’s important to not lose sight of culture as a key driver of success. While the business itself is transitioning into a standalone company, it will also be building a new corporate identity. Sometimes there’s a move to hang on to the culture of the former parent, and sometimes we see the opposite reaction, where they want to turn 180 degrees. It’s our job to ensure that management has a plan to address what needs to happen on the culture front.

**Wolfe:** Culture. Culture is a critical element of any successful company and in a carve-out the culture is often blurred as the division is separated from its parent. We like to see management working actively to enhance the culture year on year because we have seen that there is a real correlation between cultural alignment and business performance over time.

**Liff:** If you have the knowledge to identify and sort through the separation issues, you can end up with a really great company that has tremendous market opportunity when freed from the constraints of the parent business. A business that may have been seen as “non-core” and therefore given little support, can really accelerate growth when pursuing its own strategy and enhancing execution with Sun Capital’s support.

**Garff:** On the other hand, some of these businesses are poor performers because the parent did not provide the financial resources, operational talent, or overall attention they require to succeed. Corporate carve-outs can be the most exciting type of transaction for us because we can have the biggest transformational impact and generate strong returns for our investors by unlocking their potential through the resources and experience of the Sun Capital team.

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**Sun Capital Partners** is a global private equity firm focused on identifying companies’ untapped potential and leveraging its deep operational and financial resources to transform results. By leveraging the operational expertise gained from successfully navigating more than 50 corporate carve-out transactions, Sun Capital has built a track record of transitioning corporate subsidiaries into thriving standalone businesses.
Sun Capital Partners, Inc. is a global private equity firm focused on identifying companies’ untapped potential and leveraging its deep operational and financial resources to transform results. Sun Capital is a trusted partner that is recognized for its investment and operational experience, including particular expertise in the consumer products and services, food and beverage, industrial, packaging, chemicals, building products, automotive, restaurant and retail sectors. Since 1995, Sun Capital has invested in more than 345 companies worldwide with revenues in excess of $45 billion across a broad range of industries and transaction structures. Sun Capital has offices in Boca Raton, Los Angeles and New York, and affiliates in London, and Shenzhen.

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