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Carve-Out Acquisitions: Finding and Evaluating Divestitures

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In this article

1. What a carve-out is, and the three ways it happens
2. Public signals that a division may be non-core
3. The source-signal table
4. Turning signals into a target list
5. The carve-out financial statements problem
6. Stand-alone cost and why allocations mislead
7. Transition services agreements
8. A diligence checklist for a divested unit
9. What evidence stays uncertain

What a carve-out is, and the three ways it happens

A carve-out is the separation of a business unit from its corporate parent. The unit has customers and operating history, but it has never existed on its own: finance, payroll, IT systems, insurance, contracts and sometimes its legal entity are shared with the parent. The carve-out definition covers the term; this article covers how a buyer finds candidates in public evidence and what it must rebuild before valuing one.

Boston Consulting Group (BCG) describes three basic routes: a trade sale, an initial public offering (IPO) of the unit, or a spin-off to the parent's shareholders (BCG, 2021). Only the trade sale produces a deal for a private equity (PE) buyer or independent sponsor, but all three leave a trail in filings.

The article assumes a United States (US) public parent filing with the Securities and Exchange Commission (SEC), because that is where the evidence lives. Nothing here is accounting or legal advice; it describes what the rules and filings say.

Public signals that a division may be non-core

Until a parent chooses to announce a sale, filings provide only indirect signals. Each is useful only if the analyst is clear about what it does and does not establish.

Segment reporting under ASC 280 and ASU 2023-07

Public companies report segment information under Topic 280 of the Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC). Accounting Standards Update (ASU) 2023-07 expanded it: a public entity must disclose, annually and in interim periods, the significant segment expenses regularly provided to the chief operating decision maker (CODM), an "other segment items" amount, and the title and position of the CODM with an explanation of how the CODM uses the segment profit measure. The update is effective for fiscal years beginning after December 15, 2023, and interim periods within fiscal years beginning after December 15, 2024. It applies even to entities with a single reportable segment (FASB ASU 2023-07).

Filings for fiscal 2024 onward can therefore show the cost lines management reviews for each segment. A segment whose margin trails its siblings, whose capital spending has been cut, or whose description has shrunk is worth a closer look. The update does not change how segments are identified or aggregated (FASB ASU 2023-07), so a small division folded into a larger segment stays invisible in the segment note.

Discontinued operations and held for sale

ASU 2014-08 set the current test. A disposal of a component is reported in discontinued operations if it represents "a strategic shift that has (or will have) a major effect on an entity's operations and financial results" and the component is held for sale, sold, or disposed of other than by sale, such as a spin-off. A component is held for sale when, among other criteria, management with the authority to do so commits to a plan to sell, an active program to locate a buyer has started, the sale is probable within one year, and the unit is being actively marketed at a price reasonable in relation to fair value (FASB ASU 2014-08).

Held-for-sale classification is the most direct public signal short of an announcement, because the criteria require an active program to locate a buyer; it also means a process is likely under way. A smaller unit can be held for sale without being a strategic shift, so "assets held for sale" deserves a search of its own.

Form 8-K items

Form 8-K is the current report a registrant files, generally within four business days of the triggering event (SEC Form 8-K, General Instructions). Four items matter here:

- **Item 2.05, Costs Associated with Exit or Disposal Activities**, is triggered when the board or authorised officers commit the company to an exit or disposal plan under which material charges will be incurred. The filing describes the course of action and estimates costs by major type (Form 8-K, Item 2.05). It signals restructuring, not necessarily a sale.
- **Item 2.06, Material Impairments**, is triggered when the company concludes a material impairment charge is required, "including, without limitation, impairments of securities or goodwill" (Form 8-K, Item 2.06). A goodwill impairment tied to one reporting unit says that business is worth less than carried, not that the parent will sell.
- **Item 1.01, Entry into a Material Definitive Agreement**, covers material agreements outside the ordinary course (Form 8-K, Item 1.01). A signed agreement to sell a division may be reported here. By then the target is gone, but it is a precedent.
- **Item 2.01, Completion of Acquisition or Disposition of Assets**, reports a completed acquisition or disposition of a significant amount of assets, including the counterparty and the consideration. "Significant" includes the case where the net book value or the amount paid or received exceeds 10 percent of the registrant's consolidated total assets (Form 8-K, Item 2.01 and Instruction 4). Completed disposals show which parents sell, what they sell, and who buys.

Exhibit 21 and the legal-entity map

Item 601(b)(21) of Regulation S-K requires an annual report exhibit that lists the registrant's subsidiaries, their jurisdictions, and the names under which they do business. Subsidiaries that would not, in aggregate, be a significant subsidiary may be omitted (17 CFR 229.601, via Cornell LII). It answers a practical question: does the division sit in its own legal entities, or is it a product line inside a shared entity? The first can be a share sale; the second is an asset deal with contract assignments. See Exhibit 21 subsidiaries mapping for the method.

The source-signal table

Signal	Where it appears	What it establishes	What it does not establish
Segment margin and expense lines	10-K and 10-Q segment note (ASC 280, ASU 2023-07)	How management measures each segment and which costs it reviews	Stand-alone profitability; corporate costs may sit outside the segment measure
CODM description	Segment note	Who allocates resources and on what measure	Whether the unit is strategic

Signal	Where it appears	What it establishes	What it does not establish
Assets held for sale	Balance sheet and notes (ASC 205-20, ASC 360)	An active plan to sell, with sale probable within one year	Price, buyer, or timetable beyond the criteria
Discontinued operations	Income statement and notes	A disposal the parent judges a strategic shift with a major effect	Anything about smaller disposals that do not meet that test
Item 2.05	Form 8-K	A committed exit or disposal plan with material charges	That a sale, rather than closure, is intended
Item 2.06	Form 8-K	A material impairment, possibly of a unit's goodwill	Intent to divest
Item 1.01 / 2.01	Form 8-K	A signed or completed transaction, counterparty, consideration	Availability; useful for precedents and seller behaviour
Exhibit 21	10-K exhibit (S-K Item 601(b)(21))	Legal entities, jurisdictions, trade names	Which entities hold the division's contracts, staff or IP

The SEC's full-text search covers electronically filed EDGAR documents since 2001, including exhibits, and supports exact-phrase queries in quotation marks (SEC, EDGAR Full-Text Search FAQ). Phrases such as "held for sale" or "strategic alternatives" plus a sector term make a first pass; see SEC EDGAR as a source.

Turning signals into a target list

A signal is a reason to open a file, not a target. Score parents first, then read the units.

1. **Pull three to five years of segment notes** for each public company in the sector: revenue, profit measure and, from fiscal 2024, significant expense lines.
2. **Flag divergence**: a segment growing slower than the parent, a falling margin, or a segment whose description has narrowed.
3. **Overlay event filings**: recent 2.05 and 2.06 8-Ks and held-for-sale balances.
4. **Map legal entities** from Exhibit 21.
5. **Check precedents**: has this parent sold units before (Item 2.01), and to whom?
6. **Record the evidence** for each flag: filing, date and quoted passage.

Illustrative example: a fictional parent's segment note

The company and figures below are fictional and illustrative only.

Fictional "Calder Hollis Inc."	FY2023	FY2024	FY2025
Segment A revenue ($m)	610	662	715
Segment A segment profit margin	18.2%	18.9%	19.4%
Segment B, "Industrial Coatings", revenue ($m)	148	141	136
Segment B segment profit margin	11.5%	10.1%	9.4%

Fictional "Calder Hollis Inc."	FY2023	FY2024	FY2025
Segment B capital expenditure ($m)	9.1	6.2	4.0

Suppose the FY2025 10-K also discloses a goodwill impairment for the Coatings reporting unit, filed under Item 2.06, and Exhibit 21 lists two Coatings subsidiaries with their own trade names. Each fact alone is weak. Together they describe a shrinking, capital-starved unit with impaired goodwill, already in separate legal entities: a candidate for an approach (the non-core carve-outs thesis sets out the hypothesis), not evidence that the parent will sell.

The carve-out financial statements problem

A division inside a parent rarely has complete financials: shared costs sit at corporate, and the books were never designed to show what the unit would cost alone.

SEC Staff Accounting Bulletin (SAB) Topic 1.B addresses this for a subsidiary registering its own securities. The staff "believes that the historical income statements of a registrant should reflect all of its costs of doing business", including expenses the parent incurred on the subsidiary's behalf. Where specific identification is not practicable, a reasonable allocation method, such as incremental or proportional allocation, may be used, with the method explained and management's assertion that it is reasonable. Because related-party arrangements are not at arm's length, the staff has required disclosure, when practicable, of management's estimate of what expenses would have been on a stand-alone basis (SEC, SAB Topic 1.B).

Regulation S-X Rule 3-05 governs the financial statements of a business that an SEC registrant acquires. It binds registrants, not private buyers, but is a useful template. Using the significance conditions of Rule 1-02(w), if none exceeds 20 percent, separate financial statements are not required; above 20 percent but not above 40 percent, at least the most recent fiscal year and interim period; above 40 percent, at least the two most recent fiscal years (17 CFR 210.3-05, eCFR; Cornell LII). The eCFR version history for the section, checked on 28 October 2026, shows no amendment in 2025 or 2026; its source note cites the 2020 rule as amended in February 2024.

Rule 3-05(e) matters most for carve-outs. For an acquisition of net assets that constitute a business, such as a product line, abbreviated financial statements are allowed when the business is 20 percent or less of the seller's total assets and revenues, has never had separate statements, was not a separate entity, subsidiary, operating segment or division, and the seller lacks the separate accounts needed for full statements. The balance sheet may be a statement of assets acquired and liabilities assumed, and the income statement may omit corporate overhead, interest on debt not assumed, and income tax, provided the notes explain the omission and how the statements are "not indicative" of future results (17 CFR 210.3-05(e), eCFR). A buyer handed such statements should read them as the rule frames them: they omit costs the buyer will bear.

Stand-alone cost and why allocations mislead

Allocated costs show what share of the parent's overhead the unit absorbed, not what it will cost to run alone. The answers can differ in either direction: allocation can overstate costs when the parent's corporate functions are expensive, or understate them when a small unit must buy its own audit, insurance, software and finance

team without the parent's scale.

Separation also has one-time costs. BCG, analysing separation cost data on more than 50 divestitures, reports that separation costs range "from approximately 1% to 5% of the divested business's revenues" and reach up to 13 percent of revenues in some large and complex carve-outs (BCG, 2021). That is a consultancy's own dataset of unspecified composition, not a benchmark for any one deal. BCG also identifies stranded costs on the parent's side: expenses in the parent's cost structure that are linked to the operations of the divested business.

Illustrative worked example: stand-alone cost build

All figures are illustrative, for a fictional unit, "Ridgeway Flow Products", with $120.0 million of revenue.

Line ($m)	Allocated basis	Stand-alone basis
Segment profit as reported by parent (before corporate costs)	18.0	18.0
Corporate allocation (3% of revenue, proportional)	(3.6)	n/a
Finance, accounting, tax and treasury	n/a	(1.8)
Human resources and payroll	n/a	(0.5)
IT: ERP licences, infrastructure, support	n/a	(2.2)
Legal and compliance	n/a	(0.6)
Insurance	n/a	(0.7)
Audit, board and executive (CEO office, CFO)	n/a	(1.4)
Lost purchasing scale	n/a	(0.6)
Run-rate operating profit	**14.4 (12.0%)**	**10.2 (8.5%)**

Here the allocated statements flatter the unit by $4.2 million a year. That gap is capitalised at whatever multiple the buyer pays, so build it bottom-up from quotes and headcount plans. One-time separation costs come on top: at an illustrative 3 percent of revenue, inside BCG's range, $3.6 million for systems, contracts, branding and recruitment.

Transition services agreements

A transition services agreement (TSA) is the bridge. BCG describes the arrangement as one in which "the parent agrees to provide services to the buyer in order to ensure continuity of operations", and reports that TSAs "are typically in effect for 3 to 24 months after the closing" (BCG, 2021). TSAs are contractual practice, not a regulatory requirement, and their terms are negotiated.

Terms worth specifying:

- **A service schedule** listing each service, its scope, service levels and monthly fee, rather than a general promise of "services as historically provided".
- **Pricing basis**, including any escalation if extended.
- **Exit by service**, letting the buyer terminate services one at a time as replacements go live.
- **Extension rights** for critical services such as ERP and payroll, because systems migrations overrun.
- **Data migration** duties, including a final extract in a usable format.
- **Reverse TSAs**, where the unit continues to serve the parent, priced on the same basis.

In the Ridgeway example, if the parent charges an illustrative $0.25 million a month for finance, IT and payroll for twelve months, that is $3.0 million paid while stand-alone functions are being built, partly overlapping stand-alone costs.

A diligence checklist for a divested unit

The following worksheet is fictional and illustrative; adapt the fields to the unit.

Area	Question	Evidence to request
Revenue	Which customers buy from the unit alone, and which buy bundles across the parent?	Revenue by customer and contract, three years
Shared contracts	Which supplier and customer contracts are in the parent's name, and which need consent to assign?	Contract list with assignment clauses
Shared systems	Which systems (ERP, CRM, payroll, email) are shared, and who owns the licences?	Systems inventory with licence holder
People	Who works wholly, partly or not at all for the unit? Who transfers?	Headcount by function with allocation percentage
IP	Who owns the patents, trademarks and software the unit uses?	IP register by legal owner
Costs	Which costs are direct, which allocated, on what key?	Allocation methodology and stand-alone estimate
Entities	Which legal entities hold assets, contracts and staff?	Exhibit 21 cross-checked against the data room
Working capital	Is cash pooled? Are receivables collected centrally?	Intercompany account analysis

Where no interest is charged on intercompany debt, SAB Topic 1.B treats an analysis of intercompany accounts (cost allocations, intercompany purchases, cash transfers) as appropriate disclosure (SEC, SAB Topic 1.B); the same analysis is a useful request in any carve-out.

What evidence stays uncertain

Public filings describe the parent, not the unit. ASU 2023-07 discloses the expenses the CODM reviews, not the unit's stand-alone cost. A division smaller than a segment may appear in no table at all. Event filings show restructuring and impairment, not intent to sell.

Private parents leave almost none of this trail. Without segment notes, 8-Ks or Exhibit 21, the signals become trade-press reporting, management changes, facility closures and job postings, each of which needs the same discipline: record what the source says, its date, and what it does not prove. The reconstruction of stand-alone costs and TSA terms cannot be read from any filing.

Docket's Scout agent answers screening criteria like these as typed values, each quoting a retained page verbatim.

Source links

Links cited in this article, in order of first appearance. Full addresses are provided for readers using extracted text.

1. https://www.bcg.com/publications/2021/beware-of-separation-costs-compromise-value-creation
2. https://storage.fasb.org/ASU%202023-07.pdf
3. https://storage.fasb.org/ASU%202014-08.pdf
4. https://www.sec.gov/files/form8-k.pdf
5. https://www.law.cornell.edu/cfr/text/17/229.601
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7. https://www.sec.gov/interps/account/sabcodet1.htm
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9. https://www.law.cornell.edu/cfr/text/17/210.3-05

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