CORPORATE RESTRUCTURING

Divestitures and Alternative Forms of Asset Separation

A divestiture is the partial or full sale or disposal of a business division. Reasons for divestitures may be that the assets could have a higher value to the acquirer or to cover immediate cash flow needs of the divesting firm intending to re-focus on its core activities. - However, there are also other forms of a corporate separating from some of its assets.

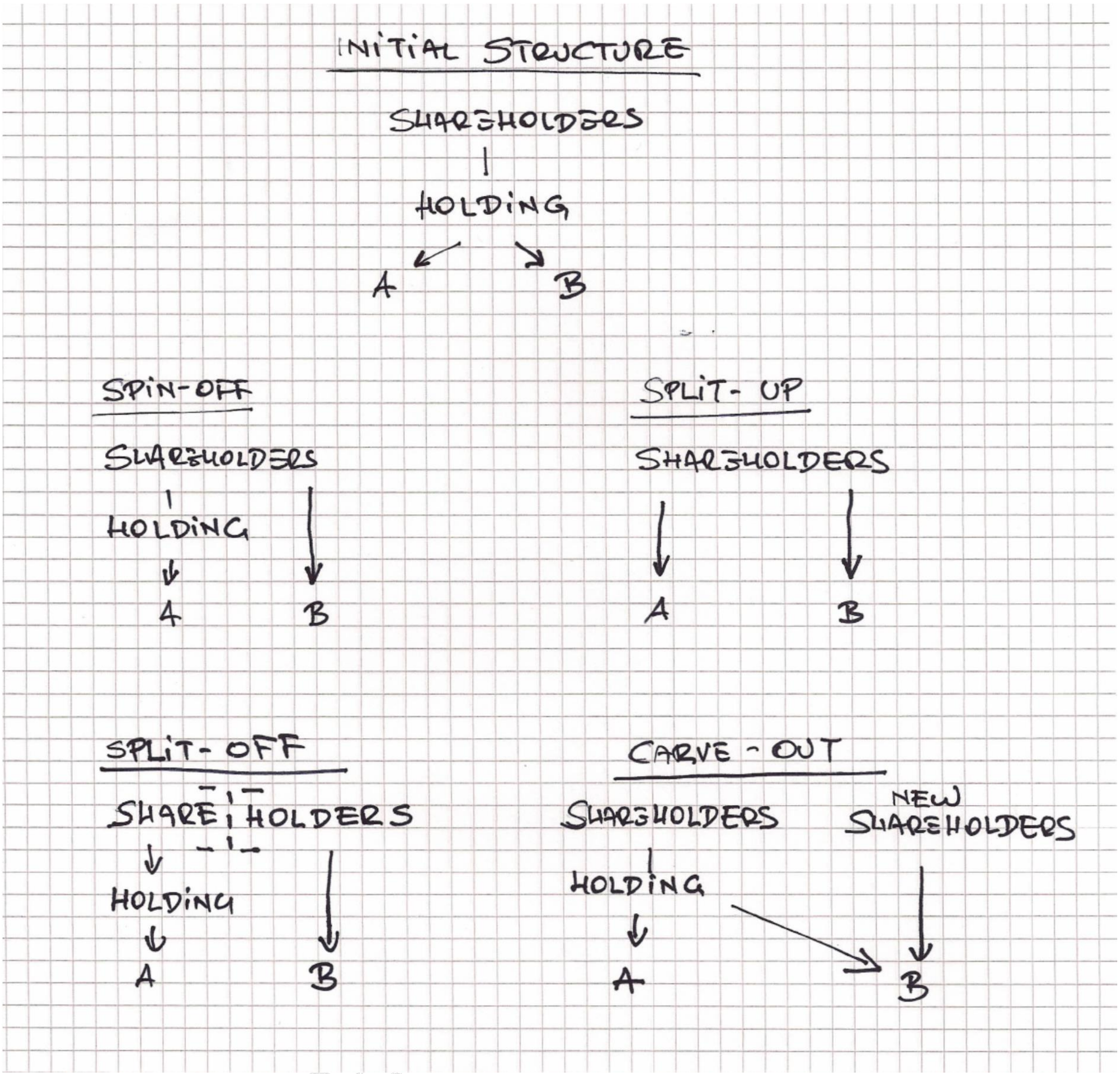
In a spin-off, for example, a firm separates out assets or a division, and creates new shares with claims on this business. Current stockholders in the firm receive these new shares in proportion to their original holdings. - Spin-offs are an effective way of creating value when subsidiaries or divisions are less efficient or undervalued. But they are also used when adverse developments faced by one portion of the business affect the earnings and valuation of other parts of the business. Among others, such transactions may create value when a parent company is unable to invest or manage its subsidiary businesses optimally, maybe because of regulatory constraints. Other than divestitures, spin-offs do not generate cash and a spun off division usually becomes an independent entity.

In the course of a split-up, on the other hand, a firm splits itself into different business lines, whereby current shareholders receive shares in such businesses in proportion to their original ownership with old firm, which ceases to exist. – In a split-off, also new shares are created for each business line, however current stockholders have to choose whether to exchange their parent company stock for these new shares, or not. – In the course of a carve-out a firm separates assets or a division and creates shares with claims on these assets with a view to sell them to the public. Such a transaction actually does raise cash, whereby, however, the parent company retains control of the carved out unit.

Tracking stocks, though uncommon in Europe, are issued by a parent company with the purpose of tracking the performance of a division, however without having a (legal) claim on its assets. Revenues and expenses of the division are separated from the parent company's financial statements and bound to the tracking stock. Investors receive dividends relating to the performance of the division regardless of the performance of the overall business. - The tracked division still gains substantially from its association with the parent company and the parent company preserves control of the tracked division. This may – for example - have to do with the fact that the division supplies a product or service that is viewed as integral or irreplaceable to the parent.

Divestitures and alternative forms of asset separation have a set of common objectives: They highlight an undervaluation and likely result in additional information being provided to markets on the operations of the separated units. The key differences among them are the respective transaction´s effect on: cash generation, ongoing control through the parent company, tax treatment and impact on the position of bondholders:

For example, divestitures, equity carve outs and tracking stocks generate cash proceeds for the parent company, whereas spin offs do not. - In a divestiture, the divesting company has no control over the assets once they are divested. At the other extreme, when tracking stocks are issued, the parent company usually retains complete control over the tracked unit, and stockholders in the unit receive no voting rights. – With a divestiture, bondholders in the parent company can be severely compromised, as they lose their claim on the assets that are divested: If the cash from the divestiture is paid out as a special dividend or used to buy back stock, then the bondholders will definitely be worse off. And, bondholders can also be negatively affected by spin offs, since the parent company maintains only a minority interest in the spun off units.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