Divestitures and Alternative Forms of Asset Separation

A divestiture is the partial or full sale of a business division, because, for instance, certain assets could be of higher value for an acquirer, immediate cash flow needs have to be covered, or the divesting firm intends to re-focus on its core activities.

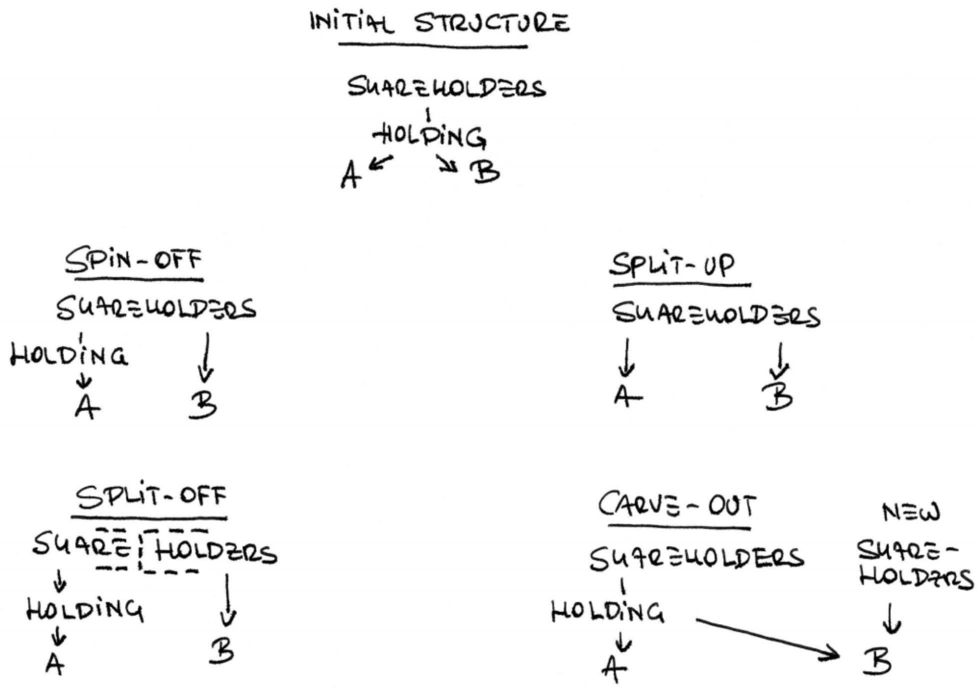
In a spin-off, for example, a firm separates out assets or a whole division, and creates new shares with claims on this business. Current stockholders in the firm receive these new shares in proportion to their original holdings. - Spin-offs are an effective way of creating value when subsidiaries or divisions are either less efficient or undervalued. They are also used though, 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 optimally manage its subsidiary businesses, perhaps due to 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 in the old firm, which ceases to exist. – Also, in a split-off new shares are created for the separated business line, however current stockholders must 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 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. The division´s revenues and expenses are separated from the parent company's financial statements and bound to the tracking stock, with investors receiving dividends relating to the performance of the division regardless of the business´s overall performance. – In this structure, the tracked division´s continuing association with its parent should still be of significant operational and commercial benefit, whereby the parent company also 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 unit(s). 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 instance, divestitures, equity carve outs and tracking stocks generate cash proceeds for the parent company, whereas spin offs do not. - In implementing a divestiture, the divesting company has no control over the assets post-transaction any longer. At the other end of the spectrum, in issuing tracking stocks, the parent company usually retains full control over the tracked unit, with stockholders in the unit receiving no voting rights. – With a divestiture becoming effective, a bondholder´s position in the parent company can be (severely) hurt, as the claim on the divested assets gets lost: That is especially the case, if the cash received from the divestiture were subsequently paid out as special dividends or used for stock buybacks. Then bondholders will definitely be worse off. Bondholders can also be negatively affected by spin offs, as the parent company will maintain only a minority interest in the spun off units.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