



Successful corporate spins

Introduction

Previous KPMG research¹ shows that divestitures are an under-leveraged lever for value-creation. For companies that consider divestitures, spins are the least common path chosen, representing only 1-2 percent of total divestiture deal volume over the past 15 years². However, spin deal value is significantly bigger—7-10x larger on average, over the same period—than the value of a typical divestiture deal.

Spin-offs can unlock significant shareholder value as companies look to reshape their portfolios or give a division a better opportunity to grow independently. But spins are also more complex and require more effort than a normal sale, as the parent company must essentially separate the business completely and by itself ahead of its public debut.

Unfortunately, on average, about one in 10 planned spins are abandoned. Since a spin can cost hundreds of millions of dollars, an abandoned spin wastes valuable resources (and time) that could be used instead to turn around an unprofitable business or capture a market opportunity.

This paper highlights how a company that has made the decision to execute a spin can better manage the complexity, execute a smooth spin, and enhance the likelihood of success of both the SpinCo and the parent company.

¹ Source: “How to win in the age of the complex deal,” KPMG LLP, 2022, and “Putting the ‘active’ in active portfolio management,” KPMG LLP, 2022

² Source: Refinitiv, KPMG analysis

Spins are an attractive option

Many companies find themselves in a situation where they need to take drastic action to refocus their business and move forward on a different path. For public companies at this inflection point, a spin can be the right approach to unlock shareholder value, but launching a new public company is not a trivial undertaking since it combines both the need for a full separation and a simultaneous public offering. But when executed skillfully, a spin can create significant shareholder value.

Example 1: Dell Technologies completed a spin of its software subsidiary, VMware, in November 2021. Stepping out of Dell's shadow was strategically important for VMware's ongoing growth in the cloud market. "If you want to be the Switzerland of the industry, then you want to be a standalone independent company, and that's where we are headed," VMware CEO Raghu Raghuram said. "It will allow partners that previously were competitors of Dell to now look at VMware with new life and say: 'Hey, we can do strategic things with VMware.'"³ Even though the companies separated, Dell and its former subsidiary agreed to a five-year "strategic partnership" that would maintain cooperation in cloud services.

Once separated from Dell, the independent VMware was not only perceived as a stronger competitor and partner, but also an attractive acquisition target. On May 26, 2022, chipmaker

Broadcom announced an offer to acquire VMware for \$61 billion (\$142.50 a share, a 44 percent premium over the stock's closing price).

Example 2: In 2019, data firm Nielsen Holdings began work on a spin of its Global Connect subsidiary, which tracks consumer goods. After substantial work on separating the two companies and preparing for a spin, Nielsen had the option to either spin or sell the Global Connect subsidiary.

Instead of executing a spin, it chose to sell, receiving \$2.7 billion from private equity firm Advent International and Jim Peck, former CEO of Transunion. "The sale of this business to Advent will deliver substantial value sooner than was anticipated through the planned spinoff and creates certainty for all stakeholders," said Nielsen CEO David Kenny.⁴ The sale of Global Connect also made parent Nielsen a more valuable company. Based on its post-spin profile, increased focus and optimized cost

structure, a private equity consortium led by Evergreen Coast Capital Corporation and Brookfield Business Partners L.P. agreed to purchase Nielsen for \$16 billion in March 2022 including assumption of debt.⁵

Example 3: Often, a spun-off firm can prosper in ways it couldn't as part of a bigger company. A notable example is PayPal Holdings, which was spun from eBay in 2015. PayPal was growing at a much faster rate than eBay, but faced increasingly tough competition in the payments arena. After the spin, PayPal's revenue soared from \$10 billion in 2016 to \$25 billion in 2021.⁶

Had PayPal remained an eBay business, it is unlikely it would have achieved the market success to become a leading payments company in a rapidly growing market. Moreover, since this was a spin, eBay shareholders were allowed to participate in PayPal's continuing success.

³Source: Mark Haranas, "Broadcom's Potential VMware Acquisition: 5 Things About Dell, Stock Prices And Hock Tan To Know," crn.com, May 23, 2022

⁴Source: Lauren Musket, cfo.com, Nov. 2, 2020

⁵Source: Cara Lombardo, "Consortium to Buy Nielsen for \$10 Billion," wsj.com, March 29, 2022

⁶Source: "Annual net revenue of eBay from 2013 to 2021," statista.com, 2022

These examples show why an increasing number of public companies are evaluating a potential spin to see if they can unlock value, too.

When companies decide to divest a business, they have three main options: sell the business, combine it with another business in a joint venture, or spin it off. A sale is the most common path and has the advantage of speed and simplicity, but it limits the

potential upside for shareholders. Also, there may not be a ready buyer at an acceptable valuation.

A spin is one of the most complex deals to execute and requires significant investment in separation and IPO readiness. But once a company has been successfully separated and spun, it can be a much more attractive asset for other large acquirers, as happened with VMware.

Finally, joint ventures allow existing shareholders to participate in the potential future upside, just like a spin can, but have their own specific challenges as they involve one or more partners.

This paper focuses on spins and their effective execution.



But spins have a high risk of failure

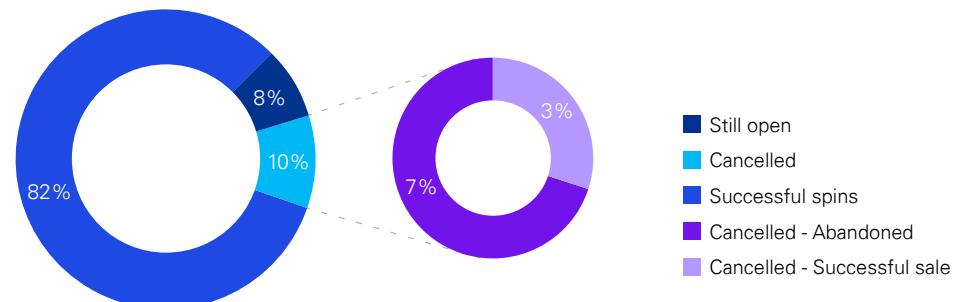
So why aren't more companies pursuing spins? One reason is clear: a spin gone bad and ultimately abandoned without a sale can be a significant drain of time and resources. On average, one in 10 announced spins is canceled and, of these, 70 percent are completely abandoned. (Exhibit 1). In such cases, resources are wasted on the abandoned spin and the company's valuation and market position can be compromised.

On the other hand, about 3 percent of announced spins over the same time period turned into successful sales. This means that while preparing the business for a spin, the parent company received an offer that exceeded the value the board expected to be captured from the spin.⁷

Spins are only 1-2 percent of total divestiture deal volume over the past 15 years⁸ but are significantly larger, with average deal value 7-10x bigger than a typical divestiture deal value (Exhibit 2).

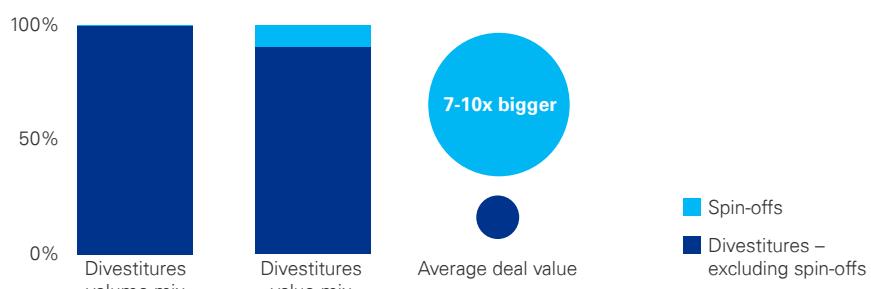
Preparing for a spin is a detailed and labor-intensive proposition, involving many of the same financial disclosures that would be necessary for an IPO. Over the past six years, 100 spins have been announced globally every year on average.⁹ As Exhibit 3 shows, it can take two or more years to complete a spin, requiring in general more time and resources by the parent than a sale.

Exhibit 1. On average, 10 percent of spins are cancelled and 7 percent of all spins completely abandoned



Source: Capital IQ, KPMG Insights and Analysis (2016-2019). (Note: data in this chart excludes spins announced in 2020 and beyond since many of these deals are still within the possible cancellation window.)

Exhibit 2. Spin-offs are less common but significantly bigger



Source: Refinitiv, KPMG Analysis (2007-2022 to date)

Exhibit 3. It can take two or more years to complete a spin



Source: Capital IQ, KPMG Insights and Analysis (2016-2021)

⁷ Source: S&P Capital IQ, KPMG analysis

⁸ Source: Refinitiv, KPMG analysis

⁹ Source: Capital IQ, KPMG analysis

There are many reasons why a spin doesn't move forward. These might include the economics of separating the business or even opposition by the shareholders.

An example of the latter is Toshiba's recent proposal to separate its Semiconductor and HDD business from its Infrastructure business. The plan, announced in February 2022, was designed to unlock value through the elimination of the conglomerate discount attributable, in the words of

the company,¹⁰ to the "co-existence of two different businesses that do not create synergies." The spin was designed to establish "a management structure equipped with expertise in each business" that would be better able to deal with the changing business environment, Toshiba said. But, at an extraordinary general meeting in March, management's spin proposal was rejected by the shareholders.¹¹

Another example highlights how, going through the rigorous process required

by a spin can, in fact, uncover new value and help to focus attention on key business challenges. Tenet Healthcare Corporation announced in March 2022¹² that "based on ongoing shareholder value creation opportunities and improved business fundamentals the company will no longer pursue a spin of its Conifer Health Solutions subsidiary." Tenet management now believes retaining the strengthened business creates more shareholder value.



¹⁰ Source: Toshiba Group IR Day 2022, February 7, 2022

¹¹ Source: "Nearly 60% of Toshiba shareholders rejected spin-off plan," Reuters, March 28, 2022

¹² Source: Company news, March 1, 2022

What makes spins so complex

Spins are a good example of complex M&A.¹³ Compared to a sale, the company needs to define and accelerate many activities, both in planning and execution.



Strong Leadership. Early in the process, a company must identify senior leaders for the SpinCo. These senior leaders should have public company as well as separation execution experience and are essential to shape, design and credibly roadshow the new business. This accelerates SpinCo decision making around topics such as branding, investments and organization structure and helps increase the market confidence in the new company.



Planning. The company must define the detailed deal perimeter. While this takes time and resources, the company also retains complete control of what assets, customers and IP are divested, without having to negotiate this with an external party. It can also make sure the deal perimeter is defined in such a way that taxes and other transaction costs are minimized.



Tax matters. The rules for qualifying for a tax-free spin are complex, and depending on the facts, the spin may not meet the requirements. If the spin is taxable, it can result in significant tax costs to both RemainCo (treated as if SpinCo was sold) and to the shareholders of RemainCo (as if they received a dividend equal to the fair value of SpinCo). Critically, typically neither

receives cash to pay this tax liability as they would in a sale. Many companies request private letter rulings from the IRS prior to the spin, to obtain a higher degree of comfort on the tax treatment of the transaction. Pursuing a dual option track, such as contemplating both a potential sale of SpinCo and a possible spin, presents unique challenges—a tax-free spin-off limits the ability for third parties to acquire either RemainCo or SpinCo after the separation, so proactive tax analysis and planning is required early on.



Execution. Compared to a sale, there are many more activities that need to be completed. The actual separation of all assets, legal entities, and infrastructure must be finished by the time the unit that is being separated is ready to go public.



Financial separation. All financial systems, processes, and data for accounting must be separated, and reporting and controls must be established. SpinCo's capital structure for equity, debt, and cash must be developed, and the required lines of credit/revolvers to fund the business must be established. Separate financial statements to support a public spin must be prepared and filed.



Operational separation. The company that is being separated must identify which managers and employees go with SpinCo or stay with the parent. There must be plans for hiring and training additional personnel to support two (or more) standalone businesses. Arms' length SpinCo and RemainCo commercial agreements must be established where needed, all infrastructure and data must be separated. This means any investment or cost required to set up new software licenses or new systems must be incurred upfront without any support from a buyer.



Additional separations. Legal entities must be identified and separated, assets transferred (this involves tax implications), and employees must be assigned to SpinCo (with new benefit plans). Possibly most onerous and disruptive of all: every vendor and customer contract must be reviewed, assigned to either SpinCo or the parent, or split/duplicated as needed.

¹³ Source: "[How to win in the age of the complex deal](#)," KPMG LLP, 2022

How to execute a spin successfully

In our experience, a business can successfully execute a spin by focusing on four core elements: develop a compelling investor story, clearly define the deal perimeter, design and implement the appropriate operating model, and execute the required operational separation quickly and efficiently. Failure to execute on any of these four elements can limit the valuation of the spin and its ability to operate effectively as a standalone business.



Develop a compelling investor story

A compelling investor story is one that is easily understood, clearly communicates the market opportunity, and explains the role the company will play in capturing it. It calls for defining the market, the strategy to seize it, and the key metrics of success. It requires

convincing investors that the business strategy and financial forecasts are achievable, and that the management team is the right team to execute against such plans. It requires the management team to follow a disciplined approach to design and implement how the standalone

business will operate and go to market. This is especially critical if the standalone company needs significant upgrades to be competitive in certain areas once the support of the parent company has been withdrawn.



Define a clear deal perimeter

Defining the details of what needs to transfer or be separated is one of the most important tasks in a separation or a spin. It consists of the detailed legal entities, contracts, customers, employees, systems, intellectual property, and real estate that will transfer.

A deal perimeter is informed by the investor story to help define what is transferring / separating and, perhaps more importantly, what is not: this should not be viewed as an opportunity for spring cleaning poorly performing assets.

Entanglements between the parent and SpinCo span the obvious, such as shared bank accounts, insurance policies, and common investor relations functions. But there are non-obvious entanglements, too, such as shared cybersecurity infrastructure, ESG programs, and shared customer and vendor contracts.

One of the most effective ways to minimize inventory entanglements is by going through each function to understand what systems, people, contracts, and processes are shared. Once these are inventoried, a

detailed replacement strategy can be developed.

Two talent entanglement issues are common. The first is hiring too early, which creates duplicate costs and drags on the parent's earnings. The second is not differentiating between roles needed to support the spin process and those that are needed to operate the standalone business. Transaction and operating costs should be limited whenever possible.



Implement an appropriate operating model

Once the deal perimeter is defined, the operating model is effectively the “blueprint” for how an entity delivers value to customers, shareholders, and employees.

The target operating model helps define how the SpinCo will go to market, support its customers,

interact with vendors, manage employees, and run the day-to-day business. It also helps determine which systems, tools, and processes the SpinCo will need.

In our experience, it is important to make the big operating model decisions early, especially those

requiring long lead times like new IT, finance, or HR systems, those having tax and legal ramifications and those having employee implications.



Execute the operational separation quickly and efficiently

Once the deal perimeter and operating model have been defined, then comes the hard work of executing the actual separation. The degree of separation and, in turn, the commitment of time, money and resources to this separation, is one of the main differences between a spin versus a sale.

A sale typically requires limited separation activities, and it usually involves significant Transition Services Agreements for services that the

parent is obliged to provide. In contrast, when there is a spin, the businesses are largely separated across nearly every dimension: systems, legal structure, back-office, front-office, and employee/benefit plans. To achieve this, a detailed separation plan must be developed early on and executed efficiently.

We have only outlined a few of the complexities that must be tackled to achieve a quick and efficient separation. While these are not

necessarily dissimilar from a normal post-sale separation, the fact that the parent company is the one bearing the cost of the effort (and the risk of a failure) in a spin makes it imperative that they are successfully executed. Of course, on the flip side, a successful spin will also greatly benefit the parent and ensure maximum value creation for the shareholders.



To achieve a successful execution across these four elements, a separation team should include all key functions, including tax and finance teams.

How KPMG can help

There is more pressure than ever before to ensure deals deliver lasting results for stakeholders. At KPMG, we see transactions through an investor's lens and are focused on helping clients identify, evaluate and successfully implement their growth strategies in today's complex business landscape. Deals fail for any number of reasons. But you can realize the results you and your stakeholders desire by taking a deliberate, forward-thinking approach to deal planning, execution, and integration in light of your entire business, your sector, and the global economy.

When it comes to selling a business, a successful strategy requires active portfolio management and a well-planned exit or divestment process. Our Deal Advisory professionals are forward-looking specialists with a broad range of skills, deep industry expertise, and a view on the future, to help you stay in front of the issues and avoid loss of value.

We will help you focus on the key questions through the critical stages in planning and executing divestitures.

Transaction Services

Tax Deal Advisory



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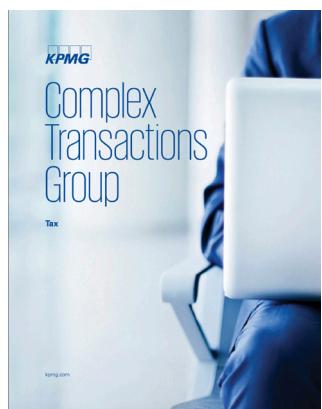
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