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Cash Sale

Carve-out IPO
(Minority stake)

Spin-off
(New entity created. Shareholders get shares in both)

Split-off
(Shareholders exchange parent shares for sub-shares)



Locked up value

Sum of parts are greater than whole

A group worth **500** – sell one of its subsidiaries for **200**

If the remaining group is worth **400**, the sum would be **600**

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Cash Sale

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Split-off
(Shareholders exchange parent shares for sub-shares)



Urgent need to **raise cash** by **selling assets**

Break into a new country

Change direction of business

Traded market price for the subsidiary

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Cash Sale

Carve-out IPO
(Minority stake)

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(New entity created. Shareholders get shares in both)

Split-off
(Shareholders exchange parent shares for sub-shares)



Shareholders want to sell **tax efficiently**

- No cash proceeds
- Shareholders can decide when

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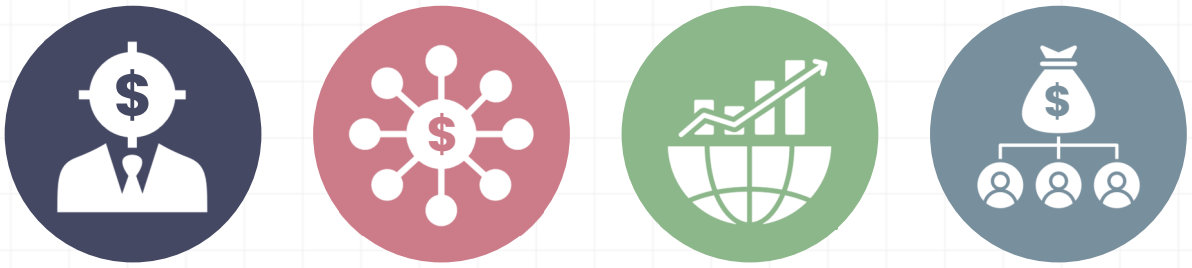
Divestiture Options – Pros and Cons



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There are many **pros** and **cons** to the various **divestiture** options:



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Private Sale to Strategic or Financial Buyer

Pros

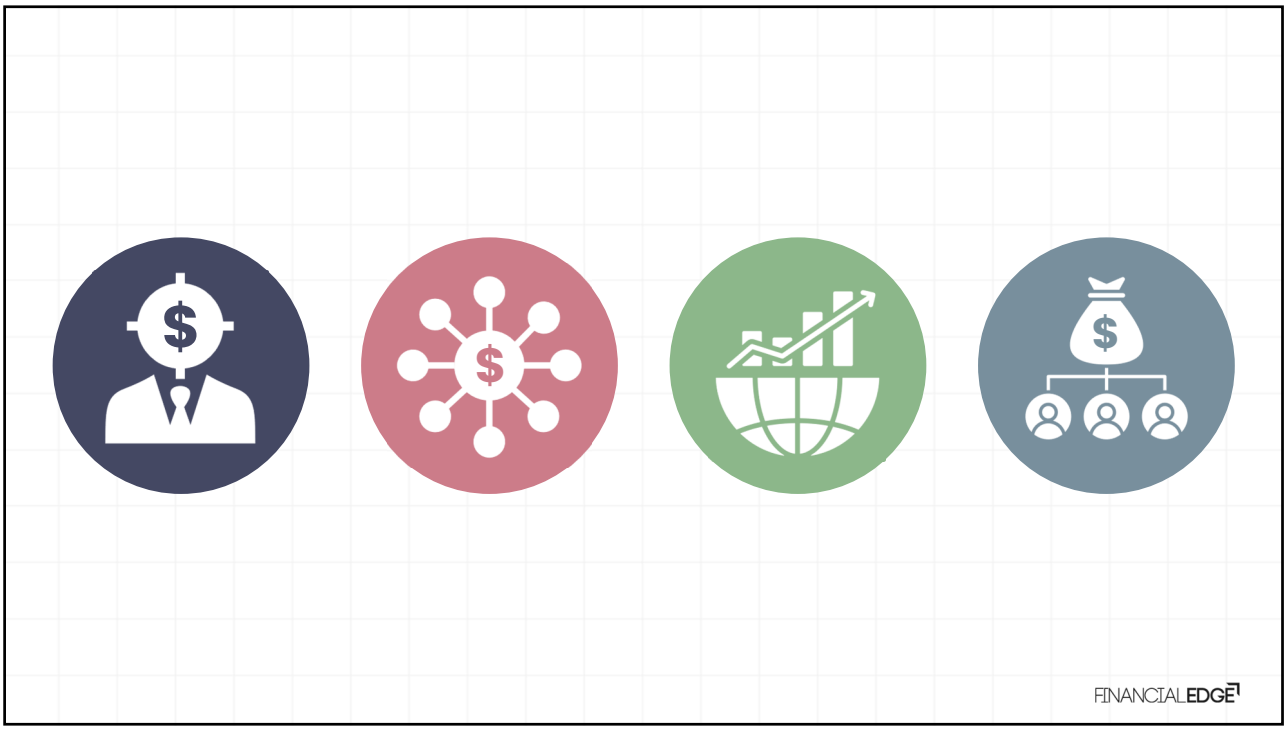
- Ability to **sell 100.0%** stake
- **Speed**
- Monetize **shareholding** and control **premium**
- **Confidentiality**
- Raises **cash** for seller

Cons

- Financial buyer needs **strong cash flows**, often no value for synergies
- Less confidentiality if **broad auction**
- **Consideration** can be a mix
- **Tax** issues

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IPO

Pros

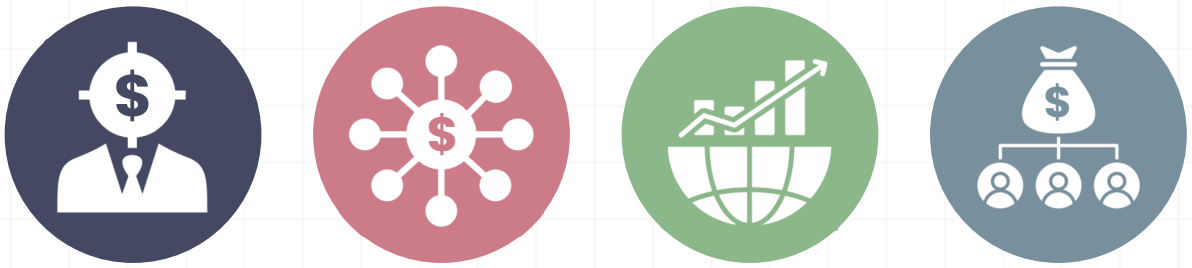
- Broaden **shareholder base**, continue to participate in **future growth**
- Establish **market value** of subsidiary
- Sale of **minority stake** only, sell down later
- Can provide **acquisition** currency
- Secondary share **sale raises cash** for seller

Cons

- IPO **discount**
- **Attractiveness** of business
- Size of **offering** might be **limited**
- Cost of **listing/continuing** obligations
- **Tax** issues

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Spin Off

Pros

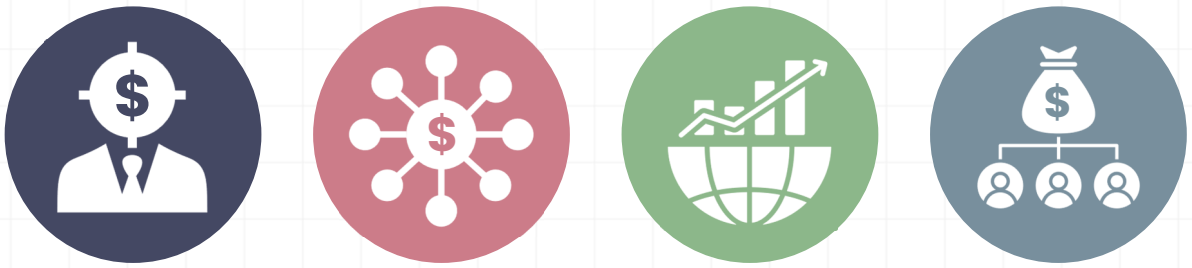
- Shareholders in group receive **separately listed shares** in subsidiary
- Shareholders retain **control premium**
- Possibility of **leveraging up** subsidiary pre-deal
- Potential for **tax free** transaction

Cons

- **Valuation of subsidiary** needs to be established
- Cost of **listing/continuing** obligations
- Lack of cash flow to parent if **debt push down** not possible

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Carve Out Followed by Spin Off

Pros

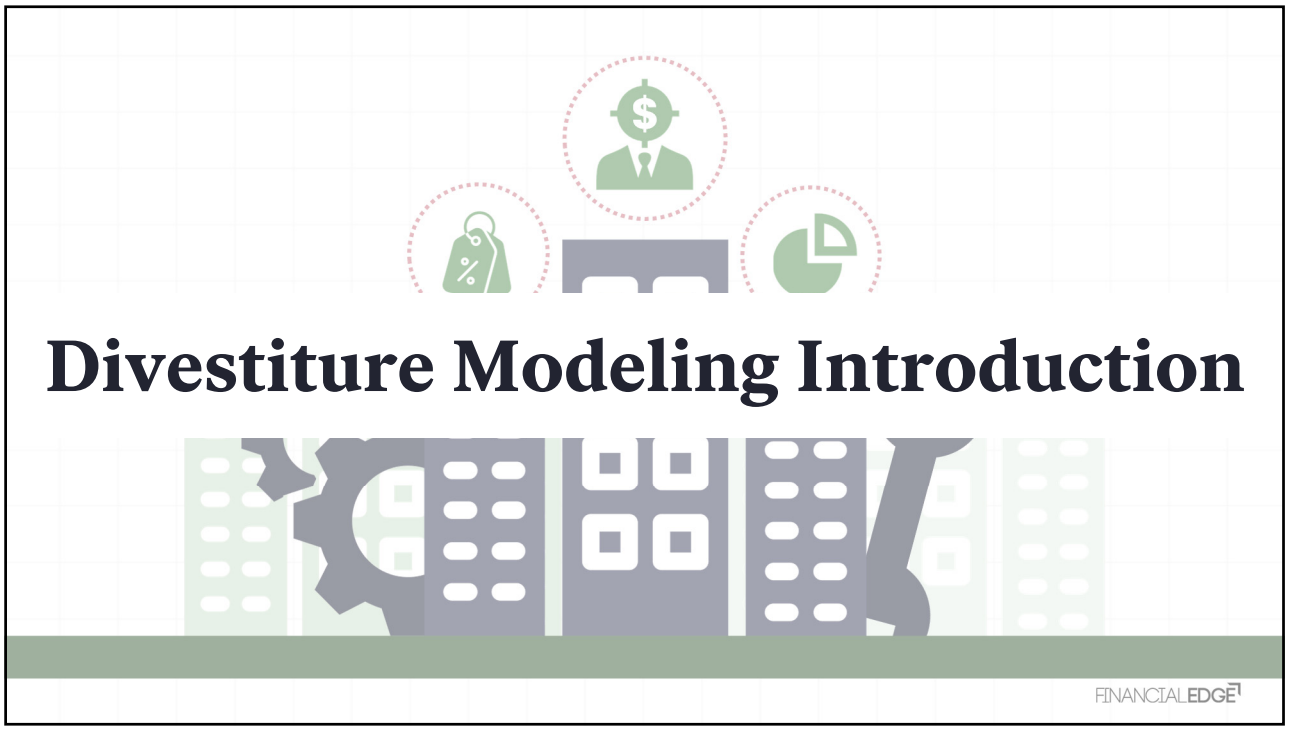
- Establishes **market value** of subsidiary first
- Initial IPO can provide **cash to parent**

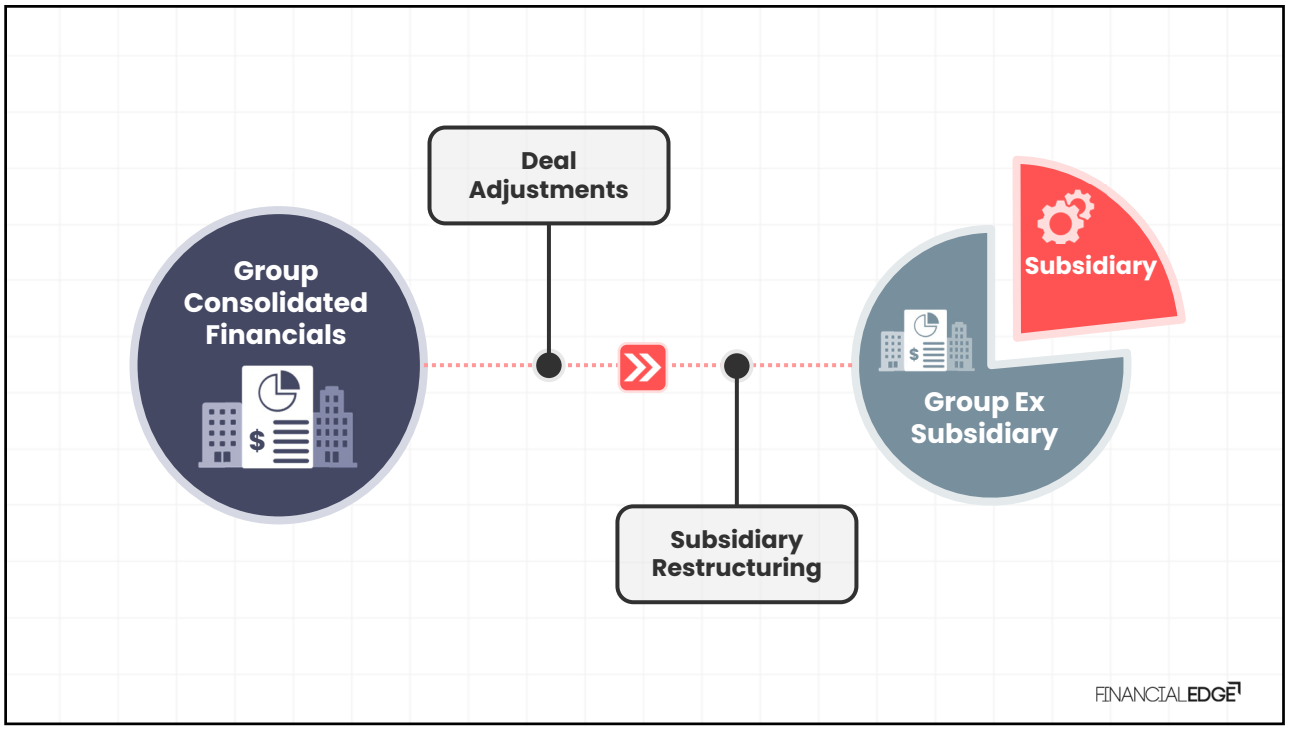
Cons

- Potential **tax** issues
- Lack of **IPO market**

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Accounting treatments differ for **divestiture options**

Private sale

IPO

Spin off **with** or **without** carve out

Assess **post tax return** generated by use of **proceeds** vs **ROE** sold

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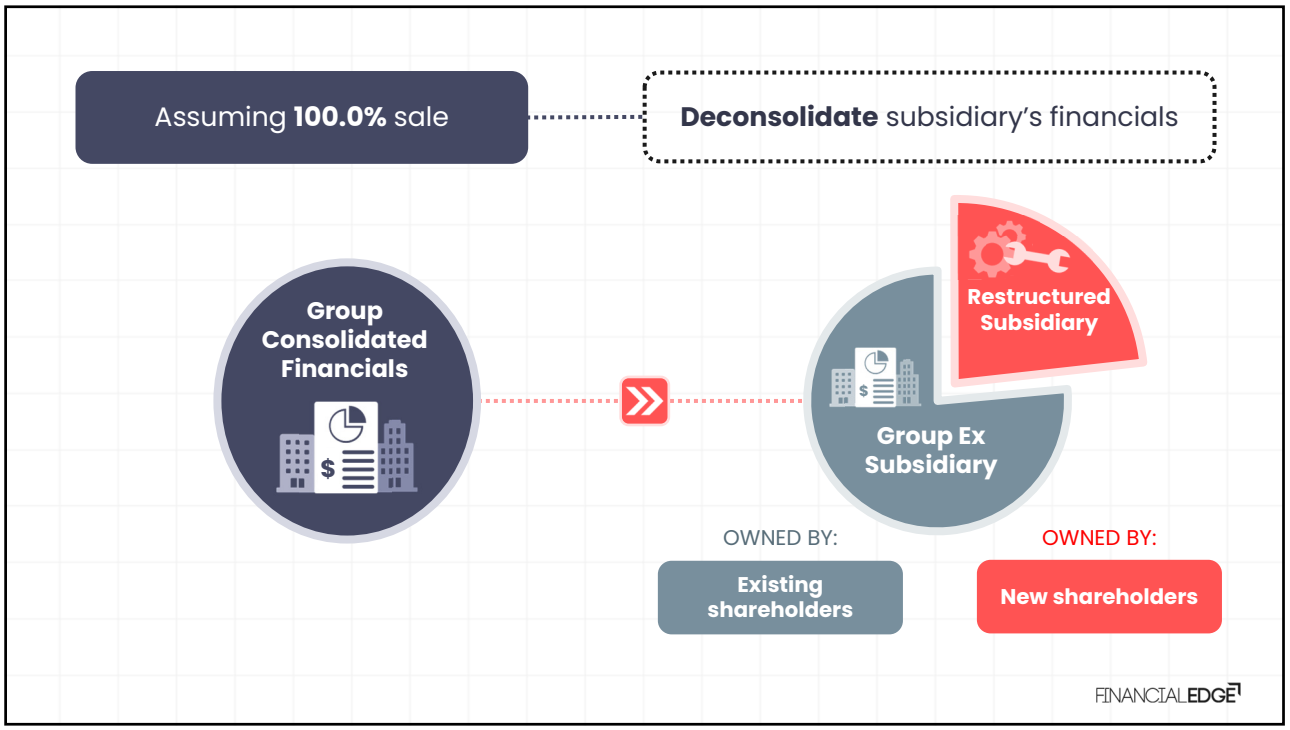


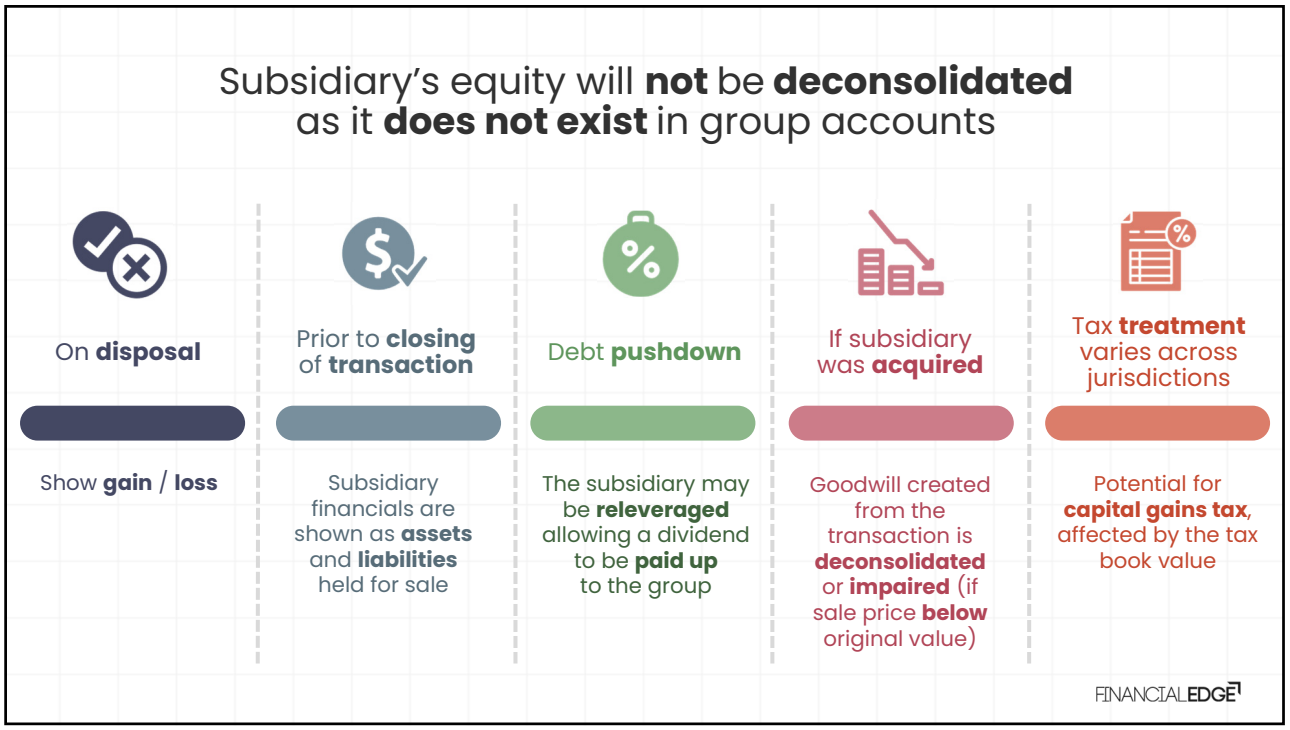
Private Sale



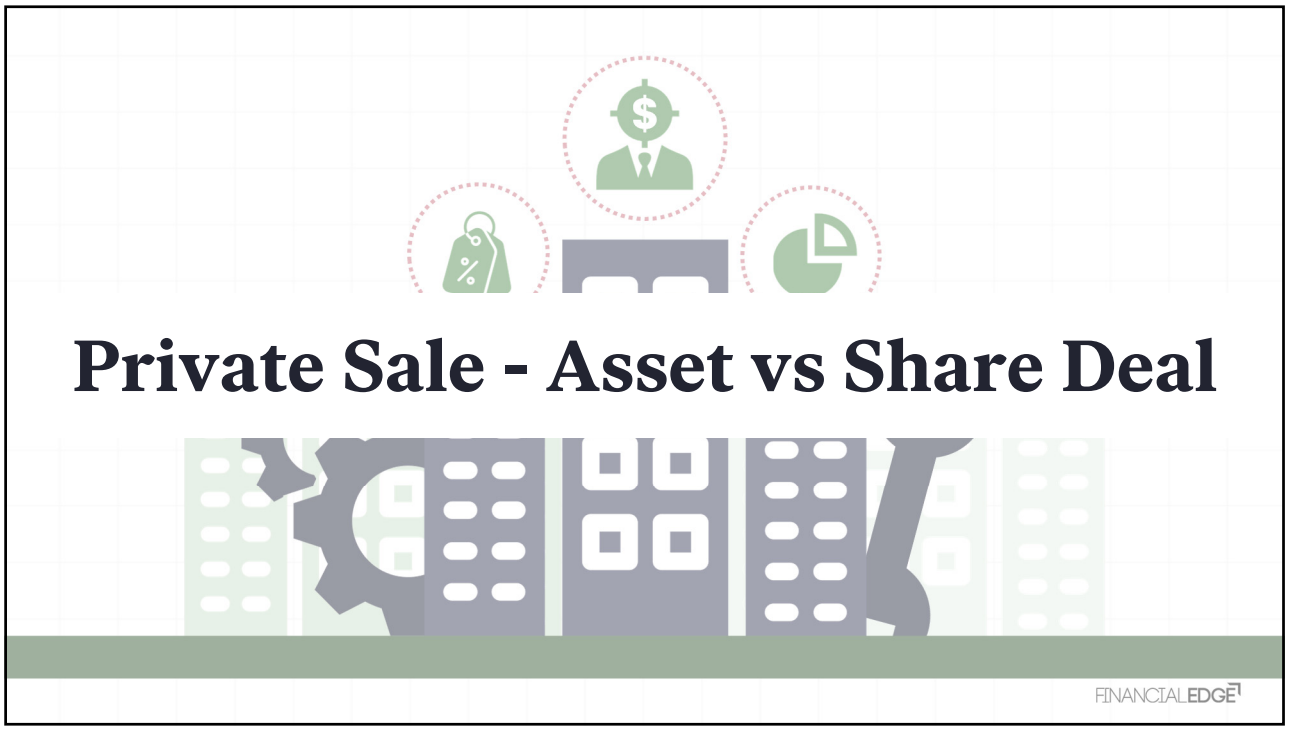
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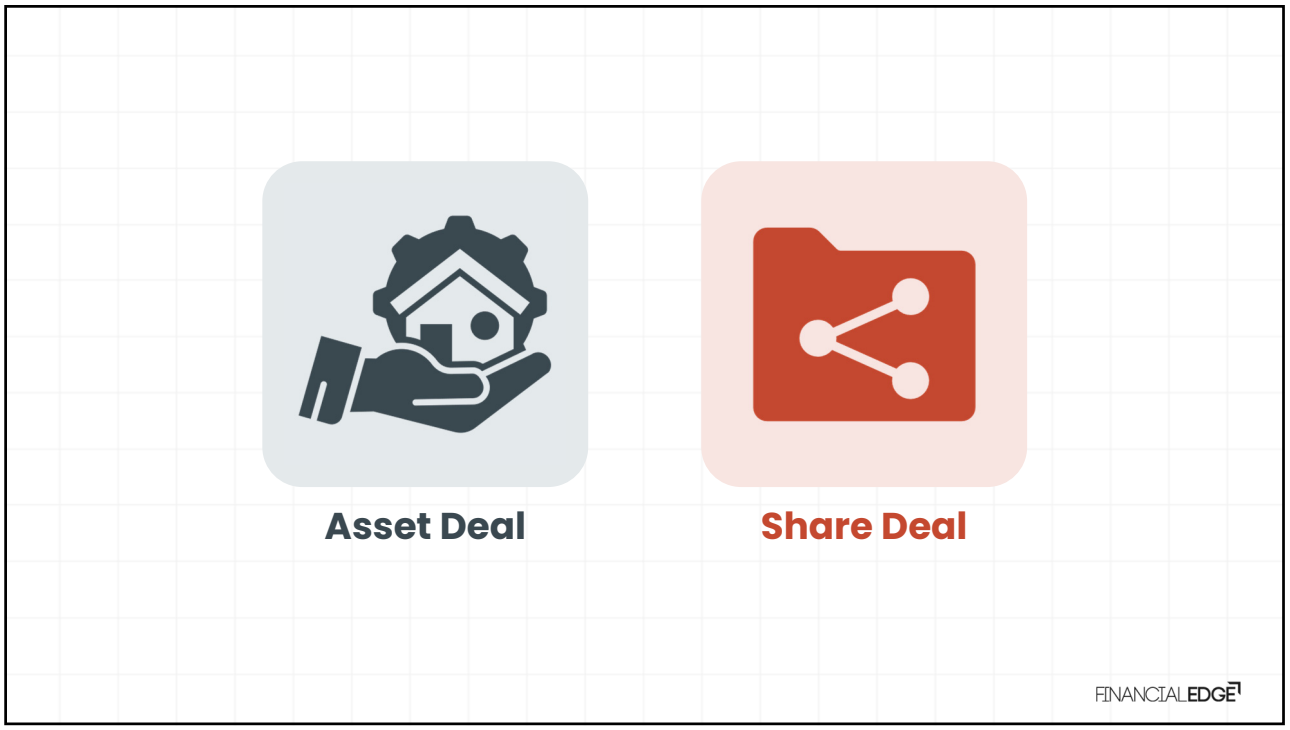
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Asset Deal

More **complex transactions**

Assets (or groups of assets) have to be **identified separately**

Legal **entity** remains with **seller**

Typically retains **long-term debt**

Cash is not included in **sale of assets**, cash free debt free

Buyer receives **tax benefits** of asset step ups

Generates **higher taxes** for the seller

Could be taxed twice – at **corporate** and **shareholder** level

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Asset Deal



Share Deal

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Share Deal

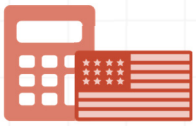


Most **private sales** are structured as share deals



Buyer will not receive **tax benefits** of asset step ups

Ownership of the assets has not changed



US tax code allows for share deal to be structured as **asset deal**

Buyer willing to pass on some of **tax benefit** to seller

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Private Sale – Book vs Tax Basis



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Book vs Tax Basis

General Rule



If **shares** are **received** in consideration for **sale**, the gain is **not taxable**, only when **shares are sold**

Dependent on jurisdiction

If Disposal is Taxable



Capital gains tax will be charged on **gain above tax basis**, not the book value of the **company acquired**

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How Do We Work Out That Tax Basis?

1



Tax basis - value in **seller's tax** accounts. Often not available **pre due diligence**

2



Financial statements provide **book basis**

Tax basis capital gain = 150

Book basis capital gain = 100

3



Tax expense in **seller's income** statement will always **reflect gain** on **tax basis**

Results in different **effective tax rate (ETR)**

Permanent difference between **accounting** and **tax rules**

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Divestitures and Tax - Examples



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Year 0	Year 25	Year 31	Year 33	Total
Nestlé **acquires** Alcon	Nestlé **IPO's** 23.0% of Alcon	Nestlé **sells** 25.0%	Nestlé sells **remaining 52.0%** to Novartis	Proceeds received
$0.28bn	**$2.3bn**	**$11.0bn**	**$28.3bn**	**$41bn**

No tax was paid on the gain, despite the **low tax base,** due to Nestlé's **long holding period.**

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Kraft **sells pizza** business to Nestlé

Proceeds $3.7bn

But pizza business had **zero tax** base.
Net proceeds only **$2.5bn**.

EV / Pre-tax earnings multiple

$3.7bn / $0.28bn = 13.2x

$2.5bn / $0.28bn = 9.0x

Warren Buffett

"I feel **poorer**...Kraft sold a very fine pizza business and they said that they got **$3.7bn** for it. But after tax that business was **sold for $2.5bn** and earned **$280.0m pre-tax** last year... **9.0 times pre-tax** earnings."

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Capital Gains Tax – Selected Countries



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Country	Pros
Germany – 30.0% to 33.0%	• Capital gains are generally included in taxable income • Capital gains on sale of domestic or foreign sub generally are 95.0% tax exempt
France – 38.0%	• Capital gains are generally included in taxable income • Capital gains on disposal of sub 88.0% tax exempt if seller has owned a substantial shareholding (over 5.0%) for at least 24 months
Italy – 27.5%	• Capital gains are generally included in taxable income • Capital gains on sale of investment generally are 95.0% tax exempt as long as the investment has been owned over at least 12 months • Additional restrictions apply
Netherlands – 25.0%	• Capital gains taxed at normal corporate income tax rate • Capital gains from selling shares in a company (if ownership was above 5.0%) generally tax exempt – some additional conditions need to be met
Spain – 25.0%	• Capital gains taxed at normal corporate income tax rate • Capital gains on disposal of domestic or foreign sub tax exempt if seller has owned at least 5.0% of shares before disposal for at least 12 months (some additional conditions need to be met
UK – 20.0%	• Capital gains are generally included in taxable income • Capital gains on disposal of domestic or foreign sub tax exempt if seller has owned at least 10.0% of shares before disposal for at least 12 months
US – 35.0%	• Capital gains are generally included in taxable income • S 338h10 election

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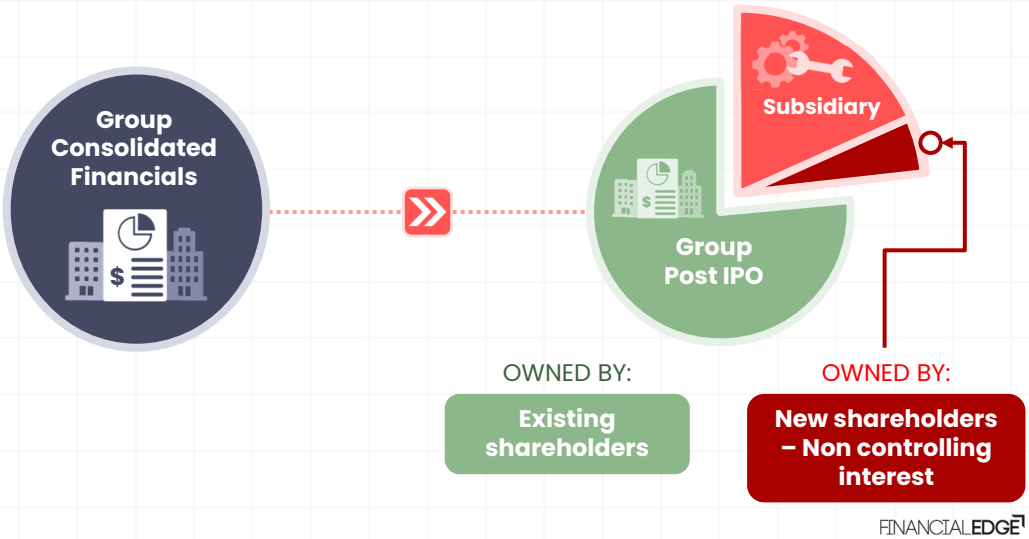
Initial Public Offering



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IPO is usually a sale of a **minority stake** – **primary** or **secondary** shares



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Initial Public Offering

Full consolidation occurs as **control remains** with the **group**

Minority stake sale results in **non-controlling interest** in group accounts

Assets

Liabilities

As control still remains with group – **no gain** or **loss** in income statement

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Initial Public Offering

If forecasting group financials, consider **subsidiary's dividend** policy

- Cash outside the group
- Leakage

Separate listing provides **liquidity** for **secondary issues** and potential **M&A**

Potential for **debt push down**

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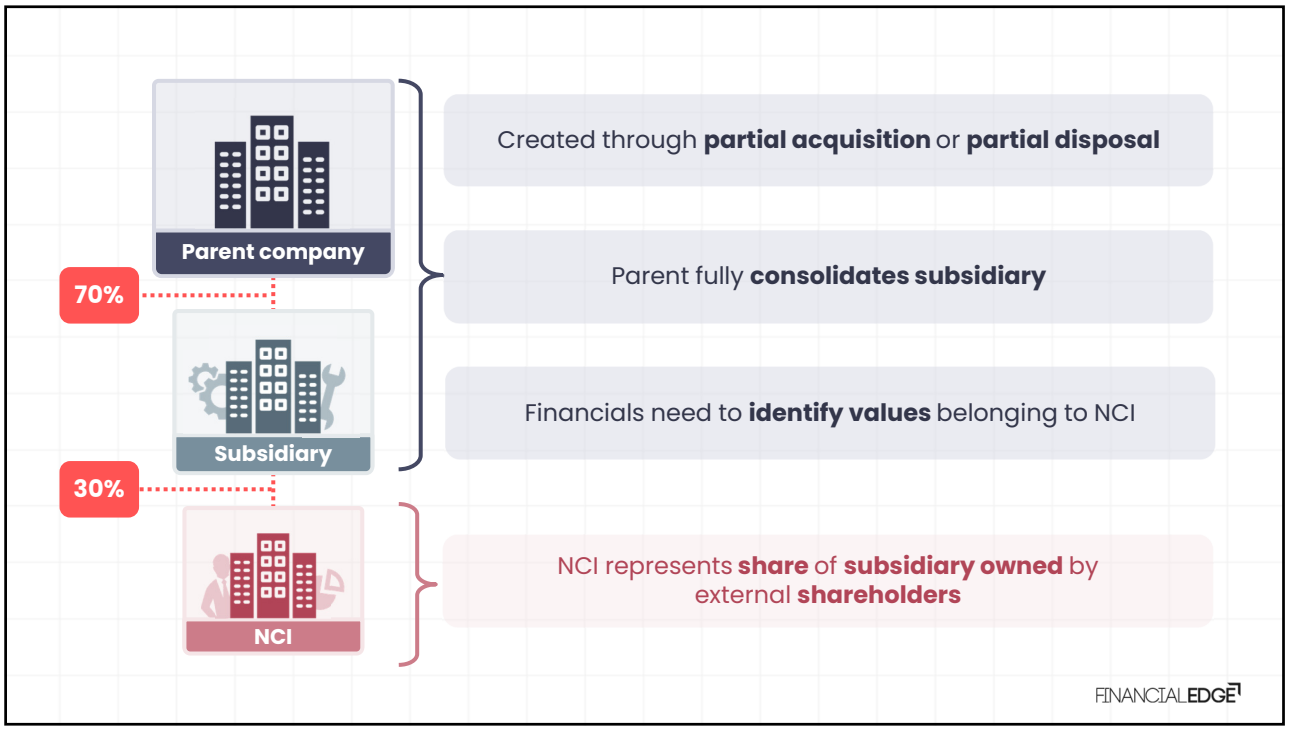


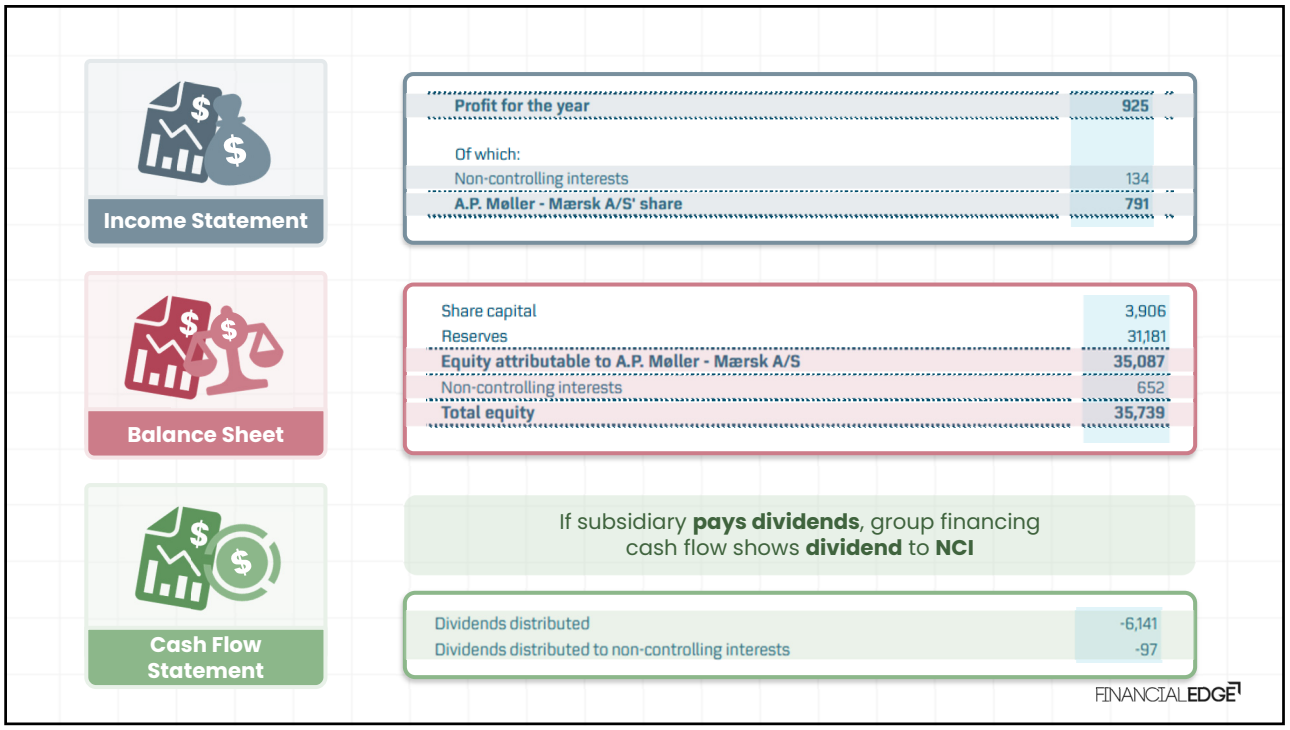
Non-Controlling Interest



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Assets and liabilities are **fully consolidated** by acquirer

Non-controlling interest **forms part of consolidated equity** unless it is redeemable (put option scenario)

Equity and liabilities			
Share capital		161	164
Additional paid-in capital		3,505	4,132
Retained earnings		11,817	11,454
Cumulative translation adjustments		(1,501)	(1,177)
Accumulated other comprehensive income		(427)	(260)
Treasury shares and DANONE call options [a]	13.2	(1,859)	(1,707)
Equity – Group share		**11,696**	**12,606**
Non-controlling interests	3.1 to 3.6	49	63
Consolidated equity		**11,745**	**12,669**
Financing	10.1 to 10.3	6,238	7,835
Derivatives – liabilities [b]	12.4, 12.5	11	4
Liabilities related to put options granted to non-controlling interests	3.6	349	248
Non-current financial debt		6,598	8,087

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Non-Controlling Interest Valuation



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Accounting Jurisdictions

US GAAP

Fair value – use minority stake valuation methodology:

- DCF
- Clean share price
- Comparable company analysis



Changes in fair value after the **first consolidation** are **ignored**

Effectively creates **goodwill** on **NCI**

- Subsidiary and equity book value = 10
- We own 90% and NCI owns 10%
- Book value NCI = 3

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Accounting Jurisdictions

IFRS



Fair value



Percentage of **fair value** of **net assets** (old method)

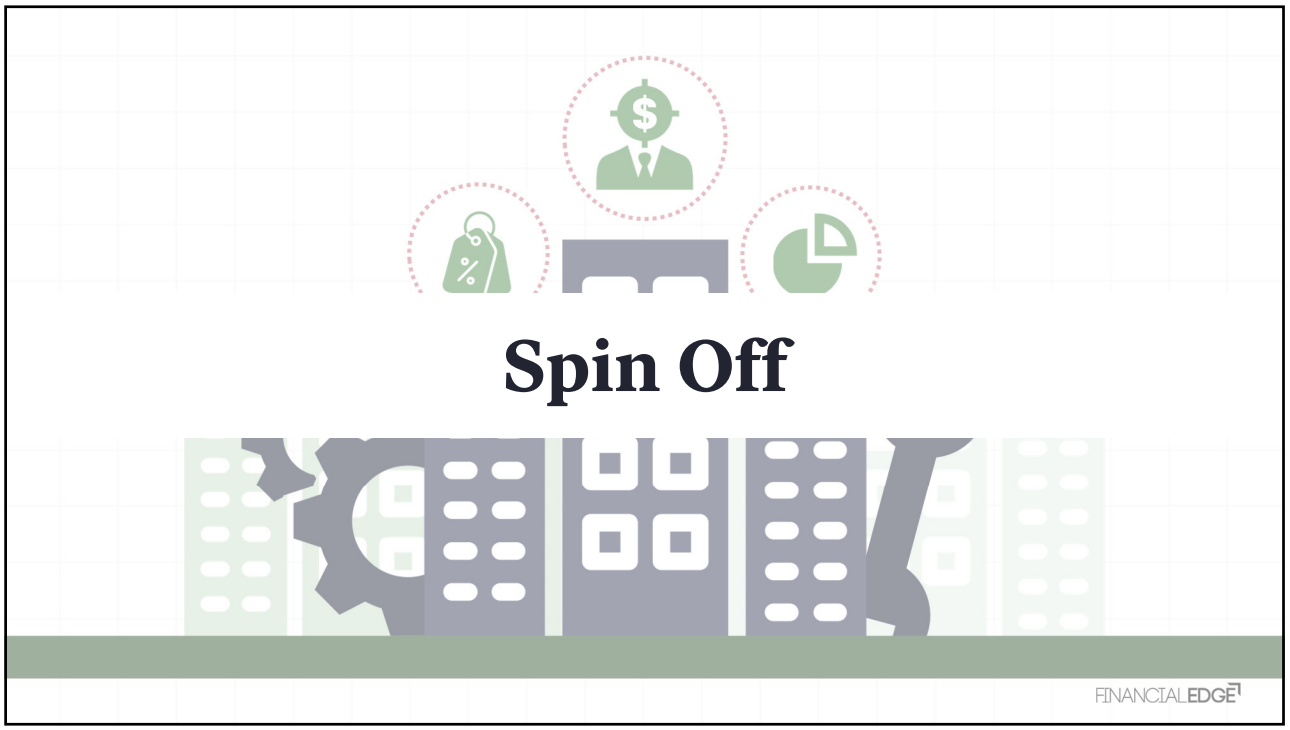
- NCI value = 1



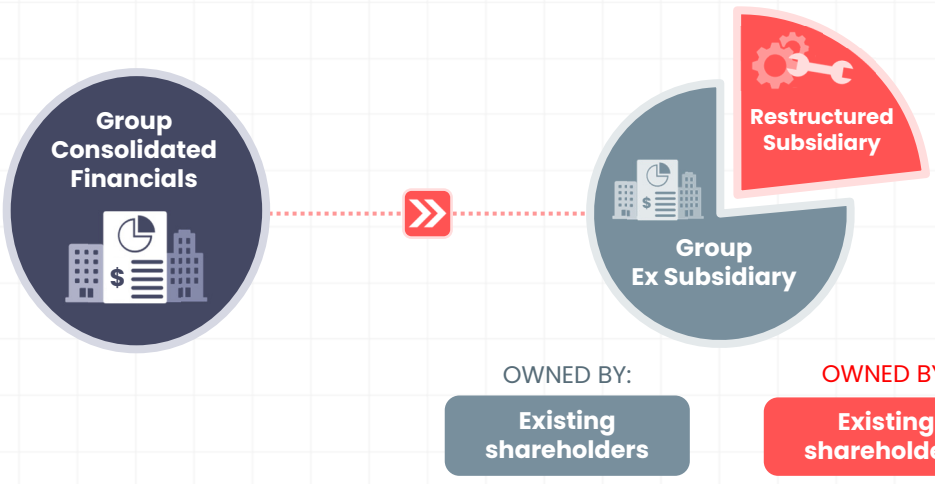
Changes in fair value after the **first consolidation** are **ignored**

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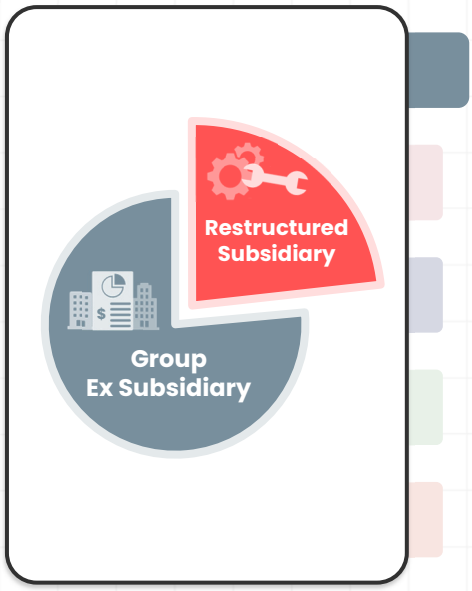
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In the **spin off**, we're going to **divest** one of those subsidiaries.



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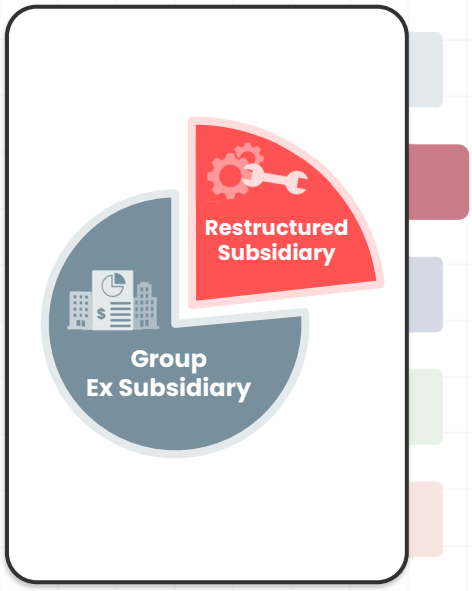


No Cash to Group

No cash to group – **capital structure** reorganization crucial for **cash extraction**

- Push debt down
- Pay up a dividend

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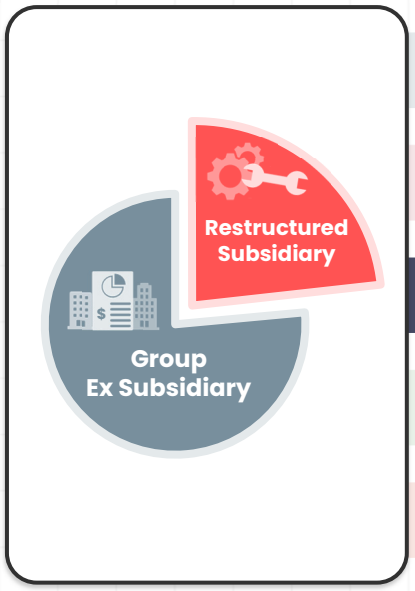
Tax Free Transaction

Transaction treated as **dividend** in kind from group perspective - subsidiary is **deconsolidated**

- No gain or loss
- Unless fair value

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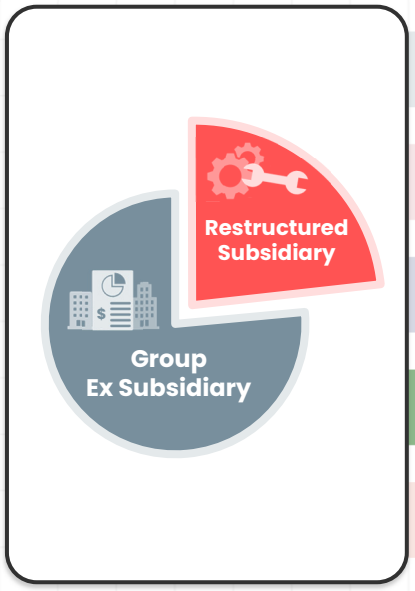


Control Premium

Retained by **existing shareholders**. If subsidiary had originally been acquired:

Goodwill will be included in net assets to calculate the gain or loss

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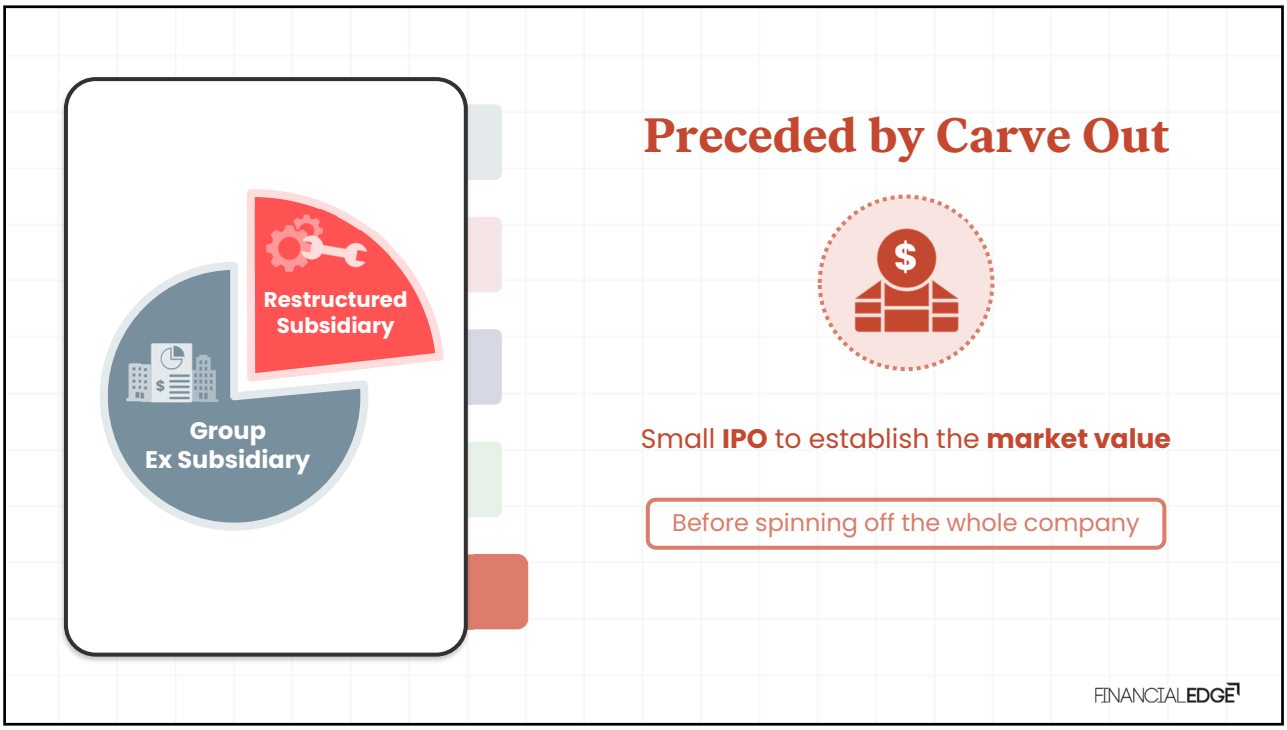
Separate Listing

Provides **liquidity** for:

- Secondary issues
- Potential M&A

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