J.P.Morgan

CFA Trending Topics

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Spin-off structuring to maximize proceeds and achieve capital structure objectives

Key takeaways:

- U.S. companies typically pursue spin-offs to maximize value of business divisions.
- Parent companies can generally receive SpinCo debt proceeds tax-free in a spin-off through the use of basis or other structuring techniques.
- The tax-free spin-off rules allow the Parent to retain up to 19.9% of the stock for a period of time (usually 12 months).
- These “retained shares” can be used by Parent to achieve capital structure objectives including liability management and share repurchase using the techniques described below.

In an equity-for-equity exchange, the Parent offers to acquire its own shares from Parent stockholders in exchange for the retained SpinCo shares, offering a discount on the SpinCo shares to incentivize participation in the exchange. Discounts depend on market conditions and other factors, with precedents in the 10-20% range. In a debt-for-equity exchange, the Parent exchanges the retained SpinCo shares for Parent debt. Specific parameters of the transaction are usually covered by an IRS Private Letter Ruling, but in general the transaction steps are: (1) banks acquire Parent debt for cash (sometimes involving a third-party tender for bonds); (2) banks hold the debt for at least 14 calendar days (tax requirement); (3) banks exchange Parent debt for SpinCo equity; and (4) immediately thereafter, banks sell the SpinCo stock pursuant to a marketed follow-on offering. The discount in a debt-for-equity exchange is typically the same as it would be in a regular-way follow-on offering – ranging from a few percentage points to 10%, depending on market conditions. In the debt-for-equity exchange, SpinCo shares are sold to public investors at a potentially lower discount, and Parent debt is retired (instead of Parent equity).

On June 21, J.P. Morgan completed a debt-for-equity exchange for MetLife of its 19.2% retained stake in Brighthouse Financial, after evaluating various alternatives for the retained stake. The equity priced at a file/offer discount of 3.3%, a discount to last sale of 1.7%, and an “unaffected” discount to the pre-tender launch price of 8.1%. The overall result helped achieve MET’s publicly-announced capital structure goals: a tax-efficient disposition of the Brighthouse stake, retirement of nearly $1bn debt, and use of available liquidity to repurchase MET shares.

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