Strategies for successful corporate separations

Goldman Sachs

EY
Building a better working world

CONTENTS

EXECUTIVE SUMMARY

Corporate separation activity has been growing at an outsized pace, especially in recent years. This increased activity is evident across companies of all sizes, industries and geographies. The allure of these transactions continues to attract company executives, investors and other stakeholders. But what is prompting the increase and do corporate separations lead to an increase in long-term value?

These are the questions Goldman Sachs and EY teams have sought to answer. As leading advisors in this space, our two organizations have collaborated to develop comprehensive insights and data analytics on spin-offs and demergers: what corporate separations are; why a company would consider separating; when the optimal time is to execute; whom it impacts; and importantly, how a company can maximize value in a corporate separation.

Our research combines quantitative analysis of more than 160 global transactions from 2012–2022 in which the business being separated had a market capitalization greater than US$1 billion, as well as firsthand interviews with some of the world's top executives who have experience with corporate separations.

We define a corporate separation as a capital markets separation of a subsidiary business. A capital markets separation offers companies a "do-it-yourself" or "self-help" alternative to optimize their portfolio without needing a buyer. We have assessed corporate separations in terms of total shareholder return for the ParentCo pre-separation, and across the two resulting businesses post-separation — RemainCo and NewCo. Our analysis shows that when corporate separations are executed well, they can lead to an excess blended return of roughly 6% from announcement to two years post-close as compared with their respective company's sector index.

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Factors that contribute to the success of a corporate separation include:

- Dedicated management focus and distinct strategic priorities of the businesses being separated
- Independent access to capital and realigned capital allocation priorities that are tailored to the respective financial profiles
- Pure-play asset exposure for investors
- Clear communication with stakeholders on go-forward strategy and the "equity story" of the businesses

Executives should proactively and regularly conduct portfolio review exercises. Although various objectives may trigger a decision to separate, executives should ideally make the decision from a position of strength. Corporate separations can be complex and bespoke. To prepare your organization for a successful execution, we have outlined several leading practices that executives can follow.

David Dubner
Global Head of
M&A Structuring
Goldman Sachs

Sharath Sharma
Global Vice Chair of
Strategic Transformations
EY Organization

WHY COMPANIES PURSUE CORPORATE SEPARATIONS

> “I look at a company through two lenses: a strategic lens to proactively optimize the company, and the other lens of risk assessment. Risk and strategy should be tied together. Of the 17 transformative deals of my career, about half I did because there was a risk. The other half were proactive decisions.
>
> **Ed Breen,** Executive Chairman and Chief Executive Officer, DuPont

Companies typically separate a business when they believe that the two companies are worth more separately than together as one company, and that the separation will create long-term value for all stakeholders.

Through proprietary research and interviews with leading executives, our findings suggest that companies seek to separate either to seize an opportunity or to manage risk. More specific objectives may include:

STRATEGIC

- Enhanced management focus
- Flexibility to pursue divergent strategies
- Repositioned equity story and established own equity currency

OPERATIONAL

- Reimagine and transform operations
- "Shrink to grow" through organic and inorganic opportunities
- Industrial, geographic and sustainability repositioning (incl. ESG)

FINANCIAL

- Efficient capital allocation strategy
- Optimized capital structure
- Access to capital markets

STAKEHOLDERS

- Pure-play investment opportunity for investors
- Attract distinct research coverage
- Recruiting and retaining employees

Corporate Separations 101

We define a corporate separation as a capital markets separation of a subsidiary business (NewCo). A parent company (ParentCo) may execute this through a prorata distribution of shares in NewCo to its shareholders (spin-off) or through an initial public offering (IPO) of the subsidiary business (carve-out IPO) followed by a back-end exit. As a result of the corporate separation, the separated business operates as a stand-alone public entity with its own equity currency and access to capital markets. In the US, these corporate separations are generally structured as tax-efficient spin-offs. Outside the US, they tend to be structured as demergers.

Companies customize these structures to meet certain corporate objectives or jurisdictional regulations. Structuring features may include:

- ParentCo retaining a stake in NewCo to further optimize capital structure
- Raising capital in NewCo at the time of separation via a sponsor investment to provide capital and investor support
- Distributing NewCo shares in exchange for ParentCo shares via a split-off to provide shareholder choice and manage earnings per share dilution and dividend payout

The popularity of corporate separations is on the rise

Although corporate separations have been around for decades, they have been given new prominence in a portfolio review strategy in recent years. In 2022 alone, there were 30 announced global separations, representing approximately 17% of announced transactions in the last decade.

Through the 2010s, following the global financial crisis, companies embraced a philosophy that bigger was better. This drove nearly a decade of mega-merger activity and portfolio diversification. As a result, today's corporate portfolios are as complex as they have ever been. Approximately two-thirds of companies listed on the S&P 500 index have three or more business segments with over $500 million in revenue.

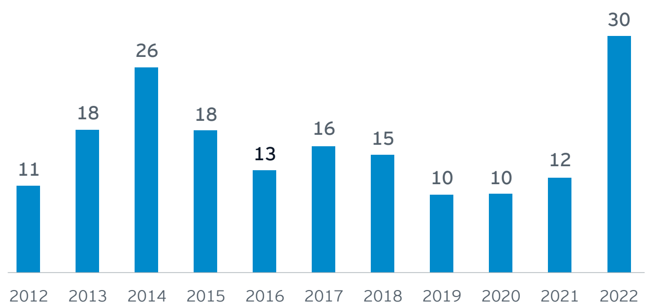
According to the latest EY CEO Outlook Survey, 48% of global CEOs expect to actively pursue a divestment, spin or IPO over the next 12 months.

Source: EY CEO Outlook Pulse March-2023

More recently, the pandemic and financial market uncertainty, coupled with challenging operating and competitive conditions, have led companies to rethink their priorities and evaluate options to reposition their portfolios for success.

After a decade of low cost of capital with US federal funds rates near zero, the rapid increase to an over 5% rate benchmark is having a material impact on growth priorities and associated capital allocation and portfolio decisions.

Number of announced transactions by year*



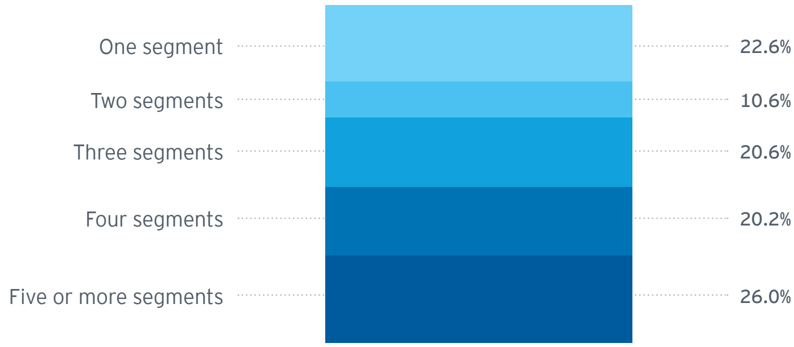
>US$1.2t

of separation transactions closed since 2012

Source: Company filings, CapIQ and other publicly available information.
**Chart represents data for 179 announced transactions.*

"We expect an elevated cost of capital and continued investor emphasis on profitability will support further spin-off activity in 2023." Goldman Sachs research

S&P 500 constituents by number of segments



Source: Company filings, CapIQ and other publicly available information.

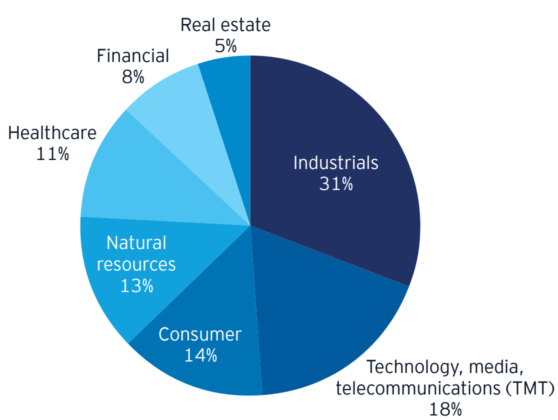
47% of separation transactions closed from 2018-22 valued >US$5b, up from 34% in 2012-17

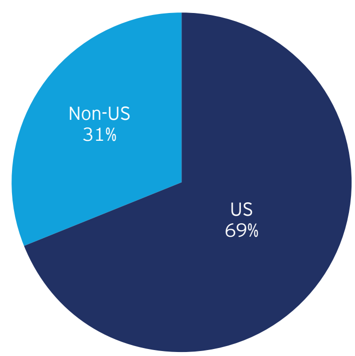
36% of separation transactions closed since 2019 with NewCo market cap >30% of ParentCo at close

As companies evaluate their portfolios, their options include a capital markets separation and sale to a strategic or financial buyer. We see companies increasingly employ dual-track processes where there is an announced separation coupled with buyer engagement prior to or following such an announcement. A corporate separation such as a spin-off or demerger can be a "do-it-yourself" or "self-help" alternative to reconfigure portfolios as it is not dependent upon a counterparty.

Corporate separation transactions are size-, industry- and geography-agnostic. However, we have seen an increase in the relative size of corporate separations in recent years. Nearly half of transactions that closed between 2018 and 2022 were valued greater than US$5 billion while only a third were valued at this level between 2012 and 2017. Two industries stand out in recent corporate separation activity: Industrials and healthcare represent roughly 50% of globally announced separations in 2022.

Separation transactions by industry and geography (2012–22)*





Source: Company filings, CapIQ and other publicly available information.
**Charts represent data for 179 announced transactions.*

HOW TO MAXIMIZE VALUE CREATION IN CORPORATE SEPARATIONS

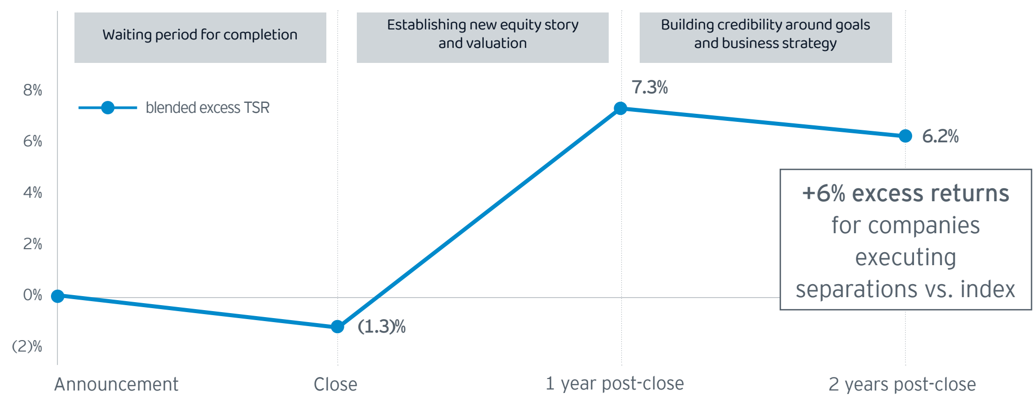
The goal of a company is to create long-term value for stakeholders. In a corporate separation transaction, long-term value creation occurs through the following:

- Dedicated management focus and strategy, which facilitates operational transformation and increases operational efficiencies, including improvements in revenue growth; operating margins; selling; general and administrative expenses (SG&A); return on invested capital; and better project investment decisions.
- Independent access to capital markets and establishing a separate equity currency. This allows companies to tailor their capital structure and allocation priorities appropriately.
- The creation of pure-play companies, which provide greater transparency for investors who are looking to hold specific classes of assets and allow them to invest more efficiently.
- Clear communication with stakeholders on the equity story of the ndependent businesses.

Based on our analysis of more than 160 transactions, corporate separations lead to an average blended excess return of approximately 6% over the respective sector indexes for the period of two years post-close of transaction. Some of this return is influenced by merger and acquisition (M&A) opportunities, where the businesses may either be a target of or grow their business through M&A.

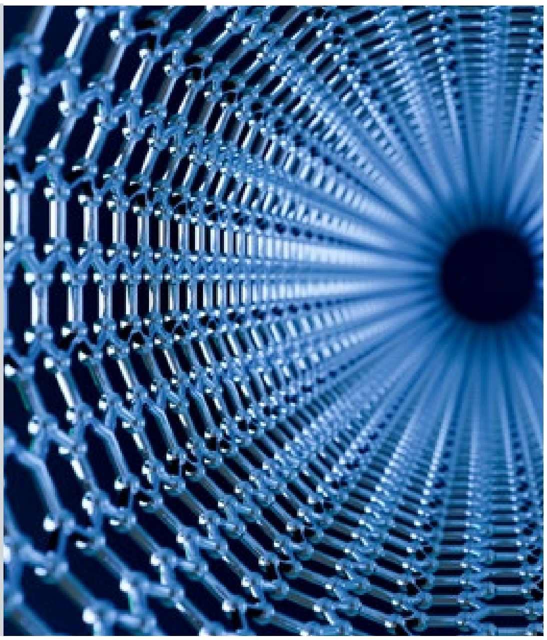
Although not to the level of US transactions, our research indicates that non-US transactions also outperform, with excess total shareholder return (TSR) of approximately 3%. Given the recent popularity of non-US separations, we expect continued increases in transaction volume outside the US.

Total shareholder return vs. sector index



Source: Company filings, CapIQ and other publicly available information.

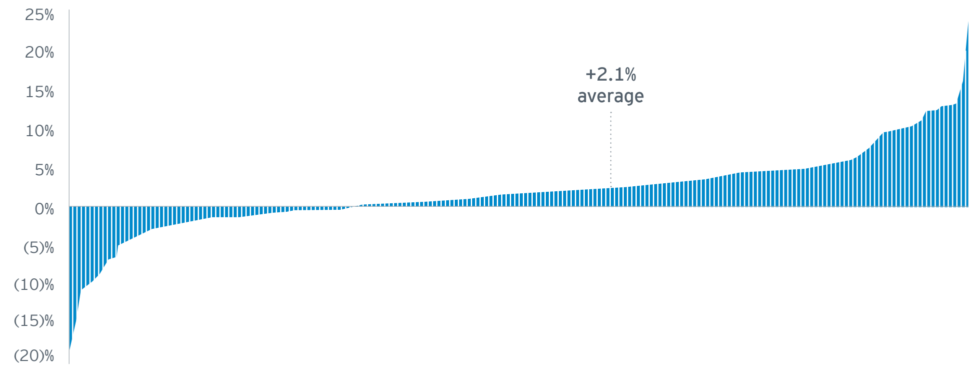
Excess TSR is defined as the change in the company's stock price relative to the change in a benchmark index (i.e., relevant sector index in the S&P 500) and dividends paid out over the same period. Our analysis measures the performance over the period from the day before the separation announcement to two years post-transaction close including: the increase in ParentCo share price from announcement to close; ParentCo dividends paid between announcement and close; increase in RemainCo and NewCo share price or combined market cap from close to two years post-close; and dividends paid by RemainCo and NewCo for the two years post-close.



In the short term, we can see the benefits of a separation through the market reaction on announcement. On average, there is a 2.1% increase in ParentCo share price vs. the broader index (relative to the relevant sector indexes) at the time of announcement.

~70%
had a positive reaction on announcement (relative to sector benchmark)

Parent share price reaction vs. sector index at announcement



Source: Company filings, CapIQ and other publicly available information.
**Includes pending and closed transactions that have announced since 2012.*

The rationale for this positive reaction to a corporate separation announcement is simple: Investors understand that separations lead to an optimized portfolio at ParentCo and the creation of more focused and pure-play businesses, which results in better returns.

We typically see a significant increase in TSR immediately post-separation as this is the first opportunity investors and research analysts have to be able to independently value the two businesses. It is essential for both businesses to effectively communicate their business strategies, and also to set and achieve realistic financial targets to build credibility. While long-term outperformance is not guaranteed, the strategic vision and decisions executives make pre-separation are critical. The key metrics that drive long-term outperformance are revenue growth and improved operating margins.

There are five areas where companies should focus their efforts to maximize long-term value for shareholders.

CASE STUDY

Active portfolio management: DuPont

As an active player in the M&A market, DuPont has demonstrated the benefit of proactive portfolio reviews. In 2015, Dow and DuPont announced a merger of equals followed by a three-way split into three public companies: Dow (materials science business), Corteva (agriculture) and DuPont (specialty products). The spin-offs, which were completed in 2019, resulted in three market-leading Fortune 250 companies.

In more recent years, DuPont has continued to engage in frequent M&A with divestitures of the nutrition and bioscience, and materials and mobility businesses. DuPont has used the capital generated from these transactions to reposition the company as a market leader in electronics, industrial technologies and next-generation automotive materials exemplified by the 2021 acquisition of Laird Performance Materials.

> “When we decide to undertake a separation, we do it for the long-term strength of the company. Some people spin to get rid of a weak link. I never do that. I want NewCo to be the best in the industry. I want to give them a chance to rock and roll.

Ed Breen
Executive Chairman and Chief Executive Officer, DuPont

Reimagining NewCo and RemainCo during separation execution

Corporate separations are catalysts to reimagine RemainCo and NewCo to maximize long-term value.

One of the main reasons companies separate businesses is to allow each to tailor their operations in accordance with their business requirements and priorities. When a company is executing on a corporate separation, there is a strong argument for both RemainCo and NewCo to seize the opportunity to fundamentally reimagine their operations, from decisions on organizational structure to decisions on fit-for-purpose technology.

Ideally, ParentCo leaders will identify operational improvements and cost optimization initiatives for both RemainCo and NewCo pre-announcement to provide ample time to implement during the execution phase. However, once there is a transaction announcement, the clock starts ticking and the markets are eager for the transaction to close. Consequently, companies can find themselves deprioritizing these same improvement initiatives that are the very source of value creation. Instead, ParentCo leaders should use the execution period to activate transformation initiatives for both RemainCo and NewCo, rather than taking a more expedient but less optimal "clone-and-go" approach. A best practice is to pursue high-value and complementary minitransformations to impact growth and gross margins. These areas are not typically impacted by corporate separations and can be pursued in tandem with the separation to generate value in the first year post-separation. However, companies should conduct a cost-benefit analysis so that any transformational initiatives are not overly cash intensive and do not materially impact the separation timeline.

Examples of optimization or transformation initiatives include:

- Investing more in capabilities and projects that are a source of differentiation
- Identifying opportunities to move appropriate systems to new or transformative solutions
- Optimizing pricing strategies and channel expansion.
- Rationalizing the number of vendors and focusing on strategic partner spend
- Augmenting organizational agility by establishing optimized delivery models
- Identifying transition service agreement (TSA) exit opportunities for modernization and innovation that will fuel business transformation and reduce costs beyond IT
- Rationalizing the number of legal entities to reduce costs and free up resources

Typically, one company focuses on growth and the other focuses on margin improvement.

As part of the optimization process, NewCo and RemainCo have the chance to assess their levers for growth as independent companies. Given the generally different financial profiles and operating stages of the two businesses, we observe that typically one company focuses on margin improvement post-separation and the other focuses on revenue growth. Our analysis shows that NewCo is often the growth company while RemainCo prioritizes margin. Of course, there are precedent transactions where this is the reverse.

Change in profit and loss (P&L) metrics between close and 2-years post-close

P&L metric (as % of revenue)	RemainCo	NewCo
Revenue growth	+0.4%	+4.7%
Change in cost of goods sold	(0.6)%	+0.3%
Change in SG&A	(0.4)%	+0.7%

Source: Company filings, CapIQ and other publicly available information.
**(P&L metrics reflect median change two years post-close).*

When becoming a new, independent public company, NewCo should carefully select and prioritize its optimization initiatives, as this is a particularly busy period. It is essential to prioritize and pursue initiatives that are cash neutral (i.e., no high-cash-drain projects) while protecting working capital to set-up for a successful debut. Although NewCos generally outperform RemainCos in the first two years post-close, only 10% simultaneously outperform the market, grow revenue and reduce SG&A expenses. Our research shows that NewCo outperformance is often linked to its revenue growth. Therefore, an optimal strategy for NewCo leadership is to focus on allocating resources and investments to initiatives that will drive the top line. In parallel, they should identify initiatives that will help improve costs in the long run. These may include:

- Increasing investment in select capabilities and projects that drive improved return on invested capital; working capital efficiencies; and cash flow growth.
- Creating a compelling equity story that is aligned to strategic priorities.
- Developing a fit-for-purpose operating model that enables growth.
- Ensuring predictable results tied to accruals and one-time cost charges from ParentCo.

For RemainCo, this is an opportunity to transform itself during the transaction. As part of its transformation efforts, RemainCo should optimize its cost structure and proactively address stranded costs, while striving for growth. This may include:

- Developing operating models suitable for RemainCo's needs, including revamping processes, people, systems, suppliers and assets.
- Reducing stranded costs (at a minimum) and implementing aggressive cost reduction programs.
- Optimizing intellectual property (IP) and rationalizing the number of legal entities.
- Reimagining areas for innovation and growth.
- Reviewing segments, peers and key performance indicators (KPIs) for executive compensation.

In an EY corporate divestment study, 60% of executives said that they should have done more to improve RemainCo than simply eliminate costs, while 56% said they should have focused on RemainCo earlier in the process.

For both NewCo and RemainCo, SG&A changes tell an interesting, yet intuitive story. NewCo SG&A costs generally increased because of incremental costs related to being stand-alone and a public company. Conversely, 67% of RemainCos were able to reduce SG&A costs because of stranded cost elimination and formal restructuring programs.

In an EY corporate divestment study, 60% of executives said that they should have done more to improve RemainCo than simply eliminate costs, while 56% said they should have focused on RemainCo earlier in the process.

CASE STUDY

Transformation during separation: United Technologies Corporation and Carrier

"There was initial skepticism about the transaction among employees, leadership team and board. To address this, we stood up a "red" team to be critical on the spin transaction and why we shouldn't separate. They helped present the downside at each stage and presented their findings to the board. We ultimately agreed the spin was still the right choice, but everyone knew the downsides and we had stress tested the decision. We closed the spin in April 2020, one week into a national lockdown. The process helped give our leadership team comfort in their decision.

Greg Hayes, Chief Executive Officer, Raytheon Technologies

United Technologies Corporation (UTC, now Raytheon Technologies) completed a spin-off of its heating, ventilation and air-conditioning (HVAC) business, Carrier, in April 2020. Leadership leveraged a unique process to build consensus around the decision to spin.

Taking advantage of the separation as an opportunity to transform operations was strategically important for Carrier's ability to build an investment case as a public company. During the transaction, UTC identified and seized value creation opportunities across footprint consolidation, lease renegotiation and facility management to achieve recurring cost savings.

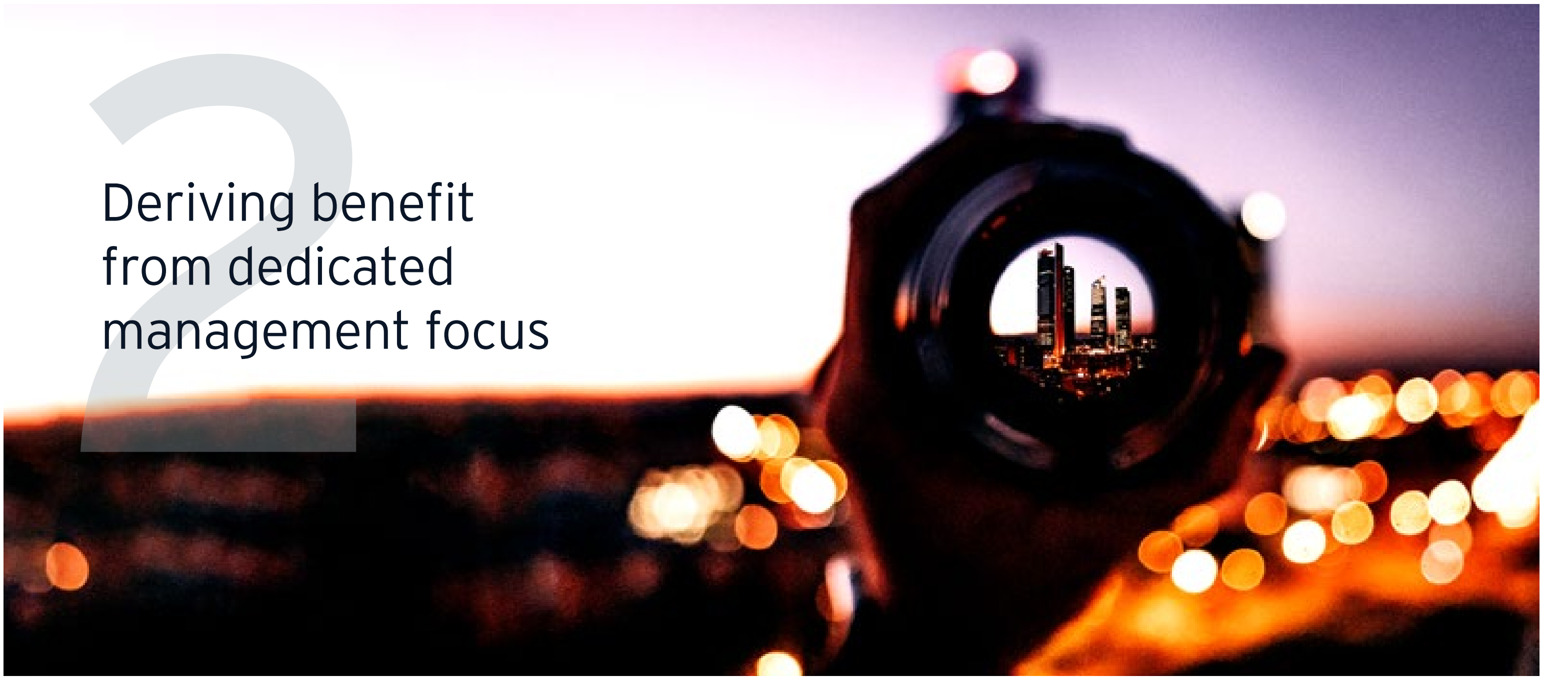
"The pandemic provided Carrier an opportunity to come together as a team at the epicenter of important secular trends including an increased focus on healthy indoor air environments, effective cold chain solutions and sustainability," explained Dave Gitlin, Chief Executive Officer. Carrier.

Once separated from UTC, Carrier was positioned as a leader in the HVAC, refrigeration, fire and security equipment market with investments focused on its organic growth. Immediately post-spin, Carrier established The Carrier Way, which would transform the business model, customer experience and culture. Carrier announced initiatives to reduce high costs, simplify processes, divest non-core assets and embark on a digital transformation, including optimizing industrial productivity by adapting digital technology and committing to taking out US$600 million (revised up to US$700 million today) of costs over three years.

In April 2023, three years after its spin-off from UTC, Carrier announced an acquisition of Viessmann Climate Solutions and a plan to exit its fire and security and commercial refrigeration businesses. This proactive portfolio transformation decision further simplifies the Carrier business portfolio and positions the company to be a pure-play and higher growth global market leader in climate solutions.

"We looked at the spin as an opportunity to create a fundamentally new company. We wanted to preserve what was working very well. But we also wanted to pivot to a new company. We seized the once-in-a-lifetime opportunity as a 100-year-old start-up.

Dave Gitlin, Chief Executive Officer, Carrier



2 Deriving benefit from dedicated management focus

Corporate separations provide an opportunity for leadership teams to focus their attention on the priorities of their specific business, rather than juggling the nuances inherent in a diversified parent. Embracing this focus is the first step that drives outperformance. This is also an opportunity to develop a corporate governance and board profile for NewCo that may differ from RemainCo.

Announce the leadership team early to help it prepare to run a public company.

Nearly two-thirds of transactions announced NewCo leadership teams within five months of the transaction announcement.

The timeline for CEO and CFO announcements varies across the transactions, with some transactions announcing NewCo CEOs concurrently with transaction announcement. Nearly two-thirds of transactions announced NewCo leadership teams within five months of the transaction announcement.

> "The primary reason we named the team early was to train them with the requirements they need. We wanted to hit ground running. Naming later could affect training.
>
> **Steve Cahillane,** Chairman and Chief Executive Officer, Kellogg Company

A best practice is to announce NewCo leaders early in the separation process to give them sufficient time to shadow ParentCo executives on public company responsibilities. This ensures that the NewCo team is well versed on leading a company and effectively communicating the strategy of NewCo at external events, such as investor days, rating agency presentations, and debt and equity roadshows. Investors can get to know the management team early, and NewCo management can gain experience in speaking about NewCo as it readies its debut in the public market.

NewCo management also functions as the internal champions for NewCo during the transaction, which is critical as decisions are made around Day 1 capital structure and other ongoing relationships, such as Transition Services Agreements (TSAs). However, ParentCo leaders should establish clearly defined roles, responsibilities and decision rights to avoid conflicts between RemainCo and NewCo leadership over decision-making regarding the separation. During the separation execution period, NewCo leadership will have limited bandwidth to enact change as the organization separates. The best use of their attention will come from focusing on core business areas, rather than adjusting back-office operations.

Select the right leadership team.

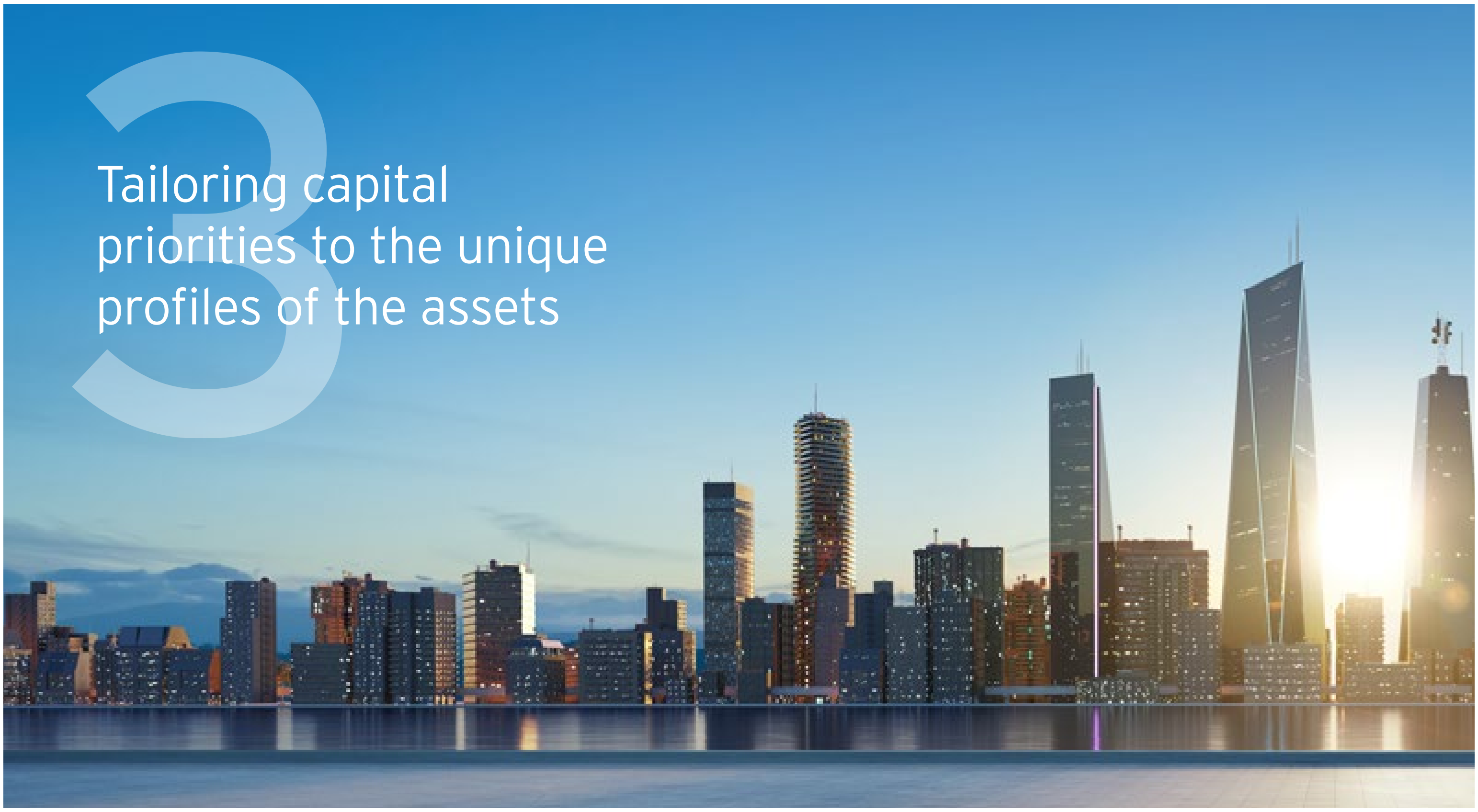
84% of NewCo CEOs promoted internally	73% of NewCo CFOs promoted internally

Based on our research, more than 60% of NewCos promoted both their CEO and CFO internally. While their familiarity with the business unit allows them to quickly set the direction of the new company during the separation, internally promoted executives are less likely to have experience leading a public company. To offset this deficit, ParentCo leaders will want to provide training for NewCo management that could range from job shadowing to boot camps to mock investor meetings.

When building out the new management team, ParentCo leaders should take the opportunity to increase management diversity. Across diversity metrics, NewCo exceeded ParentCo leadership teams in percentage of growth of diversity across gender, race, ethnicity and age. For example, NewCo organizations had around 11% more diverse leadership teams than ParentCos. Companies should also thoughtfully mix talent between internal and external for other executives.

C-suite readiness checklist

- [ ] Conduct on-the-job training through job shadowing.
- [ ] Hold public meeting boot camps so that NewCo leaders can improve their skills around public company responsibilities, including capital allocation, investor relations and enterprise strategy.
- [ ] Hold meetings for NewCo board and management to align on NewCo strategy and messaging.
- [ ] Conduct mock investor meetings.
- [ ] Increase diversity when building the NewCo management team.



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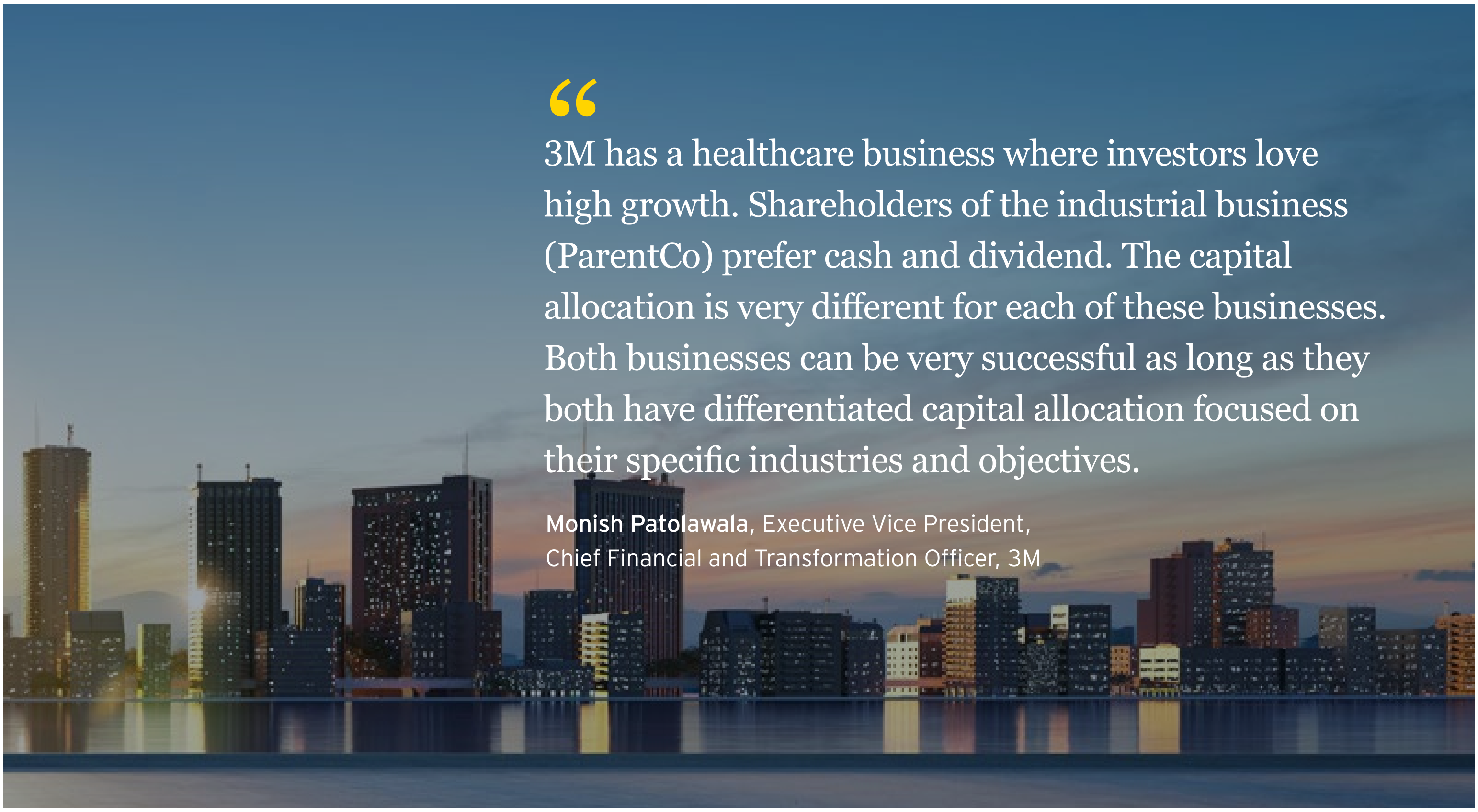
Tailoring capital priorities to the unique profiles of the assets

A transformative corporate separation allows each business to have its own access to capital and the ability to strategize around capital allocation priorities. We often see separations occur between businesses that differ in their growth profile, cash flow generation or lifecycle. The priorities for these businesses differ significantly, which impacts their access to debt and equity capital. ParentCo should set up RemainCo and NewCo with appropriate capital structures that allow them ongoing access to liquidity, balance sheet optimization and operating cash flow, with enough room to grow independently.

Decisions relating to RemainCo's capital structure will depend on how its leverage profile and ratings will change with the removal of NewCo's assets. ParentCos will want to consider the size of the business being separated, leverage put on the NewCo business, cost of capital and go-forward flexibility on financing structure, all of which can impact equity value and profitability.

Since NewCo is a new company with no prior track record, it is imperative not to overleverage the company. The capital structure (including funded debt, pension, other post-employment benefits (OPEB) and contingent liabilities) should be appropriate for its financial profile and in line with public peers.

As part of the separation, RemainCo may conduct liability management exercises to manage its capital structure and appropriately lever NewCo. There has also been an increased incidence of retained-stake separations where RemainCo retains a stake in NewCo to enhance cash proceeds without overleveraging NewCo.



> 3M has a healthcare business where investors love high growth. Shareholders of the industrial business (ParentCo) prefer cash and dividend. The capital allocation is very different for each of these businesses. Both businesses can be very successful as long as they both have differentiated capital allocation focused on their specific industries and objectives.
>
> **Monish Patolawala**, Executive Vice President, Chief Financial and Transformation Officer, 3M

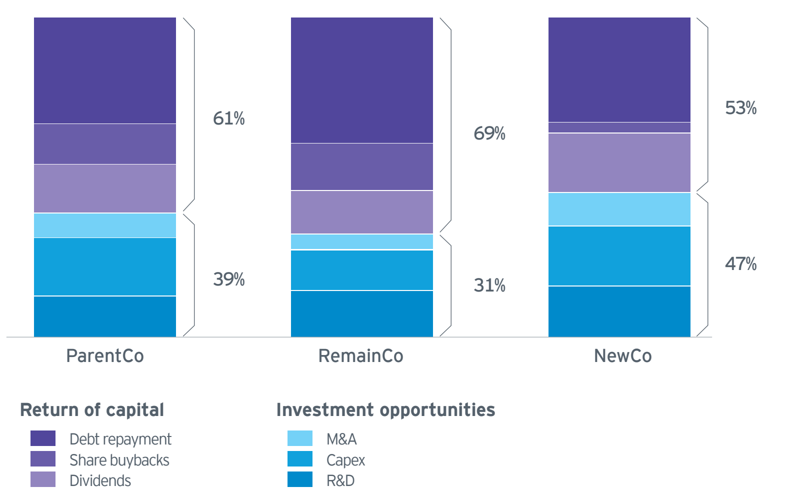
Refocus capital allocation strategies as a value lever.

Given generally differing business priorities between RemainCo and NewCo, each company's leadership will want to develop its own unique capital allocation strategy.

Although each corporate separation is bespoke, our analysis suggests that RemainCo tends to focus on increasing its return of capital post-separation, while NewCo increases its allocation toward investment into organic and inorganic business opportunities, including M&A. This is consistent with our finding that NewCos often prioritize growth and RemainCos often prioritize margin improvement and cash generation.

Change in capital allocation — ParentCo vs. RemainCo vs. NewCo*

(2-year average pre-close vs. 2-year average post-close)



Source: Company filings, CapIQ and other publicly available information.
**Charts represent data for separation transactions closed since 2012.*
**Measures two-year average pre-close to two-year average post-close.*

Managing the separation matters

Some of the frequent questions that come up during a corporate separation execution are: How long will it take? How much will it cost? Is the value from the separation worth these costs?

While these questions may not impact long-term outperformance, the separation process brings some uncertainty for stakeholders that will need to be managed well.

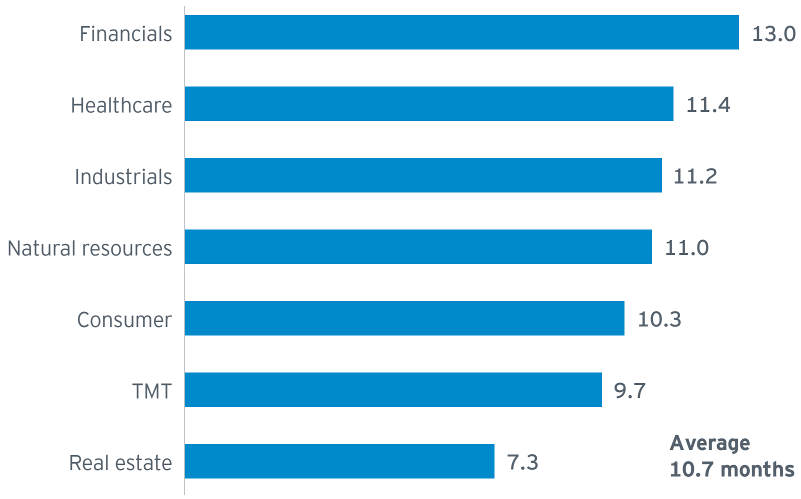
How long will it take?

Once a ParentCo announces the transaction, the clock starts ticking and there is pressure to hit the timeline. It is imperative to lay out key milestones and timing of key decisions early in the process to ensure stakeholder alignment and transparency, priority management, and efficient allocation of resources and capital. Investors, research analysts and other stakeholders are also likely to ask for process updates at company events throughout the separation execution.

Our experience and analysis of previously completed transactions shows that over 60% took longer than nine months from announcement to close with no significant variance in timing between US and non-US transactions. The separation timeline is heavily impacted by some items with long lead times, including preparation of audited financials, review of regulatory filings (e.g., SEC review in the US can take four to five months), tax rulings (e.g., IRS private letter ruling in the US), shareholder vote requirements (more common in non-US jurisdictions), legal entity reorganization, and operational and system separation. The timeline can also depend on the degree of entanglement and shared functionality between ParentCo and NewCo. We see longer timelines for more regulated industries like financials and healthcare.

Our analysis shows no significant correlation between time from announcement to close and post-separation performance. We recommend that companies balance timeline commitments communicated to stakeholders against the benefits of providing NewCo with time to implement improvements and changes that are the very source of value creation.

Timeline between announcement and close*



Source: Company filings, CapIQ and other publicly available information.
**Chart represent data for 144 closed transactions, excluding carveouts.*

>60%

of the transactions took longer than **nine months** to close from announcement date

To meet timelines and ensure the viability of a corporate separation, ParentCos should first conduct a showstopper analysis prior to announcement to assess any material legal, tax, contractual and regulatory considerations. Certain activities such as perimeter identification, carve-out financial preparation and tax planning can be started prior to announcement to provide sufficient flexibility. Understandably, ParentCos will need to juggle preparedness objectives against the size of the working team and risk of a leak.

During the execution, a stage gate approach and a trial operational separation through a "company-in-a-company" strategy can help to meet timelines and have separation workstreams keep pace. As part of this strategy, companies can use interim operating models to maintain a flexible transaction close, especially in markets with long lead time separation requirements.

Stage gates and company-in-company

- The stage gate review process is a series of executive checkpoints that serve as a program-wide calibration to verify that all workstreams are progressing on time and in sync with the transaction timeline. It allows all stakeholders across NewCo and ParentCo to align to the same objectives and provides updates and escalates risks to leadership.
- Company-in-company (CiC) is a test period in which NewCo operates as a stand-alone business but remains a subsidiary of ParentCo until the legal separation date. The objective is to set up both companies for success at close by allowing space to test the ability of NewCo to operate independently while still having access to ParentCo if any issues arise.

How much will it cost?

Our analysis of precedents indicates a wide distribution of one-time operational separation costs, ranging from 1% to 6% (bottom to top quartile) of NewCo equity value, with a median of 3% of NewCo equity value.[1] Typically, the degree of entanglement determines the degree of operational separation costs — already stand-alone business units cost less to separate, whereas carve-outs of products with no dedicated infrastructure cost more. The total one-time costs depend on a variety of factors, including the number of countries in which the business operates, degree of entanglement with the parent (e.g., shared manufacturing sites, shared locations, type and number of enterprise resource planning (ERP) tools), and regulatory requirements.

Interestingly, according to our analysis, there is no correlation between one-time costs and outperformance. If the separation has value creation potential, the one-time cost is typically justified.

Estimated one-time operational costs of separation (as % of NewCo equity value)	
Bottom quartile (25th percentile)	1%
Median (50th percentile)	3%
Average	5%
Top quartile (75th percentile)	6%

Source: Company filings, CapIQ and other publicly available information.

Companies looking to minimize one-time costs may wish to consider:

- Avoiding double costs created by a separate first, optimize later mindset.
- Staffing a lean, minimally viable Day 1 organization and focusing full efforts on hiring toward the Day 2 organization.
- Leveraging ecosystem partners and alliances to find new solutions vs. trying to build new or replicate RemainCo environments.

1, One-time cost benchmarks vary significantly across transactions and need to be customized depending on the specific situation. NewCo equity value as of the first day of separation.

Consider the tax impact.

Most corporate separations incur some level of tax, which can be significant in certain cases. Although the final steps of a US spin-off or non-US demerger can be tax-free, the preceding legal entity reorganization can create tax as assets and shares of legal entities are transferred. The global profile of the business, in terms of operations and legal entities, is a critical component to the tax cost and complexity of the transaction. Understanding the profile can be a significant effort but is critical to determining the tax costs. We frequently see companies design "reverse" internal separation transactions to address business considerations in local markets, such as timing of regulatory approvals. Efficient tax planning, developed early in the process, can help to optimize tax costs. Obtaining valuations and tax attributes studies early is also critical to optimizing tax planning.

Establish a governance structure to manage multiple workstreams.

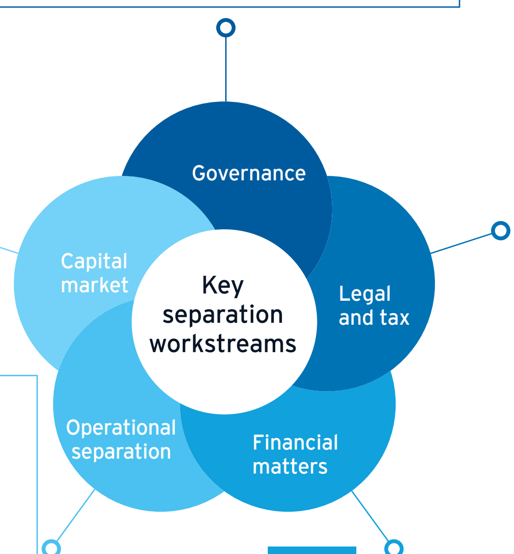
A strong governance structure is imperative to managing numerous separation workstreams and to maintaining pace to stage gate milestones. Using a separation management office as a centralized nerve center will drive accountability, improving the likelihood of meeting timeline obligations.

Governance and management
- Provide oversight, structure and guidance to transaction and operational separation teams.

Communications/change management/IR
- Manage communications to internal and external stakeholders.

Stand-alone business plans
- Define high-level strategic objectives and plans for each business, along with the key performance indicators and timelines.

Capital structure, treasury, and credit rating
- Support credit ratings assessment and define capital structure.



Tax planning/legal entity separation
- Structure the separation to achieve tax-free treatment; estimate tax. provision and enable tax compliance
- Align on key decisions on commercial model and country footprint for each country and separate key financial processes.

Legal and regulatory
- Ensure compliance with legal and regulatory requirements.

Filing prospectus documents
- File with regulators per jurisdiction and complete other regulatory requirements.

Separation agreements
- Execute and finalize transaction agreements required for the separation (e.g. tax matters agreement, employee matters agreement, IP sharing agreements, transition service agreements).

Operational separation
- Define future-state operating model for both businesses.
- Align on technology strategy and enable fit-for-purpose design and optimization.

Employee management
- Define and execute org design and drive talent selection.
- Plan for adjustments to equity-based compensation.

Transition services
- Structure and execute schedules and exhibits between RemainCo and NewCo for shared services that will not separate by Day 1.

Financials and valuation
- Develop historical deal-basis financials and forecasts.

Accounting and audit
- Complete carve-out financial statements and align with auditor.

5 Communicating with stakeholders

> “The first lesson: Keep the customer as the focus of the transaction. You need to satisfy the customer. If that falls apart, which it can, you can lose the whole benefit of the spin.
>
> **Greg Hayes**
> Chief Executive Officer, Raytheon Technologies

Although it may seem obvious, managing the various priorities of different stakeholders in this dynamic environment is critical to success. Customers, suppliers, employees and shareholders have varying levels of expectations from a corporate separation program, which is why frequent, transparent communication is essential. When each group understands the strategic vision, they will be more likely to accept it.

Customers of both NewCo and RemainCo businesses will need consistent and steady guidance from the time of the initial announcement to preserve the customer experience throughout the separation. Customers are ultimately the cornerstone of the transaction rationale and will be the determining factor of post-close performance.

Suppliers require regular communication through the transaction execution, including updates on contracts and systems to maintain business continuity and minimize dis-synergies due to loss of scale.

Employees often fear they have a lot to lose in a corporate separation when it comes to equity compensation, pension, retirement and other benefits. ParentCos will want to implement workplace financial solutions so that there is fairness for all employees from the C-suite down. When necessary, addressing these concerns openly and dispelling rumors will build confidence in leadership's ability to navigate the process. Executives interviewed suggested that regular, even monthly, communications to employees can help communicate the strategic vision of the transaction and bolster employee buy-in. As part of employee communications, culture should be defined early in the separation to drive future growth upon transaction close.

Investors and research analysts will need their own communications plan. ParentCos will need to think about what investors want to know, what they need to know, and the most appropriate timing to communicate these messages.

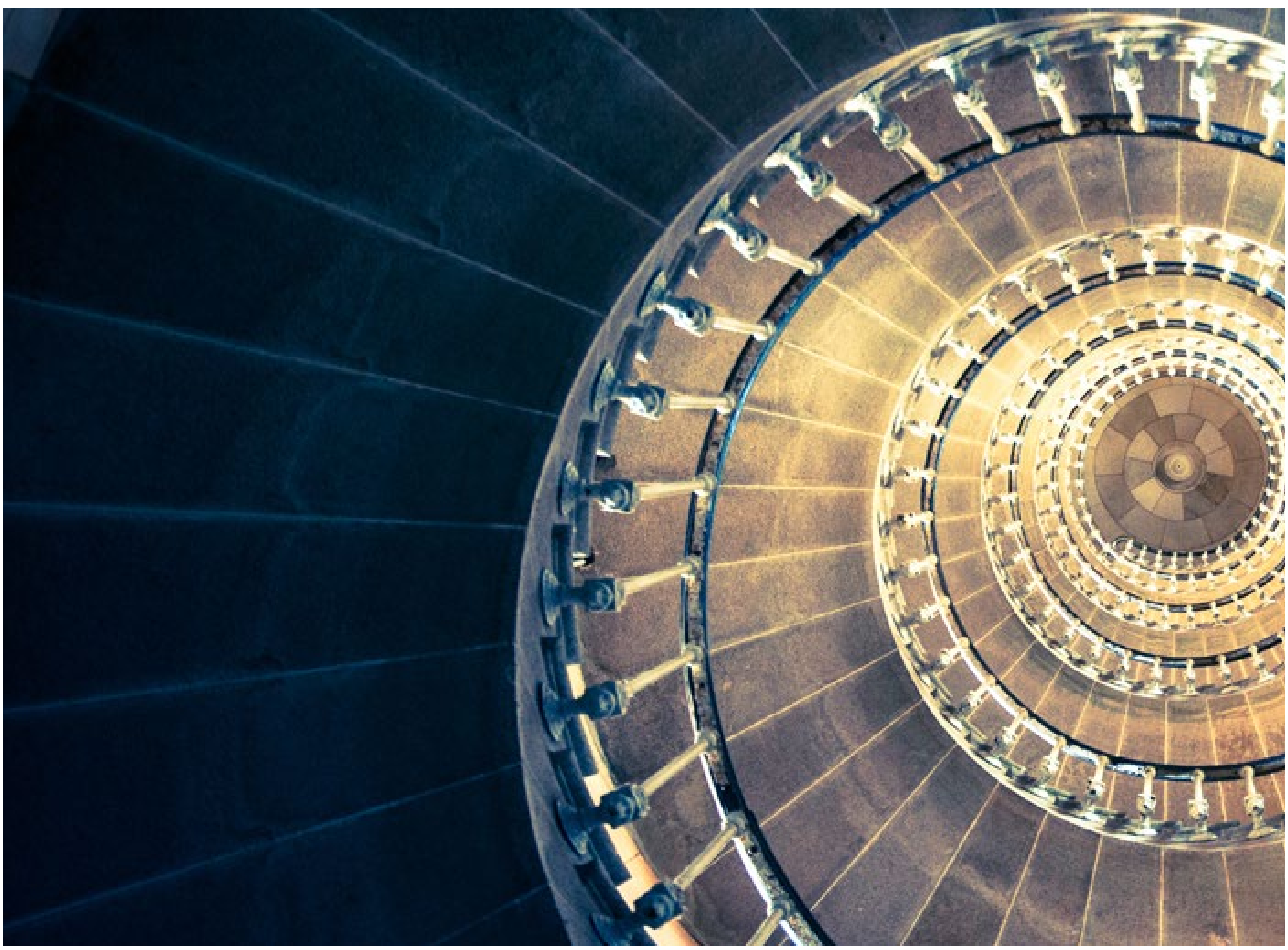
Research analysts and the investor community will ask questions through the separation execution and request key items to help them model or update investment parameters. Some of these commonly asked questions include anticipated structure of separation, key financial metrics for NewCo, separation costs and dis-synergies, expected capital structure and allocation, and timing updates. Identifying and preparing for key areas of focus across stakeholders will help to streamline investor questions and answers through the separation process.

> "Communication is vitally important. We have a great team and great employees. We continuously communicate to let them know what's happening and what to expect. Even when there is no new news, we continue to communicate and answer questions.
>
> **Steve Cahillane**
> Chairman and Chief Executive Officer
> Kellogg Company

Investor relations execution

One of the most important workstreams is to communicate the equity story of NewCo and RemainCo to their key stakeholders. This is as important for NewCo on its path to becoming a new public company as it is for RemainCo. RemainCo may use this opportunity to rebrand itself and meet with both existing and potentially new investors. Stakeholder communications should include:

- **Building the equity story.** On the path to becoming a newly listed public company, NewCo management will need to build an investment case for the new business, for both existing and prospective shareholders. NewCos communicate the equity story through the "box" in the regulatory filings, investor day presentations, earnings calls, and debt and equity roadshows. The story highlights the strengths of the business and go-forward strategy, along with key initiatives on growth.
- **Hosting investor days.** These are typically dedicated days when management presents the strategy for NewCo and separately for RemainCo, and meets with investors, research analysts and other stakeholders. Focus areas for the investor days include: equity story for NewCo and RemainCo, historical financial metrics, growth strategy, capital return and allocation priorities, and expected shareholder value creation. Investor day generally occurs after the regulatory filings are made public and before the close.
- **Roadshow presentations.** As the execution nears completion, management teams will meet with existing and potential investors to highlight the business strategy as well as answer any investor questions. These roadshow meetings typically occur in the two weeks leading into completion.



Due to the nature and rationale of these corporate separations, RemainCo and NewCo will typically have differences in shareholder bases. Some driving factors will include relative sizing, industry, capital structure and allocation, and growth opportunities. Expect trading levels to be elevated for the first quarter after close to account for investor transition.

> "We spent a lot of time with the NewCo management team developing the financial goals and equity story for the business. This was a crucial part of the separation process.
>
> **David Redfern**
> President of Corporate Development, GSK

Investor relations execution

EQUITY STORY

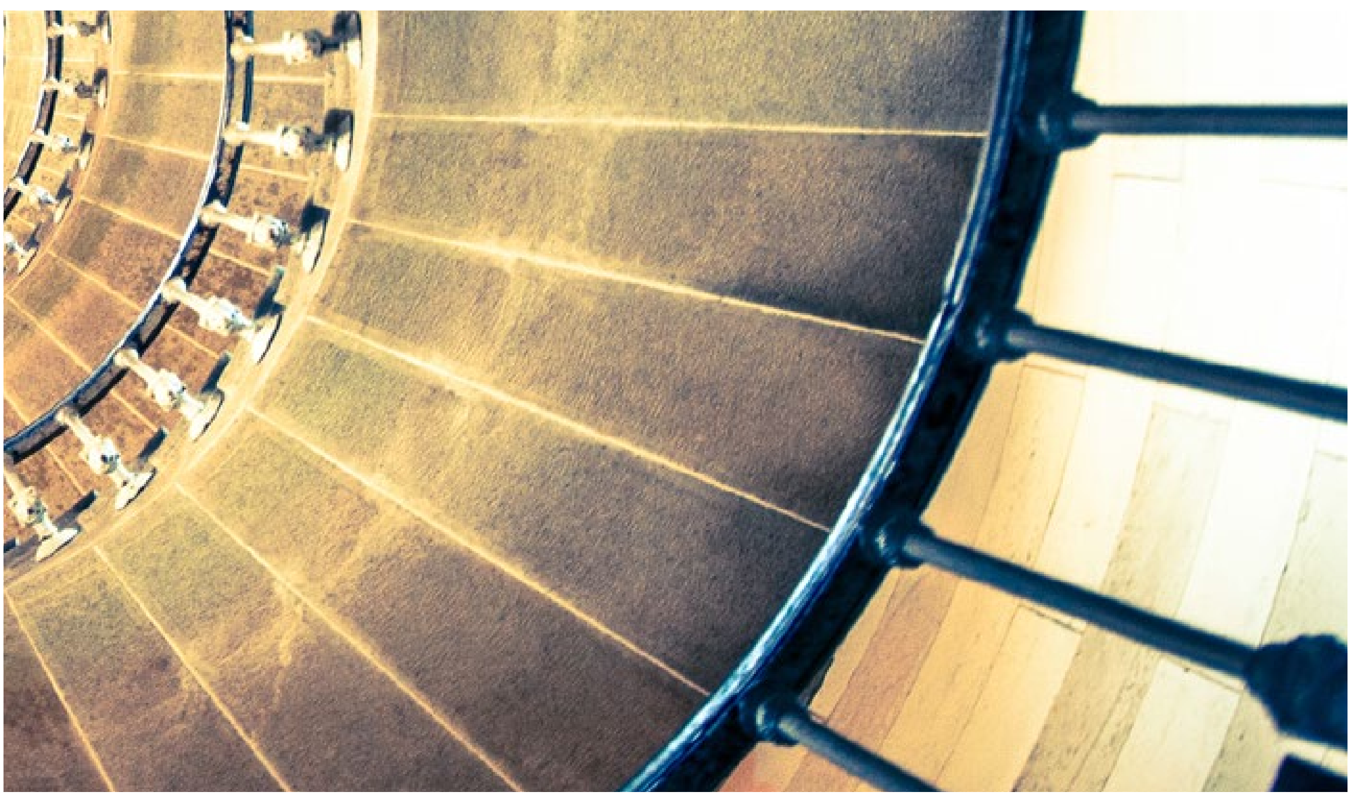
- Investment case
- Financial profile and goals
- Go-forward strategy and growth initiatives

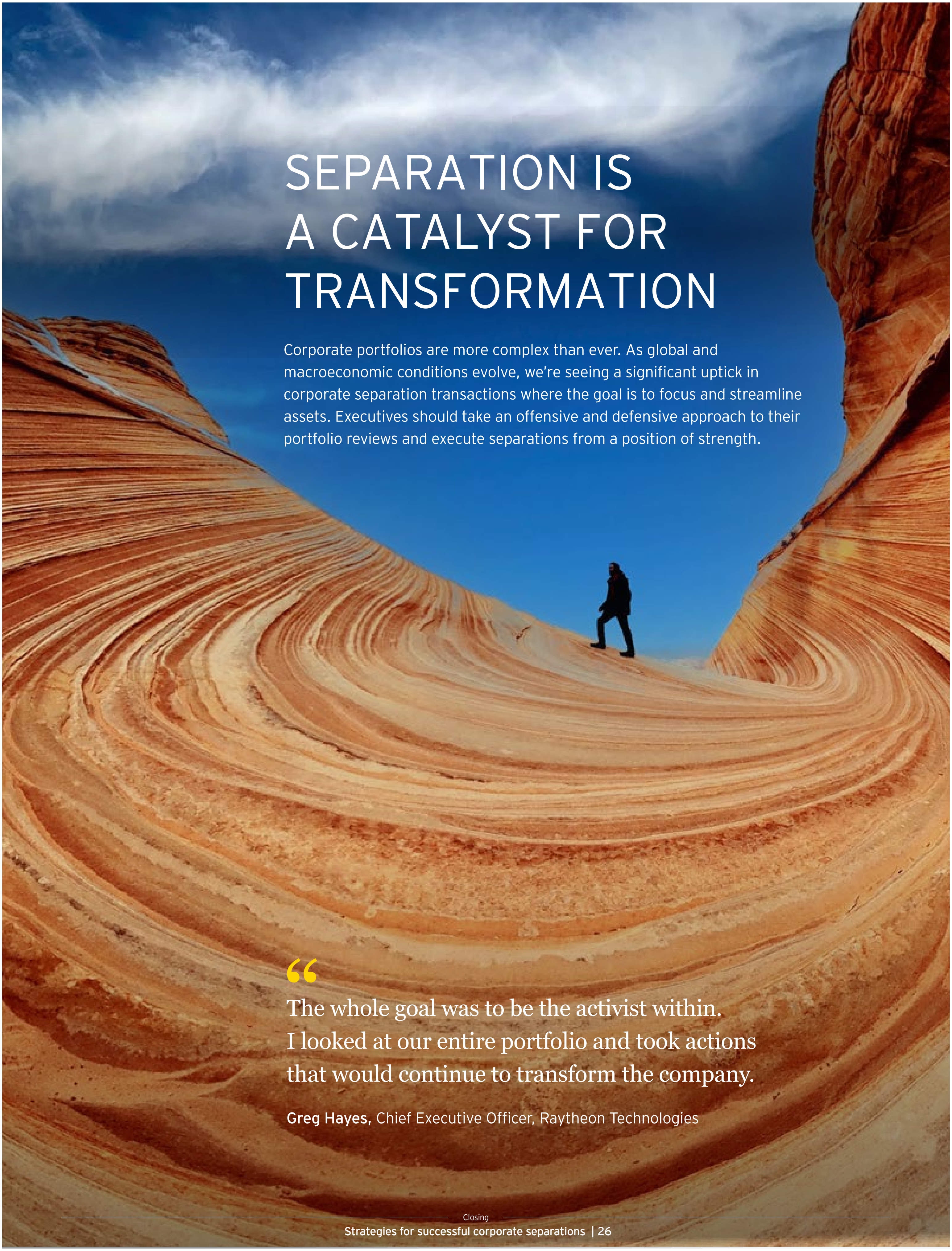
EXECUTION

- Listing and domicile
- Investor targeting and transition
- Research coverage

INVESTOR COMMUNICATION

- Press releases
- Investor presentation
- Investor Day
- Roadshow meetings





SEPARATION IS A CATALYST FOR TRANSFORMATION

Corporate portfolios are more complex than ever. As global and macroeconomic conditions evolve, we're seeing a significant uptick in corporate separation transactions where the goal is to focus and streamline assets. Executives should take an offensive and defensive approach to their portfolio reviews and execute separations from a position of strength.

> “The whole goal was to be the activist within. I looked at our entire portfolio and took actions that would continue to transform the company.
>
> **Greg Hayes,** Chief Executive Officer, Raytheon Technologies

“

We’re leading this transformation from a position of strength. We’re excited about the future!

Steve Cahillane
Chairman and Chief Executive Officer, Kellogg Company

As part of a continuous portfolio review strategy, corporate separations are a proven method to create opportunities, enable business transformation, manage risk and create shareholder value. The markets continue to reward companies that execute these transactions well.

However, simply executing a corporate separation transaction does not guarantee success. Companies must actually transform themselves to maximize value and achieve the benefits of the separation, and they should activate transformational initiatives early in the process. This reimagination of RemainCo and NewCo as two independent public companies must include:

- Streamlined operations and investment strategies
- Distinct and marketable equity stories
- Differing capital strategies, tailored to unique financial profiles
- Focused leadership teams, with an opportunity to bring new, diverse thinking

Although corporate separations can take time to implement and can incur significant one-time costs, the value creation potential continues to outweigh the costs. By using a separation as a catalyst for transformation, companies can greatly increase the odds of creating long-term value and outperforming in the market.

SEVEN value-creation questions for C-suite executives

1 Do transformation opportunities exist? Will the separated businesses operate more efficiently as two distinct entities?

2 Should debt and liabilities be allocated differently between the two businesses?

3 Do we have the right management team to lead two independent public companies?

4 Will investment strategies differ for each business?

5 Do conflicts of interest exist that hinder asset performance? Will they disappear through a separation?

6 When is the right time to separate? How to separate from a position of strength vs. reacting to external pressure?

7 Is our shareholder base and research coverage aligned with our portfolio mix? How would it change through a separation?

EY

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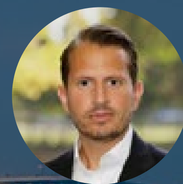

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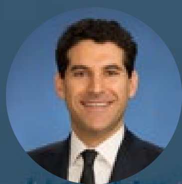

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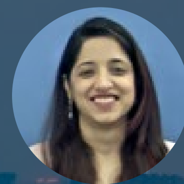

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