Spin cycle:
The rise of technology sector “de-mergers”
Introduction
Overview

The technology sector is continually being reshaped through merger and acquisition (M&A) activity. While acquisitions by Apple Inc., Facebook, Inc., Microsoft Corporation, and other technology giants regularly make headlines, a converse trend is also generating considerable buzz: Well-known technology companies are spinning-off or “de-merging” key assets, business units, and divisions into separately traded public companies (versus engaging in asset sales/carve-outs). Among recent examples, Agilent Technologies completed the spin-off of its electronic measurement division into Keysight Technologies; JDSU Uniphase Corporation announced its plan to separate its optical components and commercial lasers company (“CCOP”) and a network and service enablement company (“NSE”); Hewlett-Packard’s plans to separate its PC/Printer and Enterprise Solutions businesses; the proposed eBay/PayPal split; and Symantec’s breakup into separate information management and information security companies are also garnering considerable media coverage. Finally, Yahoo announced plans for a tax-free spin-off of its remaining stake in Alibaba Group Holding Ltd. into a newly formed registered investment company called SpinCo; Yahoo said it will also spin off its Small Business unit as part of the deal.

Why are these spin-offs or de-mergers happening, and why are they happening now? Are they solely companies’ response to internal issues or do they address broader, more fundamental changes taking place among their customers and in the larger technology sector ecosystem? This article will present a brief history of technology sector divestiture activity; assess the spin-off value proposition; analyze the typical drivers of technology spins; present examples of notable spin-offs; and explore how digital disruption is creating opportunities for companies to use both spin-offs and sales to create shareholder value.
Sales ‘n spins: A brief history of technology sector divestitures

The technology sector may be considered young by other industries’ standards, but it has a rich history of M&A divestitures through spin-offs and asset sales. In the late 1990s, as the “dot.com” era and Y2K spurred massive equity market gains and one of the most active IPO markets in history, spin-offs were one of technology companies’ mechanisms for unlocking value. Generally, spin-offs are undertaken when there is expected to be a robust public market valuation for the asset being spun off and/or the parent company wishes to take advantage of the potential tax-free nature of the transaction. Asset sales typically are undertaken when the seller expects that the privately negotiated value will be higher and/or there are tax attributes that can be taken advantage of (NOLs) that may otherwise expire in the ordinary course.

Looking back through the 1990s and early 2000s, there have been many high-profile spin-off transactions, including AT&T’s spin-off of Lucent Technologies, Motorola’s spin-off of Freescale Semiconductor, and HP’s spin-off of Agilent Technologies. In addition, many smaller deals took the form of asset sales, often originating in large diversified businesses that were facing Wall Street pressure to improve or maintain profit levels, growth rates, and market share even as competition increased. These investor demands, coupled with a robust private equity (PE) market and loose credit markets through 2008, spurred technology company boards and management to sell underperforming assets so they could focus on growing their core business—either organically or through acquisitions. A preference for asset sales continued in the wake of the 2008-2009 U.S. and global recessions. Overriding factors were the collapse in equity market values and credit defaults. Companies with strong cash balances could survive; others had to figure out ways to generate liquidity.

What’s behind today’s spin cycle?
Although asset sales remain attractive to certain of today’s technology companies, a confluence of transformative marketplace trends and drivers is prompting boards and management teams to increasingly include spin-offs among their strategies as a way to spur growth, maximize shareholder value, and position the company for future success.

One trend evident across the general business landscape is the increasing speed
of change. This trend is technology-driven, with the speed of change for technology companies even faster, making it challenging for a slower-moving corporate giant to concurrently grow its existing businesses, incubate innovations, and sustain ROI amid shortened business and product life cycles. Will the speed of change cause today’s technology leaders to fall behind the growing number of new entrants? Astute executives realize they have to move fast or risk playing catch-up to a longtime competitor or a disruptive upstart that identifies the sector’s burgeoning opportunities and rapidly moves to capitalize on them. Similarly, the pace of change coupled with slow-to-move entities and a build-up of cash reserves are prompting activist shareholders to demand that company boards and executives consider a variety of capital allocation decisions to take advantage of technology-driven opportunities.

Among technology-based trends, the proliferation of sensor technology, the lead up to the Internet of Things (IoT), the advent of scalable infrastructure through cloud-based computing, and expanded data capture and analysis are creating tremendous opportunities for new markets, products, and services, and driving segmentation behavior. For example, the shift from on-premises computing to cloud/Software as a Service (SaaS) can be a transformative paradigm for many large, bellwether technology companies, spurring the need for new business models, capabilities, and go-to-market strategies. The move to cloud—or at least a more balanced business model of on-premises computing and cloud—will likely drive spin-offs or sales of legacy businesses to capture value that can be reinvested into cloud. IoT is the next phase. Technology companies are trying to determine where to focus their businesses and invest their capital to provide the best opportunities for growth and shareholder value in this new, somewhat unknown, and rapidly evolving ecosystem. One option is for a large technology company to divide into two smaller, more nimble entities, which can react more quickly to marketplace opportunities and threats specific to their sphere of activity. Splitting into two companies also provides an opportunity for both companies to refine their market positioning into distinct strategies and business models. This may help drive capital markets value, as the companies can craft their story to investors to maximize valuation on the aspects of the business that command higher value.

A number of current financial trends are aligning to support technology sector spins-offs (as well as sales and acquisitions). These include strong corporate balance sheets and historically high cash reserves; robust equity valuations and stock market conditions; the strongest debt capital markets and bank liquidity since before the 2008 crisis (historically low rates and an aggressive lending environment); substantial/record PE fundraising; and a highly competitive large-cap PE landscape where large-scale carve-outs and buyouts are proving attractive. Among other financial drivers, some technology company executives have recognized that their cost structure is bloated; due, perhaps, to overhang from prior acquisitions where synergies haven’t been fully captured. Or they conclude that it doesn’t make sense to have two very different business models within one company. In these cases, a spin-off can help to right-size a company and provide a trigger point for large-scale transformation. For example, management could construct separate operating models for the existing and new businesses that are targeted in terms of capital structure, markets, geographic footprint, customers, and IT support.
Spin stories

Prominent technology companies are using asset spin-offs to enhance performance, drive growth, and meet other strategic goals. The following are examples of recent noteworthy transactions.

**Yahoo/SpinCo**
**Our take on the spin: Non-core assets**

On January 27, 2015, Yahoo announced plans for a tax-free spin-off of its remaining 15 percent stake in China’s Alibaba Group Holding Ltd. into a newly formed registered investment company called SpinCo. The publicly traded entity will absorb all of Yahoo’s 384 million Alibaba shares, worth $40 billion. Those shares will then be distributed to Yahoo’s investors. Yahoo originally bought into e-commerce giant Alibaba in 2005, paying $1 billion for a 40 percent stake. The following week, Yahoo announced it will also spin off its Small Business Unit as part of the deal. Yahoo’s Small Business Unit helps small enterprises set up and run their businesses online. The transaction is expected to occur in fourth quarter 2015, and the unit will move to SpinCo prior to the transaction’s completion.

**Agilent/Keysight**
**Our take on the spin: Two distinct businesses and growth opportunities**

On November 1, 2014, scientific instrument maker Agilent Technologies Inc. completed its separation into two publicly traded companies through a spin-off of its electronic measurement business, renamed Keysight Technologies Inc. The remaining company, which keeps the Agilent name, will focus on life sciences, diagnostics and applied markets. Agilent shareholders received a pro-rated distribution of the new company’s shares as a tax-free spin-off. Agilent, which was itself spun-off from Hewlett-Packard Co. in 1999, has had four other major spin-offs since 2005: Avago, Verigy, Lumileds, Varian). Management’s belief that shareholder value will increase by having a singular focus on two diverse businesses rather than two diverse focuses on a single business was a primary driver of the Keysight spin-off. President and CEO William Sullivan said the split will allow both Agilent and Keysight to maximize growth.

**Motorola/Motorola Mobility/Google/ Lenovo**
**Our take on the spin: Rapidly changing market opportunities**

As technology companies seek to leverage growth opportunities in today’s rapidly changing marketplace, one spin-off sometimes triggers a series of transactions. In January 2011, technology giant Motorola completed the separation of its cellular phone business, Motorola Mobility, from its enterprise and public safety business. In August of that same year, Google announced its purchase of Motorola Mobility for $12.5 billion—a deal that was sealed in May 2012—launching the Internet search giant into the mobile market. After taking advantage of substantial levels of cash on Mobility’s balance sheet, monetizing certain non-core assets, and leveraging various tax attributes, Google obtained a substantial portfolio of patents it believed “leveled the playing field against patent attacks against Android devices.” Google subsequently sold the residual business to the world’s largest PC Manufacturer and top five handset manufacturer Lenovo. Through the sale of Mobility, Google sought to maintain a neutral position as a supplier of operating systems to handsets and to protect a portion of its lucrative advertising business. These deals demonstrate both the opportunities and challenges for a large conglomerate to better serve customer needs in diverse, rapidly changing market segments.
JDSU
Our take on the spin: Two distinct market opportunities
In September 2014, JDSU Uniphase Corporation, which provides network and service enablement solutions and optical products worldwide, announced its plan to separate into two standalone, publicly traded companies: an optical and commercial lasers company (“CCOP”) consisting of JDSU’s current Communications and Commercial Optical Products segment; and a network and service enablement company (“NSE”) consisting of JDSU’s current Network Enablement, Service Enablement and Optical Security and Performance Products (OSP) segments, which is expected to be completed through a spin-off with separate corporate brand identities for each business to be announced at a later date.22 According to JDSU, the standalone CCOP company, to be named Lumentum Holdings Inc.,23 will devote enhanced focus to its leading position in telecom, expand its position in the high-growth datacom market, and grow its commercial lasers and 3-D sensing businesses. The standalone NSE company will continue its leadership in network enablement, while continuing to transition to a more software-centric company aligned with the industry’s rapid shift to software-defined networks. JDSU management said the separation is expected to produce a combined expense reduction of approximately $50 million, create clearer investment profiles for both companies, and enhance shareholder value.24

Hewlett-Packard
Our take on the spin: Two distinct businesses and market opportunities
In October 2014, Hewlett-Packard (HP) announced plans to separate into two new, publicly traded companies: one selling security software and the other providing data management. The spin-off is expected to be completed by the end of December 2015. Symantec’s security business generated revenue of $4.2 billion in fiscal 2014, while the data management business, which provides data backup, recovery and management services, generated $2.5 billion.25 The Mountain View, California-based company said in a statement that it made the decision after an extensive business review and had concluded it needed to be nimbler and more focused. Symantec’s Chief Executive Officer, Michael Brown, said in the statement, “It has become clear that winning in both security and information management requires distinct strategies, focused investments and go-to market innovation...Separating Symantec into two, independent publicly traded companies will provide each business the flexibility and focus to drive growth and enhance shareholder value.”26

Symantec
Our take on the spin: To focus on core business
Norton antivirus maker Symantec Corp announced in October 2014 that it will split into two publicly traded companies; one selling security software and the other providing data management. The spin-off is expected to be completed by the end of December 2015. Symantec’s security business the flexibility and focus to drive growth and enhance shareholder value.27

eBay/PayPal
Our take on the spin: Two distinct growth and market opportunities
In September 2014, eBay and PayPal announced that they are going their separate ways, with the payments company splitting from online marketplace eBay to form its own, publicly traded company.28 Historically, the two entities were complementary because the cash-generating eBay enterprise was funding PayPal’s growth. Now, however, the roles are reversed: eBay’s business has been bolstered heavily by PayPal’s strong growth, especially its forays into mobile payment,29 and PayPal has the necessary cash flows to fund its own future growth. Company executives decided to split the businesses to help each grow faster in their respective markets. The separation is expected to be complete by the second half of 2015, pending regulatory approval.30
Spin off, stand up, simplify

Over the last three years (2012 to 2014), the number of announced U.S. technology sector spin-offs has increased by 71.4 percent; we anticipate this trend to continue, as a spin-off’s value proposition can be quite compelling for companies trying to enhance shareholder value while continuing to grow and innovate in the rapidly evolving technology marketplace. Dividing a single, diversified business into two or more individually traded companies (RemainCo and SpinCo) offers numerous potential benefits, such as to:

• Increase each entity’s strategic, operational, and financial flexibility
• Enable greater management focus on trends and investment opportunities as the pace of technology change accelerates
• Allow for more efficient allocation of capital for product development or market expansion
• Unlock trapped or hidden potential in both companies, providing a long-term platform for growth and value
• Allow a company to concurrently operate under an existing business model (e.g., hardware for the RemainCo) and a new one (e.g., SaaS or through a SpinCo acquisition)
• Maximize the corporation’s overall portfolio value
• Enhance capital markets profile with more refined corporate positioning
• Offer existing and new shareholders clear investment profiles in distinct growth markets
• Facilitate compliance with market- or product-specific regulations
• Reduce a corporation’s tax burden (versus an asset sale) due to a spin-off’s potentially tax-free status.

In general, a sale de-emphasizes the business in play. Corporate leaders decide to sell the asset to a third party because they no longer view it as strategic/core or can better monetize it given strong capital conditions. In contrast, a spin-off emphasizes both the SpinCo business and the RemainCo business. The new corporate structure allows each respective entity to potentially leverage better-aligned organizational efficiencies, leadership attention, and capital investments. Case in point, as companies seek organic and inorganic growth opportunities amidst intense capital markets scrutiny, an increasingly competitive marketplace, and a rapidly evolving technology landscape, the importance of the buy-versus-build decision is amplified. Many boards and executives recognize that building the next software or hardware breakthrough internally takes too long and is too uncertain, especially in large organizations where business division managers may lose focus and motivation, and the competition for capital can become fierce. However, by spinning-off a “higher tech” portion of the business to form two smaller, independent organizations, and following that spin with one or more strategic acquisitions, a corporation may be able to quickly “build” the capabilities and/or product sets it needs to increase revenue and market share. In short, separating parts of a large business through a spin-off can drive enhancements that may lead to a better, more focused strategy, and an ability to more astutely address challenges like buy-versus-build.
The rise of technology sector “de-mergers”
Does 1+1=3 or is it actually less than 2?

Among the rationales for a spin-off is that a company is inefficiently running two businesses as a single entity. In effect, this suggests that there are few synergies/“negative” synergies in operating the companies on a combined basis, or that 1+1<2. By deconstructing the combined entity into SpinCo and RemainCo, management may be able to eliminate the negative synergies and operate both organizations more efficiently, unlocking trapped value. But does this notion of 1+1<2 always apply?

It is difficult to ascertain with precision what level of financial performance would have been achieved by the parent company had the deal not been consummated. Even with sophisticated modelling by internal financial planning executives and rigorous assessments by third-party stock analysts, the output of such modelling exercises depends on the accuracy of the assumptions underpinning the model. In a rapidly changing technology marketplace, it is difficult to develop critical assumptions with a level of accuracy needed to develop a definitive view of the future.

There is a host of research that suggests spin-off transactions create value not only for the SpinCo but for the RemainCo as well, which could be stated as 1+1=3 (as separate companies). However, much of this research is somewhat dated and not specifically focused on any particular industry sector. Does the assertion that 1+1=3 still hold true in general and—by extension—for today’s technology companies? Or does the rapidly changing technology marketplace demand that management take a closer look at what comprises the combined businesses to ensure that their collective capabilities are what are necessary to address near- and longer-term opportunities?

There are a few exchange-traded funds and indexes that focus on investing in entities that have been spun-off. Over the last five years, the Guggenheim Spin-Off ETF [CSD] has increased by 125 percent while the NASDAQ Composite [IXIC] increased by 107 percent and the DJIA increased by 66 percent. This index demonstrates the opportunity for shareholder value capture from the spun company (SpinCo) at least compared to the NASDAQ, and the DJIA. But what about RemainCo? Numerous studies (again, somewhat dated) have shown that in the three years post-transaction, both SpinCo and RemainCo outperform broader market indices; however, the excess returns for RemainCo are generally somewhat less than SpinCo.

Does the assertion that 1+1=3 still hold true in general and—by extension—for today’s technology companies?

So, 1+1 may indeed be less than 2, inferring that the parts comprising the whole are more valuable on their own, but how much more valuable? Increasing numbers of technology sector investors and management teams seem to be betting that decoupling disparate businesses will provide both entities the opportunity to thrive on their own with focused management teams and unhindered access to capital. Or, it may make both more attractive acquisition targets for larger competitors, which need to fill strategic gaps in their portfolios.
Look before you leap, learn before you spin

We believe that increasing numbers of companies will be assessing their position in the evolving technology landscape and ability to take advantage of growth opportunities via spin-offs and asset sales. However, these can be incredibly complex and high risk transactions. Executives need to think before they leap. Deloitte’s years of experience with these types of engagements have produced a number of learnings that we suggest technology companies carefully consider before they separate:

**Learning 1: Developing a clear separation strategy and blueprint will help to align the operating model with the future vision of the two businesses.**

A separation strategy is typically set early in the transaction process and helps the separation management team develop guiding principles for the deal. Based on these principles, the team prepares a separation blueprint, which includes critical, function-based decisions that range from what should happen on Day 1 to what the end-states for SpinCo and RemainCo should look like. The blueprint typically addresses how to balance the companies’ separate operating and organization needs, and how to manage separation risk in areas such as country presence, legal entity structure, product roadmap, determination of ownership and licensing of patents and other intellectual property rights, branding strategy, route-to-market (direct vs. channel) and customer experience. The separation blueprint also serves as the basis for creating detailed execution plans for achieving a successful spin-off transaction.

**Learning 2: Establishing robust and centralized governance can keep the separation and spin-off transaction process synchronized and on track.**

Objectives, roles, and accountabilities need to be clearly established for both SpinCo and RemainCo teams and individuals. One company’s staffing plan included an executive steering committee, separation management office (consisting of executive sponsors, separation leaders, transition managers, and external resources), functional teams, and cross-functional teams. All separation teams worked from a common roadmap and planning process and had clearly defined roles: Working teams developed options, conducted analyses, and developed the fact base; team leads assess options and made decisions; and the Project Management Office (PMO) drove the process and facilitated decision-making.

**Learning 3: Running the current business and the spin-off will require a significant number and mix of dedicated resources.**

Spinning off an asset is significantly more complex and may require more resources with different skill sets than integrating an acquisition. Every asset, process, and person needs to be examined and in place by Operational Separation Day (Day 1), in an effective and efficient manner. Separation may require significant IT resources for technical separation and transition services; an adequate mix of business leadership and analytical staff is required to design, plan, and manage implementation of the operating model for SpinCo and separation tasks from RemainCo. As is the case with any complex, lengthy M&A transaction, continuous alignment is necessary to avoid rework and redirection as complexity builds, due to the integrated nature of the “two” businesses.
Learning 4: Limiting in-flight projects and adopting an “all hands on deck” focus to succeed will likely be necessary to support a spin-off’s significant budgetary and personnel requirements.

Juggling the short-term resource requirements for a spin-off transaction with the ongoing needs of running an existing business can be extremely challenging. Often, in-flight projects may need to be re-evaluated in the context of a spin-off transaction. Those projects that are further integrating the existing business or are not investing in the right capabilities may need to be delayed or redirected. Possible disruptions could include putting an ERP transformation on hold; changing a CRM upgrade from “Big Bang” to phased deployments; implementing a hiring freeze; and postponing sales compensation changes. Hiring external resources to advise and assist during a spin-off can help to ease some of the demands on internal personnel. These resources can bring experience, objectivity, proven tools/methods, and necessary “bandwidth” to the process, allowing employees to focus on the multitude of options and decisions that need to be made as well as run the day-to-day business.

Learning 5: Addressing employee engagement, retention, and morale is essential when planning any M&A transaction, including a spin-off.

Employee relations are often likely to suffer when rumors about a potential transaction, either an acquisition or a divestiture, proliferate and employees speculate about their future. Effectively transitioning an organization requires a strategy to proactively engage employees and reduce their uncertainty. Preparing managers and executives to communicate with their people and lead them through change is critical to the spin-off process.

Employees need to understand the decisions that may impact them and the rationale behind those decisions before any public announcements are made. Functions such as human resources and employee communications are critical in influencing employee morale. Short-term incentives based on performance milestones or a time horizon can be effective in retaining specific employees and maintaining their focus. A divestiture or spin-off transaction often leads to ambiguity or changes in levels, roles and accountability, with conflicting priorities between the new and old companies, resulting in escalating levels of anxiety for employees. In Deloitte’s experience, companies that establish a change management office that deals with communications planning and employee training-enablement can help to mitigate these challenges and bring their deal to market in a timely and more-efficient manner.

Learning 6: Preparing for an issue-free separation includes proactive identification and minimization of “dis-synergies” and stranded costs to stay cost-competitive post-transaction.

Following a spin-off, organizations are frequently left with a disproportionately larger cost structure relative to their new size, due to the duplication of capabilities and resources required by both companies. This could result in reduced overall margins for both entities and stunt their competitive positioning. Often, the separation blueprint includes an optimal profile for SpinCo in terms of market presence, cost structure, and capabilities. Management also needs to strategize how to get RemainCo in similar fighting shape. Due to tight integration and the proliferation of shared services, most companies will need to implement strategic and targeted cost-reductions as part of their separation planning. Fortunately, a spin-off provides an opportunity to evaluate the overall cost structure and delivery of shared services to provide a long-term platform for growth and value. For example, internal shared service centers could be outsourced to a third-party services provider, who will convert the center to a platform, which services two different companies. Due to their expertise and scale, they may be able to drive the cost down better than the prior corporation. Also, if the people, processes, and know-how are sold in a sold in such a carve-out, there would be an upfront payment made to the company. Leftover costs not required to support RemainCo operations are stranded costs and should be minimized/eliminated.

Learning 7: Deciding on a spin versus a sale is not always clear-cut.

When contemplating a divestiture, many parent companies travel a dual sale/spin track, as they evaluate which approach may provide greater short-and long-term value. For example, a company can realize immediate liquidity with an asset sale but the transaction may be accompanied by a tax cost. Conversely, a spin-off is often tax-free but doesn’t always offer a clear, short-term liquidity event. Sometimes, and often unintentionally, a spin-off becomes the first step in market-signaling a sale. A company announces a spin, the announcement may attract potential strategic and private equity buyers, and the intended spin-off transaction may turn into a sale. External advisors can help company management consider various alternatives to aid decision-making.
Conclusion

The current cycle of asset spin-offs is likely to continue as both established and new technology companies evaluate ways to grow revenue and maximize shareholder value in a transformative marketplace. One spin-off transaction may also spur M&A activity within the wider technology sector, as well. For example, the two new companies may be seen as attractive acquisition targets, driving the current cycle of growth deals; tuck-in M&A activity may increase as de-merged companies look to fill R&D capability and/or product portfolio gaps; and newly created companies may look to further transform their capabilities and develop new business models to achieve desired future growth. The value proposition of an asset sale will also remain attractive; a concept that will be explored in a future article. Observations and learnings from other companies’ experiences can help executives determine which approach will best accomplish their strategic goals.
Contacts

**Nik Chickermane**
Principal  
M&A Consultative Services  
Deloitte Consulting LLP  
+1 415 783 6266  
nchickermane@deloitte.com

**Ken Kirschner**
Partner  
M&A Transaction Services  
Deloitte & Touche LLP  
+1 212 436 2365  
kkirschner@deloitte.com

**Dan Knappenberg**
Principal  
Deloitte Transactions and  
Business Analytics LLP  
+1 408 704 4558  
dknappenberg@deloitte.com

**Ron Rivera**
Managing Director  
U.S. Lead, Technology  
Investment Banking  
Deloitte Corporate Finance LLC  
+1 404 631 3710  
rorivera@deloitte.com

**Marco Sguazzin**
U.S. Lead, TMT  
M&A Consultative Services  
Deloitte Consulting LLP  
+1 415 783 6860  
masguazzin@deloitte.com

**Timothy Tufer**
Partner  
M&A Transaction Services  
Deloitte & Touche LLP  
+1 408 704 4888  
ttufer@deloitte.com