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Spin doctors

Attorneys, M&A advisors assist clients with corporate spin-offs and divestitures

By BERNADETTE STARZEE

A whole is often better than the sum of its parts, but some business owners choose to roll the dice with the parts.

Attorney Louis Vlahos has noted an uptick in shareholders opting, for various reasons, to spin-off part of their corporation, creating two separate companies. When a spin-off is done for a valid business reason and one or more of the parent corporation's shareholders control the spun-off company (and certain other conditions are met) it can be a tax-free transaction.

"The spin-offs that I'm encountering are not limited to any particular industry," said Vlahos, a partner at Uniondale-based law firm Farrell Fritz, who has a concentration in tax law. "I think the number of such transactions is attributable to the realization by closely held businesses and their advisers that a serious dispute among groups of shareholders need not end in litigation, or the sale of the business, or the buyout of one or more of the owners, each of which can be very expensive, and not only from a tax perspective. After all, buyouts usually have to be financed."

Vlahos said spin-offs occur for a variety of reasons.

"Sometimes there is a difference of opinion about which line of business to pursue, or which geographic region to concentrate on," he said.

As baby boomers age, parents in family businesses are stepping back as the next generation assumes control.

"The parents may have been the moderating force between the kids, and now you might have two kids who are feeling their oats and want to go in different directions," Vlahos said. In one recent spin-off, he said, two brothers had developed different lines within the company, and they were disagreeing about how to allocate resources between the two lines. "They reached a deadlock and decided to go their separate ways," he said.

In another deal, a company that did business in New York and Philadelphia decided to divide along geographic lines.

"One owner was only participating in the Philly part of the business, so they separated and gave that person equity in only that company," Vlahos said.

Sometimes, splitting a company in two allows one part to compete for business that it otherwise would not be able to get.

"If I run two lines of a business, and I compete with Company B as to one line, but my other line could sell services to Company B, I might not get that business, since Company B is more likely to buy those services from a company that is not their competitor," Vlahos said. "Spinning off one of the lines would allow the other to compete for Company B's business."

LOUIS VLAHOS: When shareholders disagree about the direction in which the business should go, a spin-off can be a cost-effective solution.

GREGG SCHOR: For owners looking to sell their business or part of their business, there are more types of buyers than ever before.

THERE WAS A TIME WHEN PRIVATE EQUITY FIRMS WERE ONLY INTERESTED IN VERY SUBSTANTIAL PURCHASES – IN THE BILLIONS OR VERY HIGH MILLIONS – BUT NOW THERE ARE ALL DIFFERENT TYPES AND SIZES OF PRIVATE EQUITY FIRMS WITH INTEREST IN TRANSACTIONS AT ALL LEVELS.

A company may want to promote a key employee to shareholder, but it might not make sense to make him or her a shareholder for the entire corporation.

"If I'm producing widgets and toys, and this guy's a key widget person but has nothing to do with toys, I might not want to give him equity in the whole corporation when he is not instrumental in the toy part at all," Vlahos said. "Separating the two businesses into two corporations allows you to give the person an interest where he is a key."

Even when a part of the business is spun off internally, however, third-party equity may be needed.

"The second company may need a whole new infrastructure," said Gregg Schor, CEO of Protegrity Advisors, a Ronkonkoma-based merger and acquisition advisory firm that serves businesses with revenues ranging from $5 million to $100 million. "A lot of services like HR, finance and other administrative functions may have been shared between the two lines, and the second company may not be able to operate from the same offices or warehouse. There may not be budget dollars available to create a new infrastructure for whichever company is being spun off. They might look for a majority or minority investor."

One of Schor's services is advising companies about whether it would make sense to divest a part of their business to a third party.

"For a variety of reasons, one area of the business may be a drain on the others and may be holding the company back," he said. "For instance, one of the business units may be more demanding on infrastructure or require more attention from management."

In a recent divestiture, a company that had been in business for 50 years sold off the legacy part of the business.

"That's how the company started, but in recent years it developed a related product line that has tremendous growth potential, and the family members saw a lot more potential in focusing on that part," Schor said.

With the evolution in technology, many companies that started as brick-and-mortar businesses have put a greater focus on e-commerce, and that has been a catalyst for some to consider spinning off or divesting part of the business, Schor said.

"The divergence in the old way and the new way of doing business may come to a tipping point where it makes sense to split them," he said.

Companies looking to sell off part of their business will find that there are plenty of buyers, Schor said.

"There are more buyers and more different types of buyers than ever before," Schor said.

There was a time when private equity firms were only interested in very substantial purchases – in the billions or very high millions – but now there are all different types and sizes of private equity firms with interest in transactions at all levels, Schor said.

"We get about three blind calls a week from private equity firms looking to introduce themselves," he said. "They say, 'Here's our deal criteria; let us know if you have any companies that fit.'"

In addition, "there are family offices who used to invest their money in private equity, but who now say, 'Why don't we acquire companies directly?'" Schor said.

Then there are "public and private companies who are having trouble growing organically, so they are looking to gain revenue, market share and talented employees through acquisition," Schor said.

"There are a lot more entities looking to buy companies than there are quality companies to acquire, so it's definitely a seller's market," he said.

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