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OPED: HOW TO GET VALUE FOR NON-CORE ASSETS WITH CVR SPINOFFS

A new type of transaction, the contingent value right spinoff, offers companies a way to unlock the value of non-core assets.

BY DEAL CONTRIBUTORS

The following article was written by Ryan Murr, Branden Berns and Stephen Glover. Murr is the co-chair of the life sciences practice group at Gibson, Dunn & Crutcher LLP, while Berns is a life sciences partner and Glover is an M&A partner.

In public M&A, valuation expectations are often wildly divergent, particularly for sellers with a collection of assets ranging from mature to early-stage. In these cases, buyers are often only interested in the more mature assets, while sellers perceive untapped value in earlier-stage assets that could create value.

In this dynamic, the most common outcomes are for the buyer to overpay for assets that it does not value or for the seller to sell the entire company without receiving value for these assets.

The only other option is to spin out the earlier-stage assets, a process that takes months to complete, is expensive and creates a new public company with the attendant costs and burdens.

As an alternative to a spinout, the authors have developed a new transaction structure — the CVR spin — in which target stockholders receive non-transferrable contingent value rights (CVRs) representing the future value of the spun-off assets.

The CVR spin gives target stockholders the benefit of ownership of a new entity holding non-core assets without an immediate requirement to register the transaction or the securities with the SEC.

The structure involves four steps. First, the target transfers the non-core assets to a new subsidiary or SpinCo that is initially wholly owned by the target. The SpinCo issues its shares to the target in consideration for the target's contribution of assets to the SpinCo.

Gibson Dunn's Ryan A. Murr, Stephen Glover and Branden C. Berns

Second, the target forms a trust and contributes the SpinCo shares to the trust in consideration for the right to receive all proceeds from the SpinCo shares held by the trust.

The target then enters into a contingent value rights agreement with a rights agent and distributes CVRs under that agreement to target stockholders shortly before the target is acquired by the buyer. CVRs are distributed by the target as a dividend and transfer the right to receive proceeds derived from the SpinCo shares held in trust.

Finally, following the distribution of the CVRs to target stockholders, the SpinCo's board and management may seek a buyer for SpinCo and return the sale proceeds to target stockholders via the CVR or run the SpinCo as a standalone entity, raising capital and continuing operations.

In the latter case, SpinCo can subsequently file a registration statement with the SEC to exchange the SpinCo shares held in trust for the CVRs and allow the CVR holders to hold SpinCo shares directly.

The CVR spin solves the problem of overpaying or underpaying for the target and offers two key advantages when compared to a traditional spinoff that is registered with the SEC prior to closing.

First, the CVR spin can be completed quickly without delaying the closing of the acquisition. The most frequently cited reason to not pursue a concurrent spinoff is the substantial timing delay.

Second, the CVR spin creates a new entity that initially has only one stockholder - the CVR Trust - which eliminates the need for the SpinCo to operate as a public company immediately.

The terms of the CVR must be carefully constructed to fit within SEC guidance, but there is ample precedent for CVRs returning value for legacy assets in the M&A context that the CVR spin can leverage.

A target could instead form a liquidating trust and rely on a set of parallel SEC no-action letters confirming that non-transferrable liquidating trust interests do not represent securities. The issuance of liquidating trust interests in connection with the bankruptcy of General Motors Co. (GM) is a notable precedent here.

The tax treatment of the CVR spin requires careful consideration. From this perspective, the ideal candidate for a CVR spin would be a target without current or accumulated earnings and profits and available net operating losses that exceed the value of SpinCo. The tax consequences of the CVR spin are likely to be manageable for targets fitting that profile, such as many development-stage biotechnology companies.

Even though divergent valuation expectations are frequent in public M&A deals, concurrent spinoffs remain uncommon because of the significant delays associated with the SEC registration process. The CVR spin allows parties to spin off non-core assets efficiently while retaining flexibility for the SpinCo to monetize or develop the assets after closing and thereby unlock value for target stockholders that would have been lost. ■

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