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Analyzing the Financial Viability of Reverse Morris Trust Transactions

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ABSTRACT

The purpose of this paper is to more deeply understand the broader implications of Reverse Morris Trust (RMT) transactions. Existing research cites that RMT transactions are “very complicated as they involve what is essentially a carveout/subsidiary sale, spin-off and public company merger all in one negotiated transaction” (Glaccum & Donnelly 2018). Notably, this transaction type is executed in a completely tax-free manner, making it a very appealing prospect for large companies today. The paper will include discussions around the advantages of such transactions, the specific 1966 court case which initially introduced the RMT deal structure, the tax code within the IRC that allows this transaction to take place, and will ultimately evaluate historic RMT transactions to consider their financial viability. The data aspect of this paper is centered around using 36-month pre-announcement returns to calculate abnormal returns for the Parent and RMT Partner companies involved. Ultimately, after performing statistical tests on these returns and comparing their significance, I attempt to determine whether RMT transactions are value-creating for the Parent, RMT Partner, both, or neither. Effectively, this analysis is conducted to better understand whether RMT transactions produce long-term financial benefits for the shareholders involved.

In conclusion, statistical analyses showed that RMTs appear to be value-creating for both Parent and RMT Partner companies. Interestingly, the value created by RMTs does not seem to be systematically different for Parent companies vs. RMT Partners, for larger deals, for deals where the seller keeps a large stake, or for deals involving debt.

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Chapter 1

Introduction

Reverse Morris Trusts (RMTs) are a unique transaction structure that has existed for less than a century. The transaction structure allows a distributing corporation, called the Parent, to spin off a holding company, called the SpinCo, with an aim of combining the SpinCo with another distributing corporation, called the RMT Partner. Interestingly, this particular form of transaction emerged from another type of transaction called the Morris Trust, which enables a distributing corporation, namely the Parent, to spin off a subsidiary while the Parent merges with another distribution corporation. For that reason, the primary difference between two transaction structures is that Morris Trusts typically combine two already public corporations while Reverse Morris Trusts combine a public corporation with the SpinCo of another public corporation (Glaccum & Donnelly 2018). Accordingly, it makes sense that the ‘reverse’ form of the Morris Trust transaction structure is, namely, the Reverse Morris Trust.

RMT Transaction Structure

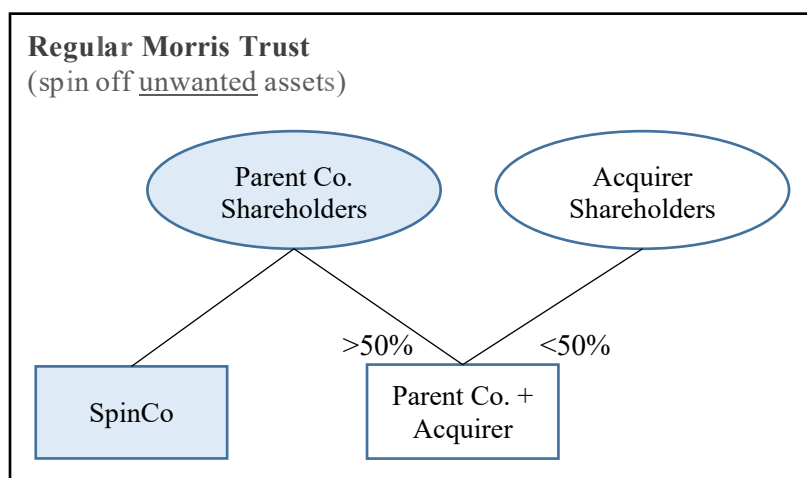


Figure 1: Transaction Structure for Morris Trusts

Source: Macabacus

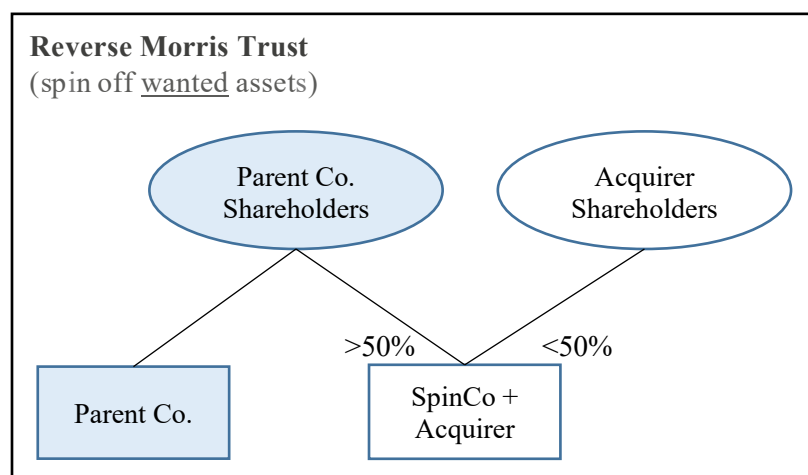


Figure 2: Transaction Structure for Reverse Morris Trusts

Source: Macabacus

Figure 1 and Figure 2 provide further detail regarding the two transaction structures. The traditional Morris Trust transaction enables a Parent to spin off any unwanted assets or divisions into a SpinCo and results in the Acquirer combining with the Parent (Handler 1980). In contrast, the RMT structure enables a Parent to spin off assets or divisions that are desired by the Acquirer into a SpinCo and results in the Acquirer combining with the Parent (Beller 1996). It is important to note that both forms of these transactions are considered tax-free if executed correctly.

Given that a spin-off is the initial step to properly execute an RMT transaction, a discussion of tax implications concerning spin-offs is necessary. Under federal tax regulation, traditional spin-offs do not have to pay federal income tax. More specifically, the Internal Revenue Code (IRC) Section 355 provides tax-exempt status for spin-offs because the parent company and its shareholders do not recognize taxable capital gains (Schler 2012).

As previously discussed, in order for a public corporation to successfully execute a Reverse Morris Trust, the corporation must first spin off certain assets within the business. As defined in *The Journal of Finance*, a spin-off is when a parent company releases control of a subsidiary by issuing shares of the subsidiary as a nontaxable stock dividend to existing

shareholders (Vijh 1994). The strategy has long been recognized by firm executives as an effective way to execute corporate restructuring. However, given the large amount of tax legislation around what qualifies a transaction to be considered a spin-off, the complexities associated with spin-offs can often be understated. In fact, as described by Michael L. Schler in his 2003 book called *Simplifying and Rationalizing the Spin-off Rules*, “the complexities and uncertainties [around spin-offs] are so great that spin-off ruling requests are reported to represent more than half the workload of the entire IRS corporate division” (Schler 2003).

Section 355 of the Internal Revenue Code governs a distributing corporation’s (referred to as “Distributing”) ability to spin off one of its subsidiary corporations (“Controlled”) in a tax-free manner. As a matter of principle, a spin-off results in the Distributing entity allocating the Controlled shares to existing Distributing shareholders, thereby giving existing Distributing shareholders possession of both Distributing and Controlled stock. There is a combination of statutory requirements and non-statutory requirements that the Distributing entity must follow to correctly spin off a Controlled entity, including maintaining a voting and ownership interest of at least 80%, having a reasonable rationale for the spin-off, being an entity with active operations, and agreeing to distribute the Controlled entity’s shares to the Distributing entity’s shareholders following the transaction (Hanafy 2001). Appendix B provides further details on these tax implications.

How Reverse Morris Trusts Came to Be

As mentioned earlier in the paper, the Reverse Morris Trust transaction structure originated from the 1996 *Commissioner v. Morris Trust* court ruling that established the Morris Trust structure. The plaintiff was a state-licensed bank in North Carolina, called American

Commercial Bank (American), that aimed to merge operations with a federally-licensed bank, called Security National Bank of Greensboro (Security National) (*C.I.R. v. Morris Trust*, 367 F.2d 794 (4th Cir. 1966)). Both companies hoped to merge and become a federally-licensed bank. However, federal law restricted the transaction, indicating that a federally-licensed bank is not legally allowed to operate the insurance operations held by American. To legally bypass this restriction, American transferred its insurance assets into a newly formed entity called American Commercial Agency, which was then spun off (Steward 1998). Maintaining the elements of a valid spin-off, American distributed this new entity's stock to its existing shareholders. American's remaining business was then merged with Security National.

Subsequently, American shareholders cited IRC Section 355 to argue that the distribution of SpinCo stock qualifies for tax-exemption. The Commissioner of Internal Revenue disputed the argument, contending that (a) the simultaneous spin-off and merger element of the transaction cannot be considered tax-free and (b) the active business requirements in Section 355 were also not met.

The court ultimately ruled in favor of the transaction taking place and awarding tax-exempt status to the distributing company's shareholders, which effectively created the Morris Trust transaction structure.

Emergence of Reverse Morris Trust Transactions

As previously discussed, there are a considerable number of requirements for a transaction to be deemed as a legitimate RMT transaction. Despite this, RMT transactions have become increasingly attractive for public companies given their ability to restructure subsidiary ownership in a tax-free manner (Hicks, Levere, Stevenson 2017). Figure 3 shows total deal value

for all RMT transactions announced during 2002 – 2021, exhibiting this growing popularity as RMT transaction value multiplied nearly ten-fold from 2018 to 2021.

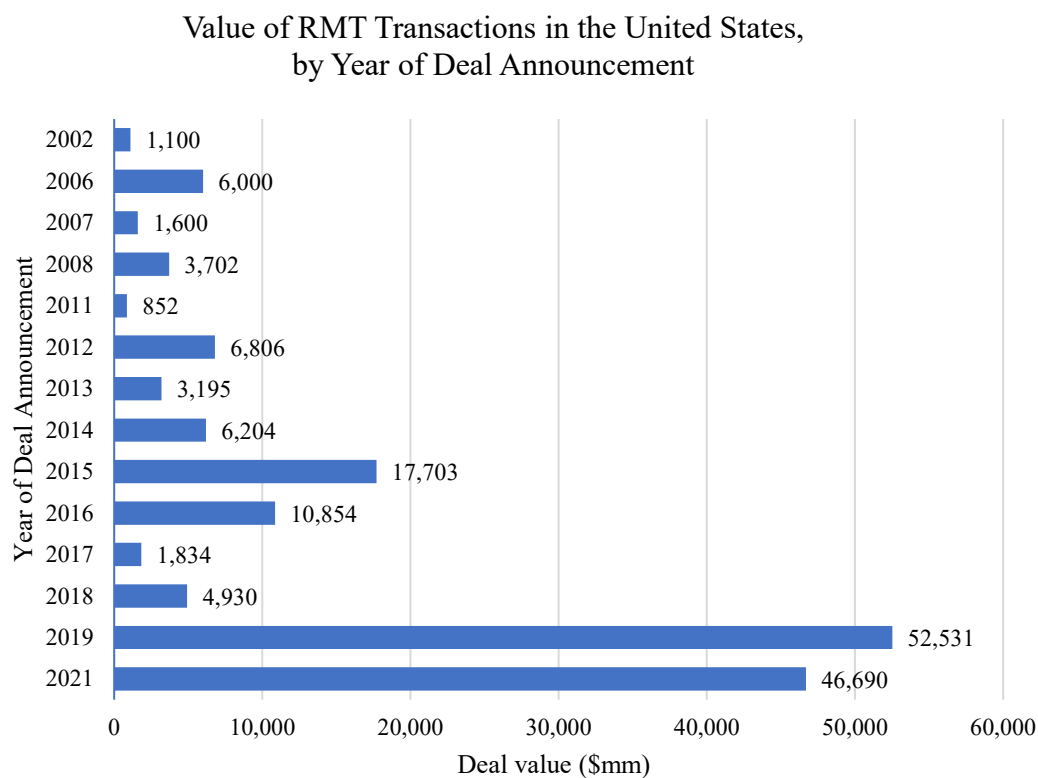


Figure 3: Value of RMT Transactions in the U.S.

Source: FactSet and Zephyr

Appendix A shows the total value of merger and acquisition deals announced for the same period, emphasizing company management’s reliance on executing RMT deals to create value in recent years (Zenner, Junek, Chivukula 2015). It is important to note the transaction value shown grossly misrepresents the volume of RMT transactions during some years. For example, as shown in Figure 3, 2021 was a record year for RMT transactions in terms of deal value with transactions crossing ~\$45 bn. However, as represented in Figure 4, 2021 was a relatively modest year for RMT transactions in terms of deal volume with merely two transactions being announced.

Number of Total RMT Transactions in the United States,
by Year of Deal Announcement

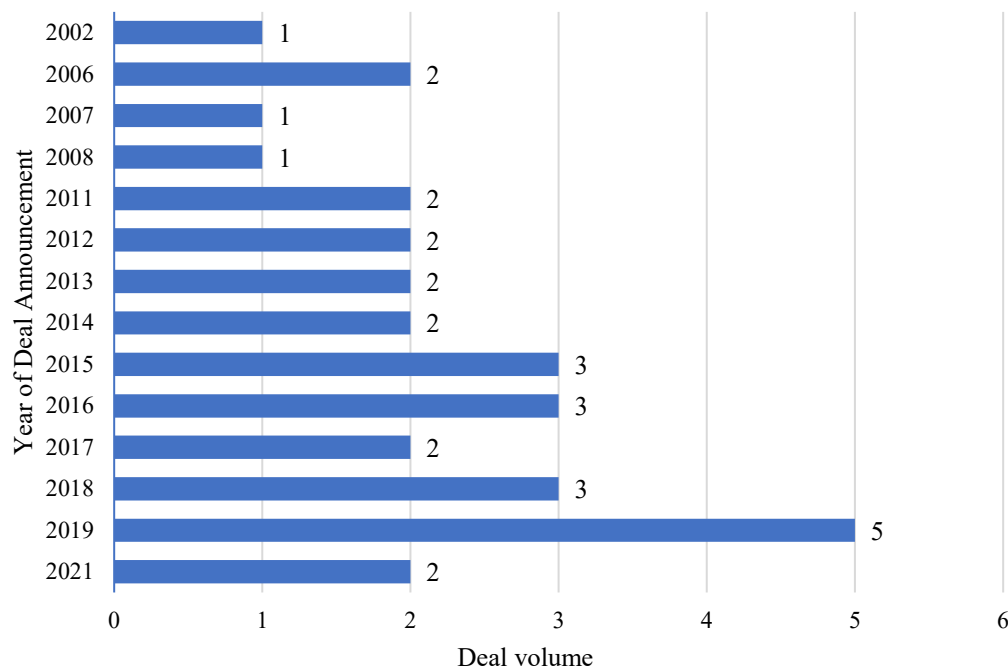


Figure 4: Volume of RMT Transactions in the U.S.

Source: FactSet and Zephyr

Broadly, RMT transactions have mostly increased in value and volume over the last 20 years. There are a variety of reasons that can attribute for the growing acceptance for such technically intricate transactions. Firstly, a low interest rate environment has afforded companies access to lower cost of capital, enabling RMT Partners to make and finance larger acquisitions from Parent companies. Additionally, institutional investors have invested more heavily in activist hedge funds which, along with causing a rapid growth in assets under management, has initiated activist pressure on company management to spin off any non-core assets (Zenner, Junek, Chivukula 2015).

Chapter 2

Deeper Context into Reverse Morris Trusts

As previously stated, a Reverse Morris Trust transaction typically requires a publicly-traded company, named the Parent, to spin off a holding company, named the SpinCo, with an aim of combining it with another publicly-traded company, named the RMT Partner. More specifically, the transaction involves the Parent distributing all of SpinCo's equity to existing shareholders of the Parent. Following this, the SpinCo merges with the RMT Partner through a "reverse subsidiary merger" that allows for the Parent's stockholders to sell their SpinCo equity in exchange for shares of the RMT Partner's stock (Canellos 2001).

It is important to note that, since the shareholders of the Parent must have at least 50.0% ownership and voting power in the newly-formed merged entity, the transaction structure effectively requires the RMT Partner to be smaller than the SpinCo business on a valuation basis. According to the highly-esteemed and trusted law firm Skadden, RMT transactions are, while complicated, very useful in negotiations based around valuation (Glaccum & Donnelly 2018). For example, the RMT transaction's advantage around tax exemption "may create transactional opportunity as Parent or RMT Partner may be willing to transact at a valuation that does not need to compensate Parent for the tax leakage" (Glaccum & Donnelly 2018). In fact, the authors further mention that such a competitive advantage "could also give RMT Partner an advantage over other interested parties in a competitive process for the SpinCo business" (Glaccum & Donnelly 2018).

The unique transaction structure may also allow for post-transaction synergies for the RMT Partner that were previously not possible. For example, the RMT structure avoids traditional IPO costs associated with a subsidiary having to go public since the RMT Partner

is an already public company that is purchasing the subsidiary. These synergies are in addition to any cost or revenue synergies generated from the transaction, assuming the subsidiary complements the RMT Partner's business.

In addition to synergies, it is important to consider how different factors influence the value of RMT transactions for the Parent and the RMT Partner. More specifically, it must be understood how these RMT transactions will result in positive net present value (NPV) deals for each party.

For Parent companies, the transaction is positive NPV if the following holds true:

$$S_{\text{Gained}} + T_{\text{Gained}} > S_{\text{Lost}} + TC_{\text{Incurred}}$$

S_{Gained} = synergies paid to parent by RMT Partner

T_{Gained} = tax benefit realized given RMT structure

S_{Lost} = synergies lost from releasing subsidiary

TC_{Incurred} = transaction costs incurred from releasing subsidiary

For RMT Partner companies, the transaction is positive NPV if the following holds true:

$$S_{\text{Gained}} > TC_{\text{Incurred}} + P_{\text{Incurred}} + C_{\text{Lost}}$$

S_{Gained} = synergies realized from merging with subsidiary

S_{Lost} = synergies lost from releasing subsidiary

TC_{Incurred} = transaction costs incurred from merging with subsidiary

P_{Incurred} = total price paid (incl. any premium paid) to Parent so subsidiary is released

C_{Lost} = control benefits lost from Parent acquiring >50% of pro-forma entity

These comparisons are necessary to specify. Investors use these relationships as a basis for forming their opinion on transactions, which ultimately dictate the abnormal returns experienced by the Parent and RMT Partner companies involved in these deals.

Complexities surrounding Reverse Morris Trust Transactions

RMTs are notoriously-recognized as difficult transactions to execute as they require a subsidiary sale, spin-off, and reverse merger combined in a single transaction (Glaccum & Donnelly 2018). For that reason, it is critical that the Parent and RMT Partner carefully plan and negotiate the transaction to ensure adequate execution of the transaction.

There are a few primary considerations that must be satisfied in order for the transaction to be legally executed. In order for the RMT Partner to formally enter into an RMT transaction, the shareholder approval of the RMT Partner is required. On the contrary, the Parent is not typically required to seek approval from its shareholders for the distribution of SpinCo's shares to the Parent. Moreover, it is required that the RMT not leave any of the three aforementioned parties insolvent or in violation of any existing financial covenants. In case the Parent is unsure if its financial conditions meet such criteria, it may pursue a "solvency" opinion to confirm its ability to participate in an RMT (Glaccum & Donnelly 2018).

Separately, preceding the execution of the transaction, the accounting teams of both the RMT Partner and SpinCo will need to collaborate to create pro forma financial statements. In order to formally confirm the RMT, the Parent, RMT Partner, and SpinCo must sign a Merger Agreement as it is the principal documentation binding the parties to the terms of the transaction. Within the agreement are governing covenants for each of the parties, including government approvals, filing of registration statements with the SEC, and, as previously mentioned, the stockholder approval of the RMT Partner (Glaccum & Donnelly 2018).

Along with the Merger Agreement, the Parent and SpinCo must sign a Separation Agreement that dictates how assets and liabilities will be allocated within the SpinCo and the Parent following the spin-off. Lastly, these three parties must also enter into a Tax Matters

Agreement that confirms their acknowledgment to cooperate when completing tax returns and/or engaging in any tax-triggering events post-transaction. This agreement is common for tax-free spin-offs. Aside from these three primary agreements, the parties involved may have to sign and engage in an Employee Matters Agreement (that discusses each party's responsibility around compensation and benefits for employees within each of the entities involved), a Transition Services Agreement (that assists the SpinCo with departing the Parent and integrating with the RMT Partner), and real estate agreements for the division of any long-term assets (Glaccum & Donnelly 2018).

Advantages of RMT Transactions

As mentioned previously, Reverse Morris Trust transactions are some of the more complicated transactions to execute by companies today. In fact, despite spin-offs having occurred for many decades, provisions around Section 355 transactions continue to be highly-contested and unclear among experts (Steinberg 1997). Due to this, it is not surprising that RMT transactions are inherently exposed to severe regulatory risks, which can quickly result in lost synergies and higher-than-expected transaction costs (Mills 2020). Therefore, given the growing acceptance of RMT transactions despite these high risks, it becomes important to discuss the different advantages of RMT transactions. The obvious advantage is the Parent being able to spin off a subsidiary in a tax-free manner. Another attractive, and often overlooked, aspect of the RMT transaction is that it enables the Parent to partially monetize its existing ownership in the controlled entity in a tax-efficient manner (Wolf 2012). Wolf explains that the conventional practice, in absence of an RMT transaction, would be the subsidiary borrowing funds and distributing the cash proceeds back to the Parent (Wolf 2012). Alternatively, subsidiaries may

often also issue debt securities to the Parent in exchange for the Parent's outstanding debt, relieving the Parent of its external debt obligations. However, both of these strategies come with heavy tax implications and significantly drive down the value of the subsidiary, which further demonstrates the effectiveness of the RMT structure. Furthermore, another key benefit of RMT transactions is the ability for a Parent to receive cash proceeds on a tax-free basis, while the SpinCo incurs new debt to finance these proceeds. The Parent company can then use this cash to pay down its outstanding debt.

Chapter 3

Data & Methodology

This section contains the chosen sample of data, explains how it was acquired, and describes the specific methodology implemented within the analysis. In addition, this section will discuss any special considerations that were considered to ensure the empirical results were not biased or skewed.

Table 1 is a comprehensive list of the recent RMT transactions that is used as the primary dataset for this paper. The list is sourced from FactSet and Zephyr.

Announce- ment date	Parent Company ("Distributing Company")	RMT Partner ("Acquiror")	Spun-off Entity ("Target")	Deal value (\$mm)
6/13/2002	HJ Heinz Company	Del Monte Foods Company	Heinz HJ Co /North American Food Operations/	1,100.00
1/23/2006	The Walt Disney Company	Citadel Broadcasting Corporation	ABC Radio Holdings	2,700.00
8/23/2006	Weyerhaeuser Co.	Domtar, Inc.	Weyerhaeuser Co. /Fine Paper Business/	3,300.00
1/16/2007	Verizon Communications, Inc.	FairPoint Communications, Inc.	Verizon Communications, Inc. /ME, NH & VT Ops/	1,600.00
6/3/2008	Procter & Gamble Co.	The J. M. Smucker Co.	The Folger Coffee Co.	3,702.13
11/17/2011	MeadWestvaco Corp.	Acco Brands Corp.	MeadWestvaco Corp. /Consumer & Office Products Business/	852.16

12/5/2011	Entergy Corporation	Mid South Transco LLC	Entergy Corporation's Electric Transmission Business	13 N.A.
3/28/2012	Tyco International Ltd	Pentair, Inc.	Tyco Flow Control, Inc.	4,811.44
7/19/2012	PPG Industries Inc.	Georgia Gulf Corporation	PPG Industries Inc.'s Commodity Chemicals Business	1,995.00
4/22/2013	International Paper Company	Unisource Worldwide, Inc.; Bain Capital Private Equity LP	xpedx, Inc.	500.00
11/4/2013	Weyerhaeuser Co	Tri Pointe Homes, Inc. /Old/	Weyerhaeuser Real Estate Co.	2,694.79
4/29/2014	Alliant Techsystems, Inc.	Orbital Sciences Corp.	Alliant Techsystems, Inc.'s Sporting Group Business	3,584.65
10/13/2014	Danaher Corp.	NETSCOUT Systems, Inc.	Danaher Corp. /Communications Business (3)/	2,619.38
3/27/2015	The Dow Chemical Co	Olin Corp.	The Dow Chemical Co. /Chlor-Alkali & Derivatives Businesses/	5,030.00
7/9/2015	The Procter & Gamble Company	Coty Inc.'s Green Acquisition Sub Inc.	Galleria Company	11,173.24
10/28/2015	Starwood Hotels & Resorts Worldwide Inc	Interval Leisure Group, Inc.	Vistana Signature Experiences, Inc.	1,500.00
1/26/2016	Lockheed Martin Corporation	Leidos Holdings Inc.	Lockheed Martin Corp. /Information Systems & Global Sol's Bus/	3,200.00
7/26/2016	Citrix Systems Inc	LogMeIn, Inc.	Get-go, Inc. (Massachusetts)	1,802.56

9/7/2016	Hewlett Packard Enterprise Co.	Micro Focus International Plc	Hewlett Packard Enterprise Co. /Software Division/	5,850.99	14
2/2/2017	CBS Corporation	Entercom Communications Corp.	CBS Radio, Inc.	1,433.72	
10/11/2017	DXC Technology Company	Ultra SC Inc	Veritas Capital Fund Management LLC /2 Portfolio Cos/	400.00	
3/7/2018	Fortive Corporation	Altra Industrial Motion Corp.	Fortive Corp. /Automation & Specialty Platform/	3,000.00	
4/12/2018	Genuine Parts Company	Essendant Inc.	Rhino SpinCo Inc.	680.00	
4/23/2018	Henry Schein, Inc.	Direct Vet Marketing, Inc.	Henry Schein Animal Health	1,250.00	
4/30/2019	Ingersoll Rand Inc.	Gardner Denver Holdings, Inc.	Ingersoll-Rand Plc /Industrial Segment/	1,900.00	
7/1/2019	Emmis Communications Corp	Standard General L.P. (Private Equity)	MediaCo Holding, Inc.	N.A.	
7/29/2019	Pfizer Inc	Mylan Nv	Pfizer, Inc. /Upjohn Business/	12,731.50	
12/15/2019	DuPont de Nemours Inc	International Flavors & Fragrances, Inc.	Dupont De Nemours, Inc. /Nutrition & Biosciences Unit/	33,506.00	
12/19/2019	Ecolab Inc.	Apergy Corp.	Nalco Co. /Upstream Energy Business/	4,393.20	
2/16/2021	Rexnord Corporation	Regal Beloit Corp.	Rexnord Corp. /Process & Motion Control Business/	3,690.00	
5/17/2021	AT&T Inc.	Discovery, Inc.	Warner Bros.	43,000.00	

Table 1: List of Recent RMT Transactions

Source: FactSet and Zephyr

<u>Variable</u>	<u>Mean</u>	<u>Std. Dev.</u>	<u>Median</u>	<u>Min</u>	<u>Q1</u>	<u>Q3</u>	<u>Max</u>	<u># Of Observations</u>
Deal Value	5,655	9,537	2,700	400	1,467	4,602	43,000	31

Note: Values in \$mm (excl. '# of Observations')

Table 2: Summary Statistics (in \$mm)

As noted in Table 2, the value of the 31 RMT transactions in this dataset varies from \$400 mm to \$43 bn. The average deal size was \$5.7 bn with a standard deviation of \$9.5 bn, suggesting that deal value varied significantly and depended on a deal-to-deal basis.

I hypothesize that RMT transactions are value-creating for both Parent and RMT Partner companies since, by revealed preference, neither party would agree to an RMT transaction unless they are convinced the transaction will add value to their organization. This is especially true given that RMT transactions are generally costly, difficult to execute, and often prone to severe regulatory risks. In a way, the transaction is a 'win-win' for both parties as the RMT Partner usually receives a complementary business from the Parent and the Parent is able to spin off non-core assets without being taxed on the proceeds received.

To get a holistic understanding of the prior RMT transactions, I used FactSet and Zephyr to generate a comprehensive list of historic RMT transactions. The list contained 31 RMT transactions in total, including the oldest transaction being announced in June of 2002 and the most recent being announced May of 2021. It is important to mention that this dataset of 31 transactions will be the primary basis of the analysis conducted within this paper. Given that this paper is centered around investigating Parent companies and RMT Partner companies within each of these 31 transactions, the forthcoming analysis should include 62 companies. However, five of the RMT Partner companies, consisting of Unisource Worldwide, Inc., Micro Focus International Plc, KeyPoint Government Solutions Inc., Direct Vet Marketing, Inc., and Standard

General LP, were privately-held companies during the month of the announcement release. Since it is not feasible to find returns data for these private companies, these five companies will be precluded from the upcoming analysis.

Following this, monthly stock return data since May of 1998 was downloaded for each of the Parent and RMT Partner companies involved in these 31 transactions, excluding the previously mentioned 5 companies. The monthly stock returns were used, as opposed to daily returns, to smooth out overly-volatile and noisy data. It is important to note that this return data was generated from the Wharton Research Data Services (WRDS) CRSP U.S. stock database to restrict returns for U.S.-listed companies and for the desired time period. Additionally, data on each of these aforementioned companies were downloaded based on the companies' PERMNO identification number since a few of companies had undergone changes to their corporate tickers and names within three years prior to the deal announcement.

Looking exclusively at raw returns misrepresents price reactions that are directly resulted from the announcement of an RMT as raw returns include reactions from broader market swings. To adjust for this, it was decided that the analysis regarding announcement returns for RMT transactions would be based on abnormal returns for each Parent and RMT Partner company. For the time period associated with each of these transactions, I retrieved monthly data on the risk-free rate and the market risk premium from Kenneth French's Data Library at the Tuck School of Business at Dartmouth College. Using the difference between the monthly returns from WRDS and the monthly risk-free rates for the 36 months prior to the announcement date of each transaction, I obtained the excess monthly return on each of the Parent and RMT Partner companies involved in the aforementioned RMT transactions. Ultimately, by running a simple regression on the excess monthly return for each of these companies and excess return on the

market for the corresponding 36 months before the transaction announcement, I was able to produce alpha and beta values for each of these companies.

It is important to note that eight companies (Fortive Corporation, DuPont de Nemours Inc., Citadel Broadcasting Corporation, FairPoint Communications, Inc., Tri Pointe Homes, Inc., Coty Inc.'s Green Acquisition Sub Inc., Gardner Denver Holdings, Inc., and Apergy Corp.) within the dataset did not have monthly returns data that went back all 36 months, since they went public less than 36 months before the RMT announcement, so the regressions were computed based only on the available months of returns.

$$R_{it} - R_{ft} = \alpha_i + \beta_i (R_{mt} - R_{ft}) + e_i$$

R_{it} = total return on stock at time t

R_{ft} = risk free rate at time t

α_i = alpha value

β_i = beta value

R_{mt} = total return on market index at time t

e_i = error term

Source: "Common Risk Factors in the Returns on Stocks and Bonds" (Fama, French 1992)

Using these calculated alpha and beta values, abnormal returns for each Parent and RMT Partner can be calculated. More specifically, the expected monthly excess returns were calculated by adding each company's alpha value to the company's corresponding beta value times the total excess return on the market index during the month of the transaction announcement. From there, each of the expected monthly excess returns were subtracted from the actual monthly excess returns, which is calculated by subtracting the return on the risk-free rate from the total return on each company's stock during the month of the transaction announcement.

Then, abnormal returns for each of these companies were regressed against a variety of different factors (in the form of dummy variables), including if the company was the Parent or RMT Partner company in the transaction, if the pro-forma stake the company held after the transaction was greater or less than 66.66% of the pro-forma entity, and if transaction involved debt. Using Stata software, each of these regressions were run along with accompanying statistical tests to confirm the significance of each of these when looking at if RMT transactions are value-creating for the Parent, RMT Partner, neither, or both.

Chapter 4

Data Analysis & Results

This section details the findings as a result of the procedures followed in the previous section. Table 3 presents results of the first four statistical tests computed to see whether overall returns of the two groups (Parent and RMT Partners) were positive, were statistically significant, and if there was a meaningful difference between their returns to conclude that one group has historically achieved superior value creation for its shareholders.

Abnormal Returns

	(1) Overall Sample	(2) Returns for Parent Companies	(3) Returns for RMT Partner Companies	(4) Difference between Returns of Parent & RMT Partner Companies [diff = mean(Parent) – mean(RMT_Partners)]
Type of Test	One-Sample t-Test	One-Sample t-Test	One-Sample t-Test	Two-Sample t-Test with unequal variances
H0	mean = 0	mean = 0	mean = 0	diff = 0
Ha	(a) mean < 0 (b) mean ≠ 0 (c) mean > 0	(a) mean < 0 (b) mean ≠ 0 (c) mean > 0	(a) mean < 0 (b) mean ≠ 0 (c) mean > 0	(a) diff < 0 (b) diff ≠ 0 (c) diff > 0
Observations	57	31	26	57
Avg. Return	0.0337 (0.0158)	0.0256 (0.0102)	0.0432 (0.0327)	-0.0176 (0.0343)
P value	(a) 0.9812 (b) 0.0377** (c) 0.0188**	(a) 0.9912 (b) 0.0176** (c) 0.0088***	(a) 0.9008 (b) 0.1984 (c) 0.0992*	(a) 0.3052 (b) 0.6105 (c) 0.6948

Note: Standard errors in parentheses. ***, ** and * respectively denote statistical significance at 1%, 5% and 10% levels.

Table 3: Statistical Analysis comparing Parent vs. RMT Partner Returns

T-test on Consolidated Dataset

The first test (1) conducted in Table 3 was a one-sample t-test on the entire dataset of 57 observations, consisting of 31 Parent companies and 26 RMT Partner companies. The Parent and RMT Partner companies were assigned dummy variables of '0' and '1', respectively. The null hypothesis was assumed to be that overall mean abnormal returns of these 57 data points is zero. The data was tested at three different alternative hypotheses, including that the mean abnormal returns are (a) less than zero, (b) not zero, or (c) greater than zero. As a result, the output indicated a blended average abnormal return of 3.37% for the combined dataset of 31 Parent and 26 RMT Partner companies. The corresponding p-values showed greatest statistical significance for (c) at a 5% level of significance, indicating that the null hypothesis must be rejected and there is strong evidence to conclude that the overall mean abnormal returns for the dataset are positive.

T-test on Parent Returns

While the previous test indicated that abnormal returns for the overall data was positive, it is important to look at the Parent and RMT Partner company groups individually. In other words, it is necessary to test if the each of the groups have positive returns or one group has negative returns and the other has significantly more positive returns, thereby skewing the data. The second test (2) in Table 3 utilized a one-sample t-test to test the 31 Parent company data points. The hypotheses were similar to before: H_0 = the overall mean abnormal return for Parent companies is zero and H_a = the overall mean abnormal returns for Parent companies are (a) less than zero, (b) not zero, or (c) greater than zero. As a result, the output indicated an average abnormal return of 2.56% for the 31 Parent companies. The p-value was most statistically significant for (c) at a 5% level of significance, suggesting that the null hypothesis must be

rejected and there is strong evidence to conclude that the mean abnormal returns for Parent companies are positive.

T-test on RMT Partner Returns

The third test (3) in Table 3 used a one-sample t-test to find the significance of returns produced by the 26 RMT Partner companies. As before, the hypotheses were as follows: H_0 = the overall mean abnormal return for RMT Partner companies is zero and H_a = the overall mean abnormal returns for the RMT Partner companies are (a) less than zero, (b) not zero, or (c) greater than zero. As a result, the output indicated an average abnormal return of 4.32% for the 26 RMT Partner companies. Interestingly, the p-values from all three of these alternative hypotheses showed no statistically significant evidence at a 5% level of significance to reject the null hypothesis that the returns deviate from zero. However, conducted at a 10% alpha level, the p-value for (c) shows statistical significance. Therefore, while it is weak, there exists statistical evidence at a 10% level of significance to conclude that the mean abnormal returns for RMT Partner companies are positive.

T-test on Difference between Parent & RMT Partner Returns

The fourth test (4) in Table 3 aimed to test for difference in means between the two groups using a two-sample t-test. The second test (2) on Parent companies and the third test (3) on RMT Partner companies indicated drastically different standard errors, suggesting that a t-test for unequal variance would be most appropriate. Utilizing the entire dataset of 57 companies, Stata was used to find if the difference between returns of Parent and RMT Partner companies was zero (null hypothesis). Accordingly, the alternative hypotheses were the difference is (a) less

than zero, (b) not zero, or (c) greater than zero. As a result, the output indicated an average difference in abnormal returns of -1.76% between 31 Parent and 26 RMT Partner companies, implying that RMT Partner companies generate an additional 1.76% abnormal return than Parent companies for RMT transactions. The corresponding p-values indicated that there is insufficient evidence to conclude a statistically significant difference between returns of Parent and RMT Partner companies, suggesting that the difference between returns of the two groups is zero.

In order to better understand the factors impacting return profiles for Parent and RMT Partner companies, a multitude of regression tests are conducted. The results of these five tests are exhibited in Table 4.

	(1) Abnormal Returns	(2) Abnormal Returns	(3) Abnormal Returns	(4) Abnormal Returns	(5) Abnormal Returns
Parent Returns	-	-	-	-	-
RMT Partner Returns	0.0202 (0.039)	-	0.4383 (0.257)	0.0167 (0.041)	0.0433 (0.056)
ln(DealValue)	-	-0.0311 (0.024)	-0.0098 (0.029)	-	-
High Stake in RMT Partner	-	-	-	-0.0204 (0.056)	-
Deal involves Debt	-	-	-	-	0.0083 (0.051)
Parent Returns x ln(DealValue)	-	-	-0.0513 (0.033)	-	-
Parent Returns x High Stake in RMT Partner	-	-	-	0.0203 (0.122)	-
Parent Returns x Deal involves Debt	-	-	-	-	-0.0416 (0.083)
Year FE	Yes	Yes	Yes	Yes	Yes
Observations	57	54	54	57	57

R-squared	0.1958	0.2545	0.3094	0.1974	0.2042
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Note: Standard errors in parentheses. ** and * respectively denote statistical significance at 5% and 10% levels

Table 4: Regression Analysis using Ordinary Least Squares Method

OLS Regression – Difference in Returns for Parent vs. RMT Partners

The first test (1) conducted in Table 4 was an ordinary least squares regression that looked at 57 observations, comprising of both Parent and RMT Partner data. The test included a fixed effect for the announcement year of the transaction as broader market movements can meaningfully influence returns in a given year for these two groups. The fixed effect controls for extreme values within the returns data as it standardizes returns on a yearly basis. Additionally, the standard errors are clustered by the year of deal announcement. The regression returned a positive coefficient for the difference between the RMT Partner and the Parent. Overall, the regression suggests that RMT Partners generate higher returns than Parent companies but the difference is not statistically significant.

OLS Regression – Effect of Different Deal Sizes on RMT Returns

The second test (2) conducted in Table 4 was an ordinary least squares regression to find possible relationships between abnormal returns experienced by RMT Partners and Parent companies and the size of RMT transactions they were involved in. This test looked at 54 observations, comprising of both Parent and RMT Partner data. The test included a fixed effect for the announcement year. The standard errors are clustered by year. Additionally, prior to administering the regression, it was discovered that the deal value variable was not originally distributed normally. A logarithmic transformation was applied to the deal value data for this

reason. The regression returned a negative coefficient for the relationship between returns and deal value for the 54 companies involved in RMT transactions. Overall, the regression suggests that larger deals tend to generate lower returns but the difference in returns experienced between small and large deals is not statistically significant.

OLS Regression – Effect of Deal Sizes on Returns by Parent vs. RMT Partner

The third test (3) conducted in Table 4 was an ordinary least squares regression that builds on the previous test. The test aims to find how the size of an RMT transaction impacts abnormal returns experienced by a Parent company when compared to its impact on the abnormal returns experienced by a RMT Partner. This test looked at 54 observations, comprising of both Parent and RMT Partner data. The test included a fixed effect for the announcement year. The standard errors are clustered by year. Additionally, given that the deal value data was not originally distributed normally, a logarithmic transformation was applied to the deal value variable for this reason. Looking at the interaction term Parent Returns x $\ln(\text{DealValue})$ in Table 3, the regression returned a negative coefficient for the relationship, indicating that the Parent's returns are inversely-related with size of the RMT deal but are not statistically significant. Additionally, with respect to the RMT Partner term, the regression returned a positive coefficient for the relationship, indicating that the RMT Partner's returns are negatively correlated with size of the RMT deal but are not significant. Overall, the regression analysis suggests the following conclusions: (a) for very small deals, RMT Partners earn higher returns than Parent companies and (b) for very large deals, Parent companies earn higher returns than RMT Partners. It is important to clarify that neither (a) nor (b) have strong statistical significance.

OLS Regression – Effect of Assuming Higher Stake in Pro-Forma on Returns

The fourth test (4) conducted in Table 4 was an ordinary least squares regression that was based on 57 observations, comprising of both Parent and RMT Partner data. The test aims to find how a Parent company's decision to maintain a larger stake in the pro-forma entity impacts abnormal returns experienced by Parent company or the RMT Partner in that transaction. The test included a fixed effect for the announcement year. The standard errors were clustered by year. Additionally, an interaction between 'Parent Returns' and 'High Stake in RMT Partner' was created to check for the influence of the term. Looking at this interaction term Parent Returns x High Stake in RMT Partner in Table 3, the regression returned a positive coefficient that was quite small in magnitude for the relationship. Moreover, the standard error for this term is large, suggesting that the data is noisy. Overall, the regression does not show a statistically significant correlation between the Parent company acquiring a high-stake in the pro-forma entity and returns experienced by the Parent or the RMT Partner company. In other words, the Parent company's decision to maintain a high stake in a pro-forma entity cannot be used to predict higher or lower returns for both the Parent company and the RMT Partner.

OLS Regression – Effect of RMT Deal Involving Debt on Returns

The fifth test (5) conducted in Table 4 was an ordinary least squares regression that was based on 57 observations, comprising of both Parent and RMT Partner data. The test aims to find whether a transaction's involvement of debt impacts abnormal returns experienced by Parent company or the RMT Partner in that transaction. The test included a fixed effect for the announcement year. The standard errors were clustered by year. Additionally, an interaction between 'Parent Returns' and 'Deal involves Debt' was created to check for the influence of the

term. With respect to the interaction term ‘Parent Returns x Deal involves Debt’ in Table 3, the regression returned a negative coefficient that was quite small in magnitude for the relationship. Moreover, the standard error for this term is very large as it is roughly double of the coefficient value, suggesting that the data is noisy. Overall, the regression does not show a statistically significant correlation between an RMT transaction involving debt and returns experienced by the Parent or the RMT Partner company. In other words, an RMT transaction’s choice to use debt has no statistically significant influence on generating higher returns for both the Parent company and the RMT Partner.

Possible Explanations for Results

There are a multitude of possible explanations for the results obtained within this study. No single explanation offered can serve to fully describe why the results in the study were the way they were. To that end, there are various valid and interesting justifications for these results.

From the one-sample t-test conducted on the 31 Parent companies involved in RMT transactions, I find that the returns experienced by the Parent companies are positive and statistically significant at a 5% level of significance. It makes sense that the RMT transaction results in positive abnormal returns for the Parent companies given that its shareholders are receiving the opportunity to capitalize on a subsidiary within a company. Furthermore, similar to the substantial bid premium offered to target shareholders in most corporate acquisitions today, it is likely there is a substantial premium offered to Parent’s shareholders for them to approve the sale of one of Parent’s subsidiaries. Unfortunately, finding the fair value of each subsidiary involved in the RMT dataset for this study and, subsequently, calculating the typical premium

offered by the RMT Partners for the subsidiary would require additional analysis and is outside the scope of this paper.

From the one-sample t-test conducted on the 26 RMT Partners, I find that the returns experienced by RMT Partners are positive and statistically significant at a 10% level of significance. Seeing that these transaction returns are positive for RMT Partners makes logical sense since RMT Partners would likely never agree to a transaction unless they believed it generated positive NPV. Interestingly, while this test indicated that returns for RMT Partners are positive, it is important to realize that these returns were extremely volatile and prone to outliers given that they had a large standard error of 0.0327.

The remaining tests conducted at the beginning of this section all proved to be not statistically significant, offering weak evidence to prove the following points:

- a) as noted in the two-sample t-test, the differences between the returns for the Parent and RMT Partner companies was not statistically different from zero
- b) larger deals tend to have lower returns
- c) for very small deals, RMT Partners earn higher returns than Parent companies
- d) for very large deals, Parent companies earn higher returns than RMT Partners
- e) the Parent company's decision to maintain a high stake in a pro-forma entity does not generate higher or lower returns for both the Parent company and the RMT Partner
- f) whether or not an RMT transaction involves debt has no influence on generating higher returns for both the Parent company and the RMT Partner

Chapter 5

Conclusion

As existing literature cites, Reverse Morris Trust (RMT) transactions are among the most complicated financial transactions. Due to this and their growing popularity among large companies today, the widespread impact of these transactions continues to be researched among experts and academics within finance. The purpose of this paper was to contribute to existing literature regarding the true financial viability of RMT transactions for the primary parties involved. More specifically, the paper is aimed at finding whether or not RMT transactions are value-creating for the Parent, RMT Partner, both, or neither. Within this study, to measure the degree of value-creation generated by each party, 36-month pre-announcement returns for 57 different companies involved as either Parent or RMT Partner companies were used as the primary basis of data. This data was regressed along with monthly market return data to compute alpha and beta values for each of these companies to find abnormal returns. Through a combination of regression and t-tests that were conducted, results regarding the correlation between abnormal returns of these companies and factors influencing them, along with their statistical significance, were calculated.

The statistical tests from the study exhibit interesting, and perhaps surprising, results. Overall, the average abnormal return is 2.56% for Parent companies and 4.32% for RMT Partner companies. While average abnormal returns experienced by RMT Partner companies were considerably larger, it is important note that these returns were noticeably noisier and more volatile than returns experienced by the Parent companies – this is evidenced by the RMT Partner returns having a standard error of 0.0327 compared to the 0.0102 for Parent returns. Based on the statistical analyses discussed previously in the paper, RMTs appear to be value-

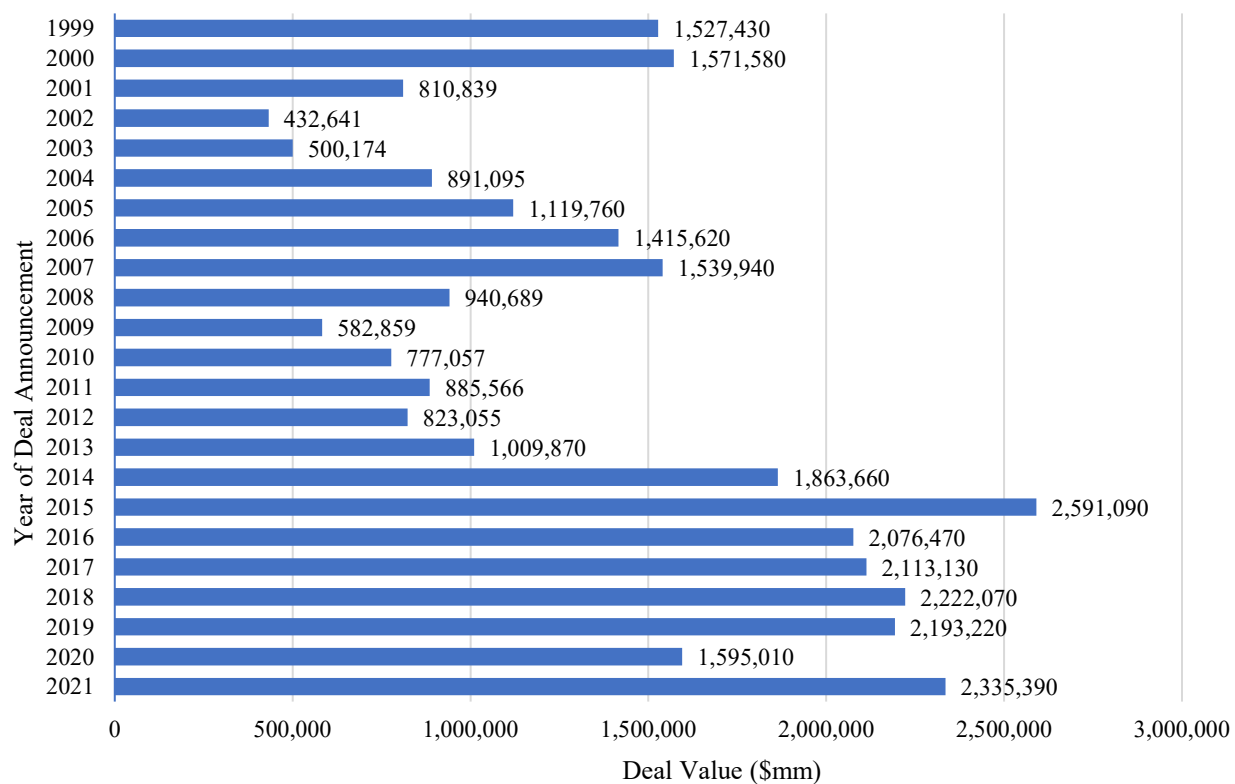
creating for both Parent companies and RMT Partners. Interestingly, the value created by RMTs does not seem to be systematically different for Parent companies vs. RMT Partners, for larger deals, for deals where the seller keeps a large stake, or for deals involving debt.

The conclusions presented in this empirical study offer unique findings regarding RMTs to the world of finance. Existing research suggests that mergers and acquisitions have historically shown positive announcement returns for the target company while generating substantially weaker, and sometimes negative or zero, returns for the acquirer (Bruner 2001). Corporate executives are often knowledgeable regarding this trend and, therefore, are careful when evaluating possible acquisitions and deciding possible bid premiums to offer. In context of the results found in this paper, and understanding how RMTs transactions affect returns for Parent and RMT Partner companies, corporate executives can more effectively forecast returns for their own firm. Alternatively, shareholders of companies that may have been rumored, or are likely, to engage in a potential RMT transaction can use this analysis to better predict returns for those companies. Altogether, these results offer meaningful contributions to existing literature regarding the effects of Reverse Morris Trust transactions on returns.

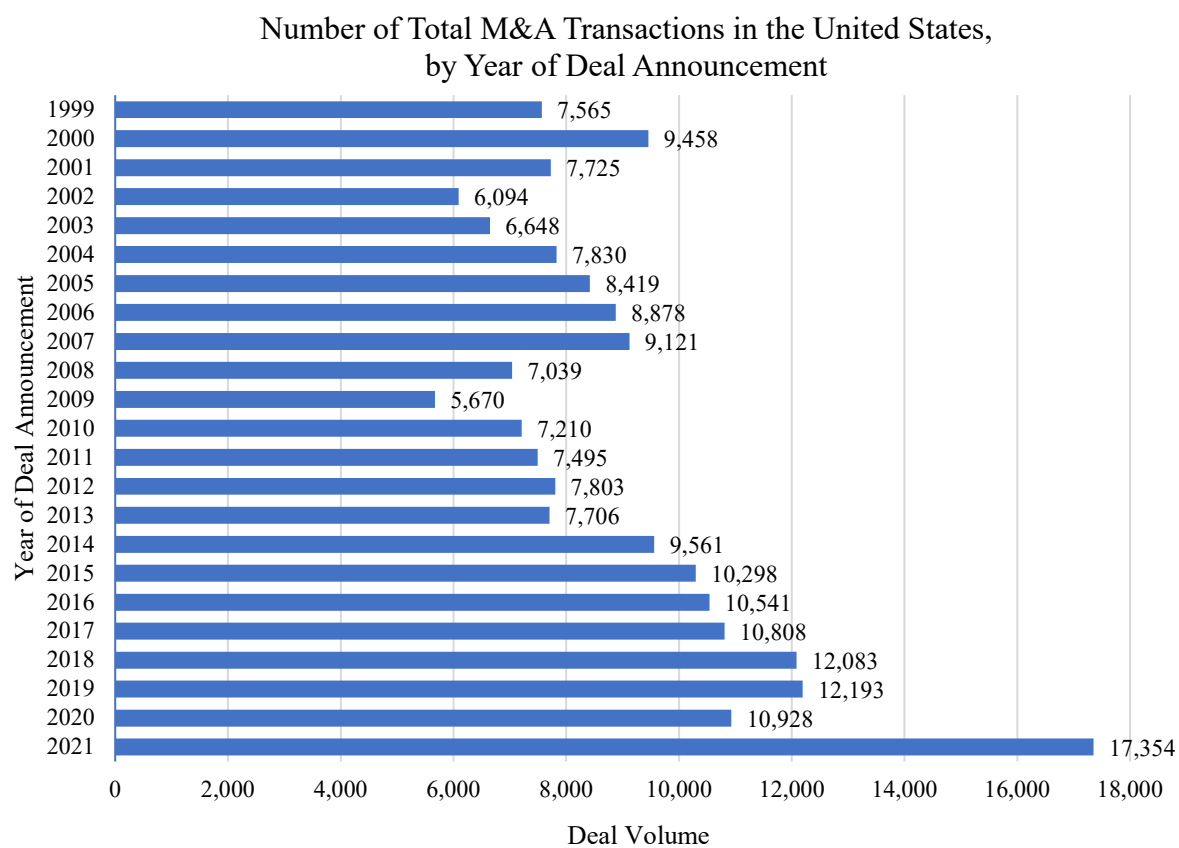
Appendix A

M&A Deals per Year

Value of Total M&A Transactions in the United States,
by Year of Deal Announcement



Source: Bloomberg



Source: Bloomberg

Appendix B

Notable Tax Considerations under IRC Section 355

This section summarizes the specific tax regulations around spin-offs detailed in Section 355 of the Internal Revenue Code (U.S. Code § 355). The rules govern how a distributing corporation (referred to as “Distributing”) can properly spin off one of its subsidiary corporations (“Controlled”) in a tax-free manner.

(i) Control: To be considered for a spin-off, the Distributing entity must have control of the subsidiary. More specifically, the Distributing entity must own at least 80% of the total combined voting power (generally proxied by a Distributing entity ability to elect directors on board of Controlled) of all stock classes able to vote in the Controlled entity and at least 80% of the outstanding shares of any stock classes held by Controlled.

(ii) Device: To qualify, a transaction cannot be used as a principal device for the “direct distribution of the earnings and profits” of the Distributing entity, Controlled, or both. However, the code does note that any sale without prearranged negotiations, that is innocent in nature, cannot be interpreted as a violation of this requirement. Everything considered, the transaction must be driven by adequate business purpose and rationale; the spin-off cannot be merely used for the Distributing shareholders to sell and capitalize in a tax-free way on their Controlled stake following the transaction.

(iii) Active Trade or Business: Under this aspect of the code, the Distributing and Controlled entities must both be considered to participate in an active trade or business. The active trade or business requirement is outlined by meeting four key qualifications: the entity being in an active trade or business, the active trade or business must be engaged for at least a five-year period ending on the “date of distribution,” the entity must have not been previously

acquired during the aforementioned five-year period ending on the “date of distribution,” and the Controlled entity must not have been acquired by the Distributing entity during the same aforementioned five-year period ending on the “date of distribution” (Kidder 2011).

(iii) Distribution: In order to qualify for tax-free consideration in a spin-off under Section 355, the Distributing entity must disperse all of the stock and securities within the Controlled entity immediately before the distributing transaction takes place (Kidder 2011). It is implied that this aforementioned stock is distributed to the Distributing entity’s shareholders.

(iv) Business Purpose: In form of a non-statutory requirement, distributing entities must hold a legitimate business purpose for the spin-off transaction to be accepted under Section 355. Examples of commonly accepted transaction rationale include enabling to the Distributing entity to focus on its core business or service, to shift overly-risky business units away from its primary function, to split unwanted assets away from necessary assets, strengthen capital efficiency, and lower costs (Kidder 2011).

(v) Continuity of Interest: Following the spin-off, the transaction must demonstrate that the Distributing entity’s shareholders maintains a minimum level of interest in both the Distributing and Controlling entity. Typically, the level of continued interest must at 50% or greater of the Controlled entity. As a secondary component to this requirement, shareholders of the Distributing entity must maintain ownership of the Distributing and Controlled entity for a specific period of time – typically five years in accordance with Section 368 of the Internal Revenue Code.

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RELEVANT EXPERIENCE

LionTree LLC

Investment Banking Summer Analyst

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Jun 2021 – Aug 2021

- Received full-time offer following 10-wk summer internship based on Technology, Media, and Telecom (TMT) transactions
- Built discounted cash flow and leveraged buyout financial models to obtain implied valuations for companies within TMT sector
- Presented case study on Tripadvisor (NASDAQ: TRIP) with potential M&A rationale and accretion/dilution analysis to senior mgmt.

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- Internship at middle market investment bank that focused on debt financing and M&A transactions for specialty finance companies
- Assisted in creating various valuation models, pitch books, and other marketing deliverables for current and prospective clients
- Conducted and presented industry research to help senior executives at the bank provide strategic advisory to existing clients

Nittany Lion Fund, LLC

Director of Compliance & Lead Fund Manager | Real Estate Sector

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- Managed ~\$300.00 k within the Real Estate Sector of the student-run hedge fund with ~\$10.65 MM in private investor capital
- Created valuations for prospective holdings using fundamental analysis, analyst reports, discounted cash flow models, and comparable analysis through data from SEC filings, FactSet, and Bloomberg, all to design an equity portfolio that outperforms S&P 500

Associate Fund Manager | Information Technology Sector

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- Co-managed ~\$2.06 MM Information Technology Sector and compiled weekly, monthly, quarterly, and annual reports for investors

Leveraged Lion Capital

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Dec 2019 – Dec 2021

- Co-administered the Healthcare Sector within the nation's first student-run syndicated paper loan and high-yield bond portfolio with \$125.00 MM in paper assets under management, striving to outperform the LSTA 100 leveraged loan benchmark index
- Analyzed potential leveraged loan and high yield bond investments by performing credit analysis, evaluating credit agreements, examining capital structures, and building financial models through Bloomberg, FactSet, Capital IQ, and research reports

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- Interviewed and selected for organization partnered with BAML, the Loan Syndication and Trading Association, and S&P Global
- Assembled weekly and monthly reports while monitoring sector holdings through industry and company analyses

LEADERSHIP & INVOLVEMENT

Racquetball

USA National Medalist, Two-Time Pennsylvania State Champion

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Jun 2014 – Present

- Competed at the U.S. National Junior Olympic Racquetball Championships, placing 2nd in 16U competition and 3rd in 18U division
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- Developed foundational leadership and effective time management skills through completing 7 necessary ranks in under 30 months
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