Dupont’s divestiture of conoco

DuPont began life in 1802, as a gunpowder manufacturer supplying the US Army under President Thomas Jefferson. The company had a long tradition of technological innovations in business and it continues to serve worldwide markets includingfoodand nutrition; healthcare; agriculture; fashion and apparel; home and construction; and electronics. Among some of its inventions are nylon stockings invented in 1939, Teflon for pans, Kevlar for bullet-proof vests, stainmaster for carpets, the synthetic fabric lycra, and Dacron for clothing.

In 1999 the company held a portfolio of 2000 trademarks and brands. DuPont was the 15th largest company in the US with its 1998 revenue reaching $45. 1 billion. The company operated 200 manufacturing and processing facilities in 65 countries with 98, 000 employees worldwide. Conoco began in 1875 as the Continental Oil and Transportation Co. , one of the first petroleum marketers in the West. The company has made it through plenty of tough and challenging times from the stock market crashing just a month after Conoco took its stock public, to overseas expansion, to the oil crisis of the 19070's.

Then in 1981 a simple proposal by Canada's Dome Petroleum about acquiring a Conoco subsidiary, Hudson's Bay Oil and Gas left the company wide open. In order to assure an adequate supply of petroleum products to use as chemical feed stocks, DuPont bought Conoco on Sept. 30, 1981. Conoco became a wholly owned DuPont subsidiary in the largest merger ever at that time, costing DuPont $7. 8 billion. As a subsidiary of DuPont, Conoco became a major, integrated, global energy company operating in 40 countries worldwide.

The company was involved in both downstream and upstream activities like exploring for, developing, refining, marketing, transporting, and selling crude oil and natural gas. In 1998, Conoco ranked 8th in worldwide production of petroleum liquids by US companies, 11th in natural gas production, and 8th in refining throughput. In 1997 both DuPont and Conoco planned to pursue new corporate strategies: DuPont wanted to transform into a life sciences company focused more on biotechnology and less on petrochemicals, and Conoco desired financial independence to make significant foreign asset investments.

While part of DuPont, Conoco doubled its value between 1986 and 1996, and realigned its assets. By late 1998, DuPont divested Conoco in a two-step process. First it would sell a minority stake in Conoco through an IPO otherwise known as an IPO carve-out. Then it would execute a spin-off and sell the rest of its ownership interest in the subsidiary at a later time. Under the split-off, DuPont shareholders would be given the opportunity to exchange their DuPont shares for shares in Conoco at a predetermined ratio of 2. 5 to 1.

Participation in the exchange rate would be completely voluntary. On October 22, 1998 the Conoco IPO netted $4. 4 billion for 30% of Conoco culminating in the largest IPO in history. Then on August 9, 1999 the swap of DuPont stock for Conoco stock was finalized. DuPont secured about $21 billion in after tax value through the IPO and stock swap. I think DuPont’s two-stage divestiture worked the best because the company was able to make the transaction tax-free at both the corporate and personal levels. This basically means that DuPont sold off shares of Conoco in two separate stages.

The company avoided the corporate capital gains tax by structuring the deal as a primary offering, which is the first of issuance of stock for public sale from a private company. Under this approach Conoco would sell new shares to the public and use themoneyfrom the offering to pay down an equivalent amount of its debt. If a second offering had been used, DuPont would directly sell a portion of its Conoco shares for cash, possibly creating a capital gains tax liability for itself if the sale proceeds exceeded its tax basis in the shares.

The primary public offering of 25% of Conoco by DuPont was also good for shareholders because it met the objectives of maximizing shareholder value and it also allowed Conoco to capitalize on different investment opportunities for energy companies going on at the time. In order to make the second stage completely tax free DuPont had to satisfy a number of IRS rules and regulations. These rules stated that DuPont had to control Conoco immediately before the split-off, meaning that it had to control at least 80% of Conoco's stock. In addition the split had to be motivated by a valid business purpose.

Also DuPont had to get rid of all Conoco stock so it would not have any control over the company after the deal was completed. Conoco had to be recapitalized or reorganized into two classes of common stock. Class A stock that carried one vote each, issued to the public and Class B stock with five votes each, retained by DuPont for later disbursement to DuPont shareholders in the exchange offer. Prior to the IPO, Conoco would have to issue a $7. 5 billion promissory note to DuPont as a dividend. The payment would be tax free to both parties because at the time DuPont owned all of Conoco.

Conoco would in turn, use the proceeds to pay back part of the note and other intercompany notes with DuPont. While I do agree with the Chief Operating Officer that a 100% IP of Conoco would raise a significant amount of cash to use in our core business growth internationally, allowing us to expand our global operations. I think the equity care-out was the best choice for DuPont to do instead of a complete 100% IPO. The reason I say that is because the deal still allowed DuPont to raise some capital but it also allowed DuPont to retain firm control of the subsidiary before, selling the remaining shares in a tax-free spin-off at a later date.

A 1998 working paper from Pennsylvania State University examined 83 equity carve-outs done between 1981 and 1990, and found that carved-out companies had significantly higher revenue and asset growth, higher earnings, and higher capital spending than the industry average during the first three years after the carve-out--achievements, the authors say, that are a direct result of 80 percent of the deals tying executive compensation to the share price of the carved-out company at the time it goes public. " It's a way of providing a stronger incentive for subsidiary executives to perform," says James A.

Miles, one of the authors of the study, along with Heather Hulburt and J. Randall Woolridge. Parent companies also benefit from a carve-out. The Penn State study, in fact, found that these companies had a higher return on assets in the first year after the carve-out. And a similar study by J. P. Morgan & Co. , which examined 101 carve-outs between 1986 and 1997, documented that, on average, the share price of the parent rose between 3 and 4 percent in the 90 days following the announcement of a carve-out.

The company’s ownership of Conoco has added great marketing and purchasing clout to DuPont’s operations just like the Executive VP for Research and Development and Product Development suggests, but again I don’t think that owning a majority share would benefit the company like getting rid of all ownership would do. The decision to retain majority ownership, however, may limit the upside to the deal. The J. P. Morgan study found a distinct difference in the share price performance of carve-outs that later became spin-offs and carve-outs that did not.

In the case of 12 carve-out companies in which the parent announced there would be a later spin-off, the share price of the carve-out performed 11 percent above the market 18 months after the initial public offering. The shares of all other carve-outs--those without an announced spin-off later--actually underperformed the market by 3 percent. In closing I think DuPont did the right thing when they decided to go through with a two-stage divestiture of Conoco. I think they got the most bang for their buck by doing the deal this way.

DuPont was able to net $4. 4 billion for 30% of Conoco resulting in the largest IPO in U. S. history. DuPont was also able to spin-off the rest of their shares of Conoco and secured about $21 billion in after tax value through the IPO and a stock swap. I think this was the best move because both companies were looking to go in different directions. DuPont wanted to transform into a life sciences company focused more on biotechnology and less on petrochemicals, and Conoco desired financial independence to make significant foreign asset investments.