



What is the Horizon Kinetics Global Spin-Off Index?

The Horizon Kinetics Global Spin-Off Index (“Index”) is a unique, rules-based index that tracks the performance of passively-distributed spin offs in the US and developed markets of Western Europe and Asia. The design of the Index was based on a significant volume of research—academic publications, Wall Street research reports and Horizon Kinetics’ own history in analyzing these types of transactions dating back nearly 20 years—that has shown that a basket of spin-off securities has historically outperformed the broader equity markets over a multi-year time period. The research analyzing this phenomenon covers approximately 50 years of transactions and dates back to the mid-1960’s in the US, while other, more recent publications have found similar results in the international markets.

We have carefully defined the spin-offs included in the Index as those which have been passively distributed to shareholders of the parent company. This means that shareholders are not required to take any action in order to receive shares of the spun-off entity. Although this definition captures the vast majority of spin off transactions, it purposefully excludes certain types of transactions that are typically referred to as spin-offs in the financial press. For example, carve-outs, which involve selling a percentage of a subsidiary to the public via an initial public offering or rights offering, and split-offs/share exchanges, which require shareholders of the parent to exchange shares of the parent for shares of the spin off, are excluded from the Index.

Why Have Spin Offs Generated Superior Returns for Shareholders?

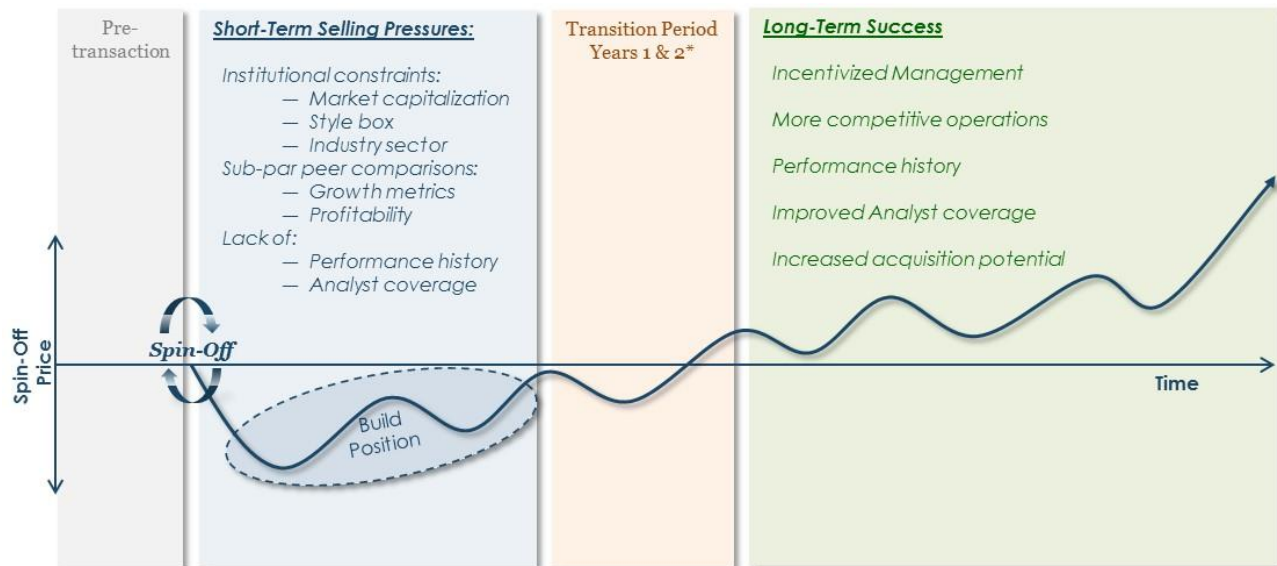
Successful spin-offs benefit from a number of technical and fundamental factors that can create significant value for shareholders. The technical aspects are related to the manner in which passive spin-offs are distributed and the consequences this can have on the shareholder base and stock price, while the fundamental aspects are related to a spin-off’s newfound ability to create value as an independent company. It is also worth noting that there have historically been a meaningful number of takeovers involving spun-off companies, which has contributed positively to their share price performance.

Shareholders do not elect to receive shares in the spin-offs that are tracked by the Horizon Kinetics Global Spin-Off Index. Instead, these shares are automatically distributed to shareholders of the parent company. As a result, there can be a large number of shareholders that do not wish to own the spin off or, more interestingly, are not allowed to own the spin-off in their portfolio even if they wanted to. This can happen when the mandate of an asset manager’s fund prevents the fund from owning the spin-off, typically because it is either too small, in a different industry than the parent, or if the spin-off is to be removed from an index (such as the S&P 500) that included its parent company. In these instances, a significant portion of the new shareholders for a spin-off can become forced sellers of the security once the distribution occurs. This can create an attractive buying opportunity for new investors; one that can persist for some time, as these companies are often too small to attract traditional Wall Street research coverage.

Once separated, spin-offs often have a number of straightforward opportunities to meaningfully improve the fundamentals of their business. For instance, these companies may have been burdened by an unfair proportion of the parent company’s general overhead expenses, which will now be eliminated. A spin-off may be able to pursue growth projects for the first time, if it had previously been starved for financial and



managerial resources under its former parent company. The elimination of conflicts of interest with the parent may also allow a spin-off to pursue a number of new client relationships or make its business significantly more efficient. Put simply, the separation may present a spun-off company with its very first opportunity to manage its business for its own benefit and the benefit of its shareholders. For successful spin-offs, this can translate into revenue growth and margin improvement during their early years as independent entities, which can have a powerful, positive, long-term impact on their earnings.



Finally, merger and acquisition activity can add meaningfully to a spin-off's returns, as evidenced by the fact that approximately 10% of the global spin-offs over the last 11 years have been acquired during their first 5 years as an independent company, at premiums that have averaged 20%. During other periods, such as the 1965-1988 time frame analyzed by Cusatis, Miles and Woolridge, the superior returns associated with spin-offs "are limited to those involved in takeover activity¹."

Clearly, takeover activity is an important aspect of the lifecycle for spin-offs and, potentially, the primary factor in generating outsized returns. It is important to note, however, that spin-offs can be prohibited from engaging in mergers and acquisitions ("M&A") for a period of up to two years following the initial distribution in order for the transaction to be treated as a tax-free distribution to shareholders. With these points in mind, the constituents in the Horizon Kinetics Global Spin-Off Index are held for a period of 5 years. This allows the Index to participate in the potential returns from M&A activity, as well as the fundamental improvements that can be generated by these companies over the long-term. Securities are removed from the Index at the end of this 5-year holding period, as we believe they will, on average, behave more in line with the market and exhibit fewer of the characteristics and performance attributes of an early-stage spin off.

What are the Benefits of the Horizon Kinetics Global Spin-Off Index?

¹ Cusatis, Miles and Woolridge "Restructuring Through Spinoffs: The Stock Market Evidence" *Journal of Financial Economics* 33, 1993, pp. 293-311



The Horizon Kinetics Global Spin-Off Index provides systematic global exposure consistent with our findings that the spin-off anomaly exists in the US and developed markets of Western Europe and Asia. In addition, the Index is uniquely designed to capture the periods and events that have historically been associated with spin-off outperformance. Based on our research, the first year of a spin-off has, on average, offered the highest returns, as share price performance may benefit from a depressed initial price, the fundamental improvements made by the company, and a gradual appreciation by the investment community of the investment merits of the spin off. In order to gain exposure to these opportunities, the Horizon Kinetics Global Spin-Off Index is reconstituted quarterly and adds eligible, new spin-offs at the first quarter that they become available.

In order to capture the outperformance associated with takeover activity, it is important to have exposure to spin-offs for a period of greater than two years, as spin-offs may be required to abstain from this type of corporate restructuring for 24 months in order for the transaction to be treated as a tax-free distribution. To this end, the Horizon Kinetics Global Spin-Off Index holds these companies for 5 years.

The Horizon Kinetics Global Spin-Off Index is also unique in that all constituents in the Index receive an equal weight, which is a methodology that we believe is superior to traditional market capitalization-based weighting schemes. This allows the Index to have a greater exposure to smaller spin-offs—the companies that are most likely to be subject to forced selling, least likely to be researched by the investment community, and which may have the highest growth potential—than it would have if using a market capitalization weighting. In other words, we believe an equal-weighting gives the Index greater exposure to the securities most likely to behave like traditional spin-offs.

Disclosures:

The Horizon Kinetics Global Spin-Off Index (the “Index” or “GSPIN”) was created by Horizon Kinetics, parent company to Horizon Asset Management LLC and Kinetics Asset Management LLC, among others. Indxx, LLC, a third party, has a contractual arrangement with Horizon Kinetics whereby it has agreed to calculate certain Index components. The Index was launched in April 2014.

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