

Break-ups create wealth

Restructuring through de-mergers and spin-offs unlocks significant value for shareholders. In nine out of a sample of ten companies studied by Business Line, significant value was unlocked for shareholders, with returns ranging from 20 per cent to 200 per cent.

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Even as you finish counting the money you made from the re-organisation of the Reliance Group into distinct entities, you hear of other restructuring plays in the happening — from media companies such as Zee Telefilms and TV Eighteen to GE Shipping and Areva T&D to the unravelling of the United Breweries group. It appears that restructuring through de-mergers and spin-offs has become the best way to unlock significant value for shareholders, once again.

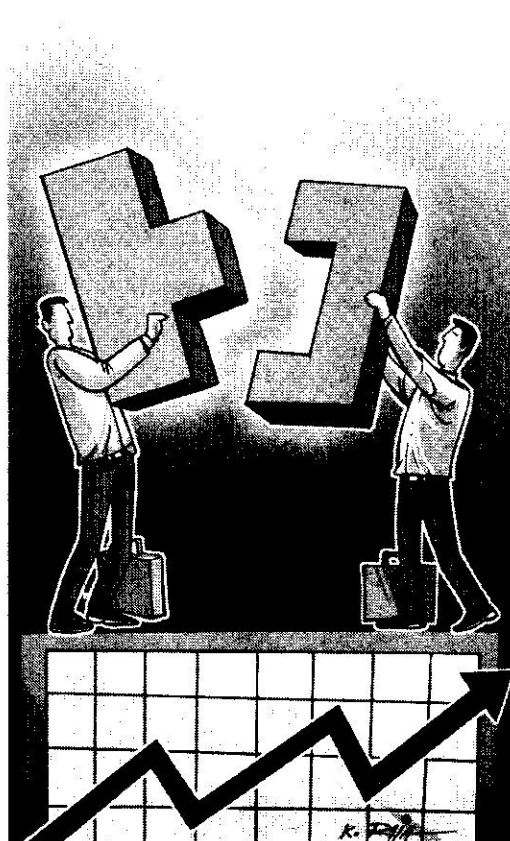
But has the restructuring effort by companies in recent years benefited shareholders? *Business Line* analysed 10 companies across sectors — FMCG, engineering, IT, sugar, automobiles and textiles — that have restructured since 2003, either by hiving off a business into a new entity or a merging it with an existing player in a similar line.

BEHIND DE-MERGERS

The rationale behind de-mergers or creation of several focused entities varies from case to case. For instance, a diversified company may find a business dragging its profitability or cash flows and decide to hive it off.

Sometimes a company does not get the valuation it deserves because one of its businesses suffers a low valuation in the market. This was the case with Eveready, where the cyclical nature of the tea business dragged down valuation of its FMCG business. Once the company spins off this business, however, its valuations may improve, as with Eveready.

In conglomerates, there is often a lack of clarity on the promoter holdings in various businesses, thanks to numerous cross-holdings. As they operate some of their high growth businesses through unlisted, associate companies, investors are denied direct exposure to these nascent, but promising plays. A round of restructuring could, in such cases improve valuations significantly simply through disclosures that clarify several issues of importance to investors. Investors in Reliance, for instance, now have a more di-



rect exposure to Reliance Infocomm.

SPINNING MONEY FROM SPIN-OFFS

If you were to invest in a company on the day the board approves a restructuring plan and wait for the new, spun off companies to list, you will be duly rewarded for your patience. In nine out of ten companies in our sample, significant value was unlocked for shareholders, with returns ranging anywhere between 20 per cent and 200 per cent. In most cases, it takes as much as a year for the new, or resulting, company to list. There could well be an opportunity loss in holding on to your investment.

You could, however, take comfort in the fact that in all nine cases, the returns generated have exceeded that of the market by a substantial margin. Prominent in this list is the de-merger of Larsen & Toubro's (L&T) cement division into UltraTech Cement. Your investment would have generated returns four times that of the market during the holding period.

Other notable examples include the spin-offs of Dabur's pharmaceutical business into Dabur Pharma, and the tea plantation business of Eveready into McLeod Russell.

The de-merger of NIIT's IT business into NIIT Technolo-

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gies is the initiative that did not click, the reason for which we will discuss up ahead.

SUSTAINING THE GAINS

While spin-offs do create value for shareholders, gains were sustained over a long term when resources were unlocked for the company as well. For instance, Dabur, in its original *avatar*, would have been hard pressed to fund the research-intensive pharmaceutical division, without sacrificing growth in its large portfolio of FMCG products.

Hiving off the pharma division freed up cash flows for its FMCG business that later funded a spate of acquisitions. Dabur now has a clutch of strong brands in its fold having made a few acquisitions and remained a strong market out-performer since the de-merger.

A de-merger could be the first in a series of restructuring initiatives that hold potential for long-term gains. After de-merging its cement business, L&T exited other non-core businesses. Now viewed as a focused engineering and construction player, L&T is well placed to capitalise on the infrastructure boom and has witnessed several bouts of re-rating over the past two years.

TIMING IS EVERYTHING

Much, however, depends upon the timing of the de-merger. For instance, EID Parry hived off its farm inputs division to Coromandel Fertilisers. You would have reason to be happy if you held on to both the stocks post de-merger; the value of your holdings would have appreciated seven-fold since.

But you may have just got lucky with EID Parry. The de-merger of the division would have led to a significant decline in revenues and earnings for EID Parry in the year following the event, had it not been for the sugar cycle turning positive just

De-mergers pack a punch

	Gains (%)	Market Return (%)
EID Parry- Coromandel Fertilisers	210	92
L&T- UltraTech Cement	209	48
KEC Intl- KEC Infrastructure	165	65
Eveready-McLeod Russell	125	58
Dabur- Dabur Pharma	99	72
Vardhman Spg-Mahavir	88	36
The Reliance Group	53	38
Eicher-Eicher Motors	35	9
Indo Rama Synthetics-Indo Rama Textiles	21	10
NIIT-NIIT Technologies	-16	-9

* Gains represent owning both stocks from the date of the restructuring proposal

* The Reliance group consists of Reliance Ind and the four companies spun-off to the Anil Ambani group

in time. Sugar being the mainstay of the company, EID Parry emerged a winner despite the hive-off.

Meanwhile, in the case of NIIT, the de-merger of its software division came at a time when its presence in both the education and the technology business was not particularly strong. The market, too, was in a correction phase, the period in question being between December 2003 and August 2004. Holding on to the stocks till date, in anticipation of a turnaround, would not have fetched you even market returns.

SPOTTING THEM IN ADVANCE

Given the superior returns that investing in restructuring plays offers, you might want to spot potential candidates in advance. This may not be too hard to do. The de-merger of EID Parry's farm inputs division to Coromandel Fertilisers, for instance, was expected, given the synergies between their respective businesses.

Grasim Industries has been a screaming restructuring theme for several years now. Hiving off its viscose and textile business to Indian Rayon and merging UltraTech Cement, which it acquired from L&T, with itself so that it becomes a pure play cement manufacturer is entirely foreseeable. Needless to mention the further restructuring that could unfold once the B. K. Birla group assets pass on to the Aditya Birla Group.

BEARING THE TIME RISK

The difficulty, though, lies in figuring out the when and how of the restructuring process. Entering these stocks too early may mean having to stay with them through various upsets, such as industry downturn, the sector losing steam in the market and an opportunity loss in not investing elsewhere during this period. If you invest in these stocks, you must have

compelling reasons to hold them even as a conglomerate.

It is also best to wait for a formal board approval of restructuring before contemplating exposures in the stock concerned.

There cannot be a better example of value unlocked than the de-merger of the cement division from L&T. But if you had gone by the first announcement of the de-merger in the year 2000, you would have waited four years before the process was finally put through. Between 2000 and 2003, the stock languished.

MONITORING, POST RESTRUCTURING

If you believe that the gains on listing of the new companies do not entirely capture the benefits of restructuring, then you can retain your holdings. Alternatively, you could hold the company that you believe would benefit most from the de-merger. For instance, you may have as well just held on to Dabur India and L&T alone, once the de-merger was through, as they have since delivered the bulk of the returns compared to their respective spin-off entities.

In some cases, the benefits of the restructuring may not be immediate and you might be willing to wait for further value to be unlocked. Doing so would, however, require constant monitoring. Eicher Motors, for instance, took over the tractors, two-wheeler, gears and engines businesses from Eicher. The company has, however, not been able to fully benefit from this move.

Heavy competition in the LCV (Light Commercial Vehicle) business and continuing uncertainty over the prospects of its new businesses have weighed on the stock over the past two years. You may have been better off exiting both stocks immediately after the de-merger was completed.