From The Ring

How to unlock value

ARUNAGIRI N

One plus one is rarely two in the investing world. "The sum of parts being larger than the whole" is gaining wisdom in the whimsical world of finance. Spin-offs in many cases magnify the valuation so as to yield juicy returns for investors.

Spinoffs and subsequent listing of demerged entities have generated handsome returns for investors. For the parent company, the rationale for demerger could be on many counts and can well be beyond the limited objective of value unlocking. Factors such as strategic sale, differing funding profile, focus on fewer areas and promoter's funding needs could be some of those drivers.

Take the case of Crompton Greaves, which is in the process of demerging its consumer business. This demerger is primarily driven by the promoter's (Avantha Group) need to raise funds for its power and infrastucture ventures. Or, take the case of Polaris, which demerged and listed its product business "Intellect" recently in the market.

While Polaris' IT services business is in a mature phase, its product business is in investment phase with significant need for regular cash infusion. This mis-match in return and funding profile underscored the need for demerger.

Rerating for both

Irrespective of the underlying rationale for demergers, historic data over the past few years shows that demergers, in a majority of the cases, resulted in sizable re-rating for both parent and off-shoot units.

According to one of the studies, of the top 11 demerged companies by market capitalisation, over 60 per cent of them have delivered "2x to 7x" returns over the event cycle. Intellect design (from Polaris), Orient Cement (from Orient Paper), NRB Industrial Bearings (from NRB), Marico Kaya (from Marico), Star Ferro (from Century Ply) and Gulf Lube (from Gulf Oil) are some of the stellar performers that created significant value from demergers.

No dimming the dazzle

Interestingly, demerger is one of the portfolio strategies that value investors rely on for cash management during market tops. When value is scarce at market tops, value investors vote for special situation-based arbitrage opportunities to eke out the extra returns while conserving cash.

In Warren Buffett's parlance it is called "work-outs." Demerger tops the work-outs during market highs with its attractive arbitrage returns profile.

The added kicker in demerger-based arbitrage strategy is that the inefficiency in the price discovery process of the demerged company (mis-pricing during the listing process) can, many times, morph the resultant company into a deep value opportunity for value investors.

Understandably, nothing is seen on the horizon that can dent the dazzle in the demerger theme for times to come.

(The writer is founder CEO, TrustLine Holdings Pvt Ltd)