A Tornado of Activity: Did Chicago Spinoffs Enhance Value?

March 5, 2014

- Shep Dunlap, Vice President, Investor Relations, Motorola Solutions
- Brian Lantz, Vice President, Investor Relations, Fortune Brands Home & Security
- Jake Welch, Vice President, ValueAct Capital
- Moderator: Jeff Bailey, Editor, YCharts

Why do companies accumulate assets only to divest them later? We heard first-hand about how spinoffs can enhance shareholder value from participants in various notable Chicago transactions.

Dividing assets and liabilities

The most difficult negotiation leading up to a spinoff is working out which company gets the debt, the cash, the best talent and the intellectual property. Generally, the divested company's balance sheet and operations are optimized to create a successful spinoff. Brian Lantz pointed out that at Fortune Brands, major restructuring was done ahead of time to create a clean balance sheet and focused business. Shep Dunlap noted that at Motorola, heavy negotiations revolved around which company would retain the powerful brand name and intellectual property.

The investor's perspective

Activist investors promote spinoffs because they think that individual businesses – when valued separately – are worth more than the enterprise as a whole. This is especially true for event-driven transaction investors, who are the first in and first out of a company during a spinoff. Conversely, ValueAct Capital, a $14 billion activist hedge fund that owns more than 10 percent of Motorola Solutions, believes the best opportunities often are with the company that remains after a spinoff. Frequently, there is more "wood to chop," said Jake Welch. "The opportunity is in operating improvements that result in cost savings, or investing in capital-starved areas of the business."

In the case of Motorola Solutions, ValueAct saw an undervalued gem with a well-known brand, a large installed base of customers, recurring revenue and margin opportunities. "It wasn't nearly as sexy as the handset business that was divested, nor was the remaining business well understood by Wall Street," said Welch.

Post-spin investor relations

Following a spinoff, transaction investors sell their positions quickly and the entire investor base can turn over in the first six months. During this time, it's important to cultivate new investors and remain open-minded about sell-side analysts. Big, long-only buy-side investors take their time getting into a new company. During this period, both Lantz and Dunlap focused on educating the buy-side and found that other investors followed once a well-known investor acquired a position. Similarly, landing immediate coverage from big-name sell-side analysts can be difficult. Initially, Dunlap was able to generate more quality research from smaller, mid-size sell-side analysts who were willing to dig in, listen to management and learn about the company.

The post-spin CEO relationship

One of the most exciting opportunities in a spinoff is working with a new CEO. "They need you and it's fun getting them out on the road," said Lantz. Post-spin, the new company becomes more outwardly focused, on the market and on the company's competitive position. Lantz noted that this external focus can be a difficult cultural shift for the new company that is no longer buried inside a larger company.

– By Bess Gallanis