Watch for Spinoffs that Create Shareholder Value

Occasionally, a publicly traded company divests one of its operating divisions by turning it into a separate publicly traded company. Investors refer to these new publicly-traded companies as “spinoffs.” Spinoffs are easy to overlook, as they are typically far less heralded than initial public offerings. But we should pay close attention to them.

Several studies have concluded that spinoffs tend to provide higher shareholder returns than the broader stock market. Some studies even suggest that shares of their former parent companies tend to outperform. Upon consideration, it is easy to understand why. The first reason is increased management focus and incentive. In a large company with multiple divisions, management may not be able to fully focus on one specific business. In a new smaller company with only one business, there are fewer distractions. Management of a spinoff is often given strong incentive, such as generous stock option grants, to increase shareholder value. This will be easier to do with management’s newfound freedom to make bolt-on acquisitions or optimize the company’s capital structure, perhaps by taking on debt. Meanwhile, the former parent now has one less operating division to consume management resources.

The second reason is a change in investor behavior. Some conglomerates with numerous operating divisions under one roof sell at a discount because they are unfocused and difficult to analyze. When one division is spun off, it will often attract new shareholders who were only ever interested in that specific business. Likewise, the former parent may attract new shareholders who appreciate its refined focus.

While high-quality spinoffs are relatively rare, there are a couple of recent transactions that caught our attention. Just over a year ago, U.S. dairy producer Dean Foods Co. (NYSE:DF) spun off its plant-based beverages division WhiteWave Foods Co. (NYSE:WWAV). WhiteWave produces the Silk brand of almond, soy and coconut milk that many readers will have seen stocked in local grocery stores. Due to the growth opportunities in the company’s business, we purchased a small number of shares for the portfolios of some clients who have a high risk tolerance.

In a very different industry sector, Twenty-First Century Fox Inc. (NYSE:FOXA) recently spun off its newspaper and publishing assets as News Corporation (NYSE:NWSA). In this instance, we found the former parent far more interesting than the spinoff. Twenty-First Century Fox owns an attractive collection of film and television assets around the world. We like the company's high quality businesses and attractive multi-year growth potential. We viewed its divestment of the newspaper and publishing assets as a positive event. We therefore purchased a moderate amount of FOXA shares for some client portfolios.

Studies suggest that spinoffs can create value for shareholders of both the new company and the former parent. That said, taking note of spinoff transactions is only a starting point. Proper analysis will always be necessary to determine if an investment opportunity truly exists. Ultimately the quality and the valuation of the businesses under consideration are more important than the structure of any corporate spinoff transaction.

Michael H.F. Armstrong *BA, CIM, FCSI*
Portfolio Manager

Andrey Schmidt *BA, LLB*
Investment Advisor