

Billion-dollar spinoffs top IPO marquee

by Heidi Moore

Posted 01:56 PM EST, Jan-28-2002

After a lean year for initial public offerings, 2002 promises to be a meatier one - primarily because units are being spun off from larger, more established companies.

This week, there will be two companies coming public with links to giant parent companies: former **Novo Nordisk SA** unit **ZymoGenetics Inc.** and the debut of the tracking stock of **Carolina Group**, the tobacco unit of **Loews Corp.**

In fact, the year has already started with news that no fewer than six big IPO spinoffs will come to market. And five of those are worth over \$1 billion each.

Of those mega-offerings, however, three will come from **Tyco International Ltd.** The conglomerate announced Jan. 22 that it will break up into four independently traded companies by the end of the year.

Other highly anticipated billion-dollar carve-outs will come from the planned debuts of **Verizon Wireless Inc.** and **Citigroup Inc.'s Travelers Property Casualty Corp.** unit.

Wall Street is depending on big fees from those carve-outs - as IPO spinoffs are called. That's not the only benefit.

Splitting off units and sending them to the public markets is advantageous to large companies because such deals allow the parent businesses to unload large amounts of debt.

That way these companies can avoid the disastrous debt debacle now plaguing scandal-ridden **Enron Corp.**, David Menlow, president of **IPOfinancial.com.**, said. The Houston-based energy trader was carrying half a billion dollars in debt in off-balance-sheet partnerships alone.

"There's going to be a move across corporate America to offload debt, to shift the balance sheet from debt to equity," Menlow said. "One of the best ways to do that is a spinoff."

Mark Minichiello, a principal with Chicago-based **Spin-Off Advisors llc** and assistant manager of the Spin-Off Fund hedge fund, said that in addition to seeing more spinoff IPOs, "You'll also see the deal size increase as companies restructure."

After all, huge IPO spinoffs were in vogue last year as well. Consider the following: **Kraft Foods Inc.'s** \$8.6 billion carve-

out from tobacco giant **Philip Morris Cos.**, **Agere Systems Inc.**'s \$3.6 billion split and IPO from **Lucent Technologies Inc.** and **Accenture Ltd.**'s \$1.73 billion debut after it split off from now embattled accounting firm **Andersen**.

In fact, New York research firm **Dealogic** indicated that 22 U.S.-marketed carve-outs raised \$24 billion in 2001. That may not sound like much, but it means carve-outs accounted for 50% of all the money raised by U.S. IPOs last year.

The spinoff trend will find more vigor in 2002 primarily because many soothsayers are predicting a better economy in the second half of the year. "A lot of restructurings were taking place [in 2001], but many more we put on hold at least until they had a better hold on the economy," Minichiello said. "It's much more advantageous to complete an IPO when the economy is rebounding."

Parent companies also spin off their slow-growing units in order to improve their return-on-equity or growth numbers. That was part of the rationale behind Citigroup's planned carve-out of **Travelers Property Casualty Corp.**

The financial services giant said most of its subsidiaries had a growth rate of more than a 20% while its property and casualty insurance unit had between 14% and 15% growth.

In addition, many spinoffs slated for this year are healthcare-related - as indeed, many of the year's general IPO filings are.

Among the healthcare deals, the first up is gene research drug company **ZymoGenetics Inc.**, expected to raise up to \$180 million next week through joint lead bookrunners **Lehman Brothers** and **Merrill Lynch & Co.**

Seattle-based ZymoGenetics was officially spun off in late 2000 by Danish pharmaceutical giant **Novo Nordisk SA**, which still owns 47% of ZymoGenetics. Novo Nordisk will continue to own about 40% of ZymoGenetics after the offering. The Danish company stands to see a profit of as much as \$45 million from its former unit's stake.

Other healthcare carve-outs coming up include **ICN Pharmaceutical Inc.**'s spinoff of Costa Mesa, Calif.-based biotechnology company Ribapharm Inc., and Ireland's **Elan Pharmaceuticals Inc.**'s carve-out of Worcester, Mass.-based diagnostic test developer Athena Diagnostics Inc.

Additionally, theater chain **Loews Corp.** will raise \$829 million through the IPO of the tracking stock of Carolina Group, its tobacco unit. That deal will be led by **Salomon Smith Barney** and **Morgan Stanley**.

Bookstore **Barnes & Noble**, will carve out its **GameStop Corp.**

video-game retailing unit in a \$343 million IPO.

While spinoffs will result in eliminating a large portion of the parent company's debt they will also create a higher standard of scrutiny, Menlow and Minichiello agreed.

As such, spinoffs may be a harder sell to investors, Menlow said. "As to whether [more carve-outs] will be viewed by investors as a desirable condition remains to be seen."

Menlow expects that independent companies that go public will fare better than their carve-out counterparts. For example, he cited the difficult birth of **Agere Systems Inc.**, which was spun off in March solely to offload the debt of troubled parent **Lucent Technologies Inc.**

Investors bought into a debt-laden stock which is reflected in its lower share price, Menlow said. Agere is currently trading at \$5.35, or 11% below its \$6 price when it made its debut in March.

Nevertheless, spinoffs can be an attractive investment right now. Menlow noted, "Valuations are so low that investors have prospects for considerable capital gains over time."