Demergers and unbundling can add real value to shareholders

By Zondi Nduli and Greg Rowan

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Mergers and acquisitions have long been a key means by which South African organisations have sought to unlock synergies, diversify their assets and offerings, and create value for their shareholders. However, over the past few years, a converse trend has been visible on the JSE with several large demergers and unbundling processes that have occurred.

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While the methodology is obviously different from what investors and shareholders have become accustomed to over the years, the rationale remains the same, and that is the maximisation of shareholder value. Unfortunately, these types of corporate actions are often observed with an unfounded amount of suspicion or concern, with many investors incorrectly assuming that an unbundling of assets somehow implies a failure of the previously merged organisation.

In most cases, this simply isn't the case, as there may be a good rationale for the proposed demerger or unbundling.

For one, the unbundling of assets has the potential to deliver significant head office cost savings. The recently managed separation successfully completed by Old Mutual plc is a case in point. The merged entity was incurring large head office costs (£130m in 2017) due to having to oversee and govern the operations of its underlying entities, including its controlling stake in Nedbank. However, all of its underlying businesses already had their own, fully functional head office structures in place.

Enhancing shareholder value

The second way in which a demerger or unbundling has the potential to enhance shareholder value is by addressing the challenges that many merged organisations inevitably face as a direct result of becoming too large in size and in its complexity of operations and governance.

Many of these conglomerates ultimately reach an inflexion point where the whole is no longer as valuable as the sum of its parts. Alternatively, the entity may find itself being constantly discounted in the markets because it's seen as over-diversified, unable to maximise on synergies or little more than a holding company; at which point a logical way to address the situation is by decoupling some of its assets.

A demerger is also an effective way of injecting new energy and focus into the individual businesses making up a previously merged entity, due to the newfound flexibility of removing reporting and decision-making ties with the parent company.

Numerous companies listed on the JSE are mature, with large and diversified operations. While the strategies of these organisations have proven themselves successful in delivering steady growth over the years; in modern, rapidly changing markets, many organisations are recognising the importance of innovation, focus and agility in order to continue driving growth.

Capitalise on opportunities

A demerger can be a very effective way of achieving these requirements for each of the underlying assets, enabling them to capitalise on opportunities that may not have been available to them due to parent company restrictions.

Finally, there are a number of company-specific considerations that can make a demerger or unbundling a value-adding option. For example, by spinning off some of its underlying assets, a very large business is able to reduce its single stock concentration risk, making it more appealing to investors or fund managers, while at the same time enhancing its trading liquidity and ultimately reducing discounts to the underlying valuation. Naspers' unbundling of its consumer internet business Prosus and television business Multichoice are good examples of this.

So, while there can be many reasons for a demerger, it's unlikely in the majority of cases, that such an action is being taken because of some sort of failure of the business, or any of its underlying entities. It's far more likely that the business has recognised that a controlled demerger or unbundling of its assets is an effective means of saving costs, streamlining operations and generally adding sustainable value to shareholders.

And while it's essential for any current or prospective investor in these entities to exercise the same levels of scrutiny and due diligence as they would when assessing a merger situation, avoiding unbundling due to unfounded fears, or disinvesting purely because of an announced demerger, could mean missing out on some significant value in the future.

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