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## US Corporate Actions

# Spin-offs: Sources of Shareholder Wealth

### Key points

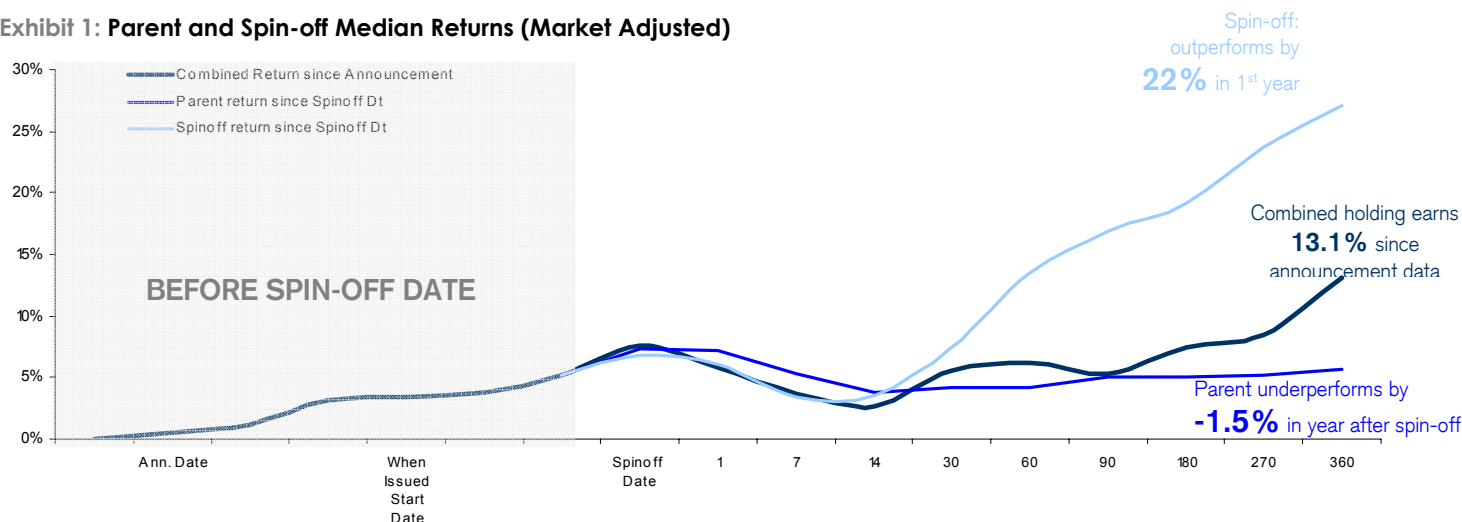
- Our analysis finds that spin-offs seem to have a wealth effect, adding around 13% to shareholder returns
- And spun-off companies generally outperform the parent (+ 22% in Year 1)
- Most performance is priced in within days of the announcement. Traders should buy as soon as possible, or preferably before an announcement
- Both parent and spin-off tend to sell-off in the days after the stocks separate. This may present a shorting opportunity as institutions sell unwanted new stocks
- This sell-off also presents a buying opportunity for long-term investors willing to hold the spin-off all year
- Upcoming spin-offs include: **BIP, AHC**
- Those seeking exposure to spin-offs can also trade the spin-off ETF, **CSD**, which beat the S&P by 4% in 2007

### U.S. Spin-offs Outperform in Year One

Investment bankers and analysts tout the ability of spin-offs to unlock shareholder wealth – But is it true? Academic studies in the past seemed to confirm it<sup>1</sup>, but most of these studies are now quite dated. We revisit the question, analyzing major U.S. spin-offs over the past 5 years (39 in total) and find that:

- Holding **both the parent and the spin-off** stock results in:
  - combined **outperformance of +13.1%** (median) or +16.9% (average) from announcement to one year after
  - 2/3 of our sample beating the market 12 months after spin-off
- **The spun-out company outperforms the Parent.** When isolating performance just to the spin-off itself, we see:
  - median spin-off performance beats the market by **22%**,
  - with 70% outperforming after 12 months
- **It's a volatile strategy!** Although well over half the events outperformed the market over 12 months, the average is skewed by some big winners and losers.
- **And an unpredictable strategy!** Over 30% of spin-offs reversed from market-beating to underperforming (or vice versa) between the first and 12<sup>th</sup> month of trading.

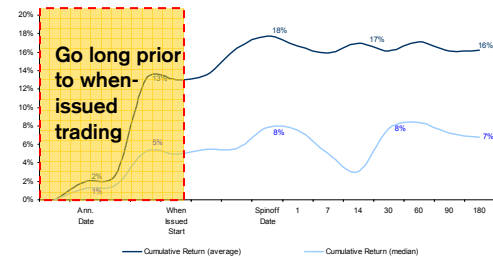
Exhibit 1: Parent and Spin-off Median Returns (Market Adjusted)



<sup>1</sup>Combined return is composed of just the parent return in the period from announcement to spin-off, but is a pro-rata parent+spin-off return from spin-off ex-date to 1 Year after spin-off. All returns market adjusted vs. S&P 500.

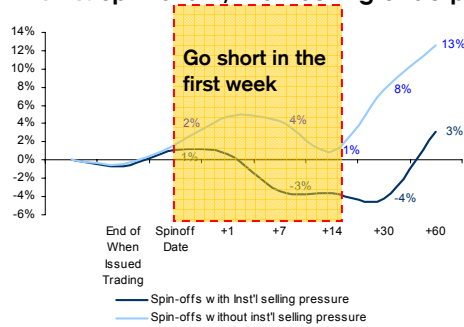
Source: CS Portfolio Strategy, Bloomberg

**Exhibit 2: Buy the parent after announcement**



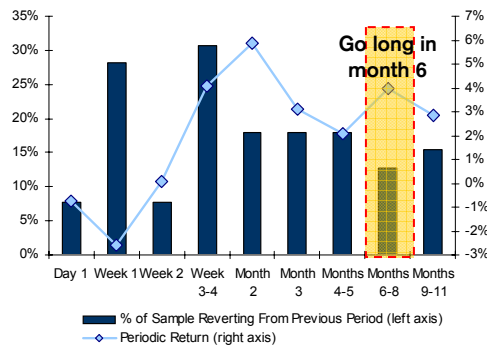
Source: CS Portfolio Strategy, Bloomberg

**Exhibit 3: Spin-offs w/ Inst'l Selling Underperform**



Source: CS Portfolio Strategy, Bloomberg

**Exhibit 4: Q3: Good Holding Period for Spin-offs**



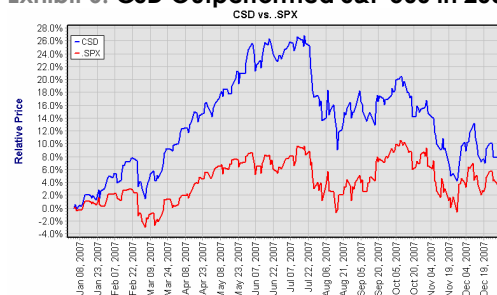
Source: CS Portfolio Strategy, Bloomberg

**Exhibit 5: Upcoming Spin-offs**

Spinoff Date	Announcement Date	Parent	Spin-off
1/31/2008	7/31/2007	BAM	BIP-W
2/11/2008	10/1/2007	BLC	AHC-W
TBA	8/29/2007	MO	Philip Morris International
TBA	11/5/2007	ETR	Entergy's non-utility nuclear assets
TBA	10/16/2007	SSP	Scripps Networks Interactive
TBA	10/23/2007	BNT	CPEX Pharmaceuticals
TBA	11/5/2007	IACI	multiple (IAC, HSN, Ticketmaster, Interval, LendingTree)
TBA	12/17/2007	CG	LTR1
TBA	12/4/2006	MDT	Physio-Control Inc
TBA	11/19/2007	NX	Quanex Building Products
TBA	10/18/2007	WW	Horizon Actuarial Services
TBA	12/13/2006	WIN	Windstream Regatta Holding

Source: CS Portfolio Strategy, Bloomberg

**Exhibit 6: CSD Outperformed S&P 500 in 2007**



Source: CS Portfolio Strategy, Bloomberg

**Trading Strategies**

**1. Buy (the Parent) as early as possible.**

Most stocks see a revaluation right after a spin-off is announced. However the market does not appear to fully price-in the benefits of the spin-off immediately. The bulk of outperformance occurs between announcement date and the start of when-issued trading in the spin-off (Exhibit 2).

Companies progress from announcement to implementation in an average of 140 days. Over this time, the parent beats the market by 6% (median) and 13% (average).

Because of point 2 below, we recommend traders sell once both stocks begin to trade independently.

**2. Post spin-off selling presents a shorting opportunity.**

In the weeks immediately after the stocks trade independently, returns dip. This was more pronounced when the spin-off was not retained in its parent's index – most notably the heavily indexed S&P 500.

Stocks with net index fund selling pressure underperform the market on average in the weeks following spin-off date. The prolonged period of underperformance leads us to believe that active investors also often sell these stocks after the spin-off, either because they fall out of their own universe, or because they no longer want exposure to the separated themes.

**3. Buy spin-offs after 6 months.**

Long-term investors should buy spin-offs before the 3<sup>rd</sup> quarter of trading – when returns tend to pick up and volatility decreases. The 3<sup>rd</sup> quarter of trading (6-9 months after spin-off) has a periodic return of 4% relative to the S&P, with a lower level of performance reversion (15%) than prior periods (Exhibit 4).

By this time, spin-offs have established an earnings track record and more analysts have initiated coverage on them. This may mark the point where fundamental and quant based investors begin to pick up these stocks.

**Upcoming Spin-offs To Trade...**

Two spin-offs are scheduled to occur within the next 30 days: BAM's spin-off of BIP, scheduled for Jan 31, and BLC's spin-off of AHC, scheduled for Feb. 11<sup>th</sup>. Both spin-offs are currently trading under when-issued tickers.

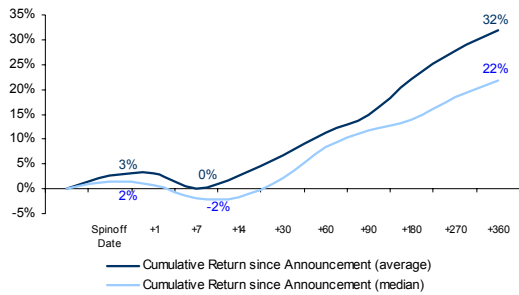
In addition, several spin-offs have been announced recently (Exhibit 5). One of the largest is the proposed breakup of IAC Interactive into 5 spun-off entities. IAC is a \$7bn S&P 500 constituent, and depending on the ultimate valuations of each entity, we could see multiple new entries into various indices.

**...Or Invest in a Spin-off ETF**

Investors seeking broad exposure to spin-offs may want to consider investing in CSD, the Claymore/Clear Spin-Off ETF. This ETF tracks the Clear Spin-off index, which is comprised of approximately 40 U.S. stocks of companies that have been spun-off within the past two years.

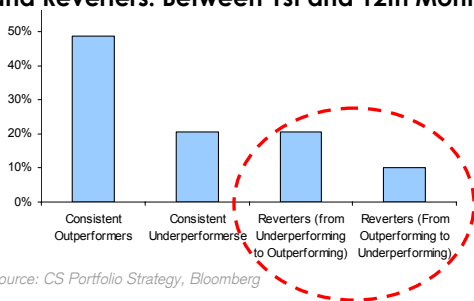
For 2007, the ETF outperformed the S&P 500 by 4.3% (Exhibit 6). However, it is currently down 1.7% vs. the S&P for the new year through Jan 23<sup>rd</sup>.

**Exhibit 7: Spin-offs Year One Outperformance**



Source: CS Portfolio Strategy, Bloomberg

**Exhibit 8: % Outperformers, Underperformers and Reverters: Between 1st and 12th Month**



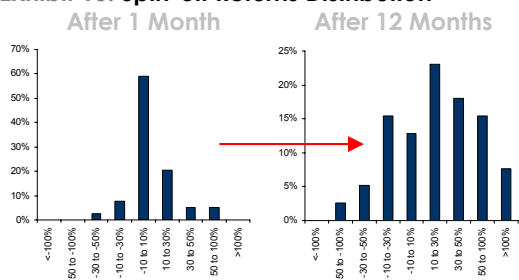
Source: CS Portfolio Strategy, Bloomberg

**Exhibit 9: Spin-offs and 12 Month Performance**

Spin-off	Parent	Spinoff Date	1 Year Relative Return
CHAP US	TXI	8/17/2005	271.0%
TGN US	CNP	1/7/2003	228.2%
KRO US	NL US	12/9/2003	133.1%
LYV US	CCU	12/22/2005	90.7%
IGI US	PBI	12/3/2001	82.8%
MSPD US	NXT	6/30/2003	69.2%
SAIA US	YRCW	10/11/2002	65.2%
EYE US	AGN	7/1/2002	59.9%
OFLX US	MCCK	8/2/2005	59.6%
NPD US	GR	6/3/2002	46.4%
HBI US	SLE	9/6/2006	44.2%
GHCJ US	NCRX	12/2/2003	43.3%
PXP US	922181Q	12/19/2002	42.4%
LEV US	BBX	1/2/2004	42.3%
FLB US	FNB	1/2/2004	41.9%
FLIB US	MOT US	12/3/2004	38.4%
EQ US	S	5/18/2006	27.7%
EPAX US	AMIE	3/1/2002	27.7%
AMP US	AXP	10/3/2005	26.3%
PHH US	CAR	2/1/2005	21.9%
BR US	ADP	4/2/2007	20.9%
DLIA US	ALOY	12/20/2005	19.4%
AYI US	329556Q	12/3/2001	18.7%
MHS US	MRK	8/20/2003	17.9%
SBH US	ACV	11/17/2006	11.9%
PJC US	USB	1/2/2004	5.2%
DDE US	DVD	4/1/2002	3.5%
SE US	DUK	1/3/2007	-5.1%
WU US	FDC	10/2/2006	-5.9%
XEC US	HP	10/1/2002	-7.7%
ME US	FST	3/3/2006	-21.5%
THS US	DF	6/28/2005	-23.8%
IAR US	VZ	11/20/2006	-24.2%
ABD US	FO US	8/17/2005	-25.3%
PSRC US	PALM	10/29/2003	-27.0%
NP US	KMB	12/1/2004	-27.3%
EXPE US	IACI	8/9/2005	-42.1%
TA US	HPT	2/1/2007	-45.2%
PCOP US	ACCL	5/3/2004	-56.4%
<b>MEDIAN</b>			<b>21.9%</b>
<b>AVERAGE</b>			<b>32.0%</b>

Source: CS Portfolio Strategy, Bloomberg

**Exhibit 10: Spin-off Returns Distribution**



Source: CS Portfolio Strategy, Bloomberg

## Market-Beating Returns...

Our sample of 39 spin-offs from 2001 to 2006 indicates that market-beating performance can be achieved either by holding on to the parent stock + spin-off, or by purchasing the spin-off itself.

- As seen in Exhibit 2, the parent stock tends to perform well immediately after announcement date, earning 6% above the market between announcement and spin-off date
- Spin-offs underperform in the first few weeks of trading, – presumably due to selling by Institutional investors who no longer want to hold the new company, or can't because it has fallen out of their universe.
- But they recover in subsequent months and end up with a +22% median outperformance after 12 months (Exhibit 7).

What factors seemed to affect performance? In our sample, we noticed:

- Several of the top spin-offs (KRO, TGN) initially had majority ownership kept by the parent company
- The top five (CHAP, TGN, KRO, LYV, IGI) also exhibited similar outperformance even after adjusting by sector returns, indicating that stock-specific factors played a large role in their one year returns
- Early underperformance for the worst spin-offs can be attributed to index selling (many had parents in the S&P 500 and had to be sold off by index funds). But they continued to underperform throughout the remainder the year – due mainly to stock-specific factors (adjusting their returns by sector performance did not noticeably change the results – except in the case of TA)

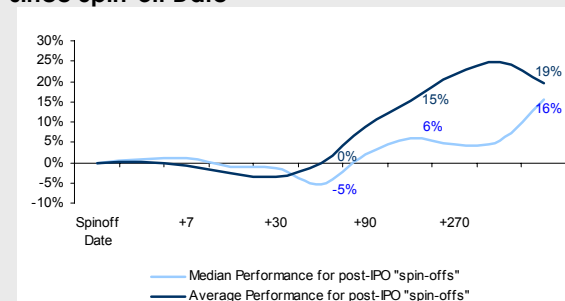
## ...But an Unpredictable Strategy

The median returns mask what is far from a consistent pattern.

- The sample size is small, with just 39 major US spin-offs in the past 5 years
- The distribution of relative returns is far from normal, with a positive skew and several large outliers. Interestingly, the distribution becomes more positively skewed the longer you hold (Exhibit 10).
- In addition, we see a lot of performance reversion early:
  - Between Day 1 and Day 30, one-third of our sample reverted from outperforming to underperforming (or vice versa), with no clear pattern
  - And between the 1<sup>st</sup> and 12<sup>th</sup> month of trading, a nearly equivalent 30% revert also (12 of our sample). But most of the reverters move the right way, from negative to positive relative performance (Ex. 8)
  - In addition, the reversion slows down after several quarters of trading. Between the 6<sup>th</sup> and 9<sup>th</sup> months after spin-off, for example, only 12% of our sample reverts (Exhibit 4). This may be due to the entry of more buy-and-hold investors mentioned earlier.
  - And In the case of spin-offs that underperformed in the first week after spin-off – about 40% of them reverted to flat or outperformance by the end of the first month.

## The Post-IPO and Class B “Spin-offs”

**Exhibit 11: Relative Performance of post-IPO “Spin-offs” since Spin-off Date**



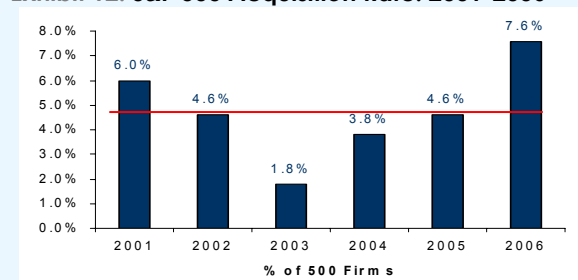
Source: CS Portfolio Strategy, Bloomberg

We excluded spin-offs of companies that had previously IPO’ed or issued similar shares under another share class, as by definition they are not true spin-offs. However, it is worth noting their performance post spin-off date. Of the 19 in this sample:

- We see several similarities to normal spin-offs, including early underperformance, dispersion (large outliers), reversion tendencies, and ultimately, medium-term outperformance
- However, these quasi-spin-offs do not begin to outperform until a bit later than normal spin-offs – between 1-2 months after spin-off date
- Their 1 year performance still beats the market by 16% (median), versus 22% for normal spin-offs (Exs. 1,11)

## Spin-offs: Attractive Takeover Targets

**Exhibit 12: S&P 500 Acquisition Rate: 2001-2006**



Source: CS Portfolio Strategy, Bloomberg

**Exhibit 13: Acquired Spin-offs**

Spin-off	Domestic or Foreign Acquirer?	Time from Spin-off to Acquisition Announcement (Yrs)
IGI US	Foreign	3.79
GHCI US	Domestic - Private Equity	3.13
CHAP US	Foreign	1.94
PSRC US	Foreign	1.87
TGN US	Domestic - Private Equity	1.54
FLB US	Domestic	0.58

Source: CS Portfolio Strategy, Bloomberg

Six of the 39 spin-offs in our sample were eventually acquired by other firms. Although an admittedly small sample, on a percentage basis, this is nearly 3 times the S&P acquisition rate of 5% over the same time period (Exhibit 12). Acquirers were from a broad cross-section of the market, including domestic competitors, foreign corporations and private equity firms (Exhibit 13).

But the length of time between spin-off and acquisition date generally ranged from 1 to 3 years. Thus, a long holding period is generally required to take advantage of acquisition premiums.

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