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Activist Threat Seen Pushing Mega-Cap Laggards Into Spinoff Mode

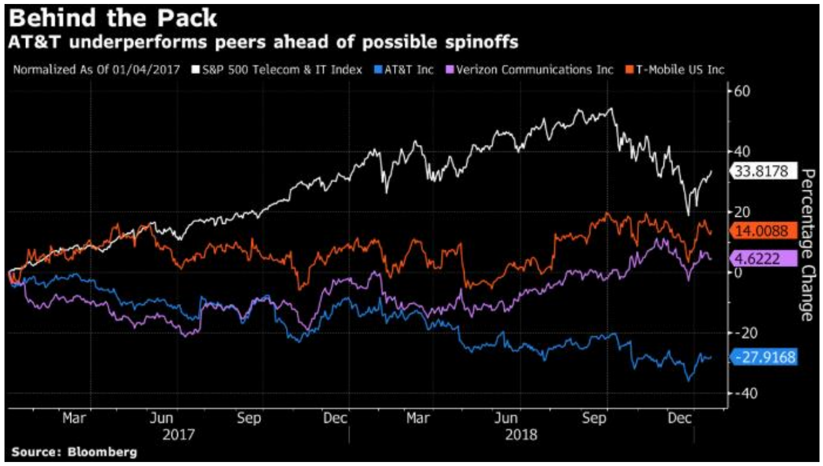
By Drew Singer / Bloomberg News

Large industrial, technology and healthcare firms could soon explore spinoffs to unload debt and stave off activists, according to a special situations research firm.

Elliott Management's recommendation this morning for eBay to review its portfolio could be the first of many similar calls to action by activists in 2019. Other top candidates to divest non-core assets include AT&T Inc., Oracle Corp., Merck & Co. Inc. and Roper Technologies Inc., The Edge Consulting Group CEO Jim Osman said in an interview. The need for divestitures comes after a rush of acquisitions created heavy debt burdens and higher capital demands.

Companies are "more conscious now of getting it done before they underperform," Osman said. "This could big a big year for corporate actions."

According to Osman, it's conceivable that AT&T would seek a three-way breakup that separates its telecom businesses from its entertainment group and its Warner Media/Xandr segments. The Edge blames AT&T's years-long underperformance on intense competition and pricing pressure that's weakened both the entertainment group and the business wireline segments. Divestment through a spinoff or sale could help lower AT&T's leverage ratio, which is higher than most of its large peers. Shares in AT&T are down nearly 30 percent since the start of 2017, while its rivals have seen their values rise.



The potential separations would follow similar moves by companies including Spirit Realty Capital Inc., DDR Corp., Honeywell International Inc. and Altice NV, each of which recently used spinoffs as vehicles to offload debt. Spinoffs such as these have been underperformers: the Bloomberg U.S. Spin-Off Index has fallen almost 13 percent since the start of 2018, while the S&P 500 is little changed.

Here are other top spinoff candidates identified by The Edge:

- Activist positions in Honeywell and DowDuPont Inc. may foreshadow a similar situation at Roper. An activist could create pressure on management to pursue strategic alternatives, such as spinning off its industrial technology and energy system & controls segments. A spinoff would reduce the company's exposure to more capital-intensive businesses, while increasing transparency in its software-as-a-service business.
- Successful animal health spinoffs at Pfizer and Zoetis make a similar move "the next logical step" for Merck, whose animal health segment is the second-largest after Zoetis Inc. The spinco could receive a stronger valuation and give investors the ability to pick between different growth profiles.
- Oracle should shed its hardware and services businesses to focus on growing its cloud business faster via acquisitions. The company has been lagging cloud revenue peers and prior IT conglomerate break-ups have a successful track record.
- An AT&T spokesperson declined to comment. Representatives from Roper, Oracle and Merck did not respond to requests seeking comment.

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