Asset sale vis-a-vis demergers

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Piramal went in for an asset sale of its domestic formulations business while Grasim drew its cement business out into a separate entity through a demerger.

Bhavana Acharya

Piramal sells its domestic formulations business. Grasim merges its cement operations with a subsidiary, and then further merges that into a group company. Wondering what the finer points of differences between the two are? Well, for starters, the first is an asset sale, and the second, a demerger.

Broadly, in an asset sale, a company sells off a business stream or an asset to another party and receives consideration for it. In a demerger, a company gathers up a business stream and takes it out into a separate company. Here's looking at certain key aspects and how they differ.

Ownership and payments

Of course, the first question to pop up is that of ownership and the money that the activity brings in. In a demerger, the original company still holds ownership of the new entity. In most cases, the new entity becomes a subsidiary of the original company.

Taking the Grasim example. Shareholders in the company received one share in the cement subsidiary for every share they held in Grasim. At the end of the demerging process, Grasim directly held 65 per cent in the subsidiary (which actually becomes an indirect holding for Grasim shareholders) while the shareholders held the remaining 35 per cent. In most cases, there is no cash consideration involved; only shares are swapped.

However, in an asset sale, a company forgoes ownership of an asset or business in exchange for cash. It does not retain ownership of that asset. In the case of Piramal, the formulations business was sold off to another pharmaceutical player, Abbott Laboratories, for $3.72 billion. Piramal no longer owns that business and holds no stake in it. Instead, it receives a cash payment of the $3.72 billion. This money will flow to the company, and shareholders stand to benefit indirectly from however the company puts the deal money to use. Here, the company will have to shell out capital gains tax on the sale consideration.

Revenues and accounts

A demerged entity, by virtue of its being owned by the parent company, will still contribute to the revenues of the parent. What's changed then? Well, instead of being part of the core company, the demerged entity

now functions on its own. Shareholders in the parent company still benefit from sustained revenue flows from the new company. However, standalone and consolidated revenues come into the picture here, with the subsidiary's revenues and profits taken into the consolidated accounts of the parent.
On the other hand, proceeds from the asset sale are a one-time occurrence and will not recur over the years. Should the company deploy the sales proceeds into a new venture or develop existing ventures, then revenues may flow from that venture.

Reasons
While it is difficult to pinpoint reasons for corporate actions such as demergers and sales, demergers usually follow company-restructuring moves. A company may choose to hive-off a business into a separate entity for a host of reasons. One, the business may hold enough scope to develop into a full-fledged standalone entity. Two, value may be unlocked by listing the subsidiary, and getting funds directly for that business.
For instance, S Kumar's Nationwide (SKNL) fleshed out its retail arm into Brandhouse Retail and listed it on the exchanges. It can now bring in private equity players which would want a part in the budding retail and not the textile sector in which SKNL operates. Three, a company may become too unwieldy if it has multiple businesses and separating them into smaller ones may allow better management.

Asset sales are undertaken if the company sees more potential in other business and would like to concentrate on them, or if the business no longer offers any synergy or, in extreme cases, becomes strapped for cash, in which case it becomes a distress sale.