Demerger to be GHCL's growth tonic

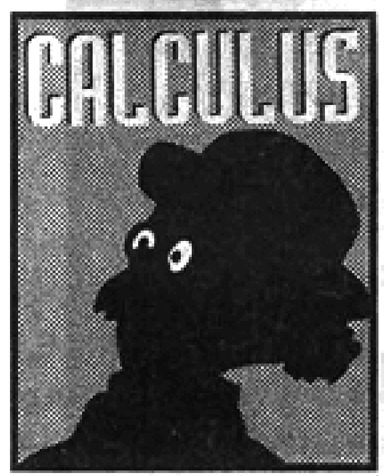
DIVERSIFIED companies, at some stage, have to decide whether a de-merger of one or more businesses makes sense. It may be a tough call, not just because it involves different stake-holders, but occasionally what might be good for shareholders may not be so for the company itself. GHCL is taking a re-look at its current structure that houses soda ash and textiles under the same roof. Its desire to unlock value for shareholders implies that it may break up into two separately listed companies.

During '06 (nine months ended December '05), of its consolidated revenue of Rs 525 crore, soda ash contributed Rs 370 crore or 70% of sales, while textiles contributed the balance Rs 115 crore. Soda ash's contribution to profit is higher at Rs 99 crore or 87% of the segmental profit of Rs 114 crore. Soda ash makers have been benefiting from rising global prices. This may change when the commodity cycle hits a rough patch.

Moreover, GHCL has done a series of acquisitions in the past 12 months, in soda ash and textiles, which changes the complexion of its company considerably. It has acquired a Romanian company Bega Upsom, which adds about 50% to its existing soda ash capacity; once its starts making profits it will be a key contributor. It was operating at low utilisation and making losses when GHCL acquired it.

In textiles, it has made larger acquisitions. Dan River of the US, a textile company, with a revenue of $250m or Rs 1,150 crore, was the first acquisition. Rosebys of the UK, a textile retailer, was the next which would add about $200m or Rs 920 crore to revenue. These would make textiles the larger business compared to soda ash.

These acquisitions do make GHCL a global company but also mean that management resources would be stretched across two unrelated and large businesses. Funding these acquisitions would need both debt and equity, and lenders/investors would be more comfortable with an arrangement where the two businesses are separate.



Shareholders, too, would be happy if they had two separately listed companies, giving them the choice to exit from a business if they wish to. At about 18 times '06 earnings, it is not undervalued. So, a low stock market valuation is not a pressing cause for a de-merger at the moment. But in the longer run, it would turn out to be more beneficial for valuations, as soda ash and textiles both suffer from cyclical downswings.