

Advanced Medical Optics

When David Potts, CEO of Allergan announced spin-off of Advanced Medical Optics he commented, "Over the last 2 years it has become increasingly apparent that the pharmaceutical and medical device businesses are fundamentally different, and are diverging, in terms of market growth rates, gross margin leverage, R&D intensity, technological know-how, regulatory processes and product life cycles. With a complete separation of the pharmaceutical and surgical and contact lens care sales forces worldwide since 1998, it also became more and more obvious that limited synergies in the office of the eye care practitioner are no longer sufficient reason for these businesses to operate within one enterprise." The spin-off benefited both firms; Allergan became a pure play pharmaceutical company that benefited from "even tighter management focus" and AMO, said Pyott "will not have to compete for financial resources with the high growth, high margin pharmaceutical operations of Allergan Nor will AMO's management team be limited by the strategic constraints of Allergan ... and will enjoy new freedom to pursue strategic alliances, collaborations and expansion opportunities in its core businesses... and make greater investment in new technologies and in sales and marketing. Since the spin-off Allergan is up 19% and AMO is 47%.

Spin City

Corporate spin-offs produced hefty returns, but healthcare spin-offs showed the real strength over the past 5 years.

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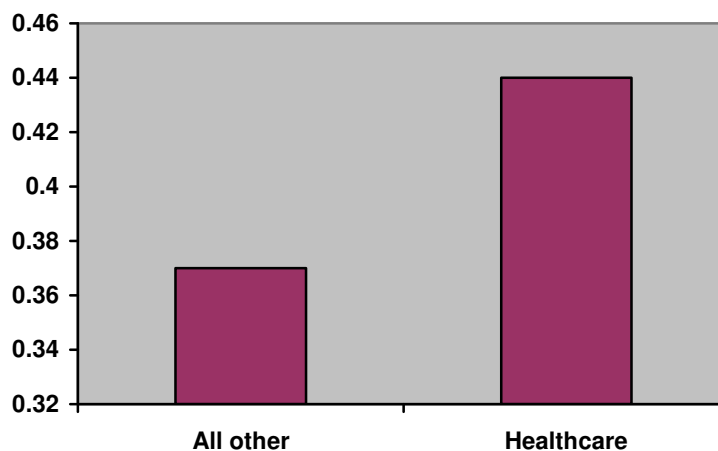
Corporate spin-offs, which rose to prominence during the restructuring craze of the 1990s, proved to be one of the most lucrative areas of investing over the past five years – particularly in healthcare. And there are more coming, including Abbott's spin off of Hospira, its hospital supply unit.

Spin-offs occur when a company distributes shares in a subsidiary to existing stockholders, usually tax free. The anticipation is that the market will value the two companies at a higher price that the parent alone commands.

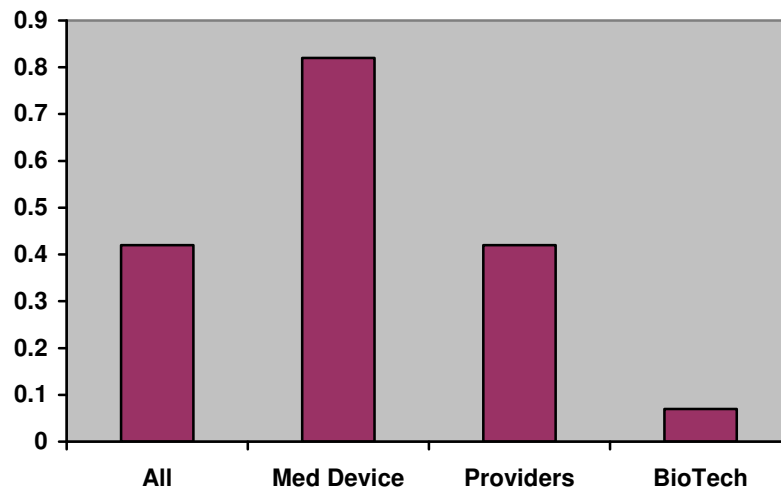
Data on the more than 100 spin-offs from the past five years show that 80 of these companies are still trading and have posted average annual returns of 37% -- far greater than the measly .1% of the S&P 500 and the 8.3% of the Russell 2000.

Healthcare spin-offs have fared even better with average annualized returns of 44%. The failure rates are similar with about 1 in 4 delisted with the rest losing money. Within healthcare, the real winners are medical device companies who have annualized returns of 85%, or 132% better than the average spin-off.

Why did healthcare spin-offs do better? Partially for the same reason as other spin-offs – it can be difficult for investors to see the nascent business in the shadow of the successful parent. However I also suspect that the health care successes – in medical device and other areas – have business models distinct from their parent companies, with different imperatives for success¹. In fact the more different the business model, the more the likelihood of a spin-off premium.



¹ See the author's other article What Medical Device Winners Know How to Do: Seven Imperatives to Transform Your Company's Performance 2003.



We are likely to see more spin-offs this year; the environment is favorable with a strengthening economy, a rebounding market and pressure from corporate boards to boost shareholder returns. The first of the significant spin-offs will be Abbott's Hospira.

Follow-up

Hospira launched into the markets at \$26.66 May 3, 2003 and is now up 20% closing the year at \$34.00

Hospira will be a specialty pharmaceutical and medication delivery company and its business will include: medication delivery systems, such as medication management systems (including electronic pumps), infusion therapy and critical care products; and specialty injectable pharmaceuticals, including generic acute-care injectables and intensive care pharmaceuticals. Hospira's focus on manufacturing and marketing products for the hospital customer also will provide opportunities for the company to enhance its contract manufacturing and alternate site businesses. The questions on investor's minds should be – does different is the business model from Abbott's pharmaceutical focus? And what will Hospira be able to do without the constraints or the assets of Abbott Labs?

Investors: watch for the spin-off, particularly if you're in healthcare, but don't count on a sure winner -- apply the same analysis that you would to other securities. If you're a large player sitting on nascent ventures, consider a spin-off sooner than later. Or start creating lots of ventures with a view to a spin-off.

About the Author:

Mary Kate Scott is the CEO of Health Technology Ventures, LLC, a privately held healthcare advisory and investment company that provides CEO and Board-level counsel and management consulting services. Mary Kate works with publicly traded companies, start-up ventures, not-for-profit entities and investors of these firms, on strategy, organization, and marketing issues including performance transitions, alliances, acquisitions, technology management, marketing and sales productivity programs. Mary Kate teaches the Business of Healthcare in the MBA program at the Marshall School of Business at the University of Southern California in 2004. Prior to Health Technology Ventures, Mary Kate was at McKinsey & Company and Procter & Gamble.