THE PERFORMANCE OF DUAL LISTED COMPANIES: A TEST OF PERFECT SUBSTITUTES AND PRICE DISCREPANCIES.

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ABSTRACT

The Dual Listed Company (DLC) form of corporate structure can be traced back to the start of the last century when the Royal Dutch Petroleum Company and The "Shell" Transport and Trading Company Plc formed the first DLC arrangement in 1907. In recent times DLCs involving Australian companies CRA, BHP and Brambles have sparked interest in this form of corporate organisation. This paper investigates the share price performance of DLCs involving these Australian companies. Specifically, we investigate whether DLC partners, which are essentially identical, trade at differing prices on their respective stock exchanges. We find significant discrepancy between quoted stock prices of DLC partners on their local exchanges. Finally, we discuss possible explanations for this price discrepancy.

Australian DLCs

A dual-listed company or corporate structure refers specifically to an entity created by the merger of two companies, each listed on a different stock exchange. The companies retain their separate legal identities and stock market listings, while combining their operations and management [5]. The implication of this is that there is no merger from a legal viewpoint and no takeover from an accounting viewpoint.

An obvious but essential point to consider in evaluating this form of corporate structure is the market reaction to the introduction of the DLC. From a financial market perspective DLCs raise two unique questions. The first is how the market reacts to the DLC partners. If the market has reacted negatively to the introduction to the DLC, is this prima-facie evidence of investor dissatisfaction? A second and associated aspect relates to the trading of the securities of the DLC partners on their respective exchanges. Companies in the DLC structure provide investors with the same dividend stream, however they are traded in different markets and currencies, meaning that their shares cannot be exchanged. An implication of this is that there is no means of riskless arbitrage to ensure that the market prices of the equivalent cash flows are the same. If there is a disparity in share price between the DLC partners, why does this occur and does this have implications with respect to the efficiency of the market? In practice significant price discrepancies exist between DLC partners as the recent price history of the three Australian DLCs shows.

Several reasons as to why these discrepancies exist have been proposed including:

- One company is the larger and senior partner thus improvement in liquidity from forming the larger structure is greater for the larger of the DLC partners, such as BHP in the case of the BHP/Billiton DLC where Australian shareholders account for 60 percent of the equity of the DLC structure.
- Relative significance of the entities within the local sharemarket, for example, BHP and Brambles are essential purchases of Australian but not for UK fund managers [1].

- The difference in performance of respective share markets. While anecdotal evidence suggests that there are advantages to be gained from the formation of a DLC structure in terms of growth, access to capital markets, and tax and accounting advantages, the question remains whether DLCs add value from a shareholder and financial market perspective.

To investigate the affect of a DLC structure on the companies involved, share prices from the ASX and the LSE were obtained for CRA/RTZ (Rio Tinto), BHP/Billiton, and Brambles Ltd/Brambles Plc and GKN Plc. The daily adjusted-closing price for each share was compared with the returns on the All Ordinaries Accumulation Index for Australian shares and the FTSE100 Accumulation Index for UK shares for the corresponding period. The results were split into two periods; one year before and one year after the date of the DLC taking effect. A Wilcoxon Matched-Pairs Signed-Rank Test was used to examine the dispersion among the residuals. Results (available on request from the authors) show that with the exception of Billiton, all companies involved in DLC structures significantly underperformed the respective market index in the year prior to entering into the arrangement.

Rio Tinto (then CRA and RTZ) shares were experiencing positive returns in the year leading up to the DLC taking effect (21/12/1995) and had marginally positive returns in London and marginally negative returns on the ASX in the year after the DLC took effect. Both market indices outperformed the respective CRA and RTZ shares before and after the initiation of the DLC. The p-values were statistically significant, from which it can be concluded that returns on CRA and RTZ shares were less than the returns on their respective index. After the introduction of the DLC arrangement, Rio Tinto significantly underperformed the index consistent with the market reacting negatively to the dual listing. While BHP shares recorded positive returns leading up to the date of the DLC (29/6/2001), they underperformed the ASX Index. These returns improved in the year post DLC, while the ASX Index recorded negative returns. In London, Billiton shares recorded high positive returns initially which fell in the year post DLC; however the returns were still positive and outperformed the FTSE100, which had negative returns over the same period. BHP shares outperformed the ASX Index over the two-year period, and the probability of observing BHP returns higher than the ASX Index was equal to 0.022, indicating there was only a 2.2% chance of observing such returns. BHP returns were higher than the ASX Index in the year after the DLC took effect, but not for the year leading up to it, and not for the two-year period overall. Billiton returns were statistically significantly higher than the index returns, consistent with the explanation that the BHP Billiton DLC was considered to be good news for both groups of shareholders. Shares in Brambles Ltd underperformed the ASX Index before and after entering the DLC structure. While share prices for Brambles Plc were only available from 12/11/2001 to 7/8/2001, they indicated negative returns in excess of those on the FTSE100 for the same period. The difference in returns for Brambles shares and both market indices for both periods was statistically significant, consistent with the explanation that the market viewed the arrangement negatively. The share prices of GKN, which de-merged its industrial services division in the DLC arrangement with Brambles, were also examined. The positive returns in the year leading up to the DLC effective date fell in the year afterwards, but remained positive, and outperformed the FTSE100. The probability of observing GKN Plc returns higher than the FTSE100 was <0.0001 for the period –1yr to 0, and for the two-year period as a whole. However, the probability of observing GKN returns higher than the index returns from the day after the de-merger and up to one year after the event was >0.9999. Therefore, it can be concluded that the returns on GKN shares were higher than the returns on the FTSE100 for the period leading up to the event and for the entire two year period, but lower for the year after the event, consistent with the market reacting positively to the divestment of the division.

Research indicates the valuation between the DLC partners has shown significant variation over time [2]. In the Rio Tinto DLC, the Australian stock has traded at an average discount of around 2% over the time of the DLC. In the case of BHP Billiton, the Australian stock traded at a premium of around 7% and Brambles Australian stock traded at a premium of around 8%. The persistence of BHP Billiton's share price premiums on the ASX over the LSE is contrary to the argument that companies can enhance their share value by listing on larger exchanges. It has also been suggested [2] that the three Australian/UK DLCs exhibit excess co-movement, implying that when the ASX is outperforming the LSE (in the same currency), the Australian partner should outperform the UK partner. Although the cash flows to the investor are the same, the pricing of those cashflows in the various markets is influenced by the performance of the markets. Excess co-movement does not explain persistent differentials in pricing, neither do explanations of differences in liquidity or tax suggesting behavioural factors (such as icon status of the stock in the home country) influence investor behaviour and positively bias stock performance in the long term.

Accounting regulations specifically dealing with DLCs may be some time in coming, and although there has yet to be any further announcements regarding Australian DLCs, many Australian companies have been reported as considering a dual listing as part of their growth strategies. For example, whilst biding for Californian wine group Kendall-Jackson, BRL Hardy Managing Director Mr Stephen Millar indicated that they would consider a DLC structure if the bid were successful [4]. In October 2001, AMP, National Australia Bank, Amcor and CSR were said to be planning to grow offshore, possibly using a DLC structure [6]. In December 2001 that the (then) head of AMP, Mr Paul Batchelor, was eager to enter into a London DLC with its next big acquisition [3]. However, Clegg noted that the experiences of BHP Billiton and Brambles-GKN do not provide evidence that tapping into deeper capital markets is a catalyst for an upward re-rating of AMP, and does not give any certainty in providing superior acquisition currency to offer to UK targets [3].

The analysis of Australian DLC share prices presented above provides mixed signals as to the market's assessment of the structure. Results of the Wilcoxon Matched-Pairs Signed-Rank Tests found that the probability of observing company returns higher than index returns' was statistically significant and extremely high when the company outperformed the relevant index, and the probability of observing company returns higher than index returns was statistically significant and extremely low when the company was outperformed by the index. The evidence presented here is consistent with the market reacting favourably to the BHP Billiton DLC but negatively to the RioTinto and Brambles DLCs. A plausible explanation for these findings relates to behavioural factors such as the corporate profile of the stock in the home country. This could influence investor behaviour and impact on stock performance in the long term.

References

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