Solving Tyco's Identity Crisis

CEO Ed Breen hás restored credibility. Now the hard part: Making sense of its mishmash of businesses

By Brian Hindo

Edward D. Breen hás worked hard to clean up the mess Dennis Kozlowski left at Tyco International. Now, Breen faces an evenharder job: proving he canrunTyco's diverse businesses.

When Breen arrived in mid-2002, Tyco was a $40 billion empire constructedforalithewrongreasons—size without strategy, dealmaking without management. By the time Kozlowski was indicted for pilfering money from the company coffers, Tyco had taken massive asset writedowns, it faced a looming debt crunch, and its accounting was in question. (It was determined "aggressive" by regulators, but not fraudulent.)

Indeed, Breen hás been on the crisis management beat since his first day on the job. In the past five years, he and his team have replaced the board and much of the sênior management, hackedthree-quarters off the debt load, settled most of the outstanding shareholder lawsuits, and restored Tyco's credibility in the eyes of creditors, investors, and its own employees.

Through ali the triage, the new management team tried to make sense of the complex tangle of businesses Kozlowski had thrown together. The coup de grâce on the scandal-plagued era carne last June as Kozlowski was servinghis 8-to-25-yeartermin federal prison. Breen broke Tyco into three parts, spinning off the health-care division, now called Covidien, and the Tyco Electronics unit as independent entities. The moves helped, but as the chairman and chief executive of the new Tyco International, Breen is still left with a fundamental question: Why does Tyco exist? "It is a collection of decent businesses," says Robert E. Mittelstaedt Jr., dean of the W.P. Carey School of Business at Arizona State University. "The question is, do they make sense [together] going forward?"

KEEPING EXPECTATIONS LOW

Starting from scratch, Breen probably wouldn't have drawn up his current portfolio of businesses. If Tyco was a sprawling $40 billion conglomerate in 2002, today what Breen reflexively calls "new Tyco" is a slightly less sprawling $18 billion conglomerate. It includes: security business ADT, a fire protection unit, a red-hot valve business, safety products manufacturing, and an industrial metais operation (table). The leftovers do have a financial affmity, says Breen—ali generate healthy cash flow (í8oo million in 2007), have recurring revenue, and require relatively low capital investment. (Research and development last year, for example, was just $121 million.) But the pruning isn't done: "We're going to exit businesses," says Breen, who adds that his goal is to focus tightly on security, fire, and valves.

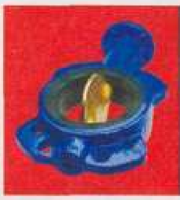
The sort of existential anxiety Tyco must deal with ís a fact of life for any conglomerate. (No one hás to ask Nike what it does for a living.) And each successful one, from a titan like General Electric to smaller ones like Emerson Electric or Danaher, hás a different strategic rationale for its collection of businesses. "There are plenty of companies that exist successfully at the size of Tyco," says Nicole Parent, amulti-industry company analyst at Credit Suisse. "What weaves them together is the operating culture."

The problem for Breen is that no one is quite sure what the operating culture at Tyco looks like. Thafs because the company has spent much of the past

FEASTING ON LEFTOVERS

The new, slimmer Tyco International has a bunch of good businesses, but do they belong together?

ADT WORLDWIDE
$7.6 billion*
Biggest division and best-known Tyco brand, sells home-security monitoring systems



FLOW CONTROL
$3.8 billion
Fastest-growing unit makes valves and pipes for the red hot oil and gas and water industries

FIRE PROTECTION
$3.5 billion
Makes everything from respirators to fire-dousing chemicals to sprinkler systems

ELECTRICAL & METAL
$2.0 billion
Manufactures materials for infrastructure projects such as pipes, wiring, razor fencing; likely to be sold off

SAFETY PRODUCTS
$1.8 billion
Sells video security and access control systems; also makes products for fire-related markets

five years assuaging creditors, quelling lawsuits, and dealing with Securities & Exchange Commission inquiries. "The current management team hás been focused on nonoperational issues," says Parent. "The underlying task at hand hás changed dramatically."

Só far, investors have been slow to latch on to the new Tyco's story. "I don't think it hás fully gotten traction," Breen admits. Since the spin-offs last June 29, Tyco shares are down 22%, trading at a recent 41. Similarly sized conglomerate Danaher's shares have slipped just 4%, while Emerson Electric hás seen shares tick up 6%. Analysts on Wall Street have taken a wait-and- see approach, with half of the 14 rating Tyco "hold" or "sell."

Diversified peers, of course, have historicallegacies and years of management tradition to guide them. Tyco's past, by contrast, is of little use to Breen. Indeed, one of his firstpoints of order was to sweep the company of many of its deal-frenzied, Kozlowski-era managers. "They were private-equity-type people," Breen says. "When *l* first got here, Pd talk about,' We're not doing any more acquisitions, we're going to focus on operational execution.' Some of them, I could just watch their eyes roll up in their head." He says he hás replaced more than half of the company's sênior management.

Só far, in just two quarters of "new Tyco," Breen hás tried to keep expectations low as the company refocuses on operations. On Feb. 5, Tyco showed progress on that front, reporting $369 million in first-quarter operating income, more than double the prior first quarter, on $4.9 billion in sales, a 12% increase. Net income, because of restructuring charges and a higher tax bill, fell by half. The results easily outpaced analysts' subdued estimates: They "perhaps reflect better business quality than many have been assuming," wrote JPMorgan analyst Stephen Tusa in a note to clients.

The days ahead won't be as exciting as the deal-a-minute Kozlowski regime. Breen sees roorn to push for operational improvements at the business lines: "This company did over 600 [deals] and didn't integrate them," he says. Tyco's Earth Tech infrastructure business is already on the block and is expected to fetch more than $1 billion. Kozlowski's legacy is fixed. Clearly, Breen's is still a work in progress. BW

LINKS

To Diversify—or Not?

The "conglomerate discount" holds that shares of a multi-industry company will always trade lower than those of single-focus rivals. This conventional wisdom is controversial in academia. For example, Harvard's Belén Villalonga has done work showing diversification in related industries can actually earn a premium. Researchers on all sides of the debate were asked how they teach the topic to MBA students; the results were published on the Web site of the Social Science Research Network in 2003 as a white paper, *Research Roundtable Discussion: The Diversification Discount.*