Corporate finance analysis

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Monmouth, Inc. Questions 1. Is Robertson an attractive acquisition for Monmouth? (MON) 2.

What is the maximum price that MON can afford to pay based on a discounted cash flow (DCF) valuation? What would be the maximum price per share? • Estimate the WACC • Credibility of the forecasts developed by Vincent and Rudd? • Estimation of the terminal value. • What determines whether sales growth is value-creating versus destructive of value? 3. What is the maximum price based on market multiples of later four quarters? EBIAT? Based on prospective EBIAT? (also on a per share basis). 4.

What price will be necessary to gain the support of the Robertson family, Simmons, and the great majority of the stockholders? What are the interests, concerns, and alternatives of each group? Does MON have a competitive advantage over the NDP in the bidding contest? How likely is NDP to increase its offer in response to the bid by MON? 5. What price can MON pay without harming its long-term trend in earnings per share (EPS) and its shareholder value? EXECUTIVE SUMMARY IS REQUIRED. IT HAS TO BE 1 PAGE –DOUBLE SPACE ALL QUESTIONS MUST BE ANSWERED ON A WORD DOCUMENT . PLEASE ATTACH ALSO YOUR EXCEL SPREADSHEET

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____ HBS Professor Thomas R. Piper and HBS MBA Heide Abelli prepared this case solely as a basis for class discussion and not as an endorsement, a source of primary data, or an illustration of effective or ineffective management. This case, though based on real events, is fictionalized, and any resemblance to actual persons or entities is coincidental.

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edu. No part of this publication may be reproduced, storedin a retrieval system, used in a spreadsheet, or transmitted in any form or by any means—electronic, mechanical, photocopying, recording, or otherwise—without the permission of Harvard Business Publishing. Harvard Business Publishing is an affiliate of Harvard Business School. THOMAS R. P IPER HEIDE ABELLI Monmouth, Inc.

Harry Vincent, executive vice president of Monmouth, Inc. , was reviewing acquisition candidates for his company's diversification program. One of the companies, Robertson Tool Company, had been approached by Monmouth three years earlier but had rejected all overtures. Now, however, Robertson was in the middle of a takeover fight that might provide Monmouth with a chance to gain control.

Monmouth, Inc. Monmouth was a leading producer of engines and massive compressors used to force natural gas through pipelines and oil out of wells. Management was concerned, however, over its heavy dependence on sales to the oil and gas industries and the violent fluctuation of earnings caused by the cyclical nature of heavy machinery and equipment sales. Although the company's long-term sales and earnings growth had been above average, management believed that its cyclical nature had dampened Wall Street's

interest in the stock substantially. Initial efforts to lessen the earnings volatility were not entirely successful.

Monmouth acquired a supplier of portable industrial power tools, a manufacturer of small industrial air and process compressors, a maker of small pumps and compressors, and a producer of tire-changing tools for the automotive market. The acquisitions broadened Monmouth's markets but still left it highly sensitive to general economic conditions. The continued volatility prompted a full review of the company's acquisition strategy. After several months of study, three criteria were established for all acquisitions. First, the industry should be one in which Monmouth could become a major player. This requirement was in line with management's goal of leadership within a few distinct areas of business.

Second, the industry should be fairly stable, with a broad market for the products and a product line of " small ticket" items. This product definition was intended to eliminate any company that had undue profit dependence on a single customer or several large orders per year. Finally, it was decided to acquire only leading companies in their respective market segments. This new strategy was initially implemented with the acquisition of the Dessex Rule Company, the world's largest manufacturer of measuring rules and tapes. Monmouth acquired a quality 4226 J U L Y 3 1 , 2 0 1 0 4226 | Monmouth, Inc.

2 BRIEFCASES | HARVARD BUSINESS PUBLISHING product line, an established distribution system of 15, 000 retail hardware stores throughout the United States, and plants in the United States, Canada, and Mexico. It

also gained the services of Michael Rudd, president of Dessex, and Jim Hackett, vice president of sales. Both were extremely knowledgeable in the hand tool business and had worked together effectively for years. Their goal was to build, through acquisition, a hand tool company with a full product line that would use a common sales and distribution system and joint advertising.

To do this they needed Monmouth’s financial strength. Dessex provided a solid base to which two other companies were added. In 2000 the Keane Corporation was acquired. The company had been highly profitable but suffered in recent years under the mismanagement of some investor-entrepreneurs. A series of acquisitions of weak companies with poor product lines eroded Keane’s overall profitability.

Discouraged, the investors wanted to exit their ownership position, and Monmouth—eager to add Keane’s well-known and high-quality measuring and fastening tools to its line—was interested in the opportunity. It was clear that some of Keane’s lines would have to be dropped and inefficient plants would have to be closed, but the rules, ratchets, and wrenches would play an important part in Monmouth’s product strategy. Monmouth further expanded into hand tools ith the acquisition of the Kroll Electric Corporation. Kroll was the world’s leading supplier of soldering tools to the industrial, electronic, and consumer markets. It provided Monmouth with a new, high-quality product line and production capacity in England, Germany, and Mexico. Monmouth was less successful in its approach to a fourth company in the hand tool business—the Robertson Tool Company.

Robertson was on the original “ shopping list” of acceptable acquisition candidates that Mr. Vincent and Mr. Rudd had developed, but several attempts to interest Robertson in exploring merger possibilities had failed. The Robertson family had controlled and managed the company since its founding in 1864, and Paul Robertson, chairman of the board, had no interest in joining forces with another organization. Robertson Tool Company Nevertheless, Robertson was too inviting a takeover target to be overlooked or ignored for long. A relatively poor sales and profit performance in recent years, conservative accounting and financial policies, and a low percentage of outstanding stock held by the family and management all contributed to its vulnerability.

Annual sales growth of 2% was far behind the industry growth rate of 6% per year, and profit margins had slipped to only one-third those of other hand tool manufacturers. Its common stock was trading near its lowest point in many years and well below its book value of $53 per share. Lack of investor interest in the stock was reflected in its low priceearnings ratio of 10–14, which compared with 12–15 times earnings for other leading hand tool companies. The stock was clearly trading on the basis of its dividend yield, with only limited hopes for capital appreciation.

(Exhibits 1 and 2 summarize Robertson’s operating results and balance sheet. What made Robertson so attractive were its basic competitive strengths, which the familydominated management had not translated into earnings. It was one of the largest domestic manufacturers of cutting & edge hand tools and a leader in its two main product areas. It held a 50% share of the $75-million market for clamps and vises, where it offered a broad, high-

quality line with a very strong brand name. Its second product line, scissors and shears, also had an excellent reputation for quality and held a 9% share of this $200-million market. Only Keystone, Inc.

, and Disston, Inc. , had larger market shares. Monmouth, Inc. | 4226HARVARD BUSINESS PUBLISHING | BRIEFCASES 3 Robertson’s greatest asset, however, was its distribution system. Forty-eight direct salespeople and 28 sales engineers marketed its products to 2, 100 hardware wholesalers in the United States and Canada.

These wholesalers in turn sold to 15, 000 retail outlets. Their efforts were supported by heavy advertising and promotional programs. Overseas the company’s products were sold in 137 countries through 140 local sales representatives. The company seemed to have all the necessary strengths to share fully in the 6%-7% annual sales growth forecast for the industry.

The Raid by The Simmons CompanyMonmouth was not alone in its interest in Robertson. The Simmons Company, a conglomerate with wide-ranging interests in electrical equipment, tools, nonferrous metals, and rubber products, had acquired 44, 000 shares of Robertson stock in 2000 and had been an attentive stockholder ever since. On March 3, 2003, Simmons informed Robertson management of its plan to tender immediately for 437, 000 of Robertson’s 584, 000 outstanding shares at $42 per share in cash. The offer would terminate on April 4, unless extended by Simmons; and the company was unwilling to acquire fewer shares than would constitute a majority. Robertson management was alarmed by both the proposal and the proposer.

The company would contribute less than one-sixth of the combined sales and would clearly be just another operating division of Simmons. It was feared that Simmons' quest for higher profits might lead to aggressive cost cutting and the elimination of marginal product lines. Loss of control seemed both painful and likely. The $42 cash offer represented a $12 premium over the most recent price of the stock and threatened to create considerable stockholder interest.

The disappointing performance of the stock in recent ears would undoubtedly increase the attractiveness of the $42 offer to Robertson's 4, 200 stockholders. And the Robertson family and management owned only 20% of the outstanding shares—too few to ensure continued control. Immediately after learning of the Simmons tender offer, Harry Vincent and Michael Rudd approached the Robertson management with an offer of help. It was clear that Robertson had to move immediately and forcefully; the first 10 days of a tender offer are critical. Messrs. Vincent and Rudd stressed that Robertson had to find a better offer and find it fast.

Indeed, Monmouth was willing to make such an offer if Robertson's management and directors would commit themselves to it—now. But Robertson was not ready for such decisive action and three days passed without any decision. With each day the odds of a successful counteroffer diminished. Finally, the Monmouth officers decided the risks were too great and that Simmons would learn of the offer of help and might retaliate. Monmouth's stock was depressed, and it was possible that an angry Simmons management might strike for control of Monmouth.

The offer was withdrawn. By late March the situation was increasing in seriousness. Robertson’s management moved to block the raid. It talked with the large shareholders personally and made a strong public statement recommending against the offer.

But announcements by Simmons indicated that a substantial number of Robertson shares were being tendered. It was no longer a matter of whether to be acquired; the issue was, by whom?! Management sought to find an alternative merger that would ensure continuity of Robertson management and operating independence. Several companies had communicated with Robertson in the wake of the Simmons announcement, but no one other that Monmouth had made a specific proposal. This was largely due to their reluctance to compete at the price levels being discussed or to enter into a fight with Simmons.

Finally, on April 3, agreement was reached with NDP Corporation 4226 | Monmouth, Inc. 4 BRIEFCASES | HARVARD BUSINESS PUBLISHING on the terms of a merger with it. NDP was a broadly diversified company with major interests in publishing and original and replacement automotive equipment. Under the merger terms, five shares of NDP common stock would be exchanged for each share of Robertson common stock. (See Exhibit 3 for a financial summary of NDP.

) Assured of continued operating independence, management supported the NDP offer. In a letter to the stockholders Paul Robertson pointed out that the exchange would be a tax-free transaction with a value of $53. 10 (NDP common stock had closed at $10. 62 on the day before the offer). He felt

confident that the necessary majority of the outstanding common stock would be voted in favor of the proposed merger when it was brought to a vote in the fall.

Simmons quickly counterattacked by pointing out that NDP common stock had recently sold for as low as $4, which would put the value at only $23. 12. Furthermore, anyone who accepted the NDP offer would suffer a sharp income loss, since NDP paid no common dividend. Opportunity for Monmouth Harry Vincent and his staff were still attracted by the potential profits to be realized from Robertson. It was felt that Robertson's efforts to sell to every market segment resulted in an excessive number of products, which held down manufacturing efficiency and ballooned inventories.

Monmouth estimated that Robertson's cost of goods sold could be reduced from 69% of sales to 65%. The other major area of cost reduction was selling expenses. There was a substantial overlap of Robertson's sales force and that established by Monmouth for its Dessex-Kroll-Keane hand tool lines. Elimination of the sales and advertising duplications would lower selling, general, and administrative expenses from 22% of sales to 19%. (Exhibit 4 provides pro-formas for Robertson Tool.) There were other possible sources of earnings, but they were more difficult to quantify.

For instance, 75% of Robertson's sales were to the industrial market and only 25% to the consumer market. In contrast, sales by Monmouth's hand tool group were distributed between the two markets in virtually the exact opposite proportions. Thus, sales increases could be expected from Robertson's " pulling" more Monmouth products into the industrial markets

and vice versa for the consumer market. Also, Monmouth was eager to use Robertson's strong European distribution system to sell its other hand tool lines.

The battle between Simmons and NDP seemed to provide Monmouth with an unexpected, second opportunity to gain control of Robertson. Simmons had ended up with just 133, 000 shares tendered in response to its offer—far short of the 249, 000 shares needed to give it majority control. Its slate of directors had been defeated at the Robertson annual meeting on April 21. Simmons now feared that Robertson might consummate the merger with NDP and that Simmons would be faced with the unhappy prospect of receiving NDP common stock for its 177, 000 shares of Robertson stock.

Simmons knew that the NDP stock had been a lackluster performer and might not show any significant growth in the near term. Finally, Simmons feared it would be difficult to sell a large holding of NDP stock, which traded in small volume. On the other hand, a merger of Monmouth and Robertson would allow Simmons to convert its shares into common stock of Monmouth. This was a much more attractive alternative, assuming that an acceptable exchange rate could be set. Simmons anticipated that earnings should rebound sharply from the cyclical downturn and that Monmouth stock would show significant price appreciation. Furthermore, the stock was traded on the New York Exchange, which provided substantial liquidity.

Monmouth, Inc. | 4226HARVARD BUSINESS PUBLISHING | BRIEFCASES 5 At a private meeting in late April, Simmons tentatively agreed to support a Monmouth-Robertson merger on the condition that the price be at least $50

for each Robertson share he held. Mr. Vincent was now faced with the critical decision of whether to move for control. If he decided to seek control, it would be necessary to establish both the price and the form of the offer. Clearly, the terms would have to be sufficiently attractive to secure the shares needed to gain majority control.

Mr. Vincent also felt that the terms should be acceptable to management.