

# [Yeats case study](https://assignbuster.com/yeats-case-study/)

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I. Executive Summary In May of 2000, Yeats Valves chairman and CEO, Bill Yeats, met with his consultant and fellow board member, Kate Porter, to discuss the final negotiations regarding the acquisition of Yeats Valves by TSE International Corporation. Although the social terms of the merger had been discussed, no specific details had been settled.

Organized in 1980 for engineering and developmental work on specialty valves and heat exchangers, Yeats Valves and Controls Inc (YVC) had a reputation for engineering excellence in the most complex phases of the business. YVC derived 50% of its profits from special applications for the defense and aerospace industries as well as prime contract work for the government. With the introduction of new products for the aerospace and defense industries, YVC’s first quarter sales in 2000 grew by 20-25%. YVC’s R&D confidence and management efficiency brought numerous merger propositions, and as Bill Yeats considered his nearing retirement, he decided that selling YVC was critical in upholding his company’s reputation. Along with retirement, many reasons existed that made an acquisition necessary for Yeats Valves. First, YVC needed a deep pocketed partner in order to expand; large investments would be needed in order for the company to continue R of new products.

Second, Yeats would gain access to a large marketing and distribution network if acquired. Third, a purchase would allow YVC to gain production know-how for high-volume manufacturing; and finally, the trend of consolidation in the industry had increased over the last year. Bill Yeats also considered alternatives to the proposed acquisition with TSE: a possible merger with the defense contractor Rockheed-Marlin, establishing a joint venture with TSE, or moving forward alone. After evaluating these alternatives, Yeats decided that the acquisition by TSE was best choice for the company. By May of 2000, the social and financial terms still needed to be confirmed.

The details discussed included YVC’s management team and employees remain intact, and also a grant of five-year options to purchase 80, 000 shares of TSE International stock at 90% of its market price at the close of the acquisition. Yeats and Porter were left with the task of establishing a settlement that would ensure YVC’s stockholders would profit from the merger; thus, two questions were at hand: Would the merger benefit Yeats Valves? If so, what is the minimum price YVC should ask? We evaluated Yeats and TSE’s FCF and found the NPV for each. Using this information, we valuated each stock price by using two different methods: P/E ratio and discounted cash flows. We concluded that the merger will benefit YVC and the asking price should range from $39. 92 to $61. 90.

Giving each method an equal weight, the asking price should be $50. 91. II. Introduction of Issue and Alternatives With YVC’s high growth, esteemed intellectual property, and excellent engineering tactics, Bill Yeats has been faced with many opportunities for diversification. With his retirement approaching, Yeats decided to take some action to ensure the future growth of YVC.

Before deciding to be acquired by TSE International, Yeats considered three options as potential alternatives. The first would be a merger with the large defense contractor, Rockheed-Marlin. Even though there was potential with this merger, Yeats decided that if he was going to merge, he would want TSE to be the partner. Yeats also considered establishing a joint venture; however, joint ventures faced the same integration problems as did acquisitions and therefore ruled as an inferior alternative. Finally, Yeats considered moving forward alone.

This would require raising large sums of new debt and equity to finance YVC’s rapid expansion. After Yeats decision to move forward with the acquisition, he and Porter were faced with many decisions regarding the specific settlement details. Yeats and Porter needed to evaluate both YVC and TSE’s proforma statements to valuate an appropriate stock price for their shares. They wanted to guarantee that the merger would create a profit for the stockholders, as well as creating a better multiple from the synergy. The methods we used to valuate an appropriate stock price are the P/E ratio and the discounted cash flow.

III. Research/Analysis When a company considers acquiring another, they should consider the following factors: the current market cap, the minimum price that should be offered to motivate shareholders to sell their shares, and a target price settled upon negotiation. We used YVC’s proforma statements to calculate a stock price that would be appropriate regarding the NPV of YVC future free cash flows. The exhibit below shows our calculations of YVC’s stock valuation using the discounted cash flow method and a 3% terminal growth rate. Free Cash Flow 5, 197 5, 159 5, 935 6, 824 7, 827 Terminal Value 108, 938 Total Free Cash Flow 5, 197 5, 159 5, 935 6, 824 116, 764 Value of the Enterprise/Value of Equity$89, 142 Number of Shares outstanding 1, 440, 000Price Per Share $61.

90 Using the P/E ratio of 10. 3 and earnings per share of 3. 87, we found the stock price to be $39. 92. This is only a $. 12 difference from YVC’s current market price.

To further our analysis, we calculated an exchange ratio for YVC’s and TSE’s current market prices, the DCF prices, and P/E ratio prices. We first calculated TSE’s discounted cash flow share of $34. 16, then the P/E ratio price using the same 10. 3 ratio and earnings per share of $2. 23.

The table below summarizes our calculations for each exchange ratio. Current Market Prices1. 81 DCF/NPV Share Prices1. 81 P/E Ratio Prices Per Share1. 74 IV.

Conclusion/Recommendation Since the range between the discounted cash flow stock price and P/E stock price is so large, we suggest using an exchange ratio. We would suggest using the average exchange ratio between the DCF and P/E ratio of 1. 775. Using this ratio, YVC can exchange its shares for TSE shares of stock. With this approach, an appropriate stock price doesn’t have to be negotiated between the two companies.