

Stock and long term trend



Team 1 Monmouth Case 1. Is Robertson a good candidate for Monmouth (assuming the price is right)? Why? Yes. Robertson Tool Company had been going through a few years of low sales and profit, and, coupled with conservative financial and accounting practices, was far behind the normal growth rate for companies in its industry. Robertson's 50% control of the market for clamps and vises, along with its good position in the scissors and shears' \$200 million markets, let it compliment the diverse holdings of Monmouth.

This will turn the favor to Monmouth, as an acquisition by NDP would surely devalue the resources of Robertson instead of using synergies created by mixing markets and offering new, complimenting, product lines. In fact, as Robertson is undervalued in the market because of unsystematic latencies and inefficiencies, the \$50/share price demanded by Simmons might be less than the long-term gain inherent in the merger of Robertson and Monmouth.

8. What price can Monmouth pay without harming its long term trend in earnings per share? Financetexts focus on the net present value of cash flow to make investment decisions.

Are companies therefore foolish if they make acquisitions based at least in part on earnings per share impact? First, we need to forecast Robertson's net income if it is acquired by Monmouth, assuming its interest expenses will be \$0.8 million for the next five years. Second, we will forecast Monmouth's total net income after the acquisition of Robertson. Monmouth must raise funds to make this acquisition. The company anticipated making the acquisition by issuing stocks. Thus, we will calculate how many shares

Monmouth should issue without harming its long term trend in earnings per share, and total shares outstanding after the acquisition.

We know that current stocks of Monmouth and Robertson closed at \$24 and \$44, respectively; therefore, we can calculate the exchange ratio as $\$44/\$24 = 1.83x$. If Monmouth acquired the entire Robertson by an exchange of stocks at a price of \$44 per share, the shares that Monmouth needs to issue is 1.07 (1.83×0.584) million. As a result, Monmouth's total shares outstanding after acquisition would increase to 5.28 ($4.21 + 1.07$) million. Now we know the total net income and total shares outstanding after the acquisition, we can then calculate the after-merge earnings per share of Monmouth.

According to the table below, the row in green shows that the after-merge EPS is lower than the before-merge EPS during the first two years, but will become higher in the following three years. Therefore, if we paid \$44 per share for Robertson's stocks, we can acquire the entire Robertson's stocks without harming Monmouth's long term trend in earnings per share. Using the same techniques, we can estimate the price range that Monmouth can pay without harming its long term trend in earnings per share.

We can use the Goal Seek function in Excel to estimate the highest exchange ratio. As you will see in the table below, the exchange ratio can increase up to 1.98x without harming Monmouth's long term trend in earnings per share. Therefore, using the exchange ratio of 1.98x, we can estimate the per-share price paid for Robertson's stocks. The estimated price would be \$47.52 (1.98×24) per share, higher than Robertson's current trading price of \$44, therefore will attract the shareholders of Robertson's to sell; but still

don't harm Monmouth's long term trend in earnings per share. However, EPS plays very little role in deciding whether an acquisition is good or not since a company's net income after the acquisition and total shares outstanding can be affected by many factors. The acquisition will bring synergies to the acquiring company, such as cost savings and efficiency. Also, the acquiring company may not need to buy the entire target company's outstanding stocks to gain control. As a result, EPS could also change due to these factors. Thus, NPV is a better alternative to value an investment.