

# [Crown corporation](https://assignbuster.com/crown-corporation/)

Crown Corporation started as mining company, but a series of acquisitions and divestitures during the 1960s had totally transformed Crown Corporation from mining company to a manufacturer of superalloy castings for aircraft and industrial uses and aluminum products for the building, packaging and aircraft industries. Sales were evenly divided between castings and aluminum products. Crown’s castings were for the most part designed for operation in the “ hot part” of the gas turbine engine.

Crown’s constant emphasis on quality and technical excellence had established a high level of confidence among its customers. The other half of crown’s sales comprised aluminum products, including a broad product line for the building and construction industry. To assure a steady and economical source, Crown Corporation participated with American Metal climax, Inc. in a project in 1966 known as Intalco, which made them a producer of primary aluminum. Crown’s share of Intalco’s output was 130 million pounds.

Crown decided to build a second aluminum ingot plant in 1967, named Eastalco, which provide Crown with additional primary aluminum capacity of 85 million pounds a year and increased net income of $3-4 million. A planned addition of 85 million pounds in 1972 would raise Eastalco’s capacity to 170 million pounds and would meet the company’s objective to be a fully integrated producer.

Crown’s sales performance was good initially, it’s sales had risen sharply rom $60 million in 1958 to $230 million in 1968 on the strength of 23 acquisitions, strong internal growth and a firming of aluminum prices. But after some time it faces some bad turns, after reaching a peak of $1. 13 in 1959, earnings per share fell to $0. 34 in 1963 as overcapacity developed in the aluminum business. During that time domestic industry capacity roses and growth potential in the industry encouraged new producers to enter into the market. So overcapacity developed and therefore, price falls down.

Producers sold their product in low rate to grab the market. But demand-supply conditions in the industry improved in the early 1960s. with this improvement higher earnings came for Crown and other aluminum producers in the industry. But some producers were still maintaining lower prices to obtain business for their idle machine. When producers started getting consumers and order from them they rose the prices slowly, and soon the industry price situation improved after 1968, whereas process of fabricated products remained weak until 1965.

Problem Definition In February 1969 Mr. Walter Bennet, treasurer of Crown Corporation was considering several financing alternatives. Crown’s decision to integrate backwards into the production of primary aluminum ingot had resulted in very heavy capital expenditures. Its need for funds for working capital and for completion of Eastalco now outstripped the company’s internal cash generation and it would be necessary to raise $30 million within the next 6 months to cover capital needs for 1969.

Expected Growth and Estimated Capital Expenditures Mr. Walter Bennett, treasurer of Crown Corporation expected that sales would increase at 6-8% annually, exclusive of acquisitions, over the foreseeable future. Sales of aluminum products were expected to rise by 15-20% annually as the company broadened its penetration of major aluminum consuming markets. Total capital expenditures, including the Eastalco project, were forecast at $39 million in 1969, $32 million in 1970, $7 million in 1971 and $50 million in 1972.

The heavy capital spending would require that Crown raise $30 million in 1969, $22 million in 1970 and $30 million in 1972. Financing Alternatives Several alternatives were open to Crown to meet its financing need. Mr. Bennett were considering those alternatives. The company’s investment banker’s pointed to the future financing flexibility afforded by the use of equity financing, by issuing $30 million common stock, but the dilution of earnings per share were the matter of concern for Bennett.

Because Crown stock had fallen from $51 a share in May 1968 to $30 a share. Investors were disappointed with the earnings. Further near-term price weakness seemed likely as earnings per share remained depressed as Crown absorbed heavy startup costs for the production of the main landing gear for the McDonnel Douglas DC-10 in 1969. Under this conditions, announcement of a large equity issue would drive stock price down to the low twenties. For that reason it would be necessary to sell 1. 4 million shares to rise the $30 million net to the company.

So Mr. Bennett was confused whether equity financing should deferred until the company get back to pattern of earnings gains. Alternative to equity financing was to take bank loans. A consortium of commercial banks had agreed to lend the company up to $30 million at 7-1/4% interest. But there were some conditions like net working capital must exceed $55 million, dividend payments were restricted to earnings accumulated after the date of the loan agreement and additional funded debt was limited to $20 million.

Another alternative could be issuing debentures. It would be possible to place a $30 million subordinated convertible debenture issues privately with the Northern Life Insurance Company. The debenture would carry a coupon of 6% with annual debt retirement of $2 million in years six through twenty. The issue would not be callable for ten years, except at par for mandatory debt retirement, and would be convertible into common stock. Other than these Mr. Bennett was interested in the debt alternatives, although the company’s use of debt had increased sharply.