Blaine case

Economics, Tax

Executive Summary: In summary, recommendation by the banker to buy back 14 million outstanding shares of Blaine Kitchenware with $ 50 million debt and $209 million cash in hand would result in following financial metric changes: * Increase the value of the firm through the benefit of tax shield from current $960million to $1. 063billion. * The offer results in 3% increase in EPS from $0. 91 to $0. 93 based on 2006 financial numbers. * An increase of 7. 3% on ROE from 11% to 18. 3% based on 2006 financial numbers. * After adjustment, share prices will be $18. 0. Proposed Buy-Back Plan Analysis:

Although Blaine's current financial situation is sound with no debt, its current balance sheet is under levered and over liquid compare to its peers. The current financial structure earns little return on the short-term assets while does not allow the firm to benefit from any debt interest tax shield. The proposed capital structure will benefit the company by levering its balance sheet. It will provide an interest tax shield for the income thus increasing the value of the firm for the shareholders. Because interest on debt is a tax-deductible expense, taking on debt will effectively lower the taxable income allowing the firm to pay less tax.

The current large cash and short-term marketable securities on the balance sheet make Blaine an attractive target for a take-over. The large cash on balance sheet could effectively be used as a collateral tofinancea take-over or merger of Blaine. Such characteristics attract private equity firms in which can utilize the over-liquid situation to their advantage. The current mature nature of business also requires a levered capital structure. A firm in this

situation should not follow a pecking order, as it would hold down the value of the firm while making it attractive for a take-over or merger.

Less cash in balance sheet also reduces agency cost by forcing managers to invest only in opportunities that are aligned with shareholders vision and interest therefore reducing wasteful investments not benefiting shareholders. As for the future acquisitions, Blaine can either use debt or issue stocks when appropriate. Furthermore the proposed share buy-back will give more control tofamilyinvestors. Since initial IPO and previous acquisitions has diluted the shares, family control in Blaine has been on decline and a source of concern.

The proposed share buy-back will return more control into family shareholder hands further solidifying their support for the new capital structure. The repurchase offer would affect both income statement and balance sheet of the firm. In the balance sheet debt is increased by $50 million, cash is reduced by $209 million while equity is reduced by $259 million. The remaining cash can be used to fund seasonal peak operation in combination with additional short-term debt should it be needed. Our EPS will increase by 3% to $0. 93 from current $0. 91 and our ROE will see a large increase from 11% to 18. % further bringing Blaine closer to its competitors. The result of additional debt in the balance sheet will increase the value of the firm from current $960million to $1. 063billion while adjusted share prices will rise to $18. The increase in share value is due to increase in the value of the firm from $960million to $1. 06billion because of levering up the firm since value of any levered firm is its unlevered value plus its tax rate multiplied by its interest bearing debt. The $18. 50 offer holds a premium over adjusted

future share price of $18 therefore making the proposed capital structure attractive to shareholders.

The debt to equity ratio of 2. 5% is still conservative and aligned with the vision of the company not to over utilize debt in its capital structure. Furthermore the increase in Enterprise Value to EBITDA ratio from 9. 9% to 14. 8% will make the firm more costly to be acquired thus less attractive for a take-over. A dividend policy in place of the stock repurchase will not provide the same value for the company and its shareholders. Dividends are subjected to higher tax rate compare to capital gain increased due to share buy-back.

This discourages shareholders from desire to receive high dividends in place of higher capital gain as share values increase. A comparison is made below between the proposed capital structure and dividend policy. | Share buyback| One-time special cash dividends| Pros| Increase EPS/ROE, pos. sign of future earnings, Lower tax rate compare to div policy| Happy shareholders, positive sign of future earnings, | Cons| Limiting liquidity, opportunity cost | Limiting liquidity, opportunity cost, higher tax rate compare to capital gain policy| Share outstanding| Decrease| No change|

EPS| Increase| No change| ROE| Increase| Increase| In summary we recommend the share buy-back plan, as it will increase the value of the firm, shield part of income from taxes, increase return on equity and lowers agency cost. The increase in value of the firm and lower cash in hand also makes the firm less attractive target of a take-over. Supporting Material: Case Exhibit 1 Income Statement| | | | | With Repurchase Option| | | | | | | | | | |

Operating Results:| | | 2004 | 2005 | 2006 | 2006 | | Revenue| | | | 291, 940 | 307, 964 | 342, 251 | 342, 251 | | Less: Cost of Goods Sold| | | 204, 265 | 220, 234 | 249, 794 | 249, 794 | | Gross Profit| | | 87, 676 | 87, 731 | 92, 458 | 92, 458 | | Less: Selling, General & Administrative| 25, 293 | 27, 049 | 28, 512 | 28, 512 | | Operating Income| | | 62, 383 | 60, 682 | 63, 946 | 63, 946 | | Plus: Depreciation & Amortization| | 6, 987 | 8, 213 | 9, 914 | 9, 914 | | EBITDA| | | | 69, 370 | 68, 895 | 73, 860 | 73, 860 | | | | | | | | | | |

EBIT| | | | 62, 383 | 60, 682 | 63, 946 | 63, 946 | | Plus: Other Income (expense)| | 15, 719 | 16, 057 | 13, 506 | 0 | No marketable security income| Less Interest| | | 0 | 0 | 0 | 3, 375 | Tax shield amount| Earnings Before Tax| | | 78, 101 | 76, 738 | 77, 451 | 60, 571 | | Less: Taxes| | | 24, 989 | 24, 303 | 23, 821 | 18, 629 | | Net Income| | | 53, 112 | 52, 435 | 53, 630 | 41, 942 | | Dividends| | | | 18, 589 | 22, 871 | 28, 345 | 22, 167 | Assume same 53% div policy| | | | | | | | | | | | | | | | | | | Margins:| | |

Revenue Growth| | | 3. 2%| 5. 5%| 11. 1%| 0. 0%| | Gross Margin| | | 30. 0%| 28. 5%| 27. 0%| 27. 0%| | EBIT Margin| | | 21. 4%| 19. 7%| 18. 7%| 18. 7%| | EBITDA Margin| | | 23. 8%| 22. 4%| 21. 6%| 21. 6%| | Effective Tax Rate (1)| | | 32. 0%| 31. 7%| 30. 8%| 30. 8%| | Net Income Margin| | | 18. 2%| 17. 0%| 15. 7%| 12. 3%| | Dividend payout ratio| | | 35. 0%| 43. 6%| 52. 9%| 52. 9%| | Case Exhibit 2 Balance Sheet| | | | | With Repurchase Option| | | | | | | | | Assets:| | | | 2004 | 2005 | 2006 | 2006 |

Cash & Cash Equivalents| | | 67, 391 | 70, 853 | 66, 557 | 21, 866 | Marketable Securities| | | 218, 403 | 196, 763 | 164, 309 | 0 | Accounts Receivable| | | 40, 709 | 43, 235 | 48, 780 | 48, 780 | Inventory| | | | 47, 262 | 49, 728 | 54, 874 | 54, 874 | Other Current Assets| | | 2, 586 | 3, 871 | 5, 157

| 5, 157 | Total Current Assets| | | 376, 351 | 364, 449 | 339, 678 | 130, 678 | | | | | | | | Property, Plant & Equipment| | 99, 402 | 138, 546 | 174, 321 | 174, 321 | Goodwill| | | | 8, 134 | 20, 439 | 38, 281 | 38, 281 |

Other Assets| | | 13, 331 | 27, 394 | 39, 973 | 39, 973 | Total Assets| | | 497, 217 | 550, 829 | 592, 253 | 383, 253 | | | | | | | | Liabilities & Shareholders' Equity:| | | | | Accounts Payable| | | 26, 106 | 28, 589 | 31, 936 | 31, 936 | Accrued Liabilities| | | 22, 605 | 24, 921 | 27, 761 | 27, 761 | Taxes Payable| | | 14, 225 | 17, 196 | 16, 884 | 16, 884 | Total Current Liabilities| | | 62, 935 | 70, 705 | 76, 581 | 76, 581 | Other liabilities| | | 1, 794 | 3, 151 | 4, 814 | 4, 814 | debt| | | | 0 | 0 | 0 | 50, 000 |

Deferred Taxes| | | 15, 111 | 18, 434 | 22, 495 | 22, 495 | Total Liabilities | | | 79, 840 | 92, 290 | 103, 890 | 153, 890 | Shareholders' Equity| | | 417, 377 | 458, 538 | 488, 363 | 229, 363 | Total Liabilities & Shareholders' Equity| 497, 217 | 550, 829 | 592, 253 | 383, 253 | | | | | | | | | EPS | | Per Outstanding Shares of| Before| $0. 908 | 59, 052, 083 | After| $0. 931 | 45, 052, 083 | Improvement| 2. 51%| | ROE| | @ Book Equity| Before| 10. 98%| $488, 363 | After| 18. 9%| $229, 363 | Equity Value| | Vu| $959, 596 | VL| $1, 063, 196 | New Share Prices| $18. 00 | Case Exhibit 3 – Peer Comparison | Home ; Hearth Design| AutoTech Appliances| XQL Corp. | Bunkerhill, Inc. | EasyLiving Systems| | Blaine Kitchenware| Blaine Kitchenware After Repurchase| | | | | | | | | Revenue| $589, 747| $18, 080, 000| $4, 313, 300| $3, 671, 100| $188, 955| | $342, 251| 342251. 25| EBIT| 106, 763 | 2, 505, 200 | 721, 297 | 566, 099 | 19, 613 | | 63, 946 | 63945. 5| EBITDA| 119, 190 | 3, 055, 200 | 796, 497 | 610, 399 | 23, 356 | | 73, 860 | 73, 860 | Net income| $53, 698| $1, 416, 012| $412, 307| $335, 073| $13, 173| | $53, 630| 41941. 55799| | | | | | | | |

Cash ; securities| $21, 495| $536, 099| $21, 425| $153, 680| $242, 102| | $230, 866| 21, 866 | Net working capital*| 54, 316 | 1, 247, 520 | 353, 691 | 334, 804 | 21, 220 | | 32, 231 | - | Net fixed assets| 900, 803 | 7, 463, 564 | 3, 322, 837 | 815, 304 | 68, 788 | | 174, 321 | 174, 321 | Total assets| $976, 613| $9, 247, 183| $3, 697, 952| $1, 303, 788| $332, 110| | $592, 253| 383, 253 | | | | | | | | |

Net debt (1)| $350, 798 | $4, 437, 314 | $950, 802 | $238, 056 | ($64, 800)| | ($230, 866)| 28, 134 | Total debt| 372, 293 | 4, 973, 413 | 972, 227 | 391, 736 | 177, 302 | | - | 50, 000| Book equity| $475, 377 | $3, 283, 000 | $2, 109, 400 | $804, 400 | $94, 919 | | $488, 363 | 229, 363 | | | | | | | | | Market capitalization| 776, 427 | 13, 978, 375 | 5, 290, 145 | 3, 962, 780 | 418, 749 | | 959, 596 | 1063196. 354| Enterprise value (MVIC)| $1, 127, 226 | $18, 415, 689 | $6, 240, 947 | $4, 200, 836 | $353, 949 | | $728, 730 | 1, 091, 330 | | | | | | | | | | Equity beta| 1. 03| 1. 24| 0. 96| 0. 2| 0. 67| | 0. 56 | 0. 7| | | | | | | | | | LTM Trading Multiples| | | | | | | | MVIC/Revenue| 1. 91x| 1. 02x| 1. 45x| 1. 14x| 1. 87x| | 2. 13x| 3. 19x| MVIC/EBIT| 10. 56x| 7. 35x| 8. 65x| 7. 42x| 18. 05x| | 11. 40x| 17. 07x| MVIC/EBITDA| 9. 46x| 6. 03x| 7. 84x| 6. 88x| 15. 15x| | 9. 87x| 14. 78x| Market/Book equity| 1. 63x| 4. 26x| 2. 51x| 4. 93x| 4. 41x| | 1. 96x| 4. 64x| | | | | | | | | Net Debt/Equity| 45. 18%| 31. 74%| 17. 97%| 6. 01%| -15. 47%| | -24. 06%| 2. 65%| Net Debt/Enterprise Value| 31. 12%| 24. 10%| 15. 23%| 5. 67%| -18. 31%| | -31. 68%| 2. 58%|