

CASE

32

National Brands vs. A-1 Holdings

At 5:30 on Friday afternoon, January 22, 2010. Bill Hall, the chairman and CEO of National Brands, Inc., was clearing up the last of the papers on his desk and looking forward to a relaxing weekend. It had been a good week. The company's annual results were in, and they showed that 2009 had been the best year in the company's history. Sales and net income were up over 8 percent from last year, and there was over \$1.1 billion dollars in the cash and equivalents account to invest in the coming year.

The phone rang. It was Maria Ortiz, his secretary. "Did you hear the latest on the newswire?" Maria asked.

"No, what's up?" Bill replied, with a suspicious feeling that his evening wasn't going to be so relaxing after all.

"Kelly O'Brien, head of A-1 Holdings, just announced that he's bought 5 percent of our outstanding shares, and now he's making a tender offer for all the rest at \$55."

"I knew it!" Bill spat out. "He was in here just a few weeks ago, talking about whether we would sell the company to him. We turned down his offer because we want to stay independent, and he left after implying we weren't looking out for

our stockholders. He's got some plan to restructure the company around a six-member board of directors instead of the 15 we have now. Now he's trying to do it anyway, whether we like it or not!"

"Looks like it," Maria agreed, "so what do you think we should do?" "OK, get ahold of Tom Straw, the chief operating officer, and Doris Faraday in finance, and tell them to get up here for a meeting right away," Bill directed. "Oh, and have Stan Lindner from public relations come, too; we're sure to have a press release about this, and—oh, wait—call my wife, too, and tell her I won't be home until late tonight."

After about half an hour, those that Bill had called began arriving, armed with pencils, papers, and calculators in anticipation of the coming session. Bill, in the meantime, had managed to compile some financial data about A-1 Holdings, which he had summarized on a sheet of paper along with comparable data on his own company, National Brands, (see Figure 1). He passed the sheet around among the others.

"OK, let's start with what we know," Bill led off. "A-1 already has 5 percent of our outstanding shares, and is making a bid for the rest at \$55, or 7 1/8 over market."

"I hate to be the devil's advocate," Stan said, thinking of the 1,000 shares he owned personally, "but that sounds like a pretty fair offer. What will happen if he succeeds?"

Most of us will be out of a job, and this company will become just another card in Kelly O'Brien's poker hand," Bill said acidly. "Our employees deserve better than that, so let's talk about what we can do to keep it from happening."

"What about a poison pill?" Tom suggested. "We could take out a fair-sized loan based on our heavy cash position, and A-1 would have a tough time absorbing it—just look at the amount of debt they're carrying now!"

Figure 1
Selected
Financial Data

	<i>National Brands</i>	<i>A-1 Holdings</i>
Total earnings expected in the coming year	\$ 400,000,000	\$ 152,000,000
Number of shares outstanding	113,640,000	61,800,000
Earnings per share	\$ 3.52	\$ 2.46
Price-earnings ratio	13.6	5.3
Market price	\$ 47.88	\$ 13.00(rounded)
Book value per share	\$ 26.84	\$ 6.39
Growth rate before merger	8.53%	19.61%
Liquid assets (cash and equivalent) .	\$1,153,000,000	\$1,736,800,000
Total assets	\$5,160,300,000	\$2,294,500,000
Total debt	\$2,110,300,000	\$1,899,500,000
Total equity	\$3,050,000,000	\$ 395,000,000
Dividend payout ratio	48.0%	0%

"That would probably work, but it's not very good for us, either," Stan agreed. He was still thinking about the seven dollars a share profit to be made in a buyout. "So, how about someone else? You know, a white knight who would top A-1's offer but would keep the structure of the company substantially the same as it is now."

"I don't know who we could ask," Bill said, "and besides that, the basic problem would probably still occur—we would lose our status as an independent entity."

Doris had been working on some figures on her pad, and she spoke up now. "There's another alternative," she said, "that I'm surprised you all haven't mentioned, given the financial status of the two companies."

"What, what!" Bill said. "Don't keep us in suspense!"

"It's the Pac Man defense," she continued, unruffled. "What we do is launch a tender offer of our own for all of A-1's outstanding stock. If it's successful, we not only thwart the takeover attempt but we gain a new business in the bargain."

"Didn't Martin Marietta try that with Bendix back in 1982?" Bill asked. "As I recall, it didn't turn out very well for them."

"You're right, it didn't," Doris agreed, "and no one else has tried it since. But, just comparing numbers here between National and A-1, I think it might work out quite well for us. I've been doing some calculating here, and I think an offer to A-1's shareholders of \$17 a share would be accepted, and we could conclude the whole affair rather quickly."

"I'm interested," Bill said. "Tell you what, put your finance staff on it over the weekend and have them work up the proposal formally. Get the legal and accounting people to help you, too. In the meantime, Stan, tip off the news media that we will have an announcement of our own shortly and draft up a public notice for A-1's shares at \$17 each. Don't release it yet, but be ready to on Monday. Oh, and be sure to include in it that I said the deal will not cause any dilution of National's earnings per share. One last thing. Doris, draft an open letter to our shareholders for my signature, explaining what's happening and reassuring them that we will keep their company intact and prosperous."

"Any questions? If not, let's get on it—Mr. O'Brien is about to get a surprise!"

Required

1.
 - a. A-1 is offering \$55 a share for National's stock. How much total cash will it have to raise to buy the company? (The remaining 95 percent?)
 - b. Assume A-1 plans to borrow the money needed to make the purchase. If A-1 uses the amount of liquid assets presently on hand at National to offset the amount it needs to borrow, what is the net amount it will have to borrow?
 - c. Assuming A-1 does borrow the amount you determined in *b* above, what will A-1's total debt be after the purchase is completed? In making your calculation, consider all forms of debt that the combined firm will have. Now compute A-1's debt-to-equity ratio (A-1's equity will not increase). Given this ratio, do you think it is likely that A-1 will be able to obtain the necessary debt financing?
 - d. Suppose instead that A-1 decides to issue stock to raise the money needed for the purchase (i.e., the amount you computed in *b* above will be raised through a stock issue instead of by borrowing). How many shares of A-1 stock will have to be issued? (Assume the price at which it will be issued is \$13 and disregard flotation costs.)
 - e. If A-1 does raise the money by issuing new shares of its stock, what will A-1's EPS be after the purchase is complete and earnings are combined?
 - f. Do you think A-1's shareholders will be happy if this deal goes through? What about the old National shareholders?