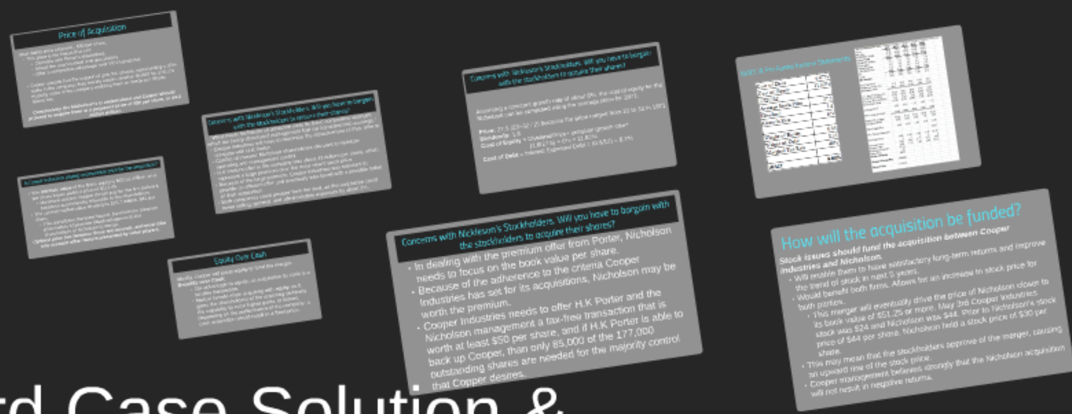
Cooper Industries



Cooper Industries Harvard Case Solution & Analysis

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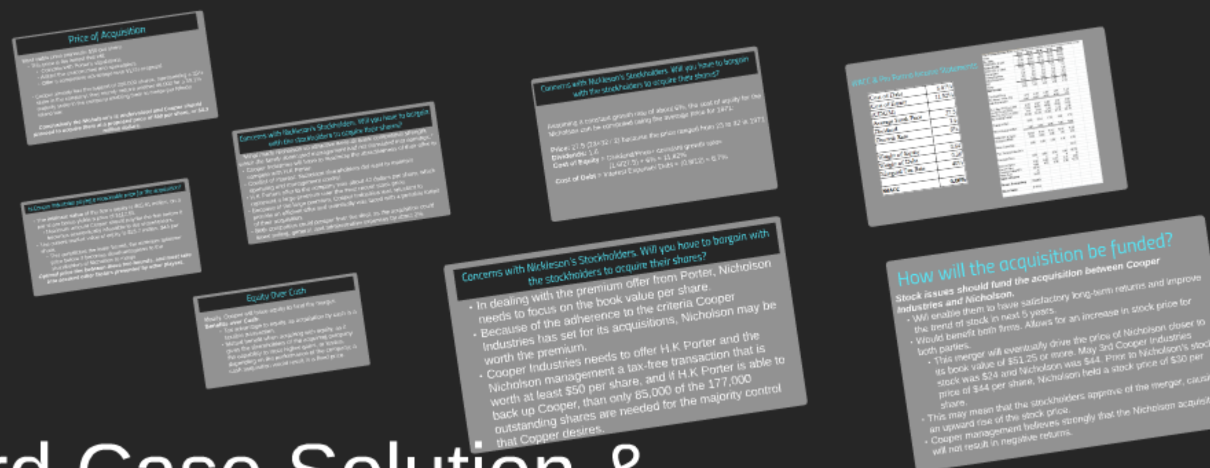

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Is Cooper Industries paying a reasonable price for the acquisition?

- The **intrinsic value** of the firm's equity is $65.91 million, on a per share bases yields a price of $112.85.
  - Maximum amount Cooper should pay for the firm before it becomes economically infeasible to the shareholders.
- The current market value of equity is $25.7 million, $44 per share.
  - This constitutes the lower bound, the minimum takeover price before it becomes disadvantageous to the shareholders of Nicholson to merge.

Optimal price lies between these two bounds, and must take into account other factors presented by other players.

Price of Acquisition

Most viable price proposal= $50 per share,

- This price is the lowest that will:
  - Coincide with Porter's stipulations
  - Attract the unaccounted and speculators
  - Offer a competitive advantage over VLN's proposal.

- Cooper already has the support of 206,000 shares, representing a 35% stake in the company; they merely require another 86,000 for a 50.1% majority stake in the company enabling them to merge per Rhode Island law.

Conclusively the Nicholson's is undervalued and Cooper should proceed to acquire them at a proposed price of $50 per share, or $4.3 million dollars.

Equity Over Cash

Ideally, Cooper will issue equity to fund the merger.

Benefits over Cash:

- *Tax advantage* to equity, as acquisition by cash is a taxable transaction.
- Mutual benefit when acquiring with equity, as it gives the shareholders of the acquiring company the capability to incur higher gains, or losses, depending on the performance of the company; a cash acquisition would result in a fixed price.

Concerns with Nickleson's Stockholders. Will you have to bargain with the stockholders to acquire their shares?

"What made Nicholson so attractive were its basic competitive strength, which the family dominated management had not translated into earnings."

- Cooper Industries will have to maximize the attractiveness of their offer to compete with H.K Porter.
- Conflict of interest: Nicholson shareholders did want to maintain operating and management control.
- H.K Porters offer to the company was about 42 dollars per share, which represent a large premium over the most recent stock price.
- Because of the large premium, Cooper Industries was reluctant to provide an efficient offer and eventually was faced with a possible forfeit of their acquisition.
- Both companies could prosper from the deal, as the acquisition could lower selling, general, and administrative expenses by about 2%.

Concerns with Nickleson's Stockholders. Will you have to bargain with the stockholders to acquire their shares?

- In dealing with the premium offer from Porter, Nicholson needs to focus on the book value per share.
- Because of the adherence to the criteria Cooper Industries has set for its acquisitions, Nicholson may be worth the premium.
- Cooper Industries needs to offer H.K Porter and the Nicholson management a tax-free transaction that is worth at least $50 per share, and if H.K Porter is able to back up Cooper, than only 85,000 of the 177,000 outstanding shares are needed for the majority control that Copper desires.

Concerns with Nickleson's Stockholders. Will you have to bargain with the stockholders to acquire their shares?

Assuming a constant growth rate of about 6%, the cost of equity for the Nicholson can be computed using the average price for 1971:

Price: 27.5 (23+32 / 2) because the price ranged from 23 to 32 in 1971
Dividends: 1.6
Cost of Equity = Dividend/Price+ constant growth rate=
(1.6/27.5) + 6% = 11.82%
Cost of Debt = Interest Expense/ Debt = (0.8/12) = 6.7%