Cooper Industries Inc.

Research Report

Nicholson File company was on the original “Shopping List” of Mr. Cizik and Mr. Rector. From Cooper’s perspective, Nicholson would help them solidify their position in the Hand tool business and meshed well with the rest of the 3 recent acquisitions. The motivation to acquire Nicholson stems from three estimates that Cooper generated while classifying companies based on the 3 selection criteria they came up with. Cooper believed that by removing underperforming products from Nicholson’s production line and focusing on the files and saw blade product line, Nicholson can share fully in the 6%-7% annual sales growth forecast for the company. Cooper estimated that Nicholson’s cost of goods sold could be reduced from 69% to 65% of sales. Elimination of the sales and advertising duplication would lower SG&A cost from 22% of sales to 19%. Nicholson’s global distribution network was of great importance to Cooper. And finally, Nicholson and Cooper sales in Industrial and consumer market were opposite to each other, meaning that the acquisition will lead to an increase in market share for both Industrial and Consumer market.

The reason to not go for the controlling shares would stem from the fact that Nicholson’s shares were not so easy to tender without the affirmation from the management and if the news of Cooper trying to fish in troubled waters reaches Porter it could lead to Porter coming after Cooper. And considering the size of Porter, the threat is significant.

But the deal should not be an “Unfriendly” acquisition, so Nicholson should also be interested in merging with Cooper. The reasons Nicholson should merge with Cooper are as follows. First, Nicholson was presented with 2 very contradictory appraisals of the VLN offer. VLN’s argument for the deal and Porter’s argument against a deal with VLN placed Nicholson in a dilemma. Both the arguments were based on some stock price. So, as to not be cheated Nicholson should go with Cooper’s offer. Second, once the merger was complete, Cooper would need to work with the Nicholson family and Management to not cheat the Nicholson shareholders. Third, Nicholson family and management only owned 20% of Nicholson’s total shares outstanding and according to Rhode Islands corporation law, a merger can be voted by shareholders holding most of the common stock outstanding. So, to avoid an unforeseen situation where they have no say in the merger and are forced to merge with VLN, if the required shares get tendered, Nicholson management has an Important reason to merge with Cooper.

Nicholson’s inhibition towards the acquisition stems from the following reasons. Cooper would be getting rid of many of Nicholson’s product lines, keeping only the Files and Saw blade product lines.

Porter was worried that Nicholson would merge with VLN which would lead to porter receiving VLN preferred stock for its 177,000 shares of Nicholson shares. The bargaining position they held in Nicholson became their Achilles heel. Nicholson family and management held 117,000 shares (20%). Their concern was that the threat from Porter pushed Nicholson’s management to 2 very contradictory appraisals of the VLN offer. VLN’s argument for the deal and Porter’s argument against a deal with VLN placed Nicholson in a dilemma. Getting cheated in the deal would be a significant concern for them. Cooper held 29,000 shares of Nicholson. Cooper was concerned about Nicholson’s merger with VLN which would fail their attempt to acquire Nicholson. VLN held 14,000 shares of Nicholson and where concerned with Nicholson’s management backing out of the deal to merge with cooper. Based on our calculation Nicholson shares are valued at $82 which is a high valuation compared with the current market price, making Nicholson an underpriced stock. Cooper must offer a price above $50 to acquire its shares. Calculation in the report assumes an offer price of $51 to calculate the required no. of shares to be issued for acquisition.

Mr. Cizik should recommend that cooper management to agree with the prospect of working with the Nicholson management after the deal and realize the potential gains Nicholson would generate in the future. These estimated cash flows are stated in the calculation along with the assumption of an annual sales growth of 6%.

APPENDIX

Link to the Cooper worksheet evaluating the intrinsic value of Nicholson price and the no. of shares to be issued to exchange for Nicholson's 50.1% share.

Cooper worksheet.xls