

Pity About Roberts

By DAVID LEYONHJELM

Ruralco's Annual Report for the year ended September 2007 provides the first opportunity to assess the impact of joining forces with Roberts. With formalities completed in September 2006, the report describes a full year as a combined business.

Although technically a reverse takeover, with Roberts shareholders retaining 73% of the combined company, it was actually a friendly merger. The new board contains directors from both companies and most middle managers and staff are still there.

With a new senior management team in place (about which I wrote last March), there is little to stand in the way of the benefits that shareholders were told would accrue from the merger. These were greater size, diversity and competitiveness, synergy savings, reduced gearing and increased market liquidity.

So, how did they go? Well, obviously size increased. Turnover was \$751 million, higher than either company individually although not equal to the sum of the two separately. Diversity is similarly greater. Fencing and livestock equipment did well, and more business came from areas such as wool and livestock, grain and stockfeed, and financial services.

Gearing has been reduced to 68%, quite a change from before the merger when Roberts had debt to equity of 121% and Ruralco 85%. Whether that's good or bad depends on your perception of risk, but most people would say it is wise in the context of the agriculture market.

Competitiveness is reflected in market share, which the company says increased in animal health by 4%. Assuming that is accurate (the margin of error can be high in share data), suppliers that rely on Ruralco will be pleased.

Competitiveness and synergy savings are also reflected in profitability. On that front, net profit after tax was \$11.2 million, return on equity 10.2% and earnings per share 25.1 cents. Not exactly Wesfarmers standard, but not disastrous either.

To assess how former Ruralco and Roberts shareholders fared, a comparison with results from the two companies prior to the merger is required.

In the year to June 2005 Roberts generated \$10 million profit after tax, representing return on equity of 18.2%. Earnings per share were 19.5 cents, or 31.2 cents after adjusting for the five-for-eight share swap of the merger.

The figures for Ruralco for the year ending September 2005 were \$3.5 million profit after tax, 9.9% return on equity and 31.4 cents per share.

The Bidders Statement sent to Roberts shareholders prior to the merger included pro forma accounts for the combined business. This is an accounting exercise and does not take account of intended management or business changes, but is still indicative of what to expect.

These accounts indicated a profit after tax of \$14 million, representing 30.5 cents per share and 14% return on equity. Fairly obviously, results have fallen short of those expectations.

The other determinant of shareholder value is the share price. At the time of the merger Ruralco's shares were trading around \$4.00. The price is around \$4.00 as I write and has not varied much in between. By contrast, the All Ordinaries rose 29% during the period of the report.

In other words, Ruralco's share price failed to keep up with increases in the overall market, while its lack of movement suggests market liquidity is still low.

Naturally, the company points to the drought as a factor limiting performance. Undoubtedly that is correct, although drought was already present at the time of the merger.

Being unclear what business it is in might also be relevant. Can it really serve two distinct customers at the same time – farmers and retailers –and be competitive to both?

Another factor may be that takeovers often fail to generate benefits for shareholders, with the exception of target company shareholders who accept money rather than shares. Indeed, this is so well known that the share price of acquiring companies usually falls when a takeover is announced, due to the anticipated loss of shareholder value.

The reason is that many takeovers are motivated by the ambitions of management, such as the creation of a larger company or enhanced career opportunities. The academic literature refers to this rather quaintly as “management utility”.

In this case both the former Roberts and Ruralco chief executives are gone and it is the major shareholders and their representatives on the board who remain.

In terms of their utility, former Ruralco shareholders are marginally better off. Even if it is not much more profitable, the company is certainly less vulnerable when a major wholesale customer falls over.

Pity about former Roberts shareholders though. Their investment is now generating lower returns and they have nothing to show for it except a bigger company. The utility of that is hard to discern.

For all that, this is just the first year. The drought is ending and the new senior management team will be out to prove it's not a bunch of duds. This time next year we will know whether Roberts shareholders really deserve our pity.