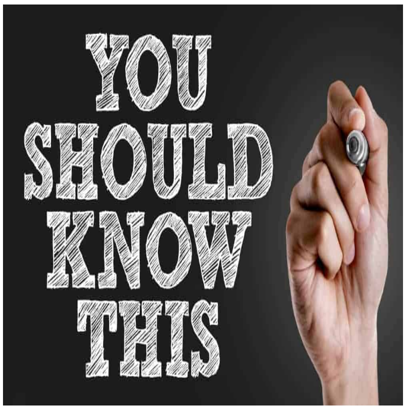

Alert: Why ZCL Composites Inc. (TSX:ZCL) Shares Spiked 36%

Description

Monday was a great day for long-suffering **ZCL Composites** (TSX:ZCL) shareholders after **Shawcor** (TSX:SCL) made an offer to acquire the entire company for $10 per share. That represents a 37% premium versus Friday's closing price.

The deal looks to be rock solid. Shawcor is offering $10 per share in cash for a total price of $312 million, including the assumption of some liabilities. This gives ZCL shareholders the benefit of knowing the deal isn't subject to the buyer obtaining financing. It represents a multiple of approximately 12.5 times ZCL's trailing earnings before interest, taxes, depreciation, and amortization.

ZCL's board of directors have suggested shareholders take the Shawcor offer. Remember, the board announced back in 2018 it was exploring strategic alternatives, which is usually boardroom code for saying the company is up for sale. ZCL shareholders will officially decide the fate of the offer during a special March 26th shareholder meeting.

The market is telling investors this deal is all but done. Shares currently trade hands at $9.92 each, less than 1% lower than the offered price. The small spread between the two prices indicates only a tiny risk the deal doesn't happen.

The deal from Shawcor's perspective

It would appear Shawcor's shareholders aren't very excited about the big acquisition. Its shares sank $0.40 each to $18.50 during Monday's trading on the Toronto Stock Exchange — a decline of more than 2%.

Shawcor is excited to add ZCL Composite’s product line to its own. Shawcor gets the majority of its revenue from its pipeline and pipe services division, offering products like pipeline coating productsand anti-corrosion systems. It also offers various composite production systems to pipelines and otheroil companies. ZCL’s storage tanks will fit nicely into the existing product mix, and it’ll offer Shawcor aline of revenue that isn’t so correlated with the oil and gas sector. Remember, ZCL’s main customer forits fuel storage tanks are gas stations.

Shawcor also figures it can cut some significant costs by combining the two companies. Much of the administrative work can be moved to Shawcor’s existing staff, and the company can likely cut some sales people as well. After these synergies are complete, Shawcor estimates it’s only paying 10.3 times EBITDA for its latest prize.

The deal is expected to immediately add to earnings in 2019. Shawcor’s management predicts ZCL will boost its bottom line by at least 10%.

Although the deal is an all-cash offer to ZCL Composites shareholders, Shawcor had to secure financing to get it done. The company announced it was adding US$500 million to its revolving credit line, debt that will partially be paid off by ZCL’s earnings. The company will be at 2.6 times debt leverage when the deal closes, well below its 3.5 times debt covenants.

The bottom line

On the surface, this looks to be a good deal for both sides. ZCL Composites shareholders get taken out at a nice premium, while Shawcor adds to its product portfolio with something a little less exposed to crude oil.

But there are question marks, which is likely why Shawcor shares are down on the news. Will it be able to achieve stated synergies? Was the price a little too high? And, perhaps most importantly, can Shawcor reverse ZCL’s lackluster fortunes? Remember, ZCL Composites shares fell more than 30% in 2018.

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