

Merger

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Hephaestus Metals (NYSE: HPH) is a manufacturer of specialty steels with exacting criteria for ductility and strength. It develops and sells cast/wrought and powder metal stainless steels and alloys, designed for high-temperatures, controlled expansion, high-strength and tool and die cutting. It also manufactures and sells other specialty metals such as titanium alloys.

Hephaestus supplies the aerospace, industrial, energy, medical, consumer products and automotive industries. It is not a large company and its rank of 800 in the Fortune 1000 belies the fact that Hephaestus has a strong position in supplying steel alloys to Boeing and Lockheed Martin who used it in fighter aircraft. For that reason, the government keeps a close watch on Hephaestus. A disruption at the manufacturer would jeopardize production of the most advanced fighters in the Air Force. To guard against this, the Defense Logistics Agency (DLA) years before had encouraged a second supply of these alloys from Igneous Vulcan (IV), a smaller company in Birmingham, AL, ranked Fortune 953. Government contracts were not enough to sustain IV, however, and in a recent economic downturn, it fell on hard times as revenues dropped and earnings turned negative. IV quietly put itself up for sale and approached Hephaestus as a potential acquirer.

Hephaestus considered this an excellent “bolt-on” opportunity. IV’s forges were modern, its alloys similar, its workforce highly trained and its customer list compatible with Hephaestus, including penetration in sectors of the economy that Hephaestus did not have. With the acquisition, overnight Hephaestus would be a dominant player in exotic steel alloys and a stronger player in titanium markets. A preliminary investigation into the merger revealed a potential for the Defense Department to balk at the loss of a second source for the alloys. On the other hand, they represented no more than 10 percent of Hephaestus’ revenues, so the company felt it could overcome any objections to the acquisition.

On the morning of March 10, Hephaestus and IV issued a joint press release that announced the merger. Hephaestus emphasized that it would keep most of IV’s trained workforce, continue to operate its furnaces and forges and produce bar, wire, strip steel, rectangular and hex-shaped bar and custom-rolled shapes. Hephaestus’ stock increased 10 percent on news of the announcement, but the CEO received a call the same day from the DLA inquiring about the availability and pricing of alloys post-merger. The CEO assured the DLA there would be no change in supply agreements and the merged companies would continue to fulfill Defense Department contracts. The DLA made no response.

Two days later, the Department of Justice announced an investigation into Hephaestus and the proposed merger with IV. The DOJ said in its statement that it had concerns about a monopoly position in certain steel alloys should the merger go through. It was clear the DOJ had been listening to the Department of Defense, and there was consternation at the DLA over the loss of a second supplier for fighter jet alloys.

The Justice Department's action triggered news about Hephaestus in the national business media, which had barely paid attention to the company. There were stories about the DOJ announcement in *The Wall Street Journal*, on *Bloomberg*, *Reuters* and *Dow Jones*. The *Financial Times* carried a brief notice of the action as well. The CEO of Hephaestus feared the media and hadn't had an interview with a reporter in years. He preferred to keep it that way. The company wasn't big enough to attract regular media attention and the business of making and supplying steel alloys wasn't newsworthy for most reporters, except for a few in the metalworking, fabricating and machine shop trades.

The CEO told his PR director to fend off media calls, which the PR director did. Three weeks later, the DOJ announced that it would recommend against approval of a merger between Hephaestus and IV. This generated a second round of stories and calls from the *Times-News* in its headquarters town of Erie, PA. The CEO again refused to talk to the media, but contacted his congressman and engaged a lobbying firm in Washington DC to help make the case for the merger. The firm, Stepanovich, was founded by a former White House communications advisor, Irent Stepanovich, who had gone into business for himself.

Stepanovich made the rounds of Pennsylvania representatives and senators and found no opposition to the merger. In fact, there was enthusiasm because of a possibility it might create more jobs in an aging part of Pennsylvania. Alabama representatives expressed concern but were supportive because the merger would save jobs in the state at a time when unemployment was high in the South. Stepanovich gathered their views and turned them over to the law firm dealing with the DOJ.

The DOJ remained unmoved. It requested that IV's alloy contract for the Defense Department be spun to a competitor who could supply the alloys at the same price and with the same fulfillment as IV. The CEO of Hephaestus found this demand to be ridiculous. There weren't any competitors who could take over the contract, even if he wished to spin it off, which he didn't. It would mean selling IV's factory and losing customers for other alloys. The CEO was seething when he talked to Stepanovich and asked what it would take to get the DOJ to understand the situation.

Stepanovich recommended a media strategy to highlight the impasse and gain grassroots support for the merger. The CEO was opposed to the idea. What

good would the media do? It would blow everything out of proportion and delay the merger all the more.

Stepanovich argued that transparency and pressure on the DOJ were needed to get the agency to see the light, especially if there was political push. He also said Hephaestus would need to be flexible in designing a contract to guarantee an alloy supply to the DLA, even if there were little profit. The CEO said he was ready to make that deal, and he had already discussed strategies with his law firm and investment banker. The CEO, however, could not be convinced about the media.

So the merger standoff continued with each side responding to the other over a period of eight months. Meanwhile, the financial situation at IV continued to deteriorate, and the firm was running out of cash. It faced the prospect of going bankrupt or of selling itself to any suitor who would have the company. IV's CEO told the Hephaestus CEO that time was running out for a merger and the company would begin to shop itself elsewhere. The CEO of Hephaestus did not want that to happen when he could take a competitor out of the picture. He pushed his law firm and Stepanovich to find a deal, any deal, short of selling the alloy business that the DOJ would accept.

Stepanovich raised the issue of a media campaign again.

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Questions for discussion:

1. Do you always need a media strategy for M&A?
2. Is it too late for a media strategy with this merger?
3. Did the Hephaestus CEO consider target audiences adequately in merger planning?
4. What would you do?