Published December 3, 2009
www.citibizlist.com

Black & Decker: How Our System Rewards Failure

By DOUGLAS M. SCHMIDT

Black & Decker Corporation (NYSE: BDK), based in the Baltimore suburb of Towson, announced in early November that it was merging with **The Stanley Works** (NYSE:SWK) based in Connecticut. As per the usual script, this "merger" was hailed as a great step forward for Black & Decker. Black & Decker shareholders would receive (in stock only) a 22% premium, Nolan Archibald (Black & Decker Chairman & CEO) would become the executive chairman of the combined company, and there would be cost cuts in order to increase value for shareholders. Yet another major Baltimore based company would be throwing in the towel. It is a long list dating back two decades that includes major insurer USG&G, developer Rouse, Maryland National Bank and Alex. Brown & Sons.

The capitulation of Black & Decker is a failure on three levels---corporate management, corporate governance and market regulation.

Black &Decker shareholders will get a small majority of shares in the combined company, but all power goes to Stanley. The Stanley CEO and CFO will run the company. Mr. Archibald will spend the obligatory three year period or less as chairman before retiring. The headquarters shifts north. Hundreds of good jobs will disappear in Maryland alone.

On an economic front, if you were a long-term shareholder, you will now receive with your "premium" a value (approximately $60) at the lower end of the range that Black & Decker traded at for four of the past ten years---$60 to $90. Why would you sell a company in a market low, prior to any up-turn in construction and housing, unless you had no faith in the company being able to prosper in a growth economy? Where is the strategic plan that should take a gold-plated brand name and makes it the surviving, value creator in the industry?

When you read the SEC merger announcements and filings, you surmise that not only will the Maryland headquarters be shut down, but there are no top jobs allotted to Black & Decker management. After over twenty years as CEO, why is there no clear successor in place for Mr. Archibald and where is the cadre of experienced, talented executives that he should have in the wings? Finally, why in the storied 100 year history of America's great tool company is Mr. Archibald, age 66, so unfortunate as to be the last CEO?

Nolan Archibald will realize, within a few years, a substantial fortune from the sale of Black & Decker. An online "New York Times" publication on November 5th praised Mr. Archibald for foregoing immediate vesting of stock and options plus other benefits worth $20 million upon the sale of the company. That is what you learn if you only read the Black & Decker filing, which highlights the $20M as if Mr. Archibald is making a personal sacrifice on behalf of the company. In the Stanley filing, you discover that Mr. Archibald, and Mr. Archibald alone among Black & Decker executives, will receive a far more lucrative package in the new company that will more than substitute for the Black & Decker one he is foregoing. It includes $20 million of equity payments over three years plus one million "sign-on options" plus a "cost synergy bonus" which ranges from $15 million to $45 million plus a multi-million dollar yearly salary, bonus and perquisites.

In addition, Mr. Archibald has enriched himself enormously in his twenty years as CEO, becoming the largest individual Black & Decker shareholder with approximately 2.5 million shares or over 4% of the total ownership. He ranks as the 7th largest institutional shareholder behind funds such as Fidelity and AllianceBernstein. Even before the incentives and pay package provided in the transaction, Mr. Archibald's current stake is worth approximately $150 million.

[Amplification: $150 million was derived from shares listed as "beneficially owned" in the March 2009 annual prospectus. Apparently, this share count has little practical meaning. After subtracting "out of money" options and adding vested restricted shares, a better approximation of shares that could be controlled and voted is approximately 2.2 million (8th on the institutional shareholder list) worth approximately $62 million after subtracting option exercise prices. Mr. Archibald's current realizable Black & Decker holdings are estimated to be worth over $110 million. This would consist of approximately $26 million in common shares, $31 million of "in the money" options, $3 million of vested restricted stock, $35 million of Accumulated Pension Benefits and $15 million in a Supplemental Savings Plan.]

Mr. Archibald was not born a Black or a Decker. He certainly did not found the company. How did a hired employee amass such a fortune? No other Black & Decker executive even comes close to this level of wealth accumulation. Ask the board of directors. The CEO works for the board of directors. The board approves the pay package each year. So what does a board do when its 66 year old CEO, who is one of the largest shareholders and who has no winning strategic plan or second tier of management in place, comes before the board with a sale of the company that he has worked out over lunch with the CEO of a competitor?

In this case, as they approved the sale of the company, the board apparently worked with the CEO to achieve an even better pay package for him in his new job. This begs the question of how many board members were hand-picked by the Chairman and what is their industry or governance experience? With a twenty plus year CEO and Chairman to whom you have awarded institutional level ownership, how objective and independent can a board be? Who among us begrudges Bill Gates or any entrepreneur a penny of his wealth that he has accumulated by growing the company he founded? But in the U.S. system, CEO employees have achieved a level of control over corporations and boards that approximates founding ownership with the result that CEOs, in the history of our country, have never been wealthier employees.

There is a regulatory and systemic problem with this deal which is common in many takeovers and which undermines faith in our markets. It is clearly legal, but it is one of the seedier sides of our markets that the SEC seems powerless to expose or control. Not only will Mr. Archibald receive a bonus worth scores of millions of dollars to make this deal work, the top two Stanley executives are also issuing themselves almost 1.8 million "merger equity grants." There is something for everybody in this deal as long as you work at the top.

These payoffs to senior executives happen in almost every major M&A deal. Buyout firms have used this tool for decades as they pry public companies loose from shareholders. When the selling CEO is faced with the difficult objective decision of whether a deal is appropriate or not, the buyer puts tens of millions of dollars on the table as "transition" money for the seller's executives. In large deals, the payoff totals hundreds of millions. If you were 66 years old and near retirement, how would you answer this question? "Do I recommend this transaction and gain $50 to $100 million in additional wealth for my family, or do I recommend keeping the company independent and retire with my current package?"

In a total transaction worth billions of dollars, these tens of millions represent chump change—grease that insures the desired outcome. It works for almost everybody except maybe those Black & Decker employees who thought they had decent jobs in a well-managed company executing on a well-designed strategic plan----because now they will be helping Mr. Archibald achieve his "cost synergy bonus."

Mr. Schmidt is CEO & Managing Director of Chessiecap, Inc., a financial services and information company. Chessiecap publishes a monthly financial newsletter entitled the "Mid-Atlantic Deal Review" found at www.midatlanticdealreview.com. Chessiecap is also the parent company of Chessiecap Securities, Inc., an investment bank raising capital and providing M&A and strategic advisory services to growth and technology companies in the Mid-Atlantic region. See www.chessiecap.com.
