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GOODYEAR TIRE & RUBBER: M&A SYNERGIES

Mark Simonson wrote this case solely to provide material for class discussion. The author does not intend to illustrate either effective or ineffective handling of a managerial situation. The authors may have disguised certain names and other identifying information to protect confidentiality.

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In late 2020, The Goodyear Tire & Rubber Company (Goodyear) chief executive officer, Richard Kramer, and Cooper Tire & Rubber Company (Cooper) chief executive officer, Bradley Hughes, met over dinner.[1] Their two firms had much in common—both were founded over 100 years ago in Akron, Ohio, and they were the two largest US tire manufacturers—so the two men met to discuss general industry conditions.[2]

During the meal, Kramer asked if Hughes was willing to consider an acquisition proposal from Goodyear.[3] Hughes, who was paid over $6 million per year to lead Cooper, explained that his company was “not for sale” and that he was optimistic about Cooper’s “standalone strategy.”[4] He acknowledged, however, that the Cooper board always considered offers that were in the best interests of its stockholders.

A few weeks later, Kramer called Hughes and told him to expect an offer by the end of the year.[5] Goodyear had been the target of a disruptive hostile takeover attempt in the past, and Kramer hoped that Cooper would be open to a friendly offer.[6] So, along with Goodyear chief financial officer, Darren Wells, and financial advisor, Lazard Freres, & Co., LLC, Kramer set out to identify potential synergies and prepare on offer.[7]

DOWNCYCLE

Goodyear realized a net loss of over $1.5 billion in 2019–2020 as it endured global weakness in the automotive industry and the onset of the worldwide COVID-19 pandemic.[8] The company’s stock was fluctuating around $10, which was off its March 18, 2020 low of $4.57 during the height of pandemic fear in the stock market, but about 70 per cent below its high of $35 in 2018 (see Exhibit 1).

Kramer attributed the stock’s decline to industry cycles. “Now that we are in another industry downcycle,” he stated, “the second of my tenure and the third of my career at Goodyear, it’s clear that our long-term approach is the right one. Our conviction in that philosophy is unwavering.”[9]

Amid the downturn, one analyst speculated that a merger between Goodyear and Cooper could “act as a pit stop” providing vital cost and revenue synergies.[10] Goodyear had used mergers and acquisitions (M&As) to achieve scale and fuel its growth in the past, so Kramer’s team needed to decide if acquiring Cooper could help both companies weather the downcycle and emerge stronger together.[11]

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COMPLEMENTARY RESOURCES

Frank Seiberling founded Goodyear in 1898 in Akron, Ohio, to manufacture bicycle and carriage tires, rubber horseshoe pads, and poker chips[12] (see Exhibit 2). Cooper was founded in 1914 in Akron, Ohio, by brothers-in-law John F. Schaefer and Claude E. Hart, who formed The Giant Tire & Rubber Company to produce tire patches, tire cement, and tire repair kits. After moving the company to Findlay, Ohio in 1917, they changed the company name to Cooper Tire & Rubber Co.[13]

The Goodyear Tire & Rubber Company

By 2020, Goodyear was one of the world's leading tire manufacturers, with $12.3 billion in sales and $16.5 billion in assets, including forty-six manufacturing facilities in twenty-one countries[14] (see exhibits 2–4). The company designed, manufactured, and distributed tires for a variety of vehicles as well as rubber-related chemicals for various applications. Goodyear also sold tires in the original equipment manufacturer (OEM) and premium replacement tire markets and operated thousands of retail outlets where it offered products and provided repair services.[15]

During the first half of 2020, production was suspended or significantly limited at most of Goodyear's manufacturing facilities around the world due to the pandemic.[16] Those factories returned to full capacity by the end of the third quarter and remained at full capacity during the fourth quarter. In 2020, Goodyear realized a net loss of $1.25 billion—the largest loss in the company's 122-year history.[17]

Cooper Tire & Rubber Company

Cooper designed and manufactured tires for passenger cars, light trucks, trucks, and motorcycles in the mid-tier replacement tire market.[18] Its 2020 revenues, which were also affected by the industry downcycle and global pandemic, fell 8 per cent to $2.5 billion, but Cooper reported a growing net income of $144 million (see Exhibit 5). The firm had $3 billion in total assets, including ten manufacturing facilities and nineteen distribution centres in fifteen countries[19] (see exhibits 2 and 6).

The company focused on the light truck and sport utility vehicle markets, two segments that Goodyear had limited exposure to. After studying Cooper's potential strategic fit with Goodyear, one industry analyst—a former Cooper vice-president—noted that Cooper had a "low-cost global footprint" for its size, with manufacturing facilities in Mexico, Serbia, and China.[20] The analyst further commented,

> All three of them, especially Mexico and Serbia, have opportunity for growth. If I'm Goodyear and I look at that, that's appealing. That's nice to have, very nice to have. . . . [In] North America, the thing that just stuck out to me is how little light-truck production Goodyear has. If you look at their Fayetteville and Lawton, Oklahoma factories, although it's a lot of volume and the total volume just in the US isn't that different between Goodyear and Cooper, but Cooper has got almost double the amount of light-truck capacity that Goodyear does. I was shocked when I saw that.[21]

The analyst concluded that a merger could allow Goodyear to realize cost savings, allowing it to increase investment in the premium Goodyear brand to achieve more pricing power and to compete with top-tier industry brands like Michelin and Bridgestone while also achieving higher volume through increased distribution of the mid-tier Cooper brand.[22]

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SYNERGIES

In mid-October, with Cooper's stock trading at $35.90, Kramer called Hughes to tell him that Goodyear intended to submit a non-binding $44 per share offer, but they would need access to some of Cooper's non-public information to finalize the offer.[23] After meeting with his board, Hughes told Kramer that Cooper was not willing to share the firm's confidential information with one of its leading competitors unless he raised his offer.[24]

After Kramer delivered a revised preliminary bid of $45.50 on November 14, Cooper agreed to share limited information and engage in discussions with Goodyear to help Goodyear to determine if it could increase its offer price.[25] After signing a confidentiality agreement and receiving the requested internal Cooper documents, the Goodyear team determined the synergies it believed would be realized in a merger.[26]

Based on the potential types of M&A synergies (see Exhibit 7), Kramer and his team identified several cost and efficiency synergies, totalling $165 million per year within two years of closing.[27] They also expected revenue, working capital, and tax synergies.[28]

Cost, Efficiency, and Capital Synergies

After gaining access to Cooper's internal files, the team first worked to identify cost synergies, a common occurrence in a horizontal merger.[29] Over 50 per cent of the $165 million in annual cost synergies were expected to be realized from a reduction in selling, general, and administrative (SG&A) expenses.[30] In 2020, the two firms had 71,839 combined employees, 9,839 at Cooper and 62,000 at Goodyear. But the team realized that there would be duplicative job functions after the merger.[31]

Next, by combining the two firms' research and development (R&D) efforts, they expected a cost savings from the headcount reduction as well as a capital synergy from the consolidation of physical R&D facilities.[32] They also anticipated efficiency synergies derived from improved logistics leading to supply chain savings in procurement and more efficient distribution.[33]

The team also expected a one-time working capital savings of $250 million from an "improvement in [the] cash conversion cycle."[34] For example, if the combined firms were able to reduce their combined investment in inventory due to the combined supply chains, this would reduce the cash invested in inventory. In 2020, inventory turnover (inventory ÷ (cost of goods sold ÷ 365) was about eleven weeks for both firms (see exhibits 3–6). A combined reduction of $250 million in inventory from consolidated purchases and coordinated inventory management would decrease their combined inventory turnover by about a week, freeing up $250 million in free cash flow.

Tax Synergies

Goodyear's reported cumulative loss of over $1.5 billion in 2019 and 2020 resulted in tax loss carryforwards—deferred tax assets—which the firm could use to offset future positive taxable income.[35] However, the deferred tax assets might have been delayed far into the future or they might have expired before they could be used due to their limited lives. At the end of 2020, the firm provided the following assessment of its ability to use the tax loss carryforwards:

> . . . in assessing our ability to utilize our deferred tax assets, we also considered objectively verifiable information including recent favorable recovery trends in the tire industry and our tire

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