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The Goldman Guide

A Colossal Screw-Up

Friday was an awesome day in the market. Something happened that almost never happens. A company that priced a deal the day before and began trading the next day pulled the IPO by day's end. While I vaguely remember the two most recent instances of this occurrence, I have to go back to 1990 or 1991 to when I was in the business and this happened to a deal a firm I was working for attempted to bring public. That company should never have gone public anyway.

There is so much irony with the latest story it is almost laughable. But, in the end, it is pitiable.

BATS Global Markets, the 3rd largest U.S. stock exchange operator priced its 6.3M share IPO on Thursday evening at $16. On Friday, shortly after its IPO began trading mid-morning, different prices were quoted for BATS stock. Within minutes, the auction price on its exchange went from $15.25 to $0.02. To make matters worse, AAPL traded down sharply after a 100 share trade on BATS was priced 9% below the market price, which prompted a halt in AAPL trading.

Apparently all of these errors were caused by BATS computer system malfunctions. BATS temporarily halted all trading while it attempted to fix the problems. However, even after it was fixed, BATS elected not to re-open trading and due to the concern of how the stock would trade, and the irony of the entire situation, the IPO was rescinded and money will be returned to investors who bought in at $16.00.

On the one hand, you have to love the irony as BATS was to be the first stock to list on its exchange. On the other, you feel bad for these guys but become wary of nascent, immature trading platforms, and how they can cause flash crashes and other issues. Imagine you are one of the biggest trading operators and you can't trade your own stock right. Ouch.

When other IPOs have been pulled post-trading, it has been because of the relative youth of the company or other factors. Not because of what is perceived as incompetence in your core. Best of luck, BATS.

Key Takeaways

- ⇒ High profile IPO pulled after trading starts
- ⇒ DJIA and S&P down, NASDAQ up?
- ⇒ Two takeover plays take center stage
- ⇒ Will the bidding war continue?
- ⇒ Should you buy stock ahead of bidding war?

This may be the top for AAPL and NASDAQ in the near term.

Up then Down

The market hasn't a clue what to do. Last week the Dow Jones Industrial Average and S&P 500 Index were down, while NASDAQ was up. Once again, with Apple (NASDAQ—AAPL) up 1.7% for the week, it carried NASDAQ to a .4% rise for the week. The stock rallied on last week's news that the Company plans to engage in a $10 billion stock buyback and offer a $2.65 per share quarterly dividend beginning in the September quarter this year.

Why is the dividend payment starting in September and not now? Are they afraid there will be a mad rush to buy stock, fueling a higher rise in the market, only to decline after the dividend payment? Are they waiting because it appears that anyone and everyone that wanted or wants to own the stock already does, and that a dividend payment later will help increase the stock price in case it drops over the summer?

All in all, it looks to me like this may be the high water mark for Apple for a while. If that's the case, considering how much it accounts for the stock market, we have likely reached a near-term high water mark for NASDAQ as well.

Perhaps buying some puts is an interesting, although speculative play. Something to think about…

We mentioned last week that window dressing might be starting. Given the AAPL craziness in the beginning of the week, poor economic news from China mid-week and the BATS debacle late, we probably will see some window dressing such as AAPL buying in the early days of trading this week.

In addition to window dressing, this type of environment is usually where a few shekels can be made by riding short term small stock waves. You may not own a surfboard, but surf those waves if you find them. They won't last long and when they break they break. So just be careful.

Key Statistics

Index	Close	YTD
DJIA	13,081	7.8%
S&P 500	1397	11.6%
NASDAQ	3068	17.8%
Russell 2K	830	12.3%

(figures are rounded)

A Tale of Two Takeover Plays

There are two companies engaged in announced takeover offers right now that I find very interesting. The one getting the most press is Great Wolf Resorts (NASDAQ – WOLF - $5.59), an indoor water park operator with locations across the U.S. Disclosure: It is a mini-vacation favorite of my kids.

Apollo Management, the huge private equity player, put in an offer to buy it for $5.00 and take it private. The Street and major shareholders are revolting, believing the price is too low. With the current price well over the buyout offer, it looks like Apollo may have to raise its bid. This story is likely to stay in the news for a while. Interestingly, it has had the same effect on a much smaller company. While WOLF targets kids and families, this takeover candidate's primary business is anything about family offerings.

Looks like the buyout price will be $6.00 or higher than the current $5.00 bid.

New Frontier Media (NASDAQ – NOOF - $1.28) announced roughly 2 weeks ago that it received an unsolicited all-cash bid for the Company at a price of $1.35 per share from an investment company incorporated in Jersey (Channel Islands not U.S.) called Longkloof Ltd., which apparently owns 15% of NOOF stock. NOOF is a leader in transactional television, primarily delivering adult-themed pay-per-view networks to cable and satellite, along with video-on-demand provision.

Management is presently reviewing the bid. Longkloof (what a name) is basically claiming that the Company management team and especially its board of directors have run NOOF like it was Joe's Candy Shop, paying large sums of money to the directors, not getting out of its own way operationally, etc. Activists believe they can run companies better or extract value from a sale.

With 2 bidders, will the price go from $1.35. 50 $1.50, to $1.75?

What usually happens in these situations is that if the bid is believed to be legitimate, the stock price will hover just below the buyout price. In this case, it had traded between 90-95% of the all-cash offer. On Friday, however, it zoomed past the buyout price, due to external factors unrelated to NOOF such as the WOLF situation. Late in the day, it was announced that NOOF had received another bid for $1.50 per share in cash from another party, driving the stock to $1.43, up 16%.

Can you say "bidding war?"

(cont'd on page 4)

At Tale of Two Takeover Plays (cont'd)

The new bidder, Manwin Holding SARL, is in the adult entertainment provision business, so presumably they would benefit from this deal even more than Longkloof, meaning they would pay even more than $1.50 per share in our view. A real bidding war could emerge here. Let's look at some financials and valuation.

If I were to perform a back-of-the-envelope valuation, I would say that $1.50 is too low. I do not know what valuation metric the buyers are using, although in the case of Longkloof, the $1.35 bid reflected an average recent trading price.

It could be based on cash flow, EBITDA, book value, etc. At $1.50 per share, NOOF would be valued at roughly $24 million. Operationally, the Company is on track to generate over $40M in revenue for its current fiscal year and record positive EBITDA along with positive cash flow. NOOF has even bought a great deal of stock in the open market, believing the share price has been too low.

From an asset perspective, NOOF has about $12M in cash and is expecting to collect $2M in a tax refund in the next 12 months. Plus, NOOF has $8.3M in receivables, $30M in non-current assets and total debt of $7M. So, for a company operating profitably, the premium on asset basis or even net asset basis is favorable to the acquirer, even if a small amount of the receivables are collected and if some non-current assets are monetized.

From Manwin's perspective, let's say they ended up paying $1.75 for NOOF. That equates to around $31M. With $12M in cash, $2M on the way, and a preliminary assumption that the receivables and debt cancel each other out, the buyer would effectively pay $17M, or less than $1.00 per share for the $40M in revenue company.

In the case of Marwin, which is in the same industry, would be able to gain operating expense efficiency, economies of scale, and the elimination of public company expense. That leads to greater cash flow and higher operating profitability. Plus, there is the value of the content and distribution rights NOOF owns.

We cannot predict if Longkloof will raise its bid. However, it is in their best interest to do so, as they are 15% owners of NOOF stock. This way, even if they do not win the bid, Marwin, which we proffer could make more money on this deal anyway, would probably bid higher.

If we were to handicap an outcome, 3:1 says the buyout is at $1.75. Hop on board. Could be a quick return.

Until next week...

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