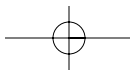
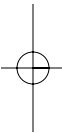
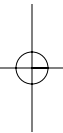


PART ONE

Questions



QUESTIONS ON EACH CHAPTER

Chapter 1: The Adversarial Nature of Financial Reporting

1. Three ways that corporations can use financial reporting to enhance their value are:
 - a. _____
 - b. _____
 - c. _____
2. Corporations routinely _____ because the appearance of _____ receives a higher _____ multiple.
3. The following are some of the powerful limitations to continued growth faced by companies:
 - a. _____
 - b. _____
 - c. _____
4. _____ reached its zenith of popularity during the _____ movement of the 1960s. However, by the 1980s, the stock market had converted the _____ into a _____.
5. The surprise element in Manville Corporation's 1982 bankruptcy was, in part, a function of _____.

6. Some of the stories used to sell stocks to individual investors are:
 - a. _____
 - b. A "play" in some current economic trend such as
 - i. _____
 - ii. _____
 - c. _____
7. The ostensible purpose of financial reporting is _____ of a corporation's earnings.
8. Over a two-year period, BGT paid L&H \$35 million to develop translation software. L&H then bought BGT and the translation product along with it. The net effect was that instead _____, _____, L&H recognized _____.

Chapter 2: The Balance Sheet

1. A study conducted on behalf of Big Five accounting firm Arthur Andersen showed that between _____ and _____, book value fell from _____% to _____% of the stock market value of public companies in the United States.
2. In the examples above, there is no accounting event because _____.
3. As in the case of _____, the historical cost principle makes comparable companies appear quite dissimilar. The equally large _____ of another company with low-cost debt will not be reflected on its balance sheet, simply because _____.

QUESTIONS

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4. Through stock-for-stock acquisitions, the sharp rise in equity prices during the late 1990s was transformed into _____, despite the usual assumption that _____.
5. A reasonable estimate of a low-profit company's true equity value would be _____.
6. Determining the cost of capital is a notoriously controversial subject in the financial field, complicated by _____ and _____.
7. Instead of striving for theoretical purity on the matter, analysts should adopt a _____, using the measure of equity value _____.
8. Users of financial statements can process only _____, and they do not always have _____.
9. Where feasible, users of financial statements should also solicit as _____ regarding risks not spelled out _____.

Chapter 3 The Income Statement

1. Students of financial statements must keep up with _____ of the past few years in transforming _____ into _____.
2. Besides facilitating comparisons between a company's present and past results, the _____ can highlight important facts _____.
3. The more widely diversified pharmaceutical manufacturers can be expected to have _____ percentage _____, as well as _____ percentage _____ expenses, than industry peers that focus exclusively on _____.
4. Executives whose bonuses rise _____ have a strong incentive not only _____, but also to use _____.

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FINANCIAL STATEMENT ANALYSIS

5. Along with _____, another major expense category that can be controlled through _____ is _____.
6. A company knows that creating _____ expectations about _____ can raise _____ and lower _____.
7. An extraordinary item is reported on an _____ basis, below the _____ from continuing operations.
8. In recent years, _____ has become a catchall for charges that companies wish analysts to consider _____, but which do not qualify for _____.
9. The most dangerous trap that users of financial statements must avoid walking into, however, is inferring that the term *restructuring* connotes _____.
10. The purpose of providing pro forma results was to help analysts _____ accurately when some event caused _____ to convey a misleading impression.
11. Computer software producers got into the act by _____ from the expenses considered in calculating _____.
12. In fact, analysts who hope to forecast future financial results accurately *must* apply _____ and set aside genuinely _____.
13. An older, but not obsolete, device for beefing up reported income is _____.
14. A corporation can easily accelerate its sales growth by _____ and _____. Creating genuine value for shareholders though is more difficult, although unwary investors sometimes fail to recognize the distinction.
15. If Company A generates external growth by acquiring Company B and neither Company A nor its new subsidiary increases

QUESTIONS

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- its profitability, then _____ the merged companies is _____ than the sum of the two companies' values.
16. As synergies go, projections of economies of scale in combinations of companies _____ tend to be more plausible than economies of scope purportedly available to companies in _____ businesses.
17. Professor Beneish's statistical analysis shows that the presence of the following factors increases the probability of earnings manipulation:
- a. _____
 - b. _____
 - c. _____
 - d. _____

Chapter 4: The Statement of Cash Flows

1. For financial reporting (as opposed to _____) purposes, a publicly owned company generally seeks to maximize _____, which investors use as a basis for valuing its shares.
2. In a classic LBO, a group of investors acquires a business by _____ and _____ the balance.
3. Analysts evaluating the investment merits of the LBO proposal would miss the point if they focused on _____ rather than _____.
4. The essential idea of a _____ is to acquire a business with a sliver of equity and a large amount of _____, and then pay off the debt with _____.

5. The EBITDA multiple may come down because _____ perceive that the LBO organizers _____ on capital spending during their stewardship, meaning that _____ will be required going forward.
6. The _____, rather than the _____, provides the best information about a highly leveraged firm's financial health.
7. Revenues build gradually during the _____ phase, when the company is just _____ and _____. Growth and profits accelerate rapidly during the _____ phase, as the company's products begin to penetrate the market and the _____. During the _____ period, growth in sales and earnings decelerates as the _____. In the _____ phase, sales opportunities are limited to the replacement of products previously sold, plus _____. Price competition often intensifies at this stage, as companies _____. The _____ stage does not automatically follow maturity, but over long periods some industries do get swept away by _____. Sharply declining sales and earnings, ultimately resulting in _____, characterize industries in decline.
8. _____ are start-ups that survive long enough to reach the stage of entering the public market.
9. _____, are past the cash strain faced by growth companies that must fund large _____ programs.
10. By studying the cash flow statement, an analyst can make informed judgments on such questions as:
 - a. _____
 - b. _____
 - c. _____

QUESTIONS

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11. If corporation's financial strain becomes acute, the board of directors may take the comparatively extreme step of _____.
12. A company with a strong balance sheet can fund much of that cash need by increasing its _____ (credit extended by vendors). External financing may be needed, however, if accumulation of unsold goods causes _____ to rise disproportionately to _____. Similarly, if customers begin paying more slowly than formerly, _____ can widen the gap between _____ and _____.
13. Overinvestment has unquestionably led, in many industries, to prolonged periods of _____, producing in turn chronically _____. In retrospect, the firms involved would have served their shareholders better if they had _____ or _____, instead of _____.
14. Another less obvious risk of eschewing financial flexibility is the danger of permanently losing _____ through _____ occasioned by recessions.
15. The cash flow statement is the best tool for measuring _____, which, contrary to a widely held view, is not merely a security blanket for _____. In the hands of an aggressive but prudent management, a cash flow cushion can enable a company to _____ when competitors are forced to cut back.

Chapter 5: What Is Profit?

1. Profitability is a yardstick by which businesspeople can measure their _____ and justify _____.
2. When calculating _____ profits, the analyst must take care to consider only genuine revenues and deduct all relevant costs.

3. There can be no bona fide profit without _____. Bona fide profits are the only kind of profits _____ in financial analysis.
4. Merely _____, it is clear, does not increase wealth.
5. An essential element of genuinely useful financial statement analysis is: _____.
6. The issuer of the statements can _____ or _____ its reported earnings simply by using its latitude to assume shorter or longer _____.
7. The rate at which the tax code allows owners to write off property overstates _____.
8. In the _____, companies typically record depreciation and amortization expense that far exceeds physical wear-and-tear on assets.
9. In many industries, fixed assets consist mainly of _____. The major risk of analytical error does not arise from the possibility that _____, but the reverse.

Chapter 6: Revenue Recognition

1. Many corporations employ _____ practices that comply with GAAP yet _____.
2. Analysts were questioning Informix's _____; in particular, when Informix revealed that about \$170 million of its 1996 sales to computer makers and _____ represented _____ that had not yet been _____.
3. Some of the reasons software manufacturers defer recognition of revenue are:

QUESTIONS

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- a. _____
- b. _____
- c. _____
- d. _____

4. Agreements with resellers that:

- a. _____
- b. _____
- c. _____
- d. _____

mean that license revenue from these transactions should not be recorded _____; rather it should instead be recorded at the time _____.

- 5. The Informix affair teaches analysts not to construe _____ as an assurance of integrity in financial reporting. _____ reporting differs from fraudulent reporting, in a _____, but a corporate culture that embraces the former can foster the latter.
- 6. Staying alert to evidence of flawed, _____, reporting is essential, even when the auditors _____.
- 7. In 1994, KnowledgeWare began supplementing its own sales-force's efforts with agreements _____. Almost immediately, the company started to encounter difficulties in _____. In restating the results, management said that it had booked as revenues _____.
- 8. The receivables-related bombshell that KnowledgeWare dropped on August 30, 1994, was telegraphed by _____ in

KnowledgeWare's 10Q for the first fiscal quarter, received by the SEC way back on November 2, 1993.

9. Prior to the change in accounting practice, which FAS 101 made mandatory, Wal-Mart booked layaway sales _____. Under the new and more conservative method, the company began to recognize the sales _____.
10. As in any sales situation, aggressive pursuit of new business could result in _____. On average, the newer members might prove to be _____ or less committed to physical fitness than _____.
11. Under GAAP, the general requirement was to spread membership fees _____. If a company offered refunds, it could not _____ until the refund period expired, unless there was _____ to enable management to estimate _____ with reasonable confidence.
12. GAAP addresses the problem through the _____, which permits the company to recognize revenue in _____, rather than in line with its billing.
13. The SEC claimed that to inflate revenues and profits, management at Sequoia Systems:
 - a. _____
 - b. _____
 - c. _____
14. Loading the distribution channels consists of _____ to accept larger shipments of goods than _____.
15. Inevitably, the underlying trend of final sales to consumers slows down, at least temporarily. At that point, the manufacturer's growth in reported revenue will maintain its trend only _____, relative to their sales. If the distributors balk,

QUESTIONS

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- _____, forcing a _____ of previously recorded profits.
16. Users of financial statements should not be intimidated by corporate _____ that denounce allegedly irresponsible _____.
 17. A stock's value is a function of expected _____, which partly depend on the _____ vis-à-vis its competitors'.
 18. Analysts who strive to go beyond routine _____ can profit by seeking _____ of corporate disclosure, even when _____ have already placed _____.
 19. Grace executives reckoned that with earnings already meeting Wall Street analysts' forecasts, a windfall _____ the company's stock price. Such an inference would have been consistent with investors' customary _____ that they perceive to be generated by _____.
 20. According to Michael Jensen: "Tell a manager that he will get a bonus when targets are realized and two things will happen":
 - a. _____
 - b. _____
 21. According to Jensen, almost every company uses a budget system that _____ employees for _____ and punishes them _____. He proposes reforming the system by severing the link between _____ and _____.

Chapter 7: Expense Recognition

1. Corporate managers are just as creative _____ and _____ the recognition of _____ as they are in maximizing and speeding up the _____.

2. To attract subscribers, AOL mailed millions of solicitations and, through arrangements with computer manufacturers, gave away free trial subscriptions. The company did not _____. Instead, AOL _____, and then _____ over periods of 12 to 18 months.
3. AOL precipitated the plunge in its share prices by cutting the price of its online service by 63%. The move represented _____, as well as to the migration of _____, where most information and entertainment was offered to subscribers _____.
4. Repeating a recurrent theme in the annals of financial reporting controversies, AOL had initially managed to _____, to which investors duly assigned _____, by exploiting the not _____ of a new industry _____.
5. During 1999, Chairman Louis Gerstner hailed IBM's _____ as a key to its recent earnings improvement.
6. The investigating accountants and lawyers interviewed more than 200 suppliers of Wickes PLC to determine how many _____. Clearly, outside analysts, working only with _____, could not have pieced together all of the details of the scheme.
7. Rudimentary analysis of Oxford's financial statements provided more than a hint of _____. Consider the Form 10-Q report for the quarter ended June 30, 1997, the last filed by the company before the October bloodbath. The _____ displayed the classic problem that first gave rise to _____. Even though _____ for 1997's first half rose by 74.6% over the comparable 1996 period, _____ deteriorated to -\$107.3 million from \$139.2 million. The bulk of that adverse swing resulted from medical costs payable turning from a large _____ to a major _____.

QUESTIONS

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Chapter 8: The Applications and Limitations of EBITDA

1. The impetus for trying to redirect investors' focus to _____ or other variants has been _____ recorded by many "new economy" companies.
2. Users of financial statements had discovered certain limitations in net income as a _____. They observed that two companies in the same industry could report similar _____, yet have substantially different _____.
3. Net income is not, to the disappointment of analysts, a standard by which every company's _____ can be compared.
4. The accounting standards leave companies considerable discretion regarding the _____ they assign to their _____. The same applies to amortization schedules for _____.
5. For some companies, the sum of net income, income taxes, and interest expense is not equivalent to EBIT, reflecting the presence of such factors as _____ below _____.
6. Shifting investors' attention away from traditional fixed-charge coverage and toward _____ was particularly beneficial during the 1980s, when some buyouts were so _____ that _____ would not cover pro forma interest expense even in a good year.
7. Capital spending is likely to exceed depreciation over time as the company _____ to accommodate _____. Another reason that capital spending may run higher than depreciation is that newly acquired equipment may be _____ than the old equipment being written off, as a function of _____.
8. Delaying equipment purchases and repairs that are _____ but not _____, should inflict no lasting damage on the

company's _____ provided the _____ lasts for only a few quarters.

9. Depreciation is not available as a long-run source of cash for _____. This was a lesson applicable not only to the extremely _____ deals of the 1980s, but also to the more _____ capitalized transactions of later years.
10. Beaver's definition of cash flow was more stringent than _____ since he did not add back either _____ or _____ to net income.
11. Beaver did not conclude that analysts should rely solely on the _____, but merely that it was the single best _____.
12. Some investment managers consider that the single ratio of _____ (as they define it) to _____ predicts bankruptcy better than all of _____ quantitative and qualitative considerations combined.
13. Aside from _____, the amount of working capital needed to run a business represents a fairly constant _____ of a company's sales. Therefore, if inventories or receivables _____ materially as a percentage of sales, analysts should strongly suspect that the earnings are _____, even though management will invariably offer a _____ explanation.
14. If a company resorts to stretching out its payables, two other ratios that will send out warning signals are:
 - a. _____
 - b. _____
15. Merrill Lynch investment strategist Richard Bernstein points out that _____ earnings tend to be more stable than _____ earnings, EBIT tends to be more stable than _____

QUESTIONS

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_____ earnings, and _____ tends to be more stable than EBIT.

16. Strategist Bernstein found that by attempting to _____ inherent in companies' earnings, investors reduced the _____ of their stock selection.

Chapter 9: The Reliability of Disclosure and Audits

1. Fear of the consequences of breaking the law keep corporate managers in line. _____ the law is another matter, though, in the minds of many executives. If their bonuses depend on _____, they can usually see their way clear to adopting that course.
2. At some point, _____ becomes a moral imperative, but in the real world, accounting firms must be _____.
3. _____ is an unambiguous violation of accounting standards, but audits do not _____.
4. When challenged on inconsistencies in their numbers, companies sometimes _____, rather than any intention to _____.
5. According to president and chief executive of Trump World's Fair Casino Hotel, the firm's focus in 1999 was threefold:
 - a. _____
 - b. _____
 - c. _____
6. One source of Sunbeam's supposedly robust 1997 profits, according to the accounting firm that the company's board hired for the review, was an _____ in 1996.

7. Deidra DenDanto, formerly of the accounting firm of _____, stated in a memo (which unfortunately never reached the board of Sunbeam) that booking _____ as sales was _____.
8. Abundant evidence has emerged over the years of corporate managers _____ to paint as rosy a picture as possible.
9. According to Wade Meyercord, an outside director of California Micro Devices, who helped to uncover the fraud and took over as chairman, the fakery included _____.
10. In theory, the _____ committee of the board of directors serves as _____ in the struggle for _____.
11. Many companies are either _____ or _____. Rather than laying down the law (or GAAP), the auditors typically wind up _____ to arrive at a point where they can convince themselves that _____ have been satisfied.

Chapter 10: Mergers-and-Acquisitions Accounting

1. Choosing a method of accounting for a merger or acquisition does not affect the combined companies' subsequent _____ or _____. The discretionary accounting choices can have a _____, however, on _____.
2. Amortization of goodwill entails _____. Neither does it generate cash _____, because it is not _____. The amortization does reduce _____.
3. From a cash flow standpoint, investors are actually better off under the _____ method.
4. There are approximately 10 academic studies of the issue, covering periods from the 1960s to the 1990s. The studies consistently found that the _____ reported earnings generated

QUESTIONS

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- by _____ did not cause the stocks of the acquiring companies' to outperform the stocks of companies employing _____.
5. Among technology companies, a popular way to boost earnings in the pooling-of-interests era involved _____ of acquired companies.
 6. For example, one M&A-related gambit entails the GAAP-sanctioned use, for financial reporting purposes, of _____. Typically, companies use this discretion to simplify the closing of their books at month- or quarter-end.
 7. There can be no guarantee of loans secured by stock issued in the combination, which would effectively _____ implicit in a bona fide _____. _____ of stock and _____ are likewise prohibited.

Chapter 11: Profits in Pensions

1. Under SFAS No. 87, "Accounting for Pensions," the investment returns on a corporate pension plan's investment portfolio flows into _____. Management can elect to _____ or a portion of the year's net pension benefit (cost) as part of _____ and then run it through _____. Alternatively, the company can recognize the pension-related income by reducing _____.
2. When projecting IBM's future earnings, it is important to segregate _____ from _____. Otherwise, the analysis will give management _____ for a general _____.
3. Analysts should also note that the accounting rules for pension income allow management, within certain bounds, to _____ from the _____ to the _____.

4. In principle, one would expect a company to base its assumption on _____.
5. Management cannot invariably modulate their impact on reported earnings as desired. Among the effects is _____ that may arise from _____. Such events may be large enough to _____.

Chapter 12: Forecasting Financial Statements

1. It is _____ that determine the value of a company's stock and the _____ that determines credit quality.
2. The process of financial projections is an extension of _____ and _____, based on assumptions about future _____, _____, and _____.
3. Sales projections for the company's business can be developed with the help of such sources as _____, _____, and firms that sell _____ models.
4. Basic industries such as _____, _____, and _____ tend to lend themselves best to the _____ described here. In technology-driven industries and "hits-driven" businesses such as _____ and _____, the connection between _____ and the _____ will tend to be looser.
5. The expected intensity of industry competition, which affects a company's _____ on to customers or to retain _____, influences the _____ forecast.
6. Since the segment information may show only operating income, and not _____, the analyst must add _____ to operating income, then make assumptions about the allocation of _____ and _____ expense by segment.

QUESTIONS

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7. The R&D percentage may change if, for example, the company _____ in an industry that is either significantly more, or significantly less, _____ than its existing operations.
8. The key to the forecasting interest expense method employed here is to estimate the firm's embedded cost of debt, that is, the _____ on the company's _____.
9. Accurately projecting interest expense for _____ companies is important because _____ may depend on the size of _____ they must cover each quarter.
10. The completed income statement projection supplies _____ of the projected statement of cash flows.
11. Before assuming a constant-percentage relationship, the analyst must verify that _____.
12. A sizable _____ might be presumed to be directed toward share repurchase, reducing _____, if management has indicated a desire to _____ and is _____ by its board of directors.
13. Typically, the analyst must modify the underlying _____ assumptions, and therefore the projections, several times during the year as _____ diverges from _____.
14. A firm may have considerable room to cut _____ in the short run if it suffers a decline in funds provided by _____. A projection that ignored this _____ could prove overly pessimistic.
15. An interest rate decline will have limited impact on a company for which interest costs represent a _____. The impact will be greater on a company with a large interest cost component and with much of its debt at _____. This assumes the return on the company's assets is _____.

16. Analysts are generally not arrogant enough to try to forecast the figures accurately to the first decimal place, that is, to the _____ for a company with revenues in the _____.
17. It is generally inappropriate to compare a _____ item (EBITDA) with a balance sheet figure, especially in the case of a _____ company.
18. It is unwise to base an investment decision on historical statements that antedate a major financial change such as:
 - a. _____
 - b. _____
 - c. _____
 - d. _____
19. A pro forma income statement for a single year provides no information about _____ in sales and earnings of _____ that is being spun off.
20. Pro forma adjustments for a divestment do not capture the potential benefits of increased _____ on the company's _____.
21. The earnings shown in a merger-related pro forma income statement may be higher than the company can sustain because:
 - a. The acquired company's owners may be shrewdly selling out at top dollar, anticipating a _____ that is foreseeable by _____, but not to the acquiring corporation's management.
 - b. Mergers of companies in the same industry often work out poorly due to _____.
 - c. Inappropriately applying _____ to an industry with very different requirements.

QUESTIONS

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22. A _____ investor buying a 30-year bond is certainly interested in the issuer's financial prospects beyond _____. Similarly, a substantial percentage of the present value of future dividends represented by a stock's price lies _____.
23. Radical financial restructurings such as _____, _____, and _____ necessitate _____ projections.
24. Of the various types of analysis of financial statements, projecting _____ and requires the greatest skill and produces _____.
25. The lack of _____ is what makes financial forecasting so _____. When betting huge sums in the face of _____, it is essential that investors understand _____ as fully as they possibly can.

Chapter 13: Credit Analysis

1. Financial statements tell much about a borrower's _____ to repay a loan, but disclose little about the equally important _____ to repay.
2. If a company is dependent on raw materials provided by a subsidiary, there may be a _____ presumption that it will stand behind the subsidiary's _____, even _____.
3. Illiquidity manifests itself as an excess of current _____, over _____. The _____ ratio gauges the risk of this occurring by comparing the claims against the company that will become payable during _____ with the assets that are already in the form of cash or that will be converted to cash during _____.
4. The greater the amount by which asset values could deteriorate, the greater the _____, and the greater the creditor's _____.

- sense of _____. Equity is by definition _____ minus _____.
5. Aggressive _____ frequently try to satisfy the letter of a _____ leverage limit imposed by lenders, without fulfilling the _____ behind it.
 6. A firm that “zeros out” its _____ at some point in each operating cycle can legitimately argue that its “true” leverage is represented by the _____ on its balance sheet.
 7. Current maturities of long-term debt should enter into the calculation of _____, based on a conservative assumption that the company will replace maturing debt with _____.
 8. Exposure to interest rate fluctuations can also arise from long-term _____. Companies can limit this risk by using _____.
 9. Public financial statements typically provide _____ information about the extent to which the issuer has _____ its exposure to interest rate fluctuations through _____.
 10. Analysts should remember that the ultimate objective is not to _____ but to _____.
 11. In general, the credit analyst must recognize the heightened level of risk implied by the presence of preferred stock in the _____. One formal way to take this risk into account is to calculate the ratio of _____ to _____.
 12. In addition to including capital leases in the total debt calculation, analysts should also take into account the _____ liabilities represented by contractual payments on _____, which are reported as _____ in the _____ to Financial Statements.

QUESTIONS

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13. A corporation can employ leverage yet avoid showing debt on its consolidated balance sheet by _____ or forming _____.
14. Under SFAS _____, balance sheet recognition is now given to pension liabilities related to employees' service to date. Similarly, SFAS _____ requires recognition of postretirement health care benefits as an on-balance sheet liability.
15. The precise formula for _____ a ratio is less important than the assurance that it is _____ for all companies being evaluated.
16. In general, credit analysts should assume that the achievement of _____ bond ratings is a _____ goal of corporate management.
17. The contemporary view is that profits are ultimately what sustain _____ and _____. High profits keep plenty of cash flowing through the system and confirm the value of productive assets such as _____ and _____.
18. The cumulative effect of a change in accounting procedures will appear _____ or after _____ have already been deducted. The sum of net income and provision for income taxes will then differ from the _____ that appears in the income statement.
19. Operating margin shows how well management has run the business _____ wisely, controlling _____ before taking into account financial policies, which largely determine _____, and _____, which is outside management's control.
20. Fixed-charge coverage is an _____ ratio of major interest to credit analysts. It measures the ability of a company's _____ to meet the _____ on its debt, the lender's most direct concern. In its simplest form, the fixed-charge

coverage ratio indicates the _____ by which _____ suffice to pay _____.

21. Regardless of whether it is _____ or _____, however, all interest accrued must be covered by _____ and should therefore appear in the _____ of the fixed-charge coverage calculation.
22. The two complications that arise in connection with incorporating operating lease payments into the fixed-charge coverage calculation are:
 - a. _____
 - b. _____
23. Companies sometimes argue that the denominator of the fixed-charge coverage ratio should include only _____ expense, that is, the difference between _____ and income derived from _____, generally consisting of marketable securities.
24. Ratios related to sources and uses of funds measure credit quality at the most elemental level—a company's ability to _____.
25. Given corporations' general reluctance to sell new equity, a recurrent cash shortfall is likely to be made up with _____ financing, leading to a rise in _____ ratio.
26. A company that suffers a prolonged downtrend in its ratio of _____ is likely to get more deeply into debt, and therefore become _____ with each succeeding year.
27. Unlike earnings, _____ is essentially a programmed item, a cash flow assured by the accounting rules. The higher the percentage of cash flow derived from _____, the higher is the _____ of a company's cash flow, and the _____ its financial flexibility on the vagaries of the marketplace.

QUESTIONS

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28. Analysts cannot necessarily assume that all is well simply because capital expenditures consistently exceed depreciation. Among the issues to consider are:
- a. _____
 - b. _____
 - c. _____
 - d. _____
29. A limitation of combination ratios that incorporate balance-sheet figures is that they have little meaning if _____.
30. The underlying notion of a turnover ratio is that a company requires a certain level of _____ and _____ to support a given volume of sales.
31. A _____ is a possible explanation of declining inventory turnover. In this case, the inventory may not have suffered a severe reduction in value, but there are nevertheless unfavorable implications for _____. Until the inventory glut can be worked off by _____ to match the lower _____, the company may have to borrow to finance its unusually high working capital, thereby increasing its _____.
32. Fixed-charge coverage, too, has a weakness, for it is based on _____, which are subject to considerable manipulation.
33. Built from two comparatively hard numbers, the ratio of _____ to _____ provides one of the best single measures of _____.
34. Expected _____ have an important bearing on the decision to _____ or _____ credit, as well as on the _____ of debt securities.
35. Line of business is another basis for defining _____.

36. Beyond a certain point, calculating and comparing companies on the basis of _____ financial ratios contributes little _____.
37. _____ or _____ financial ratios can have different implications for different companies.
38. Quantitative models such as Zeta, as well as others that have been devised using various mathematical techniques, have several distinct benefits such as:
- a. _____
 - b. _____
 - c. _____
39. Like the quantitative models consisting of _____, the default risk models based on stock prices provide useful, but _____, signals.

Chapter 14: Equity Analysis

1. In this chapter, the discussion focuses primarily on the use of financial statements in _____.
2. Of the methods of fundamental common stock analysis, no other approach matches the intuitive appeal of regarding the stock price as the _____ of expected _____ dividends. This approach is analogous to the _____ calculation for a bond and therefore facilitates the comparison of different _____ of a single _____.
3. By thinking through the logic of the _____ method, the analyst will find that value always comes back to _____.
4. The company's earnings growth rate may diverge from its sales growth due to changes in its _____.

QUESTIONS

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5. As a rule, a _____ company will not increase its dividend on a regular, annual basis.
6. Many analysts argue that _____, rather than _____, is the true determinant of dividend-paying capability.
7. Cash generated from _____, which is generally more difficult for companies to manipulate than _____, can legitimately be viewed as the preferred measure of future _____.
8. The ability to vary the _____, and therefore to assign a _____ or _____ multiple to a company's earnings, is the equity analyst's defense against earnings _____ by management.
9. It is appropriate to assign an _____ discount factor to the earnings of a company that competes against larger, better-capitalized firms. A small company _____ of depth in management and concentration of _____.
10. A building-materials manufacturer may claim to be cushioned against fluctuations in housing starts because of a strong emphasis in its product line on _____.
11. Analysts should be especially wary of companies that have tended to jump on the bandwagon of _____ associated with the _____ of the moment.
12. Earnings per share will not grow merely because _____.
13. Leverage reaches a limit, since lenders will not continue advancing funds beyond a certain point as _____.
14. One way to increase earnings per share is to _____.
15. To the extent that the company funds share buybacks with idle cash, the increase in _____ is offset by a reduction arising from _____.

16. Like most ratio analysis, the Du Pont Formula is valuable not only for _____ but also for _____.
17. Besides introducing greater volatility into the _____, adding debt to the balance sheet demonstrates _____.
18. Some companies have the potential to raise their share prices by _____, while others can increase their value by _____.
19. Management's main adversaries in battles over _____ were aggressive _____.
20. At least in the early stages, before some raiders became overly aggressive in their financial forecast assumptions, it was feasible to extract value without creating undue bankruptcy risk, simply by _____.
21. In future bear markets, when stocks again sell at depressed price-earnings multiples, investors will probably renew their focus on _____.
22. A leveraged buyout can bring about improved profitability for either of two reasons:
 - a. _____
 - b. _____
23. Today's _____ may be a precursor of tomorrow's bankruptcy by a company that has economized its way to _____.
24. A focus on _____ multiples, the best-known form of fundamental analysis, is not the investor's _____ to relying on technicians' stock charts.
25. For the investor who takes a longer view, _____ provides an invaluable reference point for valuation.

QUESTIONS

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FINANCIAL STATEMENT EXERCISES

1. Indicate in which of the principal financial statements each item appears.
 - a.

<i>Item</i>	<i>Balance Sheet</i>	<i>Income Statement</i>	<i>Statement of Cash Flows</i>
Accounts Payable			
Accumulated Depreciation			
Adjusted Net Income			
Capital Expenditures			
Cash and Equivalents—Change			
Common Shares Outstanding			
Current Debt—Changes			
Direct Operating Activities			
Earnings per Share (Fully Diluted)			
Earnings per Share (Primary)			
Equity in Net Loss (Earnings)			
Extraordinary Items			
Financing Activities—Net Cash Flow			
Gross Plant, Property, and Equipment			
Income before Extraordinary Items			
Indirect Operating Activities			
Interest Paid—Net			
Investing Activities			
Investment Tax Credit			
Long-Term Debt Due In One Year			
Minority Interest			
Net Receivables			
Operating Activities—Net Cash Flow			
Other Assets and Liabilities—Net Change			
Other Investments			
Preferred Stock—Nonredeemable			
Pretax Income			
Retained Earnings			
Sale of Property, Plant, and Equipment			
Selling, General, and Administrative Expense			
Stock Equivalents			
Total Current Assets			
Total Income Taxes			
Total Preferred Stock			

b.

<i>Item</i>	<i>Balance Sheet</i>	<i>Income Statement</i>	<i>Statement of Cash Flows</i>
Accrued Expenses			
Adjusted Available for Common			
Available for Common			
Cash and Equivalents			
Common Equity			
Cost of Goods Sold			
Deferred Taxes			
Dividends per Share			
Earnings per Share (Primary)			
Equity			
Financing Activities			
Funds from Operations—Other			
Income Taxes Paid			
Interest Expense			
Inventory—Decrease (Increase)			
Investing Activities—Other			
Investments at Equity			
Long-Term Debt			
Long-Term Debt—Reduction			
Net Plant, Property, and Equipment			
Notes Payable			
Other Assets			
Other Current Liabilities			
Preferred Dividends			
Prepaid Expenses			
Receivables—Decrease (Increase)			
Sale of Investments			
Savings Due to Common			
Special Items			
Total Assets			
Total Equity			
Total Liabilities and Equity			

QUESTIONS

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C.

<i>Item</i>	<i>Balance Sheet</i>	<i>Income Statement</i>	<i>Statement of Cash Flows</i>
Accounts Payable and Accrued Liabilities— Increase (Decrease)			
Acquisitions			
Assets			
Capital Surplus			
Cash Dividends			
Common Stock			
Deferred Charges			
Discontinued Operations			
Earnings per Share (Fully Diluted)			
EPS from Operations			
Exchange Rate Effect			
Financing Activities—Other			
Gross Profit			
Income Taxes—Accrued—Increase (Decrease)			
Intangibles			
Inventories			
Investing Activities—Net Cash Flow			
Investments—Increase			
Liabilities			
Long-Term Debt—Issuance			
Minority Interest			
Non-Operating Income/Expense			
Operating Profit			
Other Current Assets			
Other Liabilities			
Preferred Stock—Redeemable			
Purchase of Common and Preferred Stock			
Sale of Common and Preferred Stock			
Sales			
Short-Term Investments—Change			
Taxes Payable			
Total Current Liabilities			
Total Liabilities			
Treasury Stock			

2. Construct common form balance sheets from the balance sheets of the following firms, determine their operating strategies, and discuss the implications.

a. Coors

Annual Balance Sheet (\$ Millions)	Dec00	Dec99	Dec98	Dec97	Dec96
ASSETS					
Cash and Equivalents	192.520	276.993	256.228	211.038	110.905
Net Receivables	127.078	159.660	126.609	124.485	114.343
Inventories	109.924	107.257	102.660	106.479	121.070
Other Current Assets	68.229	68.911	63.494	75.192	70.324
Total Current Assets	497.751	612.821	548.991	517.194	416.642
Gross Plant, Property, and Equipment	2,432.750	2,328.568	2,229.723	2,144.937	2,127.811
Accumulated Depreciation	1,696.957	1,614.567	1,515.282	1,411.820	1,313.709
Net Plant, Property, and Equipment	735.793	714.001	714.441	733.117	814.102
Investments at Equity	56.300	69.200	62.300	51.700	47.600
Other Investments	193.675	2.890	31.444	47.100	0.000
Intangibles	29.446	31.292	23.114	22.880	21.374
Other Assets	116.339	116.172	80.308	40.092	62.818
TOTAL ASSETS	1,629.304	1,546.376	1,460.598	1,412.083	1,362.536
LIABILITIES					
Long-Term Debt Due in One Year	0.000	0.000	40.000	27.500	17.000
Accounts Payable	186.105	155.344	132.193	113.864	110.696
Taxes Payable	0.000	8.439	10.130	13.660	8.983
Other Current Liabilities	193.231	228.921	201.589	204.122	155.769
Total Current Liabilities	379.336	392.704	383.912	359.146	292.448
Long-Term Debt	105.000	105.000	105.000	145.000	176.000
Deferred Taxes	89.986	78.733	65.779	76.219	76.083
Investment Tax Credit	0.000	0.000	0.000	0.000	0.000
Other Liabilities	122.593	128.400	131.109	95.150	102.518
EQUITY					
Common Stock	9.801	9.703	9.688	9.736	9.989
Capital Surplus	11.203	5.773	10.505	0.000	31.436
Retained Earnings	911.385	826.063	754.605	726.832	674.062
Common Equity	932.389	841.539	774.798	736.568	715.487
TOTAL EQUITY	932.389	841.539	774.798	736.568	715.487
TOTAL LIABILITIES AND EQUITY	1,629.304	1,546.376	1,460.598	1,412.083	1,362.536
COMMON SHARES OUTSTANDING	37.131	36.722	36.655	36.859	37.922

QUESTIONS

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b. Genesee

Annual Balance Sheet (\$ Millions)	Apr01	Apr00	Apr99	Apr98	Apr97
ASSETS					
Cash and Equivalents	21.274	15.678	13.800	20.500	37.148
Net Receivables	3.471	2.776	10.222	10.163	11.037
Inventories	8.758	9.197	16.414	14.258	13.957
Other Current Assets	5.697	0.174	1.148	1.998	1.979
Total Current Assets	39.200	27.825	41.584	46.919	64.121
Gross Plant, Property, and Equipment	17.917	17.201	125.206	117.911	112.033
Accumulated Depreciation	5.680	4.572	88.166	84.600	79.047
Net Plant, Property, and Equipment	12.237	12.629	37.040	33.311	32.986
Investments at Equity	0.000	0.000	5.343	5.534	4.949
Other Investments	10.229	0.000	28.285	34.638	32.144
Intangibles	25.426	26.662	28.280	10.737	0.000
Other Assets	2.910	28.655	3.421	4.450	2.729
TOTAL ASSETS	90.002	95.771	143.953	135.589	136.929
LIABILITIES					
Long-Term Debt Due in One Year	1.474	0.300	0.082	0.000	0.000
Notes Payable	0.000	0.000	3.000	0.000	0.000
Accounts Payable	1.281	1.454	8.421	8.358	9.611
Taxes Payable	0.000	0.064	1.215	0.692	0.932
Other Current Liabilities	1.468	3.746	10.964	9.011	8.424
Total Current Liabilities	4.223	5.564	23.682	18.061	18.967
Long-Term Debt	4.499	5.973	4.679	0.000	0.000
Deferred Taxes	0.000	0.381	8.251	9.295	8.789
Minority Interest	0.000	0.000	2.479	2.227	1.690
Other Liabilities	11.947	0.646	15.825	15.886	15.928
EQUITY					
Common Stock	0.858	0.858	0.858	0.858	0.858
Capital Surplus	5.392	5.847	5.856	5.842	5.834
Retained Earnings	64.576	79.903	85.769	86.895	88.368
Less: Treasury Stock	1.493	3.401	3.446	3.475	3.505
Common Equity	69.333	83.207	89.037	90.120	91.555
TOTAL EQUITY	69.333	83.207	89.037	90.120	91.555
TOTAL LIABILITIES AND EQUITY	90.002	95.771	143.953	135.589	136.929
COMMON SHARES OUTSTANDING	1.674	1.620	1.619	1.618	1.617

c. Red Hook

Annual Balance Sheet (\$ Millions)	Apr01	Apr00	Apr99	Apr98	Apr97
ASSETS					
Cash and Equivalents	21.274	15.678	13.800	20.500	37.148
Net Receivables	3.471	2.776	10.222	10.163	11.037
Inventories	8.758	9.197	16.414	14.258	13.957
Other Current Assets	5.697	0.174	1.148	1.998	1.979
Total Current Assets	39.200	27.825	41.584	46.919	64.121
Gross Plant, Property, and Equipment	17.917	17.201	125.206	117.911	112.033
Accumulated Depreciation	5.680	4.572	88.166	84.600	79.047
Net Plant, Property, and Equipment	12.237	12.629	37.040	33.311	32.986
Investments at Equity	0.000	0.000	5.343	5.534	4.949
Other Investments	10.229	0.000	28.285	34.638	32.144
Intangibles	25.426	26.662	28.280	10.737	0.000
Other Assets	2.910	28.655	3.421	4.450	2.729
TOTAL ASSETS	90.002	95.771	143.953	135.589	136.929
LIABILITIES					
Long-Term Debt Due in One Year	1.474	0.300	0.082	0.000	0.000
Notes Payable	0.000	0.000	3.000	0.000	0.000
Accounts Payable	1.281	1.454	8.421	8.358	9.611
Taxes Payable	0.000	0.064	1.215	0.692	0.932
Other Current Liabilities	1.468	3.746	10.964	9.011	8.424
Total Current Liabilities	4.223	5.564	23.682	18.061	18.967
Long-Term Debt	4.499	5.973	4.679	0.000	0.000
Deferred Taxes	0.000	0.381	8.251	9.295	8.789
Minority Interest	0.000	0.000	2.479	2.227	1.690
Other Liabilities	11.947	0.646	15.825	15.886	15.928
EQUITY					
Common Stock	0.858	0.858	0.858	0.858	0.858
Capital Surplus	5.392	5.847	5.856	5.842	5.834
Retained Earnings	64.576	79.903	85.769	86.895	88.368
Less: Treasury Stock	1.493	3.401	3.446	3.475	3.505
Common Equity	69.333	83.207	89.037	90.120	91.555
TOTAL EQUITY	69.333	83.207	89.037	90.120	91.555
TOTAL LIABILITIES AND EQUITY	90.002	95.771	143.953	135.589	136.929
COMMON SHARES OUTSTANDING	1.674	1.620	1.619	1.618	1.617

QUESTIONS

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3. Construct common form income statements from the income statement of the following firms, determine their operating strategies, and discuss the implications.

a. Coors

<i>Annual Income Statement (\$ Million, except per Share)</i>	<i>Dec00</i>	<i>Dec99</i>	<i>Dec98</i>	<i>Dec97</i>	<i>Dec96</i>
Sales	2,414.415	2,056.646	1,899.533	1,822.151	1,732.233
Cost of Goods Sold	1,396.546	1,092.195	1,043.072	1,003.612	996.745
Gross Profit	1,017.869	964.451	856.461	818.539	735.488
Selling, General, and Administrative Expense	722.745	692.993	617.432	585.491	527.007
Operating Income before Depreciation	295.124	271.458	239.029	233.048	208.481
Depreciation, Depletion, and Amortization	129.283	123.770	115.815	117.166	121.121
Operating Profit	165.841	147.688	123.214	115.882	87.360
Interest Expense	6.414	8.478	12.532	15.460	17.057
Non-Operating Income/Expense	25.313	17.162	19.813	14.954	11.013
Special Items	(15.215)	(5.705)	(19.395)	31.517	(6.341)
Pretax Income	169.525	150.667	111.100	146.893	74.975
Total Income Taxes	59.908	58.383	43.316	64.633	31.550
Income before Extraordinary Items and Discontinued Operations	109.617	92.284	67.784	82.260	43.425
Available for Common	109.617	92.284	67.784	82.260	43.425
Adjusted Available for Common	109.617	92.284	67.784	82.260	43.425
Adjusted Net Income	109.617	92.284	67.784	82.260	43.425

b. Genesee

<i>Annual Income Statement (\$ Millions, except per Share)</i>	<i>Apr01</i>	<i>Apr00</i>	<i>Apr99</i>	<i>Apr98</i>	<i>Apr97</i>
Sales	46.533	45.548	150.007	154.093	154.543
Cost of Goods Sold	35.853	36.568	106.998	112.150	111.796
Gross Profit	10.680	8.980	43.009	41.943	42.747
Selling, General, and Administrative Expense	8.182	7.801	36.070	36.346	34.979
Operating Income before Depreciation	2.498	1.179	6.939	5.597	7.768
Depreciation, Depletion, and Amortization	3.009	2.853	6.591	6.285	5.172
Operating Profit	(0.511)	(1.674)	0.348	(0.688)	2.596
Interest Expense	0.422	0.351	0.873	0.000	0.000
Non-Operating Income/Expense	1.429	0.734	6.320	3.801	3.279
Special Items	(1.600)	0.000	0.000	0.000	0.000
Pretax Income	(1.104)	(1.291)	5.795	3.113	5.875
Total Income Taxes	(0.040)	(0.150)	2.095	0.974	1.831
Minority Interest	0.000	0.000	1.237	0.804	0.698
Income before Extraordinary Items and Discontinued Operations	(1.064)	(1.141)	2.463	1.335	3.346
Available for Common Savings Due to Common Stock Equivalents	(1.064)	(1.141)	2.463	1.335	3.346
	0.000	0.000	0.000	0.000	0.000
Adjusted Available for Common	(1.064)	(1.141)	2.463	1.335	3.346
Discontinued Operations	(1.350)	(2.259)	0.000	0.000	0.000
Adjusted Net Income	(2.414)	(3.400)	2.463	1.335	3.346

QUESTIONS

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c. Red Hook

<i>Annual Income Statement (\$ Millions, except per Share)</i>	<i>Dec00</i>	<i>Dec99</i>	<i>Dec98</i>	<i>Dec97</i>	<i>Dec96</i>
Sales	34.412	32.194	32.641	34.286	35.678
Cost of Goods Sold	<u>21.340</u>	<u>19.342</u>	<u>20.574</u>	<u>22.564</u>	<u>21.538</u>
Gross Profit	13.072	12.852	12.067	11.722	14.140
Selling, General, and Administrative Expense	<u>11.747</u>	<u>11.290</u>	<u>9.086</u>	<u>9.981</u>	<u>7.853</u>
Operating Income before Depreciation	1.325	1.562	2.981	1.741	6.287
Depreciation, Depletion, and Amortization	<u>3.240</u>	<u>3.271</u>	<u>3.343</u>	<u>3.399</u>	<u>2.043</u>
Operating Profit	(1.915)	(1.709)	(0.362)	(1.658)	4.244
Interest Expense	0.594	0.534	0.679	0.648	0.291
Non-Operating Income/Expense	0.443	(0.048)	0.127	0.363	0.906
Special Items	<u>1.010</u>	<u>0.000</u>	<u>(5.173)</u>	<u>0.000</u>	<u>0.000</u>
Pretax Income	(1.056)	(2.291)	(6.087)	(1.943)	4.859
Total Income Taxes	<u>(0.328)</u>	<u>(0.768)</u>	<u>(2.076)</u>	<u>(0.544)</u>	<u>1.773</u>
Income before Extraordinary Items and Discontinued Operations	(0.728)	(1.523)	(4.011)	(1.399)	3.086
Preferred Dividends	<u>0.000</u>	<u>0.000</u>	<u>0.000</u>	<u>0.000</u>	<u>0.044</u>
Available for Common Savings Due to Common Stock Equivalents	(0.728)	(1.523)	(4.011)	(1.399)	3.042
	<u>0.000</u>	<u>0.000</u>	<u>0.000</u>	<u>0.000</u>	<u>0.044</u>
Adjusted Available for Common	<u>(0.728)</u>	<u>(1.523)</u>	<u>(4.011)</u>	<u>(1.399)</u>	<u>3.086</u>
Adjusted Net Income	(0.728)	(1.523)	(4.011)	(1.399)	3.086

4. For the firms listed, determine the stage of growth based on an analysis of their financial statements.
- a. Remec, Inc.

Annual Balance Sheet (\$ Millions)	Jan01	Jan00	Jan99	Jan98	Jan97
ASSETS					
Cash and Equivalents	138.526	34.836	83.011	41.937	63.173
Net Receivables	49.678	33.112	27.295	25.495	15.973
Inventories	58.866	42.147	38.312	30.381	19.332
Prepaid Expenses	0.000	0.000	0.000	0.000	0.000
Other Current Assets	19.152	10.086	8.022	6.831	3.616
Total Current Assets	266.222	120.181	156.640	104.644	102.094
Gross Plant, Property, and Equipment	144.849	113.621	86.421	64.188	45.961
Accumulated Depreciation	62.008	53.331	41.714	32.199	27.418
Net Plant, Property, and Equipment	82.841	60.290	44.707	31.989	18.543
Other Assets	41.161	43.458	17.224	17.232	4.803
TOTAL ASSETS	390.224	223.929	218.571	153.865	125.440
LIABILITIES					
Long-Term Debt Due in One Year	0.000	0.225	0.000	0.000	0.482
Notes Payable	0.000	0.000	0.075	0.000	1.891
Accounts Payable	19.948	8.320	8.156	8.532	5.974
Taxes Payable	1.271	1.250	0.000	2.546	2.249
Accrued Expenses	0.000	0.000	14.602	9.070	7.386
Other Current Liabilities	19.599	14.776	0.000	0.000	0.000
Total Current Liabilities	40.818	24.571	22.833	20.148	17.982
Long-Term Debt	0.000	5.049	0.000	0.000	2.462
Deferred Taxes	6.457	6.417	4.131	5.118	1.179
Investment Tax Credit	0.000	0.000	0.000	0.000	0.000
Minority Interest	1.462	0.000	0.000	0.000	0.000
Other Liabilities	0.000	0.000	0.000	0.104	0.262
EQUITY					
Common Stock	0.447	0.254	0.249	0.212	0.137
Capital Surplus	317.203	170.133	165.633	95.303	85.856
Retained Earnings	23.837	17.505	25.725	32.980	17.562
Common Equity	341.487	187.892	191.607	128.495	103.555
TOTAL EQUITY	341.487	187.892	191.607	128.495	103.555
TOTAL LIABILITIES AND EQUITY	390.224	223.929	218.571	153.865	125.440
COMMON SHARES OUTSTANDING	44.669	38.145	37.320	31.775	30.802

QUESTIONS

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<i>Annual Income Statement (\$ Millions, except per Share)</i>	<i>Jan01</i>	<i>Jan00</i>	<i>Jan99</i>	<i>Jan98</i>	<i>Jan97</i>
Sales	273.499	189.189	179.215	156.057	118.554
Cost of Goods Sold	191.396	132.094	127.512	102.672	82.010
Gross Profit	82.103	57.095	51.703	53.385	36.544
Selling, General, and Administrative Expense	64.574	52.183	47.739	28.781	23.531
Operating Income before Depreciation	17.529	4.912	3.964	24.604	13.013
Depreciation, Depletion, and Amortization	12.416	11.486	9.930	5.381	3.648
Operating Profit	5.113	(6.574)	(5.966)	19.223	9.365
Interest Expense	0.000	0.000	0.000	0.000	0.000
Non-Operating Income/Expense	11.509	2.601	3.008	2.280	0.048
Special Items	(2.750)	(3.130)	0.000	1.733	(0.424)
Pretax Income	13.872	(7.103)	(2.958)	23.236	8.989
Total Income Taxes	2.917	(0.428)	1.873	8.501	4.017
Minority Interest	0.076	0.000	0.000	0.000	0.000
Income before Extraordinary Items and Discontinued Operations	10.879	(6.675)	(4.831)	14.735	4.972
Preferred Dividends	0.000	0.000	0.000	0.000	0.000
Available for Common Savings Due to Common Stock Equivalents	10.879	(6.675)	(4.831)	14.735	4.972
Adjusted Available for Common	10.879	(6.675)	(4.831)	14.735	4.972
Extraordinary Items	0.000	0.000	0.000	0.000	0.000
Discontinued Operations	0.000	0.000	0.000	0.000	0.000
Adjusted Net Income	10.879	(6.675)	(4.831)	14.735	4.972

<i>Annual Statement of Cash Flows (\$ Millions)</i>	<i>Jan01</i>	<i>Jan00</i>	<i>Jan99</i>	<i>Jan98</i>	<i>Jan97</i>
INDIRECT OPERATING ACTIVITIES					
Income before Extraordinary Items	10.879	(6.675)	(4.831)	14.735	4.972
Depreciation and Amortization	16.207	13.378	9.930	5.381	3.648
Extraordinary Items and Discontinued Operations	0.000	0.000	0.000	0.000	0.000
Deferred Taxes	(7.106)	(1.925)	1.310	(2.408)	(0.767)
Sale of Property, Plant, and Equipment and Sale of Investments—Loss (Gain)	0.000	0.000	0.000	(2.833)	0.000
Funds from Operations—Other	9.590	0.000	0.139	0.000	0.000
Receivables—Decrease (Increase)	(16.644)	(6.678)	7.079	(6.525)	(4.863)
Inventory—Decrease (Increase)	(16.806)	(2.553)	(1.584)	(9.304)	(2.539)
Other Assets and Liabilities—Net Change	14.140	4.490	(5.780)	1.741	0.378
Operating Activities—Net Cash Flow	10.260	0.037	6.263	0.787	0.829
INVESTING ACTIVITIES					
Investments—Increase	0.000	0.000	0.000	0.000	0.000
Sale of Investments	0.000	0.000	0.000	0.000	0.000
Short-Term Investments—Change	0.000	0.000	0.000	0.000	1.483
Capital Expenditures	34.547	23.199	18.279	17.351	7.363
Sale of Property, Plant, and Equipment	0.000	0.000	0.000	0.000	0.000
Acquisitions	0.000	5.825	0.000	5.066	4.012
Investing Activities—Other	(4.739)	(26.840)	(1.589)	5.120	(0.146)
Investing Activities—Net Cash Flow	(39.286)	(55.864)	(19.868)	(17.297)	(10.038)
FINANCING ACTIVITIES					
Sale of Common and Preferred Stock	138.195	3.349	52.676	2.898	71.261
Purchase of Common and Preferred Stock	0.000	0.000	2.851	0.000	0.000
Cash Dividends	0.000	0.000	0.000	0.000	0.000
Long-Term Debt—Issuance	0.000	6.026	0.000	12.213	1.100
Long-Term Debt—Reduction	5.277	1.466	0.000	19.510	3.413
Current Debt—Changes	0.000	0.000	(1.391)	0.000	0.000
Financing Activities—Other	0.000	0.000	0.000	0.000	1.109
Financing Activities—Net Cash Flow	132.918	7.909	48.434	(4.399)	70.057
Exchange Rate Effect	(0.202)	0.005	0.217	0.000	0.000
Cash and Equivalents—Change	103.690	(47.913)	35.046	(20.909)	60.848
DIRECT OPERATING ACTIVITIES					
Interest Paid—Net	0.074	0.208	0.098	0.321	0.414
Income Taxes Paid	0.238	0.808	4.661	10.162	3.091

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b. Hormel Foods Corp.

Annual Balance Sheet (\$ Millions)	Oct00	Oct99	Oct98	Oct97	Oct96
ASSETS					
Cash and Equivalents	106.610	248.562	238.032	152.386	203.115
Net Receivables	307.732	266.059	222.919	233.966	230.869
Inventories	281.404	270.239	239.548	265.346	271.097
Prepaid Expenses	6.342	5.757	7.972	7.450	6.563
Other Current Assets	9.021	9.526	8.894	12.204	11.615
Total Current Assets	711.109	800.143	717.365	671.352	723.259
Gross Plant, Property, and Equipment	1,081.612	1,002.186	938.581	919.929	828.614
Accumulated Depreciation	540.063	496.562	451.674	431.191	407.128
Net Plant, Property, and Equipment	541.549	505.624	486.907	488.738	421.486
Other Investments	151.383	142.879	111.364	113.372	0.000
Intangibles	92.632	98.544	105.244	131.710	124.193
Other Assets	145.267	138.395	135.012	123.363	167.200
TOTAL ASSETS	1,641.940	1,685.585	1,555.892	1,528.535	1,436.138
LIABILITIES					
Long-Term Debt Due in One Year	38.439	41.214	6.117	4.595	2.548
Accounts Payable	154.893	162.585	119.836	120.385	121.004
Taxes Payable	2.609	12.186	1.172	4.712	9.804
Accrued Expenses	134.489	157.520	128.752	118.906	121.442
Other Current Liabilities	12.195	11.902	11.774	11.980	11.611
Total Current Liabilities	342.625	385.407	267.651	260.578	266.409
Long-Term Debt	145.928	184.723	204.874	198.232	127.003
Other Liabilities	279.510	274.313	270.052	267.523	257.175
EQUITY					
Common Stock	8.120	8.364	8.628	8.881	9.087
Capital Surplus	0.000	0.000	0.000	0.000	32.214
Retained Earnings	865.757	832.778	808.246	793.321	744.785
Less: Treasury Stock	0.000	0.000	3.559	0.000	0.535
Common Equity	873.877	841.142	813.315	802.202	785.551
TOTAL EQUITY	873.877	841.142	813.315	802.202	785.551
TOTAL LIABILITIES AND EQUITY	1,641.940	1,685.585	1,555.892	1,528.535	1,436.138
COMMON SHARES OUTSTANDING	138.569	142.724	146.992	151.554	155.020

<i>Annual Income Statement (\$ Millions, except per Share)</i>	<i>Oct00</i>	<i>Oct99</i>	<i>Oct98</i>	<i>Oct97</i>	<i>Oct96</i>
Sales	3,675.132	3,357.757	3,261.045	3,256.551	3,098.685
Cost of Goods Sold	<u>2,608.988</u>	<u>2,315.069</u>	<u>2,340.060</u>	<u>2,444.737</u>	<u>2,355.573</u>
Gross Profit	1,066.144	1,042.688	920.985	811.814	743.112
Selling, General, and Administrative Expense	<u>737.651</u>	<u>737.125</u>	<u>677.207</u>	<u>590.719</u>	<u>578.767</u>
Operating Income before Depreciation	328.493	305.563	243.778	221.095	164.345
Depreciation, Depletion, and Amortization	<u>65.886</u>	<u>64.656</u>	<u>60.273</u>	<u>52.925</u>	<u>42.699</u>
Operating Profit	262.607	240.907	183.505	168.170	121.646
Interest Expense	14.906	13.746	13.692	15.043	1.619
Non-Operating Income/Expense	16.680	24.312	19.144	12.558	14.106
Special Items	<u>0.000</u>	<u>0.000</u>	<u>28.379</u>	<u>5.176</u>	<u>(8.659)</u>
Pretax Income	264.381	251.473	217.336	170.861	125.474
Total Income Taxes	<u>94.164</u>	<u>88.035</u>	<u>78.045</u>	<u>61.369</u>	<u>46.066</u>
Income before Extraordinary Items and Discontinued Operations	<u>170.217</u>	<u>163.438</u>	<u>139.291</u>	<u>109.492</u>	<u>79.408</u>
Available for Common	<u>170.217</u>	<u>163.438</u>	<u>139.291</u>	<u>109.492</u>	<u>79.408</u>
Adjusted Net Income	170.217	163.438	139.291	109.492	79.408

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Annual Statement of Cash Flows (\$ Millions)	Oct00	Oct99	Oct98	Oct97	Oct96
INDIRECT OPERATING ACTIVITIES					
Income before Extraordinary Items	170.217	163.438	139.291	109.492	79.408
Depreciation and Amortization	65.886	64.656	60.273	52.925	42.699
Deferred Taxes	7.160	1.968	4.516	(0.444)	(2.347)
Equity in Net Loss (Earnings)	3.083	(4.830)	(4.323)	(3.402)	0.000
Sale of Property, Plant, and Equipment and Sale of Investments—Loss (Gain)	0.360	1.293	(15.346)	@CF	@CF
Funds from Operations—Other	0.000	0.000	0.000	0.050	(8.394)
Receivables—Decrease (Increase)	(41.673)	(43.140)	11.047	(3.097)	2.773
Inventory—Decrease (Increase)	0.000	0.000	0.000	0.000	0.000
Accounts Payable and Accrued Liabilities—Increase (Decrease)	(38.420)	86.792	8.286	2.101	52.040
Income Taxes—Accrued— Increase (Decrease)	0.000	0.000	0.000	0.000	0.000
Other Assets and Liabilities—Net Change	(11.750)	(28.476)	25.276	4.864	(56.771)
Operating Activities—Net Cash Flow	154.863	241.701	229.020	162.489	109.408
INVESTING ACTIVITIES					
Sale of Investments	0.000	0.000	@CF	0.000	0.000
Short-Term Investments—Change	54.288	(26.154)	(28.565)	9.109	(1.526)
Capital Expenditures	100.125	79.121	75.774	116.381	122.942
Sale of Property, Plant, and Equipment	3.866	1.155	39.792	4.163	5.410
Acquisitions	0.000	0.000	0.000	0.140	12.845
Investing Activities—Other	(36.044)	(42.177)	5.722	(81.805)	(18.418)
Investing Activities—Net Cash Flow	(78.015)	(146.297)	(58.825)	(185.054)	(150.321)
FINANCING ACTIVITIES					
Purchase of Common and Preferred Stock	75.330	87.636	80.076	45.457	23.966
Cash Dividends	48.735	47.858	47.678	47.178	45.613
Long-Term Debt—Issuance	4.439	26.100	17.589	77.625	110.553
Long-Term Deb— Reduction	43.183	4.778	4.312	4.349	3.393
Current Debt—Changes	0.000	0.000	0.000	0.000	0.000
Financing Activities—Other	(1.703)	3.144	1.363	0.304	2.266
Financing Activities—Net Cash Flow	(164.512)	(111.028)	(113.114)	(19.055)	39.847
Exchange Rate Effect	0.000	0.000	0.000	0.000	0.000
Cash and Equivalents—Change	(87.664)	(15.624)	57.081	(41.620)	(1.066)
DIRECT OPERATING ACTIVITIES					
Interest Paid—Net	14.800	14.800	13.600	14.908	1.629
Income Taxes Paid	98.100	76.400	76.500	66.500	38.263

c. Diametrics Medical, Inc.

Annual Balance Sheet (\$ Millions)	Dec00	Dec99	Dec98	Dec97	Dec96
ASSETS					
Cash and Equivalents	8.714	14.126	6.409	11.761	5.855
Net Receivables	6.682	6.791	5.420	3.768	2.589
Inventories	4.280	4.116	4.768	3.588	4.464
Prepaid Expenses	0.000	0.000	0.000	0.000	0.000
Other Current Assets	0.397	0.285	0.454	0.311	0.544
Total Current Assets	20.073	25.318	17.051	19.428	13.452
Gross Plant, Property, and Equipment	22.475	19.455	20.077	18.060	16.296
Accumulated Depreciation	15.138	13.681	13.155	10.674	8.008
Net Plant, Property, and Equipment	7.337	5.774	6.922	7.386	8.288
Intangibles	0.000	0.148	0.223	1.820	2.260
Other Assets	0.401	0.732	1.150	0.028	0.059
TOTAL ASSETS	27.811	31.972	25.346	28.662	24.059
LIABILITIES					
Long-Term Debt Due in One Year	0.426	0.350	0.417	0.970	1.250
Notes Payable	0.000	0.000	0.829	0.000	0.032
Accounts Payable	2.400	2.439	2.535	2.262	1.613
Accrued Expenses	1.914	2.415	1.855	3.687	3.848
Other Current Liabilities	1.000	5.104	0.000	0.000	0.060
Total Current Liabilities	5.740	10.308	5.636	6.919	6.803
Long-Term Debt	7.472	7.814	8.163	8.538	8.463
Other Liabilities	0.414	0.009	0.181	0.062	0.119
EQUITY					
Common Stock	0.267	0.258	0.234	0.209	0.152
Capital Surplus	147.292	143.463	130.478	113.970	88.452
Retained Earnings	(133.374)	(129.880)	(119.346)	(101.036)	(79.930)
Common Equity	14.185	13.841	11.366	13.143	8.674
TOTAL EQUITY	14.185	13.841	11.366	13.143	8.674
TOTAL LIABILITIES AND EQUITY	27.811	31.972	25.346	28.662	24.059
COMMON SHARES OUTSTANDING	26.713	25.778	20.890	20.890	15.209

Annual Income Statement (\$ Millions, except per Share)	Dec00	Dec99	Dec98	Dec97	Dec96
Sales	25.258	18.687	12.156	10.434	3.797
Cost of Goods Sold	<u>15.581</u>	<u>13.556</u>	<u>8.188</u>	<u>7.503</u>	<u>6.477</u>
Gross Profit	9.677	5.131	3.968	2.931	(2.680)
Selling, General, and Administrative Expense	<u>10.263</u>	<u>12.951</u>	<u>17.737</u>	<u>18.814</u>	<u>16.653</u>
Operating Income before Depreciation	(0.586)	(7.820)	(13.769)	(15.883)	(19.333)
Depreciation, Depletion, and Amortization	<u>2.157</u>	<u>2.225</u>	<u>3.147</u>	<u>4.163</u>	<u>3.114</u>
Operating Profit	(2.743)	(10.045)	(16.916)	(20.046)	(22.447)
Interest Expense	0.587	0.630	0.807	1.018	0.607
Non-Operating Income/Expense	0.682	0.431	0.335	0.491	0.814
Special Items	<u>0.000</u>	<u>0.000</u>	<u>0.000</u>	<u>(0.464)</u>	<u>(1.335)</u>
Pretax Income	(2.648)	(10.244)	(17.388)	(21.037)	(23.575)
Total Income Taxes	<u>0.000</u>	<u>0.000</u>	<u>0.000</u>	<u>0.000</u>	<u>0.000</u>
Adjusted Net Income	(2.648)	(10.244)	(17.388)	(21.037)	(23.575)

Annual Statement of Cash Flows (\$ Millions)	Dec00	Dec99	Dec98	Dec97	Dec96
INDIRECT OPERATING ACTIVITIES					
Income before Extraordinary Items	(2.648)	(10.244)	(17.388)	(21.037)	(23.575)
Depreciation and Amortization	2.157	2.225	3.147	4.163	3.114
Sale of Property, Plant, and Equipment and Sale of Investments—Loss (Gain)	0.000	0.000	0.001	(0.081)	(0.002)
Funds from Operation—Other	0.000	0.013	(0.652)	0.029	0.465
Receivables—Decrease (Increase)	0.109	(1.371)	(1.652)	(1.179)	(0.581)
Inventory—Decrease (Increase)	(0.164)	0.651	(1.326)	0.876	(0.632)
Accounts Payable and Accrued Liabilities—Increase (Decrease)	(0.647)	0.405	(1.506)	0.418	0.348
Income Taxes—Accrued—Increase (Decrease)	0.000	0.000	0.000	0.000	0.000
Other Assets and Liabilities—Net Change	(4.217)	5.275	(0.044)	0.233	0.523
Operating Activities—Net Cash Flow	(5.410)	(3.046)	(19.420)	(16.578)	(20.340)
INVESTING ACTIVITIES					
Short-Term Investments—Change	5.058	(8.363)	5.426	(4.999)	22.387
Capital Expenditures	3.438	1.689	2.253	2.958	1.597
Sale of Property, Plant, and Equipment	0.000	0.945	0.000	0.237	0.102
Acquisitions	0.000	0.000	0.000	0.000	1.068
Investing Activities—Other	0.004	0.026	0.012	(0.037)	(0.037)
Investing Activities—Net Cash Flow	1.624	(9.081)	3.185	(7.757)	19.787
FINANCING ACTIVITIES					
Sale of Common and Preferred Stock	3.837	12.996	16.519	25.547	0.966
Long-Term Debt—Issuance	0.116	0.000	1.819	1.058	0.500
Long-Term Debt—Reduction	0.371	1.245	1.918	1.295	1.079
Current Debt—Changes	0.000	0.000	0.000	0.000	(0.108)
Financing Activities—Net Cash Flow	3.582	11.751	16.420	25.310	0.279
Exchange Rate Effect	(0.150)	(0.270)	(0.111)	(0.068)	0.024
Cash and Equivalents—Change	(0.354)	(0.646)	0.074	0.907	(0.250)
DIRECT OPERATING ACTIVITIES					
Interest Paid—Net	0.587	0.630	1.544	0.378	0.510

5. Perform a Du Pont analysis for the firms in the table that follows:

Du Pont Analysis of Food Processing Industry's 2000 Results				
<i>Company Name</i>	<i>Sales-Net</i>	<i>Assets- Total</i>	<i>Net Income (Loss)</i>	<i>Stockholders' Equity</i>
Dean Foods Company	4,065.636	2,003.542	106.118	657.685
Dreyer's Grand Ice Cream Inc.	1,194.356	468.451	25.378	200.912
Earthgrains Company	2,039.300	2,339.500	54.500	654.900
Flowers Foods Inc.	1,619.980	1,562.646	5.045	502.460
Interstate Bakeries Corp.	3,522.929	1,651.925	89.388	591.677
International Multifoods Corp.	2,384.715	736.207	5.135	255.124
Pro-Fac Cooperative Inc.	1,268.542	1,187.266	16.164	159.843
Quaker Oats Company	5,041.000	2,418.800	360.600	376.300
Suiza Foods Corp.	5,756.303	3,780.478	118.719	598.832
Tofutti Brands Inc.	13.343	4.813	0.956	3.953
Wrigley (WM) Jr. Company	2,145.706	1,574.740	328.942	1,132.897

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6. Using the information in the financial statements of American Greetings, calculate the following ratios:

<i>Annual Ratio Report (Ratio, except as Noted)</i>	<i>Feb01</i>	<i>Feb00</i>	<i>Feb99</i>	<i>Feb98</i>	<i>Feb97</i>	<i>Feb96</i>
LIQUIDITY						
Current Ratio						
Quick Ratio						
Working Capital per Share						
ACTIVITY						
Inventory Turnover						
Receivables Turnover						
Total Asset Turnover						
PERFORMANCE						
Sales/Net Property, Plant, and Equipment						
Sales/Stockholder Equity						
PROFITABILITY						
Operating Margin before Depreciation (%)						
Operating Margin after Depreciation (%)						
Pretax Profit Margin (%)						
Net Profit Margin (%)						
Return on Assets (%)						
Return on Equity (%)						
Return on Investment (%)						
Return on Average Assets (%)						
Return on Average Equity (%)						
LEVERAGE						
Interest Coverage before Tax						
Interest Coverage after Tax						
Long-Term Debt/Common Equity (%)						
Long-Term Debt/Shareholder Equity(%)						
Total Debt/Total Assets (%)						
Total Assets/Common Equity						
Dividend Payout (%)						

Annual Balance Sheet (\$ Millions)	Feb01	Feb00	Feb99	Feb98	Feb97
ASSETS					
Cash and Equivalents	51.691	61.010	144.555	47.623	35.050
Net Receivables	387.534	430.825	390.740	373.594	375.324
Inventories	365.221	249.433	251.289	271.205	303.611
Other Current Assets	401.290	359.416	359.234	330.823	290.906
Total Current Assets	1,205.736	1,100.684	1,145.818	1,023.245	1,004.891
Gross Plant, Property, and Equipment	1,086.094	1,019.121	958.623	938.743	920.194
Accumulated Depreciation	608.906	571.706	523.817	491.111	457.407
Net Plant, Property, and Equipment	477.188	447.415	434.806	447.632	462.787
Intangibles	229.802	149.437	135.516	0.000	0.000
Deferred Charges	717.400	679.214	595.136	481.236	464.599
Other Assets	81.948	141.233	108.052	193.779	202.843
TOTAL ASSETS	2,712.074	2,517.983	2,419.328	2,145.892	2,135.120
LIABILITIES					
Long-Term Debt Due in One Year	0.664	2.279	2.218	47.200	0.436
Notes Payable	378.240	107.415	15.559	152.440	132.735
Accounts Payable	304.063	213.180	175.366	145.554	157.628
Taxes Payable	192.936	13.090	27.165	22.536	5.475
Other Current Liabilities	235.378	246.524	197.366	149.486	146.469
Total Current Liabilities	1,111.281	582.488	417.674	517.216	442.743
Long-Term Debt	380.124	442.102	463.246	148.800	219.639
Deferred Taxes	27.292	44.997	49.752	42.722	43.244
Other Liabilities	146.187	195.985	142.045	91.937	67.839
EQUITY					
Common Stock	63.489	64.520	69.093	71.182	74.982
Capital Surplus	286.054	304.946	304.086	290.820	272.262
Retained Earnings	1,144.774	1,328.703	1,293.924	1,183.595	1,049.261
Less: Treasury Stock	447.127	445.758	320.492	200.380	34.850
Common Equity	1,047.190	1,252.411	1,346.611	1,345.217	1,361.655
TOTAL EQUITY	1,047.190	1,252.411	1,346.611	1,345.217	1,361.655
TOTAL LIABILITIES AND EQUITY	2,712.074	2,517.983	2,419.328	2,145.892	2,135.120
COMMON SHARES OUTSTANDING	63.489	64.520	69.093	71.183	74.982

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<i>Annual Income Statement (\$ Millions, except per Share)</i>	<i>Feb01</i>	<i>Feb00</i>	<i>Feb99</i>	<i>Feb98</i>	<i>Feb97</i>
Sales	2,518.814	2,175.236	2,205.706	2,198.765	2,161.089
Cost of Goods Sold	901.214	737.323	690.031	724.762	740.558
Gross Profit	1,617.600	1,437.913	1,515.675	1,474.003	1,420.531
Selling, General, and Administrative Expense	1,348.745	1,148.467	1,122.506	1,128.122	1,082.095
Operating Income before Depreciation	268.855	289.446	393.169	345.881	338.436
Depreciation, Depletion, and Amortization	98.057	64.342	67.049	65.926	64.566
Operating Profit	170.798	225.104	326.120	279.955	273.870
Interest Expense	55.387	34.255	29.326	22.992	30.749
Non-Operating Income/Expense	7.376	(3.670)	(1.272)	13.349	11.209
Special Items	(24.154)	(46.555)	(13.925)	22.125	0.000
Pretax Income	98.633	140.624	281.597	292.437	254.330
Total Income Taxes	191.306	50.625	101.375	102.353	87.235
Income before Extraordinary Items and Discontinued Operations	(92.673)	89.999	180.222	190.084	167.095
Extraordinary Items	(21.141)	0.000	0.000	0.000	0.000
Adjusted Net Income	(113.814)	89.999	180.222	190.084	167.095

<i>Annual Statement of Cash Flows (\$ Millions)</i>	<i>Feb01</i>	<i>Feb00</i>	<i>Feb99</i>	<i>Feb98</i>	<i>Feb97</i>
INDIRECT OPERATING ACTIVITIES					
Income before Extraordinary Items	(92.673)	89.999	180.222	190.084	167.095
Depreciation and Amortization	98.057	64.342	67.049	65.926	64.566
Extraordinary Items and Discontinued Operations	0.000	0.000	0.000	0.000	0.000
Deferred Taxes	61.227	54.248	(8.940)	(20.186)	0.294
Funds from Operations—Other	36.501	42.548	10.226	5.018	5.100
Receivables—Decrease (Increase)	29.201	(35.883)	(10.450)	(20.567)	(25.389)
Inventory—Decrease (Increase)	(46.587)	11.655	17.809	5.915	32.371
Other Assets and Liabilities—Net Change	24.074	(58.390)	(44.648)	(8.873)	(90.134)
Operating Activities—Net Cash Flow	109.800	168.519	211.268	195.192	153.903
INVESTING ACTIVITIES					
Capital Expenditures	74.382	50.753	60.950	67.898	92.895
Sale of Property, Plant, and Equipment	22.294	1.490	2.522	2.148	2.579
Acquisitions	179.993	65.947	52.957	0.000	0.000
Investing Activities—Other	34.125	(22.437)	26.453	77.699	(14.737)
Investing Activities—Net Cash Flow	(197.956)	(137.647)	(84.932)	11.949	(105.053)
FINANCING ACTIVITIES					
Sale of Common and Preferred Stock	0.000	1.171	18.981	16.915	6.997
Purchase of Common and Preferred Stock	45.530	130.151	131.745	170.015	1.863
Cash Dividends	52.743	51.213	52.410	51.959	50.152
Long-Term Debt—Issuance	0.000	1.076	317.096	9.430	8.451
Long-Term Debt—Reduction	80.431	16.397	22.669	6.988	12.232
Current Debt—Changes	257.541	81.097	(158.657)	8.049	4.869
Financing Activities—Other	0.000	0.000	0.000	0.000	0.000
Financing Activities—Net Cash Flow	78.837	(114.417)	(29.404)	(194.568)	(43.930)
Exchange Rate Effect	0.000	0.000	0.000	0.000	0.000
Cash and Equivalents—Change	(9.319)	(83.545)	96.932	12.573	4.920
DIRECT OPERATING ACTIVITIES					
Interest Paid—Net	54.637	34.051	27.831	22.735	29.914
Income Taxes Paid	(18.174)	19.821	102.363	101.261	99.391

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7. Using the information in the financial statements of Solelectron Corp, calculate the following ratios:

<i>Annual Ratio Report (Ratio, except as Noted)</i>	<i>Aug01</i>	<i>Aug00</i>	<i>Aug99</i>	<i>Aug98</i>	<i>Aug97</i>	<i>Aug96</i>
LIQUIDITY						
Current Ratio						
Quick Ratio						
Working Capital per Share						
ACTIVITY						
Inventory Turnover						
Receivables Turnover						
Total Asset Turnover						
PERFORMANCE						
Sales/Net Property, Plant, and Equipment						
Sales/Stockholder Equity						
PROFITABILITY						
Operating Margin before Depreciation (%)						
Operating Margin after Depreciation (%)						
Pretax Profit Margin (%)						
Net Profit Margin (%)						
Return on Assets (%)						
Return on Equity (%)						
Return on Investment (%)						
Return on Average Assets (%)						
Return on Average Equity (%)						
LEVERAGE						
Interest Coverage before Tax						
Interest Coverage after Tax						
Long-Term Debt/Common Equity (%)						
Long-Term Debt/Shareholder Equity(%)						
Total Debt/Total Assets (%)						
Total Assets/Common Equity						
Dividend Payout (%)						

Annual Balance Sheet (\$ Millions)	Aug01	Aug00	Aug99	Aug98	Aug97
ASSETS					
Cash and Equivalents	2,790.100	2,434.100	1,688.400	308.804	482.902
Net Receivables	2,443.600	2,146.300	1,118.300	670.194	418.682
Inventories	3,209.900	3,787.300	1,080.100	788.519	494.622
Other Current Assets	260.500	260.500	107.300	120.041	79.426
Total Current Assets	8,704.100	8,628.200	3,994.100	1,887.558	1,475.632
Gross Plant, Property, and Equipment	2,511.800	1,849.800	1,186.900	859.831	648.777
Accumulated Depreciation	1,207.100	769.400	533.300	411.792	322.416
Net Plant, Property, and Equipment	1,304.700	1,080.400	653.600	448.039	326.361
Other Assets	2,921.600	667.000	187.000	74.971	50.426
TOTAL ASSETS	12,930.400	10,375.600	4,834.700	2,410.568	1,852.419
LIABILITIES					
Long-Term Debt Due in One Year	0.000	0.000	0.000	2.821	1.464
Notes Payable	306.200	69.200	21.400	0.000	0.000
Accounts Payable	1,786.100	2,694.100	902.600	666.557	415.896
Accrued Expenses	530.200	442.300	129.300	106.959	81.005
Other Current Liabilities	66.800	11.200	59.900	64.497	45.577
Total Current Liabilities	2,689.300	3,216.800	1,113.200	840.834	543.942
Long-Term Debt	5,027.500	3,319.500	922.600	385.519	385.850
Other Liabilities	62.900	37.200	5.800	2.889	3.558
EQUITY					
Common Stock	0.700	0.600	0.300	0.117	0.115
Capital Surplus	3,877.600	2,259.100	1,910.100	510.757	451.093
Retained Earnings	1,272.400	1,542.400	882.700	670.452	467.861
Common Equity	5,150.700	3,802.100	2,793.100	1,181.326	919.069
TOTAL EQUITY	5,150.700	3,802.100	2,793.100	1,181.326	919.069
TOTAL LIABILITIES AND EQUITY	12,930.400	10,375.600	4,834.700	2,410.568	1,852.419
COMMON SHARES OUTSTANDING	658.200	605.000	542.800	470.668	458.184

Annual Income Statement (\$ Millions, except per Share)	Aug01	Aug00	Aug99	Aug98	Aug97
Sales	18,692.301	14,137.500	8,391.400	5,288.294	3,694.385
Cost of Goods Sold	16,810.000	12,610.800	7,431.400	4,625.788	3,161.516
Gross Profit	1,882.301	1,526.700	960.000	662.506	532.869
Selling, General, and Administrative Expense	897.800	533.200	337.900	239.317	187.857
Operating Income before Depreciation	984.500	993.500	622.100	423.189	345.012
Depreciation, Depletion, and Amortization	536.100	251.400	183.200	124.200	104.590
Operating Profit	448.400	742.100	438.900	298.989	240.422
Interest Expense	176.000	71.600	39.700	26.459	26.551
Non-Operating Income/Expense	116.900	106.900	33.100	26.453	28.536
Special Items	(547.000)	(37.900)	0.000	0.000	(4.000)
Pretax Income	(157.700)	739.500	432.300	298.983	238.407
Total Income Taxes	(34.200)	238.800	138.400	100.159	80.348
Net Income	(123.500)	497.200	293.900	198.824	158.059

Annual Statement of Cash Flows (\$ Millions)	Aug01	Aug00	Aug99	Aug98	Aug97
INDIRECT OPERATING ACTIVITIES					
Income before Extraordinary Items	(123.500)	500.700	293.900	198.824	158.059
Depreciation and Amortization	0.000	251.400	183.200	124.200	104.590
Sale of Property, Plant, and Equipment and Sale of Investments—Loss (Gain)	(10.000)	(8.700)	(4.900)	(2.277)	0.000
Funds from Operations—Other	1,063.700	121.700	53.900	8.039	14.316
Receivables—Decrease (Increase)	52.400	(934.100)	(458.300)	(250.575)	(66.293)
Inventory—Decrease (Increase)	1,024.100	(2,096.000)	(288.200)	(164.058)	(115.560)
Other Assets and Liabilities— Net Change	(1,379.100)	1,822.300	258.400	235.632	117.464
Operating Activities—Net Cash Flow	627.600	(342.700)	38.000	149.785	212.576
INVESTING ACTIVITIES					
Short-Term Investments—Change	652.300	(516.600)	(279.200)	174.254	(76.309)
Capital Expenditures	536.800	506.000	425.800	244.375	188.171
Sale of Property, Plant, and Equipment	98.700	88.900	41.300	60.220	0.000
Acquisitions	2,458.700	0.000	124.700	174.885	0.000
Investing Activities—Other	(233.900)	(1,133.000)	(31.000)	(14.394)	16.637
Investing Activities—Net Cash Flow	(2,478.400)	(2,066.700)	(819.400)	(199.180)	(247.843)
FINANCING ACTIVITIES					
Sale of Common and Preferred Stock	1,479.100	133.100	1,125.400	50.328	38.078
Cash Dividends	0.000	1.400	0.000	0.000	0.000
Long-Term Debt—Issuance	1,540.700	2,296.300	732.100	0.000	0.000
Long-Term Debt—Reduction	18.300	0.800	1.200	1.205	3.079
Current Debt—Changes	(52.300)	16.900	21.400	0.000	0.000
Financing Activities—Other	20.600	29.900	(0.500)	(2.184)	0.000
Financing Activities—Net Cash Flow	20.600	29.900	(0.500)	46.939	34.999
Exchange Rate Effect	(112.100)	(6.500)	4.600	2.611	(3.489)
Cash and Equivalents—Change	1,006.900	58.100	1,100.400	0.155	(3.757)
DIRECT OPERATING ACTIVITIES					
Interest Paid—Net	11.000	17.600	26.400	24.999	38.306
Income Taxes Paid	151.400	135.700	9.500	75.817	93.420

COMPUTATIONAL EXERCISES

The Arithmetic of Growth Valuations

Using a simple framework we call “the arithmetic of growth valuations,” we explore the consequences for the owner’s wealth of changes in expectations regarding the corporation’s earnings growth. We provide four numerical examples to illustrate this point. The reader will be well served by coming back to these simple examples and work through the consequences of the strategies and schemes presented throughout the book.

Case 1

A corporation is currently reporting annual net earnings of \$30.0 million. Assume that five years from now, when its growth has leveled off somewhat, the corporation will be valued at 15 times earnings.

Further assume that the company will pay no dividends over the next five years and that investors in growth stocks currently seek returns of 25% (before considering capital gains taxes). Suppose the corporation’s earnings have been growing at a 15% annual rate and appear likely to continue increasing at the same rate over the next five years.

At the end of that period, earnings (rounded) will be \$_____ million annually. Applying a multiple of 15 times to that figure produces a valuation at the end of the fifth year of \$_____ million. Investors seeking a 25% rate of return will pay \$_____ million today for that future value.

Say the founder still owns 20% of the shares outstanding, which means she is worth \$_____ million. Suppose investors conclude for some reason that the corporation’s potential for increasing its earnings has changed from 15% to 25% per annum.

The value of corporation’s shares will change from \$_____ million to \$_____ million, keeping previous assumptions intact. Now the founder’s shares are worth \$_____ million, a difference of \$_____.

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Case 2

A corporation is currently reporting annual net earnings of \$20.0 million. Assume that five years from now, when its growth has leveled off somewhat, the corporation will be valued at 20 times earnings.

Further assume that the company will pay no dividends over the next five years and that investors in growth stocks currently seek returns of 22% (before considering capital gains taxes). Suppose the corporation's earnings have been growing at a 20% annual rate and appear likely to continue increasing at the same rate over the next five years.

At the end of that period, earnings (rounded) will be \$_____ million annually. Applying a multiple of 20 times to that figure produces a valuation at the end of the fifth year of \$_____ million. Investors seeking a 22% rate of return will pay \$_____ million today for that future value.

Say the founder still owns 40% of the shares outstanding, which means she is worth \$_____ million. Suppose investors conclude for some reason that the corporation's potential for increasing its earnings has changed from 20% to 18% per annum.

The value of corporation's shares will change from \$_____ million to \$_____ million, keeping previous assumptions intact. Now the founder's shares are worth \$_____ million, a difference of \$_____.

Case 3

A corporation is currently reporting annual net earnings of \$20.0 million. Assume that five years from now, when its growth has leveled off somewhat, the corporation will be valued at 12 times earnings.

Further assume that the company will pay no dividends over the next five years and that investors in growth stocks currently seek returns of 25% (before considering capital gains taxes). Suppose the corporation's earnings have been growing at a 10% annual rate and appear likely to continue increasing at the same rate over the next five years.

At the end of that period, earnings (rounded) will be \$_____ million annually. Applying a multiple of 12 times

to that figure produces a valuation at the end of the fifth year of \$_____ million. Investors seeking a 25% rate of return will pay \$_____ million today for that future value.

Say the founder still owns 20% of the shares outstanding, which means she is worth \$_____ million. Suppose investors conclude for some reason that the corporation's potential for increasing its earnings has changed from 10% to 20% per annum.

The value of corporation's shares will change from \$_____ million to \$_____ million, keeping previous assumptions intact. Now the founder's shares are worth \$_____ million, a difference of \$_____.

Case 4

A corporation is currently reporting annual net earnings of \$20.0 million. Assume that five years from now, when its growth has leveled off somewhat, the corporation will be valued at 20 times earnings.

Further assume that the company will pay no dividends over the next five years and that investors in growth stocks currently seek returns of 22% (before considering capital gains taxes). Suppose the corporation's earnings have been growing at a 12% annual rate and appear likely to continue increasing at the same rate over the next five years.

At the end of that period, earnings (rounded) will be \$_____ million annually. Applying a multiple of 20 times to that figure produces a valuation at the end of the fifth year of \$_____ million. Investors seeking a 22% rate of return will pay \$_____ million today for that future value.

Say the founder still owns 40% of the shares outstanding, which means she is worth \$_____ million. Suppose investors conclude for some reason that the corporation's potential for increasing its earnings has changed from 12% to 18% per annum.

The value of corporation's shares will change from \$_____ million to \$_____ million, keeping previous assumptions intact. Now the founder's shares are worth \$_____ million, a difference of \$_____.

QUESTIONS

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Market Value versus Book Value of Bonds

This is an example of how a liability can be an asset. Long-term bonds, that are carried in the books at face value in the liability side of the balance sheet, are in fact an asset when their market value is above their face value; on the other hand, when the market value of a bond is below its book value, the bonds represent a larger liability than accounted for in the balance sheet.

Case 1

A firm shows in its books bonds with a face value of \$20,000,000. The bonds were issued at par, with a semiannual coupon rate of 12.125%, and now have eight years to maturity. However, the bonds are now priced to yield 15.730%. The market value of this long-term obligation is \$_____ and the difference between the market value and the book value of the bond is \$_____.

Case 2

A firm shows in its books bonds with a face value of \$50,000,000. The bonds were issued at par, with a semi-annual coupon rate of 14.125%, and now have eight years to maturity. However, the bonds are now priced to yield 10.500%. The market value of this long-term obligation is \$_____ and the difference between the market value and the book value of the bond is \$_____.

Case 3

A firm shows in its books bonds with a face value of \$35,000,000. The bonds were issued at par, with a semi-annual coupon rate of 6.000%, and now have eight years to maturity. However, the bonds are now priced to yield 10.000%. The market value of this long-term obligation is \$_____ and the difference between the market value and the book value of the bond is \$_____.

Acquisitions Driven by P/E Multiples

Management can boost sales through techniques that more properly fall into the category of corporate finance. Increasing the rate of revenue increases through mergers and acquisitions is the most common example. A corporation can easily accelerate its sales growth by buying other companies and adding their sales to its own. Creating genuine value for shareholders through acquisitions is more difficult, although unwary investors sometimes fail to recognize the distinction.

In the following fictitious examples, Big Time Corp. is set to acquire Small Change, a smaller, privately owned company in the same industry. What will be the impact of a stock-for-stock transaction on the price-per-share of Big Corp?

Case 1

Big Time Corp.'s sales increase by 10.0% between Year 1 and Year 2. Small Change, a smaller, privately owned company in the same industry, also achieves 10.0% year-over-year sales growth. Suppose now that at the end of Year 1, Big Time acquires Small Change with shares of its own stock. The Big Time income statements under this assumption ("Acquisition Scenario") show a _____ sales increase between Year 1 and Year 2.

On the face of it, a company growing at _____ a year is sexier than one growing at only 10.0% a year. Observe, however, that Big Time's profitability, measured by net income as a percentage of sales, does not improve as a result of the acquisition. Combining two companies with equivalent profit margins of _____ produces a larger company that earns _____ on sales.

If Big Time decides not to acquire Small Change, its number of shares outstanding remains at 125.0 million. The earnings increase from \$_____ million in Year 1 to \$_____ million in Year 2 raises earnings-per-share from \$_____ to \$_____. With the price-earnings multiple at _____ times, equivalent to the average of the company's industry peers, Big Time's stock price rises from \$_____ to \$_____ a share.

In the Acquisition Scenario, on the other hand, Big Time pays its industry-average earnings multiple of 12 times for Small Change, for

Acquisitions Driven by P/E Multiples Big Time Corp. and Small Change Inc						
Debt	\$ 1,000	32.0				
Equity	\$ 1,000	25.0				
Big Time Annual Coupon Rate for Debt	10%					
Small Change Annual Coupon Rate for Debt	15%					
(\$000,000) Omitted						
	Non-Acquisition Scenario				Acquisition Scenario	
	Big Time Corp		Small Change Inc.		Big Time Corp	
	Year 1	Year 2	Year 1	Year 2	Year 1	Year 2
Sales	\$5,000.0		\$238.1		\$5,000.0	
Cost and Expenses						
Cost of Goods Sold	3,422.7		160.6		\$3,422.7	
Selling, General, and Administrative Expenses	1,250.0		61.9		\$1,250.0	
Interest Expense	100.0		4.8		\$100.0	
Total Costs and Expenses	4,772.7		227.3		\$4,772.7	
Income before Income Tax Expenses	227.3		10.8		\$227.3	
Income Taxes	77.3		3.7		77.3	
Net Income	\$ 150.0		\$ 7.1		\$150.0	
Year-over-Year Sales Increase						
Net Income as a Percentage of Sales	3.0%		3.0%		3.0%	
Shares Outstanding (million)	125.0				125.0	
Earnings per Share						
Price-Earnings Multiple (times)						
Price per Share						
Year-over-Year Increase						
Market Capitalization						
Year-over-Year Increase						
Debt/Equity Ratio						
Acquisition Price						
Number of Shares						
			taxrate	34%		
			growth_rate	10%		
			industry_pe_mult	12		

a total acquisition price of million. At Big Time's Year 1 share price of \$_____, the purchase therefore requires the issuance of million shares.

With the addition of Small Change's net income, Big Time earns \$_____ million in Year 2. Dividing that figure by the increased number of shares outstanding (_____ million) produces earnings per share of \$_____. At a price-earnings multiple of 12 times, Big Time is worth \$_____ a share, precisely the price calculated in the Non-Acquisition Scenario.

The mere increase in annual sales growth from _____% to _____% has not benefited shareholders, whose shares increase in value by _____% whether Big Time acquires Small Change or not.

Case 2

Big Time Corp.'s sales increase by 8.0% between Year 1 and Year 2. Small Change, a smaller, privately owned company in the same industry, also achieves 8.0% year-over-year sales growth. Suppose now that at the end of Year 1, Big Time acquires Small Change with shares of its own stock. The Big Time income statements under this assumption ("Acquisition Scenario") show a _____% sales increase between Year 1 and Year 2.

On the face of it, a company growing at _____% a year is sexier than one growing at only 8.0% a year. Observe, however, that Big Time's profitability, measured by net income as a percentage of sales, does not improve as a result of the acquisition. Combining two companies with equivalent profit margins of _____% produces a larger company that also earns _____% on sales. Shareholders do not gain anything in the process, as the figures below demonstrate.

If Big Time decides not to acquire Small Change, its number of shares outstanding remains at 125.0 million. The earnings increase from \$_____ million in Year 1 to \$_____ million in Year 2 raises earnings-per-share from \$_____ to \$_____. With the price-earnings multiple at 16 times, equivalent to the average of the company's industry peers, Big Time's stock price rises from \$_____ to \$_____ a share.

Acquisitions Driven by P/E Multiples Big Time Corp. and Small Change Inc						
Debt	\$ 1,000	32.0				\$ 1,000
Equity	\$ 1,000	25.0				\$ 1,000
Big Time Annual Coupon Rate for Debt	10%					
Small Change Annual Coupon Rate for Debt	15%					
(\$000,000) Omitted						
Non-Acquisition Scenario						
		Big Time Corp		Small Change Inc.		Acquisition Scenario
		Year 1	Year 2	Year 1	Year 2	
Sales		\$ 5,000.0		\$ 238.1		\$ 5,000.0
Cost and Expenses						
Cost of Goods Sold		3,422.7		160.6		\$ 3,422.7
Selling, General, and Administrative Expenses		1,250.0		61.9		\$ 1,250.0
Interest Expense		100.0		4.8		\$ 100.0
Total Costs and Expenses		4,772.7		227.3		\$ 4,772.7
Income before Income Tax Expenses		227.3		10.8		\$ 227.3
Income Taxes		77.3		3.7		77.3
Net Income		\$ 150.0		\$ 7.1		\$ 150.0
Year-over-Year Sales Increase						
Net Income as a Percentage of Sales		3.0%		3.0%		3.0%
Shares Outstanding (million)		125.0				125.0
Earnings per Share						
Price-Earnings Multiple (times)						
Price per Share						
Year-over-Year Increase						
Market Capitalization						
Year-over-Year Increase						
Debt/Equity Ratio						
Acquisition Price						
Number of Shares						
	taxrate	34%				
	growth_rate	8%				
	industry_PE_mult	16				

In the Acquisition Scenario, on the other hand, Big Time pays its industry-average earnings multiple of 16 times for Small Change, for a total acquisition price of \$_____ million. At Big Time's Year 1 share price of \$_____, the purchase therefore requires the issuance of \$_____ million shares. With the addition of Small Change's net income, Big Time earns \$_____ million in Year 2. Dividing that figure by the increased number of shares outstanding (_____ million) produces earnings per share of \$_____. At a price-earnings multiple of 16 times, Big Time is worth \$_____ a share, precisely the price calculated in the Non-Acquisition Scenario.

The mere increase in annual sales growth from 8.0% to _____% has not benefited shareholders, whose shares increase in value by _____% whether Big Time acquires Small Change or not.

Case 3

Big Time Corp.'s sales increase by 16.0% between Year 1 and Year 2. Small Change, a smaller, privately owned company in the same industry, also achieves 16.0% year-over-year sales growth. Suppose now that at the end of Year 1, Big Time acquires Small Change with shares of its own stock. The Big Time income statements under this assumption ("Acquisition Scenario") show a _____% sales increase between Year 1 and Year 2.

On the face of it, a company growing at _____% a year is sexier than one growing at only 16.0% a year. Observe, however, that Big Time's profitability, measured by net income as a percentage of sales, does not improve as a result of the acquisition. Combining two companies with equivalent profit margins of _____% produces a larger company that also earns _____% on sales. Shareholders do not gain anything in the process, as the figures below demonstrate.

If Big Time decides not to acquire Small Change, its number of shares outstanding remains at 125.0 million. The earnings increase from \$_____ million in Year 1 to \$_____ million in Year 2 raises earnings-per-share from \$_____ to \$_____. With the price-earnings multiple at 24 times,

Acquisitions Driven by P/E Multiples Big Time Corp. and Small Change Inc						
Debt	\$ 1,000	32.0				\$ 1,000
Equity	\$ 1,000	25.0				\$ 1,000
Big Time Annual Coupon Rate for Debt	10%					
Small Change Annual Coupon Rate for Debt	15%					
(\$000,000) Omitted						
Non-Acquisition Scenario						
		Big Time Corp		Small Change Inc.		Big Time Corp
		Year 1	Year 2	Year 1	Year 2	Year 1
Sales		\$ 5,000.0		\$ 238.1		\$ 5,000.0
Cost and Expenses						
Cost of Goods Sold		3,422.7		160.6		\$ 3,422.7
Selling, General, and Administrative Expenses		1,250.0		61.9		\$ 1,250.0
Interest Expense		100.0		4.8		\$ 100.0
Total Costs and Expenses		4,772.7		227.3		\$ 4,772.7
Income before Income Tax Expenses		227.3		10.8		\$ 227.3
Income Taxes		77.3		3.7		77.3
Net Income		\$ 150.0		\$ 7.1		\$ 150.0
Year-over-Year Sales Increase						
Net Income as a Percentage of Sales		3.0%		3.0%		3.0%
Shares Outstanding (million)		125.0				125.0
Earnings per Share						
Price-Earnings Multiple (times)						
Price per Share						
Year-over-Year Increase						
Market Capitalization						
Year-over-Year Increase						
Debt/Equity Ratio						
Acquisition Price						
Number of Shares						
	taxrate					34%
	growth_rate					16%
	industry_PE_mult					24

equivalent to the average of the company's industry peers, Big Time's stock price rises from \$_____ to \$_____ a share.

In the Acquisition Scenario, on the other hand, Big Time pays its industry-average earnings multiple of 24 times for Small Change, for a total acquisition price of _____ million. At Big Time's Year 1 share price of \$_____, the purchase therefore requires the issuance of _____ million shares. With the addition of Small Change's net income, Big Time earns \$_____ million in Year 2. Dividing that figure by the increased number of shares outstanding (_____ million) produces earnings per share of \$_____. At a price-earnings multiple of 24 times, Big Time is worth \$_____ a share, precisely the price calculated in the Non-Acquisition Scenario.

The mere increase in annual sales growth from 16.0% to _____% has not benefited shareholders, whose shares increase in value by _____% whether Big Time acquires Small Change or not.

Stock Prices and Goodwill

Including goodwill in the calculations of the ratio of Total Assets to Total Liabilities can distort the economic reality of the consequences of acquisitions.

Case 1

The shares of Amalgamator and Consolidator are both trading at multiples of 2.5 times book value per share. Shareholders' equity is \$200 million at Amalgamator and \$60 million at Consolidator. Amalgamator uses stock held in its treasury to acquire Consolidator for \$_____ million.

The purchase price represents a premium of 75% above the prevailing market price. Prior to the acquisition, Amalgamator's ratio of total assets to total liabilities is _____ times, while the comparable figure for Consolidator is _____ times.

The total-assets-to-total-liabilities ratio after the deal is _____ times. By paying a premium to Consolidator's tangible asset value, Amalgamator creates \$_____ million of goodwill.

	United Amalgamators Corporation	United Consolidators Inc.	Purchase Price	Combined Companies Pro Forma
Case 1				
Tangible Assets	1000	400		1400
Intangible Assets (Goodwill)	0	0		
Total Assets	1000	400		1603
Liabilities	800	340	Premium	1140
Stockholder Equity (SE)	200	60		75%
Total Liabilities and Shareholders' Equity	1000	400	Multiple	1603
				2.5
Total Assets/Total Liabilities				
Tangible Assets/Total Liabilities				
Market Capitalization				
Case 2				
Tangible Assets	1000	400		1400
Intangible Assets (Goodwill)	0	0		
Total Assets	1000	400		1813
Liabilities	800	340	Premium	1140
Shareholders' Equity (SE)	200	60		
Total Liabilities and SE	1000	400		1813
				75%
Total Assets/Total Liabilities				
Tangible Assets/Total Liabilities				
Market Capitalization				
				Rally Multiple 4.5

*Ignores possible impact of EPS dilution

Case 2

As the scene opens, an explosive stock market rally has driven up both companies' shares to 4.5 times book value. The ratio of total assets to total liabilities, however, remains at _____ times for Amalgamator and _____ times for Consolidator. As in Case 1, Amalgamator pays a premium of 75.% above the prevailing market price to acquire Consolidator.

The premium is calculated on a higher market capitalization, however. Consequently, the purchase price rises from \$_____ million to \$_____ million. Instead of creating \$_____ million of goodwill, the acquisition gives rise to a \$_____ million intangible asset. Somehow, putting together a company boasting a _____ times ratio with another sporting a _____ times ratio has produced an entity with a ratio of _____ times.

Now, let us exclude goodwill in calculating the ratio of assets to liabilities. Amalgamator's ratio of tangible assets to total liabilities following its acquisition of Consolidator is _____ times in both Case 1 and Case 2. This is the outcome that best reflects economic reality.

Case 3

The shares of Amalgamator and Consolidator are both trading at multiples of 1.5 times book value per share. Shareholders' equity is \$400 million at Amalgamator and \$260 million at Consolidator. Amalgamator uses stock held in its treasury to acquire Consolidator for _____ million.

The purchase price represents a premium of 35.00% above the prevailing market price. Prior to the acquisition, Amalgamator's ratio of total assets to total liabilities is _____ times, while the comparable figure for Consolidator is _____ times.

The total-assets-to-total-liabilities ratio after the deal is _____ times. By paying a premium to Consolidator's tangible asset value, Amalgamator creates \$_____ million of goodwill.

Case 4

As the scene opens, an explosive stock market rally has driven up both companies' shares to 3.5 times book value. The ratio of total

	<i>United Amalgamators Corporation</i>	<i>United Consolidators Inc.</i>	<i>Purchase Price</i>	<i>Combined Companies Pro Forma</i>
Case 3				
Tangible Assets	1200	600		1800
Intangible Assets (Goodwill)	0	0		
Total Assets	1200	600		2067
Liabilities	800	340	Premium	1140
Shareholders' Equity (SE)	400	260		
Total Liabilities and SE	1200	600		2067
			Multiple	1.5
Total Assets/Total Liabilities				
Tangible Assets/Total Liabilities				
Market Capitalization				
Case 4				
Tangible Assets	1200	600		1800
Intangible Assets (Goodwill)	0	0		
Total Assets	1200	600		2769
Liabilities	800	340	Premium	1140
Shareholders' Equity (SE)	400	260		
Total Liabilities and SE	1200	600		2769
			Rally Multiple	3.5
Total Assets/Total Liabilities				
Tangible Assets/Total Liabilities				
Market Capitalization				
*Ignores possible impact of EPS dilution				

assets to total liabilities, however, remains at _____ times for Amalgamator and _____ times for Consolidator. As in Case 3, Amalgamator pays a premium of 35.00% above the prevailing market price to acquire Consolidator.

The premium is calculated on a higher market capitalization, however. Consequently, the purchase price rises from \$_____ million to \$_____ million. Instead of creating \$267 million of goodwill, the acquisition gives rise to a \$_____ million intangible asset. Somehow, putting together a company boasting a times ratio with another sporting a _____ times ratio has produced an entity with a ratio of _____ times.

Now, let us exclude goodwill in calculating the ratio of assets to liabilities. Amalgamator's ratio of tangible assets to total liabilities following its acquisition of Consolidator is _____ times in both Case 3 and Case 4. This is the outcome that best reflects economic reality.

Projecting Interest Expense

For the following three examples, calculate the embedded cost of Long-Term Debt.

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Colossal Chemical Corporation							
(\$000,000 omitted)							
Long-Term Debt (Excluding Current Maturities)				2001	2002		
Notes Payable due dates				Rate			
	2003			12.00%	82		44
	2004			7.50%	56		80
Debentures due dates							
	2009			12.50%	55		55
	2011			10.875%	120		120
Industrial Development Bonds							
	2014			5.875%	40		40
					\$353		\$339
(\$000,000 omitted)							
2001 Amount	2002 Amount	÷ 2	=	Average Amount Outstanding	@Rate	=	Estimated Interest Charges on Long-Term Debt
_____	_____	+2	=	_____	_____%	=	\$ _____
_____	_____	2	=	_____	_____%	=	\$ _____
_____	_____	2	=	_____	_____%	=	\$ _____
_____	_____	2	=	_____	_____%	=	\$ _____
_____	_____	2	=	_____	_____%	=	\$ _____
Total				_____			\$ _____
Interest Charges on Long-Term Debt				Average Amount of Total Long-Term Debt Outstanding		Embedded Cost of Long-Term Debt	
\$ _____		÷		\$ _____		= _____%	

Colossal Chemical Corporation							
(\$000,000 omitted)							
Long-Term Debt (Excluding Current Maturities)				2001		2002	
Notes Payable due dates				Rate			
	2003			9.50%	96		65
	2004			9.75%	65		90
Debentures due dates							
	2009			11.875%	50		60
	2011			12.125%	90		90
Industrial Development Bonds							
	2014			5.125%	60		60
					\$361		\$365
(\$000,000 omitted)							
2001 Amount	2002 Amount	÷2	=	Average Amount Outstanding	@Rate	=	Estimated Interest Charges on Long-Term Debt
_____	_____	+2	=	_____	_____%	=	\$ _____
_____	_____	2	=	_____	_____%	=	\$ _____
_____	_____	2	=	_____	_____%	=	\$ _____
_____	_____	2	=	_____	_____%	=	\$ _____
_____	_____	2	=	_____	_____%	=	\$ _____
Total				_____			\$ _____
Interest Charges on Long-Term Debt				Average Amount of Total Long-Term Debt Outstanding		Embedded Cost of Long-Term Debt	
\$ _____		÷		\$ _____	=		_____%

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Colossal Chemical Corporation							
(\$000,000 omitted)							
Long-Term Debt (Excluding Current Maturities)				2001	2002		
Notes Payable due dates				Rate			
	2003			6.600%	55		75
	2004			5.750%	40		60
Debentures due dates							
	2009			10.25%	90		90
	2011			9.125%	75		75
Industrial Development Bonds							
	2014			8.500%	80		80
					\$340		\$380
(\$000,000 omitted)							
2001 Amount	2002 Amount	÷ 2	=	Average Amount Outstanding	@Rate	=	Estimated Interest Charges on Long-Term Debt
_____	_____	+2	=	_____	_____%	=	\$ _____
_____	_____	2	=	_____	_____%	=	\$ _____
_____	_____	2	=	_____	_____%	=	\$ _____
_____	_____	2	=	_____	_____%	=	\$ _____
_____	_____	2	=	_____	_____%	=	\$ _____
Total				_____			\$ _____
Interest Charges on Long-Term Debt				Average Amount of Total Long-Term Debt Outstanding	Embedded Cost of Long-Term Debt		
\$ _____		÷		\$ _____	= _____%		

Sensitivity Analysis in Forecasting Financial Statements

1. Given the base case below, calculate the independent effects of a 1% increase in Gross Margin, a 1% decline in the tax rate, and a 5% increase in Sales.
2. Using the same case, calculate the independent effects of a 2% increase in Gross Margin, a 2% decline in the tax rate, and a 5% decrease in Sales.
3. Using the same case, calculate the composite effects of a 5% increase in Sales, a 2% decline in Gross Margin, a 5% increase in SG&A as percent of Sales, and a 2% decline in the tax rate.

Impact of Changes in Selected Assumptions on Projected Income Statement	
Colossal Chemical Corporation Year Ended December 31, 2002 (\$000,000 omitted)	
	<i>Base Case</i>
Sales	\$2,110
Cost of Goods Sold	1,161
Selling, General, and Administrative Expense	\$528
Depreciation	121
Research and Development	84
Total Costs and Expenses	<u>1,893</u>
Operating Income	\$217
Interest Expense	34
Interest (income)	<u>-5</u>
Earnings before Income Taxes	\$188
Provision for Income Taxes	<u>\$64</u>
Net Income	<u><u>\$124</u></u>
<i>Note:</i> Use this chart when calculating Cases 1 through 3.	

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4. Given the base case below, calculate the independent effects of a 1% increase in Gross Margin, a 1% decline in the tax rate, and a 5% increase in Sales.
5. Using the same case, calculate the composite effects of a 5% increase in Sales, a 2% decline in Gross Margin, a 5% increase in SG&A as percent of Sales, and a 2% decline in the tax rate.

Impact of Changes in Selected Assumptions on Projected Income Statement	
Colossal Chemical Corporation Year Ended December 31, 2002 (\$000,000 omitted)	
	<i>Base Case</i>
Sales	\$2,110
Cost of Goods Sold	1,477
Selling, General, and Administrative Expense	\$253
Depreciation	121
Research and Development	84
Total Costs and Expenses	<u>1,935</u>
Operating Income	\$175
Interest Expense	34
Interest (income)	<u>-5</u>
Earnings before Income Taxes	\$146
Provision for Income Taxes	<u>\$50</u>
Net Income	<u><u>\$96</u></u>
<i>Note:</i> Use this chart when calculating Cases 4 and 5.	

