Unit 4 Discussion Case Question for Brain Mass

Decision case 13-5: Acquisition Decision found on pages 691-692

Directions to students: In the text, read Decision Case 13-5 (found on page 691) Acquisition Decision. This case asks you to evaluate an acquisition decision. Answer parts 1 – 4.

You are expected to develop ratios to support your position. Complete your answers in a Word Document and submit to Unit 4 Decision Case drop box.

**Decision Case 13-5 Acquisition Decision**

Diversified Industries is a large conglomerate that is continually in the market for new acquisitions. The company has grown rapidly over the last 10 years through buyouts of medium-size companies. Diversified does not limit itself to companies in any one industry, but looks for firms with a sound financial base and the ability to stand on their own financially.

The president of Diversified recently told a meeting of the company’s officers: “I want to impress two points on all of you. First, we are not in the business of looking for bargains. Diversified has achieved success in the past by acquiring companies with the ability to be a permanent member of the corporate family. We don’t want companies that may appear to be a bargain on paper but can’t survive in the long run. Second, a new member of our family must be able to come in and make it on its own-the parent is not organized to be a funding agency for struggling subsidiaries.”

Ron Dixon is the vice president of acquisitions for Diversified, a position he has held for five years. He is responsible for making recommendations to the board of directors on potential acquisitions. Because you are one of his assistants, he recently brought you a set of financials for a manufacturer, Heavy Duty Tractors. Dixon believes that Heavy Duty is a “can’t-miss” opportunity for Diversified and asks you to confirm his hunch by performing basic financial statement analysis on the company. The most recent comparative balance sheets and income statement for the company follow.

**Heavy Duty Tractors Inc.**

**Comparative Statements of Financial Position**

**(Thousands omitted)**

December 31, 2008 December 31, 2007

**Assets**

Current assets:

Cash $48,500 $24,980

Marketable securities 3,750 0

Accounts receivable, net of allowance 128,420 84,120

Inventories 135,850 96,780

Prepaid items 7,600 9,300

Total current assets $324,120 $215,180

Long-term investments $55,890 $55,890

Property, plant, and equipment:

Land $45,000 $45,000

Buildings and equipment, less accumulated

Depreciation of $385,000 in 2008 and

$325,000 in 2007 545,000 605,000

Total property, plant, and equipment $590,000 $650,000

Total assets $970,010 $921,070

December 31, 2008 December 31, 2007

**Liabilities and Stockholder’s Equity**

Current Liabilities:

Short-term notes $80,000 $60,000

Accounts payable 65,350 48,760

Salaries and wages payable 14,360 13,840

Income taxes payable 2,590 3,650

Total current liabilities $162,300 $126,250

Long-term bonds payable, due 2015 $275,000 $275,000

Stockholder’s equity:

Common stock, no par $350,000 $350,000

Retained earnings 182,710 169,820

Total stockholders’ equity $532,710 $519,820

Total liabilities and stockholder’s equity $970,010 $921,070

**Heavy Duty Tractors Inc.**

**Statement of Income and Retained Earnings**

**For the Year Ended December 31, 2008**

**(Thousands omitted)**

Sales revenue $875,250

Cost of goods sold 542, 750

Gross profit $332,500

Selling, general, and administrative expenses 264,360

Operating income $68,140

Interest expense 45,000

Net income before taxes and extraordinary items $23,140

Income tax expense 9,250

Income before extraordinary items $13,890

Extraordinary gain, less taxes of $6,000 9,000

Net income $22,890

Retained earnings, January 1, 2008 $169,820

Dividends paid on common stock 10,000

Retained earnings, December 31, 2008 $182,710

**Required**

1. How liquid is Heavy Duty Tractors? Support your answer with any ratios that you believe are necessary to justify your conclusion. Also indicate any other information that you would want to have in making a final determination on its liquidity.
2. In light of the president’s comments, should you be concerned about the solvency of Heavy Duty Tractors? Support your answer with the necessary ratios. How does the maturity date of the outstanding debt affect your answer?
3. Has Heavy Duty demonstrated the ability to be a profitable member of the Diversified family? Support your answer with the necessary ratios.
4. What will you tell your boss? Should he recommend to the board of directors that Diversified put in a bid for Heavy duty Tractors?