







14 Cases in Finance (HW1)

Case 8 Pulper Paper Products Company 125

EXHIBIT 1 | Income Statements for the Fiscal Years Ended April 30, 1993-96 (thousands of dollars except per-share figures)

	1993	1994	1995	1996
Net sales	\$26,331	\$27,219	\$36,897	\$41,308
Cost of goods sold	15,728	16,077	21,937	24,555
Depreciation and amortization	—	310	—	239
	\$10,603	\$10,632	\$14,293	\$16,014
General and admin. expense	5,814	5,087	7,139	7,821
Selling expense	—	3,879	2,603	3,147
Operating expenses	\$ 5,814	\$ 5,085	\$ 9,742	\$10,968
Operating profit	\$ 4,789	\$ 3,667	\$ 4,351	\$ 5,046
Interest expense	—	32	220	379
Other expenses (income)	—	83	239	271
Profit before taxes	\$ 4,789	\$ 3,677	\$ 4,370	\$ 4,786
Income taxes	2,709	1,893	2,719	2,132
Profit after taxes	\$ 2,084	\$ 1,784	\$ 2,154	\$ 2,656
Number of shares (000)	1,000	1,115	1,116	1,118
Earnings per share	\$2.08	\$1.60	\$1.93	\$2.33
Dividends per share	1.00	1.00	1.00	1.00

*Included in cost of goods sold in 1993.
—Included in general and administrative expenses in 1993.

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EXHIBIT 2 | Balance Sheets as of April 30, 1993-96 (thousands of dollars)

	1993	1994	1995	1996
Assets				
Current Assets				
Cash and securities	\$ 1,691	\$ 266	\$ 658	\$ 834
Accounts receivable	4,734	5,542	6,350	7,754
Inventory	7,276	7,743	10,959	14,260
Prepayments and other	233	134	153	563
Total current assets	\$13,934	\$13,745	\$18,120	\$23,511
Property, plant, equip.	—	8,718	11,265	12,468
Less: accumulated deprec.	—	3,384	4,812	5,209
Net prop., plant, equip.	\$ 4,797	\$ 5,334	\$ 6,453	\$ 7,259
Other assets	59	257	386	224
Total assets	\$18,790	\$19,336	\$24,859	\$30,894
Liabilities and Owners' Equity				
Current Liabilities				
Short-term notes	\$ —	\$ —	\$3,118	\$ 7,221
Accounts payable	1,127	1,619	2,158	1,958
Accruals	365	297	703	1,014
Other current liabilities	271	251	418	824
Current portion, long-term debt	615	117	51	32
Total current liabilities	\$ 2,408	\$ 2,384	\$ 6,448	\$11,089
Long-term debt	338	221	507	458
Deferred taxes	538	568	714	756
Other liabilities	136	126	119	151
Total liabilities	\$ 3,400	\$ 3,299	\$ 7,788	\$12,454
Owners' Equity				
Common stock	5,887	5,587	5,587	5,587
Retained earnings	9,793	10,450	11,487	12,978
Total owners' equity	\$15,370	\$16,037	\$17,074	\$18,563
Total liabilities and net worth	\$18,790	\$19,336	\$24,859	\$30,894

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EXHIBIT 3 | Cash Flow and Ratio Analysis, Fiscal Years Ended April 30, 1993-96 (dollar figures in thousands)

Cash Flow	1993	1994	1995	1996
Sources				
Profit after taxes plus deprec. and amort.*	\$ 2,294	\$ 2,821	\$ 3,345	\$ 3,345
Deferred taxes	30	146	42	—
New long-term debt	—	337	—	—
New short-term debt	—	3,118	4,103	—
Accounts payable	482	539	(900)	—
Accruals	2	306	311	—
Other current liabilities	(20)	167	406	—
Other liabilities	(13)	(10)	35	—
Total sources	\$ 2,788	\$ 7,424	\$ 8,042	\$ 8,042
Uses				
Dividends paid in cash	\$ 1,117	\$ 1,117	\$ 1,117	\$ 1,117
Capital expenditure	979	1,575	1,530	—
Repayment of long-term debt	615	117	81	—
Accounts receivable	808	808	1,404	—
Inventory	487	3,216	3,401	—
Prepayments and other current assets	(98)	(41)	410	—
Other assets	196	129	(160)	—
Intangibles*	68	111	115	—
Total uses	\$ 4,213	\$ 7,032	\$ 7,866	\$ 7,866
Change in cash and securities	\$ (1,425)	\$ 392	\$ 176	\$ 176
Working capital	\$11,526	\$11,361	\$11,572	\$12,442
Ratio Analysis				
Profitability				
Sales growth	n.a.	3.4%	35.6%	12.0%
Gross profit margin	40.3%	39.1	38.7	38.8
Operating expenses/sales	29.1	25.6	26.4	26.5
Pre-tax margin	17.9	13.5	11.8	11.5
After-tax margin	7.6	6.5	5.8	6.3
Return on avg. owners' equity	n.a.	11.4	13.0	14.6
Return on total assets	10.7	9.2	8.7	8.4
EBIT/Total assets	25.0	19.2	18.5	16.5
Dividend payout	50.2	62.6	51.9	42.9
Turnover on Sales				
Receivables	5.6x	4.9x	5.8x	5.3x
Inventory	3.6	3.5	3.4	2.9
Accounts payable	23.4	16.8	17.1	21.1
Working capital	2.3	2.4	3.2	3.3
Fixed asset	5.5	5.1	5.8	5.7
Net worth	1.7	1.7	2.2	2.2
Leverage				
Total debt/owners' equity	22.3%	20.6%	45.6%	67.0%
Long-term debt/owners' equity	2.2	1.4	3.9	2.4
Interest coverage	n.a.	115.9x	20.9x	13.5x
Liquidity				
Quick ratio	2.7x	2.4x	1.1x	0.8x
Current ratio	5.8	5.8	2.8	2.1

*Intangibles amortized as purchased.

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EXHIBIT 4 | Summary Figures from Preliminary Projection of Financial Position, Fiscal Years Ending April 30, 1997-2000 (millions of dollars)

	1997	1998	1999	2000
Sources of Funds				
Net sales	\$55.2	\$60.7	\$66.8	\$73.5
Profit after taxes	3.3	3.6	4.2	4.8
Noncash charges	—	—	1.0	1.1
Cash generated from operations	\$ 4.2	\$ 4.5	\$ 5.2	\$ 5.9
Disposition of assets	—	—	—	—
Total sources	\$ 4.4	\$ 4.5	\$ 5.2	\$ 5.9
Uses of Funds				
Dividends	\$ 1.1	\$ 1.1	\$ 1.1	\$ 1.1
Increase in working capital*	2.4	2.4	3.1	3.6
Capital expenditures	—1.0	—1.0	—1.0	—1.0
	\$ 4.5	\$ 4.5	\$ 5.2	\$ 5.7
Effect on Short-Term Debt				
*Including retirement of short-term debt	0.7	0.2	0.8	1.1
Leaving a balance in short-term debt of	\$ 6.5	\$ 6.3	\$ 5.5	\$ 4.4
Assumptions:				
1. 10% sales growth				
2. 6% to 6.5% after-tax margin				
3. Accounts receivable turnover 5.7 (17.5% of sales)				
4. Inventory turnover 3.6 (27.8% of sales)				
5. Accounts payable turnover 21.3 (4.7% of sales)				

Totals may not add because of rounding.

Rockshoff My Library Cases in Finance x About Support

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EXHIBIT 5 | Libri's Letter Outlining Proposed Term-Loan Arrangement

Caston Trust Company
Broad Street Commercial Lending Center
1111 Broad Street
Richmond, Virginia

Francis X. Libri
Vice President and Manager

May 15, 1996

John Rutz
Vice President-Finance
Padgett Paper Products Company
Richmond, Virginia

Dear John:

Thank you for the opportunity last week to review the financial plans you have for Padgett. This letter sets forth our thoughts relating to the need to properly incorporating your bank loan into those plans.

Currently, Padgett has \$6,823,000 outstanding in short-term 90-day notes, and we understand that an additional \$1.0 million to \$1.5 million is likely to be borrowed to support new investments of your new acquisition. This is in contrast with the occurrence of May 1994 when we financed your previous acquisition, and our loan outstanding increased from \$200,000 to \$1,800,000. At that time, an anticipated restructuring of the loan was postponed until a clearer definition of longer term corporate cash need could be ascertained.

In late 1995, we expressed an interest in discussing with you a restructuring of the current loan outstanding so that legitimately long-term funds could be secured on a proper long-term basis. Our subsequent conversations and cash flow study were complicated by the anticipated major acquisition and its impact.

Enclosed is a copy of our most recent Padgett forecast, the results of which we have just reviewed. On balance, our feeling is that the forecast may tend to underestimate the cash requirement in that it assumes moderate sales growth, the stability of traditional margins, and tight control over capital expenditures and dividends. The forecast does seem to indicate a long-term need of at least \$1 million, which opened to properly funded through the bank on anything resembling a 100-day term loan basis.

Given what appears to be the clear nature of the need, it seems appropriate that financing discussions with an insurance company be initiated. This suggestion is rooted in our fee feeling that it is strategically unwise from the standpoint of the company, as well as that of the bank, to fill substantial long-term financial need through the continued use of 90-day notes.

On a confidential basis and without revealing your name, we have talked with three insurance companies within the last week. Discussions included the following generalized parameters for the insurance company lending:

Amount: no problem
Term: 12-15 years
Rate: fixed, 0.5 percent minimum
Payment: level payments based on fee flexibility offered (e.g., three years of grace)
Prepayment: all ward protection designed to discourage it, however, there are provisions for prepayment without penalty if they were to turn you down for a requested increase in the amount and you were able to obtain a commitment from another source
Availability of money: good

Caston would continue to provide for Padgett's seasonal working capital financing on a floating prime-rate basis. Our pricing, based on the structure of the long-term debt outlined, would probably be prime plus 0.5 percent.

We all recognize the fact that interest rates have existed to rise again. Our Economics Department does not feel that long-term interest rates will see reduced levels in the foreseeable future. Financing demands on the capital markets are expected to continue strong, inflationary pressures seem to be rising, the deficits are not yet under control, and any advantage to be gained in avoiding the long-term market is, at best, marginal. It might, in fact, be dangerous.

For any needs consistent with prudent bank lending, Caston Trust stands ready to finance your business. Our desire to assist in every way we can is complete and sincere.

Sincerely,
Francis X. Libri
Vice President

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EXHIBIT 6 | Proposed Financial Statements for Fitch News Ending April 30, 1996-2000 Assuming 5 Percent, 10 Percent, and 15 Percent Sales Growth (Dollar Figures in millions except per-share amounts)

	1996	1997	8% Growth			10% Growth			15% Growth		
	Actual	Est.	1998	1999	2000	1998	1999	2000	1998	1999	2000
Income Statements											
Revenue	\$11.50	\$12.00	\$12.90	\$13.83	\$14.81	\$15.84	\$16.91	\$18.03	\$19.20	\$20.44	\$21.74
Cost of sales	24.00	26.00	27.27	28.66	30.14	31.71	33.39	35.17	37.05	39.04	41.14
General & admin.	7.20	10.25	10.75	11.29	11.87	12.49	13.15	13.84	14.57	15.34	16.14
Selling expenses	3.33	4.81	5.04	5.29	5.56	5.85	6.15	6.47	6.81	7.17	7.54
Interest expense	0.30	0.95	0.90	0.72	0.51	0.81	0.84	0.77	0.77	0.71	0.65
Other (income) expense	(0.07)	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Income (loss)	\$4.23	\$0.93	\$0.95	\$0.86	\$0.71	\$0.51	\$0.73	\$0.52	\$0.59	\$0.80	\$0.35
Income tax expense	2.01	0.47	0.48	0.43	0.36	0.26	0.37	0.26	0.30	0.40	0.18
Net income	\$2.22	\$0.46	\$0.47	\$0.43	\$0.35	\$0.25	\$0.36	\$0.26	\$0.29	\$0.40	\$0.17
EPS (10,000 shares)	\$0.22	\$0.046	\$0.047	\$0.043	\$0.035	\$0.025	\$0.036	\$0.026	\$0.029	\$0.040	\$0.017
Dividends per share	1.00	1.00	1.00	1.19	1.27	1.13	1.31	1.47	1.18	1.43	1.66

*Includes interest calculated on the term debt at 8%.

Notes: Figures may not add due to rounding.

My Library Cases in Finance x

22 Cases in Finance (FIN301)

EXHIBIT 6 | (continued)

	1998		1999		2000		10% Growth		15% Growth			
	Actual	Est.	Actual	Est.	Actual	Est.	1998	1999	2000	1998	1999	2000
Analysed Ratios												
Sales growth	12.0%	38.3%	5.0%	5.0%	5.0%	5.0%	10.0%	10.0%	10.0%	10.0%	15.0%	15.0%
U.S. growth	3.4	3.4	3.2	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0
Operating margins	28.0	28.0	28.0	28.0	28.0	28.0	28.0	28.0	28.0	28.0	28.0	28.0
Operating exp./sales	25.0	25.7	25.7	25.7	25.7	25.7	25.7	25.8	25.8	25.8	25.7	25.8
Altice tax margin	8.3	5.8	6.0	6.3	6.4	6.0	6.3	6.3	6.4	6.3	6.4	6.4
Revenue equity	14.6	17.4	16.5	16.3	15.6	17.1	17.8	17.6	17.9	19.1	18.6	18.6
Revenue on total assets	18.5	18.9	18.9	19.1	19.0	19.0	20.4	20.4	20.4	20.4	21.2	21.2
Return on total assets	18.5	18.9	18.9	19.1	19.0	19.0	20.4	20.4	20.4	20.4	21.2	21.2
Dividend payout	42.9	33.8	33.3	33.3	33.3	33.3	33.3	33.3	33.2	33.2	33.2	33.2
Profitability												
Equity	5.3%	5.7%	5.7%	5.7%	5.7%	5.7%	5.7%	5.7%	5.7%	5.7%	5.7%	5.7%
Inventory	2.9	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5
Working Capital	3.3	3.8	3.5	3.2	3.0	3.5	3.3	3.0	3.4	3.2	3.0	3.0
Net worth	2.2	2.8	2.8	2.4	2.3	2.7	2.8	2.6	2.8	2.8	2.8	2.8
Leverage												
Equity	67.0%	68.3%	57.1%	48.3%	41.3%	42.3%	55.7%	49.3%	49.4%	49.3%	62.7%	62.7%
Debt	33.0%	31.7%	42.9%	51.7%	58.7%	57.7%	44.3%	50.7%	50.6%	50.7%	37.3%	37.3%
Interest coverage	2.4	1.9	1.5	1.1	0.9	1.5	1.1	0.8	1.5	1.1	0.8	0.8
Debt to equity	13.5	7.0	8.7	10.3	12.6	6.0	9.6	11.1	7.5	6.3	6.9	6.9
Capital												
Quick ratio	0.8%	1.0%	1.1%	1.3%	1.0%	1.1%	1.1%	1.2%	1.1%	1.2%	1.4%	1.4%
Current ratio	1.0%	1.1%	1.1%	1.2%	1.1%	1.1%	1.1%	1.1%	1.1%	1.1%	1.1%	1.1%
Working Capital	\$12.4	\$14.89	\$13.40	\$25.96	\$23.35	\$10.29	\$27.46	\$25.23	\$19.40	\$23.86	\$23.35	\$23.35

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more detail on the first case rubric

Here is the grading criteria for the case and items that I look for to see that you met requirements.

Use of Theory and Application (1) - did you use material from your finance courses? Remember, this is a FINANCE CAPSTONE

Analysed Padgett's historical capital raising strategies. - analyze means that you should use financial tools.

Fully explored the ethical issues presented by the case. Fully explore, not just a general paragraph on this, bring in examples from other situations to illustrate your point.

Analysed Padgett's competitive standing in the paper industry - this would suggest that you should actually look at the industry ratios and compare padgett to not only the industry but key competitors and leaders in this industry. Office Max, Office Depot, Staples. What are the trends. We did this in FIN301.

Analysed Padgett's historical financial performance, including sales growth, profitability, asset efficiency, and leverage. Again, this is from FIN301

Assessed the detailed financial forecasts and sensitivity analyses and determined the impact of the various growth forecasts on the firm's ability to service debt. This is taking the items above and building a forecast (from FIN 471)

Developed a restructuring plan for Padgett that would allow it to service the debt. Using tools from 471, 325 and the credit course.

Even though I look for this, you have NO IDEA how many people still don't use APA, page numbers, etc.

The key here is that this is a culmination of your finance skills. This is a BIG project. Don't just think you can sit down and shoot out 3 or 4 pages of text and do OK. These papers are usually 10 - 16 pages in order to fully meet requirements of each of the sections. Graphs and charts to illustrate cash needs and showing trends are key to success! I am looking for application of your finance courses up to this point. The down side or up side for you is that I have designed several of the finance classes and taught ALL of the finance courses here at Baker over the last 14 years so I know what you have been taught over the last few years. :-)

Make your education count and you will do fine.

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