Case 11-2 Amerbran Company (A)[*]

Note: *This case is unchanged from the Eleventh Edition.*

Approach

This case is based on actual financial statements of American Brands, Inc. Although the numbers have been changed from those reported, the magnitudes and relationships have been preserved. This case provides additional practice in preparing a statement of cash flows. Since specific information is not given on cash collections and operating disbursements, it is expected that students will use the indirect approach in developing the cash generated by operations amount. The statements in Exhibit 1 also provide the raw data for the (B) case, which is a ratio analysis case that appears in Chapter 13.

Answer to Question

The required cash flow statement appears below. The explanatory notes to the statement are as follows:

Note 1 This is the net of the following components:

Increase in accounts receivable	$(68,827)
Increase in inventories	(19,510)
Decrease in prepaid expenses	1,027
Increase in accounts payable	33,075
Increase in accrued expenses payable	194,728
	$ 140,493

Note 2. The two components of this acquisition, as given in the case, could be shown separately.

Note 3. The decrease in long-term debt is less than the decrease in long-term liabilities because the latter also includes deferred taxes.

Note 4. Lacking specific information to the contrary, it is assumed that reissuance of treasury stock for bonuses generated no cash. The stock dividend was, in effect, a 2-for-1 stock split. The only difference is that if it were a stock split, the total shown for common stock at par would have remained $161,417 rather than doubling to $322,834.

Note 5. The three major categories of cash flows generated a net of $11,785 of cash. Since the increase to be explained is only $4,960, "miscellaneous activities" must have used $6,825 of cash. Some students may include this line in operating activities, rather than as a fourth category; if they do, the net cash flow from operations becomes $567,303.

AMERBRAN COMPANY
Statement of Cash Flows
For the year ended December 31, 20x1
(in thousands)

Net cash flow from operating activities:	
Net income	$328,773
Noncash items included in income:	
Depreciation and amortization	115,974

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Deferred taxes	(17,548)
Net change in receivables, inventories, and payables (Note 1)	140,493
Write-off of obsolete equipment	66,046
Income from subsidiary	(59,610)
Net cash flow from operating activities	(574,128)
Cash flows from investing activities:	
Acquisitions of property, plant, and equipment	(260,075)
Proceeds from disposals	33,162
Acquisition of Company X (Note 2)	(133,721)
Net cash used by investing activities	(360,634)
Cash flows from financing activities:	
Increase in short-term debt	79,664
Decrease in long-term debt (Note 3)	(34,606)
Dividends paid	(216,158)
Purchase of treasury stock (Note 4)	(30,609)
Net cash used by financing activities	(201,709)
Cash flows from miscellaneous activities (Note 5)	(6,825)
Net increase in cash	4,960
Cash at beginning of year	23,952
Cash at end of year	$ 28,912

*Case 11-3: Great Value Variety Stores**

Note: *A new case for the Twelfth Edition.*

Approach

The premise motivative to case is that traditional ratio analysis and the definition of funds as working capital used in many finance classes may not reveal a company's liquidity crisis as early as would a careful analysis of the firm's cash flows.

This case requires two class sessions. Trying to use it for only one session is likely to result in student confusion and frustration unless the instructor provides handouts before class with all of the ratio analysis and conversion of working capital flow to cash flow calculations done for the students.

My two-day approach involves six steps: (l) Calculate the ratios for just one year, being sure the students understand what each ratio indicates (a few ratios have not yet been formally presented in the text, but students seem to catch on to them quickly). (2) Use a transparency spreadsheet with all of the ratios for all of the years, and discuss trends. (3) Discuss the working capital concepts of funds and how it differs from the cash concept. (4) Do the conversion from working capital to cash for at least one year. (5) Use a transparency to compare net income, working capital, and cash flow generated by operations, as well as financing and investing activities, for the 10-year period. (6) Give a brief "post mortem" along the lines mentioned below. Note the year 2007 is included in these handouts, the instructor may not want to show 2007 letting the students predict what 2007 may look like.

**This teaching note was prepared by James S. Reece.*