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**Question 5: Financial Accounting and Financial Statement Analysis****(22 points)**

Fridgee Inc. was established in the year 1990 with the main objective of establishing commercially viable biotech processes with applications in medicine and the agricultural industry. Over the last decade, the company has been a pioneer in fermentation technology.

The company is going to merge with Stewart Inc. on the last day of 2006 and for this purpose undertook a project to analyze Stewart's last few years financial statements. The balance sheets of Stewart Inc. for the years 2004-2006 are as follows:

**Balance sheet of Stewart Inc. as at 31 December (all figures in '000 CU – Currency Unit)**

	<b>2004</b>	<b>2005</b>	<b>2006</b>
Cash	2,000	2,500	3,000
Accounts receivable	3,500	3,660	3,400
Inventories	3,200	4,200	4,300
Held-to-maturity securities	8,000	8,000	8,000
Property, plant and equipment	15,000	17,500	20,950
Land	4,000	5,000	7,500
<b>Total assets</b>	<b>35,700</b>	<b>40,860</b>	<b>47,150</b>
Current liabilities	2,500	4,000	3,000
Long-term liabilities	4,000	4,000	4,000
Common stock (10 CU par value)	9,000	10,000	10,000
Additional paid-in-capital	9,000	10,000	10,000
Retained earnings	11,200	12,860	20,150
<b>Total liabilities and equity</b>	<b>35,700</b>	<b>40,860</b>	<b>47,150</b>

- a) From the financial statements of Stewart Inc. calculate the current ratio and the quick ratio for the years 2005 and 2006. (4 points)

The acquisition will take place with a single transaction; the exchange of common stock. The shareholders of Stewart Inc. will receive 3 Fridgee shares (10 CU par value) for 2 Stewart shares. Immediately before the merger project was announced, the market price of shares was:

- Fridgee share: 40 CU

- Stewart share: 50 CU.

Below is the balance sheet of Fridgee Inc. as at 31 December 2006 (all figures in '000 CU):

	<b>2006</b>
Cash	8,000
Accounts receivable	7,000
Inventories	4,250
Held-to-maturity securities	2,000
Property, plant and equipment	24,500
Land	8,500
<b>Total assets</b>	<b>54,250</b>
Current liabilities	7,500
Long-term liabilities	7,000
Common stock (10 CU par value)	15,000
Additional paid-in capital	15,000
Retained earnings	9,750
<b>Total liabilities and equity</b>	<b>54,250</b>

As at 31 December 2006, the fair values of assets and liabilities are (all figures in '000 CU):

	<b>Fridgee Inc.</b>	<b>Stewart Inc.</b>
Cash	8,000	3,000
Accounts receivable	7,000	3,400
Inventories	4,600	5,000
Held-to-maturity securities	2,000	10,000
Property, plant and equipment	30,000	30,000
Land	10,000	10,000
<b>Total assets</b>	<b>61,600</b>	<b>61,400</b>
Current liabilities	7,500	3,000
Long-term liabilities	7,000	4,000
<b>Total liabilities</b>	<b>14,500</b>	<b>7,000</b>

- b) Calculate goodwill resulting from the acquisition of Stewart Inc.

(6 points)

- c) Applying the purchase method, prepare the balance sheet of the combined entity below. [Hint: you have to fill the “Combined entity” column, the two empty columns are at your disposal for calculations.] (12 points)

[Add additional items if necessary]			<b>Combined entity</b>
Cash			
Accounts receivable			
Inventories			
Held-to-maturity securities			
Property, plant and equipment			
Land			
<b>Total assets</b>			
Current liabilities			
Long-term liabilities			
Common stock			
Additional paid-in capital			
Retained earnings			
<b>Total liabilities and equity</b>			