UNIVERSITÀ
DEGLI STUDI DI TRIESTE

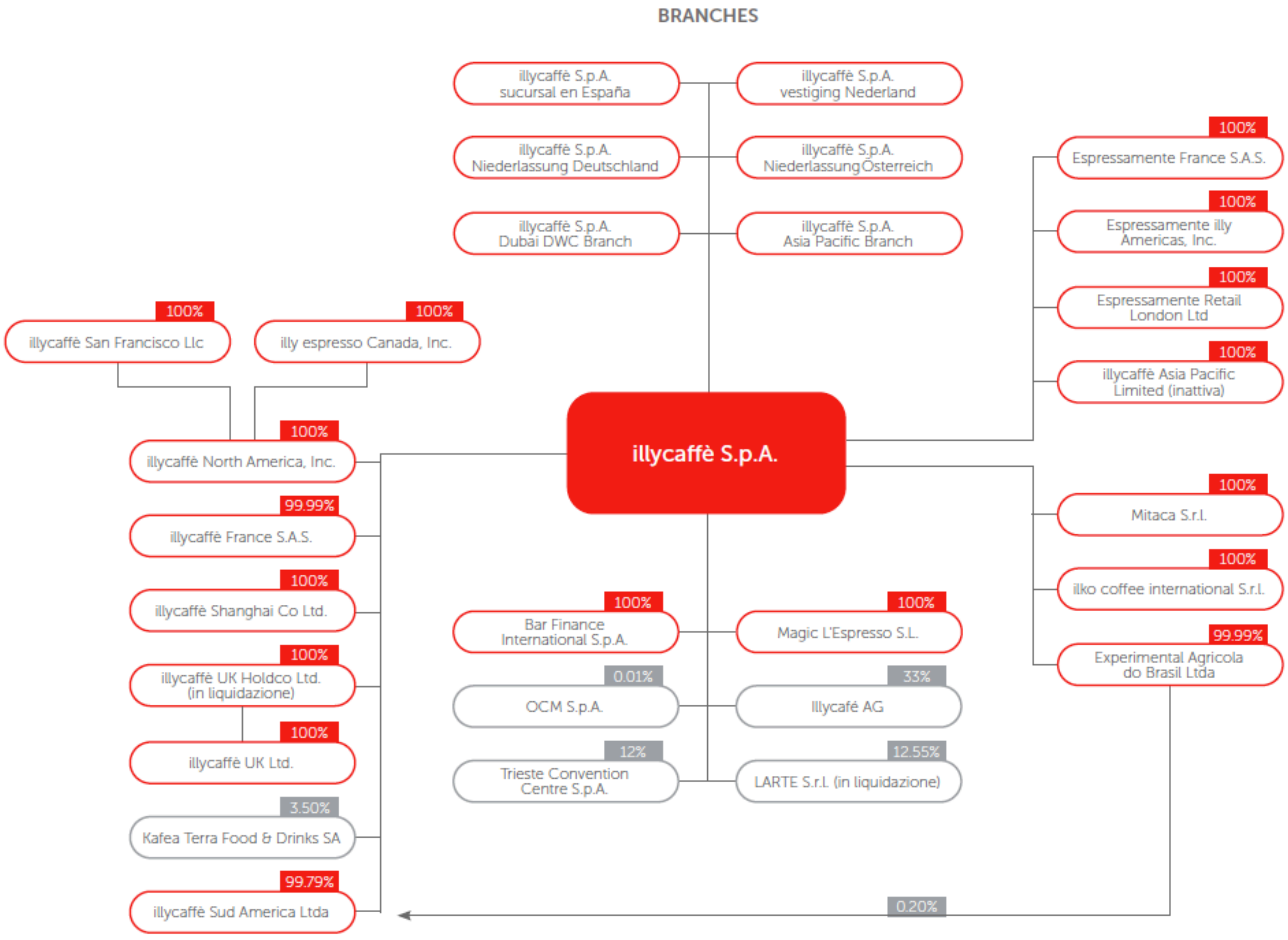
CONSOLIDATED FINANCIAL STATEMENTS

An introduction to the idea of group of companies & business combinations

GROUP OF COMPANIES

Gruppo Illy SpA is the Holding company of the Illy Family. The Illy Group controls the two subsidiaries illycaffè SpA and Polo del Gusto Srl.
The group of companies controlled by illycaffè SpA is structured to provide authentic Italian coffee and the spirit of the traditional Italian coffee shop all over the world.
Polo del Gusto oversees the companies Dammann Frères Sas, Domori SpA, Agrimontana SpA and Fgel Srl under the guiding values of the Family Holding.

GROUP OF COMPANIES

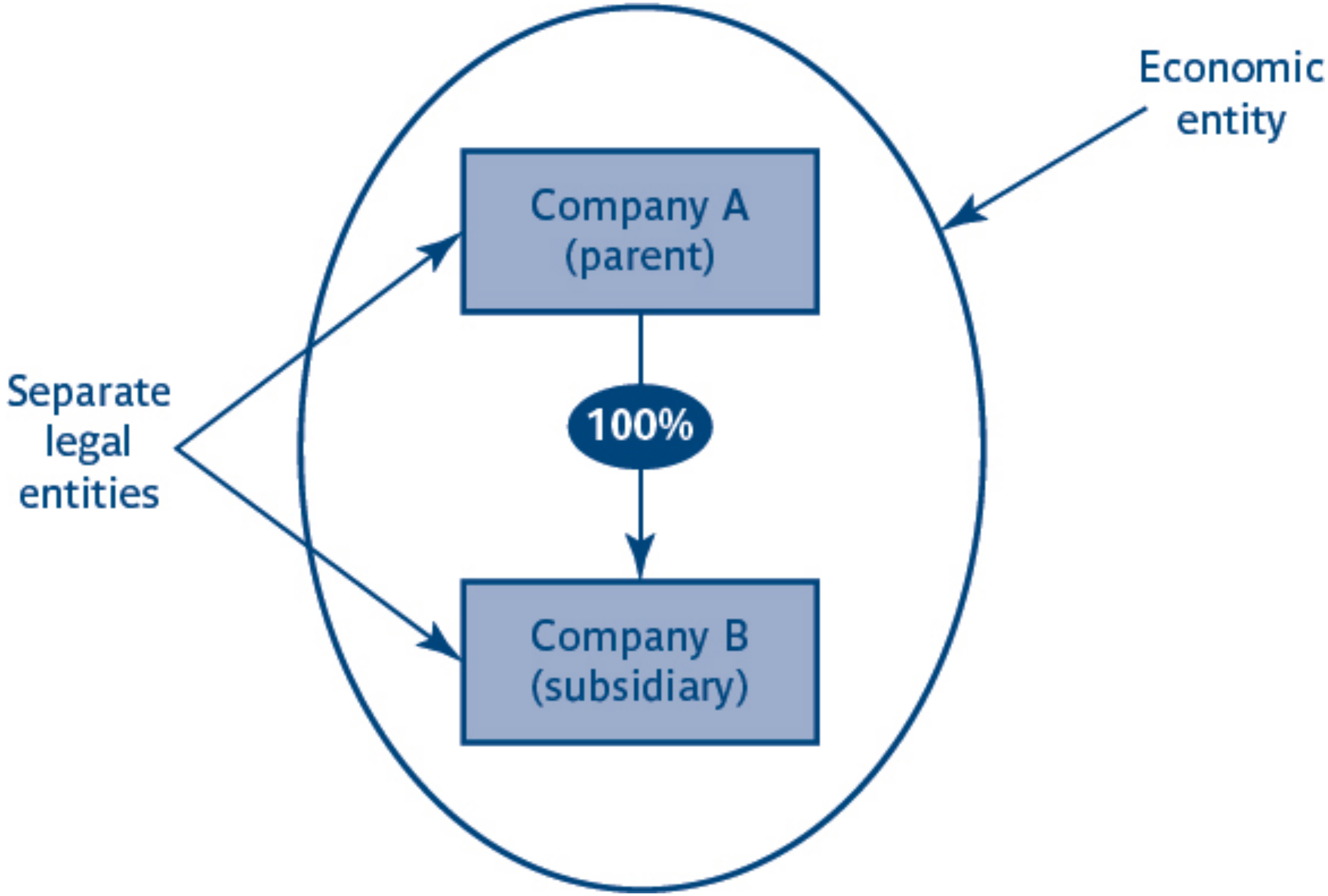


Note: companies included in the full consolidation scope of illycaffè S.p.A. are shown in red except for the following:
- *Bar Finance International spa, which is excluded because it is a financial company;*
- *illycaffè Asia Pacific Limited (HK), since it is inactive.*

KEY TERMS

- **Parent company** or **holding company** ➜ the entity that controls one or more other entities known as subsidiaries.
- **Subsidiary company** ➜ is the company whose shares are owned by the parent company.
- **Group of companies** ➜ an economic entity formed of a set of companies which are either companies controlled by a same company. A group therefore exists when a parent company controls one or more subsidiary companies.
- **Wholly owned subsidiary** ➜ where the parent company owns all the issued equity share capital of a subsidiary.
- **Partially** or **partly owned subsidiary** ➜ when the parent company owns less than 100% of the issued equity share capital of a subsidiary.
- **Non-controlling interest**, also known as a **minority interest** ➜ the ownership position of shareholders that own less than 50% of outstanding shares and therefore have no control over decisions.

AN ECONOMIC ENTITY FORMED OF A SET OF COMPANIES



TWO TYPES OF EXPANSION

Internal Expansion

ORG Company (before the split-off)

Cash	450	Short Term Loans	1.200
Accounts Receivable	2.100	Accounts Payable	3.500
Accruals and Prepaid expenses	400	Accrued Expenses	180
Invertory	3.150	Deferred Revenues	220
Property, Plant & Equipment	12.400	Long-Term Liabilities	6.900
Intellectual Property & Patents	1.500		
		Owners' Equity	**8.000**
Total Investments	*20.000*	*Total Sources*	*20.000*

Assets

EXP Business Unit

Cash	150	Short Term Loans	900
Accounts Receivable	500	Accounts Payable	2.000
Accruals and Prepaid expenses	50	Accrued Expenses	80
Invertory	1.500	Deferred Revenues	120
Property, Plant & Equipment	7.000	Long-Term Liabilities	4.900
Intellectual Property & Patents	800		
		Owners' Equity	**2.000**
Total Investments	*10.000*	*Total Sources*	*10.000*

Shares

New entities are created

External Expansion

Shares

ACQ Company

Cash	4.000	Short Term Loans	600
Accounts Receivable	1.800	Accounts Payable	2.100
Accruals and Prepaid expenses	400	Accrued Expenses	350
Invertory	1.200	Deferred Revenues	150
Property, Plant & Equipment	5.800	Long-Term Liabilities	7.300
Intellectual Property & Patents	2.300		
		Owners' Equity	**5.000**
Total Investments	*15.500*	*Total Sources*	*15.500*

PRC Company

Cash	300	Short Term Loans	700
Accounts Receivable	550	Accounts Payable	560
Accruals and Prepaid expenses	100	Accrued Expenses	80
Invertory	550	Deferred Revenues	120
Property, Plant & Equipment	2.900	Long-Term Liabilities	1.540
Intellectual Property & Patents	600		
		Owners' Equity	**2.000**
Total Investments	*5.000*	*Total Sources*	*5.000*

90 @ 20 $/#

10 @ 20 $/#

Assets

Obtaining control of one or more businesses

INTERNAL EXPANSION: CREATING A BUSINESS ENTITY

→ **New entities are created**

- Subsidiaries
- Partnerships
- Joint ventures
- Special entities

→ **Motivating factors:**

- Helps establish clear lines of control and facilitate the evaluation of operating results
- Special tax incentives
- Regulatory reasons
- Protection from legal liability
- Disposing of a portion of existing operations

INTERNAL EXPANSION: CREATING A BUSINESS ENTITY

→ **A spin-off**

Occurs when the ownership of a newly created or existing subsidiary is distributed to the parent's stockholders without the stockholders surrendering any of their stock in the parent company

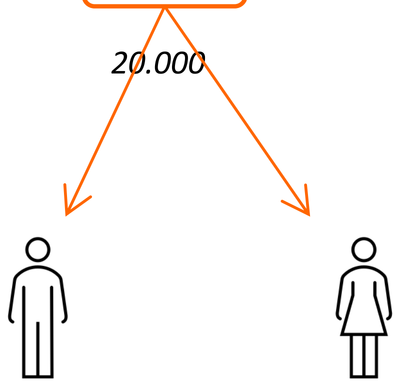
→ **A split-off**

Occurs when the subsidiary's shares are exchanged for shares of the parent, thereby leading to a reduction in the outstanding shares of the parent company

SPIN-OFF

ORG Company (before the spin-off)

Cash	450	Short Term Loans	1.200
Accounts Receivable	2.100	Accounts Payable	3.500
Accruals and Prepaid expenses	400	Accrued Expenses	180
Invertory	3.150	Deferred Revenues	220
Property, Plant & Equipment	12.400	Long-Term Liabilities	6.900
Intellectual Property & Patents	1.500		
		Owners' Equity	**8.000**
Total Investments	*20.000*	*Total Sources*	*20.000*



37.50% **62.50%**

300 @ 10 $/# # 500 @ 10 $/#

SPIN-OFF

ORG Company (before the spin-off)

Cash	450	Short Term Loans	1.200
Accounts Receivable	2.100	Accounts Payable	3.500
Accruals and Prepaid expenses	400	Accrued Expenses	180
Invertory	3.150	Deferred Revenues	220
Property, Plant & Equipment	12.400	Long-Term Liabilities	6.900
Intellectual Property & Patents	1.500		
		Owners' Equity	**8.000**
Total Investments	*20.000*	*Total Sources*	*20.000*

EXP Business Unit

Cash	150	Short Term Loans	900
Accounts Receivable	500	Accounts Payable	2.000
Accruals and Prepaid expenses	50	Accrued Expenses	80
Invertory	1.500	Deferred Revenues	120
Property, Plant & Equipment	7.000	Long-Term Liabilities	4.900
Intellectual Property & Patents	800		
		Owners' Equity	**2.000**
Total Investments	*10.000*	*Total Sources*	*10.000*

SPIN-OFF

ORG Company (after the spin-off)

Cash	300	Short Term Loans	300
Accounts Receivable	1.600	Accounts Payable	1.500
Accruals and Prepaid expenses	350	Accrued Expenses	100
Invertory	1.650	Deferred Revenues	100
Property, Plant & Equipment	5.400	Long-Term Liabilities	2.000
Intellectual Property & Patents	700		
		Owners' Equity	**6.000**
Total Investments	*10.000*	*Total Sources*	*10.000*

37.50%

300 @ 7.5 $/#

62.50%

500 @ 7.5 $/#

EXP Business Unit

Cash	150	Short Term Loans	900
Accounts Receivable	500	Accounts Payable	2.000
Accruals and Prepaid expenses	50	Accrued Expenses	80
Invertory	1.500	Deferred Revenues	120
Property, Plant & Equipment	7.000	Long-Term Liabilities	4.900
Intellectual Property & Patents	800		
		Owners' Equity	**2.000**
Total Investments	*10.000*	*Total Sources*	*10.000*

37.50%

600 @ 1.25 $/#

62.50%

1,000 @ 1.25 $/#

SPLIT-OFF

ORG Company (before the split-off)

Cash	450	Short Term Loans	1.200
Accounts Receivable	2.100	Accounts Payable	3.500
Accruals and Prepaid expenses	400	Accrued Expenses	180
Invertory	3.150	Deferred Revenues	220
Property, Plant & Equipment	12.400	Long-Term Liabilities	6.900
Intellectual Property & Patents	1.500		
		Owners' Equity	**8.000**
Total Investments	*20.000*	*Total Sources*	*20.000*

37.50% **62.50%**

300 @ 10 $/# # 500 @ 10 $/#

SPLIT-OFF

ORG Company (before the split-off)

Cash	450	Short Term Loans	1.200
Accounts Receivable	2.100	Accounts Payable	3.500
Accruals and Prepaid expenses	400	Accrued Expenses	180
Invertory	3.150	Deferred Revenues	220
Property, Plant & Equipment	12.400	Long-Term Liabilities	6.900
Intellectual Property & Patents	1.500		
		Owners' Equity	**8.000**
Total Investments	*20.000*	*Total Sources*	*20.000*

EXP Business Unit

Cash	150	Short Term Loans	900
Accounts Receivable	500	Accounts Payable	2.000
Accruals and Prepaid expenses	50	Accrued Expenses	80
Invertory	1.500	Deferred Revenues	120
Property, Plant & Equipment	7.000	Long-Term Liabilities	4.900
Intellectual Property & Patents	800		
		Owners' Equity	**2.000**
Total Investments	*10.000*	*Total Sources*	*10.000*

SPLIT-OFF

ORG Company (intermediate step)

Cash	300	Short Term Loans	300
Accounts Receivable	1.600	Accounts Payable	1.500
Accruals and Prepaid expenses	350	Accrued Expenses	100
Invertory	1.650	Deferred Revenues	100
Property, Plant & Equipment	5.400	Long-Term Liabilities	2.000
Intellectual Property & Patents	700		
Investment in EXP	**2.000**	**Owners' Equity**	**8.000**
Total Investments	*12.000*	*Total Sources*	*12.000*

1,600 @ 1.25 $/#

37.50%

300 @ 10 $/#

62.50%

500 @ 10 $/#

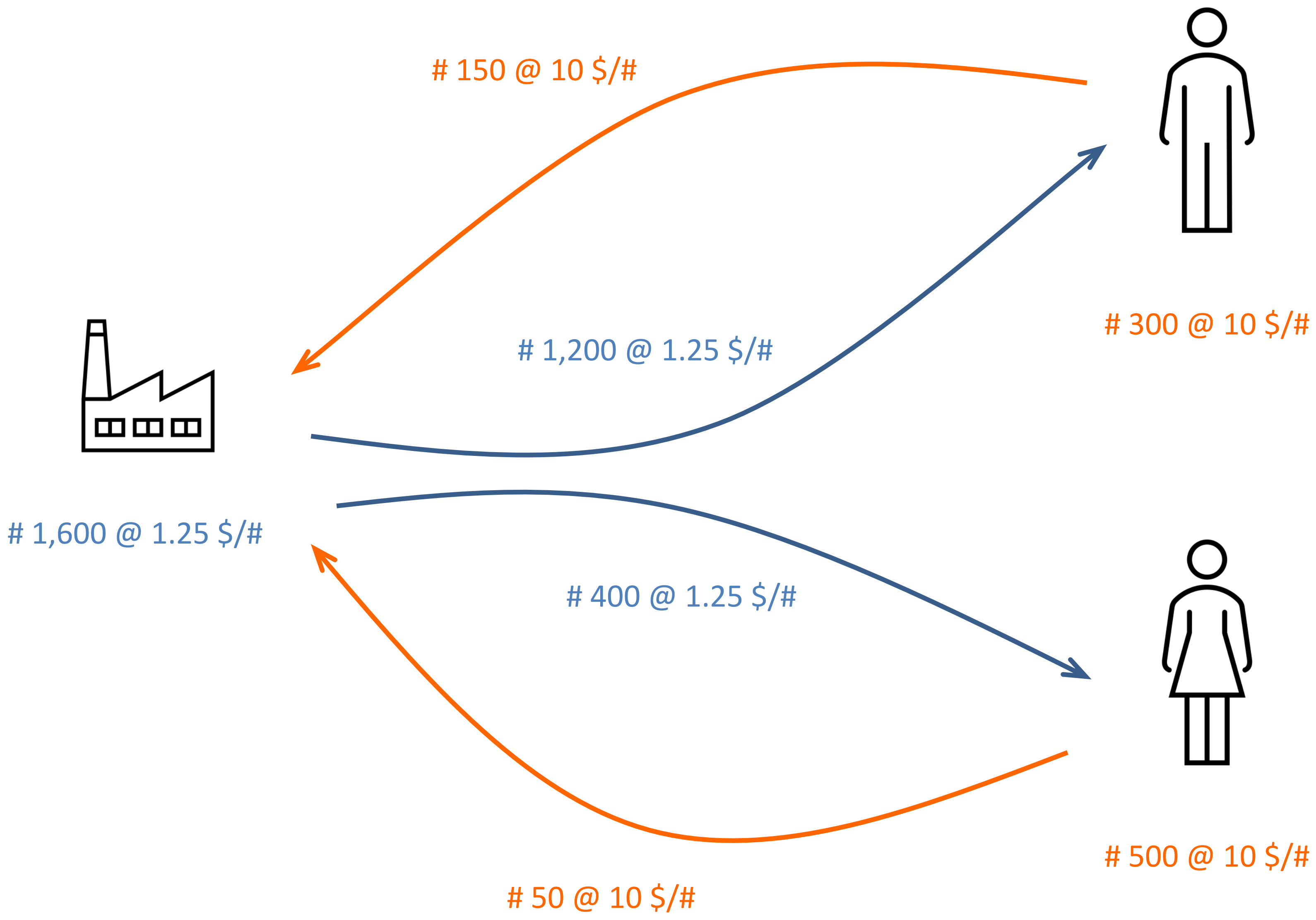
EXP Business Unit

Cash	150	Short Term Loans	900
Accounts Receivable	500	Accounts Payable	2.000
Accruals and Prepaid expenses	50	Accrued Expenses	80
Invertory	1.500	Deferred Revenues	120
Property, Plant & Equipment	7.000	Long-Term Liabilities	4.900
Intellectual Property & Patents	800		
		Owners' Equity	**2.000**
Total Investments	*10.000*	*Total Sources*	*10.000*

100.00%

1,600 @ 1.25 $/#

SPLIT-OFF



SPLIT-OFF

ORG Company (after the split-off)

Cash	300	Short Term Loans	300
Accounts Receivable	1.600	Accounts Payable	1.500
Accruals and Prepaid expenses	350	Accrued Expenses	100
Invertory	1.650	Deferred Revenues	100
Property, Plant & Equipment	5.400	Long-Term Liabilities	2.000
Intellectual Property & Patents	700		
		Owners' Equity	**6.000**
Total Investments	*10.000*	*Total Sources*	*10.000*

25.00%

150 @ 10 $/#

75.00%

450 @ 10 $/#

EXP Business Unit

Cash	150	Short Term Loans	900
Accounts Receivable	500	Accounts Payable	2.000
Accruals and Prepaid expenses	50	Accrued Expenses	80
Invertory	1.500	Deferred Revenues	120
Property, Plant & Equipment	7.000	Long-Term Liabilities	4.900
Intellectual Property & Patents	800		
		Owners' Equity	**2.000**
Total Investments	*10.000*	*Total Sources*	*10.000*

75.00%

1,200 @ 1.25 $/#

25.00%

400 @ 1.25 $/#

ACCOUNTING FOR INTERNAL EXPANSION

- The transferring company creates a subsidiary that it owns and controls.
- The company transfers assets and liabilities to an entity that the company has created and controls and in which it holds majority ownership.
- The company transfers assets and liabilities to the created entity at book value, and the transferring company recognizes an ownership interest in the newly created entity equal to the book value of the net assets transferred.
- If assets are impaired at the time of transfer, the transferring company should recognize an impairment loss and transfer the assets to the new entity at the lower fair value.
- Subsidiary records all assets and liabilities received in the transfer at the book values at the time of transfer.

SPIN-OFF – WITH NEW SHAREHOLDERS

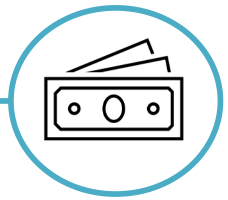
ORG Company (before the spin-off)

Cash	450	Short Term Loans	1.200
Accounts Receivable	2.100	Accounts Payable	3.500
Accruals and Prepaid expenses	400	Accrued Expenses	180
Invertory	3.150	Deferred Revenues	220
Property, Plant & Equipment	12.400	Long-Term Liabilities	6.900
Intellectual Property & Patents	1.500		
		Owners' Equity	**8.000**
Total Investments	*20.000*	*Total Sources*	*20.000*

€ 2,000

Newco

Cash	**2.150**	Short Term Loans	900
Accounts Receivable	500	Accounts Payable	2.000
Accruals and Prepaid expenses	50	Accrued Expenses	80
Invertory	1.500	Deferred Revenues	120
Property, Plant & Equipment	7.000	Long-Term Liabilities	4.900
Intellectual Property & Patents	800		
		Owners' Equity	**4.000**
Total Investments	*12.000*	*Total Sources*	*12.000*



€ 2,000

SPIN-OFF

ORG Company (after the spin-off)

Cash	300	Short Term Loans	300
Accounts Receivable	1.600	Accounts Payable	1.500
Accruals and Prepaid expenses	350	Accrued Expenses	100
Invertory	1.650	Deferred Revenues	100
Property, Plant & Equipment	5.400	Long-Term Liabilities	2.000
Intellectual Property & Patents	700		
		Owners' Equity	**6.000**
Total Investments	*10.000*	*Total Sources*	*10.000*

37.50%

300 @ 7.5 $/#

62.50%

500 @ 7.5 $/#

Newco

Cash	**2.150**	Short Term Loans	900
Accounts Receivable	500	Accounts Payable	2.000
Accruals and Prepaid expenses	50	Accrued Expenses	80
Invertory	1.500	Deferred Revenues	120
Property, Plant & Equipment	7.000	Long-Term Liabilities	4.900
Intellectual Property & Patents	800		
		Owners' Equity	**4.000**
Total Investments	*12.000*	*Total Sources*	*12.000*

18.75%

600 @ 1.25 $/#

31.25%

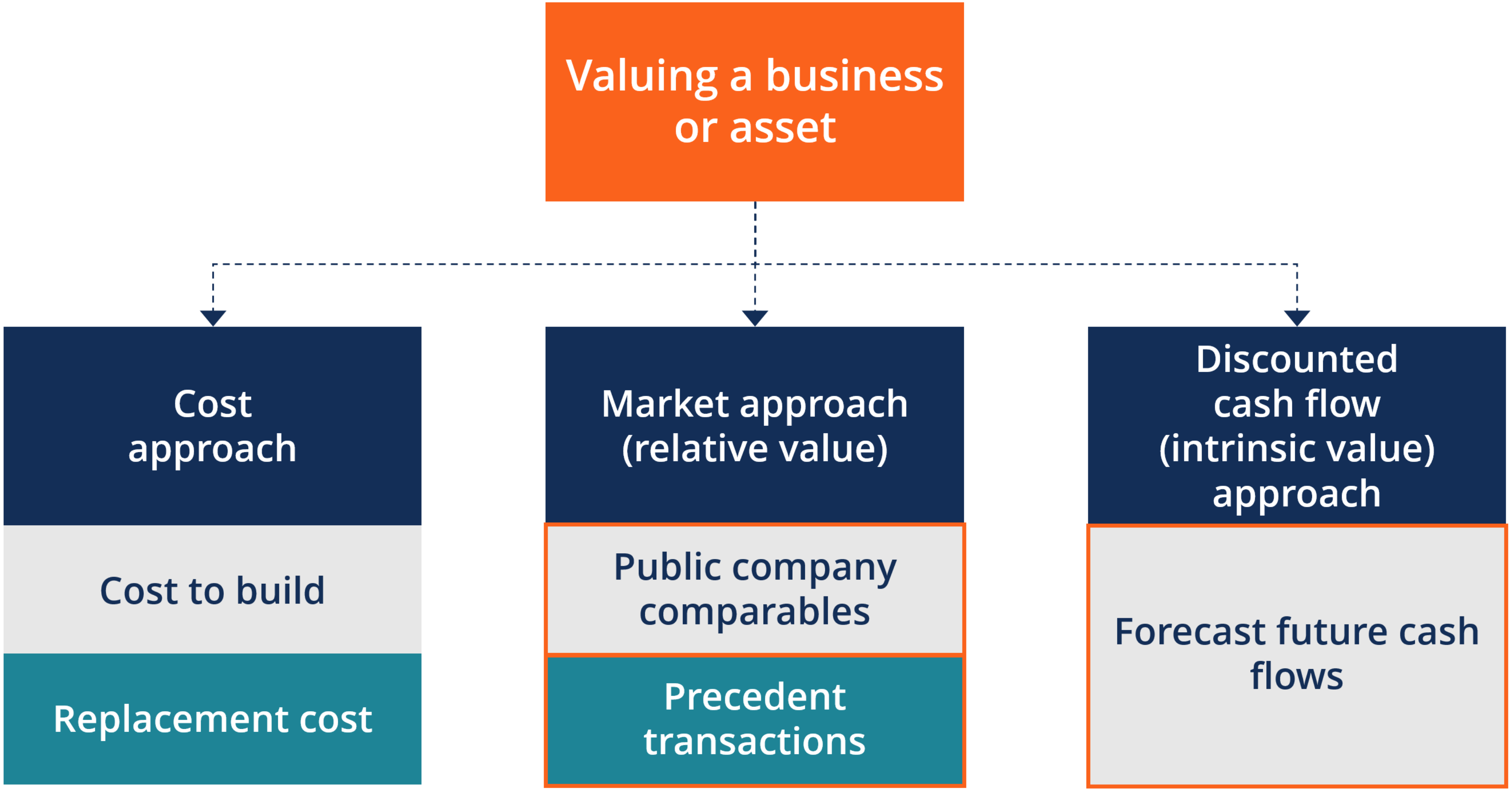
1,000 @ 1.25 $/#

50.00%

1,600 @ 1.25 $/#

NEW BASIS OF MEASUREMENT

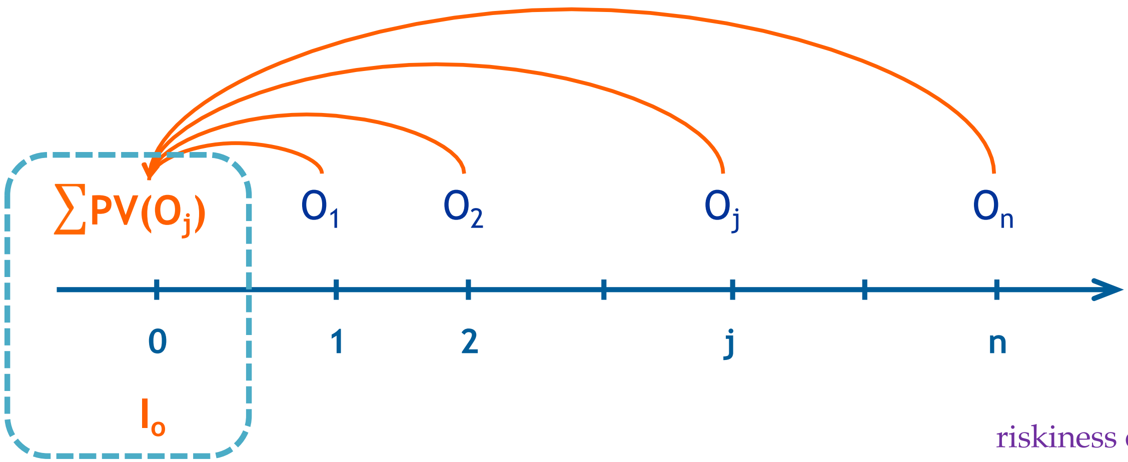
DIFFERENT APPROACHES



CAPITAL INVESTMENTS

This slide concerns concepts that have only been partially examined and will not be assessed in the exam

«Companies create value for their owners by investing cash now to generate more cash in the future. The amount of value created is the difference between investments made and cash inflows—adjusted for the fact that tomorrow's cash flows are worth less than today's, due to the time value of money and riskiness of future flows. […] a company's return on invested capital (ROIC), and its revenue growth, determine how revenues get converted into cash flows. Therefore, value creation is ultimately driven by ROIC, revenue growth and, of course, the ability to sustain both over time».



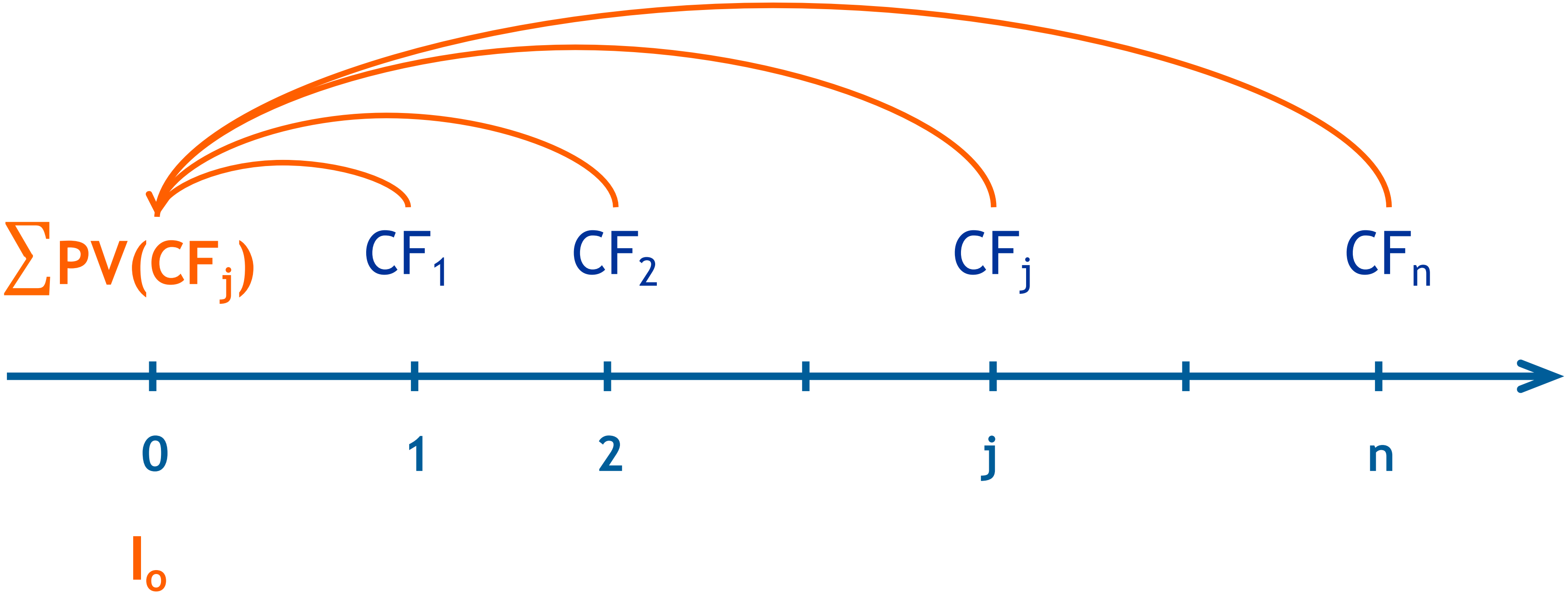
$$PV(O_j) = \frac{O_j}{(1+r)^j}$$

$$r = \underbrace{\boxed{r_f}}_{\text{time value of money}} + \overbrace{\boxed{(r_m - r_f) \times \beta}}^{\text{riskiness of future flows}}$$

Excerpt from: T. Koller, R. Dobbs, B. Huyett, "Value. The Four Cornerstones Of Corporate Finance McKinsey & Company, John Wiley & Sons, 2011.

CAPITAL INVESTMENTS

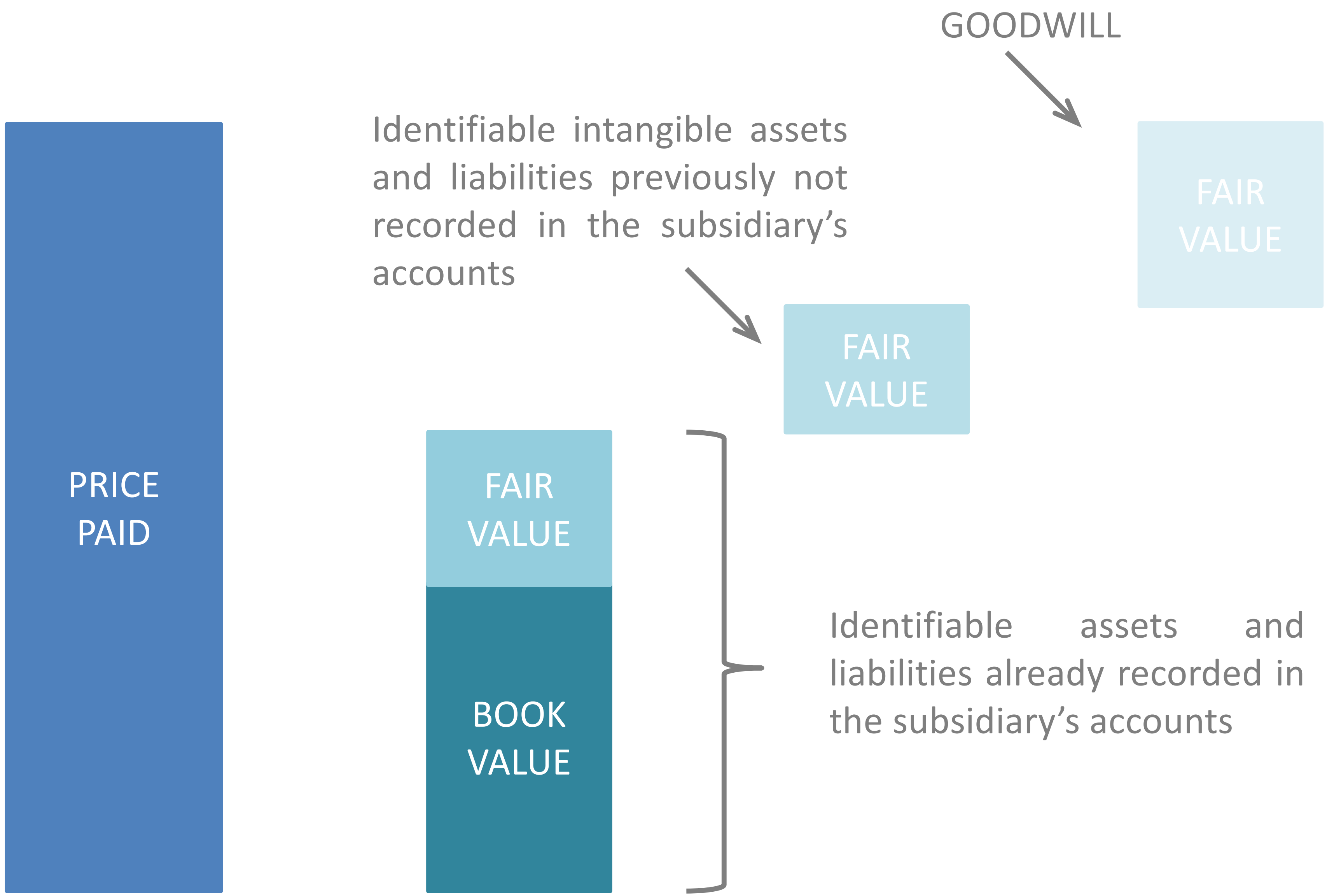
This slide concerns concepts that have only been partially examined and will not be assessed in the exam



$$\frac{\sum PV(CF_j)}{I_o} > 1$$

$$\underbrace{\sum PV(CF_j) - I_o}_{NPV} > 0$$

RECOGNITION PRINCIPLE



EXTERNAL EXPANSION: BUSINESS COMBINATIONS

→ **Expansion through business combinations**

- Entry into new product areas or geographic regions by acquiring or combining with other companies
- A business combination occurs when "... an acquirer obtains control of one or more businesses"
- The concept of control relates to the ability to direct policies and management

BUSINESS COMBINATIONS

ACQ Company

Cash	4.000	Short Term Loans	600
Accounts Receivable	1.800	Accounts Payable	2.100
Accruals and Prepaid expenses	400	Accrued Expenses	350
Invertory	1.200	Deferred Revenues	150
Property, Plant & Equipment	5.800	Long-Term Liabilities	7.300
Intellectual Property & Patents	2.300		
		Owners' Equity	**5.000**
Total Investments	*15.500*	*Total Sources*	*15.500*

25.00% **75.00%**

125 @ 10 $/#   # 375 @ 10 $/#

BUSINESS COMBINATIONS – NET ASSETS FOR CASH

ACQ Company

Cash	4.000	Short Term Loans	600
Accounts Receivable	1.800	Accounts Payable	2.100
Accruals and Prepaid expenses	400	Accrued Expenses	350
Invertory	1.200	Deferred Revenues	150
Property, Plant & Equipment	5.800	Long-Term Liabilities	7.300
Intellectual Property & Patents	2.300		
		Owners' Equity	**5.000**
Total Investments	*15.500*	*Total Sources*	*15.500*

€ 2,000

PRC Company

Cash	300	Short Term Loans	700
Accounts Receivable	550	Accounts Payable	560
Accruals and Prepaid expenses	100	Accrued Expenses	80
Invertory	550	Deferred Revenues	120
Property, Plant & Equipment	2.900	Long-Term Liabilities	1.540
Intellectual Property & Patents	600		
		Owners' Equity	**2.000**
Total Investments	*5.000*	*Total Sources*	*5.000*

€ 2,000

90 @ 20 $/#

10 @ 20 $/#

BUSINESS COMBINATIONS – NET ASSETS FOR CASH

ACQ Company (after acquisition)

Cash	2.300	Short Term Loans	1.300
Accounts Receivable	2.350	Accounts Payable	2.660
Accruals and Prepaid expenses	500	Accrued Expenses	430
Invertory	1.750	Deferred Revenues	270
Property, Plant & Equipment	8.700	Long-Term Liabilities	8.840
Intellectual Property & Patents	2.900		
		Owners' Equity	**5.000**
Total Investments	*18.500*	*Total Sources*	*18.500*

125 @ 10 $/#

375 @ 10 $/#

PRC Company (after acquisition)

Cash	2.000	Short Term Loans	-
Accounts Receivable	-	Accounts Payable	-
Accruals and Prepaid expenses	-	Accrued Expenses	-
Invertory	-	Deferred Revenues	-
Property, Plant & Equipment	-	Long-Term Liabilities	-
Intellectual Property & Patents	-		
		Owners' Equity	**2.000**
Total Investments	*2.000*	*Total Sources*	*2.000*

90 @ 20 $/#

10 @ 20 $/#

BUSINESS COMBINATIONS – STOCKS FOR CASH

ACQ Company

Cash	4.000	Short Term Loans	600
Accounts Receivable	1.800	Accounts Payable	2.100
Accruals and Prepaid expenses	400	Accrued Expenses	350
Invertory	1.200	Deferred Revenues	150
Property, Plant & Equipment	5.800	Long-Term Liabilities	7.300
Intellectual Property & Patents	2.300		
		Owners' Equity	**5.000**
Total Investments	*15.500*	*Total Sources*	*15.500*

PRC Company

Cash	300	Short Term Loans	700
Accounts Receivable	550	Accounts Payable	560
Accruals and Prepaid expenses	100	Accrued Expenses	80
Invertory	550	Deferred Revenues	120
Property, Plant & Equipment	2.900	Long-Term Liabilities	1.540
Intellectual Property & Patents	600		
		Owners' Equity	**2.000**
Total Investments	*5.000*	*Total Sources*	*5.000*

90 @ 20 $/#

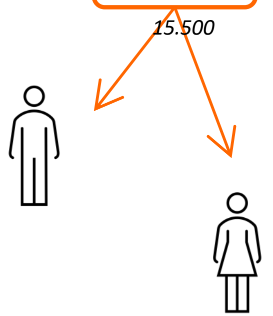
10 @ 20 $/#

€ 2,000

BUSINESS COMBINATIONS – STOCKS FOR CASH

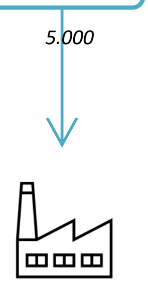
ACQ Company (after acquisition)

Cash	2.000	Short Term Loans	600
Accounts Receivable	1.800	Accounts Payable	2.100
Accruals and Prepaid expenses	400	Accrued Expenses	350
Invertory	1.200	Deferred Revenues	150
Property, Plant & Equipment	5.800	Long-Term Liabilities	7.300
Intellectual Property & Patents	2.300		
Investment in PRC	**2.000**	**Owners' Equity**	**5.000**
Total Investments	*15.500*	*Total Sources*	*15.500*



PRC Company

Cash	300	Short Term Loans	700
Accounts Receivable	550	Accounts Payable	560
Accruals and Prepaid expenses	100	Accrued Expenses	80
Invertory	550	Deferred Revenues	120
Property, Plant & Equipment	2.900	Long-Term Liabilities	1.540
Intellectual Property & Patents	600		
		Owners' Equity	**2.000**
Total Investments	*5.000*	*Total Sources*	*5.000*



BUSINESS COMBINATIONS – NET ASSETS FOR STOCKS

ACQ Company

Cash	4.000	Short Term Loans	600
Accounts Receivable	1.800	Accounts Payable	2.100
Accruals and Prepaid expenses	400	Accrued Expenses	350
Invertory	1.200	Deferred Revenues	150
Property, Plant & Equipment	5.800	Long-Term Liabilities	7.300
Intellectual Property & Patents	2.300		
		Owners' Equity	**5.000**
Total Investments	*15.500*	*Total Sources*	*15.500*

€ 2,000

PRC Company

Cash	300	Short Term Loans	700
Accounts Receivable	550	Accounts Payable	560
Accruals and Prepaid expenses	100	Accrued Expenses	80
Invertory	550	Deferred Revenues	120
Property, Plant & Equipment	2.900	Long-Term Liabilities	1.540
Intellectual Property & Patents	600		
		Owners' Equity	**2.000**
Total Investments	*5.000*	*Total Sources*	*5.000*

20 @ 10 $/#

90 @ 20 $/#

10 @ 20 $/#

BUSINESS COMBINATIONS – NET ASSETS FOR STOCKS

ACQ Company (after acquisition)

Cash	4.300	Short Term Loans	1.300
Accounts Receivable	2.350	Accounts Payable	2.660
Accruals and Prepaid expenses	500	Accrued Expenses	430
Invertory	1.750	Deferred Revenues	270
Property, Plant & Equipment	8.700	Long-Term Liabilities	8.840
Intellectual Property & Patents	2.900		
		Owners' Equity	$\boxed{\textbf{7.000}}$
Total Investments	*20.500*	*Total Sources*	*20.500*

PRC Company (after acquisition)

Cash	-	Short Term Loans	-
Accounts Receivable	-	Accounts Payable	-
Accruals and Prepaid expenses	-	Accrued Expenses	-
Invertory	-	Deferred Revenues	-
Property, Plant & Equipment	-	Long-Term Liabilities	-
Intellectual Property & Patents	-		
Investment in ACQ	**2.000**	**Owners' Equity**	$\boxed{\textbf{2.000}}$
Total Investments	*2.000*	*Total Sources*	*2.000*

BUSINESS COMBINATIONS – STOCKS FOR STOCKS

100 @ 20 $/#

ACQ Company

Cash	4.000	Short Term Loans	600
Accounts Receivable	1.800	Accounts Payable	2.100
Accruals and Prepaid expenses	400	Accrued Expenses	350
Invertory	1.200	Deferred Revenues	150
Property, Plant & Equipment	5.800	Long-Term Liabilities	7.300
Intellectual Property & Patents	2.300		
		Owners' Equity	**5.000**
Total Investments	*15.500*	*Total Sources*	*15.500*

PRC Company

Cash	300	Short Term Loans	700
Accounts Receivable	550	Accounts Payable	560
Accruals and Prepaid expenses	100	Accrued Expenses	80
Invertory	550	Deferred Revenues	120
Property, Plant & Equipment	2.900	Long-Term Liabilities	1.540
Intellectual Property & Patents	600		
		Owners' Equity	**2.000**
Total Investments	*5.000*	*Total Sources*	*5.000*

90 @ 20 $/#

200 @ 10 $/#

10 @ 20 $/#

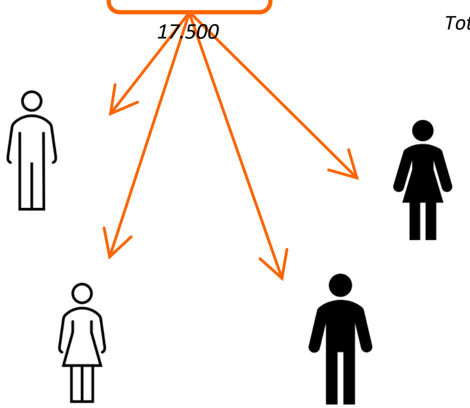
BUSINESS COMBINATIONS – STOCKS FOR STOCKS

ACQ Company (after acquisition)

Cash	4.000	Short Term Loans	600
Accounts Receivable	1.800	Accounts Payable	2.100
Accruals and Prepaid expenses	400	Accrued Expenses	350
Invertory	1.200	Deferred Revenues	150
Property, Plant & Equipment	5.800	Long-Term Liabilities	7.300
Intellectual Property & Patents	2.300		
Investment in PRC	**2.000**	**Owners' Equity**	**7.000**
Total Investments	*17.500*	*Total Sources*	*17.500*

PRC Company

Cash	300	Short Term Loans	700
Accounts Receivable	550	Accounts Payable	560
Accruals and Prepaid expenses	100	Accrued Expenses	80
Invertory	550	Deferred Revenues	120
Property, Plant & Equipment	2.900	Long-Term Liabilities	1.540
Intellectual Property & Patents	600		
		Owners' Equity	**2.000**
Total Investments	*5.000*	*Total Sources*	*5.000*

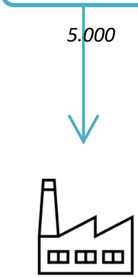


125 @ 10 $/#

20 @ 10 $/#

180 @ 10 $/#

375 @ 10 $/#



100 @ 20 $/#

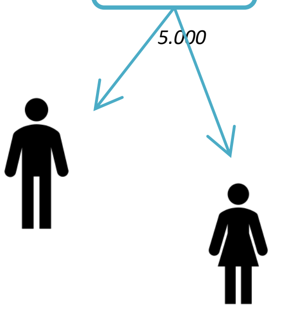
BUSINESS COMBINATIONS – BUSINESS UNIT FOR CASH

ACQ Company

Cash	4.000	Short Term Loans	600
Accounts Receivable	1.800	Accounts Payable	2.100
Accruals and Prepaid expenses	400	Accrued Expenses	350
Invertory	1.200	Deferred Revenues	150
Property, Plant & Equipment	5.800	Long-Term Liabilities	7.300
Intellectual Property & Patents	2.300		
		Owners' Equity	**5.000**
Total Investments	*15.500*	*Total Sources*	*15.500*

PRC Company

Cash	300	Short Term Loans	700
Accounts Receivable	550	Accounts Payable	560
Accruals and Prepaid expenses	100	Accrued Expenses	80
Invertory	550	Deferred Revenues	120
Property, Plant & Equipment	2.900	Long-Term Liabilities	1.540
Intellectual Property & Patents	600		
		Owners' Equity	**2.000**
Total Investments	*5.000*	*Total Sources*	*5.000*



90 @ 20 $/#

10 @ 20 $/#

BUSINESS COMBINATIONS – BUSINESS UNIT FOR CASH

ACQ Company

Cash	4.000	Short Term Loans	600
Accounts Receivable	1.800	Accounts Payable	2.100
Accruals and Prepaid expenses	400	Accrued Expenses	350
Invertory	1.200	Deferred Revenues	150
Property, Plant & Equipment	5.800	Long-Term Liabilities	7.300
Intellectual Property & Patents	2.300		
		Owners' Equity	**5.000**
Total Investments	*15.500*	*Total Sources*	*15.500*

PRC Business Unit

Cash	50	Short Term Loans	300
Accounts Receivable	220	Accounts Payable	180
Accruals and Prepaid expenses	30	Accrued Expenses	20
Invertory	170	Deferred Revenues	50
Property, Plant & Equipment	1.450	Long-Term Liabilities	1.250
Intellectual Property & Patents	380		
		Owners' Equity	**500**
Total Investments	*2.300*	*Total Sources*	*2.300*

PRC Company - PRC Business Unit

Cash	250	Short Term Loans	400
Accounts Receivable	330	Accounts Payable	380
Accruals and Prepaid expenses	70	Accrued Expenses	60
Invertory	380	Deferred Revenues	70
Property, Plant & Equipment	1.450	Long-Term Liabilities	290
Intellectual Property & Patents	220		
		Owners' Equity	**1.500**
Total Investments	*2.700*	*Total Sources*	*2.700*

BUSINESS COMBINATIONS – BUSINESS UNIT FOR CASH

€ 500

PRC Business Unit

Cash	50	Short Term Loans	300
Accounts Receivable	220	Accounts Payable	180
Accruals and Prepaid expenses	30	Accrued Expenses	20
Invertory	170	Deferred Revenues	50
Property, Plant & Equipment	1.450	Long-Term Liabilities	1.250
Intellectual Property & Patents	380		
		Owners' Equity	**500**
Total Investments	*2.300*	*Total Sources*	*2.300*

ACQ Company

Cash	4.000	Short Term Loans	600
Accounts Receivable	1.800	Accounts Payable	2.100
Accruals and Prepaid expenses	400	Accrued Expenses	350
Invertory	1.200	Deferred Revenues	150
Property, Plant & Equipment	5.800	Long-Term Liabilities	7.300
Intellectual Property & Patents	2.300		
		Owners' Equity	**5.000**
Total Investments	*15.500*	*Total Sources*	*15.500*

PRC Company - PRC Business Unit

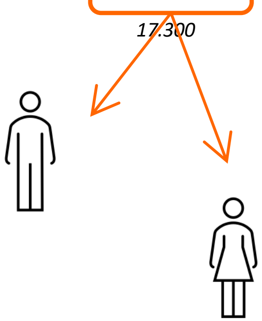
Cash	250	Short Term Loans	400
Accounts Receivable	330	Accounts Payable	380
Accruals and Prepaid expenses	70	Accrued Expenses	60
Invertory	380	Deferred Revenues	70
Property, Plant & Equipment	1.450	Long-Term Liabilities	290
Intellectual Property & Patents	220		
		Owners' Equity	**1.500**
Total Investments	*2.700*	*Total Sources*	*2.700*

€ 500

BUSINESS COMBINATIONS – BUSINESS UNIT FOR CASH

ACQ Company (after acquisition)

Cash	3.550	Short Term Loans	900
Accounts Receivable	2.020	Accounts Payable	2.280
Accruals and Prepaid expenses	430	Accrued Expenses	370
Invertory	1.370	Deferred Revenues	200
Property, Plant & Equipment	7.250	Long-Term Liabilities	8.550
Intellectual Property & Patents	2.680		
		Owners' Equity	**5.000**
Total Investments	*17.300*	*Total Sources*	*17.300*

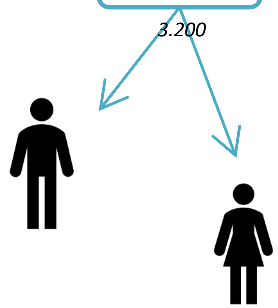


375 @ 10 $/#

PRC Company - PRC Business Unit

Cash	750	Short Term Loans	400
Accounts Receivable	330	Accounts Payable	380
Accruals and Prepaid expenses	70	Accrued Expenses	60
Invertory	380	Deferred Revenues	70
Property, Plant & Equipment	1.450	Long-Term Liabilities	290
Intellectual Property & Patents	220		
		Owners' Equity	**2.000**
Total Investments	*3.200*	*Total Sources*	*3.200*

90 @ 20 $/#



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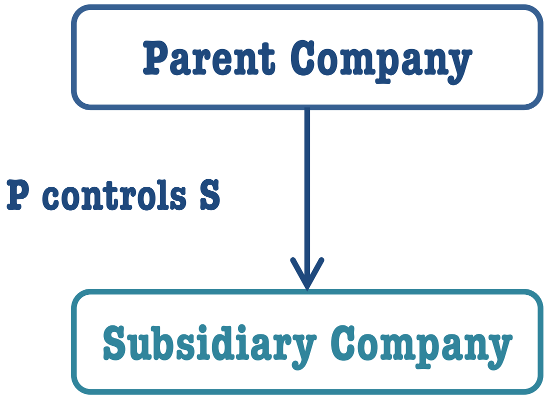
ORGANIZATIONAL FORMS – WHAT ACQUIRED?

Common Stock

Results in a parent-subsidiary relationship



Two separate legal entities

Target's Assets

Results in a home office-branch/division relationship

One legal entity

SPECIAL ISSUES

The **acquirer** is required also to recognize and measure:

1. the fair value of the identifiable assets acquired, and liabilities assumed.
2. the purchased goodwill.
3. any non-controlling interest in the **acquiree.**

CONTROL OF ANOTHER BUSINESS ENTITY

→ **The Usual Way**

Owning more than 50% of the subsidiary's outstanding voting stock (50% plus only 1 share will do it)

→ **The Unusual Way**

Having contractual agreements or financial arrangements that effectively achieve control

- Informal arrangements
- Formal agreements

ORGANIZATIONAL STRUCTURE AND FINANCIAL REPORTING

→ Merger

- A business combination in which the acquired business's assets and liabilities are combined with those of the acquiring company, resulting in no additional organizational components
- Two companies are merged into a single entity

→ Controlling ownership

- A business combination in which the acquired company remains as a separate legal entity with a majority of its common stock owned by the purchasing company leading to a parent–subsidiary relationship
- Accounting standards normally require consolidated financial statements.

Noncontrolling ownership

- The purchase of a less-than-majority interest in another corporation does not usually result in a business combination or a controlling situation

Other beneficial interest

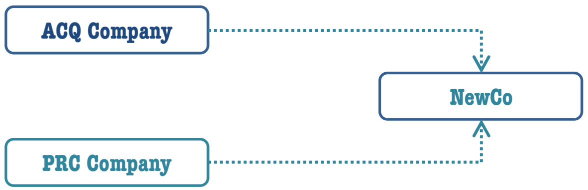
- One company may have a beneficial interest in another entity even without a direct ownership interest
- The beneficial interest may be defined by the agreement establishing the entity or by an operating or financing agreement

ACCOUNTING FOR EXTERNAL EXPANSION: BUSINESS COMBINATIONS

There are three primary legal forms of business combinations:

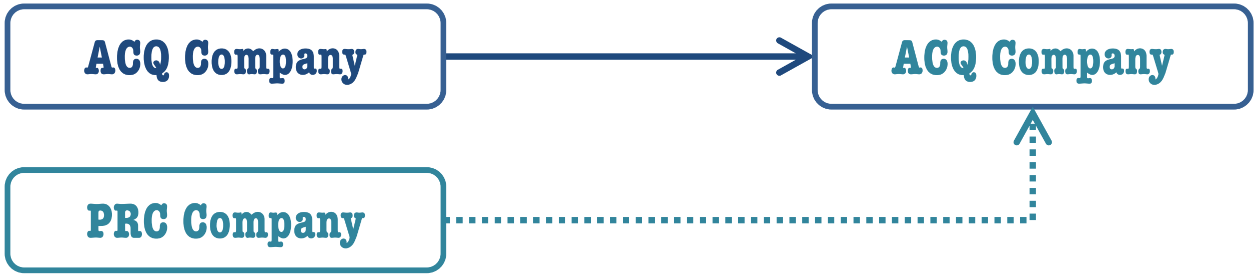
- Statutory merger:

- Statutory consolidation:



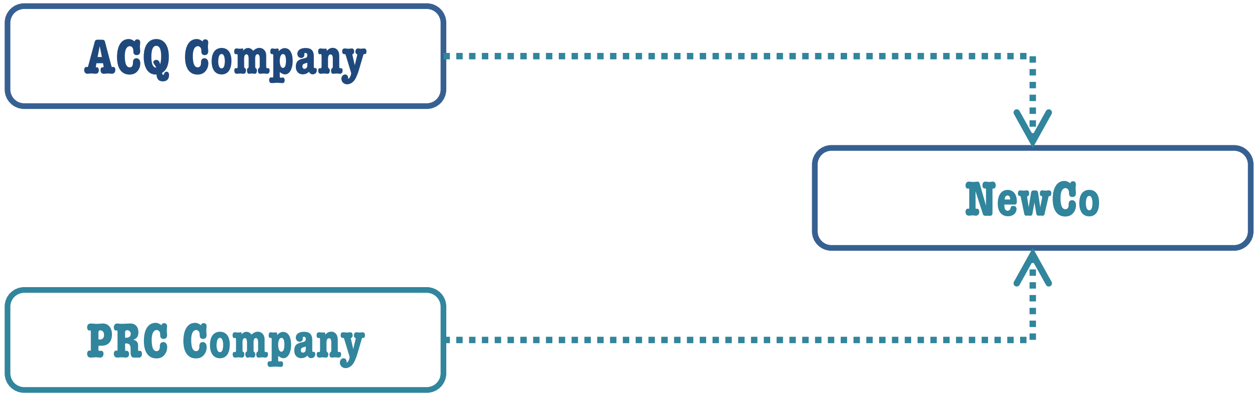
- Stock acquisition:

STATUTORY MERGER



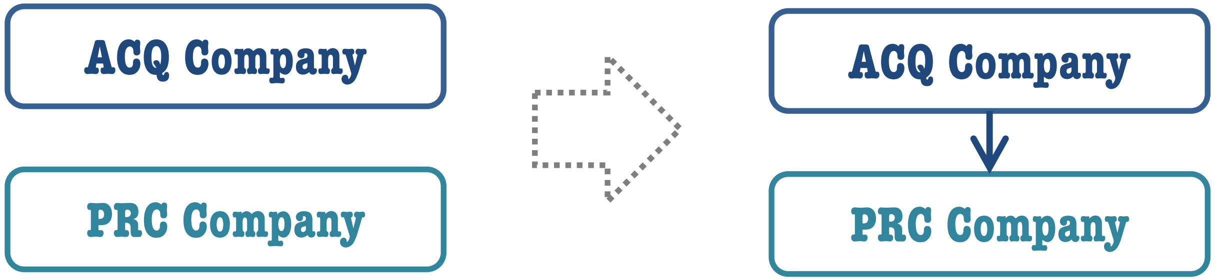
- The acquired company's assets and liabilities are transferred to the acquiring company, and the acquired company is dissolved, or liquidated.
- The operations of the previously separate companies are carried on in a single legal entity following the merger.
- **Result:** one legal entity survives

STATUTORY CONSOLIDATION



- Both combining companies are dissolved and the assets and liabilities of both companies are transferred to a newly created corporation
- **Result:** one "new" legal entity survives
- In many situations, however, the resulting corporation is new in form only, and in substance it actually is one of the combining companies reincorporated with a new name

STOCK ACQUISITION



- One company acquires the voting shares of another company and the two companies continue to operate as separate, but related, legal entities.
- The acquiring company accounts for its ownership interest in the other company as an investment.
- The relationship that is created is referred to as a parent–subsidiary relationship.
- For general-purpose financial reporting, a parent company and its subsidiaries present consolidated financial statements.

METHODS OF EFFECTING BUSINESS COMBINATIONS

→ Acquisition of assets

- Sometimes one company acquires another company's assets through direct negotiations with its management
- Statutory merger
- Statutory consolidation

→ Acquisition of stock

- A majority of the outstanding voting shares usually is required unless other factors lead to the acquirer gaining control
- **Noncontrolling interest:** the total of the shares of an acquired company not held by the controlling shareholder

→ Major Decision Factors

- Legal considerations—Buyer must be extremely careful NOT to assume responsibility for (and thus “inherit”) the target company’s
  - ✓ Unrecorded liabilities
  - ✓ Contingent liabilities (lawsuits)
- Tax considerations—Often requires major negotiations involving resolution of
  - ✓ Seller’s tax desires
  - ✓ Buyer’s tax desires
- Ease of consummation—acquiring common stock is simple compared with acquiring assets

ACQUIRING ASSETS

Major Advantages of Acquiring Assets

- Will not inherit a target's contingent liabilities (excluding environmental)
- Will not inherit a target's unwanted labor union

Major Disadvantages of Acquiring Assets

- Transfer of titles on real estate and other assets can be time consuming
- Transfer of contracts may not be possible

Advantages of Acquiring Common Stock

- Easy transfer
- May inherit nontransferable contracts

Disadvantages of Acquiring Common Stock

- May inherit contingent liabilities or unwanted labor union connection
- May acquire unwanted facilities/units
- Will likely be hard to access target's cash

STATUTORY MERGER: TWO POSSIBILITIES IN REAL LIFE

→ **Peaceful Merger:**

- One entity transfers assets to another in exchange for stock and/or cash
- It liquidates pursuant to state laws

→ **Hostile Takeover:**

- One company buys the stock of another, creating a temporary parent-subsidiary relationship
- The parent then liquidates the subsidiary into the parent pursuant to state laws

The result, in both cases, is that just one legal entity survives

VALUATION OF BUSINESS ENTITIES

→ Value of individual assets and liabilities

- Value usually determined by appraisal

→ Value of potential earnings

- "Going-concern value" based on:
  - ✓ A multiple of current earnings
  - ✓ Present value of the anticipated future net cash flows generated by the company

→ Valuation of consideration exchanged

- Cash: little difficulty
- Securities: unless traded in the market, estimates of their value must be made

WHY BUSINESSES OPERATE IN THE FORM OF GROUPS?

- A desire for each part to the business to have its own limited liability (financial problems in one part of the business can't have an adverse effect on the others).
- The will to make each part of the business have some sense of independence and autonomy.
- To create or preserve a market image of a smaller independent business.
- To separate functions of a business: production, distribution, retail, etc.
- To enhance the geographical basis of a certain business .
- Others.