

The Financial Detective, 2005

Financial characteristics of companies vary for many reasons. The two most prominent drivers are industry economics and firm strategy.

Each industry has a financial norm around which companies within the industry tend to operate. An airline, for example, would naturally be expected to have a high proportion of fixed assets (airplanes), while a consulting firm would not. A steel manufacturer would be expected to have a lower gross margin than a pharmaceutical manufacturer because commodities such as steel are subject to strong price competition, while highly differentiated products like patented drugs enjoy much more pricing freedom. Because of unique economic features of each industry, average financial statements will vary from one industry to the next.

Similarly, companies *within* industries have different financial characteristics, in part, because of the diverse strategies that can be employed. Executives choose strategies that will position their company favorably in the competitive jockeying within an industry. Strategies typically entail making important choices in how a product is made (e.g., capital intensive versus labor intensive), how it is marketed (e.g., direct sales versus the use of distributors), and how the company is financed (e.g., the use of debt or equity). Strategies among companies in the same industry can differ dramatically. Different strategies can produce striking differences in financial results for firms in the same industry.

The following paragraphs describe pairs of participants in a number of different industries. Their strategies and market niches provide clues as to the financial condition and performance that one would expect of them. The companies' common-sized financial statements and operating data, as of early 2005, are presented in a standardized format in **Exhibit 1**. It is up to you to match the financial data with the company descriptions. Also, try to explain the differences in financial results *across* industries.

This case was prepared by Sean Carr, under the direction of Robert F. Bruner. It was written as a basis for class discussion rather than to illustrate effective or ineffective handling of an administrative situation. Copyright © 2005 by the University of Virginia Darden School Foundation, Charlottesville, VA. All rights reserved. *To order copies, send an e-mail to sales@dardenbusinesspublishing.com. No part of this publication may be reproduced, stored in a retrieval system, used in a spreadsheet, or transmitted in any form or by any means—electronic, mechanical, photocopying, recording, or otherwise—without the permission of the Darden School Foundation.*

Health Products

Companies A and B manufacture and market health-care products. One firm is the world's largest prescription-pharmaceutical company. This firm has a very broad and deep pipeline of ethical pharmaceuticals, supported by a robust research and development budget. In recent years, the company has divested several of its nonpharmaceutical businesses, and it has come to be seen as the partner of choice for licensing deals with other pharmaceutical and biotechnology firms.

The other company is a diversified health-products company that manufactures and mass markets a broad line of prescription pharmaceuticals, over-the-counter remedies (i.e., nonprescription drugs), consumer health and beauty products, and medical diagnostics and devices. For its consumer segment, brand development and management are a major element of this firm's mass-market-oriented strategy.

Beer

Of the beer companies, C and D, one is a national brewer of mass-market consumer beers sold under a variety of brand names. This company operates an extensive network of breweries and distribution systems. The firm also owns a number of beer-related businesses, such as snack and aluminum-container manufacturing, and several major theme parks.

The other company produces seasonal and year-round beers with smaller production volume and higher prices. This company outsources most of its brewing activity. The firm is financially conservative, and has recently undergone a major cost-savings initiative to counterbalance the recent surge in packaging and freight costs.

Computers

Companies E and F sell computers and related equipment. One company focuses exclusively on mail-order sales of built-to-order PCs, including desktops, laptops, notebooks, servers, workstations, printers, and handheld devices. The company is an assembler of PC components manufactured by its suppliers. The company allows its customers to design, price, and purchase through its Web site.

The other company sells a highly differentiable line of computers, consumer-oriented electronic devices, and a variety of proprietary software products. Led by its charismatic founder, the company has begun to recover from a dramatic decline in its market share. The firm has an aggressive retail strategy intended to drive traffic through its stores and to expand its installed base of customers by showcasing its products in a user-friendly retail atmosphere.

Books and Music

The book and music retailers are companies G and H. One focuses on selling primarily to customers through a vast retail-store presence. The company is the leader in traditional book retailing, which it fosters through its "community store" concept

and regular discount policy. The firm also maintains an online presence and owns a publishing imprint.

The other company sells books, music, and videos solely through its Internet Web site. While more than three-quarters of its sales are media, it also sells electronics and other general merchandise. The firm has only recently become profitable, and it has followed an aggressive strategy of acquiring related online businesses in recent years.

Paper Products

Companies I and J are both paper manufacturers. One company is the world's largest maker of paper, paperboard, and packaging. This vertically integrated company owns timberland; numerous lumber, paper, paperboard, and packing-products facilities; and a paper-distribution network. The company has spent the last few years rationalizing capacity by closing inefficient mills, implementing cost-containment initiatives, and selling nonessential assets.

The other firm is a small producer of printing, writing, and technical specialty papers, as well as towel and tissue products. Most of the company's products are marketed under branded labels. The company purchases the wood fiber used in its paper-making process on the open market.

Hardware and Tools

Companies K and L manufacture and sell hardware and tools. One of the companies is a global manufacturer and marketer of power tools and power-tool accessories, hardware and home-improvement products, and fastening systems. The firm sells primarily to retailers, wholesalers, and distributors. Its products appear under a variety of well-known brand names and are geared for the end user.

The other tool company manufactures and markets high-quality precision tools and diagnostic-equipment systems for professional users. The firm offers a broad range of products, which it sells via its own technical representatives and mobile franchise dealers. The company also provides financing for franchisees and for customers' large purchases.

Retailing

Companies M and N are two large discount retailers. One firm carries a wide variety of nationally advertised general merchandise. The company is known for its low prices, breadth of merchandise, and volume-oriented strategy. Most of its stores are leased and are located near the company's expanding network of distribution centers. The company has begun to implement plans to expand both internationally and in large urban areas.

The other firm is a rapidly growing chain of upscale discount stores. The company competes by attempting to match other discounters' prices on similar merchandise and by offering deep discounts on its differentiated items. Additionally, the company has partnerships with several leading designers. Recently, the firm has divested several

nondiscount department-store businesses. To support sales and earnings growth, this company offers credit to qualified customers.

Newspapers

Companies O and P own newspapers. One is a diversified media company that generates most of its revenues through newspapers sold around the country and around the world. Because the company is centered largely on one product, it has strong central controls. Competition for subscribers and advertising revenues in this firm's segment is fierce. The company has also recently built a large office building for its headquarters.

The other firm owns a number of newspapers in relatively small communities throughout the Midwest and the Southwest. Some analysts view this firm as holding a portfolio of small local monopolies in newspaper publishing. This company has a significant amount of goodwill on its balance sheet, stemming from acquisitions. Key to this firm's operating success is a strategy of decentralized decision making and administration.

EXHIBIT 1 | Common-Sized Financial Data and Ratios (Continued)

Market Data	Health Prod.		Beer			Computers			Books & Music			Paper			Tools			Retail			Newspapers		
	A	B	C	D	E	F	G	H	I	J	K	L	M	N	O	P	Q	R	S	T	U	V	
Beta	0.65	0.85	0.55	0.60	1.20	1.05	1.70	0.51	1.15	1.10	1.00	1.00	0.85	1.10	0.85	1.10	0.85	1.10	0.85	1.10	0.85	0.90	
Price/Earnings	22.29	22.32	16.85	19.73	30.48	41.85	27.32	21.63	30.97	33.78	13.64	23.01	18.97	24.19	20.54	13.29							
Price to Book	5.93	3.08	13.99	2.56	17.46	5.13	nmf	2.36	1.91	1.80	4.65	1.85	4.23	3.64	2.07	3.09							
Dividend Payout	38.21	46.28	33.16	0.00	0.00	0.00	0.00	0.00	101.46	86.16	15.30	70.62	21.56	14.85	37.53	30.81							
Liquidity																							
Current Ratio	1.96	1.50	0.92	3.35	1.20	2.63	1.57	1.49	1.91	1.94	1.63	1.77	0.90	1.69	0.88	0.55							
Quick Ratio	1.42	1.13	0.47	2.77	1.01	2.43	nmf	0.46	1.15	1.00	0.87	1.03	0.17	0.94	0.69	0.39							
Asset Management																							
Inventory Turnover	3.08	0.93	12.60	7.44	67.96	74.78	13.56	2.42	6.75	7.11	3.89	3.59	7.69	5.86	33.35	43.48							
Receivables Turnover	7.06	5.47	21.87	18.68	12.23	8.28	nmf	72.11	8.68	11.64	5.82	4.42	192.73	8.31	10.98	8.50							
Fixed Assets Turnover	4.67	2.86	1.72	12.67	30.68	12.03	29.42	6.54	1.43	1.86	7.63	7.50	4.50	2.77	3.43	2.59							
Debt Management																							
Total Debt/Total Assets	5.34	14.99	51.19	0.00	2.18	0.00	56.94	7.42	42.78	18.36	25.21	14.45	26.16	29.54	15.22	26.81							
LT Debt/Shareholders' Equity	8.06	10.66	310.28	0.00	7.79	0.00	nmf	21.01	171.21	45.32	77.03	18.29	47.92	69.34	23.04	33.66							
Interest Coverage After Tax	27.34	32.57	6.25	nmf	191.19	93.00	6.49	9.52	1.56	2.98	8.62	4.55	8.86	4.92	7.83	6.69							
DuPont Analysis																							
Net Profit Margin	17.97	21.58	15.00	5.76	6.18	3.33	8.50	2.53	1.87	1.96	8.17	3.39	3.59	4.02	12.65	8.86							
Asset Turnover	0.93	0.44	0.97	2.23	2.31	1.11	2.56	1.43	0.73	1.20	1.11	1.09	2.54	1.47	0.48	0.85							
Return on Equity	26.75	16.64	83.97	15.95	46.92	5.44	nmf	10.58	5.79	5.71	28.30	7.36	20.79	14.47	9.86	20.89							

Sources of data: S&P's Research Insight; Value Line Investment Survey.

nmf = not a meaningful figure.