Since December 31, 2003, there have been substantial changes in the corporate lives of both Consolidated and Sailcraft.

On December 31, 2003, the balance sheet of Consolidated indicates that Consolidated owned " Marketable Securities," at a recorded cost of $1,700,000. These securities consisted of 76,000 shares of the common stock of Sailcraft. From about July 1, 2003, the management of Consolidated had been considering increasing its ownership in Sailcraft. On January 10, 2004, Consolidated acted on this by making a tender offer to all the Sailcraft shareholders (both common and preferred). On January 9, 2003, the day prior to the initial tender offer, the common stock of Sailcraft was selling for $22 per share. Accordingly, Consolidated offered the shareholders $24.50 per share. Preferred (which is non-voting stock) was selling for $92 per share. Accordingly, Consolidated offered $94 per share.

The response of Sailcraft's management was immediate. They urged the common shareholders not to accept the offer. Because of their resistance, Consolidated was ultimately required to pay $29 per share for the Sailcraft common stock, but Consolidated was able to obtain an additional 77,000 shares of the common stock of Sailcraft. This gave Consolidated 51% ownership of the common stock of Sailcraft. Consolidated was able to purchase 51% of the Sailcraft preferred for $94 per share.

With Consolidated's control firmly established, Sailcraft, on February 25, 2004, announced a new "Five-year Plan." It stated that for the next five years no dividends would be paid on Sailcraft common stock. As to the preferred dividends, Sailcraft would pay them regularly. The retained earnings were to be used to improve the quality of the Sailcraft products.

On March 30, 2004, the Board of Directors of Consolidated decided that it would
continue its program of expansion. Further, it decided that it would implement this program by purchasing new assets with its own stock. Therefore, on April 15, Consolidated placed a "buy order" with a broker for 5,000 shares of its common stock. The purchases were made by the broker in 6 separate transactions.

On May 15, 2004, Consolidated utilized 2,500 of these shares to purchase a patent right from Mr. Jones. This patent, which covered a new fiberglass formula for manufacturing skills, had been developed by Mr. Jones at a cost of about $10,000.

On June 15, the Board of Directors of both Sailcraft and Consolidated passed resolutions recommending that Sailcraft sell all its assets to Consolidated, in exchange for stocks of Consolidated. The following exchange ratio was recommended:

a. Each share of Sailcraft's $5 par value common stock would receive three shares of Consolidated's $5 par value common stock;

b. Each share of Sailcraft's 5% non-cumulative preferred stock would receive one share of the 6% cumulative preferred stock of Consolidated.

On July 31, 2004, a special meeting of the Sailcraft shareholders was called to vote on the proposal. At that meeting the Chairman of the Board of Directors of Sailcraft recommended the amalgamation. He emphasized that the Board had made an impartial and unbiased study of the proposal and found it advantageous to Sailcraft. At that meeting, there was substantial opposition to the amalgamation, among both the common and preferred shareholders. The preferred shareholders were upset about the exchange ratio, especially in light of the fact that they had a liquidation preference of $105 and they had not been paid any dividends in two years.

In spite of the opposition, the sale was approved by 72% of the common shares of Sailcraft.

What relief is available to:

1. Begley, a common shareholder of Sailcraft;
2. Mrs. Couch, a preferred shareholder of Sailcraft;
3. Ms. Davis, holder of a Mortgage Bond of Sailcraft?

II
[Page limit: one page
10% of your grade]

Assume that, on July 31, 2004, the equity accounts of Sailcraft and Consolidated
were the same as on December 31, 2003. Assume further that the sale of assets was completed on August 5, 2004. Would it be permissible for Consolidated to declare a dividend of $4,000,000 on September 1, 2004?

III

(Page limit: one page
10% of your grade]

A Corporation, a Kentucky Corporation, has the following equity accounts:

Stated Capital 1,000,000 (100,000 shares of common stock, par value $10 per share)

Capital Surplus 500,000

Earned Surplus (250,000)

Although the earned surplus account indicates a deficit of $250,000, A has made $100,000 in each of the last 3 years. The Chairman of the Board of Directors of A comes to you with the following questions:

a. Can A pay a 25% stock dividend?

b. What entries are necessary in the equity accounts?

IV

[Page limit: one page
10% of your grade]

X Corporation has $1,000,000 in subordinated debentures outstanding. Sam Davis owns 56% of the debentures. The President of X has convinced Mr. Davis, who is also in charge of X's engineering department, that Mr. Davis should agree to postpone the due date of the debentures. Mr. Epstein, a holder of $1,000 of the debentures, does not favor the postponement. He comes to you for advice. Discuss the issues presented by Mr. Epstein's problem.
SAILCRAFT, INC.

Ten years ago, three young men started a new company, "Sailcraft, Inc.", which manufactures small fiberglass sailing boats. From its inception, the company has steadily grown until the balance sheet for the company looks as follows.

BALANCE SHEET -- DECEMBER 31, 2003 -- SAILCRAFT, INC.

ASSETS

Current Assets

Cash
Accounts Receivable
Less provision for bad debts
Inventories

TOTAL CURRENT ASSETS

Fixed assets
(property, plant and equipment)
Land
Buildings
Machinery
Office equipment
Less accumulated depreciation

NEW FIXED ASSETS

TOTAL ASSETS

LIABILITIES

Current Liabilities

Accounts payable
Notes payable
Accrued expenses payable

TOTAL CURRENT LIABILITIES

Long term Liabilities

First mortgage bonds, 5% interest due 2005

TOTAL LIABILITIES

STOCKHOLDERS EQUITY

Capital Stock
<table>
<thead>
<tr>
<th>Stock Type</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Preferred stock, 5% non-cumulative, $100 par</td>
<td>$600,000</td>
</tr>
<tr>
<td>value each, liquidation value of $105,</td>
<td></td>
</tr>
<tr>
<td>authorized, issued, and outstanding 6,000</td>
<td></td>
</tr>
<tr>
<td>shares</td>
<td></td>
</tr>
<tr>
<td>Common stock, $5 par value each, authorized,</td>
<td>1,500,000</td>
</tr>
<tr>
<td>issued and outstanding 300,000 shares</td>
<td></td>
</tr>
<tr>
<td>Capital surplus</td>
<td>2,100,000</td>
</tr>
<tr>
<td>Accumulated retained earnings</td>
<td>700,000</td>
</tr>
</tbody>
</table>

**TOTAL STOCKHOLDERS EQUITY** 4,500,000

**TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY** $8,650,000
Although Sailcraft lost money its first two years in existence, for the last eight years it has shown a profit. Income (after allowance for depreciation and interest charges) for the last 5 years has been as follows:

<table>
<thead>
<tr>
<th>Year</th>
<th>Income</th>
</tr>
</thead>
<tbody>
<tr>
<td>1999</td>
<td>$ 50,000</td>
</tr>
<tr>
<td>2000</td>
<td>100,000</td>
</tr>
<tr>
<td>2001</td>
<td>275,000</td>
</tr>
<tr>
<td>2002</td>
<td>140,000</td>
</tr>
<tr>
<td>2003</td>
<td>330,000</td>
</tr>
</tbody>
</table>

The following is the income statement from 2003:

**INCOME STATEMENT 2003**

Net Sales ........................................ $ 10,100,000
Cost of sales and operating expenses
  Cost of goods sold .................................. 7,684,000
  Depreciation ..................................... 500,000
  Selling and administrating expenses ............ 1,325,000
  Operating profit .................................. 591,000

Other income
  Dividends and interest ............................ 27,000

TOTAL INCOME ..................................... 618,000

Less: interest on bonds ............................ 98,500

Income before provision for federal income tax .... 519,000

Provision for federal income tax .................. 189,500

NEW PROFIT FOR YEAR ......................... $ 330,000

The present market values of the securities of Sailcraft, which are widely traded over the counter, is as follows:

1. Common is selling for $25.00
2. Preferred is selling for $95.00
3. First Mortgage bonds, principal value of $100 are selling for $98.00

**CONSOLIDATED SPORTS**

Consolidated Sports, Inc. is a diversified corporation that generally limits itself to expansion into the leisure time industry. Industries in which it has holdings include the manufacturing of water and snow skis, bowling equipment, lawn furniture and baseball
bats. Consolidated Sports is an older company that has always made its move into new areas with great caution.

The balance sheet for Consolidated Sports is as follows:

**BALANCE SHEET -- DECEMBER 31, 2003 -- CONSOLIDATED SPORTS**

### ASSETS

**Current Assets**

- Cash: $900,000
- Marketable securities at cost (market value $1,900,000): $1,700,000
- Accounts receivable: $4,200,000
  - Less provision for bad debts: 200,000
- Inventories: 5,400,000

**TOTAL CURRENT ASSETS** $12,000,000

**Fixed assets**

- (property, plant, and equipment)
  - Land: 900,000
  - Buildings: 7,600,000
  - Machinery: 1,900,000
  - Office equipment: 200,000

**Less accumulated depreciation** 3,600,000

**NET FIXED ASSETS** 7,000,000

**Prepayments and deferred charges**

- 200,000

**Intangibles**

- (goodwill, patent, trademarks)
  - 200,000

**TOTAL ASSETS** $19,400,000

### LIABILITIES

**Current Liabilities**

- Accounts payable: $2,000,000
- Notes payable: 1,700,000
- Accrued expenses payable: 860,000
- Federal income tax payable: 640,000

**TOTAL CURRENT LIABILITIES** $5,000,000
Long term liabilities

First mortgage bonds 5% interest, due 2005 5,400,000

TOTAL LIABILITIES 10,400,000

STOCKHOLDERS EQUITY

Capital Stock

Preferred stock, 6% cumulative $100 par value each, authorized, issued, and outstanding 12,000 shares 1,200,000

Common stock, $5 par value each, authorized, issued, and outstanding 600,000 shares 3,000,000

Capital Surplus 1,400,000

Accumulated retained earnings 3,400,000

TOTAL STOCKHOLDERS’ EQUITY 9,000,000
TOTAL LIABILITIES AND STOCKHOLDERS’ EQUITY 19,400,000

The net income for Consolidated Sports for the last five years is as follows:

1999 .................. $700,000
2000 .................. $688,000
2001 .................. $694,000
2002 .................. $638,000
2003 .................. $672,000

The present market values of the securities of Consolidated Sports, which are widely traded in the over the counter market, are as follows:

1. Common stock is selling for $10.00
2. Preferred stock is selling for $100,000
3. First mortgaged bonds are selling for $98.00

INFORMATION ABOUT THE INDUSTRY

The sports and leisure industry generally seems to be one of the more attractive industries at the present time, although there is wide variation in some of the companies. The following are examples:

1. Wilson sporting goods (general sporting equipment including baseball, basketball, football, tennis and ice hockey equipment) has earnings per share for its common stock (eps) of $8 and is presently selling for
$79 per share. Historically, its beta has been around 1.0.

2. Head Skis (specializing in skis, tennis equipment) has eps for its common stock of $7 and is selling for $200. Historically, its beta has been around 0.8.

3. ARF (specializing in bowling equipment and sunfish sailing equipment [inexpensive and very popular sailing equipment]) has eps for its common stock of $10 and is selling for $150. Historically, its beta has been around 1.0.

4. MacGregor (specializing in baseball and basketball equipment) has eps for its common stock of $10 and is selling for $75. Historically, its beta has been around 1.3.