

CPPA Case Competition

October 19, 2013



The case was authored by **Faizan Hamdani**. All rights reserved.



Time: 60 minutes

It is February 1, 2013 and what a fantastic year it has been for Klaran Motors. Phillip Henderson, CEO of Klaran Motors, a private car manufacturer of sedan and SUV vehicles, has just gone over the 2012 financials (year-ending December 31, 2012) and is delighted. Revenues have increased by 200%, expenses are down and profits have nearly doubled since fiscal year 2011. With nearly \$430 million in cash in hand and an increase in current assets, the company is highly liquid thus opening future growth opportunities for the company. They also expanded on their single manufacturing plant in Guelph, by opening two more plants in Montreal and Vancouver thus driving the production cost per unit down.

With such a successful year, Phillip realizes that to remain competitive, the company needs to expand. As such, he is considering expanding Klaran Motors, a proud Canadian brand into the US market. He has already been approached by and given a Letter of Intent from Tezla Inc. (Tezla), a luxury car maker based out of Los Angeles to enter into a merger. Tezla have sent over their financials to Klaran Motors with the hopes of finalizing the merger by Q3 of 2013.

Phillip Henderson has just called a Board of Directors meeting to discuss the potential merger with Tezla and the future of Klaran Motors.

Attending the meeting are the following individuals, each of whom are to report on their department and provide strategic input for Klaran's future and their opinions on the prospective merger proposal.

- Sarah Morgan, *CFO of Klaran Motors*
- Ahmed Rizvi, *Manager of HR & Marketing*
- Janice Chu, *Director of Manufacturing and Operations*

You have also been invited to the meeting as an independent consultant to assess the situation and provide a final recommendation for your client, Klaran Motors.

Phillip - "Great year everyone! This has been a record year in the fifteen years this company has been operating. Financially, we have never been in a better position and the expansion of our plants has increased productivity and our cars have reached our clients at reduced cost and time. I want to hear some ideas now where we can go forward and how to leverage our position going forward. Ahmed, what do you think?"

Ahmed - "Well Phillip we indeed have had a great year – but on paper. Unfortunately our record year has come at a price. To achieve our productivity, employees on average had to work overtime at a wage lower than industry average. We had to cut our benefits and we have several pending lawsuits filed by former employees claiming compensation by citing injuries, stress and anxiety. If won, these lawsuits could cost Klaran Motors \$50-\$60 million spread over the next 3 years, with payments starting in August 2013."

Phillip - "I see. What impacts do you think this prospective merger will have on the marketing side of things? Will people respond positively to a merger between Klaran Motors and Tezla?"

Ahmed - "I think a merger will be great for Klaran Motors. Jaguar and Tata did it. Volkswagen and Porsche did it. Both are now competitively placed and dominant in the motor car industry. With Tezla's reputation of luxury and our stellar reputation for quality products as well as a strong Canadian brand, we can together start a revolution in the car business. Marketing it with those factors can certainly lead to a successful campaign."

Phillip - "Great. Janice, what is the update on the operations and factory front? How are our new plants in Montreal and Vancouver operating?"

Janice - "The plants are operating in-line just below expectations when looked at quantitatively as they are experiencing a loss. However, having plants located in Vancouver and Montreal are giving us easier access to clients in the United States. This has led to higher volumes of cars being sold in both markets and our North American presence has increased in past several months. Our customers have responded really well.

In regards to the merger, we will have to retrain our workers on the plant to come in line with safety and quality control standards both in the USA and Canada. However the biggest problem we will have to come to terms with is restructuring our plants in our Guelph location where the equipment has become outdated and will need to be replaced should we wish to continue with a merger. Tezla contracts dictate that all the machinery and parts bought the assembly of vehicles is purchased from their supplier based out of Detroit, Michigan."

Phillip - "I see. Now I want to figure out whether this merger that we are all considering is actually feasible or if it is just a pipe dream. Sarah, what are the financial records looking like?"

Sarah - "The books look absolutely fine Phillip. The financials suggest that we have the ability to look at further opportunities for growth as we have adequate amounts of cash on hand. However, we do have a

significant amount tied up in our receivables and I believe the best strategy would be to liquidate our receivables. I was hoping the independent consultant could provide us with some strategies to do so.

I do however want to bring up a different perspective. After diving into the numbers and doing further research I think it would be more prudent for Klaran Motors to stay away from a merger at this point in time and instead, focus on expanding in Canada, as we have recently done in the past. I strongly believe that the market in Canada can still be exploited and that we can gain the exact same value from staying single and not merging.”

Phillip - “I am going to need more than that Sarah. We have a very lucrative opportunity with Tezla to further grow as one organization catering to both the USA and Canada markets. What specifics can you provide me with?”

Sarah - “Well I have looked at the revenue projections drafted by the management at Tezla (Exhibit B), which although are above average for North American standards, I believe can be bettered by just focusing on the Canadian markets in the long run. It is no secret that the US automotive industry has been unstable for quite a while in the US and I think it would be an unnecessary risk to enter the market at this stage. Growing in Canada will have its own benefits in the future and I think before we dive too heavily into the US market with Tezla, we must make sure that our brand is reputable first in Canada. ”

Phillip – “Ok fair enough. I would like to see you prepare a table with Tezla’s key indicators (Exhibit C), so I can make a better informed decision. Alright everyone, good job and thank you for the update. As you know, we have hired an external consultancy firm to help us in making a decision on the future of Klaran Motors. I am sure they will provide us with a clear and concise decision in respect to the merger, and then present it to us to myself and the Board of Directors. I have informed them to use every piece of information that we have spoken of today and have given them access to our working papers and projections. I am confident they will do a thorough job.

You now gather your meeting minutes from the conversation between Klaran’s executives as well as other schedules and research you have drawn up and head back to your office to consult with your co-workers. As an independent consultant, you are faced with a tough task. Should Klaran take up Tezla’s offer and merge with the US Luxury car maker or should they stay as a single entity and continue developing in the Canadian market?

You must analyze the information and report back to Phillip Henderson within a week’s time with your findings which should include perspectives on marketing, HR as well as any financial and accounting discoveries or results you find.

Good luck!

Exhibit A – Automotive Market Share Analysis (Canada – 2012)

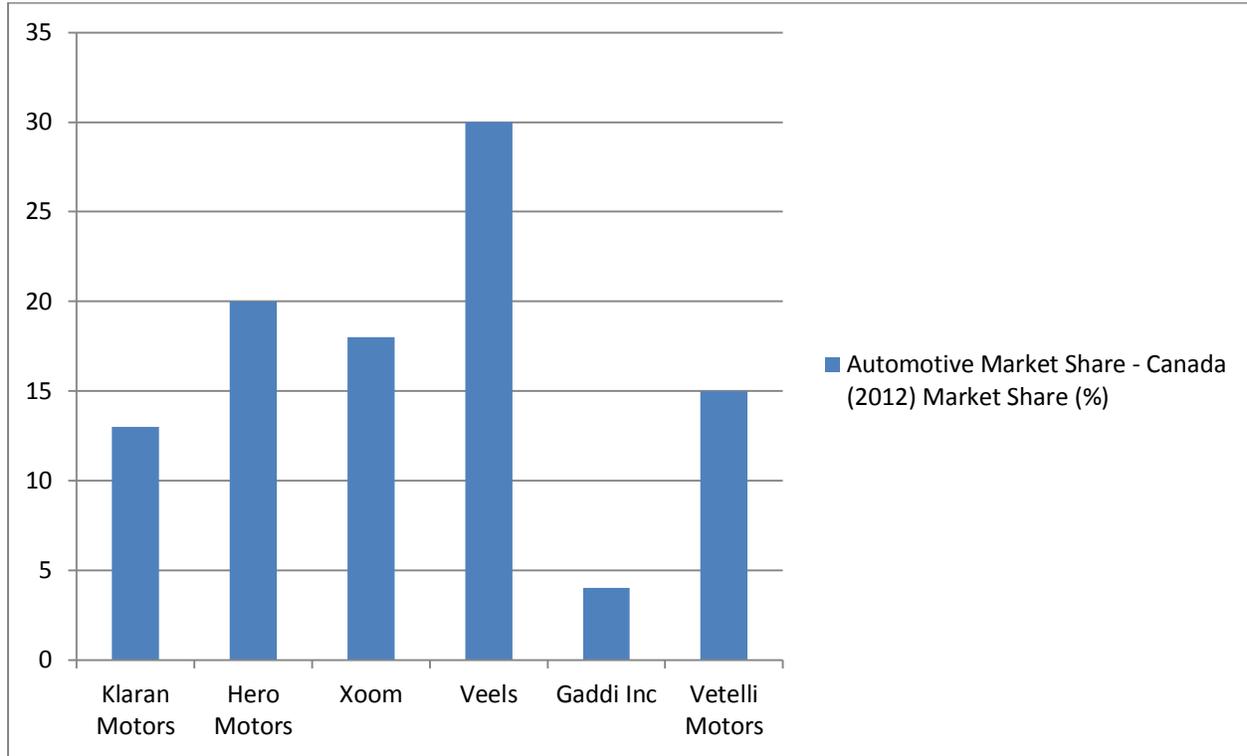


Exhibit B – Tezla Merger Projections

Prepared by Tezla Management

	Year 1	Year 2	Year 3	Year 4
Cars manufactured	22,400	23,600	30,000	38,000
Cars Sold	17,450	20,000	26,000	33,000
Revenues (billions)	0.785	1	1.3	1.8
Profit Margin	45%	55%	57%	60%
Profit Realized (billions)	0.35	0.55	0.74	1.08

Exhibit C – Analysis of Key Indicators

Prepared by Sarah Morgan

Key Indicators	Tezla Motors	Industry average (Luxury Vehicles)
Current Ratio	0.85	1.7
Quick Ratio	0.72	1.34
Market Share (Luxury vehicles)	17%	6%
Return on Equity Ratio	0.2	0.11
Number of independent showrooms (N. America)	99	86
Average Growth rate - Expected number of cars sold	14%	4%

Exhibit D – Klaran Motors Consumer Survey

500 consumers were asked why they chose Klaran motors as their car of choice. They voted for one or more of the following reasons:

Reason	Votes	Percentage
Reliability	401	80.2
Price	312	62.4
Canadian Brand	465	93
Low Maintenance	233	46.6
Recommended by friend	286	57.2
Prestige	109	21.8
Customer Service	304	60.8

Exhibit E – Car Sales in the United States of America (in millions)

