Evaluation of Potential Acquisitions

Student’s Name

Institution

Credit rate or score

Credit rate is a rate obtained relating to the creditworthiness of a borrower. The aim is checking whether the borrower is in a position to fulfil a financial obligation based on past borrowing history. No restriction provided as to people liable for credit rating. Individuals, corporations, state or sovereign governments fall under the credit score regulations.

Credit rating is a factor to consider when companies are in need of financial assistance. It will help to evaluate the financial capability of the companies to repay their loans.

Borrowing period

The company may borrow long-term loans to finance the acquisition. Long-term loans have benefits in terms of repayment amounts and repayment periods. As an acquisition, the units make profits and have good performance. Therefore, the repayment relies on the ability of the acquired companies to repay the loan. The company can utilize proceeds from the acquisitions to repay the loan amounts. This will take a long period hence using short-term funds to finance the acquisition is not applicable.

Effects of inflation

Inflation refers to the increase in prices of items due to excess flow of money in the economy. Therefore, in case of inflation in the economy, the cost of acquisition is higher. In other words, the company will pay more to acquire the targets (Penman, & Penman, 2007). The factor is significant as it may lead to reduced profits of the company. It will increase the acquisition cost making the company to utilize more funds on the purchase. Companies need to consider the time of acquisition and the cost. This is to reduce the cost impact on the shareholder’s investment.

Relationship between yield curves and the term structure of interest rates

Yield curves represent the yield to maturity of debt while the term structure relates the yields and the maturity period of debt. Both are used to value the debt instruments of a company. In this case, they will measure the maturity period and yields of debt involved in the acquisition process of the companies.

The impact of technology on interest rates

Gas is an important commodity on the functioning of the automobiles. It propels the vehicles and plays a role in combustion in the engine. The technology developed to change the conversion processed as indicated is pricey. This means that the company will pump more funds. The need for increased funds will lead to the increase in interest rates. The aim is to cover the risk attributable to borrowing large sums of money.

Ratios to consider in assessing the financial health of the potential acquisition

Ratios are a good measure of finance performance. They play a role in financial decision-making and firm prediction. In this case, the most relevant rations to consider in evaluating the financial health of a company include liquidity, profitability, efficiency and leverage ratios (Delen, Kuzey, & Uyar, 2013). Liquidity ratios include the quick ratio and current ratio. The acid test ratio will measure the ability of the company to access quick cash to facilitate its operations in order to meet its immediate demand. Liquidity ratio will measure the company’s ability to generate cash from its current asset to meet its demand. Current assets include the stock, accounts receivable, cash and prepayments.

Profitability ratios measure the company’s financial viability and as a comparable to other organization. They include net profit margin, operating profit margin, return on assets, and return on equity. These ratios will help to measure the financial viability of the company and the frequency of the acquisitions to settle their liabilities.

Efficiency ratios measure the ability of the company to pay their suppliers and collect debts from their credit customers. They include inventory turnover and average collection period.

Leverage ratios measure the extent of the company’s solvency and the use of debt to finance the company’s operations. They include debt to equity and debt to asset ratio. The ratios play a major role in measuring the financial health of the potential acquisitions.

References

Delen, D., Kuzey, C., & Uyar, A. (2013). Measuring firm performance using financial ratios: A decision tree approach. *Expert Systems with Applications*, *40*(10), 3970-3983.

Penman, S. H., & Penman, S. H. (2007). *Financial statement analysis and security valuation* (Vol. 3). New York: McGraw-Hill.