**WINNEBAGO'S USE OF LIFO**

David Frost sat at his desk staring off into the distance at the Rocky Mountains framed by his office window. He began to imagine taking some time off from his hectic work schedule and driving to Mount Elbert in his recreational vehicle (RV) with his six-year-old son, Wyatt, to enjoy the great outdoors. As a child, David made the trip with his father on numerous occasions and David had fond memories of those adventures. As David pondered the notion of a vacation, he glanced down at the investment file on his desk and was immediately reminded of the task at hand. He opened up the file of information on potential companies in which to invest and the first article was on Winnebago Industries. Could this be the place for their “mad money”?

***Background***

David and his wife, Anna, both had MBAs and worked for different employers. Although the recession was tough on their neighbors and friends, David and Anna were fortunate and had managed to accumulate a substantial amount of “mad money” in their joint bank savings account. Anna had been asking David for his ideas on how to invest the money to grow the Frost family portfolio.

David stared at the article on Winnebago Industries and thought to himself, “this might be fate”. In fact, David owned a Winnebago RV and the company had always fascinated him. As a child, David toured the Winnebago factory and was captivated by the manufacturing process.

Several weeks ago, David accessed the company’s 2012 annual report on line at [www.winnebagoind.com](http://www.winnebagoind.com). As he assessed the company’s financial performance, he remembered that he muttered to himself, “Wow!” The root of David’s excitement was that his analysis revealed net income and earnings per share had more than quadrupled since 2010. As he delved further into the financial statements, David compared gross income over the past three years and noticed it had increased each year. He also concluded that the phenomenal growth in net income was the result of an income tax benefit. David deduced that Winnebago recorded a significant income tax benefit in 2012 because the company reduced its deferred tax asset valuation allowance. He recalled from the days of being an MBA student that the income tax benefit was unlikely to persist in future years.

For this reason, David chose to focus his investment evaluation of Winnebago on income before income taxes and he assumed an overall income tax rate of 30%. David quickly put his business education to good use, remembering that to properly analyze any company’s financial performance one must calculate several ratios. David calculated the current ratio, return on assets, profit margin, asset turnover, gross profit ratio and inventory turnover for 2011, 2012 and 2013 to determine whether Winnebago would ultimately be a good investment. As David was preparing to undertake comparisons of the ratios, he realized that he was late to a business meeting.

At his business meeting, David ran into a friend, Ira, who was an analyst for a large investment bank. David began to discuss his thoughts regarding Winnebago with Ira. As David discussed Winnebago’s performance, Ira interrupted and said “David, you do know that Winnebago uses the Last-In, First-Out (LIFO) accounting method to value the company’s inventory. To properly analyze the company’s performance, you better adjust the financial statements to reflect the use of the First-In, First-Out (FIFO) inventory accounting method.” David remembered the two inventory valuation techniques, however, David did not immediately comprehend any real significance and Ira’s comments vaguely annoyed him.

Back at his desk, with the thought of a vacation with his son starting to fade, David realized several weeks had passed since his initial analysis of Winnebago. David was curious to see if Winnebago’s performance had changed because he had heard that the 2013 financial results were about to be released. He accessed the Winnebago website ([www.winnebagoind.com](http://www.winnebagoind.com)) and learned that the company had posted its 2013 annual report in the Investor Relations section. As he reviewed the financial statements, Ira’s comments kept bugging him. David got up from his desk and pulled his old accounting text off the bookshelf.

***Challenges***

As David began to review the text, the authors listed several reasons why companies use LIFO and discussed several limitations on its use. David recalled from his accounting class that many companies that employ LIFO report a LIFO reserve account in their financial statement notes. Sure enough, after reviewing the financial statements, David noted that Winnebago had a LIFO reserve. However, as David began to compare and digest the financial statements, he noticed that Winnebago’s LIFO reserve had decreased. He also recalled that, at times, companies undergo LIFO liquidations. He was uncertain as to whether Winnebago had undergone such a liquidation. For investment purposes, the text also indicated that to properly analyze a company’s performance the FIFO inventory technique is preferred because it allows the investor to make “apple-to-apple” comparisons to other companies, especially international companies. They went on to explain that more international companies use FIFO as International Financial Reporting Standards (IFRS) prohibit the use of LIFO. The text implied that one could easily convert the pertinent financial statements, including cash flows, from LIFO to FIFO.

***Next Step***

David concluded he had no other choice but to do more work: the LIFO to FIFO adjustment had to be done in order to properly analyze the company’s performance. As David contemplated making these comparisons, he knew it was important to “get it right” because their investments would help fund Wyatt’s college education, as well as Anna and David’s retirement. This was not the time for sentimentality, but rather objective, rational analysis. In the words of the immortal Bard, “to invest, or not to invest in Winnebago Industries, that is the question.”