Finance 4310 Class Problem

## Percent of Sales Technique

	XYZ Company
	Income Statement
For the	he Year Ended 12/31/xxxx
Sales	\$140,000
Cost of Goods Sold	<u>117,000</u>
Gross Profit	23,000
Operating Expenses	12,830
EBIT	10,170
Interest Expense	4,610
EBT	5,560
Taxes @ 39%	2,168
Net Income	3,392
Dividend	1,018
Addition to Retained Earnin	ngs \$2,374

	XYZ Company	
	Balance Sheet	
	12/31/xxxx	
	Assets	
Current Assets		
Cash	\$7,500	
Accounts Receivable	12,100	
Inventory	10,400	
Prepaid Items	5,900	
Other CA	4,300	
Total Current Assets	\$40,200	
Net Plant & Equipment	82,300	
Total Assets	\$122,500	

	XYZ Company	
	Balance Sheet	
	12/31/xxxx	
	Liabilities & Equity	
Current Liabilities		
Accounts Payable	\$7,200	
Wages Payable	3,600	
Notes Payable	5,400	
Taxes Payable	4.200	
Total Current Liabilities	\$20,400	
Long Term Debt	<u>35,700</u>	
Total Liabilities	\$56,100	
Common Stock	28,700	
Retained Earnings	37,700	
Total Liabilities & Equity	\$122,500	

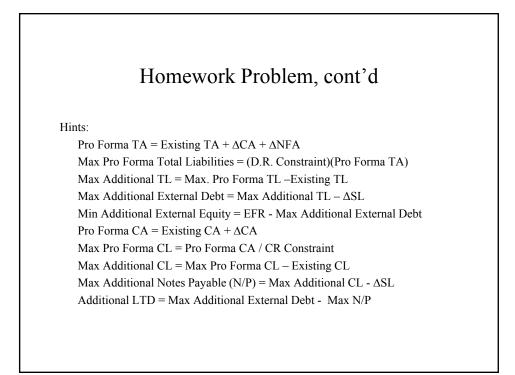
## Homework Problem, cont'd

[The projected sales for the forecast period is \$165,000. Assume that the existing profit margin and payout ratio will be maintained in the forecast period. The firm estimates that additional net fixed asset investment of \$18,000 will be required during the forecast period. Assume that all current assets are spontaneous except Other Current Assets which is assumed not to change. Assume that all current liabilities except Notes Payable are spontaneous.

A. Prepare the pro forma Balance Sheet and pro forma Income Statement. The EFR will be a plug number that makes the balance sheet balance like in the class example.

B. Using the existing financial statements as your basis, estimate firm XYZ's EFR for the forecast period again, but this time using the cookbook model. Also based on the cookbook equation, how much funding is expected to come from each of the internal sources of funds (change in SL and retained earnings). If firm XYZ must maintain a minimum current ratio of 1.8 and a maximum debt ratio of 0.50, how would you propose the EFR be financed (how much short term debt, long term debt, and equity)?

C. Based on your results in part B, prepare a Pro Forma Sources and Uses of Funds Statement to reflect the financing allocations that you decided on in part B. The only format change required is to break the total EFR down into the amounts of short term debt, long term debt, and new equity. You will have to use the numbers for  $\Delta CA$ ,  $\Delta SL$ , addition to R.E., and EFR that you calculated in part B to make it balance, since they may be slightly different than those from part A. **Explain the basis for your financing allocations.** 



## Check Answers

Pro forma EFR = \$18,589 Cookbook EFR = \$18,941 Financing Plan with constraints at their limits Additional Notes Payable: \$2,820 Additional LTD: \$11,861 Additional Equity: \$4,260 A more conservative plan would use less debt, more equity.