Great Lakes Industrial Supply, Inc.

Chuck Kolias, Chief Financial Officer of Great Lakes Industrial Supply, Inc. was preparing for a meeting with his company's bank later in the week. At that meeting, Mr. Kolias intended to present a request that the bank grant Great Lakes Industrial Supply a five-year loan to finance anticipated growth in the company and the expansion of the company's warehouse facilities.

In preparation for his meeting, Mr. Kolias had gathered some recent financial statements for Great Lakes. (see Excel template and Exhibit 1).

Company Background

Great Lakes Industrial Supply, Inc (Great Lakes) was a rapidly growing distributor of industrial hoses, fittings and related supplies in the upper mid-west United States. Supplies were sold to industrial clients through a chain of 12 outlets located throughout Ohio, Pennsylvania Michigan, and Illinois. These outlets kept sufficient inventory on hand to service immediate customer demand, but the bulk of Great Lakes' inventory was managed at a central warehouse outside Cleveland, Ohio. Individual stores could be easily serviced by this warehouse, which could usually fill orders from individual outlets within 24 hours.

For the year ended December, 2016, Great Lakes had sales of $23,505,000. Net income for that period was $1,190,000. During the previous three years, sales had grown at a compound annual rate in excess of 20%. This record was a reflection of Great Lakes' reputation for excellent service and competitive pricing, which yielded high levels of customer satisfaction.

Past Relationship with SkyBank

In 2012, Great Lakes had borrowed funds from SkyBank to build a warehouse. This loan was being repaid in equal annual installments of $125,000. At the end of 2016, the balance due on the loan was $875,000. Also, in 2012, Great Lakes established a line of credit at SkyBank. The company had not yet borrowed any money under this credit arrangement.

The Current Financial Need

Great Lakes had decided to expand its warehouse facilities to accommodate future growth. Indeed, the current warehouse facilities were practically bulging at the seams. During the next 18 months, Great Lakes planned to invest $2,400,000 on its expansion, $2,000,000 of which would be spent during 2017 (no other capital expenditures were planned for 2017 and 2018). This expansion would fulfill the company's anticipated needs for several years. The warehouse construction project was expected to be completed in early 2018. Therefore, Great Lakes would not be able to deduct any depreciation on the new building in 2017. However, Mr. Kolias was told by his accountant that in 2018, Great Lakes could recognize a depreciation expense of 5% of the warehouse's total cost. The dollar value of Great Lakes' depreciation expense on its other assets in 2017 and 2018 would be the same as it was in 2016.

The warehouse expansion project was designed so that disruption of the company's current operations would be minimized. However, management expected that by the end of 2017, Great Lakes would temporarily have to decrease its inventories to a level of $1,625,000, significantly lower than the $2,190,000 shown on the balance sheet at the end of 2016. This cutback in inventories was expected to last only until the warehouse construction project was completed in early 2018. Mr. Kolias had estimated that, by the end of 2018, inventory would rise back to the proportional relationship to sales that it had in 2016.

Other than this temporary drop in inventory in 2017, the warehouse expansion was not expected to affect Great Lakes' operations in any other material respects. Operating margins were expected to be consistent with recent past experience (the temporary drop in inventory would not affect cost of goods sold as a percentage of sales, for example). Likewise, current accounts other than inventory were expected to maintain steady relationships to sales. Cash balances, for instance, would be maintained at a level of 3% of sales during the next two years. Although the Federal statutory marginal corporate tax rate was 35%, the average tax rate on Great Lakes' pre-tax income had typically been higher than this due to miscellaneous local taxes. The higher overall level of taxation was expected to continue in the future at rates consistent with the most recent past experience. In view of this anticipated stability, Mr. Kolias expected Great Lakes' dividend payout policy to remain unchanged in the foreseeable future.

Great Lakes had preliminary discussions with SkyBank about borrowing money to finance the warehouse expansion and the growth of the business. The proposed terms of the financing called for taking down (i.e., borrowing) the loan in two separate parts on an as-needed basis: one in 2017 and one in 2018. The loan would be repaid in four equal annual installments. The first installment payment would take place one year after the construction of the warehouse was completed (i.e., in 2019). The interest rate was set at 10% per year.

Mr. Kolias' Task

In preparation for his meeting, Mr. Kolias intended to develop a set of pro forma financial statements for the company. He and his staff had projected a 20% increase in sales each year in 2017 and 2018 from $23,505,000 to $28,206,000 and $33, 847,000, respectively. Mr. Kolias' first priority was to predict what the rest of the income statement and the balance sheet for the firm would look like at the end of 2017 and 2018.

Exhibit 1 Financial Statements for Great Lakes Industrial Supply, Inc. (amounts are in $000)

For years ending 12/31	2014	2015	2016
INCOME STATEMENT			
Net sales	$ 16,230	$ 20,355	$ 23,505
Cost of sales	9,430	11,898	13,612
Gross Profit	6,800	8,457	9,893
Selling, general, and administrative expens	5,195	6,352	7,471
Depreciation	160	180	213
Net interest expense	119	106	94
Pre-tax income (EBT)	1,326	1,819	2,115
Income taxes	546	822	925
Net income	$ 780	$ 997	$ 1,190
Dividends	$ 155	$ 200	$ 240
BALANCE SHEET			
Assets			
Cash balances	$ 508	$ 609	$ 706
Accounts receivable	2,545	3,095	3,652
Inventories	1,630	1,838	2,190
Total current assets	4,683	5,542	6,548
Gross plant & equipment	3,232	3,795	4,163
Accumulated depreciation	1,335	1,515	1,728
Net plant & equipment	1,897	2,280	2,435
Total assets	$ 6,580	$ 7,822	$ 8,983
Liabilities			
Current maturities of long-term debt	$ 125	$ 125	$ 125
Accounts payable	1,042	1,325	1,440
Accrued expenses	1,145	1,432	1,653
Total current liabilities	2,312	2,882	3,218
Long-term debt	1,000	875	750
Common stock	1,135	1,135	1,135
Retained earnings	2,133	2,930	3,880
Total shareholders' equity	3,268	4,065	5,015
Total liabilities and Equity	$ 6,580	$ 7,822	$ 8,983

Grading Rubric
EMBA Excel Modeling Assignments

	An "A" for this component of the Model **100 - 90**	**A "B" for this component of the Model** **89 – 80**	**A "C or LESS" for this component of the Model** **79 and below**
Accuracy	There are very few, if any, errors in calculations and data entry. Those errors that do exist have little bearing on the final analysis	There are some errors in calculations and data entry, with varying degrees of significance. The errors may have some bearing on the final analysis. However, the errors do not detract from the overall logic of the model.	The model has error(s) in calculations and data entry that affect the final analysis.
Technical	The model is fully dynamic and exhibits advanced technical competency	The model is largely dynamic but lacks complete linkage/dynamism. The model exhibits above average technical competency	The model is largely not dynamic and exhibits average to below average technical competency.
Formatting	The model is expertly formatted, with good use of color and fonts. There are few, if any, inconsistencies. The model is very clear and easy to follow	The model decently formatted with some inconsistencies. Overall presentation could be improved but the model is generally clear and able to be followed without much difficulty	The model is poorly formatted with inconsistencies and poor layout. It requires a great deal of effort to follow the model.
Completeness	The analysis provided in the model is complete in that all parts of the assignment are fully addressed.	The analysis provided in the model addresses most to all points in the assignment but some analysis is not fully developed or is missing	The analysis is missing either a major component of the assignment or is missing several smaller components. Alternatively, all points might be addressed but the analysis is very poor.

Each of the areas above will be graded accordingly and equally weighted to arrive at a final grade.