Appendix A

THE BASIC FORECASTING MODEL

This information is being provided as supplementary material and is not required reading as part of the course.

Financial Forecasting and Decision Making
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Objective

The basic forecasting model will be presented in this appendix. This model is often called the percent of sales method. The percent of sales method is developed from the idea that a company's assets, liabilities, and expenses are related to the company's sales volume. Generally speaking, the larger a company's sales are, the larger its other accounts will be.

Key Words

pro forma. A forecasted financial statement using assumptions about the future.

spontaneous accounts. Assets and liabilities that need to increase as sales increase.

quasi-spontaneous. Accounts such as retained earnings and fixed assets that may increase as sales increase.

reconciliation. The balance sheet and income statements are related. When we forecast them, we must make sure they agree by using the reconciliation equation.

reconciliation equation. A pro forma version of the equation:

$$\text{assets} = \text{liabilities} + \text{owner's equity}$$

retention ratio. The proportion of earnings retained in the company. It is one minus the payout ratio.

EFN. External financing needed as a company grows.

first-pass forecast. The first forecast that is computed with basic assumptions. These assumptions can be changed to better manage the company.

The Need for a Sales Forecast

A good sales forecast is important as a starting point for the percent of sales method. In spite of its importance, we shall not discuss it in depth. Sales forecasts are more generally prepared by a sales staff, marketing, or marketing research department. We will assume that the company already has a sales forecast and will prepare the pro forma financial statements from the forecast of sales.

In the first section of this chapter, we will discuss pro forma balance sheets. In the second section, we will discuss pro forma income statements. The third section in the chapter will show you how to reconcile the pro forma income statement with the pro forma balance sheet. This reconciliation is necessary because the two financial statements are interrelated. The final section gives you a problem to work on your own so that you can be sure you are on the right track.

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Forecasting the Balance Sheet

Many balance sheet accounts are closely related to sales. This is an important point that you must understand before proceeding. For example, think of inventory. If a company wants to increase its sales (assuming that the management is not trying to change the inventory management system at the same time), inventory will have to increase to accommodate the larger sales volume. Although the relationship between other balance sheet accounts and sales may not be so obvious, the relationships do exist.

When an account is directly related to sales, the account is called spontaneous. We use the term *spontaneous* in a similar manner as in "spontaneous combustion." Spontaneous combustion implies that a fire is started without anyone applying a match to, say, some oily rags. A spontaneous asset is an asset that increases (spontaneously) when sales increase. A spontaneous liability is a liability that increases when sales increase. Certainly, management can prevent a spontaneous account from increasing, and in some instances may want to do just that. However, in the absence of specific management action preventing the spontaneous increase, a spontaneous account will rise when sales do.

Generally, we consider cash, accounts receivable, and inventory to be spontaneous. These accounts need to increase as sales increase. Receivables often increase on their own, whereas the company must plan for cash and inventory increases. Marketable securities are spontaneous only if we use them to invest temporary excess cash balances. Any other reason for holding marketable securities means they are non-spontaneous.

Fixed assets are *quasi-spontaneous*. It would be ridiculous to believe that fixed assets will increase when sales increase. However, if a company has reached its practical fixed asset capacity, increasing sales will require an increase in the fixed asset.

Fixed asset expenditures generally are made in large lump-sum purchases. For example, if sales are expected to increase a little each of the next ten years, it would not be in a company's best interests to build ten small factories during each of the next ten years. More often than not, it is less expensive to plan ahead and build a factory to handle the growth of several years.

We consider liabilities to be spontaneous. For example, accounts payable, taxes payable, and accruals generally are related to sales volume. As sales increase, a company must make more expenditures so its accounts payable and accruals will rise. If its new sales are profitable, taxes payable will rise, too. Once again, management could prevent the increases from happening; but unless they prevent it, the increases will occur.

We do not consider liabilities that require specific negotiation with a lender to be spontaneous. Notes payables, bank loans, and bonds are not spontaneous. Although they may increase from time to time, it is a management decision. The increases are not spontaneous.

Equity accounts are not spontaneous. To increase common or preferred stock requires specific management action. Management may decide to increase one of these accounts in response to sales increases, but it does not occur spontaneously.

Retained earnings is the one exception to equity accounts. We will call retained earnings a quasi-spontaneous account. If a company's sales increase, retained earnings will increase only if the new sales are profitable and only if the dividend payout ratio is not increased to offset the increased profitability. To find out how much retained earnings will increase, add the new retained earnings to the previous balance. The new retained earnings will be the expected total sales multiplied by the company's profit

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margin (ratio of net income to sales) which is multiplied by the company's retention ratio (one minus the payout ratio).

The computation described in the preceding paragraph is a simplification. It presumes that the profit will increase at the same rate as the company's sales. This issue will be covered more completely when we reconcile the income statement and the balance sheet in Section III. An example of pro forma balance sheet preparation follows.

In projecting the balance sheet, with a first pass, we assume that the spontaneous accounts increase in the same proportion as sales. After the first pass of the forecast, we can change this assumption.

The 20X6 balance sheet for the Comfortable Company appears after this paragraph. Comfortable is a producer of fine furniture. There is nothing outstanding to note about this balance sheet. However, we can identify the spontaneous accounts, cash, receivables, inventory, accounts payable, and accruals. The Comfortable Company is operating at its fixed asset capacity, so any sales increases will require new fixed assets. Its profit margin is 5 percent and Comfortable keeps a 40 percent payout ratio.

Comfortable Company
20X6 Balance Sheet

Cash	$10,000	Accounts Payable	$5,000
Marketable Securities	5,000	Accruals	2,000
Receivables	25,000	Notes Payable	12,000
Inventory	35,000	Total	19,000
Total	75,000	Long-term Debt	48,000
Net Fixed Assets	80,000	Common Stock	32,000
		Retained Earnings	56,000
Total Assets	$155,000	Total	$155,000

Selected Income Statement Figures

Sales	$100,000
Net Income	5,000
Dividends	2,000

The Comfortable Company Management expects a sales increase of 20 percent in 20X7. This estimate is based upon a thorough market analysis prepared by an outside marketing analysis and consulting firm. Because fixed assets are at their practical capacity, net new fixed assets costing $12,000 must be purchased. In addition, the current notes payable are due and must be paid off during the year.

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We assume that fixed asset increases are net of next year's depreciation. This would include depreciation on the new fixed assets and depreciation on the existing fixed assets.

We have prepared a pro forma balance sheet based upon the outlined facts. Let us examine each account to determine how the balance was computed. Cash is the first account listed. Cash is a spontaneous asset. Because sales will increase by 20 percent, the model assumes that cash will increase by 20 percent as well. The predicted cash balance is $12,000, a 20 percent increase over 20X6's $10,000 balance. Management may not want an increase in cash of 20 percent and can certainly prevent it. However, in the absence of specific management action, the increase will occur. Similarly, we have increased each of the other spontaneous assets and liabilities by 20 percent.

1. 20 percent sales increase in 20X7.
2. Net fixed asset increase of $12,000 will be required.
3. The current notes payable are due.

Comfortable Company
20X7 Pro forma Balance Sheet

Cash (10,000)(1.2)	$12,000	Accounts Payable (5,000)(1.2)	$6,000
Marketable Securities	5,000	Accruals (2,000)(1.2)	2,400
Receivables (25,000)(1.2)	30,000	Notes Payable (paid off)	0
Inventory (35,000)(1.2)	42,000	Total	8,400
Total	89,000	Long-term Debt (same)	48,000
Net Fixed Assets (80,000+12,000)	92,000	Common Stock (same)	32,000
Total Assets	$181,000	Retained Earnings*	59,600
		Subtotal	148,000
		EFN	33,000
		Total	$181,000

Retained Earnings Computation

$$*\$56,000 + (120,000)*\left(\frac{5,000}{100,000}\right)(1-\frac{2,000}{5,000}) = \$59,600$$

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Marketable securities is the next account listed, and the balance remained the same as shown historically. Marketable securities is not spontaneous. Unless Delta's management decides to adjust this balance, it will remain the same.

We consider receivables and inventory to be spontaneous. Their pro forma balances increase by 20 percent over the balance in 20X6.

Fixed assets increase by a net amount of $12,000. Fixed assets are not related to sales in the same way as the truly spontaneous accounts. Instead, Comfortable's management obtained estimates for the fixed assets and decided to make the purchase. The $12,000 is added to the previous period's balance and is net of 20X7 depreciation.

The total assets are $181,000. The liabilities and equities must total to this amount, too.

Accounts payable and accruals are spontaneous. Their balance is expected to increase by 20 percent over the 20X6 balance. The notes payable are due in 20X7. Unless management decides to renew them, this balance will drop to zero.

Long-term debt and common stock will not change, at least not at this stage of the planning process. Their balances remain constant.

The pro forma retained earnings balance is $59,600. We arrive at this balance in the computation at the bottom of two. The 20X6 retained earnings balance, $56,000, is increased by the new retained earnings. The new retained earnings is found by multiplying the total expected 20X7 sales, $120,000, by the profit margin, $5,000/ $100,000, and by the retention ratio, 1 − ($2,000/ $5,000). The product of the first two terms, sales times the profit margin, provides an estimate for 20X7's net income (profit). The profit estimate times the retention ratio (the retention ratio is one minus the payout ratio) provides the expected increase in retained earnings.

Summing the liabilities and equities shows a balance of $148,000, which is $33,000 short of the asset balance. The total increase in the assets was greater than the increase in the liabilities and equities. We will call this $33,000 difference External Financing Needed (EFN).

The EFN exists because when a company's sales grow, generally the accompanying growth in assets is not offset by the growth in liabilities and equities. It is ironic that a company that is extremely profitable and is growing very fast will have to raise considerably more external funds than a static company.

At this stage of the forecasting procedure, Comfortable management must decide how to raise the EFN. They can consider either new long-term debt or a common stock sale. Most corporate finance books discuss capital structure and financing decisions, and we urge you to examine this issue in more depth. We will deal only with the forecast after this decision has been made.

One final way to deal with the EFN is to reduce the growth in the assets. Perhaps better asset management would reduce the external funding requirements. Reducing the relationship between any of the spontaneous assets and sales will reduce the EFN. For example, better inventory management will reduce the ratio of inventory to sales and reduce the EFN as the company grows.

Suppose that management decided to raise the $33,000 with a common stock sale. The only change to the balance sheet would be the common stock account. Its balance would rise to $65,000, an amount that is $33,000 larger than its present balance.

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This completes our discussion of the balance sheet for the moment. We will return to it later to combine it with the income statement. In the next section, we will examine the forecasted income statement. The same percent of sales model will be used.

The Forecasted Income Statement

In the previous section, we used a simplification to find net income. The simplification was that net income would remain a fixed percentage of sales. The profit margin was used to convert the sales estimate to the net income estimate.

In this section, we will bypass this simplification by constructing a pro forma income statement. We will use percent of sales method in this section as well.

An income statement will include estimates for sales (which we assume to be available to us) and estimates for various expenses. Most expenses will be related to sales. As sales go up, the expenses will rise as well. We will treat the expenses as variable because this will overstate the pro forma expenses and understate pro forma income.

To construct the income statement from the percent of sales method, we compute each item on the most recent income statement as a percentage of sales. We apply these percentages to the pro forma sales estimate to obtain the estimated balances in these accounts. An example is the best way to learn the procedure.

The 20X6 Comfortable Company income statement appears after this paragraph. The income is $5,000 from sales of $100,000. The interest expense is based upon the 10 percent notes payable and the 15 percent long-term debt. The interest computation is included at the bottom of the income statement.

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Comfortable Company
20X6 Income Statement

		%
Sales	$100,000	100.0
Cost of Goods Sold	55,000	55.0
Gross Profit	45,000	45.0
Selling and Administrative Expenses	26,600	26.6
EBIT	18,400	18.4
Interest*	8,400	8.4
EBT	10,000	10.0
Taxes (50%)	5,000	5.0
Net Income	$5,000	5.0

*	Notes Payable	$12,000 @ 10% =	$1,200
	Long-term Debt	48,000 @ 15% =	7,200
	Total Interest		$8,400

Comfortable is still expecting a 20 percent sales increase in 20X7 over the 20X6 sales. The 20X7 pro forma income statement follows.

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Comfortable Company 20X7 Pro Forma Income Statement		
		%
Sales	$120,000	100.0
Cost of Goods Sold	66,000	55.0
Gross Profit	54,000	45.0
Selling and Administrative Expenses	31,920	26.6
EBIT	22,080	18.4
Interest*	7,200	6.0
EBT	14,880	12.4
Taxes (50%)	7,440	6.2
Net Income**	$7,440	6.2

* Assumes that the notes payable are paid off early in 20X7.
** Net Income is not the same percentage of sales as in 3 because debt did not remain the same percentage of sales.

Historically, the cost of goods sold was 55 percent of sales. We apply this percentage to the estimated sales. The estimate for cost of goods sold is $66,000 in 20X7. This leaves Comfortable with gross profit amounting to $54,000. Selling and administrative expenses were 26.6 percent of sales in 20X6. Applying this percentage to the 20X7 sales estimate produces selling and administrative expenses of $31,920. Subtracting this expense from gross profit gives the earnings before interest and taxes (EBIT) of $22,080. EBIT is 18.4 percent of sales in 20X6 and in the 20X7 estimate.

So far, we have applied a straight percentage to each of the items in the income statement. However, when we begin our computation of the interest expense, an inconsistency arises. The inconsistency is that in the balance sheet computation we knew that the short-term notes payable were due in 20X7. Therefore, the 20X7 interest expense, in the absence of using debt to finance the EFN, will be $7,200.

Notice that the percentage of sales is now 6 percent instead of the 8.4 percent incurred in 20X6. This difference occurred for two reasons. First of all, as we mentioned earlier, the notes payable were due in 20X7. Therefore, no interest was paid on them. Secondly, we violated the strict percent of sales. Interest expense was kept at a particular balance instead of as a percentage of sales. In other words, it was treated as a non-spontaneous account.

The taxes are assumed to be 50 percent of the earnings before taxes, leaving net income of $7,440. This net income is not the same percentage of sales as the 20X6 income. Several problems must now be addressed. These problems will be discussed here, but they will be solved in the next section.

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The first problem is that the net income that we computed in the income statement was $7,440. The net income that was used in the retained earnings computation in the balance sheet was 5 percent of $120,000, or $6,000. The difference happened because interest expense was treated as a non-spontaneous account. In other words, it was not held to 8.4 percent of sales.

We can reconcile this difference:
(8.4% − 6.0%)($120,000)(50%) = $1,440

Interest expense was 8.4 percent of sales in 20X6 and is expected to be 6 percent of sales in 20X7. Multiplying this difference by the $120,000 expected sales and then by the tax rate, 50 percent, produced $1,440. This number is the difference between the interest expense for the two years.

We know that the interest expense will not be 8.4 percent of sales, so the income statement will be the most correct estimate of income. This means we must go back and adjust our balance sheet for this new set of information.

The second problem is the EFN. If we finance the EFN or a portion of the EFN with debt, then we will have a new computation for interest expense. This fact would render both the income statement and the balance sheet incorrect. As a matter of fact, it makes the computation more difficult because we need to know the complete balance sheet to compute the EFN and the interest computation on the income statement, and we need the income statement to complete the retained earnings section on the balance sheet. It is a circular problem. The income statement is needed to find the balance sheet, but the balance sheet is needed to find the income statement. Fortunately, it is not an unsolvable problem. In the next section, this problem and the previous one will be solved.

Reconciling the Two Pro Forma Financial Statements

The two problems that must be solved both deal with the interest computation. Both of the problems can be solved in one step. The solution requires an equation with an algebraic manipulation.

The procedure for reconciling the income statement and balance sheet are as follows:

Reconciling the Pro forma Balance Sheet and Income Statement

1. Prepare a pro forma estimate of the assets and total liabilities. Use the percent of sales method in the way we did in Section I. Do not prepare an estimate for the retained earnings or the EFN—this will come later.
2. Prepare a pro forma estimate of EBIT. Use the percent of sales method. Remember that the problems with the income statement occur after EBIT, so there is no problem with its preparation.
3. Use the following equation to solve for the EFN.

$$\text{Beginning Retained Earnings} + \text{Interest on } [(\text{EBIT} - \text{Existing Debt} - \text{New Interest})(1 - T)(1 - PO)] + \text{Total Debt and Common Stock} = \text{Pro forma Assets}$$

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This equation is not as overwhelming as it may seem at first glance. The term in the brackets is the new retained earnings. Notice that it is the bottom section of an income statement in equation form. We are subtracting the interest expense from the EBIT, the old interest, and the new interest. The new interest is the proportion of the EFN to be debt-financed EFN times the interest rate on the new debt. This gives us earnings before interest and taxes. When we multiply by one minus the tax rate, T, then the net income is computed. It is based upon the amount of EFN. Multiplying the net income by one minus the payout ratio, PO, gives the incremental addition to retained earnings.

This is added to the existing retained earnings balance to arrive at the pro forma retained earnings balance. The only unknown is the EFN, and it will be found momentarily.

The pro forma retained earnings balance is added to the total debt and common stock. Total debt includes any existing debt, which will remain on the balance sheet, plus any new debt, which is the EFN.

The sum of all these terms is the total right-hand side of a balance sheet. The total of these liabilities and equities must be equal to the total of the assets. Remember we already found the total pro forma assets, so we set the liabilities and equities equal to that number. Once again, the easiest way to learn this procedure is with an example.

Let us re-compute the income statement and balance sheet for Comfortable Company for 20X7 using the outlined reconciliation procedure. The first step in the procedure is to find the pro forma assets. If we look back, we can see that the assets total $181,000. The current liabilities can also be found, and they total $8,400. The existing long-term debt is $48,000 and the common stock is $32,000. The total of the liabilities and common stock is $88,400. We must now turn our attention to the income statement.

We can use the pro forma income statement to find the EBIT. It is $22,080. The tax rate is still 50 percent, and the payout ratio is still 40 percent. Let us assume that we will finance the EFN with a long-term debt issue at an effective interest rate equal to 15 percent. We now know everything that we need to prepare the pro forma financial statements.

Reconciliation of the Income Statement and the Balance Sheet

$$\$56{,}000 + 88{,}400 + \text{EFN} + [(22{,}080 - 7{,}200 - ((\text{EFN})(0.15)))(1 - 0.50)(1 - 0.40)] = \$181{,}000$$

$$\text{EFN} = \$\underline{33{,}650}$$

We show the reconciliation in the preceding box. The old retained earnings balance is $56,000. The debt and common stock is $88,400 plus the EFN. This is the old debt, common stock, and new debt (EFN).

The incremental retained earnings computation is inside of the brackets. EBIT is $22,080. From EBIT, the interest on the existing debt—$7,200—is subtracted. The interest on the new debt must also be subtracted. The new debt is EFN and its interest rate is 15 percent. Therefore, the interest cost on the new debt is (EFN)(15 percent). Income before taxes is multiplied by one minus the tax rate, (1 − 50%), and by one minus the payout ratio (1 − 40%). The term in brackets is the new retained earnings.

The expression on the left-hand side of the equation is the total new liabilities and equities. It must equal the total of the pro forma assets, $181,000, found earlier.

We have an equation and one unknown, EFN. Solving algebraically for EFN produces an amount equal to $33,650. Now that we know the EFN and how it is financed, the final version of the pro forma financial statements can be prepared.

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We show the complete reconciled income statement in the following text. It is the same as before down to EBIT. The new interest computation is based on the existing long-term debt plus the EFN.

Comfortable Company Reconciled Income Statement	
Sales	$120,000
Cost of Goods Sold	66,000
Gross Profit	54,000
Selling and Administrative Expenses	31,920
EBIT	22,080
Interest*	12,248
EBT	9,832
Taxes (50%)	4,916
Net Income	4,916
Dividends (40%)	1,966
Addition to Retained Earnings	2,950
Beginning Retained Earnings	56,000
Ending Retained Earnings	$58,950
* (48,000 + 33,650)(15%) = $12,247.50 which rounds to $12,248.	

The reconciled balance sheet appears after this paragraph. The asset side is the same as before. The asset side does not depend on the method of financing. The only difference is in the computation of the retained earnings. The new retained earnings balance is $58,950. We computed it at the bottom of the pro forma income statement. Notice that the EFN is shown as long-term debt because that was our method of financing.

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Comfortable Company Reconciled Balance Sheet			
Cash	$12,000	Accounts Payable	$6,000
Marketable Securities	5,000	Accruals	2,400
Receivables	30,000	Notes Payable	0
Inventory	42,000	Total	8,400
Total	89,000	Long-term Debt-Existing	48,000
Net Fixed Assets	92,000	Long-term Debt-EFN	33,650
Total Assets	$181,000	Common Stock	32,000
		Retained Earnings	
		(56,000 + 2,950)	58,950
		Total	$181,000

A couple of additional points must be made. The first is, hopefully, obvious to you. The balance sheet and income statements that we prepared in Sections I and II are not the correct procedure. The reconciliation is necessary to be entirely accurate. However, we use the estimates if a "quick and dirty" estimate is all that we require.

The final point to be made is that we did not have to assume debt financing. Suppose, first of all, that the EFN would come strictly from equity financing. In our reconciliation the (EFN)(15 percent) computation would not be made. The EFN would still be added to long-term debt and common stock, but now it would be considered a new stock issue instead of a new debt issue.

Now suppose that 30 percent of EFN would be debt and 70 percent would be equity. The computation of the new interest would be:

$$(30\%)(EFN)(15\%)$$

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The total EFN would be added to the common stock and existing debt, as follows:

Reconciliation of the Income Statement and the Balance Sheet—30 Percent Debt to Equity Ratio

$$\$56{,}000 + 88{,}400 + EFN + [(22{,}080 - 7{,}200 - (30\%)((EFN)(0.15)])(1 - 0.5)(1 - 0.4) = \$181{,}000$$

$$EFN = \$32{,}576$$

Financing the EFN

Debt	Equity
$9,773	$22,803

Using the percent of sales method, reasonable estimates for pro forma financial statements can be prepared. The last section of this chapter will present a final overall example. Try working the example before you peek at the answer.

Overall Example

Zeta Company
20X8 Balance Sheet

Cash	$5,000	Accounts Payable	$3,000
Marketable Securities	5,000	Taxes Payable	12,000
Accounts Receivable	10,000	Accruals	3,500
Inventory	35,000	Total Current Liabilities	18,500
Total Current Assets	55,000	Notes Payable (8%)	15,000
Building	100,000	Bonds Payable (12%)	30,000
Equipment	15,000	Common Stock	48,000
Total Assets	$170,000	Retained Earnings	58,500
		Total	$170,000

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Zeta Company 20X8 Income Statement	
Sales	$245,000
Cost of Goods Sold	145,000
Gross Profit	100,000
Selling and Administrative Expenses	60,000
EBIT	40,000
Interest*	4,800
EBT	35,200
Taxes (46%)	16,192
Net Income	19,008
Dividends (40%)	15,000
Addition to Retained Earnings	$4,008

* 15,000 @ 8% =	$1,200
30,000 @ 12% =	3,600
Interest Exp	$4,800

A balance sheet and income statement for the Zeta Company are presented. Using this information and the information in the following box about the next year, compute pro forma financial statements.

Assumptions for 20X9

Changes in 20X9

- $25,000 sales increase
- $5,000 new equipment required
- Building maintenance will offset depreciation
- 45 percent of EFN to be financed with 10 percent debt

Steps to prepare pro forma statements

- Find new total assets
- Find pro forma EBIT
- Find EFN with reconciliation computation
- Complete income statement and balance sheet

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The computations for the financial statements appear after this paragraph. Before you look at the answers, try to work this one out on your own.

Asset Computation	
Cash	$5,510
Marketable Securities	5,000
Receivables	11,020
Inventory	38,571
Total Current Assets	60,101
Building	100,000
Equipment	20,000
Total Assets	$180,101

Liabilities and Equity Computation	
Accounts Payable	$3,306
Taxes Payable	13,224
Accruals	3,857
Total Current Liabilities	20,387
Notes Payable	15,000
Bonds Payable	30,000
Common Stock	48,000
Total	113,387
Retained Earnings (Beginning)	$58,500

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EBIT Computation	
Sales	$270,000
Cost of Goods Sold	159,840
Gross Profit	110,160
Selling and Administration Expense	66,150
EBIT	$44,010

Zeta Company

Reconciliation Computation

$113,387 + 58,500+ EFN + [44,010 – 4,800 – (0.45)(EFN)(0.10)](1 – 0.46)(1 – 15/19) = $180,101

EFN = $ 3,776

9,214 = [39,410 – 0.045EFN](0.54)(0.210526) + EFN

9,214 = 4,458 – 0.005116EFN + EFN

3,756 = 0.994884 EFN

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Zeta Company
Pro forma Income Statement

Sales		$270,000
Cost of Goods Sold		159,840
Gross Profit		110,160
Selling and Administrative Expenses		66,150
EBIT		44,010
Interest—Old	$4,800	
Interest—New*	170	4,970
EBT		39,040
Taxes (46%)		17,958
Net Income		21,082
Dividends		16,644
Addition to Retained Earnings		4,438
Beginning Retained Earnings		58,500
Retained Earnings		$62,938

* New Interest
(3776)(0.45)(10%) = 170

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Zeta Company
Pro forma Balance Sheet

Cash	$5,510	Accounts Payable	$3,306
Marketable Securities	5,000	Taxes Payable	13,224
Receivables	11,020	Accruals	3,857
Inventory	38,571	Total Current Liabilities	20,387
Total Current Assets	60,101	Notes Payable	15,000
Building	100,000	Debt - EFN (3,776)(0.45)	1,699
Equipment	20,000	Bonds Payable	30,000
Total Assets	$180,101*	Common Stock	
		48,000 + (0.55)(3,776)	50,077
		Retained Earnings	62,938
		Total	$180,101

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