Finance 4020  
Financial Analysis and Introduction to Loan Structuring  
Fall 2010

Instructor:  
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Course:  
CRN #81635  
4:30 p.m.-7:00 p.m., T  
313 ALC

Course description:  
This is a course about analyzing the funding needs of non-financial businesses and then determining the appropriate financial structures to meet those needs. We will focus primarily on bank loan solutions. Our principal analytical tools will be business plan analysis, financial statement inspection, cash flow statements, financial ratios, common-sized financial statements, and pro forma statements. Our learning method will be intensive case analysis. Student involvement in case discussion is an important part of the learning process.

Critical thinking through writing (CTW):  
All successful students should be adept at critical thinking. For this reason, Georgia State University requires that all undergraduate students take CTW courses in their majors. FI 4020 is one of the Department of Finance’s CTW courses.

What is critical thinking in business? It is the process of assessing a situation, identifying an underlying problem, developing alternative solutions to the problem, acquiring information that can be used to examine the alternatives, reasoning logically from this evidence, and making an informed, implementable decision. This skill is central to effective decision-making. Critical thinking is not something that is innate but, instead, is learned.

One way to develop critical thinking is through writing. FI 4020 is a writing intensive course. There are two reasons for making writing such an important part of this course. First, employers will expect you to be able to author well conceived analyses. Second, research shows that if we write about what we are studying, our learning increases. Because of the value of writing, written work is a large portion of your grade. There are no true-false or multiple choice questions in this course.

One way of implementing writing in the course is through business analyses. You will do three, two-page, written analyses of cases using a format that is included on the myRobinson course site and will be discussed in class. We will use the same format throughout the term so that you will be able to use feedback from earlier analyses to improve your later write-ups. These business analyses will be graded for writing in addition to subject matter content. You will find that these business analyses will greatly enhance your critical thinking skills.
Course prerequisites:
1. FI 3300
2. A good understanding of AC 2101 and AC 2102
3. CSP: 1, 2, 6. Employers will expect you to have these skills. While you should enter FI 4020 with the basic skills, this course will give you an opportunity to develop greater expertise. All case exhibits are available in downloadable form (see Data Files below) and you will be expected to use a spreadsheet program to do your work.

Course objectives:
The course has four broad objectives: the development of critical thinking skills; the enhancement of written and oral communication expertise; honing of spreadsheet skills; and gaining the ability to analyze the financial health, project the funding need, and choose a loan structure for firms with low to moderate complexity. The fourth objective should leave you with the ability to do the following at the end of the course.
1. Describe the purpose and component parts of both an indirect and direct cash flow statement.
2. Construct an indirect cash flow statement for periods of different length (e.g., 3 months, one year, two years, etc.).
3. Construct a common-size income statement.
4. Describe and compute all financial ratios using either annual or interim data.
5. Decompose a company’s ROE using DuPont analysis and effectively use the results.
6. Describe the limitations of industry financial ratios.
7. Identify a company’s cash conversion cycle and explain its impact on that company’s financing need.
8. Evaluate the level of a business’s liquidity.
9. Evaluate the management of a business’s overall and key component assets.
10. Explain the reasons why equity is important to a business and be able to evaluate the debt-equity mix in a business.
11. Evaluate the level of a firm’s profitability to include its determinants and adequacy.
12. Identify the major components of a company’s business plan and explain the impact of that plan on the company’s financial performance.
13. Explain how seasonality affects financing need.
14. Explain how growth affects financing need.
15. Construct annual and interim pro forma income statements and balance sheets and use them to estimate the amount and nature of a firm’s funding need.
16. Describe the major commercial loan types.
17. Analyze financial projections to determine the appropriate loan type for that business.
18. Design a spreadsheet to compute common-size statements, financial ratios, cash flow statements, and pro forma financial statements.
19. Use scenario analysis and a spreadsheet pro forma model to evaluate risk.

Required materials:
and financial ratios. If you have access to a cheap copy of the Seventh or Eighth Edition go ahead and use it. The changes between editions are not very significant.

2. Some of the cases and readings are at www.study.net. You must purchase this packet.
3. The remainder of the cases and readings, and all of the spreadsheets are on the http://undergrad.robinson.gsu.edu course website.

Assignments:
The Fraser book is intended as background material on financial accounting and the tools of financial analysis. This book will largely be a review of what you have already been exposed to in AC 2101, AC 2102, and Fl 3300. The teaching notes focus on technical issues such as cash flow statements and ratios. While some of the notes may be review, much of it will be new.

The course uses a building block design. Each day we will learn new techniques that will be useful for future classes as well as the class when the technique is first used. For this reason, it is critical that you do not fall behind the assignments. Make sure that you have always studied all designated readings prior to class and that you have completely prepared the assigned case. Success in the course depends on being fully prepared for each class.

Office hours:
With your varied work and class schedules, fixed office hours are generally inconvenient for most of you. For that reason, although I am in the office and available much of the time, I have not set inflexible office hours. Do not misinterpret this as a message that I do not want to meet with you. To the contrary, I am anxious to do all that is reasonably possible to help you succeed in this course. This includes meeting and working with you to provide assistance. If you would like to meet with me, let me know and we will arrange a mutually satisfactory time. Also, I have provided my home telephone number and you may call me at home seven days a week, at reasonable hours (i.e., before 10:00 p.m.). Further, you may email me at anytime.

Communication:
There will be times during the term that I will communicate with you either individually or as a class. I will normally do this via email. We are required to use your official GSU PantherMail addresses when sending email to classes. If you regularly check your PantherMail account, you need do nothing else about emails. However, if you use another email address such as a Hotmail, Yahoo, or work account for your primary email and don’t frequently check your PantherMail account, you may want to re-direct your GSU emails to your other account. Instructions for doing this can be found at: http://www.gsu.edu/help/31718.html#7. Note that not all browsers are compatible with PantherMail. Whichever approach you use, make sure you periodically check for messages. You will be responsible for complying with anything that I send in an email so make sure your email account is working properly and you check your email frequently. If there is a problem with your Georgia State email account, it is your responsibility to work with the University to resolve the problem.
Grading:
Your grade will be determined by the following.

- Business analyses  20 %
- Quizzes  20
- Exam #1  20
- Exam #2  20
- Class contribution  20

Make up examinations are never given.

Class starts promptly at the scheduled time. If you will be unable to arrive on time, you must withdraw from the course.

The lowest grade of the three business analyses will be dropped when determining the business analyses average.

Quizzes will be unannounced, generally administered at the beginning of class, and typically take about ten minutes. They will normally involve the application of a technique or concept learned in prior classes to the assigned case for that day. In some cases, a quiz may be based on the reading assignment. Quizzes on readings will be closed-book but quizzes on cases will be open-book, open-notes. Assignments other than business analyses will be graded as quizzes unless otherwise noted. The correlation between class preparation and quiz success is very high. The quiz time allotted will only be adequate if you arrive at class on time and fully prepared. If you are late for class or absent, you will miss the quiz and receive a zero. The two lowest quiz grades will be dropped when determining the quiz average with one important exception. Failure to turn in the Comfort Zone spreadsheet assignment double-quiz will result in a zero for that assignment and that double-zero will not be dropped from your quiz average.

Both the mid-term and final examinations will be cases. In each instance, I will give you the case at the start of the exam session along with an exam.

An attendance sheet will be passed around each class. It is your responsibility to see that you have signed the sheet. If you are not on the list, you will be considered absent. Any student who is absent for four classes, including the first day of class, will be dropped from the course. You will not receive any formal update on your attendance record so you should keep track of your absences. If you are not sure of your record, I will normally have my roll with me and you may check the actual number. Students who leave class early will be considered absent even if they have signed the list earlier in the class period. Students arriving late will be permitted to sign the list only at the discretion of the instructor.

A large class contribution component to your grade is necessary because this is a case oriented course. Cases do more than teach particular subject matter. They are also excellent vehicles for teaching problem solving and logical thinking. Further, case discussion develops the oral communication skills of the class. Experience indicates that you will not develop these skills and learning will be reduced unless you actively contribute in class. Since the development of these skills is a major course objective, class contribution is given significant weighting.
Class contribution is not synonymous with attendance. It means that you are well prepared to discuss the assigned case and readings, and do so effectively. Quality is important. Asking questions in class can be a valuable learning vehicle and such questions are encouraged for that reason, but questions do not earn class contribution points. Points are earned and lost through the following activities.

Positive Qualitative Contribution
- Thoroughness of analysis
- Proper substantiation of position
- Extension of knowledge
- Getting to the heart of key issues
- Opening new doors for investigation
- Statement of practical experiences
- Perceptive questioning of other students
- Distinction between fact and opinion

Negative Qualitative Contribution
- Being unprepared
- Re-statement of point already made
- Verbosity
- Incomplete analysis
- Unfounded criticism
- Off-the-point statements
- Closed-minded argumentation
- Off-the-cuff remarks
- Personal attacks on or disrespect of others

Each student starts with zero class contribution points and may work towards twenty by performance. Please understand that I am serious about the contribution requirement. Do not expect me to inflate your contribution grade because you attended class and claim that you were prepared and followed the discussion. The only way to earn points is through your verbal contributions in class. A student who attempts to avoid a poor class contribution grade by not participating will simply ensure a failing grade.

Course grades will include the following possible grades.

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Here is the combined grade distribution for my most recent five offerings of FI 4020.

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<td>F</td>
<td>7%</td>
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Data files:
Most of the case exhibits are included in files available through the FI 4020 myRobinson course site (https://undergrad.robinson.gsu.edu). When you login to myRobinson, choose FI 4020 for this term and make sure you also choose the correct section. Look in the case exhibits folder. You must download the spreadsheet files and use them as a starting point for your case computations. Do this all at once at the beginning of the term. This will prevent you from overriding the case files on the course website.

Academic honesty:
It is your responsibility to read the University Policy on Academic Honesty. It can be found in “On Campus-The Official Student Handbook” under Code of Conduct (http://www.gsu.edu/~wwwcam/code/academicconduct/index.html). This document establishes clear standards for academic honesty and it will be enforced in this course. My policy is completely consistent with that document.

Here is my position. A university can successfully function only when its integrity is maintained. One important element of integrity is personal honesty. Cheating, a form of personal dishonesty, is unfair to students who do not cheat because their performance may appear relatively inferior, and it is unfair to students who do cheat because it short circuits the learning process. In short, cheating is a cancer that invades and subverts the legitimate academic process. It will not be tolerated at any level. Consequently, my position is simple. All work on anything graded must be your own. Anyone violating the academic honesty standards will receive an F for the course. Further, the person providing assistance is equally as guilty of cheating as the recipient of the assistance and will suffer the same penalty. In addition, I will make every effort to see that the guilty party receives the most severe University disciplinary action appropriate. There will be no exceptions or second chances. Period. If at any time you are not sure whether something is a violation of the academic honesty policy please contact me for clarification.

To give you an idea of the types of actions that I consider to be violations of academic honesty, here is a non-exhaustive list.

- You may not get help from or provide help to anyone (including those not currently in the class) when doing a graded business analysis write-up or any assignment that will be graded such as pro forma statements. This includes discussing any aspect of the analysis; looking at someone’s notes, spreadsheet, or written analysis; and sharing calculations and spreadsheets.
- You may not look at another student’s quiz or exam paper, copy from another student’s quiz or exam paper, communicate in any way with others about the quiz or exam, or get
information about quizzes or exams from people not in the class. A person who allows someone else to look, copy, or share information is equally guilty of a violation.

- You may not use analysis developed by others without attribution when contributing in class.
- Any work that uses numbers that are inconsistent with my fall 2008 packet but similar to other packets will be considered acts of academic dishonesty.
- You may not sign someone else’s name to the attendance sheet.

**Working in groups:**
You are permitted to work in groups for cases in which you are not doing graded business analyses or some other graded assignment. The only acceptable way to use a group is for each person to completely work a case prior to meeting with other group members. Other approaches reduce learning. If you do work in a group, you are responsible for explaining anything you present in class. Taking credit for a point that another person generated will be considered cheating.

**Courtesy**
We all work better together if we observe some simple courtesies. Here are a few examples of personal decorum that reflect respect for your colleagues.

- Arrive for class before the scheduled start time.
- There will be a break around the middle of each class. Unless you are having a medical problem, please do not leave the classroom except during the break period. Return from the break before class restarts.
- Do not use communication devices for calls or text messages during class. If you should forget to turn off your phone and it signals a call or message, silence it immediately and do not take the call, read the message, or send a message.
- It is fine to use laptops during class but they should only be used for the purposes of the class. It is rude to read and send emails or to use your web browser.
- Class contribution is important but wait until you are recognized before speaking. If a classmate is answering a question, do not speak out an answer to the question.
- Food and drink are fine during class but please do not take overly fragrant food (e.g., food with raw onions, garlic) to class because the odor can be offensive to others in a closed classroom. Please make sure you put all trash in the proper receptacle at the end of class.
- These courtesies are requirements, not suggestions. You will be asked to leave the class if you do not properly respect the class.

**Photographs and 3x5 card information:**
It will be necessary for you to provide some information (address, telephone numbers, email, employer, and occupation) on a 3x5 card and a photograph. There are two reasons why I ask for this information. First, I occasionally have a need to communicate with you for course-related reasons and the contact information makes this possible. Second, I want to learn your names as soon as possible and the photos are a great help. With class contribution a significant portion of your grade, identification is particularly important. This information will be
considered privileged and will not be released to anyone else. I will use it sparingly and, then, only for the purposes of this course.

Withdrawal:
The last day to withdraw and be eligible for a "W" is October 8. From the University Undergraduate Catalogue—“Students will receive a grade of W or WF for any class dropped during this period depending on whether they have exceeded their limit of withdrawals with a grade of W. Specifically, students will automatically be awarded a W if they have not exceeded their limit and a WF if they have.”

Student Evaluation of Instructor:
Your constructive assessment of this course plays an indispensable role in shaping education at Georgia State. Upon completing the course, please take the time to fill out the online course evaluation.

Disability Services:
Students who wish to request accommodation for a disability may do so by registering with the Office of Disability Services in Suite 230 or the Student Center. Students may only be accommodated upon issuance by the Office of Disability Services of a signed Accommodation Plan and are responsible for providing a copy of that plan to instructors of all classes in which an accommodation is sought.

Warning:
This course outline provides a general plan for the course; deviation may be necessary. Any schedule change will be announced in class or transmitted via email, and you are responsible for the announced change regardless of whether you are in class at the time of the announcement or have read your email. This includes announcements made the first night of class.

Course Outline

8/24  T  Course introduction; cash cycle and funds flows

8/31  T  Read:
1. Course outline
2. Cash cycle notes from last class
3. Fraser, ch. 1-3  (These chapters review the principles of financial accounting. I will assume that you know this material as part of the course’s accounting prerequisites. Review these chapters as necessary.), 4 (This is an in-depth look at cash flow statements. While much is a review, the treatment is intensive and probably includes some new material. Study carefully.)
4. “Cash Flow Statements” All notes are at the myRobinson course website (https://undergrad.robinson.gsu.edu). Choose FI 4020 under courses for this term. Make sure you also choose the correct section (CRN # 81635).
Prepare: 1. Provide a small photograph of yourself (you may copy ID or license). Please cut out the photo, write your name on the back, and turn it in before class starts.
2. Setup GSU email account to forward to your main email address if GSU is not your main email.
3. Quizzes may begin starting today. If so, the quiz will be on the course outline, handout on the cash cycle from last class, chapter 4 of Fraser, and the note “Cash Flow Statements.” Quizzes based on reading are closed book; case-based quizzes are open-book, open-note.

9/7 T Read: 1. “Common-Size Financial Statements”
2. “A Basic Set of Financial Ratios”
3. Fraser, ch. 6. This chapter discusses many financial ratios and will help you better understand the value of the ratios. However, there are some ratios included that we will not use. The only ratios you will need to know are those listed in “A Basic Set of Financial Ratios” included in your packet.

Prepare: Riley Supply (Preparation questions for all cases are in the last section of this course outline. Proper case preparation will always include doing cash flow statements, ratios, and common-size income statements for all possible years. Make sure you use the proper definitions and formatting as described in Reading #2. You do not have to turn in a business analysis of this case.) This case is available on the myRobinson course site.

9/14 T Prepare: Panera Bread Company (you do not have to turn in a business analysis of this case). Note that this is the first of our cases that is available through www.study.net.

2. “Business Analysis”

Prepare: California Choppers (you do not have to turn in a business analysis of this case).
9/28  T  Prepare:  Quality Furniture Company including a business analysis to turn in. Everyone must turn in this business analysis. Remember that you may not give or receive any assistance on the business analyses. You are required to turn in a Statement of Academic Honesty along with your analysis. It is available at the myRobinson course website. Make sure that you study the reading in your packet entitled, “Business Analysis.” It identifies the required headings and explains what should be included under each heading. As always, the preparation questions at the back of this syllabus are a valuable resource.

10/5  T  Prepare:  Jones Electrical Distribution (you do not have to turn in a business analysis of this case)

10/12  T  Examination (This examination date may change)

10/19  T  Read:  1. “Pro forma Statements”

Prepare:  Today’s class will focus on pro forma financial statements. Reread Jones Electrical Distribution and review our class discussion. Please take your Jones Electrical case and notes to class.

10/26  T  Prepare:  Chang Dental Clinic (you do not have to turn in a business analysis of this case)

11/2  T  Prepare:  More Vino, LTD. including a business analysis of More Vino LTD. to turn in. Remember that you may not give or receive any assistance on the business analyses. You are required to turn in a Statement of Academic Honesty along with your analysis. It is available at the myRobinson course website. Make sure that you re-read the reading in your packet entitled, “Business Analysis.” It identifies the required headings and explains what should be included under each heading. As always, the preparation questions at the back of this syllabus are a valuable resource.

11/9  T  Read:  “Annualizing Financial Ratios”
“Seasonal Sales Projections”

Prepare:  Be Our Guest, Inc. (you do not have to turn in a business analysis of this case)

11/16  T  Prepare:  Comfort Zone including a business analysis of Comfort Zone to
turn in. Remember that you may not give or receive any assistance on the business analyses. You are required to turn in a Statement of Academic Honesty along with your analysis. It is available at the myRobinson course website. Make sure that you re-read the note in your packet entitled, “Business Analysis.” It identifies the required headings and explains what should be included under each heading. As always, the preparation questions at the back of this syllabus are a valuable resource.

11/23  T  No class—Thanksgiving break

11/30  T  Prepare: Comfort Zone (continued) including pro forma financial statements to turn in and be graded as a double quiz. This is not optional; you must turn in this assignment. Failure to do so will mean that your counted quizzes will include two zeroes for this assignment. You will turn in a CD and a paper copy of your spreadsheet. Remember you may not give or receive any assistance on a graded assignment. You are required to turn in a Statement of Academic Honesty along with your analysis.

12/14  T  Final examination from 4:15 p.m.-6:45 p.m. in regular classroom

Case Preparation Questions

Note that questions sometimes continue on the next page.

Riley Supply

1. Use a spreadsheet program such as Excel for computations for this case and all others. Employers expect finance majors to be adept with spreadsheets. If you are not proficient, now is the time to develop those skills. Later cases cannot be done without spreadsheets so you should get as much practice as you can now. Don’t forget that all of the income statement and balance sheet data are in Excel files that can be downloaded using the instructions provided earlier in the course outline. See “Data Files.” To minimize spreadsheet errors, keep all numbers for a particular year in the same column. For example, The Riley Supply case has data for the year 2005 in Column C. Do your ratios for 2005 in Column C below the financial statements. Also, put the FYE 2004-FYE 2005 cash flow statement in Column C.


3. Calculate common-size income statements for each year.

4. Calculate all financial ratios (use “A Basic Set of Financial Ratios”) for each year. Make sure that you use the methodology and formatting discussed in “A Basic Set of Financial Ratios.” Learn these ratios because you will need to know all financial ratios for quizzes and exams. There will be no formula sheets on the exams. You will always be expected to have all ratios and cash flow statements for all years of data. This is not extra work.
Once you have entered the ratio and cash flow statement formulas for one year in your spreadsheet, simply copy those formulas to the columns for the other years. The work is getting the formulas for the first year. Going to class without all of this completed means that you are unprepared for quizzes and class discussion.

5. Identify the major factors influencing Riley’s cash flow. Use the cash flow statements together with the ratios and common-size statements.

6. What is the length of Riley’s cash conversion cycle? Does it take a long time for Riley to go from spending cash to receiving cash? Why?

7. What are the implications of Riley’s cash flow for the financing needs of the firm?

Panera Bread Company

1. Keep using a spreadsheet for your calculations on this and future cases. Make sure that you do calculations for all years for this and all other cases.

2. How would you assess the strength of Panera’s marketing?

3. What have been the key drivers for Panera’s cash flow from operations?

4. Is this company liquid?

5. Is this an asset intensive business? Why or why not?

6. Is the leverage risk high?

7. What is the source of Panera’s profitability? Is it good?

California Choppers

1. Do the standard set of analytics: common-size income statements, cash flow statements, and financial ratios for all years. If Exhibits 1, 2, and 5 are in the case, ignore them.

2. What was California Choppers’ condition in 2000? How has it changed over the six-year period?

3. Have all of the company’s initiatives been successful?

4. How would you evaluate the human resource aspects of the company?

Quality Furniture

1. Although the case is titled Quality Furniture Company, it is really about Lloyds, Inc. Your analysis should be about Lloyds. Confine your work to Lloyds only—do not do Quality Furniture itself.

2. Start by computing cash flow statements (use indirect method), financial ratios (use the note on financial ratios for equations and formatting), and common-size income statements. Use net sales for all ratio and common-size computations requiring sales. When you do cash flow statements do not combine any balance sheet accounts (e.g., all short-term debt or all long-term debt), show each separately. Analyze intensively the balance sheet and income statements of Lloyds, Inc. using your computational results.

3. Due from stockholders is a loan by the business to stockholders.

4. Exhibit 3 is the aging of Quality Furniture Company’s accounts receivable to Lloyds, Inc. Lloyd’s income statement stops at net profit before tax. Treat that as net income in all of your calculations.

5. How strong is the company's balance sheet? How about its income statement? Why?

6. How might Quality Furniture Company’s trade credit evaluation of Lloyds, Inc. differ from a commercial bank's evaluation of the company?
7. What action should be taken by the credit department of Quality Furniture Company?
8. You are now ready to write your business analysis. Make sure you attach a copy of your cash flow statements to your report.

Jones Electrical Distribution
1. Analyze Jones Electrical to identify its strengths and weaknesses (By now, you should know which analytical tools you should use so explicit requirements will no longer be specified. For you to be considered prepared for class, you must have done all relevant calculations for all years. Continue to use a spreadsheet.).
2. Ignore the 2007, first quarter data and Exhibit 3.
3. Net worth is the same thing as the total equity of the company (common or capital stock, paid-in-capital in excess of par, and retained earnings). It is unlikely that the common stock or paid-in-capital in excess of par accounts have changed over the period.
4. What is the current condition of the company?
5. Why has this profitable firm had to borrow so much?
6. As the banker, what decision would you make?

Chang Dental Clinic
1. Do your normal full analysis of the company for 2002-2005.
2. The footnotes in this case are very important. Make sure you use the information in the footnotes when doing ratios and pro formas.
3. Be careful with accumulated depreciation. There are two ways a company can show this on its balance sheet: as a positive number that gets subtracted from gross fixed assets or a negative number that gets added to gross fixed assets. Both approaches lead to the same net fixed assets so either way is acceptable. In Chang Dental Clinic, accumulated depreciation is displayed as a negative number so it is added to GFA. Also, note that the Chang case uses the term “amortization” rather than “depreciation”. They are the same.
   a. The case provides assumptions for many items and you should use those assumptions. For other items use the historical data as guidance.
   b. Amortization expense is the same as depreciation expense.
   c. The situation in this case is a little different than in our other cases because Chang involves the sale of the assets of the company (not the sale of the entire company). It is a bit like starting a new company. When someone purchases the assets of a company they typically get all of the “hard” assets such as inventory and fixed assets. Cash, accounts receivable, etc. typically stay with the seller. On the liability side, the debts of the company stay with the seller and the equity of the seller disappears. The buyer’s balance sheet will reflect the debt required to execute the purchase as well as the amount of equity put in by the new owner.
      i. Assume that the transaction occurs at the end of January 2006. The pro forma is for a year (through January 2007), but the FYE is a month later than before. Just treat it as a “normal” year. The data file includes the balance sheet after the buyout. Use it as the beginning balance sheet of
the new company. The following points explain how that balance sheet was constructed and gives some guidance for your pro forma balance sheet.

ii. The 2005 balance sheet amounts for gross fixed assets and accumulated depreciation go away at the time of the purchase. They are replaced by the gross fixed asset amounts shown on page 3 (the fixed assets’ market value on that date) and zero for accumulated depreciation (it is as if the fixed assets are new on that date). At the end of the pro forma year, accumulated depreciation will be increased by the depreciation expense for the year.

iii. Inventory at the time of purchase will be as shown on page 3.

iv. Goodwill on the 2005 balance sheet will be replaced by the amount shown on page 3 at the time of the purchase.

v. The term loan will appear on the balance sheet at the time of the purchase as both a current liability and long term liability.

vi. The equity on the 2005 balance sheet will go away at January 31, 2006 and will be replaced by the amount Miller is investing in the company. After that date it will increase by retention.

vii. Other balance sheets accounts (cash, accounts receivable, prepaid expenses, and accounts payable) go away at the time of the transaction. These accounts will reappear at the end of your pro forma year.

5. Is the proposed loan structure appropriate? Can Miller pay off the debt according to schedule with his business plan?

More Vino LTD.

1. Analyze More Vino to identify its strengths and weaknesses.

2. The company began operations during FY 2/28/06. Thus, the balance sheet for FYE February 28, 2005 is all zeros. This makes it possible to do two years of cash flow statements (2/05-2/06 and 2/06-2/07).

3. Amortization expense in this case is the same thing as depreciation expense.

4. There are two bank loans. The bank line of credit is the same thing as a permanent working capital loan, while the “bank loan” is a term loan.

5. There may be a few ratios that are not meaningful because of the nature of some of the numbers.

6. You are now ready to do your business analysis. Attach a copy of your cash flow statement to your business analysis.

7. You should not include the results of pro forma statements in your business analysis. You should, however, produce pro forma statements for our class discussion.

8. You can visit the company website at: http://www.morevino.com/. There is also a Facebook page: http://www.facebook.com/morevino.

Be Our Guest, Inc.

1. This case has both annual and quarterly data. You must analyze all time periods. Make use of the teaching note, “Annualizing Financial Ratios.”

2. What are the key success factors in the equipment rental business? How has the company performed the past few years?
3. As the bank loan officer, Anne Granger, how would you view this company? What concerns might you have about the business and the lending relationship? What factors provide a source of comfort when considering the credit risk?

4. How much total bank financing will the company need over the next year, including both short-term borrowing and term loan borrowing? To answer this question, you must construct quarterly income statements and quarterly balance sheets for the next year. The basic approach to quarterly projections is the same as for annual pro formas. For each period (quarter) you must make assumptions for each pro forma item. The assigned teaching note, “Seasonal Sales Projections,” will show you how to estimate quarterly sales. You must use this procedure. Do not estimate quarterly sales using quarterly sales growth rates. You will end up with four columns of pro forma financial statements (one for each quarter of the next year). The assumptions for each quarter will generally be different. For example, the 1st quarter ACP will vary from the 2nd quarter ACP.

5. The prime rate at this time was 8.5%.

6. What should Al Lovata and Simone Williamson ask for when talking with the bank? If the company needs additional bank financing, what loan structure or mixture of loans best meets their needs? Do the covenants appear appropriate?

7. The negative cash accounts mean they over drafted their bank account in 1994 and 1997. This is the same thing as borrowing money (e.g., a (1,000) cash account means there is zero cash and the line of credit is actually 1,000 higher). You should use a small positive minimum cash amount for your quarterly pro formas.

8. “Distributions to shareholders” is another way of saying dividends.


Comfort Zone- Class 1

1. This is a case that really demonstrates the value of using Excel or a similar program. There is a huge amount of data and all data are available in the data file. Set up the ratios and cash flow statements for a quarter, for example, and then “copy” the formulas to the other time periods. It takes a while to set up the first period, but after that the savings are huge.

2. Be careful with the ratio computations when the data are quarterly. Adjust the data where necessary so that the resulting ratios use our normal standards of comparison (refer again to the note—“Annualizing Financial Ratios”).

3. Gross accounts receivable and the allowance for bad debts are both shown on the quarterly historical balance sheets. Normally these two items are netted and only one item appears on a balance sheet. So, for all our other cases this semester, when we looked at accounts receivable and computed the average collection period we were actually looking at a netted number. When you compute the average collection period, net the accounts receivable number and the allowance for bad debts and use the netted number in the ACP.

4. You should have complete sets of both annual and quarterly ratios and cash flow statements. Note that the quarterly income statements in the case are cumulative within each year and that you will need to look at each quarter, not the cumulative amounts for all of your calculations (e.g., You care about the third quarter, not the 9-month period ending at the end of the third quarter). You can construct the quarterly
income statements for a year by using the 3-month, subtracting the 3-month from the 6-month (to get the second quarter), subtracting the 6-month from the 9-month (to get the third quarter), and subtracting the 9-month from the 12-month income statements (to get the fourth quarter). If you do not construct these “true” quarterly income statements your quarterly calculations will all be wrong. Of course, no adjustments are necessary for the balance sheets because they are “snapshots” not “flows”. All quarterly analysis will be based on the 3-month income statements.

5. A stock dividend is not the same thing as a cash dividend. With a stock dividend, the company gives each stockholder additional shares of stock in the company. For example, if you owned 100 shares of stock and the company gave a 10% stock dividend you would own 110 shares afterwards. There is no cash flow involved and there is no effect on the total equity of the business. It is similar (but not identical) to the effect of a stock split. Therefore, stock dividends do not appear on cash flow statements.

6. Analyze the financial data and identify the factors that have caused Comfort Zone’s cash crisis. Make sure you consider both year-to-year issues as well as any intra-year (seasonal) issues.

7. How serious are Comfort Zone’s financial problems?

8. You are ready to write your business analysis. It should not include any discussion about the projected funding need.

Comfort Zone- Class 2

1. You will get more detailed instructions about this assignment at a later date. Start by generating pro forma income statements and balance sheets for each of the next six quarters. Be careful that your assumptions are appropriate for each quarter. By covering a period of one and one-half years you will explicitly include estimates of quarterly needs. Your pro forma spreadsheet should start with the assumptions at the top, followed by the quarterly income statements, and then the balance sheets as you move down the sheet. The projections will be turned in and graded. The following 2 questions are for class discussion and will not be submitted for grading.

2. Develop a comprehensive financing plan for Comfort Zone. Determine the amount and type of loan needed.

3. Identify the critical factors of the plan and do appropriate sensitivity analysis.