**2)** You have been provided financial information (see following page) of the Crum Company (CC). The firm expects sales to grow by 50% next year, and operating costs should increase at the same rate. Fixed assets were being operated at 40% of capacity this past year, but all other assets were used to full capacity. Underutilized fixed assets cannot be sold. Current assets and spontaneous liabilities (A/P and Accruals) should increase at the same rate as sales next year. CC plans to finance any Additional Funds Needed (AFN) as 35% Notes Payable (short-term debt) and 65% common stock (Common Equity). After taking financial feedbacks (refer to pages 497-505) into account, and after the 2nd pass, **determine CC’s projected Return on Equity (ROE = Net Income / Common Equity) using the Percent of Sales Method.**

**Is the ROE:**

a. 16.98%

b. 23.73%

c. 25.68%

d. 19.61%

e. 23.24%

**SHOW ALL WORK.**

**See following page for the format.**

Crum Company Financial Information: Growth rate = 50%

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| INCOME STATEMENT | Past Year | Next Year  1st Pass | Next Year  2nd Pass | Next Year  Final |
| Sales | $ 1,000.00 |  |  |  |
| Operating Costs, 80% | 800.00 |  |  |  |
| EBIT | 200.00 |  |  |  |
| Interest | 16.00 |  |  |  |
| EBT | 184.00 |  |  |  |
| Taxes, 40% | 73.60 |  |  |  |
| Net Income | 110.40 |  |  |  |
| Dividends, 60% | 66.24 |  |  |  |
| Addition to Retained Earnings | 44.16 |  |  |  |
| **BALANCE SHEET** |  |  |  |  |
| Current Assets | $ 700.00 |  |  |  |
| Net Fixed Assets | 300.00 |  |  |  |
| Total Assets | $ 1,000.00 |  |  |  |
|  |  |  |  |  |
| A/P and Accruals | $ 150.00 |  |  |  |
| N/P, 8% | 200.00 |  |  |  |
| Common Stock | 150.00 |  |  |  |
| Retained Earnings | 500.00 |  |  |  |
| Total Liabilities & Common Equity | $ 1,000.00 |  |  |  |

|  |  |  |  |
| --- | --- | --- | --- |
| AFN | Past Year | Next Year, 1st Pass | Next Year, 2nd Pass |
| Profit Margin | 11.04% |  |  |
| ROE | 16.98% |  |  |
| Debt / Assets | 35.00% |  |  |
| Current Ratio | 2.0 times |  |  |
| Payout Ratio | 60.00% |  |  |

|  |  |  |  |
| --- | --- | --- | --- |
| AFN Financing | Weights | Dollars | Interest Expense |
| Notes Payable | 0.3500 |  |  |
| Common Stock | 0.6500 |  |  |
| TOTAL | 1.0000 |  |  |