CUMULATIVE CASE STUDY:

DESERT COFFEE ROASTERS, INC.

Learning Objectives

- Prepare pro forma financial statements.
- Evaluate pro forma financial statements and make modifications as necessary.
- Prepare capital budgeting scenarios.
- Establish appropriate capital structure.
- Write and present a financial plan encompassing pro forma financial statements, capital budgeting, and capital structure plans.

Introduction

Don Garcia, president and founder of Desert Coffee Roasters, Inc., paused for a moment as he sipped on a cup of High Desert Java, his company's signature coffee blend. It was early January 2003, and Don was reflecting on his 20-year career in the coffee business. What had started out as a relatively modest operation as a coffee distributor to local convenience stores had mushroomed into a burgeoning business as a regional coffee roaster and wholesale supplier to a wide variety of customers across the Southwest United States.

Now Don faced some important decisions. He still operated the company as a small business even though sales had grown from about $7 million in 1993 to approximately $50 million in 2002, the most recently completed fiscal year. Financial planning, though, was still practically non-existent. As a result of a number of recent acquisitions, he knew that some outdated equipment would need to be replaced. Additionally, future expansion would need financing.

Furthermore, Don owned 60 percent of the common stock. The remaining 40 percent of the company was owned by various members of the Garcia family, many of whom had first put up the money so Don could get started, and were now retired. They appreciated the dividend checks they received every three months and were accustomed to an annual 10 percent increase. Since they felt the company was financially stable, they hoped for even larger dividends in the future. Moreover, Don was concerned about the lack of diversification in his own portfolio and the ability to attract high quality managerial talent. He wanted to link the compensation of his employees, especially senior management, to the performance of the company through stock-based pay, probably using restricted stock. But without a ready secondary market for the company's stock, he knew it would be difficult to accomplish.

Rather than paying larger dividends, Don was convinced that this was the right time to expand the company. More people were demanding specialty coffees, especially since the quality of lower grade coffee had deteriorated in recent years. He also knew that other specialty coffee roasters would be available for sale in the future. He wondered whether and how he should re-capitalize the company. Should he bring in more private investors? Should he go public? If so, how much of his ownership interest should he sell, and how would he convince his family

members to sell their stock? Maybe he should just finance his expansion plans using bank debt. He called his financial staff into his office to discuss these thorny issues.

Overview of Desert Coffee Roasters, Inc.

Desert Coffee Roasters, Inc. (DCRI) is a leading wholesale supplier in the specialty coffee industry. The company sells over 90 coffee selections through a coordinated multi-channel distribution network in its wholesale and consumer direct operations. This distribution network is designed to maximize brand recognition and product availability.

The majority of DCRI's revenue is derived from wholesale customer accounts located in New Mexico, Arizona, and California, with its headquarters in Albuquerque, New Mexico. The wholesale operation serves supermarket, specialty food store, convenience store, food service, hotel, restaurant, university, travel, and office coffee service customers. Wholesale customers resell the coffee in whole bean or ground form for home consumption and/or brew and sell coffee beverages at their place of business.

Corporate Objectives and Philosophy

Desert Coffee Roasters' principal corporate objective is to be the leading wholesale specialty coffee company in the Southwestern United States. It intends to do this by providing the highest quality and most unique coffee and coffee blends and by having the largest market share in its targeted markets while maximizing company value. DCRI works diligently at differentiating and reinforcing the Desert Coffee Roasters brand and engendering a high degree of customer and consumer loyalty. It uses the following elements to accomplish its goals.

High Quality Coffee

Desert Coffee Roasters buys some of the highest quality Arabica beans available from the world's major coffee-producing regions. It uses a roasting process that maximizes each coffee's individual taste and aroma and uniquely blends different coffee beans and other flavors to produce one-of-a-kind taste combinations. DCRI's passion for coffee yields some of the highest quality coffee in the world.

Outstanding Customer Service

An important element in DCRI's competitive strategy is outstanding customer service. DCRI desires to create customers for life. Because coffee is a convenience purchase, bought at the same time as other products such as groceries and gasoline, the company seeks to use its multi-channel distribution network to make its coffee products easily available for consumers at home or on the road.

To ensure a high level of responsiveness to customer needs, the company has established regional distribution centers to supply coffee to its wholesale customers from which customer service calls are dispatched. DCRI has established relationships with some of its vendors so that the vendors will ship items directly to a customer, thereby decreasing shipping times and costs.

Customer Coffee Education

Desert Coffee Roasters educates its wholesale customers, employees, and vendors in a variety of ways about the history of coffee, the roasting process, and current issues involving the coffee industry. Each of DCRI's sales representatives is knowledgeable about these areas and is empowered to impart their knowledge at appropriate times during customer interactions. Additionally, the company hosts seminars with leading coffee experts, to which customers, employees, and vendors are invited. DCRI has also led tours of coffee producing countries. These tours have been extremely important in maintaining customer loyalty.

Employee Development

Desert Coffee Roasters endeavors to be one of the top-ranked companies in terms of employee satisfaction. It believes that employee training and development along with a collaborative work environment and generous benefits are vital to attracting and retaining high quality, motivated employees. DCRI sponsors a series of monthly workshops aimed at personal and professional development. Its performance review process incorporates a highly positive, people-centered approach that seeks to maximize each employee's potential, leading to high quality customer relationships.

Socially Responsible Business Practices

DCRI is committed to contributing to the welfare of various coffee farms, cooperatives, and non-profit organizations in the United States and in coffee-producing countries in the form of cash, products, and paid employee time. In the past year, the company reimbursed approximately 40 percent of its employees for 1,000 hours of community volunteer time. In addition, the financial crisis in coffee producing regions continued to take its toll as increasing numbers of coffee farmers left the business due to low commodity coffee prices. DCRI contributed a significant sum of money last year to social and environmental programs in major coffee producing regions. The company anticipates continuing this kind of support for the foreseeable future.

Coffee Products and Roasting Process

Desert Coffee Roasters roasts high-quality Arabica coffees and offers over 90 coffee selections including single-origins, estates, certified organics, Fair Trade, proprietary blends, and flavored coffees that it sells under the Desert Coffee Roasters® brand. The company carefully selects its coffee beans and then appropriately roasts the coffees to maximize their taste and flavor differences.

DCRI roasts its coffee in batches to ensure consistency varying both the degree of roast and the roasting profile (i.e., roast time and temperature) to maximize a particular coffee's taste characteristics. Historically, the person in charge of coffee roasting had to be part scientist and part artist. The science of roasting involves understanding the chemical changes that occur in the coffee bean at different temperatures.[1] In the first stage of roasting, the beans slowly dry and begin to smell like toast or popcorn. The second step, called the "first crack," begins at about 400

[1] For more information about the entire process of bringing coffee to market, see the following web sites: www.coffeeresearch.org, www.coffeeuniverse.org, and www.coffeescience.org.

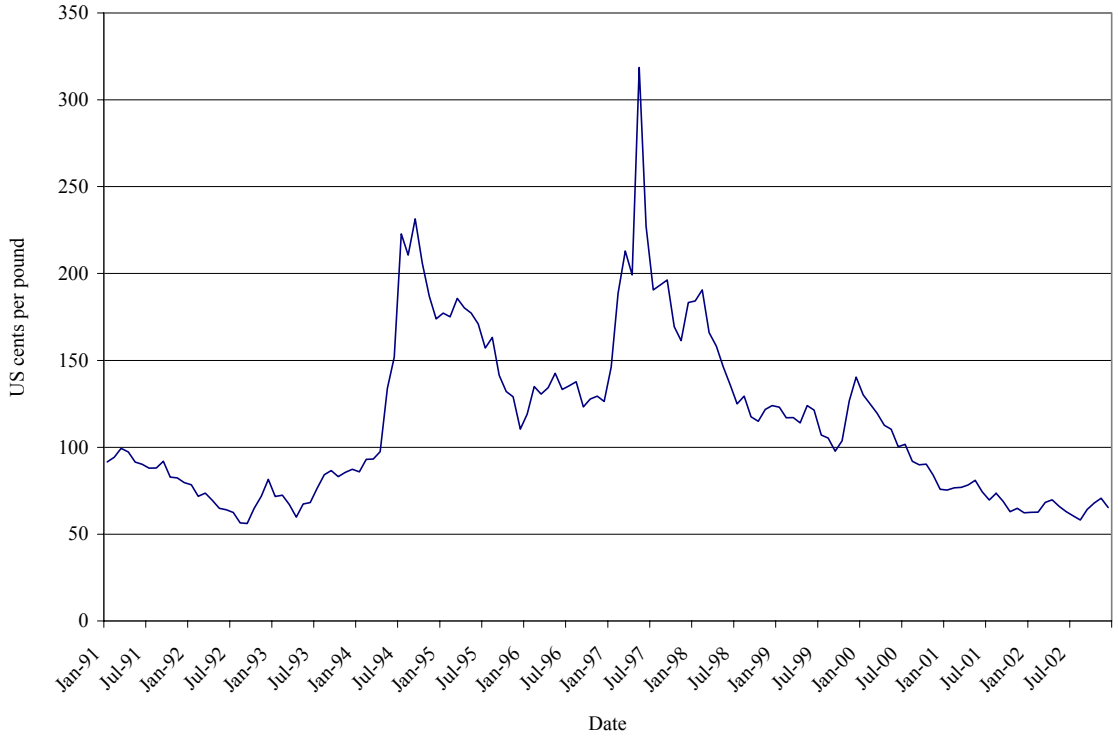
degrees F. The bean increases in size, turns a light brown color, and loses about 5 percent of its weight. The next step occurs at about 428 degrees F. The color changes from light brown to medium brown and the bean loses another 13 percent of its weight. The bean undergoes a chemical process called pyrolysis and also releases carbon dioxide gas. This step is followed by a second pyrolysis ("second crack") between 437 and 446 degrees F. At this stage, the roast color is defined as medium-dark brown and the beans take on an oily sheen. This substance is not actually an oil because it is water soluble. It is this chemical reaction that gives coffee its flavor and aroma. Roasting past this point will result in the oil being stripped off, resulting in a less aromatic bean. In America, the trend is to roast to a dark black at a final temperature of about 464 degrees F. This type of roast will mask poor blending, dirty machines, and stale coffee.

The head coffee roaster must also be part artist since every coffee will taste different at different roast degrees. One purpose of the roast is to bring out different nuances of each type of bean. Therefore, the coffee roaster must experiment to determine the proper roast degree necessary to achieve the desired aroma and flavor. Diego Gonzalez, the chief roaster at DCRI, was justifiably proud of his staff and their seemingly innate ability to roast coffee to perfection.

Coffee Supply and Cost

Coffee is the world's second largest traded commodity. Its supply and price are subject to high volatility. Although most coffee trades in the commodity market, coffee of the quality sought by DCRI tends to trade on a negotiated basis at a substantial premium, or "differential", above commodity coffee pricing, depending on supply and demand at the time of purchase. Figure 1 shows International Coffee Organization (ICO) indicator prices for Colombian mild Arabica coffee beans for 1991–2002.

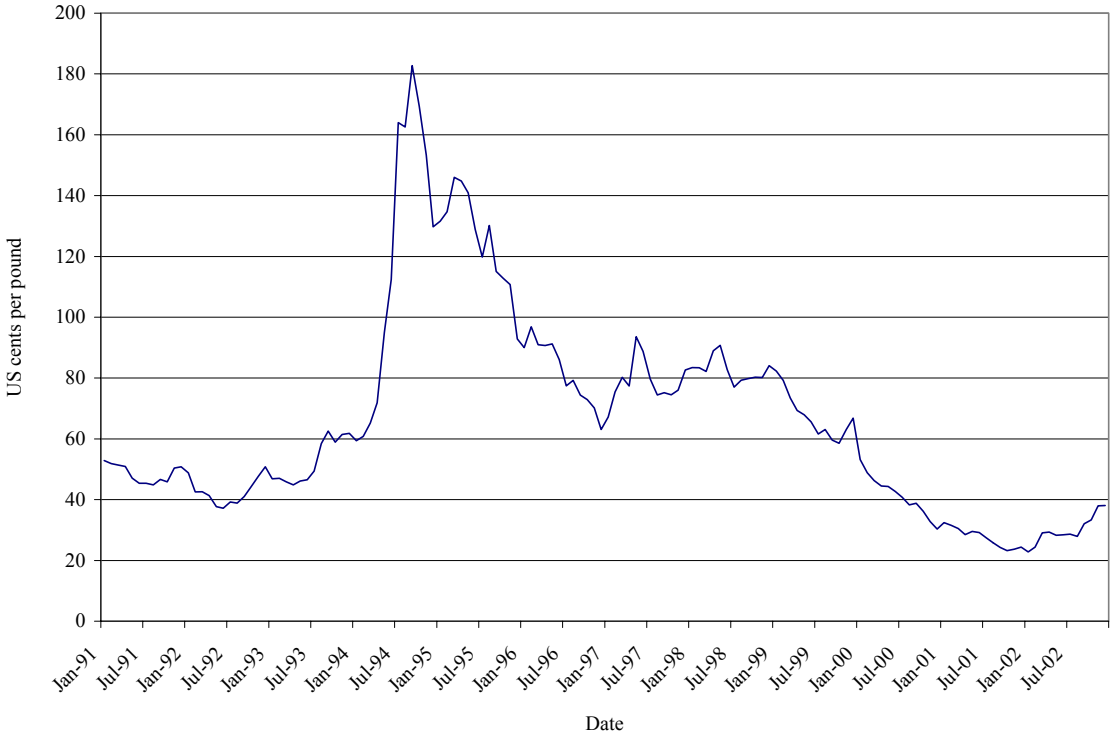
Figure 1: ICO Indicator Prices for Colombian Mild Arabica Coffee Beans: 1991-2002 (US cents per pound)



DCRI uses a combination of outside brokers and direct relationships with farms, estates, and cooperatives for its supply of green coffee. Supply and price can be affected by many factors, including weather, politics, and economics in coffee producing countries as well as the specific region and type of coffee. Wholesale coffee auctions on the internet result in some special "estate-grown" coffees going for up to $7.35 per pound, whereas other coffees have been auctioned for as low as $1.32 per pound. Outside brokers, knowledgeable in all aspects of coffee production and sales, provide the bulk of green coffee to DCRI.

In recent years, green coffee prices have plummeted to 100-year lows as a result of worldwide overproduction, the collapse of a pricing cartel that kept prices at sustainable levels over the years, and new coffee roasting technology that has prompted a shift away from higher quality Arabica beans to lower quality Robusta beans. Historical ICO indicator prices for Robusta beans for 1991–2002 are shown in Figure 2.

Figure 2: ICO Indicator Prices for Robusta Coffee Beans: 1991-2002 (US cents per pound)



Since Desert Coffee Roasters sells coffee made only from high quality Arabica beans, it would appear that the coffee crisis would not affect DCRI. However, because Arabica prices are based on a differential above commodity prices, the dramatic drop in coffee pricing has had a negative impact on growers of both high quality and low quality coffee beans alike. The low coffee prices experienced in recent years are generally not considered high enough to support proper farming and processing practices and can negatively affect the supply of top grade coffees. As yet, the crisis has not affected DCRI's supply of coffee, but if the crisis continues, it could have a detrimental impact on Don's growth plans.

Competition

The specialty coffee segment of the coffee industry is highly competitive. Not only does Desert Coffee Roasters compete against small independent roasters, but it also competes against major food processing companies, such as Kraft Foods, Sara Lee, and Proctor & Gamble as well as Starbucks, the largest independent specialty coffee company. The specialty coffee market is expected to become even more competitive as regional and national companies expand and build brand awareness in new markets.

As the business is still highly fragmented, DCRI competes primarily by providing high quality coffee, easy access to its products, and superior customer service. An important element in its ability to compete is a convenient network of outlets from which wholesale customers can obtain coffee and from which the ultimate coffee consumer can purchase it. This multi-channel distribution system differentiates DCRI from its major competitors who tend to focus on only one primary channel of distribution. DCRI is also one of the few coffee companies that roasts its

coffees individually, varying both the degree and timing of the roast to maximize a coffee's particular taste characteristics. Finally, being an independent roaster allows DCRI to be more focused on its business and more in tune with the needs of its customers.

Financial Forecast Variables

A number of variables are important in forecasting the financial statements and financial performance of DCRI. These variables include factors affecting sales, such as the expected growth rate in pounds of coffee shipped, and anticipated sales prices. Additionally, the company must plan for inventory costs, including expected cost for green coffee beans, labor and overhead costs. Selling expenses include costs associated with salaries and benefits for sales managers and personnel. General and administrative costs include salaries and benefits for senior executives as well as administrative support staff. For the first pass through the forecasting process, Don would like to assume that any external financing needed would come from short-term bank loans. Tables 1, 2, and 3 contain DCRI's historical income statements, balance sheets, and cash flow statements, respectively.

Table 1: Desert Coffee Roasters, Inc.: Income Statements 1999–2002 (All Dollar Figures in Thousands, Except for per Share Figures)

	1999	2000	2001	2002
Sales	$32,459	$42,013	$47,771	$50,032
Cost of sales	$18,162	$23,897	$26,219	$26,397
Gross profit	***$14,297***	***$18,116***	***$21,552***	***$23,635***
Selling expenses	$8,207	$10,185	$11,716	$12,581
General, and administrative expenses	$2,331	$2,944	$3,486	$3,745
Depreciation expense	$1,006	$1,316	$1,525	$1,642
Operating income	***$2,753***	***$3,671***	***$4,825***	***$5,667***
Interest income	$11	$13	$9	$8
Interest expense	$272	$307	$227	$264
Pre-tax income	***$2,492***	***$3,377***	***$4,607***	***$5,411***
Income taxes	$946	$1,127	$1,840	$2,159
Net income	**$1,546**	**$2,250**	**$2,767**	**$3,252**
Shares outstanding	***3,048***	***3,048***	***3,048***	***3,048***
Earnings per share	***$0.51***	***$0.74***	***$0.91***	***$1.07***
Dividends	***$307***	***$338***	***$371***	***$409***

Table 2: Desert Coffee Roasters, Inc.: Balance Sheets 1999–2002 (All Dollar Figures in Thousands)

	1999	2000	2001	2002
Assets				
Cash	$207	$245	$490	$400
Short-term investments	$0	$0	$0	$0
Accounts receivable	$3,112	$4,727	$5,615	$6,831
Inventories	$2,705	$3,674	$4,168	$4,468
Prepaid expenses	$617	$381	$1,094	$932
Total current assets	***$6,641***	***$9,027***	***$11,367***	***$12,631***
Gross property, plant, and equipment	$9,073	$10,735	$13,920	$17,981
Accumulated Depreciation	$3,980	$5,296	$6,821	$8,463
Net property, plant, and equipment	***$5,093***	***$5,439***	***$7,099***	***$9,518***
Other non-current assets	$205	$422	$957	$1,005
Total Assets	**$11,939**	**$14,888**	**$19,423**	**$23,154**
Liabilities & Owners' Equity				
Accounts payable	$2,276	$3,063	$3,050	$3,136
Accrued liabilities	$777	$1,057	$1,673	$1,151
Current portion of long-term debt	$127	$127	$127	$127
Notes payable	$1,434	$1,381	$2,927	$4,322
Total current liabilities	***$4,614***	***$5,628***	***$7,777***	***$8,736***
Long-term debt	$1,159	$1,032	$905	$778
Other non-current liabilities	$325	$475	$592	$647
Total liabilities	***$6,098***	***$7,135***	***$9,274***	***$10,161***
Common stock	$6,558	$6,558	$6,558	$6,558
Retained earnings	-$717	$1,195	$3,591	$6,435
Total equity	***$5,841***	***$7,753***	***$10,149***	***$12,993***
Total liabilities and owners' equity	**$11,939**	**$14,888**	**$19,423**	**$23,154**

Table 3: Desert Coffee Roasters, Inc.: Cash Flow Statements 1999–2002 (All Dollar Figures in Thousands)

	2000	2001	2002
Cash flow from operating activities:			
Net income	$2,250	$2,767	$3,252
Depreciation	$1,316	$1,525	$1,642
Change in accounts receivable	-$1,615	-$888	-$1,216
Change in inventories	-$969	-$494	-$300
Change in prepaid expense	$236	-$713	$162
Change in accounts payable	$787	-$13	$86
Change in accrued liabilities	$280	$616	-$522
Change in non-current liabilities	$150	$117	$55
Net Cash Flow from Operating Activities	***$2,435***	***$2,917***	***$3,159***
Cash flow from investing activities:			
Capital expenditures	-$1,662	-$3,185	-$4,061
Change in short-term investments	$0	$0	$0
Change in non-current assets	-$217	-$535	-$48
Net Cash Flow from Investing Activities	***-$1,879***	***-$3,720***	***-$4,109***
Cash flow from financing activities:			
Change in debt loans	-$180	$1,420	$1,269
Change in common stock	$0	$0	$0
Cash dividends	-$338	-$372	-$409
Net Cash Flow from Financing Activities	***-$518***	***$1,048***	***$860***
Change in Cash account	$38	$245	-$90
Sum of CF from Operating + Investing + Financing	$38	$245	-$90

Growth in Pounds Shipped

Table 4 shows the number of pounds of coffee shipped by DCRI, the proportion of pounds shipped by sales channel, and the growth rate in pounds shipped by sales channel for the period 1999–2002. Growth in supermarket and convenience store sales will continue to be strong, averaging about 20 and 12 percent, respectively, in 2003. Given an expected recovery in the economy, the office coffee service market will turn around and shipments should grow about 8 percent in 2003. Likewise, restaurants, other food service, and other retail segments will all grow at about 3 percent in 2003. Finally, the consumer direct market is expected to see sizable growth at roughly 25 percent in 2003, albeit from a relatively low base. Don wondered if more could be done to boost consumer direct sales from its web site and catalog.

Table 4: Desert Coffee Roasters, Inc.: Coffee Shipped by Sales Channel 1999–2002

Number of coffee pounds shipped by sales channel: (000)

	1999	2000	2001	2002
Supermarkets	1,261	1,353	1,532	1,837
Convenience stores	1,198	1,457	1,799	1,999
Office coffee service distributors	792	1,294	1,501	1,512
Restaurants	599	609	577	574
Other food service	392	462	521	500
Other retail	117	136	124	128
Consumer direct	144	125	149	203
Total	**4,502**	**5,435**	**6,204**	**6,752**

Percentage of coffee pounds shipped by sales channel:

	1999	2000	2001	2002
Supermarkets	28.0%	24.9%	24.7%	27.2%
Convenience stores	26.6%	26.8%	29.0%	29.6%
Office coffee service distributors	17.6%	23.8%	24.2%	22.4%
Restaurants	13.3%	11.2%	9.3%	8.5%
Other food service	8.7%	8.5%	8.4%	7.4%
Other retail	2.6%	2.5%	2.0%	1.9%
Consumer direct	3.2%	2.3%	2.4%	3.0%
Total	**100.0%**	**100.0%**	**100.0%**	**100.0%**

Growth rate in coffee pounds shipped by sales channel

	1999	2000	2001	2002
Supermarkets		7.4%	13.2%	19.8%
Convenience stores		21.6%	23.5%	11.1%
Office coffee service distributors		63.3%	16.1%	0.7%
Restaurants		1.7%	-5.2%	-0.5%
Other food service		17.9%	12.8%	-4.1%
Other retail		16.1%	-8.7%	3.4%
Consumer direct		-13.2%	19.1%	36.0%
Growth rate in total pounds shipped		**20.7%**	**14.1%**	**8.8%**

Because of the continuing economic recovery forecast for 2004 and increasing demand for premium coffees, growth rates would likely increase in 2004. Of course, competitive factors and a slower than expected economic rebound may lower growth expectations by as much as 300 basis points below the forecast. A recent industry report predicted that in 2005 the industry would be consolidating and regional competitors would become nationwide firms. Consequently, it was possible that in 2005 competition would increase dramatically and sharply lower growth rates. Don, however, felt that his competitive advantages could overcome any challenges to his business.

Pricing

As mentioned previously, the market for specialty coffee is very competitive. Table 5 shows

historical average prices per pound that DCRI has been able to charge its customers as well as the annual growth rates in prices.

Table 5: Desert Coffee Roasters, Inc.: Pricing of Coffee 1999–2002

Estimated pricing per pound by sales channel

	1999	2000	2001	2002
Supermarkets	$7.10	$7.80	$7.76	$7.45
Convenience stores	$7.15	$7.84	$7.79	$7.52
Office coffee service distributors	$7.23	$7.76	$7.72	$7.27
Restaurants	$7.35	$7.50	$7.47	$7.03
Other food service	$7.32	$7.50	$7.47	$7.39
Other retail	$7.29	$7.33	$7.34	$7.27
Consumer direct	$7.49	$7.66	$7.92	$8.05
Weighted average price per pound	**$7.21**	**$7.73**	**$7.70**	**$7.41**

Percentage change in price per pound by sales channel

	1999	2000	2001	2002
CPI-Food inflation rate: as of June year-over-year	**2.12%**	**2.32%**	**3.35%**	**1.68%**
Supermarkets		9.86%	-0.51%	-3.99%
Convenience stores		9.65%	-0.64%	-3.47%
Office coffee service distributors		7.33%	-0.52%	-5.83%
Restaurants		2.04%	-0.40%	-5.89%
Other food service		2.46%	-0.40%	-1.07%
Other retail		0.55%	0.14%	-0.95%
Consumer direct		2.32%	3.35%	1.68%
Percentage change in average price per pound		**7.21%**	**-0.39%**	**-3.77%**

The competitive environment for coffee will keep DCRI's prices per pound of coffee from growing too rapidly. However, the improving business environment is expected to lead to general inflation in food prices of 1.30 percent, 2.30 percent, and 3.30 percent in 2003–2005, respectively. In certain markets, DCRI hopes to increase prices by more than those amounts. For example, in the convenience store segment, DCRI hopes to be successful in passing along price increases 60–80 basis points higher than the expected average for the entire food segment. In the office coffee service segment, price increases should be 30–50 basis points higher than the overall inflation rate for food. In other sales channels, price increases will be more or less in line with the average inflation rate in overall food prices.

Cost of Sales

DCRI computes cost of sales as the sum of the costs of raw materials inventory, direct labor, and overhead. Table 6 shows the details for each account as well as total cost of sales for 1999–2002. Each element of cost is discussed below.

Table 6: Desert Coffee Roasters, Inc.: Cost of Sales 1999–2002 (All Total Dollar Figures in Thousands)

Cost of Sales Summary	**1999**	**2000**	**2001**	**2002**
Inventory	$5,769	$5,898	$5,299	$4,182
Labor	$2,652	$3,196	$3,951	$4,285
Overhead	$9,741	$14,803	$16,969	$17,930
Total cost of sales	**$18,162**	**$23,897**	**$26,219**	**$26,397**
Inventory: Pounds of coffee				
Beginning inventory (pounds)	2,483	2,323	3,581	6,729
Plus: Pounds purchased	4,342	6,693	9,352	7,417
Coffee available for sale	6,825	9,016	12,933	14,146
Minus: Pounds shipped	4,502	5,435	6,204	6,752
Ending inventory	**2,323**	**3,581**	**6,729**	**7,394**
Inventory: Total dollars				
Beginning inventory	$3,418	$2,705	$3,674	$4,168
Cost of raw materials purchased	$5,056	$6,867	$5,793	$4,482
Ending inventory	$2,705	$3,674	$4,168	$4,468
Cost of goods sold: Raw materials	**$5,769**	**$5,898**	**$5,299**	**$4,182**
Avg price: NY Mild Arabica beans	$1.1645	$1.0260	$0.6194	$0.6043
Labor				
Total employees in company	175	202	236	244
Production employees	88	101	118	122
Average salaries & benefits per employee	$30,136	$31,647	$33,481	$35,123
Growth rate in salaries & benefits per employee		5.01%	5.80%	4.90%
Total salaries & benefits	$2,652	$3,196	$3,951	$4,285
Gross PP&E per employee	$103.10	$106.29	$117.97	$147.39
Overhead				
Total Overhead	$9,741	$14,803	$16,969	$17,930
Overhead / Pounds of coffee shipped	$2.16	$2.72	$2.74	$2.66

Raw Materials Inventory Costs

Green (unroasted) coffee beans constitute the raw materials inventory for DCRI, while finished goods inventory consists of roasted whole beans and packaged ground coffee awaiting delivery. Because of DCRI's unique roasting method, work-in-process and finished goods inventory are minimized. Table 6 shows the historical computations for raw materials, purchases, and shipments (sales) both in pounds of coffee and in dollars. Ending raw materials inventory is valued at the average price for mild Arabica coffee beans in New York during each year.

As mentioned earlier, coffee prices were at historic lows in 2002. However, late in the year, prices began rising. DCRI's coffee brokers expect prices to continue to rise in the future, probably reaching as high as 80 cents per pound, on average, during 2005. Additionally, in the future, DCRI plans to buy all of its forecasted shipment of coffee in the year prior to its

shipment. In other words, if in 2004, DCRI forecasts shipments of 9,000 pounds of coffee beans, in 2003 it will purchase 9,000 pounds of coffee beans. Any loss or shrinkage that occurs during the roasting process is minimal.

Labor Costs

DCRI's production employees have grown from 88 in 1999 to 122 in 2002, while total wages and benefits have increased from about $2.7 million to $4.3 million. DCRI plans for new employees based on the amount of gross property, plant, and equipment it expects to deploy in future years. The company expects the trends in the relationships to continue in the future.

Factory Overhead

For simplicity, DCRI allocates overhead based on pounds of coffee shipped. It will allocate overhead to cost of sales in this manner for the foreseeable future.

Selling Expenses

Selling expenses consist of salaries and benefits paid to sales personnel and marketing expenses, which include several forms of advertising. DCRI primarily uses in-house sales representatives, except for the office coffee and food service segments. For these customers, DCRI uses independent distributors because customer size or location makes it difficult to provide quality service.

The company employs area and regional sales managers assigned to geographic territories, reporting to the vice-president of sales, Sue Gutierrez. Individual sales representatives are assigned to accounts in the various sales channels with a sales manager over each channel. Table 7 details DCRI's selling expenses as well as its general and administrative expenses.

Table 7: Desert Coffee Roasters, Inc.: Selling Expenses and General & Administrative Expenses 1999–2002 (All Total Dollar Figures in Thousands)

Selling expenses	**1999**	**2000**	**2001**	**2002**
Sales employees	70	81	94	98
Average salaries & benefits per employee	$68,671	$73,988	$79,989	$86,276
Growth rate in salaries & benefits per employee		7.74%	8.11%	7.86%
Total salaries & benefits	$4,807	$5,993	$7,519	$8,455
Lbs shipped per sales employee	64,329	67,112	65,990	68,909
Marketing expenses	$3,400	$4,192	$4,197	$4,126
Total selling expenses	$8,207	$10,185	$11,716	$12,581
Growth rate in marketing expense		23.29%	0.12%	-1.69%
General and administrative expenses				
G&A employees	17	20	24	24
Average salaries & benefits per employee	$109,511	$115,070	$122,246	$129,679
Total salaries & benefits	$1,862	$2,301	$2,934	$3,112
Other expenses in G&A	$469	$643	$552	$633
Total G&A expenses	$2,331	$2,944	$3,486	$3,745
Other G&A expense / Sales	1.44%	1.53%	1.16%	1.27%

In the past, each member of DCRI's sales team has handled an average of about 67,000 pounds of coffee. Don expects this relationship to hold in the future and, consistent with his philosophy that you have to pay up for good employees, sales employees will experience 8 percent annual increases in their pay.

Don noticed that marketing expenses have been flat for the past three years whereas the growth rate in coffee shipments has declined. He wondered if a boost in marketing expenses would increase sales and if so, by how much. Furthermore, he knew a decision to increase marketing expenses would have ripple effects. If higher marketing expenses really did increase sales, Don figured that the production area would also be affected. For example, if Don increased direct advertising expenditures and subsequently sales rose, this would likely require an increase in production capacity and hence, an increase in the number of production employees. For now, though, he thought that an annual increase in marketing costs of about 5 percent would provide a boost to sales and would be a good first pass estimate for forecasting purposes.

General and Administrative Expenses

Table 7 also shows general and administrative expenses for DCRI for 1999–2002. G&A expenses consist of salaries and benefits for senior executives as well as other administrative personnel. Headquarters staff had grown from 17 to 24 individuals in the past four years. Don expects a small increase in staff as the company grows over the next few years. He also expects average salary and benefits to increase in line with their recent annual growth rates. Other G&A expenses are expected to be estimated based on their relationship to sales. This ratio should be

consistent with previous experience.

Capital Expenditures

Don felt strongly that he needed to spend money to make money. Over the past four years, this philosophy led him to nearly double his company's investment in gross property, plant, and equipment. With his conviction that sales would continue to grow in the future, he knew that he would have to plan for capacity additions as well as to replace aging equipment. As shown in Table 8, the ratio of gross property, plant, and equipment to pounds of coffee shipped has increased by about 16 percent in the past two years. He figured that to properly plan for future growth, this ratio would have to grow by 15–17 percent per year over the next three years. After that, he would have built up enough capacity to last DCRI for several years.

Depreciation expense is forecasted as a percentage of total dollar sales. The trend in this ratio is expected to continue into the foreseeable future.

Table 8: Desert Coffee Roasters, Inc.: Property, Plant, and Equipment 1999–2002 (All Total Dollar Figures in Thousands)

Property, plant, and equipment	**1999**	**2000**	**2001**
Production equipment	$2,770	$2,662	$3,255
Computer equipment and software	$2,791	$3,525	$3,068
Furniture and fixtures	$0	$0	$871
Equipment on loan to wholesale customers	$2,067	$2,925	$3,656
Vehicles	$256	$329	$423
Leasehold improvements	$1,108	$1,170	$1,419
Construction in progress	$81	$124	$1,228
Gross PP&E	$9,073	$10,735	$13,920
Accumulated depreciation	$3,980	$5,296	$6,821
Net PP&E	$5,093	$5,439	$7,099
Capital expenditures:			
Gross PP&E / Pound of coffee shipped	$2.02	$1.98	$2.24
% increase in Gross PP&E / Pound shipped		-1.99%	13.60%
Capital expenditures		$1,662	$3,185
Depreciation expense:			
Depreciation expense	$1,006	$1,316	$1,525
Depreciation expense / Sales	3.10%	3.13%	3.19%

Other Financial Statement Accounts

Other balance sheet accounts not previously mentioned are cash, accounts receivable, prepaid expenses, other non-current assets, accounts payable, accrued liabilities, and other non-current liabilities. Table 9 shows ratios of these accounts as a percent of sales for 1999–2002. The forecasts for the ratios in 2003–2005 are likely to be consistent with historical trends.

Several years ago, DCRI borrowed money on a long-term basis. This debt calls for annual principal payments of $127,000. Any additional borrowings have been on a short-term basis. Table 9 shows the average effective interest rate on all of DCRI's debt and short-term

investments. Don guesses that the company can borrow in the future at prime plus 200 basis points. Cash and short-term investments are invested in money market accounts on a short-term basis. Interest rates generally approximate the 3-month CD rate. If the economy recovers as expected, interest rates are likely to rise in the future.

Table 9 also shows DCRI's effective tax rates for 1999–2002. These rates are likely to be fairly constant in the future. Finally, the table shows the dividend payout ratio and the annual growth rate in dividends for 1999–2002. As previously mentioned, a total of 40 percent of DCRI's stock is owned by Don's extended family members. To keep them happy (and away from meddling in the business), dividends have been raised each year.

Table 9: Desert Coffee Roasters, Inc.: Other Balance Sheet Accounts as Percent of Sales, Interest Rates, and Ratios 1999–2002

	1999	2000	2001	2002
Cash / Sales	0.64%	0.58%	1.03%	0.80%
Accounts receivable / Sales	9.59%	11.25%	11.75%	13.65%
Prepaid expenses / Sales	1.90%	0.91%	2.29%	1.86%
Other non-current assets / Sales	0.63%	1.00%	2.00%	2.01%
Accounts payable / Sales	7.01%	7.29%	6.38%	6.27%
Accrued liabilities / Sales	2.39%	2.52%	3.50%	2.30%
Other non-current liabilities / Sales	1.00%	1.13%	1.24%	1.29%
Average interest rate on 3-month CDs	5.33%	6.46%	3.69%	1.73%
Average prime interest rate + 200 basis points	9.99%	11.28%	8.92%	6.68%
Effective tax rate	37.98%	33.36%	39.94%	39.90%
Growth rate in dividends	10.00%	10.00%	10.00%	10.00%
Dividend payout ratio	19.85%	15.01%	13.43%	12.57%

DCRI's Financial Goals

Don is focused on building the Desert Coffee Roasters brand and profitably growing the business. Although the sales growth rate has slowed in recent years, he believes the company can continue to grow sales at least in the 10–15 percent range over the next few years. It can achieve this goal by increasing market share in existing markets, expanding into new geographic markets, and selectively pursuing other opportunities, including opportunistic acquisitions.

In addition to the sales growth goals stated above, DCRI has several other financial objectives:

- Growth rate of pounds of coffee shipped in excess of 10 percent per year.
- Growth in earnings per share in excess of 20 percent per year.
- Return on equity greater than 20 percent.
- Total Debt to Equity ratio no higher than 60 percent.

As Don finished his cup of coffee, he again pondered the future. Could the growth continue? Can he meet his financial objectives and still run a socially responsible business? How should he evaluate the replacement of aging coffee roasters? Will the competition ever let up? How should he finance future expansion? What are the pros and cons of using restricted stock in a company-wide compensation system?

Learning Team Meeting 1 Assignment: Financial Plan Report

- Based on data in the case, prepare base case pro forma income statements, balance sheets, and cash flow statements for the next three years.
- Write a 3–5 page report discussing whether or not DCRI's financial goals likely will be met in the future. Discuss the recommendations you would make to Don Garcia for improving the company's financial health.
- This assignment is due in Workshop 2.

Learning Team Meeting 2 Assignment: Financial Plan Integration Report

Marketing Expenses

DCRI's president, Don Garcia, has noted with interest the historical relationship between marketing expenditures and pounds of coffee shipped. Since brand name recognition is an important part of DCRI's strategy, Don felt that the company should be engaged in additional marketing, including a more aggressive advertising campaign.

He assigned DCRI's vice-president of marketing, Maria Lara, to research this issue. After reviewing relevant literature and talking with friends in the advertising business, she engaged a market research firm to conduct a study. Their results are shown in the equation below that describes the relationship between the growth rate in total pounds of coffee shipped and the growth rate in marketing expenditures.

$g_{lbs} = (1.10 \times g_{mktg}) - (6.75 \times g^2_{mktg})$

where,

g_{lbs} = annual growth rate in total pounds of coffee shipped

g_{mktg} = annual growth rate in marketing dollars

Don needed help in interpreting and applying the formula. He called you into his office to ask about it and how it might apply to the pro forma financial statements you developed earlier. Would increased marketing expenditures help or hurt coffee sales? How much should the company spend on marketing costs next year?

Required:

- Review your recommendations from Learning Team Meeting 1. Evaluate the pro forma financial statements using common size financial statements, percentage growth analysis, and financial ratio analysis. Refine and realistically quantify your recommendations from Learning Team Meeting 1. Prepare a set of modified pro forma financial statements implementing these recommendations.
- Write a 3–5 page report describing and justifying your revised recommendations and the resulting impact on DCRI's financial plan.
- This assignment is due in Workshop 3.

Learning Team Meeting 3 Assignment: Capital Budgeting Scenario Report

In early January 2003, you were nearly finished with an exhaustive analysis of capital budgeting proposals for Desert Coffee Roasting Inc. (DCRI). In one week you were to make a presentation to Don Garcia, founder and CEO of DCRI, and the rest of the management team detailing your recommendation for the firm's capital budget for the coming year. A total of 6 projects had been proposed totaling nearly $37 million. However, Don had previously made clear that he thought the company could fund at most only $6 million in projects. Still, this amount represented a major increase in the firm's asset base which, at the end of 2002, was just over $23 million. You have just one more project to analyze, a major expansion of the business to a new state, and then you must decide how to allocate funds among a set of projects ranging from a new-product introduction, a major acquisition, market expansion, roaster replacements, and a pollution control project.

Proposals for capital spending were primarily proposed by the top management team. The senior managers of DCRI consisted of the following individuals:

Don Garcia, Chairman, President and Chief Executive Officer. As previously mentioned in the case, Don had founded the company and felt personally responsible for the financial well-being of his extended family and his employees. He had built the company from the ground up. He knew that strong competitive pressures existed in the coffee and food service industries and that the company sometimes had to take on considerable risks in order to succeed.

Sue Gutierrez, Vice-President of Sales. Sue was responsible for coordinating all the activities of the sales force, including any changes in geographical positioning. She had been with the company for five years, having been lured back to the Southwest from a successful career at a major consumer products company. An aggressive personality, Sue had successfully managed the company's rapid expansion in sales personnel and felt she could handle an even larger department.

Maria Lara, Vice-President of Marketing. Maria was responsible for developing new products, advertising, market research, and brand management. Maria had come up with the idea for roasting chile with coffee beans to develop a new and unique coffee blend. A high-energy individual, Maria was always coming to Don with new ideas and new ways of thinking about their business. Maria was also Don's cousin.

Diego Gonzalez, Vice-President of Production and Distribution. Diego was responsible for purchasing green coffee beans, roasting them, and distributing the roasted beans. An industrial engineer by training, Diego had always loved the smell of coffee. However, now he was concerned about efficient operations and improving his roasting techniques.

Mary Bishop, Vice-President of Finance. Hired from a national bank three years ago, Mary was increasingly concerned about the rapid rate of DCRI's growth and its growth plans because of the impact on the balance sheet. She also felt strongly that the company would need to develop other external equity financing sources and that the family might be more of a hindrance than a help.

Market Expansion

One of the capital budgeting projects proposed by Sue Gutierrez, vice-president of sales, was to expand into Colorado. Don knew that competitive pressures in the industry meant that he had to grow the business or become a takeover target, perhaps of one of the big food processing companies. Since Colorado was adjacent to New Mexico, the expansion seemed like a natural fit. Therefore, Don was receptive to the idea. However, he also knew that he had to be disciplined about growth. He wanted to grow if it made financial sense to do so. He asked Mary Bishop, the vice-president of finance, to develop a proposal to evaluate the financial viability of expanding into Colorado. Mary has in turn assigned the project to you.

Investment Details

Because DCRI was running at near capacity now, it would have to purchase a new coffee roaster. One of the roasters available on the market was the IRC-80, developed by the Industrial Roasting Company. This roaster represented a new breed of coffee roaster that uses state of the art technology and software to carefully control the roasting process. According to the manufacturer, not only would the quality of each individual roast be perfectly controlled, but the roaster would use 20 percent less fuel than older roasters. However, new technology comes at a price. The turnkey price of the IRC-80 was $1,319,000. The IRC-80 was projected to last 10 years and had a 7-year MACRS class life. For analytical purposes, the investment was assumed to take place at the beginning of 2003 and the first depreciation deduction would occur in 2003.

You assume that DCRI would make an immediate impact in the Colorado market given its emphasis on high quality coffee and its unique blends. Therefore, you figure that sales will be 500,000 pounds each year. The average selling price per pound will be $7.53 and is projected to grow at 3 percent per year.

The addition of the IRC-80 and the expansion will necessitate the hiring of 10 additional workers in the Albuquerque plant. On average, these workers will earn $35,000 per year in 2003, but this amount is expected to rise by 5 percent per year thereafter. The cost of coffee is expected to be $0.70 per pound in 2003 and is expected to increase by 7 percent per year. Overhead costs start at $1,350,000 per year and are forecast to rise by 1 percent per year.

The entry to a new market would require new sales staff. As a rule of thumb, Sue Gutierrez figures that an additional sales representative is needed for about every 67,000 pounds in additional coffee shipped. Sue usually rounds up her estimate of required staff figuring it can't hurt to ask for a bit more than really needed. Given that DCRI has to be aggressive in the field, it has had a history of paying its sales staff very well and providing profit incentives to meet sales targets. Sue thinks that, on average, each sales rep will earn $90,000 in 2003. Furthermore, in order to recruit the very best individuals, this amount is likely to increase by 8 percent per year. As each employee needs the latest technology (laptop computer, PDA, etc.), Sue decides that $30,000 per year in equipment and office furniture lease payments will be adequate. Given the pricing pressures in the electronic equipment and furniture industries, this amount is likely to not increase in the future. Finally, in consultation with Maria Lara, VP of marketing, you learn that the first year of a market expansion is crucial to building sales. Therefore, you plan for marketing expenses of $350,000 in 2003. In subsequent years, you figure that marketing expenses will be 7 percent of sales.

The market expansion will require an increased investment in net working capital. You estimate

that days' sales outstanding will be 51, days' cost in inventory will be 70, and days' payables outstanding will be 43. Even though the project will launch shortly in 2003, for analytical purposes, the investment in net working capital will be assumed to take place at the end of the year. Given the 10-year time frame for the project, you plan to recover all the working capital in 2012, the tenth and final year used for analysis of the expansion project.

Finally, you decide to use a 40 percent marginal tax rate for DCRI and a weighted average cost of capital of 10 percent.

Now that you've gathered all the relevant information, you sit down at your computer and start developing the spreadsheet. You also know that Mary wants to see the results using the following different capital budgeting techniques: net present value, internal rate of return, profitability index, modified internal rate of return, and payback period. You're sure that you have to be ready to explain the economic meanings of these techniques.

DCRI's Capital Budget

After analyzing the expansion to Colorado, you are now ready to tackle the capital budget. Essentially, Don needs to know which projects should be funded. The managers of each department have put together cash flow estimates for each of their proposals. It is now up to you to make a recommendation based on the financial viability of each project. You must be prepared to defend your decision in the upcoming executive committee meeting since the vice-presidents will each be advocating their own projects. Because the projects were not similar, they posed different levels of risk for the company. Therefore, Mary Bishop had developed different hurdles for capital projects as shown in Table 10. She would like some input from you on how to evaluate the pollution control project.

Table 10: Desert Coffee Roasters, Inc.: Minimum Acceptable Criteria for Capital Budgeting Proposals

Type of project	*Minimum acceptable IRR*	*Maximum acceptable payback years*
New product	13.00%	7 years
Market expansion	10.00%	5 years
Efficiency improvements	8.00%	3 years

Projects 1 and 2: Market expansions to Colorado and Texas

As mentioned above, Sue Gutierrez and Maria Lara proposed expanding operations to Colorado. In addition, they thought that the company could also expand eastward to Texas. This was potentially a much bigger market than Colorado and could open the door to the entire southern part of the U.S. Whether the company could sustain both expansions at the same time was an open question. In the upcoming meeting, you were hoping that Sue and Maria could address this issue. Perhaps these projects weren't "all or none"-type projects but could be executed in stages.

While both projects were classified as market expansions, Texas clearly represented a larger market size. However, along with the increased population came more competition, especially in the large metro markets of Dallas and Houston and in the numerous college towns in the state.

Colorado seemed to be the safer bet and was closer to DCRI's roasting plant in Albuquerque. It was also cheaper. DCRI would have to invest just $1.319 million in a new roaster to take the Colorado option. The Texas expansion entails a much larger investment of $3.534 million. The cash flows for the Texas expansion and projects 3, 4, and 5 are given in Table 11. Use your cash flow estimates for the Colorado expansion in the column for project 1.

Table 11: Desert Coffee Roasters, Inc.: Capital Budgeting Proposals: 2003

Project number	***1***	***2***	***3***	***4***	***5***	***6***
Description	***Colorado expansion***	***Texas expansion***	***New coffee line***	***Replace roasters***	***Acquisition***	***Pollution control***
Type	***Market expansion***	***Market expansion***	***New product***	***Efficiency***	***New product***	***Environmental***
Year:			***Incremental Cash Flows***			
0		-$3,534,000	-$1,582,000	-$4,845,000	-$24,050,000	-$1,650,000
1		-$583,296	$465,263	$661,105	$4,374,354	$0
2		$1,260,859	$766,303	$831,781	$3,146,041	$0
3		$1,104,938	$725,619	$710,338	$3,208,962	$2,000,000
4		$975,064	$696,446	$628,331	$3,273,141	
5		$862,103	$383,065	$574,938	$3,338,604	
6		$786,450	$197,318	$591,281	$3,405,376	
7		$744,379	$192,677	$608,404	$3,473,484	
8		$646,834	$158,739	$539,522	$3,542,953	
9		$486,552	$123,951	$472,081	$3,613,812	
10		$2,872,825	$279,133	$551,449	$41,652,800	
Payback (years)						
Maximum acceptable payback						
IRR						
MIRR						
Minimum acceptable IRR						
Weighted average cost of capital						
NPV at WACC						
NPV at minimum acceptable IRR						
Profitability index						

Project 3: Chile Flavored Coffee

Don always thought one of the strengths of the company was its responsiveness to ultimate customer tastes. But when one of his friends, a large chile producer, suggested that he blend red and green chile with his coffee beans, Don had a hard time taking him seriously. However, with salsa becoming an increasing popular condiment in America, Don thought his friend might be on to something. Maria market-tested the concept and found sufficient interest among consumers to proceed. She had Diego Gonzalez, DCRI's master coffee roaster, develop a technique to blend the chile flavor with the coffee beans during the roasting process. The market would probably be small at first, but was expected to expand as more consumers sampled the product. The project would require an initial capital expenditure of $1,582,000 and was classified as a new product proposal.

Project 4: Roaster Replacement

Diego had just returned from a trip to the production facilities of the Industrial Roasting Company, the makers of commercial coffee roasting equipment. He was convinced that DCRI should replace its aging and, in his opinion, obsolete coffee roasters. While the current roasters still produced a good product, technology, as it always seems to do, had advanced forward. Now, rather than using drum type roasters, more commercial roasters were changing to a convection air type of system. Coupled with sophisticated software, a computer could store specific roasting profiles for each bean type, degree of roast, and blend. The result was that the roasting process could be more automated yielding higher quality and more flexibility. In particular, it made blending a much simpler and cheaper process.

In addition to being higher in quality, the new roasters and associated equipment were more efficient. Rather than roasting in relatively small batches, the green coffee beans could be fed continuously to the roasting compartments. The insulated roaster/cooler housing contained a conveyor belt by which the compartments are guided through a total of three roasting and two cooling zones. The conveyor belt has a variable speed drive that allows exact control of the required roasting time. In addition, the cooling zones used forced air rather than water, thus conserving precious natural resources in the arid Southwest.

Because of the increased efficiency, Diego thought that inventory could be reduced. Moreover, the new process would be less labor intensive. Therefore, at least a dozen production workers could be let go. While Don had prided himself on maintaining a family atmosphere at the company, Diego felt that unless the company became more efficient and controlled costs better, it would mean financial trouble in the future. The roaster replacement project would be classified as an efficiency project.

Project 5: Acquisition

Maria was an energetic individual and always on the lookout for new business opportunities. Being VP of marketing, she also had been looking for ways of extending DCRI's brand name and looking for complementary products that the company could sell. While on vacation in the high country of Colorado recently, she happened to eat some of the best chocolate she had ever tasted. She examined the wrapper carefully and discovered that the company that made the chocolate, High Country Chocolate Company, was located in Denver. Because the company was publicly traded, she quickly perused its most recent financial filings and stock performance. She discovered that the company had a market valuation of just over $24 million. Maria also thought that selling chocolate would be the perfect complement to selling coffee. She reasoned that anyone who drank DCRI's high-quality coffee would also enjoy a few bites of high-quality chocolate at the same time. Based on the company's financial history and with a few assumptions, she derived some cash flow estimates. Maria knew that the cost of the acquisition would be beyond the maximum budget Don had set, but she thought this was a good opportunity and the time was right for such a move. The acquisition would be classified as a new product project.

Project 6: Pollution Control

As were many industrial companies, commercial coffee roasters have been coming under increasing scrutiny by regulators and environmental watchdog groups for creating air pollution. While many people regard the smell of coffee roasting in their neighborhood café as a pleasant

experience, commercial operations such as DCRI's could create a rather unpleasant concentration of coffee roasting smells. Although DCRI complied with all current EPA standards, it thought that the smell emanating from its plant could cause local governmental authorities to impose restrictions on its operations. Diego had recently become aware of a coffee roasting company in Europe that recycles most of the air passing through its roasters to virtually eliminate any smell from escaping outside. After making a few inquiries, he discovered that the equipment to do this cost $1,650,000. Because many other companies are just now facing odor problems that previously hadn't, the manufacturer of the equipment thought that the price of the equipment could rise to $2,000,000 within three years.

Required:

- Write a 3–5 page report discussing the following items:
    - The project of market expansion to Colorado.
        - Develop detailed cash flow estimates for the project.
        - Evaluate its financial viability using the following capital budgeting techniques: net present value, internal rate of return, modified internal rate of return, profitability index, and the payback period.
        - If the Colorado expansion were an independent project, would you recommend DCRI pursue it? Why or why not?
    - The capital budget for Desert Coffee Roasters, Inc.
        - Based on the cash flows given in Table 11, compute the payback period, IRR, MIRR, NPV at the minimum required rate of return, NPV at the WACC, and the profitability index.
        - Explain how you would evaluate Project 6, the pollution control project.
        - Which set of projects would you recommend? Why?
- This assignment is due in Workshop 4.

Learning Team Meeting 4 Assignment: Capital Structure and Final Presentation

At their annual holiday gathering in November 2002, Don's family wondered how the company was doing. They had caught wind of Don's desire to expand the company and were curious if they could expect another 10 percent increase in their dividends for 2003. Don hedged a bit, not knowing how much he should reveal in an otherwise festive setting.

Actually, Don had already been in touch with both his commercial bankers and an investment banking group about securing long-term financing. He was considering two proposals for raising $15 million in early 2003. Absent any opportunistic acquisitions, this amount of money would probably fund Don's asset expansion plans for the next two years.

The first proposal was to borrow the money from a local commercial bank. The bank quoted him an interest rate of 6.50 percent for a five-year loan. The repayment schedule for the loan is for $3 million to be due each year with the first payment due on January 15, 2004.

The second proposal was to issue common stock to the public using a regional investment bank to underwrite the $15 million issue. Based on an analysis of other coffee roasting and food processing companies, the investment bankers thought that the share price would be about $15 per share. So, Don was looking at issuing 1 million new shares to the public, increasing the number of shares outstanding by about one-third.

Don wasn't exactly sure how to weigh these two proposals. He called you and your team into his office to ask you some pointed questions.

Required:

- For each financing plan, create a set of pro forma financial statements for the next three years.
- Evaluate the pro formas using common size financial statements, percentage change analysis, and financial ratios.
- Discuss which of the financing alternatives moves Desert Coffee Roasting closer to an optimal capital structure.
    - Conduct an EBIT-EPS analysis for 2003. Start with EBIT of $2,000 and increment EBIT by $500 until you reach $8,000. Determine the "crossover point". Discuss the likelihood of DCRI reaching the crossover point.
    - Compare and contrast the Times Interest Earned ratio and the Fixed Payment Coverage ratio under each financing alternative.
    - Discuss the qualitative factors that are involved in making a capital structure decision and their application to DCRI.
- Prepare a 20-25 minute presentation with 10-12 slides discussing the following:
    - Initial set of pro forma financial statements and recommendations from Learning Team Meeting 1.

  - Capital budgeting analysis
  - Optimal capital structure analysis
  - Resulting pro forma financials from Learning Team Meeting 3.
  - Explanation of the progress of your case study analysis including justification and quantification of your recommendations. Be specific.
  - Description of how your results would be integrated into the organization's strategic plan.
- This assignment is due in Workshop 5.