**Rocky Mountain Vacations**

**Student Instructions**

**Discussion Questions**

1. Assuming the status quo, prepare pro forma income statements, cash budgets, balance sheets, and ratio tables for quarters 1, 2, 3 and 4 of 2017. Note: The status quo includes the decision to reduce the dividends to $200,000 and to delay the purchase of new service bay equipment beyond 2017 due to the low utilization of existing facilities.
2. Discuss the changes in cash flows, the financial decisions made, and whether the company is meeting its financial goals and lending conditions in each quarter based on Part 1.
3. What possible actions can RMV take to achieve its financial goals (higher profitability, reduced borrowing, and capital accumulation for the new dealership) and lending conditions? Are they reasonable?
4. Implement all reasonable actions identified in Part 3, and prepare revised pro forma income statements, cash budgets, balance sheets and ratio tables for quarters 1, 2, 3 and 4 of 2017.
5. Is RMV able to meet its financial goals and lending conditions after making the changes to the financial plan? How should the company proceed?

**Submission Requirements**

1. Prepare proforma income statements, cash budgets, and balance sheets for Quarter 1, 2, 3 and 4 of 2017 as required in Discussion Question 1 – these should be the first four worksheets in your Excel workbook.
2. Prepare revised proforma income statements, cash budgets, and balance sheets for Quarter 1, 2, 3 and 4 of 2017 as required in Discussion Question 4 – these should be the last four worksheets in your Excel workbook.
3. Prepare a 1.5-page memorandum addressing Discussion Questions 2, 3, and 5.

**Submit both the Excel and Word files through the course Moodle site.**

**Recommended Templates**

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| **Budgeted Income Statement** |
|  | **Quarter 1** | **Quarter 2** | **Quarter 3** | **Quarter 4** | **Year** |
| **Sales** |  |  |  |  |  |
|  RV  |  |  |  |  |  |
|  Freedom |  |  |  |  |  |
|  Independence |  |  |  |  |  |
|  Autonomy |  |  |  |  |  |
|  Total |  |  |  |  |  |
|  Service  |  |  |  |  |  |
|  Parts |  |  |  |  |  |
|  Storage |  |  |  |  |  |
| **Total sales** |  |  |  |  |  |
| **Expenses** |  |  |  |  |  |
|  RV |  |  |  |  |  |
|  Freedom |  |  |  |  |  |
|  Independence |  |  |  |  |  |
|  Autonomy |  |  |  |  |  |
|  Total |  |  |  |  |  |
|  Service |  |  |  |  |  |
|  Parts |  |  |  |  |  |
|  Supplies |  |  |  |  |  |
|  Selling |  |  |  |  |  |
|  Administration and storage |  |  |  |  |  |
|  Depreciation |  |  |  |  |  |
| **Total expenses** |  |  |  |  |  |
| **Operating profit** |  |  |  |  |  |
|  Interest income |  |  |  |  |  |
|  Interest expense |  |  |  |  |  |
| **Income before tax** |  |  |  |  |  |
|  Income tax  |  |  |  |  |  |
| **Net income** |  |  |  |  |  |

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| **Cash Budget** |
|  | **Quarter 1** | **Quarter 2** | **Quarter 3** | **Quarter 4** | **Year** |
| **Cash balance, beginning** |  |  |  |  |  |
|   |  |  |  |  |  |
| **Cash receipts** |  |  |  |  |  |
|  RV |  |  |  |  |  |
|  Last quarter |  |  |  |  |  |
|  This quarter |  |  |  |  |  |
|  Service |  |  |  |  |  |
|  Parts |  |  |  |  |  |
|  Storage |  |  |  |  |  |
|  Interest income |  |  |  |  |  |
| **Total cash receipts** |  |  |  |  |  |
|   |  |  |  |  |  |
| **Cash disbursements** |  |  |  |  |  |
|  Purchases |  |  |  |  |  |
|  Last quarter |  |  |  |  |  |
|  This quarter |  |  |  |  |  |
|  Service technicians |  |  |  |  |  |
|  Parts |  |  |  |  |  |
|  Supplies |  |  |  |  |  |
|  Selling |  |  |  |  |  |
|  Administration and storage |  |  |  |  |  |
|  Interest expense |  |  |  |  |  |
|  Income tax |  |  |  |  |  |
|  Regular dividends |  |  |  |  |  |
|  Capital purchase |  |  |  |  |  |
| **Total cash disbursements** |  |  |  |  |  |
|   |  |  |  |  |  |
| **Sub-total** |  |  |  |  |  |
|   |  |  |  |  |  |
| **Financing** |  |  |  |  |  |
|  Repayment  |  |  |  |  |  |
|  Line-of-credit |  |  |  |  |  |
|  Term loan – Regular loan payment |  |  |  |  |  |
|  Term loan – Extra loan payment |  |  |  |  |  |
|  Borrowing |  |  |  |  |  |
|  Line-of-credit |  |  |  |  |  |
|  Term loan |  |  |  |  |  |
|  Special dividends |  |  |  |  |  |
|  Issuance and repurchase of shares |  |  |  |  |  |
| **Total financing** |  |  |  |  |  |
|  |  |  |  |  |  |
| **Temporary investment** |  |  |  |  |  |
|  |  |  |  |  |  |
| **Cash balance, ending** |  |  |  |  |  |

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| **Budgeted Balance Sheet** |
|  | **Quarter 1** | **Quarter 2** | **Quarter 3** | **Quarter 4** |
| **Current assets** |  |  |  |  |
|  Cash |  |  |  |  |
|  Temporary investments |  |  |  |  |
|  Accounts receivable |  |  |  |  |
|  Inventory |  |  |  |  |
|  Income taxes receivable |  |  |  |  |
| **Total current assets** |  |  |  |  |
|  Fixed assets, net |  |  |  |  |
| **Total assets** |  |  |  |  |
|  |  |  |  |  |
| **Current liabilities** |  |  |  |  |
|  Accounts payable |  |  |  |  |
|  Line of credit |  |  |  |  |
|  Income taxes payable |  |  |  |  |
|  Current portion of long-term debt |  |  |  |  |
| **Total current liabilities** |  |  |  |  |
|  Term loan |  |  |  |  |
| **Shareholders’ equity** |  |  |  |  |
|  Common shares |  |  |  |  |
|  Retained earnings |  |  |  |  |
| **Total liabilities and equities** |  |  |  |  |

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| **Key Financial Ratios** |
|   | **Quarter 1** | **Quarter 2** | **Quarter 3** | **Quarter 4** |
| Current ratio (> 1.50) | XX | XX | XX | XX |
| Net profit margin | - | - | - | XX |
| Total asset turnover | - | - | - | XX |
| Return on assets | - | - | - | XX |
| Return on equity | - | - | - | XX |
| Line of credit / A/R + Inventory (< 1.0) | XX | XX | XX | XX |
| Times interest earned (> 4.50) | - | - | - | XX |
| Long-term debt / Total capitalization (= 25%) | XX | XX | XX | XX |
| Line of credit financing (maximum $5,500,000) | XX | XX | XX | XX |

**Sample Response: Discussion Question 2**

**Quarter 1**

Cash flows before financing, despite Quarter 1 being our busiest quarter for computer sales, consulting, and training, are low compared to the peak periods in Quarter 2 and 3 due to minimal A/R collections from our slowest period, Quarter 4. This has left the Current Ratio at a level which is dangerously close to the 1.5 minimum requirement set by the bank. This has been made worse by the inability to delay the purchase of storage racks to a later period. In the future, the company should try not to commit to capital purchases in Quarter 1, so as not to put downward pressure on the Current Ratio. The maximum was borrowed on the term loan to help increase the company’s Long-term Debt to Total Capitalization Ratio towards the desired target of 40 percent and to generate more cash to raise the Current Ratio.

**Quarter 2**

Cash flows before financing were at their highest due to Quarter 2 being the second busiest quarter for computer sales, but also because of considerable A/R collections from Quarter 1. With this cash, the LOC was paid down to zero, and the remainder was placed in a temporary investment to serve as a reserve for future expansion in 2006/2007 and/or to fund potential losses or capital investments needed if a national computer chain enters the local market as rumoured. The maximum term loan was negotiated on the vehicle purchase despite the abundance of cash in order to raise the Long-term Debt to Total Capitalization Ratio closer to the desired goal, but the company will remain considerably below this target as long as it retains its cash as a reserve instead of paying out special dividends. Given future uncertainty, a conservative financial strategy is strongly recommended.

**Quarter 3**

Cash flows before financing remained high despite a significant reduction in sales because of high A/R collections from Quarter 2 and minimal inventory purchases for Quarter 4, which is our slowest period. Surplus cash was used to build up the financial reserve further.

**Quarter 4**

Cash flows before financing are at their lowest level due to minimal sales and A/R collections from Quarter 3 and the need to build up inventories for Quarter 1. Usually, the company makes heavy use of its line of credit in Quarter 4 to finance the inventory expansion. It would be illogical to carry a large reserve earning only 2.5 percent and at the same time borrow on the line of credit at 6 percent. The reserve was liquidated, and only a minimal amount compared to previous periods was borrowed on the line of credit to meet the company’s ending quarter cash goal. The excess borrowing capacity on the company’s line of credit will add to the financial flexibility it needs to deal with the business uncertainty in the coming year and the potential acquisition. The lower line of credit borrowing will lead to an improved Current Ratio in Quarter 1 of next year – it should be much higher than the 1.5 requirement set by the bank. The Annual Cash Flow Coverage Ratio requirement of 4.0 was met with little difficulty.

**Evaluation Rubric**

**Total: \_\_\_\_\_\_\_\_\_ / 100**

**Letter Grade: \_\_\_\_\_\_\_\_\_**

**Quality of Spreadsheet: 20%**

|  |  |
| --- | --- |
| Physical Appearance | /5 |
| Input Section | /5 |
| Automation | /10 |

# Thoroughness of Analysis: 60%

|  |  |
| --- | --- |
| Discussion Question 2 |   |
|  Quarter 1 | /10 |
|  Quarter 2 | /10 |
|  Quarter 3 | /10 |
|  Quarter 4 | /10 |
| Discussion Question 3 |  /10 |
| Discussion Question 5 | /10 |

# Memo Layout and Writing Quality: 20%

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| --- | --- |
| Layout |  /5 |
| Grammatical and Spelling Errors |  /5 |
| Writing Style |  /10 |

# Comments

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