

Corporate Finance 15.402
Assignment 2: Wilson Lumber 2 (REQUIRED)

Now that you have a better understanding of Wilson's business so far, you need to look at the future and forecast his funding needs.

1. Do you agree with Mr. Wilson's conclusion that a \$325,000 line of credit will be sufficient to meet his foreseeable funding needs? How much will he need to borrow to finance his expected sales over the next few years?
2. As Mr. Wilson's financial advisor, would you recommend further expansion of his business and more debt financing? Why or why not?
3. As his banker, would you be willing to lend to Mr. Wilson? If so, what conditions might you attach to the loan? If not, explain your reasons.

To answer question 1, assume that sales reach \$2.5MM in 1985 and construct a *pro forma* income statement and balance sheet projections for 1985-1988. Do this for each of the following three scenarios:

1. Sales grow at 25% per year in 1986-1988 and accounts payable remains at 55 days.
2. Sales grow at 25% per year in 1986-1988 and accounts are paid by the tenth day in order to get the 2% discount.
3. Sales grow at 14% per year in 1986-1988 and accounts are paid by the tenth day in order to get the 2% discount.

You will need to estimate the size of the bank loan under each scenario. To do this, you should first forecast the value of assets using the appropriate assumptions. Next, forecast non-bank liabilities – including a guess as to the value of the Net Income. The difference gives you an estimate of the amount that Wilson needs to borrow from the bank. Plug in an estimate of the bank loan. Recalculate net Income using the interest of the estimated bank loan. Iterate until the balance sheet balances.