

## Scenario II:

Ultimately Klein Electronics needs to re-evaluate its cash usage. The first quarter of 2005 contains the slowest sales month of the fiscal year, July. Since there is a planned expenditure on equipment in August, Klein would be wise to increase the amount of cash coming into the company, as well as conserve cash being paid out. In Scenario II (S2), the earlier suggestion of lower inventory carryover from Scenario I is continued at 20%. This alone is not enough to improve cash utilization. Klein should increase collections on credit sales to 40% in the first month of sale and 50% in the month following sale. Ninety percent of Klein's sales are on credit. The company winds up with much of its cash awaiting payment from accounts receivable customers. With Klein collecting more money in the first month of sale, it should also lower the amount of cash paid out for inventory in month of purchase to 60% versus 70%. This brings the payments for inventory more in line with money that the company is receiving from sales on credit.

Readjusting cash flow between customers and suppliers alone is not enough to improve Klein's financial standings. A small, but drastic means of improving cash flow would be a 2% cut in Selling, General & Administrative Expenses. The Master Budget shows these expenses account for more than 50% of the cash received from sales in the month of July. This decrease in expenses could be justified by stating the large equipment purchase in early August will allow the company to operate more efficiently. The actual cut is only \$3,925 per month, or \$47,100 per year. This small amount may be found by outsourcing a particular task or department function, or by eliminating an expensive or underutilized benefit offered to employees. Unfortunately the cut will most likely come in the form of one or more employees being downsized. Any of these options will hurt employee morale in the short run, but improve the company's financial standings in the long run.

The small cut in expenses, along with the timely cash usage, combines to create the ability for some repayment of the short-term loan, \$5,424 in September (S2, Exhibit 4). It also reflects a net income at quarter end of \$3,881 versus a loss of \$7,500 in the Master Budget (S2, Exhibit 5).

Comparing Scenario II to the Master Budget and Scenario I, the debt ratio improves slightly to 78% and the equity ratio also improves to 22% (S2, Exhibit 8). Unfortunately to generate the small net income even after a cut in expenses, the break even point increased to \$1,536,975 from Scenario I, but is still a drastic decrease from the master budget break even point of \$1,813,189.

Scenario II:

Exhibit 1

**Klein Electronic Company  
Schedule of Expected Cash Collections  
Quarter Ending September 30, 2004**

	<u>July</u>	<u>August</u>	<u>September</u>	<u>Total</u>
Accounts Receivable:				
80% x 220000	176000			176000
10% x 220000		22000		22000
July Credit Sales:				0
40% x 405000	162000			162000
50% x 405000		202500		202500
8% x 405000			32400	32400
August Credit Sales:				0
40% x 472500		189000		189000
50% x 472500			236250	236250
September Credit Sales:				0
40% x 720000			288000	288000
<b>Total Cash Collections:</b>	<b>338000</b>	<b>413500</b>	<b>556650</b>	<b>1308150</b>

Exhibit 2

**Klein Electronic Company  
Budgeted Purchases  
Quarter Ending September 30, 2004**

	<u>July</u>	<u>August</u>	<u>September</u>
Next mon't budgeted sales	288750	440000	451000
Ratio of inventory to future sales	0.2	0.2	0.2
Budgeted ending inventory	57750	88000	90200
Add budgeted sales	247500	288750	440000
Required available merchandise	305250	376750	530200
Deduct beginning inventory	100000	57750	88000
<b>Inventory to be purchased</b>	<b>205250</b>	<b>319000</b>	<b>442200</b>

Exhibit 3

**Klein Electronic Company  
Cash Payments for Inventory  
For Quarter ending September 30, 2004**

	<u>July</u>	<u>August</u>	<u>September</u>	<u>Total</u>
Accounts Payable:				
June 30	35000			35000
July Purchases				0
60% x 360000	123150			123150
40% x 360000		82100		82100
August Purchases:				0
60% x 635000		191400		191400
40% x 635000			127600	127600
September:				0
60% x 808000			265320	265320
<b>Total payments for inventory</b>	<b>158150</b>	<b>273500</b>	<b>392920</b>	<b>824570</b>

Scenario II:

Exhibit 4

**Klein Electronic Company  
Cash Budget  
July 2004 – September 2004**

	<u>July</u>	<u>August</u>	<u>September</u>	<u>Total</u>
Beginning Cash Balance	60,000	929,833	40,000	60,000
Add Receipts:				
Cash Sales	45,000	52,500	80,000	177,500
Plus Bond	980,000			980,000
A/R collections	338,000	413,500	556,650	1,308,150
Total Cash Available	<u>1,423,000</u>	<u>1,395,833</u>	<u>676,650</u>	<u>2,525,650</u>
Cash Disbursements				
Payments for merchandise	158,150	273,500	392,920	824,570
Sales Commissions	60,000	36,000	42,000	138,000
Selling, General & Admin Exp	192,325	192,325	192,325	576,975
Equipment Purchases		800,000		800,000
Income taxes Qtr end 6/30		50,000		50,000
Dividends Payable				0
Bond interest	24,000			24,000
Mature bond	800,000			800,000
Total Cash Disbursements	<u>1,234,475</u>	<u>1,351,825</u>	<u>627,245</u>	<u>3,213,545</u>
Cash Excess (Deficiency)	<u>188,525</u>	<u>44,008</u>	<u>49,405</u>	<u>-687,895</u>
Financing				
Borrowing	741,608		0	741,608
Repayments			-5,424	-5,424
Interest	-300	-4,008	-3,981	-8,289
Total Financing	60000	741,308	-9,405	727,895
Cash balance Ending	<u>929,833 *</u>	<u>40,000</u>	<u>40,000</u>	<u>40,000</u>

\* More then \$40000 due to early August cash purchase of equipment

Scenario II:

Exhibit 5

**Klein Electronic Company**  
**Income Statement**  
**For Quarter ending September 30, 2004**

Sales		1,775,000
Cost of goods sold:		
Beginning inventory	100,000	
Purchases	966,450	
Goods available for sale	<u>1,066,450</u>	
Ending inventory	90,200	
Cost of goods sold		<u>976,250</u>
Gross Margin (Profit)		798,750
Operating expenses:		
Commissions exp	142,000	
Bad debt expense	30,100	
Selling, general &		
Administrative Expenses	576,975	
Depreciation – Building	6,249	
Depreciation – Equip	<u>11,667</u>	
Total operating expenses		<u>766,991</u>
Income from operations		31,759
Other expense:		
Notes Int Exp	8,289	
Bond interest expense	<u>17,500</u>	25,789
Income before taxes		<u>5,970</u>
Income taxes		<u>2,090</u>
Net Income		<u><u>3,881</u></u>
Basic earnings per share:		\$0.13

Scenario II:

Exhibit 6

**Klein Electronic Company**  
**Balance Sheet**  
**Quarter Ending September 30, 2004**

<b>Assets</b>			
Current Assets			
Cash		40,000	
Account Receivable	509,350		
Less Allowance for doubtful accounts	<u>-50,100</u>	459,250	
Inventories		90,200	
Total Current Assets			589,450
Property, Plant & Equipment Assets			
Land		830,000	
Building	500,000		
Less Accumulated depreciation	<u>-236,249</u>	263,751	
Equipment	1,000,000		
Less Accumulated depreciation	<u>-51,667</u>	948,333	
Total Property, Plant & Equipment Assets			<u>2,042,084</u>
Total Assets			<u><u>2,631,534</u></u>
<b>Liabilities and Equity</b>			
Current Liabilities			
Accounts Payable		176,880	
Income Taxes Payable		2,090	
Dividends payable		15,000	
Notes Payable		796,184	
Commissions Payable (8% Sep sales)		64,000	
Bond Interest Payable (Aug & Sep)		13,333	
Bonds Payable, Maturing 7/31/2024	1,000,000		
Less discount on Bonds payable	<u>19,833</u>	980,167	
Total Current Liabilities			2,047,654
Stockholders' Equity			
Common Stock, \$10 par value		300,000	
Net income		3,881	
Retained Earnings		280,000	
Total stockholders' Equity			<u>583,881</u>
Total Liabilities and Equity			<u><u>2,631,534</u></u>

Scenario II:

Exhibit 7

<b>Klein Electronic Company</b>		
<b>Statement of Cash Flows</b>		
<b>Quarter Ending September 30, 2004</b>		
Cash flows from operating activities		
Cash Received from customers	1,485,650	
Cash paid for merchandise	-824,570	
Cash paid for commissions	-138,000	
Cash paid for interest on short term loans	-8,289	
Cash paid for Selling, General, & Admin Exp	-576,975	
Cash paid for taxes	-50,000	
Net cash provided by operating activities		-112,184
Cash flows from investing activities		
Cash paid for equipment purchase	-800,000	
Net cash provided by investing activities		-800,000
Cash Flows from Financing activities		
Cash received from Short term loan	741,608	
Cash paid on short term loan	-5,424	
Cash paid to retire bond	-800,000	
Cash paid for retired bond interest	-24,000	
Cash received from Bond issue	980,000	
Net cash provided by financing activities		892,184
Net increase (decrease) in cash		<u>-20,000</u>
Cash balance at beginning of Quarter		<u>60,000</u>
Cash balance at end of Quarter		<u><u>40,000</u></u>

Exhibit 8

<b>Contribution Margin Ratio:</b>		
<u>Sales – Variable Costs</u>	<u>666550</u>	
Sales	1775000	0.38
<b>Current Ratio:</b>		
<u>Current Assets</u>	<u>589,450</u>	
Current Liabilities	2047653.51	0.29
<b>Debt Ratio</b>		
<u>Total Liabilities</u>	<u>2,047,654</u>	
Total Assets	2,631,534	0.78
<b>Equity Ratio</b>		
<u>Total Equity</u>	<u>583,881</u>	
Total Assets	2,631,534	0.22
<b>Debt-to-Equity Ratio:</b>		
<u>Total Liabilities</u>	<u>2,047,654</u>	
Total Stockholder Equity	583,881	3.51
<b>Break Even Sales</b>		
<u>Fixed costs</u>	<u>576,975</u>	
Contribution Margin Ratio	0.38	1,536,465