PRINCIPLES OF FINANCE
Financial Planning and Control Solutions

1. Avalanche Outfitters (AO) sells tents for $250 each. AO’s fixed operating costs equal $500,000, and its variable cost ratio is 75 percent. The company is financed with $937,500 of debt with an interest rate of 8 percent and $625,000 of common equity; it has no preferred stock. The firm’s marginal tax rate is 40 percent.

   a. What is AO’s operating breakeven point?

   b. What will be AO’s net operating income (NOI) when 10,000 tents are sold?

   c. What is AO’s degree of operating leverage (DOL) at sales of 10,000 tents?

   d. Based on your computations in part (c), what will AO’s EBIT and net income be if sales are 5 percent higher than forecast? Assume that AO’s sales forecast was 10,000 tents.

   e. One of AO’s competitors, La Paz Outfitters (LPO), has the same operating structure as AO—that is, LPO sells tents for $250 each, its fixed operating costs are $500,000, and its variable operating costs are 75 percent of the selling price. LPO normally sells 13,000 tents per year.

      i. What is LPO’s DOL?

      ii. Which company is operating closer to its operating breakeven point, AO or LPO?