Financial Planning and Control

1. Financial planning—forecasting future financial needs

2. Financial control—evaluating and implementing financial plans

3. Pro forma (projected) financial statements—start with a sales forecast
   a. Step 1—forecast the income statement
   b. Step 2—forecast the balance sheet
   c. Step 3—raise the additional funds needed (AFN) = external funds
   d. Step 4—include financing feedbacks

4. Other considerations in financial forecasting
   a. Excess capacity
   b. Economies of scale
   c. Lumpy assets
5. Financial control—operating section of the income statement
   a. Operating breakeven analysis
      • EBIT = 0
      • Sales = Operating expenses
   b. Operating leverage
      • Fixed operating costs
      • Degree of operating leverage (DOL) = percentage change in operating income (EBIT) that results from a 1 percent change in sales
   c. The closer a firm is to its operating breakeven point, the higher its DOL is, which means the riskier its normal operations are.
6. Financial control—financing section of the income statement
   a. Financial breakeven analysis
      • $\text{EPS} = 0$
      • $\text{EBIT} = \text{Fixed financial expenses on a pre-tax basis} = \text{Interest} + \frac{D_p}{(1 - T)}$
   b. Financial leverage
      • Fixed financing costs; Interest and preferred dividends
      • Degree of financial leverage (DFL) = percentage change in earnings per share (EPS) that results from a 1 percent change in EBIT
   c. The closer a firm is to its financial breakeven point, the higher its DFL is, which means the riskier its financing is.
Financial Planning and Control

7. Financial control—entire income statement
   
a. Total leverage
      • Any fixed costs; fixed operating costs, fixed financing costs, or both fixed costs
      • Degree of total leverage (DTL) = percentage change in earnings per share (EPS) that results from a 1 percent change in sales
   
b. The higher a firm’s DTL, the greater the overall (total) risk associated with both its operations and its financing.
Financial Planning and Control

Sales
(Variable operating costs)
Gross profit
(Fixed operating costs)
Earnings before interest & taxes (EBIT) = Net operating income (NOI)
(Interest)
Earnings before taxes (EBT) = Taxable income
(Taxes)
Net income
(Preferred dividends)
Earnings available to common stockholders (EAC)

Operating section
DOL = \( \frac{\text{Gross profit}}{\text{EBIT}} \)

Financing section
DFL = \( \frac{\text{EBIT}}{\text{EBIT} - \left[ 1 + \frac{D_p}{(1-T)} \right]} \)

DTL = DOL \times DFL
= \frac{\text{Gross profit}}{\text{EBIT} - \left[ 1 + \frac{D_p}{(1-T)} \right]}