Debt, Equity, and Retained Earnings

REVIEW PACKET

1. **Sources of Capital.** There are three main sources of capital for any business. List what they are; provide a definition of each in your own words; and then give the advantages and disadvantages of each.

Source of Capital	Definition	Advantages & Disadvantages
A.		ADV 1
		ADV 2
		DIS 1
		DIS 2
B.		ADV 1
		ADV2
		DIS 1
		DIS 2
C. Retained Earnings		ADV 1
		DIS 1

2. **Where on the Balance Sheet?** Using the balance sheet shown to the right, answer the questions below.

   A. What <u>types</u> of **short-term debt** financing has this company used?

   B. What <u>types</u> of **long-term debt** financing has this company used?

   C. What are the **payments** called that this company will have to make on their debt?

   D. What <u>other</u> types of financing has this company used to grow? (Hint: there are 3 additional types of financing used other than debt)

BALANCE SHEET
(dollars in thousands)

ASSETS	
Current Assets	
Cash and Cash Equivalents	5,000
Accounts Receivable	4,000
Inventory	7,000
Other Current Assets	1,000
Total Current Assets	**17,000**
Property, Plant, and Equip.	22,500
Other Assets	500
Total Assets	**40,000**
LIABILITIES	
Current Liabilities	
Accounts Payable	4,000
Bank Line of Credit	1,000
Commercial Paper	2,000
Total Current Liabilities	**7,000**
Mortgage Bonds	10,000
Debenture Bonds	1,500
Total Liabilities	**18,500**
STOCKHOLDERS' EQUITY	
Preferred Stock	1,500
Common Stock	14,000
Retained Earnings	6,000
Total Stockholders' Equity	**21,500**

3. **Case Studies.** For each of the case studies below, imagine that you are an investment banker advising the companies. Indicate which source of capital would be most appropriate and explain why you feel this is so. Be specific with your reasons!

Less Is Moe, Inc., would like to expand soon. The plan is to build another plant in a nearby city. Less Is Moe's financial position is excellent. While it is highly profitable, it does not have enough profit available for capital investment. It has little debt. Its tax liabilities are very high. The company does not want to give up any additional control.

Moe's Mulching, Inc., is in a strong financial position. Summer is coming – a time when Moe's business makes most of its money. Moe would like to buy another truck and hire a few more workers. He just needs some money for a few months for operating costs-working capital. The company will earn more than enough in the summer to pay it back.

Moe Money, No Problems, Inc., was originally a family-run business; it went public several years ago. At the time, Moe's family wanted to open operations in several cities. Now they have many locations throughout the Midwest. Those expansions were funded by corporate bonds. The family still owns 70 percent of the stock. Although the company has not shown a profit for the last two quarters, its financial condition is not critical; but more debt could strain the already strained cash flow. Moe's family would prefer to maintain their image of a growing, prosperous firm. They need money for modernization of their kitchens to meet environmental protection laws and to become more efficient.