Lloyd Marks

Pro Forma Financial Statement for Edwards Lifesciences

3-28-16

**Overview:**

Edwards Lifesciences is a manufacturer of medical devices. It was performing well until 2013 when it got a $60 million settlement from a patent infringement lawsuit and even better in 2014 when it got an additional $740 million. The company put much of this money in cash and short term investments. Because the asset base had grown substantially (due to the settlement) the total asset turnover dropped significantly and this caused a big drop in the return on equity. I have proposed a steady 2% growth in the company’s income parameters but with exceptions as noted. I have posited a number of changes over the next few years. These changes involve investing in new equipment with a future increase in sales, investing in a new affiliate, cutting back on G & A expenses, reducing accounts receivable, and declaring a sizeable dividend. These changes resulted in a steadily improving return on equity.

**A few words about the spreadsheet methodology:**

Net income each year is added to retained earnings. This increases shareholder equity. Total assets is set equal to the total liability plus shareholder’s equity. Then cash is calculated as a dependent variable (total assets minus all assets except cash).

**Trying out different scenarios:**

The box to the right of the balance sheet “Adjustable Parameters” describes various interventions undertaken over the years 2015 - 2019. The magnitudes of these interventions (shown in the boxes with the tan background) are independent variables which can be modified to test out different scenarios. (The rest of the spreadsheet is locked).

**2014:**

The big cash settlement is received. Things are looking very good, indeed. Net profit margin jumps from 19% to 35%. Cash flow goes from -$90 to +$709 ! Return on equity goes from 25% to 37%. The company grows; G & A increases by $125, out of pace from prior years. Most of the settlement money is kept as cash and cash equivalents with an increase from $420 to $653. Also, $270 is placed in short term investments. In other words, the money was not immediately put to work to generate more sales and profits. These decisions resulted in the following findings in 2015.

**2015:**

Although sales continue to grow, the increased G & A causes the net profit margin to decrease from 19%, the year before the big settlement to 12%, the year after the settlement. Net profit margin, total asset turnover and leverage are all decreased from 2013 with a resulting large drop in return on equity from 25% in 2013 to 12% in 2015. Now the company decides to put the cash to work; it invests $300 in a new factory with the anticipation that sales will increase in a couple of years when the factory comes on line. Half of the cost of the factory is equipment that is depreciated over 10 years.

**2016:**

A new CEO comes on board and does some “belt tightening,” reducing G & A by 15%. This has an immediate beneficial effect on net profit which jumps from $294 to $400; the net profit margin increases from 12% to 17%. Also, the return on equity goes from 12% to 14%. And the cash flow situation improves, going from $294 (excluding the $300 spent on the factory) to $400.

**2017:**

Things continue on an upward track. The company is still extremely cash rich. They declare a dividend of $1000. Because of the dividend, stockholder’s equity drops from $2885 to $2294. This causes the financial leverage to increase from 1.46 to 1.58. Total asset turnover increases from 57% to 68%. These changes cause an increase in the return on equity to 18%.

**2018:**

The investment in the new factory is paying off. Sales and cost of goods are increased by 15% on top of the 2% normal rate of growth. Sales have shot up from $2465 to $2891. Net income has shot up from $409 to $624. Net profit margin has increased from 17% to 22%. Return on equity has increased from 18% to 21%. They have made so much money in 2018 that they decide to invest $500 in an unconsolidated affiliate.

**2019:**

The investment in the unconsolidated affiliate has paid off well. Sales and cost of goods have increased 10% on top of the normal 2% growth rate. Net sales have increased by $352. Net income has increased from $624 to $798. Net profit margin has increased from 22% to 25%. Collections are streamlined. This results in a 25% drop in accounts receivable. Accounts receivable turnover goes from 10% to 15%. Return on equity has increased from 21% to 29%. Things are going so well, that a dividend of $1000 is declared. This causes negative cash flow of -$130. Even so, cash and cash equivalents remain high at $526.