Exercise 6-12

Sales = 15,000 games
Selling price per game = $20
Fixed costs = $182,000
Variable costs = $6 per game
Contribution margin = Sales – variable costs = $20 - $6 = $14

Part 1

Magic Realm, Inc.
Contribution Income Statement
For the year ended xxxx

Sales (15,000 games x $20/game) $300,000 $20
Less variable expense
(15,000 games x $6/game) 90,000 6
Contribution margin $210,000 $14
Less fixed expenses 182,000
Net income $ 28,000

Degree of operating leverage = Contribution margin ÷ Net income
Degree of operating leverage = $210,000 ÷ $28,000 = 7.5

Part 2(a)

Management anticipates a 20% increase in sales, from 15,000 to 18,000 (given)
The degree of operating leverage is 7.5
Therefore net operating income should increase by 7.5 times or 150% (20% x 7.5)
<table>
<thead>
<tr>
<th>Part 2(b)</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Last year’s net income</td>
<td>$28,000</td>
</tr>
<tr>
<td>Expected increase (150% x $28,000)</td>
<td>42,000</td>
</tr>
<tr>
<td>Expected net income</td>
<td>$70,000</td>
</tr>
</tbody>
</table>