

Cartwright lumber company case essay sample

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Cartwright

1. Why has Cartwright Lumber borrowed increasing amounts despite its consistent profitability? Cartwright lumber has had to borrow substantial amounts of money due to the fact that the firm is a growing company with sales rising quickly. In order for the company to sustain this growth rate, they will have to get additional external funding. Growth in sales nearly doubled from 2001 to 2003, with a percentage growth of 18% and 34% in 2002 & 2003 respectively. While sales are growing steadily, the company's cash is steadily decreasing year to year by 20% and 17% in 2002 and 2003. Taken together with the fact that accounts receivable has grown at a higher rate than sales, 30% & 42%, this firm can not support the growing sales relying on its assets. The DSO ratio for accounts receivable is 36. 28, 39. 70 & 42. 36 in 2001, 2002, and 2003 respectively. With credit terms of 30 days, the DSO is showing that on average customers are not paying on time and year to year they are paying increasingly later. All these factors combined demonstrate poor management of the firm's assets. This is the reason why the firm is primarily relying on its debts to sustain the increase in sales growth.

1. Although Mr Butler has seen an increase in his sales for the last few years, there are a few reasons why he needed a loan from the bank to keep his operations going. 1) Shortage of Cash: Despite good profits, Mr. Butler had experienced a shortage of cash from 1988 to 1990. During this period of time, there was a decrease in cash reserves, as well as in inventory turnover, indicating that Mr. Butler's money had been tied up in his inventory. This can be resolved by working on his receivables turnover ratio, which decreased

from 1988 to 1990, as seen in Appendix A. 2) Debt Consolidation: In late 1988, Mr. Butler took a loan of \$70,000 that carried an interest rate of 11%. The annual interest payable to the bank compounded to his cash shortage problem. 3) Expansion of operational business: Additional investments in working capital and inventory purchases will be required to keep up with the company's increasing sales volume.

2. How has management met the financing needs of the company? Has the financial strength of the company improved or worsened? In an effort to sustain the increase in sales, management has continually raised funding through borrowing from both the bank & its suppliers. The firm has extended its trade credit a significant amount in an effort to remain below the 250,000 ceiling imposed by their current bank. In turn, they are giving up discounts on their purchases made. From 2001 to the first quarter of 2004, the firm's total liabilities increased tremendously by 127% from \$324 to \$737. We can see the effects of this financing practice by analyzing the firm's debt management ratios. The firm's debt ratio has increased over the past four years from 54.55% to 58.70% to 62.70% to 67.37%. This increasing debt ratio illustrates the firm's attempt to use its debt to highly leverage the firm. Although we do not have an industry average to compare this debt ratio to, this debt ratio is very high. Examining Cartwright Lumber Company's current ratio and quick ratio in combination with their debt ratio, the firm's financial strength has weakened.

The Current Ratio is approximately 1.35X and the Quick Ratio is 0.55X. These ratios are very low, raising a red flag that this company may have difficulties paying off debts. Furthermore, the company is relying heavily on <https://assignbuster.com/cartwright-lumber-company-case-essay-sample/>

its inventory which is the least liquid of a firm's current asset. This firm's financial management is very risky and I feel it is worsening the company's financial strength. Furthermore, analyzing the company's profitability ratios, Cartwright Lumber's profitability is decreasing year to year although net income has increased. From 2001 to 2004, the profit margin decreased from 1.83X to 1.25X while the operating margin decreased from 2.18X to 1.53X. Therefore, the firm's practicing of continually taken on more debts has not improved their profitability. In calculating the firm's ROE, we could say that by leveraging the firm, the company has been able to increase the ROE and therefore is more profitable. The firm's ROE is 11.48%, 12.64%, 12.64% in 2001, 2002 & 2003. However, when we calculate the firm's ROE for the first quarter of 2004, it has decrease to 10.08%.