

Nelson Nurseries Final Case Study

BMGT340
By: Michelle Burgos

Question 1: What is your assessment of the financial health of Nelson Nurseries? In what area(s) is the company performing well, and what area(s) are they performing poorly?

Answer 1:

Looking at the profit and loss statement we can see that Nelson Nurseries has been able to continually increase their sales every year; furthermore, it is projected that the demand for the “more-mature plants” will increase in 2020 further increasing the company’s revenue because Roger had the foresight to increase his “top-line expansion efforts” the company will be able to keep up with this increase in demand for their products in 2020. Currently, their expenses are manageable, as long as there is not a substantial increase in their SG&A expense after they begin to increase their revenue, they should not run into many issues.

Currently, the company has seen a substantial dip in their cash on hand. This could potentially be dangerous as it could lead to the company needing to borrow money in an economy where the interest rates are rising. This would be detrimental to the company as stated from Christine that it would be impossible for them to meet the interest payments if adverse weather wiped out their inventory. This is the current area in which the company is doing the most poorly and could potentially cause the most harm to the financial health of the company if not addressed. Nelson Nurseries has seen an increase in their accounts receivables which would allow for the company to increase their total cash on hand in the future on top of their forecasted sales. This would greatly alleviate the current drought in cash on hand that is leaving the company in a risky position. However, this currently entrails that there is less money available in working capital for the company. Being that the current cash on hand is a major issue for the company, Roger and Christine need to devise a way to change their current credit terms with the small nurseries to help increase their total cash on hand.

The company throughout 2018-2020 has been able to maintain their current liabilities low as Christine has gone through great lengths to ensure they do not borrow from the bank by ensuring they pay their suppliers early enough to obtain a 2% discount for their supplies; however, going back to the current low cash on hand of the company, if they do not address the issue, and do not have enough to pay the suppliers early enough to acquire that discount, they may need to begin borrowing more money to offset this loss.

Currently, the company’s total assets have a healthy mix of different assets, other than their current capital. The company has a total of \$1,181 in assets while maintaining a low balance of \$47.3 liabilities. Furthermore, there has been a steady increase in their return on assets over the years. They are currently sitting at 5.1% and show trends of steady growth. Also, due to the inventory on hand taking two to five years until they are mature enough to sell, being that this inventory was acquired around 2017, this would entail that in 2020 a large portion of the inventory will be ready to sell to customers that are willing to pay a premium. If Roger and Christine are willing to dedicate a larger portion of their inventory to the customers that are willing to pay a premium, this would help them lower their total accounts receivable and increase cash flow into the business.

Overall, based on numerous different financial statements, ratios, and other key factors that play a role in the financial health of a company, Nelson Nurseries’ financial health appears to be in a good place; however, this could quickly change if Roger and Christine do not address the issue with their low cash on hand.

Question 2: Please forecast Nelson's financial statements and financial position for the Year 2020. Based on your forecast, do you anticipate that Nelson's financial position will improve or deteriorate during the year?

Answer:

In the Case study, Roger projects to increase their revenue by 30% in 2020.

	2018	2019	2020	Percentage/reason used
Profit and Loss Statement				
Revenue	908.2	1,048.80	1363.44	Projected growth of 30%
COGS	437.7	503.4	604	Increase in COGS from the need of more inventory after the purchase of land
Gross Profit	470.5	545.4	759.44	Revenue - COGS
SG&A expense	356	404.5	468.217631	AVG % increase from 2017-2019 15.57%
Depreciation	36.3	40.9	46	Stated on Page 2 by Chris
Operating Profits	78.2	100	245.222369	equals D5-D6-D7
Taxes	26.2	39.2	52.4	Trend increase in previous years of 13.1
Net Profit	52	60.8	192.822369	
Balance Sheet				
Cash	66.8	9.4	50	Increase in cash due to sales
Accounts Receivable	119.5	146.4	177.346204	AVG % increase from 2017-2019 21.14%
Inventory	523.4	656.9	750.899079	AVG % increase from 2017-2019 14.31%
Other Current Assets	22.6	20.9	19.1	Continuous decrease
Current Assets	732.3	833.6	997.345283	
Net Fixed Assets	384.3	347.9	301.9	Added Depreciation of 46
Total Assets	1,116.60	1,181.50	1299.24528	
Accounts Payable	4.5	5	5.5	Increase as no change to credit terms and increase in sales

Wages Payable	22.1	24.4	27.4	Will Slightly increase due to more demand for product; however, if congress raise the rate, this will increase drastically
Other Payables	16.6	17.9	19.1	Will increase due to the purchase of land. Will require more money to get operational
Current Liabilities	43.2	47.3	52	
Net worth	1,073.40	1,134.20	1247.24528	
Capital Expenditure	88.1	4.5	75	Spent 75 on land
Purchases	161.2	185.1	200	

I believe that Nelson's financial health will improve as long as the company is able to ensure that their SG&A expense does not increase substantially, the year 2020 will be the year they turn a major profit. However, the issue of cash on hand needs to be addressed as it is putting the company at major risk. Furthermore, my forecast was made using averages calculated from previous years and the year 2020 appears to be extremely different from all the years prior due to the many factors aligning for the company. For example, the economy in the area is currently good and the demand for their product is on the rise. Bigger nurseries are willing to pay more for their product that will now be mature enough to sell at a premium. Also, this increase in projected sales will help alleviate the spending made on the new 12-acre land.

Question 3: Provide an explanation of the accounts payable policy that Cristine Barton is using to operate the business. What recommendations would you have for her to change or improve the policy as it is currently being implemented.

Answer 3:

Christine's current accounts payable policy consists of her avoiding bank borrowing to avoid any debt to the banks. Furthermore, to ensure that she borrows as little money as possible from the banks, Christine pays her suppliers within the 10 days of the company's purchases to acquire a 2% discount on all their supplies purchased. This discount plays a big role in the company's ability to ensure they do not borrow money because if they did have to pay 2% more for

supplies, in 2019 they would have paid \$513.468 in COGS in lieu of 503.4. This large increase in costs would trickle down and harm the company's overall financial health.

Due to the nature of business Nelson Nurseries find themselves in, I believe that it is imperative that the company continues to only buy inventory that they are projected to sell. This is because the company is currently facing an issue where they are low on cash on hand; therefore, if they continue to purchase inventory, they will not be able to turn around for over 386.3 days (Exhibit from Benchmark Inventory Days), then they will be in danger of needing to borrow money. Currently the company is sitting on a large amount of inventory, so even though they will be missing out on the 2% discount, there is not much need to purchase more inventory. I recommend the company waits until after the second quarter of 2020 to purchase more inventory after they have gauged exactly how well the 2020 year is going. This will help ensure their account payable does not increase and will be able to increase their amount of cash on hand.

Question 4: The recent trends in Nelson's cash position are a bit alarming. In your opinion, explain why Nelson is experiencing a decline in its cash balances, and provide a couple suggestions/recommendations that would help to improve the company's cash position.

Answer 4:

There are a few factors that are currently causing the company to have low cash on hand. One of the biggest factors playing a role is the continuous increase of accounts receivable over the years. The company has seen an average of 21.14% increase in their Accounts Receivables from 2017-2019. If the company continues with this trend, then they will continue to not have any cash on hand and majority of their revenue will be sitting in receivables. To help resolve this issue, I believe that the company should implement one of the strategies their suppliers use. Christine should implement a plan to change the current credit terms to benefit them more in lieu of the small nurseries. They could do this by adding terms that if companies pay for their supplies within a certain time period, they should receive 2-4% sales on the product. This would help encourage the small nurseries to pay their credits to Nelson Nurseries faster in order to receive this discount. As we have seen from the case study, when there are discounts at stake, smaller businesses are more willing to pay quicker to help cut down on their own costs.

Another issue faced by the company is the large amount of inventory the company has been sitting on. Because of the nature of the business, if they are trying to turn the most profit from their product, they must wait 2 to five years to fully mature. Because of this waiting period, they must purchase inventory in advance to meet their future demand. However, it seems that the company has gone too far with the purchasing of inventory as they have not been able to turn over a large portion of their inventory. This amount only continues to grow as seen in average increase in inventory of 14.31% from 2017-2019. I would recommend that they purchase land based on the number of sales they are projected to make, this would allow them to recoup what they have lost while maintaining a healthy inventory for the future. This of course would have to occur after they have filled the new 12-acre land with inventory.

Furthermore, another issue that has played a role in this decline of cash is the fact the company is strongly against taking any loans. Because the company is insistent on not taking loans from the bank, they will need to spend more of their capital on purchases made by the company. For example, because Christine is against loans, they have been spending money a lot sooner than they would on inventory from their suppliers to receive the 2% discount. This may not initially seem like a negative; however, this forces the company to spend cash faster to meet

these terms. And with the new purchase of land, I am assuming they have been purchasing more inventory with cash to fill this land in 2019. Lastly, the fact that the inventory takes roughly 386.3 days to turnaround, it delays the return on the money spent for the product. I believe that if the company is more selective on how they purchase inventory and use metrics to determine exactly how much they should purchase. This would greatly decrease the amount of money spent on inventory.

The increase in taxes paid because of the increase in revenue has played a big role in lowering the amount of capital within the company. Because of the fast growth of the company, they have been hit with a substantial increase in taxes paid every year. Christine will need to adjust her metrics to take into account this increase in taxes. Furthermore, the amount of taxes that will be paid in 2020 will be drastically more than all the years prior due to the projected 30% increase in revenue.