Case 6

Bluffton Pharmacy

Two New Pharmacy Owners Learn Valuable Lessons About Financial Statements and Analysis

It has been a little more than two years since Angela Crawford and Martin Rodriguez purchased the Bluffton Pharmacy from Frank White, the previous owner and founder, who had started the pharmacy in 1969. The two have spent many long hours in the store and have learned many valuable lessons as business owners that they had not had the opportunity to learn as employees of large chain pharmacies where they had previously worked.

Crawford and Rodriguez just received an e-mail from their accountant that contained the balance sheet and the income statement for Bluffton Pharmacy for the fiscal year that has just ended. The two financial statements appear below.

Bluffton Pharmacy

Balance Sheet, December 31, 20XX

	Assets
Current Assets	
Cash	$ 74,473
Accounts Receivable	$112,730
Inventory	$224,870
Supplies	$ 21,577
Other Assets	$ 10,202
Total Current Assets	$443,851
Fixed Assets	
Autos, net	$ 33,156
Equipment, net	$ 35,706
Furniture and Fixtures, net	$ 16,323
Total Fixed Assets	$ 85,185
Total Assets	$529,036
	Liabilities
Current Liabilities	
Accounts Payable	$ 29,585
Notes Payable	$ 70,902
Line of Credit Payable	$ 32,136
Total Current Liabilities	$132,623
Long-term Liabilities	
Note Payable	$170,880
Loan	$ 93,346
Total Long-term Liabilities	$264,226
	Owner's Equity
Crawford and Rodriguez, Capital	$132,187
Total Liabilities and Owner's Equity	$529,036

Bluffton Pharmacy

Income Statement December 31, 20XX

Prescription Sales Revenue		$2,228,767
All Other Sales Revenue		$ 167,757
Total Sales		$2,396,524
Cost of Goods Sold		
Beginning Inventory, 1/1/xx	$ 169,578	
+ Purchases	$1,938,097	
Goods Available for Sale	$2,107,675	
− Ending Inventory, 12/31/xx	$ 224,870	
Cost of Goods Sold		$1,882,805
Gross Profit		$ 513,719
Operating Expenses		
Utilities	$ 10,305	
Rent	$ 35,948	
Advertising	$ 9,586	
Insurance	$ 9,586	
Depreciation	$ 5,033	
Salaries and Benefits	$ 321,134	
Computer and E-commerce	$ 11,983	
Repairs and Maintenance	$ 28,758	
Travel	$ 4,793	
Professional Fees	$ 3,595	
Supplies	$ 5,991	
Total Operating Expenses		$ 446,712
Other Expenses		
Interest Expense	$ 24,879	
Miscellaneous Expense	$ 374	
Total Other Expenses		$25,253
Total Expenses		$ 471,965
Net Income		$ 41,754

To see how their pharmacy's financial position has changed since their first full year of operation, Crawford and Rodriguez want to calculate 12 financial ratios. They also want to compare Bluffton Pharmacy's ratios to those of the typical small pharmacy in the industry. The table below shows the value of each of the twelve ratios from last year and the industry median for small pharmacies.

Ratio Comparison

Ratio	Bluffton Pharmacy Current Year	Bluffton Pharmacy Last Year	Pharmacy Industry Median*
Liquidity Ratios			
Current ratio		3.41	4.71
Quick ratio		1.72	2.42
Leverage Ratios			
Debt ratio		0.70	0.62
Debt-to-Net-Worth ratio		2.23	2.1
Times Interest earned ratio		3.04	3.9
Operating Ratios			
Average Inventory Turnover ratio		10.90	11.7 times/year
Average Collection Period ratio		14.0	15.0 days
Average Payable Period ratio		5.0	14.0 days
Net Sales to Total Assets ratio		4.75	4.68
Profitability Ratios			
Net Profit on Sales ratio		1.94%	2.9%
Net Profit to Assets ratio		9.20%	8.2%
Net Profit to Equity ratio		29.21%	48.0%

*from Risk Management Association Annual Statement Studies and National Community Pharmacists Association

"Let's see how our ratios compare to last year's numbers," says Angela.

"I hope we're headed in the right direction," says Martin.

"There's only one way to find out," says Angela with a slight hint of tension in her voice.

Questions

1. Calculate the 12 ratios for Bluffton Pharmacy for this year.
2. How do the ratios you calculated for this year compare to those for the pharmacy last year? What factors are most likely to account for these changes?
3. How do the ratios you calculated for this year compare to those of the typical company in the industry? Do you spot any areas that could cause the company problems in the future? Explain.
4. Develop a set of specific recommendations for improving the financial performance of Bluffton Pharmacy, using the analysis you conducted in questions 1–3.

Case 7

Bluffton Pharmacy, Part 2

How should the owners of a small pharmacy create a cash flow forecast for their business?

It has been a little more than two years since Angela Crawford and Martin Rodriguez purchased the Bluffton Pharmacy from Frank White, the previous owner and founder, who had started the pharmacy in 1969. Although Crawford and Rodriguez have prepared budgets for Bluffton Pharmacy and have analyzed their financial statements using ratio analysis, they have not created a cash flow forecast. During a recent meeting, their banker explained the importance of reliable cash flow forecasts, telling them that banks traditionally are "cash flow lenders." Bankers appreciate strong balance sheets and income statements, but they are most interested in a company's cash flow because they know that positive cash flow is required to repay a loan.

Crawford and Rodriguez expect sales to increase 4.5 percent next year, to $2,504,368. Credit sales account for 79 percent of total sales, and the company's collection pattern for credit sales is 11 percent in the same month in which the sale is generated, 63.5 percent in the first month after the sale is generated, and 22 percent in the second month after the sale is generated. The pharmacy's cost of goods sold is 77.4 percent, and vendors grant "net 30" credit terms, which means the pharmacy pays for the goods it purchases every month in the following month. Crawford and Rodriguez have been working with their accountant to develop estimates for their expenses for the upcoming year (see the accompanying table on page 783).

Actual sales for the last two months, November and December, were $272,357 and $315,458. The company's cash balance as of January 1 is $74,473. The interest rate on Bluffton Pharmacy's current line of credit is 8.25%, and whatever the pharmacy borrows must be repaid the following month (with interest), even if it must borrow again in that month. The entrepreneurs have established a minimum cash balance of $15,000.

Questions

1. Develop a monthly cash budget for Bluffton Pharmacy for the upcoming year.
2. What recommendations can you offer Angela Crawford and Martin Rodriguez to improve their pharmacy's cash flow?
3. If you were Bluffton Pharmacy's banker, would you be comfortable extending a line of credit to the pharmacy? Explain.

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Sales	$2,30,402	$2,37,915	$2,15,376	$1,77,810	$1,75,306	$1,72,801	$1,62,784	$1,67,793	$1,97,845	$2,47,932	$2,55,445	$2,62,959
Other Cash Receipts	105	55	60	75	85	55	65	60	65	85	95	110
Rent	3,083	3,083	3,083	3,083	3,083	3,083	3,083	3,083	3,083	3,083	3,083	3,083
Utilities	1,049	1,083	980	809	798	787	741	764	901	1,129	1,163	1,197
Advertising	1,150	1,188	1,075	888	875	863	813	838	988	1,238	1,275	1,313
Insurance	–	–	2,700	–	–	2,700	–	–	2,700	–	–	2,700
Salaries, Wages, and Benefits	27,404	27,515	27,182	26,627	26,590	26,553	26,405	26,479	26,923	27,663	27,774	27,885
Computer System and E-commerce	1,042	1,042	1,042	1,042	1,042	1,042	1,042	1,042	1,042	1,042	1,042	1,042
Repairs and Maintenance	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000
Travel	–	–	150	–	5,000	–	–	–	200	–	–	–
Professional Fees	–	–	–	–	–	–	–	–	–	–	–	3,900
Supplies	644	665	602	497	490	483	455	469	553	693	714	735
Loan Payments	2,073	2,073	2,073	2,073	2,073	2,073	2,073	2,073	2,073	2,073	2,073	2,073
Other	50	50	50	40	40	40	40	45	50	50	50	50