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 a reliable cash flow forecast, 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 that 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 the following estimates for their sales and expenses for the upcoming year:

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Sales	$230,402	$237,915	$215,376	$177,810	$175,306	$172,801	$162,784	$167,793	$197,845	$247,932	$255,445	$262,959
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

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 percent, 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

C7-1. Develop a monthly cash budget for Bluffton Pharmacy for the upcoming year.

C7-2. What recommendations can you offer Angela Crawford and Martin Rodriguez to improve their pharmacy's cash flow?

C7-3. If you were Bluffton Pharmacy's banker, would you be comfortable extending a line of credit to the pharmacy? Explain.