Jones Electrical Distribution Case Analysis (Chen Ziao U1420681G)

Is Jones doing a good job of managing his business? Why or why not?

Generally speaking, Jones is managing his business well in terms of revenue and profit. The Net Sales and Net Income are rapidly increasing from 2004 to 2005, in average rates of 17.50% and 55.30%. The sales volume is built by successful price competing strategy. His company reduce supplier risk by purchasing from nearly 100 suppliers. The tight control over operating expense makes it only increase at an average rate of 12.95% from 2004 to 2006, which is much less than the increasing rate of Net Sales. Furthermore, the Working Capital Turnover Ratio increases from 6.42 to 8.66 from 2014 to 2016, which indicates that they efficiently utilize its working capital to support its sales. However, Jones Electrical Distribution fails to manage its cash flow well. The cash decreases at an average rate of 19.41% and Accounts Receivables increases at an average rate of 18.91%. If we assume that all Net Sales are Credit Sales, it can be deduced that the Accounts Receivables Turnover Ratio decreases from 9.17 to 9.0. This shows that the company's ability to collect credits from customers has decreased. In addition, in terms of inventory management, the inventory grows at 25.36% on average and the inventory turnover ratio decreases from 5.89 in 2005 to 5.53 in 2006. It shows that the company does not do well in managing inventory, which is one of the reasons of the lack of cash. The following table further illustrate the effect of poor Accounts Receivable and inventory management.

Sales Increase %	2004 AR	2006 AR Due to Sales Increase	2006 Actual AR	Difference
38.05%	$187	$258	$264	$6
	2004 Inventory	2006 Inventory Due to Sales Increase	2006 Actual Inventory	Difference
	$243	$335	$379	$44
Total				$50

In total, $50 thousands investment in Accounts Receivable and Inventory is due to poor Accounts Receivable and Inventory management.

Why does Jones want a larger loan?

From the Balance Sheet, Line of credit payable increases 29.99% each year. Since the Total PP&E does not change much, most cash are used to purchase raw materials to cater for the surging demand. Although the poor Accounts Receivable and Inventory management has used $50 thousands, it just accounts for only 23.2% of changes in total current assets. Hence, the sales growth accounts for the majority of the financing need. Given the projected sales of 2017 is $2.7 million, we can approximate figures such as COGS, operating expenses, Accounts Receivables and Accounts Payables and assume figures such as Cash, Long-term Debt and Total PPE remains the same rate as 2016. After that, Line of Credit Payable can be calculated approximately as $340,000 (Total Assets: $924,000, Total Liability Without Line of Credit Payable: $292,000, Net Worth: $293,000). Since the maximum loan provided by Metropolitan is only $250,000, Jones would need a larger loan to finance its growing business.

Should the Bank provide the requested loan? —any required terms and conditions?

Base on the sales growth and good expense management of Jones Electrical Distributions, the Bank can provide the requested loan. However, according to question 2's calculation, the projected Line of Credit Payable is very close to the limit $350,000 already. If Jones decide to make the payment within 10 days of invoice data to suppliers, it would incur less account payable but need more cash to make payments and in this case, the Line of Credit Payable would definitely surpass the $350,000 limit. Therefore, the standard covenant should restrict Jones from choosing the 2% payment discount to ensure Jones has adequate cash in hand. Apart from this, according to question 1's answer, Jones needs improvement in Accounts Receivables and Inventory management in maintain healthy cash flow. Hence, the covenants should set a lower limit on Inventory Turnover or Accounts Receivable Turnover or as the case states, Jones's utilization of the line would be limited to an amount equal to 75% of Accounts Receivable and 50% of Inventory. Other terms and conditions mentioned in cases would include:

1. Additional investments in fixed assets could be made only with bank's prior approval.
2. Interest rate is a floating-rate with 1.5% above prime rate.
3. Relationship with Metropolitan Bank should be terminated.