

MINI CASE: SCANDI HOME FURNISHINGS, INC.

Kaj Rasmussen founded Scandi Home Furnishings as a corporation during mid-2018. Sales during the first full year (2019) of operation reached \$1.3 million. Sales increased by 15 percent in 2020 and another 20 percent in 2021. However, profits after increasing in 2020 over 2019 fell sharply in 2021 causing Kaj to wonder what was happening to his “pride and joy” business venture. After all, Kaj has continued to work as close as possible to a 24/7 pace beginning with the startup of Scandi and through the first three full years of operation.

Scandi Home Furnishings, located in eastern North Carolina, designs, manufactures, and sells to home furnishings retailers Scandinavian-designed furniture and accessories. The modern Scandinavian design has a streamlined and uncluttered look. While this furniture style is primarily associated with Denmark, both Norway and Sweden designers have contributed to the allure of Scandinavian home furnishings. Some say that the inspiration for the Scandinavian design can be traced to the “elegant curves” of art nouveau from which designers were able to produce aesthetically pleasing, structurally strong modern furniture. Danish furnishings and the home furnishings produced by the other Scandinavian countries—Sweden, Norway, and Finland—are made using wood (primarily oak, maple, and ash), aluminum, steel, and high-grade plastics.

Kaj grew up in Copenhagen, Denmark and received a college degree from a technical university in Sweden. As is typically in Europe, Kaj began his business career as an apprentice at a major home furnishings manufacturer in Copenhagen. After “learning the trade,” he quickly moved into a management position in the firm. However, after a few years, Kaj realized that what he really wanted to do was to start and operate his own Scandinavian home furnishings business. At the same time, after traveling throughout the world including the U.S., he was sure that he wanted to be an entrepreneur in the United States. Thus, while it was hard to give up the Tivoli Gardens with its many entertainment and dining activities, as well as the other attractions in Copenhagen, Kaj moved to the U.S. in early 2007. With \$140,000 of his personal assets, and \$210,000 from venture investors, he began operations in mid-2007. Kaj, with a 40 percent ownership interest and industry-related management expertise, was allowed to operate the venture in a way that he thought was best for Scandi. Four years later, Kaj is sure he did the right thing.

Following are the three years of income statements and balance sheets for the Scandi Home Furnishings Corporation. Kaj has felt that in order to maintain a competitive advantage that he would need to continue to expand sales. After first concentrating on selling Scandinavian home furnishings in the northeast in 2019 and 2020, he decided to enter the west coast market. An increase in expenses associated with identifying, contacting, and selling to home furnishings retailers in California, Oregon, and Washington. Kaj Rasmussen was hoping that you could help him better understand what has been happening to Scandi Home Furnishings both from operating and financial standpoints.

SCANDI HOME FURNISHINGS, INC.***Income Statements***

Item	<u>2019</u>	<u>2020</u>	<u>2021</u>
Net Sales	\$1,300,000	\$1,500,000	\$1,800,000
Cost of Goods Sold	<u>780,000</u>	<u>900,000</u>	<u>1,260,000</u>
Gross Profit	520,000	600,000	540,000
Marketing	130,000	150,000	200,000
General & Administrative	150,000	150,000	200,000
Depreciation	<u>40,000</u>	<u>53,000</u>	<u>60,000</u>
EBIT	200,000	247,000	80,000
Interest	<u>45,000</u>	<u>57,000</u>	<u>70,000</u>
Earnings Before Taxes	155,000	190,000	10,000
Income Taxes (40%)	<u>62,000</u>	<u>76,000</u>	<u>4,000</u>
Net Income	\$93,000	\$114,000	\$6,000

Balance Sheets

Item	<u>2019</u>	<u>2020</u>	<u>2021</u>
Cash	\$50,000	\$40,000	\$10,000
Accounts Receivables	200,000	260,000	360,000
Inventories	<u>450,000</u>	<u>500,000</u>	<u>600,000</u>
Total Current Assets	700,000	800,000	970,000
Fixed Assets, Net	<u>300,000</u>	<u>400,000</u>	<u>500,000</u>
Total Assets	\$1,000,000	\$1,200,000	\$1,470,000
Accounts Payable	\$130,000	\$170,000	\$180,000
Accruals	50,000	70,000	80,000
Bank Loan	<u>90,000</u>	<u>90,000</u>	<u>184,000</u>
Total Current Liabilities	270,000	330,000	444,000
Long-Term Debt	300,000	400,000	550,000
Common Stock (\$10 par)*	300,000	300,000	300,000
Capital Surplus	50,000	50,000	50,000
Retained Earnings	<u>80,000</u>	<u>120,000</u>	<u>126,000</u>
Total Liab. & Equity	\$1,000,000	\$1,200,000	\$1,470,000

Note: 30,000 shares of common stock were issued to Kaj Rasmussen and the venture investors when Scandi Home Furnishings was incorporated in mid-2007.

Questions

- A. Kaj was particularly concerned by the drop in cash from \$50,000 in 2019 to \$10,000 in 2021. Calculate the average current ratio, the quick ratio, and the networking capital to total assets ratio for 2019-2020 and 2020-2021. What has happened to Scandi's liquidity position?
- B. An analysis of the cash conversion cycle should also help Kaj understand what has been happening to the operations of Scandi. Prepare an analysis of the average conversion periods for the three components of the cash conversion cycle for 2019-2020 and 2020-2021. Explain what has happened in terms of each component of the cycle.
- C. Kaj should be interested in knowing whether Scandi has been building or burning cash. Compare the cash build, cash burn, and the net cash build/burn positions for 2020 and 2021. What, if any, changes have occurred?
- D. Creditors, as well as management, are also concerned about the ability of the venture to meet its debt obligations as they come due, the proportion of current liabilities to total debt, the availability of assets to meet debt obligations in the event of financial distress, and the relative size of equity investments to debt levels. Calculate average ratios in each of these areas for the 2019-2020 and 2020-2021 periods. Interpret your results and explain what has happened to Scandi.
- E. Of importance to Kaj and the venture investors is the efficiency of the operations of the venture. Several profit margin ratios relating to the income statement are available to help analyze Scandi's performance. Calculate average profit margin ratios for 2019-2020 and 2020-2021 and describe what is happening to the profitability of Scandi Home Furnishings.
- F. Kaj and the venture investors are also interested in how efficiently Scandi is able to convert their equity investment, as well as the venture's total assets, into sales. Calculate several ratios that combine data from the income statements and balance sheets and compare what has happened between the 2019-2020 and 2020-2021 periods.
- G. A ROA model consisting of the product of two ratios provides an overview of a venture's efficiency and profitability at the same time. A ROE model consists of the product of three ratios and simultaneously shows an overview of a venture's efficiency, profitability, and leverage performance. Calculate ROA and ROE models for the 2019-2020 and 2020-2021 periods. Provide an interpretation of your findings.
- H. Kaj has been able to obtain some industry ratio data from the home furnishings industry trade association of which he is a member. The industry association collects proprietary financial information from members of the association, compiles averages to protect the proprietary nature of the information, and provides averages for use by individual trade association members. Over the 2019-2020 and 2020-2021 periods, the inventory-to-sale conversion period has averaged 200 days, while the sale-to-cash conversion period (days of sales outstanding) for the industry has average 60 days. How did Scandi's operations in terms of these two components of the cash conversion cycle compare with these industry averages?
- I. Trade association data for the home furnishings industry shows an average net profit margin of 6.5 percent, a sales-to-assets ratio of 1.3 times, and a total-debt-to-total-assets ratio of 55 percent over the 2019-2020 and 2020-2021 time periods. Compare and contrast to the industry average in terms of the ROA and ROE models. Make sure you compare the components of each model as well as the product of the components