Stephen Benson

March 23rd, 2005

Advanced Financial Management

Mr. Ted Poatsy

Clarkson Executive Summary

Clarkson Lumber Company is looking to increase profits and gain better control of operating expenses. Currently, they've been experiencing a slow and steady growth, but because of the need to payoff a $200,000 note that was issued to former partner Mr. Hotlz to buyout his interest in the business, operating expenses have begun to increase at a rapid rate, and is creating a loss in profits. This has caused Mr. Clarkson to look for a larger loan that would bolster his cash flow, and allow him to take advantage of discounts on his inventory purchases. Northrup National Bank is considering extending Clarkson Lumber Company a revolving note of up to $750,000. Before making a recommendation on this note, I see three areas that need better management to improve profitability; inventory, operating expenses, and the $200,000 note for Mr. Holtz.

When looking over the previous three years, I began to notice that there seems to be an excessive amount of inventory left over at year end. For the previous two years, Clarkson has had an average of 53 days for his inventory turnover. Clarkson should be able to move his purchasing into more of a just-in-time scenario. By gaining more control of his forecasting, Mr. Clarkson should be able to predict with more care, exactly how much inventory is going to be needed for the next quarter, instead of trying to buy enough to carry for the year. I think it is feasible to reduce this amount by about $500,000 for the year. If Clarkson could've done this in 1995, they would have attained a gross profit of about $1,255,000, an increase of over $200,000.

Because the $200,000 note has begun to be paid, operating expenses have increased to the point of being unable to maintain a minimum amount of cash for purchases. One area of recommendation would be to reduce Mr. Clarkson's salary by $20,000 to $70,000 for the year. By reducing his salary, using 1995 as example, and better inventory control, EBIT would have been $335,000, over a 200% difference. I would also recommend a bonus to Mr. Clarkson based on the percentage of growth in profitability at year end. For example, in 1995, Clarkson experienced a growth in profits of 113%; I would give Mr. Clarkson 13% of the profits from 1995, or $10,000.

Now that Clarkson Lumber Company is gaining better control of inventory and operating expenses, I would recommend paying off the note with the gained cash. By paying off this note sooner, Clarkson will be able to have more working capital to take advantage of cash purchases, instead of having to pay on terms. This note must be paid as soon as possible, otherwise Clarkson is going to continue to struggle with working capital, and will continue to need to borrow at higher interest rates.

Once the $200,000 note has been paid, Clarkson will be able to generate more working capital. However, this is still not going to be enough to take advantage of the discounts in its accounts payable. I would recommend taking the revolving note with Northrup National Bank, but I do not see a need to take advantage of the full $750,000. When using 1995 as an example for changes, at year end, Clarkson would've had a net income of over $200,000. This recommendation will put Clarkson in a better situation starting in 1998; we are going to need working capital starting now.