GSB

AT LOUISIANA
STATE UNIVERSITY

Recreational Products, Inc.

Freshman Case
Week 1

Subject Area:
Business Finance

Case Leader: George Schloegel

2019 Session

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Recreational Products, Inc.

Recreational Products Inc. (RPInc) is a U.S. manufacturer of outdoor recreation equipment and accessories...particularly golf and tennis,... located in a mid-sized community in the southeastern United States.

RPInc distributes its products directly to relatively small retail outlets throughout the U.S. **RPInc's** treasurer, **Mark Clemens**, is reviewing the financial position of his company in early December in preparation for his meeting with **Samantha Twain**, a loan officer at the **Imaginary Funding Bank (IFBank)**.

RPInc is a long-time customer of **IFBank** and December is the normal time of the year to arrange seasonal credit for the next twelve months.

As part of the leisure activities industry, **RPInc's** sales and profits have grown steadily over the past several years. (See **Exhibit 1** for selected historical data.) **Clemens** is preparing to make his annual request for seasonal financing for the following fiscal year (January through December). The seasonal financing is in the form of a line of credit with a maximum limit of $2.5 million secured by **RPInc's** accounts receivable and inventory. The loan also carries a seasonal limit equal to the total of 70% of accounts receivable and 40% of inventory. The requested maximum limit represents a $200,000 increase over the prior year's line of credit. **Clemens** wants the cushion since **RPInc** expects an increase in sales in the coming year and it may temporarily need the extra funding to help cover payments on a plant and equipment update intended to allow **RPInc** to increase capacity and use more efficient manufacturing processes. The update/expansion has the added benefit of providing **RPInc** the opportunity to expand their product line in the future. The analysis of the update/expansion indicates a potential reduction in cost margins and would be profitable under conservative sales estimates.

The total for the update/expansion plan is $1.2 million. This amount does not include normal annual plant and equipment expenditures attributed to replacement/maintenance. (**Exhibit 3** shows forecasted total plant and equipment expenditures.) **Clemens** plans to pay the majority of the update/expansion costs by reducing cash. (**RPInc** has a minimum operating cash requirement of $100,000.) **RPInc** has accumulated the cash over the past several years to use if it chooses to expand manufacturing capacity. **RPInc** has made this choice since it faces some difficulties with collateral given that the existing 8% bonds are secured by a first mortgage on property/equipment plus additions. However, given the level of **RPInc's** accumulated cash and the forecasted cash for the coming year (shown in **Exhibit 3**) **Clemens** sees little risk associated with the financing plan.

In early October **Clemens** recognized that it was unlikely that **RPInc** would be able to pay off the current year's seasonal funding as forecasted. The current year forecasts has indicated that the seasonal loan would be repaid by the end of August but by the end of September an outstanding balance equaling approximately 105% of the maximum credit line still remains. The more troubling aspect of the situation was that disbursements generally exceeds receipts in the fourth quarter of each year, so **Clemens** feels it is unlikely that **RPInc** could repay the loan by the end of the year. **Clemens** knows he has to carefully review the financial results before meeting with **Samantha Twain and IFBank**. **Clemens** does not believe the situation is dire, but he knows **Ms. Twain** will have several questions for him. In preparation for the meeting with the **IFBank**, **Clemens** has gathered data regarding the actual financial results for the current year. **Clemens** has also included a revised forecast for the final quarter of the current year.

(**Exhibits 7 and 8** show actual financial results through September with forecasted year-end values.)

(**Exhibits 5 and 6** present additional information about accounts receivable.)

Clemens plans to initially focus his financial examination on the difference in actual and forecasted sales. Sales forecast errors pose a particular problem due to the seasonality of sales versus the necessary level production process. Based on data through the end of September, sales were about 5% below the current year sales forecast on which **Clemens** had based the current year's financial plan. (see **Exhibits 2 and 7**) **Clemens** feels that the decline in company sales were primarily due to a mild economic slowdown. His initial expectation was that a thorough analysis of the financial results would show that the lower sales were the main cause of the **RPInc's** funding problems. Since specifics were still not available, the forecast has not been adjusted to reflect several other developments. Planned production has outpaced sales, so **RPInc** expects to hold a substantial amount of left-over inventory at year-end. Surplus inventory can usually be sold to retail liquidators for cash, but the price has to be discounted by around 30% to move the merchandise. Although steps had been taken to assure collection of future accounts receivable, **RPInc** has not fully determined the magnitude of any uncollectable receivables and their impact on the business for the current year. As usual, **Clemens** provides **IFBank** with **RPInc's** most recent five years of financial results,

Clemens is providing **IFBank** with forecasted financial information for the next fiscal year, and a set of financial ratios for **RPInc** as well as the Dunn & Bradstreet standard ratios for the recreational products industry. (**Exhibit 1** contains historical financial data including actual results for the year current year, but the forecasted results available to **Clemens** in early December are virtually the same as the final reported results.) (**Exhibit 2** contains the forecasted Balance Sheet and Income Statement for the coming year.) (**Exhibit 3** contains a forecasted Cash Budget for the coming year.) (**Exhibit 4** contains financial ratios for **RPInc** and the Dunn & Bradstreet standard ratios for the recreational products industry.)

The financial forecasts are based on **RPInc's** operating circumstances. **RPInc's** sales are highly seasonal, but it has been much more cost efficient to manufactor its products at a steady rate throughout the year. This mismatch of sales and production means that **RPInc** has to finance large quantities of inventory during the low sales months to ensure that sufficient quantities are on hand to meet demand during high sales periods. If sales fail to meet expectations, the result would be larger than expected inventories that would require additional funding. In the past, inventory remaining at year-end usually had to be sold at a substantial discount. On the other hand, if actual sales exceeded the forecast, **RPInc** would face the possibility of lost sales due to stock-outs. **RPInc** has found over the past several years that the distribution of sales during the year is relatively steady so distribution is reflected in the cash budget projection made by **Clemens**. The cash budget also reflects the steady year-round rate of production necessary to minimize costs.

The trade credit terms **RPInc** uses are common in the industry. **RPInc** uses trade credit to finance its raw materials which are purchased on net 30 terms. **RPInc's** sales are all made on credit with net 60 terms. At the end of September of the current year, nearly all accounts payable were normal and current.

In regard to accounts receivable, several years ago RPInc faced a collection problem. The firm developed a reminder policy of contacting customers who take over 45 days to pay. This policy was instituted based on an industry study that indicated that the probability of collection declined as the number of days since purchase increased. As a result of the collection policy, at the end of the current year, relatively few of the receivables were overdue and uncollectable. (**Exhibit 5**)

In his meeting with **IFBanker, Samantha Twain, Mark Clemens** will emphasize that his primary concern going forward is based on some talk about a possible further economic slowdown for the coming year. To guard against this possibility, **Clemens** lowered the previous sales forecast (Sales were previously forecasted to increase 5% each of the next two years.) **Clemens** is aware that **Twain** will want to know if competition from imports could become a problem. **Clemens** has heard that some firms had contemplated production cuts because of increasing foreign competition, but **RPInc** has not yet felt any dramatic impact.

After completing the normal review process, **Samantha Twain** is inclined to recommend renewing the seasonal line of credit (with the requested increase limit) at a floating rate of 1% over prime.

NOTES:

1. *The estimated costs of goods sold and selling and administrative expenses for the coming year are based on the average cost of each during the past several years.*

2. *The plant expansion is $1.2 million. The additional plant in the 2014 cash budget represents necessary replacement/maintenance due to wear and tear.*

3. *The 8% bonds represent a private debt placement. The bonds carry a principal repayment provision that effectively results in the bonds being amortized over 20 years.*

Study Questions

1. **Approach this case from the position of:**
   a. **The customer, Mark Clemens and**
   b. **The Banker, Samantha Twain**
2. **Based on the financial information given in the case, analyze the financial position of RPInc. Do you view Recreational Products Inc. situation as serious or merely a bump in the road?**
   Be prepared to briefly defend your assessment.

3. **Do you believe Recreational Products Inc's financial forecasts and financial statements are sound? Are the assumptions underlying Mark Clemens' revised forecast for the remainder of the current year reasonable?**
Why or why not?

4. **Should the Imaginary Funding Bank be willing to extend the line of credit into the next year? If so, should the terms and arrangements be modified?**
Explain your conclusions.

5. **VERY IMPORTANT .....Be prepared to present your conclusions from either the customer: Mark Clemens' point of view AND from the Bank's, Samantha Twain's point of view.**

6. **How should Mark Clemens and Samantha Twain approach each other?**

Note: At the conclusion of all evening sessions, return to the dorm in groups. No one, especially ladies, should walk back to the dorms alone.

Exhibit 1
Recreational Products, Inc.
Historical Financial Data (In thousands of dollars)

Balance Sheet	This Year Projected	----------Previous Years ----------			
ASSETS					
Cash & Marketable Securities	1026	777	681	542	367
Accounts Receivable	1363	1227	1096	986	920
Inventory	2260	2249	1981	1729	1515
Other Assets	421	401	392	375	360
Total Current Assets	5070	4654	4150	3632	3162
Plant and Equipment	6145	5761	5408	5074	4759
Less: Allowance for Depreciation	-2842	-2496	-2172	-1868	-1582
Net Plant and Equipment	3303	3265	3236	3206	3177
TOTAL ASSETS	$8,373	$7,919	$7,386	$6,838	$6,339
LIABILITIES					
Accounts Payable	537	535	476	420	372
Federal Income Tax Liability	119	107	87	66	48
Misc. Deferrals & Liabilities	146	131	107	82	59
Bond Payment (prin. & interest)	303	303	303	303	303
Bonds (8%) *	2621	2709	2791	2866	2936
Total Liabilities	3726	3785	3764	3737	3718
CAPITAL					
Common Stock (800,000 shares)	800	800	800	800	800
Capital Surplus	1127	1127	1127	1127	1127
Retained Earnings	2720	2207	1695	1174	694
Total Capital	4647	4134	3622	3101	2621
TOTAL LIABILITIES & CAPITAL	$8,373	$7,919	$7,386	$6,838	$6,339
INCOME STATEMENT					
Sales	15145	13636	12185	10957	10226
Operating Cost (excluding Depreciation)	9732	8652	7635	6769	6231
Selling & Administration Expenses	3677	3256	2927	2644	2464
Depreciation	346	324	304	286	238
Interest Charges	240	246	250	258	272
Total	13995	12478	11116	9957	9205
Profit before Taxes	1150	1158	1069	1000	1021
Taxes	460	463	428	400	408
Profit After Taxes	690	695	641	600	613
Dividends	180	180	120	120	120

* Bonds are secured by a 1st Mortgage on Property/Equipment plus Additions

Exhibit 2

Recreational Products Inc.

Financial Forcast for the Coming Year (Balance Sheet and Income Statement)

		Next Year			
	Current Year	1st Q	2nd Q	3rd Q	4th Q
BALANCE SHEET					
Cash & Marketable Securities	1026	100	100	554	254
Accounts Receivables	1363	2496	4212	2340	1404
Inventory	2260	2651	1283	1186	2384
Other	421	432	432	432	432
Total Current Assets	**5070**	**5679**	**6027**	**4512**	**4474**
Plant & Equipment	6145	7751	7751	7751	7751
Less Allowance for Depr.	-2842	-2934	-3027	-3119	-3211
Net Plant & Equipment	3303	4817	4724	4632	4540
TOTAL ASSETS	**8373**	**10496**	**10751**	**9144**	**9014**
Accounts Payable	537	537	537	537	564
Fed. Income Tax Payable	119	136	125	145	119
Misc. Deferrals & Liabilites	146	115	142	91	175
Bank Loan	0	2153	1734	0	0
Bond Payment (Prin. & Int)	303	303	303	303	303
Bonds (8%) *	2621	2574	2574	2526	2526
Total Liabilities	**3726**	**5818**	**5415**	**3602**	**3687**
Common Stock (800,000 shares)	800	800	800	800	800
Capital Surplus	1127	1127	1127	1127	1127
Retained Earnings	2720	2751	3409	3615	3400
TOTAL CAPITAL & LIABILITIES	**8373**	**10496**	**10751**	**9144**	**9041**
INCOME & EXPENSE STATEMENT					
Sales	**15145**	**3276**	**9360**	**13416**	**15600**
Selling & Admn. Expense	3677	939	1879	2818	3757
Operating Cost	9732	2051	5861	8401	9768
Depreciation	346	92	185	277	369
Interest Charges	240	68	136	204	272
Total	**13995**	**3150**	**8061**	**11700**	**14166**
Profit Before Taxes	**1150**	**126**	**1299**	**1716**	**1434**
Taxes	460	50	520	686	574
Profit After Taxes	**690**	**76**	**779**	**1030**	**860**
Dividends (accrued)	180	45	90	135	180

* Bonds (8%) are securred by a 1st Mortgage on property & equipment plus additions

EXHIBIT 3

Recreational Products Inc.

Forcasted Cash Budget for Current Year and Next year by Month (in thousands of dollars)

	November	December	January	February	March	April	May	June	July	August	Sepember	October	November	December
SALES	757	606	780	1092	1404	1872	2184	2028	1716	1404	936	780	780	624
Collections			757	606	780	1092	1404	1872	2184	2028	1716	1404	936	780
Raw Materials payable			537	537	537	537	537	537	537	537	537	537	564	564
Labor/other			212	212	212	212	212	212	212	212	212	212	222	222
Overhead (excluding depreciation)			65	65	65	65	65	65	65	65	65	65	68	68
Selling & Admn. Expenses			313	313	313	313	313	313	313	313	313	313	313	313
Taxes			0	0	33	0	0	481	0	0	146	0	0	-86
Plant			400	400	806	0	0	0	0	0	0	0	0	0
Bonds payment			0	0	152	0	0	0	0	0	151	0	0	0
Other interest			0	0	5	14	15	13	12	5	0	0	0	0
Dividends			0	0	45	0	0	45	0	0	45	0	0	45
Monthly Cash Flow			-770	-921	-1388	-49	262	206	1045	896	247	277	-231	-346
Cummulative Bank Loan payments	0	0	0	765	2153	2202	1940	1734	689	0	0	0	0	0
Cash Balances	1026	256	100	100	100	100	100	100	100	307	554	831	600	254

Exhibit 4
Recreational Products Inc.
Historical Financial Ratios & Forcasts

Ratio	Projected Next Year	Current Year	Previous Years				Dunn & Bradstreet--Industry Ratios
Current Ratio	3.85	4.59	4.33	4.27	4.17	4.04	1.80
Quick Ratio	1.80	2.54	2.24	2.23	2.18	2.11	1.01
Inventory Turnover	6.54	6.70	6.06	6.15	6.34	6.75	5.14
Fixed Asset Turnover	3.44	4.59	4.17	3.77	3.42	3.22	5.21
Total Asset Turnover	1.73	1.81	1.72	1.65	1.60	1.61	1.58
Days Sales Outstanding	32.85	32.85	32.84	32.83	32.85	32.84	54.38
Debt Ratio	40.90%	44.50%	47.78%	50.96%	54.65%	58.65%	57.80%
Long Term Debt to Assets	28.02%	31.30%	34.20%	37.79%	41.91%	46.32%	19.10%
Times Interest Earned	6.27	5.79	5.71	5.28	4.88	4.75	N/A
Gross Profit Margin	37.38%	35.74%	36.55%	37.34%	38.22%	39.07%	36.90%
Net Profit Margin	5.51%	4.56%	5.10%	5.26%	5.48%	5.99%	4.10%
Return on Assets	9.54%	8.24%	8.77%	8.68%	8.77%	9.67%	6.47%
Return on Equity	16.14%	14.85%	16.80%	17.70%	19.35%	23.39%	15.32%

EXHIBIT 5
Recreational Products, Inc.
Accounts Receivable Aging Schedule
(in thousands of dollars)
As of September 30th Current Year

Age of Accounts Receivable	Balances
0 to 30 days	861
31 to 60 days	1,267
61 to 90 days	72
91 to 120 days	43
121 to 150 days	21
151 to 180 days	15
181 to 210 days	8
211 to 240 days	7
Over 240 days	7

EXHIBIT 6
Dunn & Bradstreet Recreational Industry Survey
Collection of Accounts Receivable

Receivables Age	Average % Collected
60 days or less	100%
over 60 days	75%
over 90 days	50%
over 120 days	0%

Exhibit 7
Recreational Products, Inc.
Projected Financial Data This Year and Next Year by Quarter(in thousands of dollars)

	This year	Next Year Projected			
BALANCE SHEET	projected	1st Q	2nd Q	3rd Q	4th Q
ASSETS					
Cash & Marketable Securities	1026	100	100	100	100
Accounts Receivable	1363	2439	4105	2301	1471
Inventory	2260	2721	1495	1608	2771
Other Assets	421	425	429	431	430
Current Assets	5070	5685	6129	4440	4772
Plant and Equipment	6145	7751	7751	7751	7751
Less: Allowance for Depreciation	-2842	-2934	-3027	-3119	-3211
Net Plant and Equipment	3303	4817	4724	4632	4540
Total Assets	$8,373	$10,502	$10,853	$9,072	$9,312
LIABILITIES					
Accounts Payable	537	557	557	557	557
Federal Income Tax Liability	119	140	120	140	119
Misc. Deferrals & Liabilities	146	78	134	85	136
Bond Payment (prin. & Interest)	303	303	303	303	303
Bank Loan	0	2229	2048	269	732
Bond (8%)	2621	2574	2574	2526	2526
Total Current Liabilities	3726	5881	5736	3880	4375
Capital					
Common Stock (800,000 shares)	800	800	800	800	800
Capital Surplus	1127	1127	1127	1127	1127
Retained Earnings	2720	2694	3190	3265	3012
TOTAL LIABILITIES & CAPITAL	$8,373	$10,502	$10,853	$9,072	$9,312
INCOME & EXPENSE STATEMENT					
SALES	15145	3192	8983	12710	14820
Operating Cost (excluding depreciation)	9732	2072	5830	8219	9618
Selling & Administration Expenses	3677	939	1878	2817	3756
Depreciation	346	92	185	277	369
Interest Charges	240	89	156	233	291
Profit before Taxes	1150	31	934	1134	786
Taxes	460	12	374	454	314
Profits after Taxes	690	19	560	680	472
Dividends accrued	180	45	90	135	180

***Exhibit 7 Prepared by Mark Clemens in December of the current year to reflect changes he anticipates for next year.

Exhibit 8
Recreational Products Inc.
Estimated Cash Budget (In thousands of dollars)

MONTH	November	December	January	February	March	April	May	June	July	August	September	October	November	December
Sales	757	606	772	1065	1355	1778	2097	1915	1599	1267	861	741	757	612
Collections			753	602	761	1047	1338	1748	2053	1887	1591	1305	889	746
Payables-Raw Materials			557	557	557	557	557	557	557	557	557	557	557	557
Labor/Other			219	219	219	219	219	219	219	219	219	219	219	219
Overhead except Depreciation			68	68	63	68	68	68	68	68	68	68	68	68
SG&A			313	313	313	313	313	313	313	313	313	313	313	313
Taxes			0	0	-9	0	0	332	0	0	60	0	0	-119
Plant Improvements			400	400	806	0	0	0	0	0	0	0	0	0
Bond Payments			0	0	152	0	0	0	0	0	151	0	0	0
Other Interest			0	0	6	15	16	15	14	8	3	2	1	3
Dividends			0	0	45	0	0	45	0	0	45	0	0	45
Monthly Cash Available			-785	-955	-1396	-125	165	141	882	722	175	146	269	-340
Bank Loan Payments		0	0	833	2229	2354	2189	2048	1166	444	269	123	392	732
Cash Balance		1026	222	100	100	100	100	100	100	100	100	100	100	100

***Exihibit 8 prepared by Mark Clemens in December of the current year to reflect changes he anticipates for next year.

Date	10 Year Treasury Rate
Feb 23, 2015	2.06%
Jan 1, 2015	1.88%
Jan 1, 2014	2.86%
Jan 1, 2013	1.91%
Jan 1, 2012	1.97%
Jan 1, 2011	3.39%
Jan 1, 2010	3.73%
Jan 1, 2009	2.52%
Jan 1, 2008	3.74%
Jan 1, 2007	4.76%
Jan 1, 2006	4.42%
Jan 1, 2005	4.22%