## Quality Furniture Company*

In March 1992, Richard Allan, an assistant credit analyst for the Quality Furniture Company, was concerned about changes in two of Quality's accounts in Minnesota—Lloyd's, Inc., of Minneapolis and The Emporium department store in St. Paul. He therefore brought the credit folders of these two customers to the attention of Watt Ralphson, the credit manager of Quality Furniture. The Quality Furniture Company had its headquarters in Scranton, Pennsylvania, and manufactured a limited line of high quality home furniture for distribution to department stores, independent home furnishing retailers, and regional chains.

Lloyd's retailed quality home furnishings from three locations—one in the downtown section of Minneapolis and the others in nearby suburban areas. Sales were somewhat seasonal, with a slight downturn in the midsummer months and a slight upturn during the December holiday season. Lloyd's sales were approximately 75% for cash or credit cards and 25% on six-month installment terms. Installment terms called for 25% down and the balance in equal monthly payments over a six-month period.

Lloyd's had been established as a partnership and was later incorporated. In June 1991, two of the four original partners sold their shares in the company to the two remaining owners.

Lloyd's had been a customer of Quality Furniture for over 30 years and had previously handled its affairs in a most satisfactory manner. The Emporium was a comparatively new customer of Quality's, having established an account in 1983. A medium-sized department store in downtown St. Paul, The Emporium was well-known for its extensive lines of home furnishings. Its account with Quality had been satisfactory through 1991.

Both accounts were sold on terms of 2%, 10, net 30, and although not discounting, had been paying invoices promptly until December 1991. Ralphson had previously established a $50,000 limit on Lloyd's and an $85,000 limit on The Emporium.

Quality Furniture advertised its lines nationally and attempted to maintain intensive coverage of its trading areas by distributing through stores strategically located within a particular marketing area. Beginning in 1990, activity in the furniture market had become sufficiently spotty that quality of product and service were not the only bases for competition among manufacturers for outlets. Credit terms and financing of dealers became equally important, thus Quality Furniture Company, in Ralphson's words, was "backed into the position of supporting numerous customers in order to maintain adequate distribution for its products."

Because of this requirement for the extension of fairly liberal credit, Ralphson had adhered strictly to a policy of obtaining current reports on the financial status of customers. These reports, obtained as annual balance sheets and profit and loss statements for customers that were considered satisfactory risks, were supplied directly by the customers. Under certain circumstances, wherein Quality was working very closely with a particular customer who was trading actively on a small investment, Ralphson received quarterly and at times monthly financial statements in order "to keep on top" of the credit situation.

In early March 1992, Richard Allen received the annual reports of Lloyd's and The Emporium. After reviewing these statements and checking the accounts receivable ledger for both customers, Allen felt that the accounts should be reviewed by Ralphson. Accordingly, he furnished Ralphson with the information found in Exhibits 1 through 5.

When reviewing the accounts, Ralphson kept in mind that 1991 had not been a particularly good year for retail furniture stores. It was generally known that stores such as The Emporium, carrying low-priced furniture lines, were the first to suffer the declines which had come in the late summer and early fall. This situation was followed by signs of a relaxing demand for furniture of higher quality and higher price toward the end of 1991. The drop in volume and the subsequent price-cutting hit the profit margins of some retailers to such an extent that the losses in the latter part of the year in some cases equaled, or more than offset, profits gained in the earlier part of the year.

**EXHIBIT 1** Aging of Quality Furniture's Accounts Receivable Balances Owed by Lloyd's and The Emporium as of March 31, 1992

| | Prior | December | January | February | March | Totals |
|---|---|---|---|---|---|---|
| Lloyd's | | $34,819 | $5,480 | $21,146 | $ 6,168 | $ 67,613 |
| The Emporium | $2,285* | 29,304 | 6,153 | 26,112 | 54,749 | 118,603 |

* Represents invoice on disputed shipment: customer claimed damaged merchandise.

**EXHIBIT 2** Lloyd's, Inc. Balance Sheets as of January 31, 1990–1992 (dollars in thousands)

| | 1/31/90 | 1/31/91 | 1/31/92 |
|---|---|---|---|
| Assets | | | |
| Cash | $ 85 | $ 65 | $ 50 |
| Accounts receivable, net | 1,385 | 1,565 | 1,610 |
| Inventory | 1,825 | 1,820 | 1,825 |
| Total current assets | $3,295 | $3,450 | $3,485 |
| Land | 355 | 355 | 355 |
| Buildings, fixtures, and equipment | 1,355 | 1,370 | 1,575 |
| Less: Accumulated depreciation | 190 | 290 | 395 |
| Net buildings, fixtures, and equipment | $1,165 | $1,080 | $1,180 |
| Investments | 65 | 65 | 65 |
| Due from stockholders | — | 215 | 290 |
| Deferred charges | 40 | 20 | 20 |
| Total assets | $4,920 | $5,185 | $5,395 |
| Liabilities and Net Worth | | | |
| Accounts payable | $ 865 | $ 870 | $ 925 |
| Notes payable—employees | 70 | 80 | 80 |
| Estimated federal income tax | 65 | — | — |
| Current maturities on long-term debt | 155 | 360 | 220 |
| Miscellaneous accruals | 220 | 205 | 65 |
| Total current liabilities | $1,375 | $1,515 | $1,290 |
| Notes payable—bank | 545 | 900 | 875 |
| Mortgage notes payable | 2,260 | 2,250 | 2,630 |
| Preferred stock—5% noncumulative | 190 | 190 | 190 |
| Common stock | 360 | 360 | 360 |
| Additional paid-in capital | — | — | 115 |
| Retained earnings (deficit) | 190 | (30) | (65) |
| Total liabilities and net worth | $4,920 | $5,185 | $5,395 |

**EXHIBIT 3** Lloyd's Inc. Income Statements for Years Ending January 31, 1990–1992 (dollars in thousands)

| | 1/31/90 | 1/31/91 | 1/31/92 |
|---|---|---|---|
| Gross sales | $11,720 | $9,600 | $9,160 |
| Less: Returns and allowances | 1,050 | 1,115 | 730 |
| Net sales | $10,670 | $8,485 | $8,430 |
| Cost of goods sold | 6,460 | 5,125 | 5,100 |

| | | | |
|---|---|---|---|
| Gross profit | $ 4,210 | $3,360 | $3,330 |
| Operating expenses | 3,570 | 3,090 | 3,045 |
| Operating profit | $640 | $270 | $ 285 |
| Other income | 400 | 65 | 85 |
| Net profit after other income | $ 1,040 | $ 335 | $ 370 |
| Other deductions | 290 | 345 | 405 |
| Net profit (loss) before tax | $ 750 | $ (10) | $ (35) |
| Income and other tax expense | 345 | — | — |
| Net profit (loss) | $ 405 | $ (10) | $ (35) |
| Dividends paid | $ 210 | $ 210 | $ — |

**EXHIBIT 4** The Emporium Balance Sheets as of January 31, 1990–1992 (dollars in thousands)

| | 1/31/90 | 1/31/91 | 1/31/92 |
|---|---|---|---|
| Assets | | | |
| Cash | $ 565 | $ 740 | $ 475 |
| Notes and accounts receivable | 5,450 | 5,500 | 5,305 |
| Inventory | 5,480 | 5,370 | 4,925 |
| Tax carry back claim | — | — | 445 |
| Total current assets | $11,495 | $11,610 | $11,150 |
| Fixed assets, net | 1,370 | 1,465 | 1,325 |
| Leasehold improvements, net | 3,480 | 3,590 | 3,460 |
| Cash value life insurance | 285 | 280 | 275 |
| Investments | 55 | 55 | 55 |
| Notes receivable—officers and employees | 105 | 110 | 140 |
| Prepaid and deferred items | 140 | 145 | 155 |
| Total assets | $16,930 | $17,255 | $16,560 |
| **Liabilities and Net Worth** | | | |
| Notes payable—Industrial Finance Corporation | $ 5,380 | $ 5,310 | $ 4,300 |
| Accounts payable | 2,305 | 2,440 | 2,660 |
| Miscellaneous accruals | 630 | 590 | 680 |
| Total current liabilities | $ 8,315 | $ 8,340 | $ 7,640 |
| Common stock and additional paid-in capital | 3,420 | 3,420 | 3,420 |
| Retained earnings | 5,195 | 5,495 | 5,500 |
| Total liabilities and net worth | $16,930 | $17,255 | $16,560 |

**EXHIBIT 5** The Emporium Income Statements for Years Ending January 31, 1990–1992 (dollars in thousands)

| | 1/31/90 | 1/31/91 | 1/31/92 |
|---|---|---|---|
| Gross sales | $32,125 | $31,265 | $28,970 |
| Less: Returns and allowances | 2,925 | 2,870 | 2,215 |
| Net sales | $29,200 | $28,395 | $26,755 |
| Cost of goods sold | 18,105 | 17,850 | 18,385 |
| Gross profit | $11,095 | $10,544 | $8,370 |
| Operating expenses | 9,080 | 8,995 | 9,780 |
| Operating profit (loss) | $2,015 | $1,550 | $(1,410) |
| Adjustments: | | | |
| Elimination—reserves for inventory losses | — | — | 870 |
| Reduction—bad debt reserve | — | — | 105 |
| Taxes carry back | — | — | 445 |
| Federal income and other tax expense | 925 | 650 | — |
| Net profit before dividends | $ 1,090 | $ 900 | $ 10 |
| Dividends paid | 725 | 600 | 5 |
| Net profit to retained earnings | $ 365 | $ 300 | $ 5 |

In the early months of 1992, the “softness” of the furniture business continued. Although there was no severe drop in the buying of furniture at the retail level, retail stores reduced orders of new lines and reorders of established lines in January, February, and March, because of a general feeling that there had been considerable “overbuying” by customers which would result in a subsequent downturn in retail sales.

Throughout the country, orders for shipment in March were down about 30% from February; February had itself shown a drop of about 10% from January. Thus, credit managers among furniture manufacturing concerns were placed in the unhappy position of trying to please sales managers who wanted to maintain volume, while they were aware that the shipment of furniture to customers who had already overextended their financial positions was potentially dangerous in such a period.

## Questions

1. What do you think is happening at Lloyd’s and The Emporium?

2. What financial ratios and questions raised in your analysis of the two companies’ financial statements support your opinions?