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## Buy Smart Company 2019

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You are employed at the U.S. General Merchandise Corporation as the Corporate Credit Manager. Your Company's principle line of business is providing general lines of merchandise for large high-volume retailers. Mrs. Green, Vice-President of Sales and Marketing has called you to her office to inform you she has a new customer with a purchase order 321W4A4L totaling \$3,000,000. She has indicated that Buy Smart Company is principally a retail drugstore chain that sells prescription and non-prescription drugs, and general merchandise. Mrs. Green also explained that Buy Smart Company is an aggressive organization that is looking to expand its market share 7.5% this year.

U.S. General Merchandise Corporation is interested in establishing a long-term profitable relationship with this new customer. Mrs. Green, who is knowledgeable in the field of finance and a team player, would appreciate an assessment of the financial strengths and weaknesses of Buy Smart Company. She has provided you with the following Buy Smart Company's financial and operating performance information:

- 1) Consolidated Balance Sheet
- 2) Consolidated Statement of Income
- 3) Consolidated Statement of Cash Flows
- 4) Financing Notes and Common Stock Performance

You return to your office and process the financial information. Your output includes the following Buy Smart Company's analytical financial and operating performance information:

- Common sized Consolidated Balance Sheet for three years
  - Common sized Consolidated Statement of Income for three years
  - Consolidated Statement of Cash Flows for three years
  - Ratios and Metrics for three years
  - Common Stock Performance for last two years
  - Financing Notes and Debt Rating
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Thoroughly examine and address each of the below listed questions. Your responses need to be specific (meticulous attention to details of the financial data) and contain supporting analysis based on your highest level of interpretation expertise.

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**Required:**

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1. Analyze the Buy Smart Company's financial statements, ratios (*every ratio should be used*), financing notes and common stock performance information. You are to perform an in-depth analysis and are required to write **TWO WELL-WRITTEN PARAGRAPHS** (*three sentences in each paragraph*) for each of the following questions.

**(5 points each for a total of 30 points)**

- A. Common sized Balance Sheet and Income Statement (Investments, financing & margins)
- B. Operating performance (Income statement), Stock performance and efficiency (Investments)
- C. An evaluation of short-term solvency (Current assets and current liabilities)
- D. Capital structure and long-term solvency (Long-term financing: debt and equity/Financing Notes)
- E. Cash Flow Statement (all three activities)
- F. Cash Conversion Cycle and Trade (Operating) Cycle

**(Five bullet points each required for both strengths and weaknesses - 5 points)**

2. Identify five strengths and five weaknesses of Buy Smart Company's financial and operating performance.

**(Five questions are required - 5 points)**

3. What five specific questions will you pose to Mrs. Green?

**(Four well written paragraphs - 15 points)**

4. Based upon your credit risk assessment of Buy Smart Company's ability to compete on margins, turnover (efficiency), leverage and cash, would you recommend an open account arrangement, and if so, what credit line would you implement? Support your decision by referencing the specific risk analysis performed in questions one through three.

<b>Buy Smart Company</b>	<b>August</b>		<b>August</b>		<b>August</b>	
(In thousands of U.S. Dollars)	<b>2018</b>	<b>%</b>	<b>2017</b>	<b>%</b>	<b>2016</b>	<b>%</b>
<b>Assets</b>						
<b>Current Assets</b>						
Cash and cash equivalents	443,000	2.0%	254,800	1.3%	919,900	5.4%
Short-term investments	-	0.0%	-	0.0%	415,100	2.4%
Accounts receivable, net	2,527,000	11.3%	2,236,500	11.6%	2,062,700	12.0%
Inventories	7,249,000	32.3%	6,790,500	35.2%	6,050,400	35.3%
Other current assets	214,000	1.0%	228,700	1.2%	257,300	1.5%
<b>Total Current Assets</b>	<b>10,433,000</b>	<b>46.6%</b>	<b>9,510,500</b>	<b>49.2%</b>	<b>9,705,400</b>	<b>56.7%</b>
<b>Fixed Assets</b>						
Land/Improvement	2,892,000	12.9%	2,326,400	12.0%	1,855,100	10.8%
Buildings	4,406,000	19.7%	3,649,500	18.9%	3,074,600	17.9%
Equipment	5,316,000	23.7%	4,749,400	24.6%	4,145,400	24.2%
Capital leases	304,000	1.4%	251,200	1.3%	211,900	1.2%
Depreciation	(3,143,000)	-14.0%	(2,776,600)	-14.4%	(2,338,100)	-13.6%
Goodwill	1,438,000	6.4%	1,060,200	5.5%	168,400	1.0%
Other	764,000	3.4%	543,000	2.8%	308,400	1.8%
<b>Total Fixed Assets</b>	<b>11,977,000</b>	<b>53.4%</b>	<b>9,803,100</b>	<b>50.8%</b>	<b>7,425,700</b>	<b>43.3%</b>
<b>Total Assets</b>	<b>22,410,000</b>	<b>100.0%</b>	<b>19,313,600</b>	<b>100.0%</b>	<b>17,131,100</b>	<b>100.0%</b>
<b>Liabilities and Shareholders' Equity</b>						
<b>Current Liabilities</b>						
Notes payable/short-term debt	83,000	0.4%	878,500	4.5%	-	0.0%
Accounts payable	4,289,000	19.1%	3,733,300	19.3%	4,039,200	23.6%
Other current liabilities	2,272,000	10.1%	2,132,500	11.0%	1,716,100	10.0%
<b>Total Current Liabilities</b>	<b>6,644,000</b>	<b>29.6%</b>	<b>6,744,300</b>	<b>34.9%</b>	<b>5,755,300</b>	<b>33.6%</b>
<b>Long-Term Liabilities</b>						
Long-term debt	1,337,000	6.0%	22,000	0.1%	-	0.0%
Deferred income tax	150,000	0.7%	158,200	0.8%	141,100	0.8%
Other liabilities	1,410,000	6.3%	1,284,800	6.7%	1,118,900	6.5%
<b>Total Long-Term Liabilities</b>	<b>2,897,000</b>	<b>12.9%</b>	<b>1,465,000</b>	<b>7.6%</b>	<b>1,260,000</b>	<b>7.4%</b>
<b>Total Liabilities</b>	<b>9,541,000</b>	<b>42.6%</b>	<b>8,209,300</b>	<b>42.5%</b>	<b>7,015,300</b>	<b>41.0%</b>
<b>Shareholders' Equity</b>						
Common stock	80,000	0.4%	80,100	0.4%	80,100	0.5%
Paid-in capital	575,000	2.6%	558,800	2.9%	558,500	3.3%
Retained earnings	13,801,000	61.6%	12,022,900	62.3%	10,311,700	60.2%
Employee stock loan receivable	(36,000)	-0.2%	(51,600)	-0.3%	(70,300)	-0.4%
Treasury stock	(1,551,000)	-6.9%	(1,505,900)	-7.8%	(764,200)	-4.5%
<b>Total Shareholders' Equity</b>	<b>12,869,000</b>	<b>57.4%</b>	<b>11,104,300</b>	<b>57.5%</b>	<b>10,115,800</b>	<b>59.0%</b>
<b>Total Liabilities and Shareholders' Equity</b>	<b>22,410,000</b>	<b>100.0%</b>	<b>19,313,600</b>	<b>100.0%</b>	<b>17,131,100</b>	<b>100.0%</b>
Common stock shares outstanding: 989,176 (2018), 991,141 (2017), 1,007,862 (2016)						

<b>Buy Smart Company</b>	<b>August</b>		<b>August</b>		<b>August</b>	
(In thousands of U.S. Dollars)	<b>2018</b>	<b>%</b>	<b>2017</b>	<b>%</b>	<b>2016</b>	<b>%</b>
Net sales	\$ 59,034,000	100.0%	\$ 53,762,000	100.0%	\$ 47,409,000	100.0%
Cost of sales	\$ 42,391,000	71.8%	\$ 38,518,100	71.6%	\$ 34,240,400	72.2%
<b>Gross Margin</b>	<b>\$ 16,643,000</b>	<b>28.2%</b>	<b>\$ 15,243,900</b>	<b>28.4%</b>	<b>\$ 13,168,600</b>	<b>27.8%</b>
GS&A expenses, total	\$ 13,202,000	22.4%	\$ 12,093,200	22.5%	\$ 10,467,100	22.1%
Other operating expenses	\$ -	0.0%	\$ (38,400)	-0.1%	\$ (52,600)	-0.1%
<b>Sum of Expenses</b>	<b>\$ 13,202,000</b>	<b>22.4%</b>	<b>\$ 12,054,800</b>	<b>22.4%</b>	<b>\$ 10,414,500</b>	<b>22.0%</b>
<b>Operating Margin (EBIT)</b>	<b>\$ 3,441,000</b>	<b>5.8%</b>	<b>\$ 3,189,100</b>	<b>5.9%</b>	<b>\$ 2,754,100</b>	<b>5.8%</b>
Interest expense	\$ (11,000)	0.0%	\$ -	0.0%	\$ -	0.0%
<b>Income (Loss) Before Federal Income Taxes</b>	<b>\$ 3,430,000</b>	<b>5.8%</b>	<b>\$ 3,189,100</b>	<b>5.9%</b>	<b>\$ 2,754,100</b>	<b>5.8%</b>
Income taxes	\$ 1,273,000	2.2%	\$ 1,147,800	2.1%	\$ 1,003,500	2.1%
<b>Net Income</b>	<b>\$ 2,157,000</b>	<b>3.7%</b>	<b>\$ 2,041,300</b>	<b>3.8%</b>	<b>\$ 1,750,600</b>	<b>3.7%</b>
Basic Earnings Per Share	\$ 2.18		\$ 2.04		\$ 1.73	
Diluted Earnings Per Share	\$ 2.17		\$ 2.03		\$ 1.72	

<b>Buy Smart Company</b> (In thousands of U.S. Dollars)	<b>August 2018</b>	<b>August 2017</b>	<b>August 2016</b>
<b>Cash Flows From Operating Activities:</b>			
Net earnings (accounting profits)	\$ 2,157,000	\$ 2,041,300	\$ 1,750,600
<b>Adjustments to Reconcile Net (Loss) Income to Net Cash Provided (Used) By Operating Activities:</b>			
Depreciation	\$ 840,000	\$ 675,900	\$ 572,200
Deferred taxes	\$ (61,000)	\$ 23,200	\$ (104,000)
Other Non-cash items	\$ 14,000	\$ 9,400	\$ 75,400
<b>Cash Provided (Used) by Changes in the Working Capital Accounts:</b>			
Inventory	\$ (412,000)	\$ (676,200)	\$ (375,700)
Accounts receivable	\$ (365,000)	\$ (40,400)	\$ (618,500)
Accounts payable	\$ 550,000	\$ (128,300)	\$ 875,600
Stock compensation expense	\$ 68,000	\$ 74,200	\$ 102,500
Other	\$ 248,000	\$ 377,600	\$ 161,500
<b>Net Cash Provided (Used) by Operating Activities (cash profits)</b>	<b>\$ 3,039,000</b>	<b>\$ 2,356,700</b>	<b>\$ 2,439,600</b>
<b>Cash Flows From Investing Activities:</b>			
Purchase Short-Term investments	\$ -	\$ (6,396,900)	\$ (12,282,400)
Sale Short-Term investments	\$ -	\$ 6,826,000	\$ 12,388,400
Capital expenditures	\$ (2,225,000)	\$ (1,785,300)	\$ (1,337,800)
Other investing cash flow items	\$ (593,000)	\$ (1,039,500)	\$ (451,700)
<b>Net Cash Provided (Used) in Investing Activities</b>	<b>\$ (2,818,000)</b>	<b>\$ (2,395,700)</b>	<b>\$ (1,683,500)</b>
<b>Cash Flows From Financing Activities:</b>			
Short-Term borrowings	\$ -	\$ (213,900)	\$ 213,900
Dividend paid	\$ (376,000)	\$ (310,200)	\$ (262,900)
Long-Term debt paid	\$ (28,000)	\$ (141,200)	\$ -
Stock purchases	\$ (294,000)	\$ (1,063,500)	\$ (668,800)
Net proceeds from issuance of Long-Term debt	\$ 1,286,000	\$ -	\$ -
Net payments/proceeds from Short-Term borrowings	\$ (802,000)	\$ -	\$ -
Proceeds from Short-Term borrowings	\$ -	\$ 850,000	\$ -
Common stock	\$ 210,000	\$ 266,100	\$ 319,100
Other	\$ (29,000)	\$ (13,400)	\$ (14,300)
<b>Net Cash Provided (Used) By Financing Activities</b>	<b>\$ (33,000)</b>	<b>\$ (626,100)</b>	<b>\$ (413,000)</b>
(Decrease) / Increase during year	<b>\$ 188,000</b>	<b>\$ (665,100)</b>	<b>\$ 343,100</b>
Beginning of year	<b>\$ 255,000</b>	<b>\$ 919,900</b>	<b>\$ 576,800</b>
End of year	<b>\$ 443,000</b>	<b>\$ 254,800</b>	<b>\$ 919,900</b>

<b>Buy Smart Company</b>			
<b>Ratios</b>			
	<b>2018</b>	<b>2017</b>	<b>2016</b>
<b>Return on Equity</b>	<b>16.8%</b>	<b>18.4%</b>	<b>17.3%</b>
<b>Return on Assets</b>	<b>9.6%</b>	<b>10.6%</b>	<b>10.2%</b>
<b>Return on Equity Drivers</b>	<b>2018</b>	<b>2017</b>	<b>2016</b>
Net profit margin	3.7%	3.8%	3.7%
Total asset turnover	2.63	2.78	2.77
Financial leverage	1.74	1.74	1.69
Sales growth	9.8%	13.4%	12.3%
Investment growth	16.0%	12.7%	17.3%
	<b>Margins</b>		
	<b>2018</b>	<b>2017</b>	<b>2016</b>
Gross margin	28.2%	28.4%	27.8%
Operating margin	5.8%	5.9%	5.8%
Net profit margin	3.7%	3.8%	3.7%
	<b>Turnover</b>		
	<b>2018</b>	<b>2017</b>	<b>2016</b>
Accounts receivable in days	15.4	15.0	15.7
Inventory in days	61.6	63.5	63.6
Fixed asset turnover	4.93	5.48	6.38
Total asset turnover	2.63	2.78	2.77
Return on assets	9.6%	10.6%	10.2%
	<b>Financial Leverage</b>		
	<b>2018</b>	<b>2017</b>	<b>2016</b>
Assets to equity	1.74	1.74	1.69
Debt to assets	43%	43%	41%
Debt to equity	0.74	0.74	0.69
Long-term debt to equity	0.2	0.1	0.1
Times interest earned	0.0	0.0	0.0
	<b>Cash &amp; Liquidity</b>		
	<b>2018</b>	<b>2017</b>	<b>2016</b>
Net working capital	3,789,000	2,766,200	3,950,100
Accounts payable in days	36.4	34.9	42.5
Cash flow liquidity	0.5	0.3	0.4
Current ratio	1.57	1.41	1.69
Acid test ratio	0.48	0.40	0.64
	<b>Cash Conversion Cycle</b>		
	<b>2018</b>	<b>2017</b>	<b>2016</b>
<b>Operating Accounts</b>	<b>40.5</b>	<b>43.5</b>	<b>36.8</b>
Inventory in days	61.6	63.5	63.6
+ Accounts receivable in days	15.4	15.0	15.7
- Accounts payable in days	-36.4	-34.9	-42.5

## QUARTERLY FINANCIAL DATA

The following table sets forth certain unaudited quarterly financial information.

### MARKET INFORMATION

The Company's common stock is listed on the New York Stock Exchange.

<b>2017</b>	<b>High</b>	<b>Low</b>
1st Quarter	51.60	39.91
2nd Quarter	47.28	40.05
3rd Quarter	49.10	43.23
4th Quarter	47.72	43.31

<b>2018</b>	<b>High</b>	<b>Low</b>
1st Quarter	47.93	36.59
2nd Quarter	39.02	33.01
3rd Quarter	38.93	34.85
4th Quarter	37.27	31.39

<b>Current Credit Ratings</b>
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<b>Rating Agency</b>	<b>Long-Term Debt Rating</b>	<b>Outlook</b>	<b>Commercial Paper Rating</b>	<b>Outlook</b>
Moody's	A2	Stable	P-1	Stable
Standard & Poor's	A+	Negative	A-1	Negative

Net cash provided by financing activities was \$534 million compared to a net cash use of \$120 million last year. On January 13, 2019, we issued \$1,000 million of 5.25% notes due in 2027. The notes were issued at a discount. The net proceeds after deducting the discount, underwriting fees and issuance costs were \$987 million. The proceeds were used to pay down short-term borrowings with the excess used to purchase short term investments in Treasury Bills. Short-term borrowings paid during the current fiscal year were \$70 million compared to proceeds of \$263 million a year ago. Shares totaling \$140 million were purchased to support the needs of the employee stock Plans during the current period as compared to \$220 million a year ago. On January 10, 2017, a stock repurchase program ("2017 repurchase program") of up to \$1,000 million was announced, to be executed over four years. We plan to continuously evaluate executing any stock repurchase under the 2017 repurchase program throughout the year. We will continue to repurchase shares to support the needs of the employee and option plans.

We had no commercial paper outstanding at January 31, 2019. In connection with our commercial paper program, we maintain two unsecured backup syndicated lines of credit that total \$1,200 million. The first \$600 million facility expires on August 10, 2019, the second on August 12, 2022. Our ability to access these facilities is subject to our compliance with the terms and conditions of the credit facilities, including financial covenants. The covenants require us to maintain certain financial ratios related to minimum net worth and priority debt, along with limitations on the sale of assets and purchases of investments. As of January 31, 2019, we were in compliance with all such covenants. The company pays a facility fee to the financing bank to keep this line of credit facility active. While we are still able to access these lines of credit, as of January 31, 2019, there were no borrowings outstanding against these credit facilities. We do not expect any borrowings under these facilities, together with our outstanding commercial paper, to exceed \$1,200 million.