Lansing Stores, Inc.

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ABSTRACT

This case study is designed to explore the credit needs and worthiness of Lansing Stores, Inc. and its ability acquire a competitor. Within the case process it will require identifying the elements necessary to evaluate a prospect for a term commercial loan, to analyze the risk potential in the integration of Lansing and Redstar financial data. Financial calculations will require spreading the financial statements, provide key ratios, and generate changes in cash position. Additionally, the case will require pro forma statement projections. It will be necessary to perform credit analysis, and to make a commercial loan decision. A list of questions must be prepared to make the loan decision. The supporting data provides information to complement the loan decision.

Keywords: Lansing Stores, Inc., Frank Carling, credit analysis, commercial loan

GENERAL INFORMATION

Frank Carling, owner of Lansing Stores, Inc. (Lansing), operates a large group of 50 convenience stores throughout Michigan and Wisconsin with the heaviest concentration of stores in Michigan. Since establishing his company, Frank Carling and Lansing have been customers of United Banks of Michigan. Mr. Bill Davenport has handled the banking business of Mr. Carling and Lansing for the past five years. Prior to that time, Mr. David Lawrence was 20 years prior to being elevated to President of United Banks of Michigan. Mr. Carling's and Lansing's loan officer for His demand deposit balances at the bank currently average $150,000, with savings and other time deposits totaling in excess of $500,000. Lansing currently has an inventory line of credit for up to $500,000 with $50,000 unused. This unsecured line of credit has been maintained for a number of years and is rested for 30 days each year per the loan agreement. The loan is current and in compliance with its terms and conditions.

Mr. Carling has a competitor, Redstar Enterprises, in his weaker Wisconsin market who is willing to sell its 45 stores and warehouses that would let him dominate the convenience store market both in Michigan and Wisconsin.. He is of the opinion that it will take a loan of $7 million made up of $6 million in long-term debt and $1 million working capital to operate the joint companies.

LANSING'S OPERATION

Lansing is a well-established and efficiently operated business whose 50 convenience stores are able to compete effectively with small mom and pop stores as well as national chains such as Seven-Eleven. The stores carry the basic convenience store items, gasoline, and higher mark-up specialty items. With the popularity of video games, the company has placed them in most of the stores in the larger communities to attract both young and old to play and spend money on other store items.

Mr. Carling's model has been one that avoided being in the real estate ownership business by leasing all of his stores from building owners. The only real estate owned by him is the warehouse in Detroit used to store all of the items bought in bulk and distributed to the stores. He has found that the cost of the two trucks, warehouse personnel, and two drivers is more than offset by the savings derived from bulk purchasing for all stores.

One thing that Carling insists upon from his store managers is cost containment and efficiency of operations to maximize profitability. To that end, Lansing has a bonus plan in place to reward the managers.

The corporate headquarters for Lansing is located in the Detroit warehouse owned and operated by Lansing. Mr. Carling, his operations manager, accountant, and seven other employees are housed there.

REDSTAR ENTERPRISES

Redstar has been in the convenience store business in Wisconsin for over twenty years, operating 44 stores. It is owned and managed by several members of the Redding family. Two years ago, the family patriarch died, requiring the family members to take over management. Since that time, the four family members have had a number of disagreements about the operation of the business which has caused substantial family issues. As a result, the family has decided the best course is to sell the business, and they have retained a business broker to handle the sale.

Their business model is similar to Lansing's with the exception of heavy family involvement and lower profitability at Redstar. Much like Lansing, they lease all of their stores, however they do own two distribution warehouses.

Mr. Carling is motivated to purchase Redstar for several reasons. First, he is of the opinion that he can bring his efficiency to Redstar to increase its profitability, and secondly, he is concerned that a major convenience store chair might purchase Redstar and try to force him out of his weaker market. Mr. Carling feels that he needs to move quickly to make the purchase. None of Redstar's locations compete directly with Lansing so there is no duplication.

Additionally, Carling believes that he could find substantial cost savings by selling off one of the warehouses and eliminating $150,000 in family salaries. Perhaps, the total savings might reach $300,000 yearly. He would keep one of the warehouses for distribution for all of the two companies' stores in Wisconsin. Part of the savings would also come about by the increase in the bulk buying for the two companies.

THE ECONOMY

Both Michigan and Wisconsin have had some serious economic woes since 2008, with both states having severe job losses as well as major real estate problems. To complicate matters further, the major driver of the economy in Michigan has been the automobile industry, which has seen some substantial financial issues. However most of the current forecasts indicate an upturn in the economic conditions for both states. Recent developments in the automobile industry show an upturn in vehicle sales with two of the "big three" automakers showing strength. Economic predictions indicate substantial employment increases with the higher volume of automobile sales.

Mr. Carling is involved in his convenience store's trade association which recently held its annual convention in Detroit. All of the presentations at the convention indicated that the industry in the two states seemed to be doing reasonably well. In an interview at the convention, Mr. Carling was very optimistic about his industry in general and Lansing specifically. He noted that even during the financial crisis, more people were buying the basic milk, bread, and gasoline at his stores. When they came in to buy the basics, they usually purchased a minimum of two other items.

THE LOAN REQUEST

Mr. Carling told United Bank's senior lending officer, Bill Davenport that Redstar was asking $6.5 million based upon a $5.5 million capital earnings value established at 15 times annual earnings. There was one item that Mr. Carling would have to deal with and that is the warehouse purchased in 2009 for $1.8 million. Redstar financed $1.55 million and currently owes $1.45 million at year-end 2010. The loan is assumable, but the high rate of 10 percent has caused Mr. Carling to wrap the loan into his total request.

It is Mr. Carling's opinion that he can purchase Redstar for $6 million and assume the warehouse debt of $1.45 million. Additionally, he will need to borrow $1 million for working capital. However, if he cannot negotiate the sellers down to the $6 million offer, he believes that it would still be profitable at $6.5 million and the assumption of the $1.45 million warehouse debt.

Mr. Carling feels strongly about his company's ability to absorb Redstar into Lansing without any financial problems. Therefore, he is requesting that Mr. Davenport and the bank consider the following financing scenarios for the company to purchase Redstar.

If Redstar can be purchased for $6 million with the assumption of the existing $1.45 million warehouse debt, then Lansing will need an additional $1 million working capital to support the operations. In this scenario, Lansing would need $8.145 million for five years.

Should Redstar demand $6.5 million with Lansing assuming the $1.45 million warehouse debt, Lansing would also require the additional $1 million working capital in which case Lansing will need total financing of $8.645 million for five years.

Mr. Davenport stated that he would recommend either proposal to the bank's loan committee at a rate of eight percent for five years. Of course, the loan will be subject to adequate cash flow to service the debt and loan committee approval.

CREDIT INFORMATION

Mr. Davenport obtained a personal credit report, a National Association of Credit Managers' Report, a Dunn & Bradstreet Report, and performed credit inquiries at other creditors. There were no problems reported by suppliers or credit agencies, but the suppliers reported that the company never took advantage of the trade discounts.

In reviewing the credit files of his bank, Mr. Davenport found that Mr. Carling had a personal mortgage for his home in the original amount of $500,000 which had paid down to $350,000, and that Mr. Carling had handled the loan as agreed. Lansing Stores, Inc. has had a line of credit for many years at the bank and had handled it in a satisfactory manner.

THE LOAN DECISION

Acting as the senior lending officer of United Banks of Michigan, you have been presented with the Lansing Balance Sheet (Exhibit 1), the Lansing Income Statement (Exhibit 2), the Redstar Audited Balance Sheet (Exhibit 3), and the Redstar Audited Income Statement (Exhibit 4). Your job is to evaluate the data and determine the following:

1. Discuss the risk potential in the integration of Lansing and Redstar.
2. Do the following financial calculations for the years 2009 and 2010:
a. Spread the financial statements.
b. Provide the key ratios
3. Discuss each of the firm's strengths and weaknesses.
4. Using reasonable assumptions provide pro forma statement projections for the periods 2011-2015.
5. What do you estimate Lansing's capacity to borrow for this transaction?
6. How would you structure the loan in terms of maturity, repayment, and collateral?
7. Can Lansing make the debt service assuming a 40 percent tax rate?
8. Prepare a list of questions to which you would need answers to make you comfortable to grant the loan.

Exhibit 1: Balance Sheet: Lansing Corporation
UNAUDITED, FISCAL YEAR ENDED JUNE 30 (THOUSANDS OF DOLLARS)

	2007	2008	2009	2010
Cash	$218.1	$495.5	$1,103.0	$1,648.6
Accounts receivable	71.6	92.8	45.5	27.6
Inventory	2,319.4	2,985.0	3,897.2	4,811.9
Current assets	$2,609.1	$3,573.3	$5,045.7	$6,488.1
Gross Fixed Assets	1,477.4	1,548.1	1,595.8	1,686.5
Depreciation	560.3	671.9	708.3	797.4
Net fixed assets	$917.1	$876.2	$887.5	$889.1
Net leasehold improvements	$120.1	$138.0	$135.4	$152.2
Total assets	$3,646.3	$4,588.5	$6,038.6	$7,529.4
Accounts payable	$196.3	$268.7	$522.8	$581.6
Accrued expenses	154.9	150.2	200.5	178.4
Income tax payable	290.6	353.7	489.9	556.3
Current liabilities	$641.8	$772.6	$1,213.2	$1,316.3
Long-term debt	-	-	-	-
Total liabilities	$641.8	$772.6	$1,213.2	$1,316.3
Surplus	$500.5	$500.5	$500.5	$500.5
Retained earnings	2,504.0	3,315.4	4,324.9	5,712.6
Total stockholders' equity	$3,004.5	$3,815.9	$4,824.9	$5,712.6
Total liabilities and equity	$3,646.3	$4,588.5	$6,038.6	$7,529.4

Exhibit 2: Income Statement: Lansing Corporation
UNAUDITED, FISCAL YEAR ENDED JUNE 30 (THOUSANDS OF DOLLARS)

	2008	2009	2010
Net sales	$12,824.2	$14,905.3	$17.734.6
Cost of goods sold	8,015.5	9,212.7	10,837.1
Gross margin	$4,808.7	$5,692.6	$6,897.5
General & administrative expenses	$3,373.1	$4,021.4	$4,795.8
Officer salaries	80.1	90.0	100.0
Depreciation	122.2	65.0	108.5
Total operating expenses	$3,575.3	$4,176.4	$5,004.3
Operating profit	$1,233.4	$1,516.2	$1,893.2
Interest expense	12.8	17.5	20.0
Other income	38.1	86.2	159.9
Income before taxes	$1,258.7	$1,584.9	$2,033.1
Income taxes	447.3	575.4	645.4
Net income	$811.4	$1,009.5	$1,387.7

Exhibit 3: Balance Sheet: Redstar Enterprises
AUDITED, FISCAL YEAR ENDED DECEMBER 31 (THOUSANDS OF DOLLARS)

	2008	2009	2010
Cash	$572.2	$1,383.6	$785.6
Accounts receivable	82.7	24.7	31.6
Inventory	6,518.2	6,506.4	7,294.0
Current assets	$7,173.1	$7,914.7	$8,111.2
Gross fixed assets	3,790.4	4,983.4	5,236.7
Accumulated depreciation	2,402.5	2,468.2	2,773.7
Net fixed assets	$1,387.9	$2,515.2	$2,463.0
Net leasehold improvements	$231.9	$249.5	$219.2
Other assets	$145.4	$200.8	$164.6
Total assets	$8,938.3	$10,880.2	$10,958.0
Accounts payable	$495.2	$656.4	$483.3
Accrued expenses	501.7	558.9	591.0
Income tax payable	209.8	271.1	312.6
Current maturity long-term debt	-	100.0	100.0
Current liabilities	$1,206.7	$1,586.4	$1,486.9
Long-term debt	-	$1550.0	$1,450.0
Total liabilities	$1,206.7	$3,136.4	$2,936.9
Common Stock	$915.0	$915.0	$915.0
Retained earnings	6,816.6	6,828.8	7,106.1
Total stockholders' equity	$7,731.6	$7,743.8	$8,021.1
Total liabilities and equity	$8,938.3	$10,880.2	$10,958.0

Exhibit 4: Income Statement: Redstar Enterprises
AUDITED, FISCAL YEAR ENDED DEMBER 31 (THOUSANDS OF DOLLARS)

	2009	2010
Net sales	$20,913.2	$22,917.7
Cost of goods sold	13,701.0	14,789.0
Gross margin	$7,212.0	$8,128.7
General & administrative expenses	$6,476.4	$6,937.2
Officer salaries	218.3	252.5
Depreciation	152.5	200.8
Total operating expenses	$6,847.2	$7,390.5
Operating profit	$365.0	$738.2
Interest expense	151.3	140.1
Other income	126.7	86.4
Income before taxes	$340.4	$684.5
Income taxes	238.2	317.2
Net income	$102.2	$367.3