

Stanford Bottling Inc. (A)

Introduction

In May 2004, Philip Abrams faced a difficult situation regarding Stanford Bottling Inc. (SBI), a small carbonated drink bottling company in which he had invested and which he had been advising during its start-up. Mark Benson, CEO of SBI was in the process of negotiating a major contract with DiscountMart, the largest warehouse outlet in the area, to sell SBI's only cola-flavored drink, Kraka Cola, and Benson was pushing Abrams for a speedy approval of the contract. Abrams was convinced that Benson's contract with DiscountMart did indeed have long-run potential for improving both the brand awareness of Kraka Cola and the profitability of SBI. These positive impacts were especially important now because preliminary estimates indicated that SBI would suffer an unexpected \$350,000 loss in its first fiscal year, which would end on June 30, 2004. Benson was fully aware that he would be under heavy pressure from his investors to show greatly improved performance in the upcoming fiscal year.

Nevertheless, Abrams was somewhat uncomfortable about the significant concessions that DiscountMart was requesting, and he was concerned that the DiscountMart contract would prove to be a mixed blessing. Certainly the volume of beverages DiscountMart might sell would be very important in making better use of SBI's as-yet underutilized bottling capacity, and perhaps even more importantly for the future, DiscountMart sales could raise Kraka Cola's (and SBI's) brand recognition throughout the San Francisco Bay Area. But DiscountMart was demanding hefty price and delivery concessions in the contract. As Abrams thought about the proposal, he commented:

We have to do something to stimulate additional contribution or SBI will have to close up shop. This DiscountMart contract may be our best alternative, because we can't count on beverage sales in the smaller convenience stores to save the company. Unfortunately, we are too small to compete directly with the major bottlers, Coca Cola and Pepsi, who control almost all the sales at supermarkets and most vending machines. Yet, we've never sold to a discount retailer like DiscountMart, and their terms look harsh. For example, in addition to the generous price concession they are requesting, DiscountMart also requires that they be given first priority each quarter to be supplied with Kraka Cola, even if that means that orders from the other customers, who pay higher prices for SBI beverages, are not fulfilled. On the other hand, losing DiscountMart's contact will leave SBI with a lot of excess bottling capacity, and the same kind of anemic sales volume that is producing the big loss this year. Moreover, SBI also must consider the market penetration that DiscountMart's sales volume would create, an important brand awareness issue for future growth. Maybe this whole dilemma is just an unavoidable hazard for any start-up firm like ours.

The Company

Based in the San Francisco Bay Area, Stanford Bottling, Inc. bottles three carbonated beverages, Dr. 7, Kraka Cola, and Rooty Beer, at a single bottling plant and distributes the drinks on pallets to retailers. SBI uses pallets as its measure of both sales and bottling capacity; a pallet consists of twenty-four cases of bottled beverage. The bottling plant can change-over very quickly among the three beverages to meet fluctuating demand, subject to its overall quarterly capacity of 26,000 pallets of total bottled product. Distribution of the pallets is handled by a local trucking company for a fixed annual fee. Other fixed expenses include advertising, general and administrative expenses, maintenance expenses, depreciation, salaries, and interest expense on long-term debt.

Fiscal 2004 year-to-date results and fourth-quarter estimates indicate that SBI will earn a contribution margin of \$3.44 million in its first year of operation, which will result in posting a pre-tax loss of \$350,000. Benson has prepared an Excel budget worksheet to project next year's (fiscal 2005's) pre-tax income for SBI (Exhibit A). As requested by Abrams, Benson has separated the DiscountMart Kraka Cola contribution from the contribution earned from sales of beverages to SBI's other retailers. Benson has constructed the worksheet so that it first allocates bottling capacity each quarter to fulfill DiscountMart's demand for Kraka Cola, which both SBI and DiscountMart agree would average about 15,000 pallets in the first quarter, and grow by 2% per quarter for the rest of the year (Exhibit B). Although the annual contract price per pallet of Kraka Cola is fixed to produce a contribution margin (beverage price less total variable beverage costs) of \$52.00 per pallet, the actual first quarter DiscountMart demand could be considerably more or less than 15,000 pallets.

In addition to the DiscountMart contribution, the worksheet shows quarterly demands for the three beverages from SBI's other convenience store retailers. Of course, these quarterly demands also are uncertain, and Benson has used his best estimates of the demand he expects to occur for each beverage in each quarter. Also shown are the (higher-than-DiscountMart) contribution margins paid by SBI's other retailers for beverages. These contribution margins vary somewhat by quarter, reflecting increased variable beverage costs in later quarters.

Looking at Benson's worksheet in Exhibit A, Abrams commented to himself:

Well, it is comforting to see that Mark's worksheet shows a positive \$268,000 pre-tax net income for next year. His expense numbers look reasonable, based upon our data from this year, but I worry that the demand quantities may turn out differently from his assumptions, especially for DiscountMart, who is a completely new customer for us. I'd better get a copy of his .xls file and do some "What If's" on my own to see how confident I am about that \$268,000 bottom line. (Exhibit C)

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Exhibit A

	A	B	C	D	E	F	G
7	Stanford Bottling Co.						
8	Operations		Bottling Capacity per qtr.	Quarter 1	26,000	Pallets	
9				Quarter 2	26,000	Pallets	
10				Quarter 3	26,000	Pallets	
11				Quarter 4	26,000	Pallets	
12							
13	DiscountMart Account		Expected Kraka Cola Demand, Pallets/Quarter		Contribution Margin per Pallet	Contribution per Quarter	Total Annual Contribution
14	Quarter 1		15,000		\$52.00	\$780,000	
15	Quarter 2		15,300		\$52.00	\$795,600	
16	Quarter 3		15,606		\$52.00	\$811,512	
17	Quarter 4		15,918		\$52.00	\$827,742	
18	Discount Mart Total		61,824				\$3,214,854
19							
20	Convenience Store Accounts						
21	Quarter	Beverage	Expected Beverage Demand, Pallets/Quarter	Available Bottling Capacity (Pallets)	Contribution Margin per Pallet	Contribution per Quarter	Total Annual Contribution
22	Quarter 1	Dr. 7	4,100	11,000	\$57.00	\$233,700	
23		Kraka Cola	4,300	6,900	\$56.50	\$242,950	
24		Rooty Beer	4,700	2,600	\$54.50	\$141,700	
25	Quarter 2	Dr. 7	4,100	10,700	\$56.50	\$231,650	
26		Kraka Cola	4,300	6,600	\$56.00	\$240,800	
27		Rooty Beer	4,700	2,300	\$54.00	\$124,200	
28	Quarter 3	Dr. 7	3,700	10,394	\$55.50	\$205,350	
29		Kraka Cola	4,300	6,694	\$55.00	\$236,500	
30		Rooty Beer	4,200	2,394	\$54.50	\$130,473	
31	Quarter 4	Dr. 7	4,300	10,082	\$55.00	\$236,500	
32		Kraka Cola	4,300	5,782	\$54.00	\$232,200	
33		Rooty Beer	3,400	1,482	\$52.00	\$77,058	
34	Conv. Store Total		50,400				\$2,333,081
35	Annual Bottling Contribution						\$5,547,935
36							
37	Stanford Bottling Co. 2005 Budget						
38	Contribution <						

Exhibit B

	A	B	C	D	E	F	G
7	Stanford Bottling Co.						
8	Operations		Bottling Capacity per qtr.	Quarter 1	26000	Pallets	
9				Quarter 2	=E8	Pallets	
10				Quarter 3	=E8	Pallets	
11				Quarter 4	=E8	Pallets	
12							
13	DiscountMart Account		Expected Kraka Cola Demand, Pallets/Quarter		Contribution Margin per Pallet	Contribution per Quarter	Total Annual Contribution
14	Quarter 1		15000		52	=MIN(C14,E8)*E14	
15	Quarter 2		=1.02*C14		52	=MIN(C15,E9)*E15	
16	Quarter 3		=1.02*C15		52	=MIN(C16,E10)*E16	
17	Quarter 4		=1.02*C16		52	=MIN(C17,E11)*E17	
18	Discount Mart Total		=SUM(C14:C17)				=SUM(F14:F17)
19							
20	Convenience Store Account						
21	Quarter	Beverage	Expected Beverage Demand, Pallets/Quarter	Available Bottling Capacity (Pallets)	Contribution Margin per Pallet	Contribution per Quarter	Total Annual Contribution
22	Quarter 1	Dr. 7	4100	=MAX(0,E8-C14)	57	=MIN(C22,D22)*E22	
23		Kraka Cola	4300	=MAX(0,D22-C22)	56.5	=MIN(C23,D23)*E23	
24		Rooty Beer	4700	=MAX(0,D23-C23)	54.5	=MIN(C24,D24)*E24	
25	Quarter 2	Dr. 7	4100	=MAX(0,E9-C15)	56.5	=MIN(C25,D25)*E25	
26		Kraka Cola	4300	=MAX(0,D25-C25)	56	=MIN(C26,D26)*E26	
27		Rooty Beer	4700	=MAX(0,D26-C26)	54	=MIN(C27,D27)*E27	
28	Quarter 3	Dr. 7	3700	=MAX(0,E10-C16)	55.5	=MIN(C28,D28)*E28	
29		Kraka Cola	4300	=MAX(0,D28-C28)	55	=MIN(C29,D29)*E29	
30		Rooty Beer	4200	=MAX(0,D29-C29)	54.5	=MIN(C30,D30)*E30	
31	Quarter 4	Dr. 7	4300	=MAX(0,E11-C17)	55	=MIN(C31,D31)*E31	
32		Kraka Cola	4300	=MAX(0,D31-C31)	54	=MIN(C32,D32)*E32	
33		Rooty Beer	3400	=MAX(0,D32-C32)	52	=MIN(C33,D33)*E33	
34	Conv. Store Total		=SUM(C22:C33)				=SUM(F22:F33)
35	Annual Bottling Contribution						=G18+G34
36							
37							
38	Contribution Expenses (Fixed)		Bottled Drink Contribution	=G35			
39			Other	554000			
40			Total Contribution			=SUM(D38:D39)	
41			Production Salaries	1136000			
42			Bottling Plant Expenses	818000			
43			Transportation	770000			
44							
45			Miscellaneous	104000			
46			Total Bottling Expenses		=SUM(D41:D45)		
47	Advertising	1030000					
48	General & Admin.	944000					
49	Depreciation	742000					
50	Interest Expense	290000					
51	Total Expenses			=SUM(D47:D50)	=E46+E51		
52	PreTax Income					=F40-F51	

Exhibit C

Uncertainty About Pallet Sales Per Quarter						
			Minimum	Maximum	Most Likely	Distribution
Discount Mart Quarter 1	Kraka Cola		6,000	24,000		Uniform
Convenience Stores						
Quarter 1	Dr. 7		3,400	4,800		Uniform
	Kraka Cola		3,800	4,800	4,300	Triangular
	Rooty Beer		3,900	5,500	4,700	Triangular
Quarter 2	Dr. 7		3,400	4,800		Uniform
	Kraka Cola		3,800	4,800	4,300	Triangular
	Rooty Beer		3,900	5,500	4,700	Triangular
Quarter 3	Dr. 7		3,300	4,100		Uniform
	Kraka Cola		3,800	4,800	4,300	Triangular
	Rooty Beer		3,200	5,200		Uniform
Quarter 4	Dr. 7		3,800	4,800		Uniform
	Kraka Cola		3,800	4,800	4,300	Triangular
	Rooty Beer		3,100	3,700		Uniform