Fresh Connections

Mary Alice McKenzie was pleased with the progress Fresh Connections had made in only a year. The company had opened for business in August of 1998 and by September of 1999 had $6 million in revenues. McKenzie and Fresh Connections CEO Douglas Hyde still had more questions, however, than answers. There were immediate operational problems: the company's production processes suffered from bottlenecks and the only way to solve this would be to purchase expensive new equipment. McKenzie was concerned with ensuring both quality and efficiency as the company grew and implemented more sophisticated systems. Where would they get the necessary capital? In addition, she had been bearing the burden of substantial up-front R&D costs for her customers, who were still free to cancel a contract at any time. How should she structure her contracts moving forward so as to protect her small firm from such dangerous financial exposure?

There were also longer-term strategic decisions to make. Which customer segment(s) should the company pursue? The fresh prepared foods market was on the rise and Fresh Connections needed to devote more effort to sales. Given the abundant opportunities, where should they channel their energies? The restaurant business? Supermarkets? Niche players like organic and specialty markets? Each segment had its own advantages and disadvantages. Which opportunities would allow them to compete effectively and grow the business without becoming overwhelmed?

These were just a few of the things she was thinking about on the company's one-year anniversary.

Background

Although Fresh Connections was only one year old, the company's roots traced back to 1907 when John and Ellen McKenzie—Mary Alice's great grandparents—started McKenzie of Vermont. A high-end meat products business located in Burlington, Vermont, the company sold sausages and other prepared meats throughout New England. The company thrived until the mid-1980s when a family disagreement over strategic direction led to a severe decline in sales and pushed the company to the brink of bankruptcy.

In 1984, after receiving her law degree and serving as a county prosecutor in Illinois, Mary Alice McKenzie returned home and took over the family business, which was in financial trouble. In an effort to open up new opportunities for the business, McKenzie joined forces with Waterbury

Research Associate Susan Harmeling and Dean's Research Fellow Christian G. Kasper prepared this case under the direction of Professor Jonathan West as the basis for class discussion rather than to illustrate either effective or ineffective handling of an administrative situation.

Holding Company (Waterbury), a local firm which was to market fresh-prepared food and specialty meat products. McKenzie of Vermont's performance continued to decline, however, and Waterbury's business fell apart when it lost access to capital. In the complicated financial work-out that followed, Mary Alice McKenzie retained only the physical meat processing facility and the fresh food manufacturing capability. She named the new business "Fresh Connections", since she had been forced to sell the McKenzie of Vermont "brand" to raise additional capital. Starting over was not an easy decision:

> When my great grandparents started McKenzie of Vermont, it was the state's first meat processing facility—it has a state inspection logo with the number 1. They did everything, from slaughtering to processing to packaging. They went through a lot with this company—they survived the Depression by bartering food—they paid local farmers in sausage in exchange for their produce. They went through new environmental regulations in the 60s when the problem of dealing with waste water at a slaughter facility became so costly that they were forced out of the slaughter and processing business altogether.
>
> My father decided to build a new plant on the outskirts of Burlington in the early 1980s in order to comply with new USDA regulations, allowing us to sell our product interstate. Then came a big strategic split between my father and my uncle—my father wanted to focus on meat products and my uncle wanted to supply commodities to small independent food stores in Vermont[1]. They essentially followed both strategies and it turned out to be a disaster. Large chains eventually did come in, of course, and by then the commodities business made up two-thirds of our sales.
>
> Disaster hit as all the local markets closed and the large food markets turned to national suppliers. They were able to negotiate large contracts at a much lower price than we could offer. Our revenues plummeted from a high of $20 million to around $6 million in just a few years. This was when my Dad got out of the business and I took over. To sell the family business and start over was very, very difficult for me. It was also quite controversial, both within the family and within the local community where my family had established a long history and good reputation. But I felt it was the right thing to do—the meat market was going nowhere while fresh prepared foods were taking off.
>
> Personally, I wanted to do this because it is my family business. Since the relationship with Waterbury didn't work out, our employees were the ones who suffered, and I wanted to fix that. It's not that I want to end my days managing a small food company in Vermont, but I do want to repair the situation by growing Fresh Connections. At some point, I'll figure out an appropriate exit strategy—maybe by taking the company public, doing a joint venture with another food company, or getting acquired by some larger entity—but that is in the future. Right now, I am in the "growing the business" stage (see **Exhibits 1** and **2** for financial statements).

[1] There were no large chains in Vermont at that time. Vermont was one of the last markets to follow the national trend.

The Fresh-Prepared Foods Industry

Fresh Connections and other fresh-prepared food companies were formed to capitalize on the growth in the "meal solutions" market. Although the terms "meal solutions" and "Home Meal Replacement" (HMR) were used interchangeably, they actually referred to two different markets. HMRs were meal items that replaced food that would otherwise be cooked at home. It did not include meals such as fast food takeout. Meal solutions was a broader definition that covered a whole spectrum of activities. These often included using chefs to produce food in-store, redesigning store layouts to redirect customer attention toward meal solutions, and cross-merchandising to offer complete meals for the entire family.

Although only one segment of the $750 billion U.S. food industry, meal solutions accounted for over $100 billion in sales. According to one industry report, foodservice—including all providers of fresh-prepared meals—was predicted to capture nearly all of the food industry growth over the next five years. This would translate into nearly $50 billion in added spending, with HMRs likely to be the fastest growing segment within the foodservice category (see **Exhibit 3** for industry data). It was estimated that 92% of supermarkets had begun selling take-home, prepared meals, and that these trends would continue. McKenzie was hoping to capitalize on this market shift:

> The HMR movement is driven by consumers—they are leaving the supermarkets and entering the food-service world. Supermarket operators are not stupid—they understand the concept of value/square foot—and they will quickly realize they need to get into fresh prepared foods to compete. Lots of ideas are springing up and no one knows who will eventually win or how the market will play out. The same trends are driving food service companies looking to capitalize on consumer demand for more convenience and value without sacrificing quality.

The Concept

McKenzie was confident that the Fresh Connections concept would separate it from other food companies:

> One interesting thing about Fresh Connections is that we are an entrepreneurial company in an industry dominated by giants. This means that while we are up against large firms with deep pockets and the capacity to outspend us, we have the advantage of being positioned to support the branded products of companies dealing with the consumer. We manufacture their own proprietary foods. We are a flexible facility with the ability to offer our clients short turnaround times on a variety of products without compromising quality.

McKenzie sought to emphasize this advantage by developing long-standing relationships with the type of customer who was willing to pay a premium for her product. These customers usually valued quality, personal attention, and customized product development. McKenzie was very clear that Fresh Connections was not pursuing clients who "just want anything to put on their shelf without regard to the ingredients used."

Fresh Connections produced fresh-prepared foods ranging from entrees to desserts (see **Exhibit 4** for sample product offerings) for a variety of customers, including supermarkets, restaurants, and specialty grocers. Occasionally, at the customer's request, Fresh Connections would produce frozen food. These requests almost always came from restaurants, as Mary Alice McKenzie explained:

> Many restaurant chains do not make their food in-house, they only assemble dishes made from components they buy from outside suppliers. It is too risky for them to source fresh components and carry that highly-perishable inventory since they may have fewer customers than they anticipate on any given night because of weather, etc. They must have frozen components on hand in order to live with the fluctuations in their business.

McKenzie saw Fresh Connections as a "knowledge-based" food company, not just another bulk manufacturer. She believed that,

> In this market, lots of people trying to get into fresh prepared foods do it out of their garage and just produce one product—say lasagna—and just make that one product and sell it to anyone who will buy it. That is not at all what we are trying to do. Custom prepared food requires knowing more about many different kinds of foods.

For Fresh Connections, this knowledge came in the form of some five thousand pre-tested "stock" recipes stored in a computerized database. These recipes gave the company two distinct options. First, they could take the recipe straight from the database and immediately begin to produce the product, completely bypassing all product development and testing. As Mary Alice McKenzie explained, the pre-tested recipes also gave Fresh Connections the ability to quickly approve or eliminate certain customer requests:

> One of our new clients sent us a list of 20 products they wanted to develop. With the help of the database, we were able to tell them right away approximately how long the shelf life would be for each product. This meant that we did not have to test every single product, and we could quickly eliminate some of the products because of an inadequate shelf life. This information, combined with the customer's information about their own distribution process, can tell us how long it will take to get the product on the shelf and how long it will last once it is there.

Second, they could quickly develop new, customized recipes by tinkering with the ingredients on any standard recipe. For example, if a client wanted mashed potatoes but did not want to pay a premium price for real butter and milk, Fresh Connections could take the stock recipe, substitute margarine and powdered milk and develop the new recipe. This would eliminate the costly and time-consuming process of going through the multiple rounds of testing that were involved in developing an entirely new recipe.

The average shelf life of Fresh Connection's products ranged from 14 to 60 days. Fourteen days was the minimum shelf life necessary to get the products through the distribution system. Due to the variation in shelf life, as well as swings in customer demand for the products, Fresh Connection's production could vary greatly from week to week.

Competitors

McKenzie believed that Fresh Connections concept differentiated them from the vast majority of food companies. The large food companies, like ConAgra and General Foods, were focused on large volume production of only a few standard products. Campbell's soup company, for example, had their production processes optimized for continuous-flow, large-scale production of chicken-noodle soup. McKenzie believed that these large companies "don't do anything close to what we are trying to do."

Fresh Connections main competition came from a small number of other fresh-foods companies. These companies were mostly small and new to the market.

Willow A subsidiary of Richeleau Foods (a large company based in Ontario). They had three U.S. plants located in Wisconsin. Willow was important to watch because their connection to a large company gave them access to significant resources. They also produce product for Morton's Deli, one of Fresh Connection's larger clients.

ASK Foods Located in Pennsylvania. Their core business was salads, although they had started to get into fresh-prepared foods. Most of their distribution was through their own fleet of trucks. Fresh Connections recently lost a major deal to them with Pathmark supermarkets. However, the arrangement was subsequently cancelled because Pathmark's primary distributor was not able to deliver the product to store before it spoiled.

Homemade Brand Foods (Homemade) Located in Massachusetts, Homemade was another salad company starting to look at fresh prepared foods. They approached the business by producing fresh prepared products for those customers who already gave them their salad business. They were planning on expanding a plant to increase their fresh-prepared foods capacity.

International Menu Solutions (IMS) They develop ethnic menus (e.g., Italian, Mexican, Chinese) and have recently purchased a number of small food companies. IMS primarily produced frozen foods, but were trying to break into fresh-prepared foods in the U.S. market. The company was formed only 12 months old, and is publicly traded in Canada.

McKenzie wasn't aware of any other significant competitors. In addition, Fresh Connections wasn't in direct competition with companies that branded their own products. Fresh Connections didn't sell directly to consumers, so they didn't worry about competing with their customers. McKenzie reflected, "We do, of course, need to understand the ultimate consumer, but we don't sell directly to them. Our competitors who focus on their own brands aren't prioritizing the needs of the resellers. This gives us an edge."

Product Development

Fresh Connections worked closely with its customers to develop the exact product specifications. Rather than create a standard product that they attempted to sell to everyone, Fresh Connections custom tailored products to meet their clients' needs. They tried to target customer volumes that would dovetail well with their production equipment. This meant that they targeted production batches of between 5,000 and 1,000 pounds. Mark Boucher, head of finance at Fresh Connections, said, "Anything over 5,000 pounds is typically handled by the mass manufacturers. At the other end of the spectrum, if a new customer approaches us with an order for less than a thousand pounds, we will often tell them to talk to a caterer."

The typical customer of Fresh Connections required between two and ten products at any one time, although there was significant season demand swings in number of products and volume. While new product offerings were always highly desired, many customers still considered cost as a key factor in selecting a supplier. Fresh Connections served three main customer segments: retailers, food service operators (restaurants), and "co-pack" companies.

Retailers Retailers—supermarket chains, organic markets and specialty grocers—accounted for 50% of Fresh Connections' business. In general, retailers—particularly the large supermarket chains—wanted customized foods of high quality, but were more concerned with price and speed of delivery. McKenzie hoped to be able to "rely less and less" on this category. Retailers were difficult to deal with, worked on razor-thin margins, did not understand the R&D process, and had food handling systems that were not well-adapted to the demands of fresh food[2]. Fresh Connections also preferred to have a broader customer base for stability as well as for the "cross-pollination" of ideas. Fresh Connections learned from their restaurant customers how to produce restaurant-quality fresh-prepared foods that were exactly what the supermarket customers were demanding. One of Fresh Connections' important supermarket accounts had just decided to cancel its fresh foods program, advising Fresh Connections that it had not been successful. The company had asked McKenzie to consider helping redesign their program, but she was skeptical of the customer's ability to market and manage fresh prepared food programs in a traditional supermarket context.

Food service operators (restaurants) Restaurants accounted for 25% of Fresh Connections' business. McKenzie hoped to aggressively develop this segment. Both quality and advanced research and development were very important to these customers, and they were willing to pay for the added value Fresh Connections offered. Restaurants typically wished to outsource base sauces, soups and other "staple" items they served in order to reduce their need for labor. In addition, this allowed their cooks to focus on the "more creative things that they want to do" while letting Fresh Connections prepare the stock recipes.

> In the Food Service business, we won't work with small, single-owner restaurant groups of 5-10 units. That is just not enough volume for us. We work with larger franchise groups and those multi-unit operators with 10-200 restaurants under control and only a few key products to be developed. The optimum chain is between 30 and 50 units with a "casual dining" atmosphere.
>
> We target this segment because they are not interested in frozen foods; they want fresh. They are more creative, making food fresh in each restaurant. What we provide for these chains are their "mother sauces" which form the core component in a lot of dishes. If the restaurant is making everything from scratch, we tell them, "Don't use your labor that way. Let us do it for you. Then your chefs can concentrate on doing what they want to do and leave the repetitive stuff to us."

McKenzie had already identified a number of restaurant chains in their target market and they were actively pursuing these opportunities.

Co-Pack companies Accounting for 25% of the business, this business was primarily meat processing for other branded companies. These customers have already done their own research and development (R&D), and were just looking for outsourced production and specialty capabilities, such as meat smoking. The customers performed periodic quality audits on Fresh Connections' facility, but Fresh Connections bore no R&D risk. McKenzie was not eager to develop more business in this category, commenting, "The margins are quite low, as you might imagine." Nonetheless, it was desirable business for Fresh Connections as it utilized plant capacity and employee knowledge that would otherwise be wasted. (See Exhibit 5 for sales by customer.)

Research and Development Process

The typical sale involved a number of steps to create the product that would eventually be sold in bulk. McKenzie described the steps involved in this research and development process:

> 1. The customer has an idea--say spinach tortellini soup. They want it to be completely fresh, with no additives and no preservatives. We look in our recipe

[2] A 1999 Hale Group study found that supermarket food-service programs resulted in an average 2% net loss.

file, find some similar recipes to get an idea of base ingredients, cooking time, etc.

2. We will then source ingredients (one of which would be partially processed spinach) and our executive chef would do a small test kitchen batch.

3. A sample from this batch is then sent to the customer who will send it back with comments: not spicy enough, not the right color, etc.

4. The modifying process will continue--additional batches will be sent to customer. As many as five or six iterations are often needed to get the product right.

5. We agree on the recipe.

6. We start shelf-life testing by cooking up yet another test batch. We package it and then perform a series of microbiological tests to determine the exact shelf-life.

7. The last step is a full batch to verify the suitability for full production.

Although the steps appeared to be linear, in reality the process was highly iterative. The experienced chefs on staff at Fresh Connections were constantly working on new recipes and making improvements to old ones. Beyond making recipes that were good to eat, they also needed to design the products for manufacturability. That is, the production recipes needed to be cost effective, take advantage of the production equipment in the plant, be easy to replicate for a largely low-skilled labor force[3], and last a long time on the shelf. Recipes that appeared to work well in the kitchen often were a complete failure in the plant. Fresh Connection's chief development chef remarked,

> There is an enormous difference between the kitchen and the plant. It's easy to make something work in the skillet. You just add ingredients until it looks right. In those huge kettles, things cook very differently. For example, the product must be consistent throughout the batch. If they cook chicken noodle soup and all the chicken settles to the bottom, we'll have a lot of angry customers.

In addition to consistency, the kettles were also impacted by such factors as the particular characteristics of the machines, the impact of waste, and issues of food safety. To compound matters, the development tended to be very time sensitive, as well as customer specific. All of these factors resulted in a costly process. Fresh Connections spent on average $3,000 per product on research and development. This translated into nearly $25,000-30,000 per month in unreimbursed expenses, since Fresh Connections completely absorbed this cost for each product developed. McKenzie and her management team were in the process of drafting a new contract whereby they would share the cost and risk of R&D. She explained why this was a high priority:

> As it stands now, the R&D process is a sunk cost. This means that if we test a recipe and develop it, we absorb 100% of those costs. Not only that, but customers can go through the whole process, develop a product, and then decide they are not interested in sourcing the product after all. This can't go on. We are in the process of developing a way to protect ourselves contractually from this sort of risk and financial exposure.

[3] Effective communications between employees was sometime difficult, since many Fresh Connections employees were recent immigrants—from countries like Bosnia and Vietnam—and had limited English skills.

> This is all part of out effort to move from a "we'll do anything to get business" mentality to a more strategic view of which business to accept or reject. We need to push back on those customers who are used to asking for recipes to be developed with no risk on the R&D side and no up-front development costs.

From Recipe to Table

Fresh Connections' production process included five primary steps. First, raw materials for recipes were ordered for just-in-time delivery to the warehouse[4]. Second, the raw materials were then prepared for cooking and the recipe ingredients were physically grouped together. Third, the ingredients were combined and cooked in large stainless steel kettles. Fourth, the hot food was packed in bags and chilled. Finally, the cooked product was packaged before being received back into finished goods inventory and shipped. The product could be packed "as is," or as part of a meal component. The final package could be one of any number of different configurations: 12 ounce trays, family pack, or bulk boxes.

Meat products required a different process, due to health safety issues[5]. Meat products were received through raw materials, marinated or cured in a separate facility, and then cooked or smoked before being moved into the packing room (see **Exhibit 6** for operations flow chart). In addition to meat products, Fresh Connections also had an arrangement with a local Chinese foods company to produce egg rolls (see **Exhibit 7** for photograph of eggroll production). Fresh Connections often directly packaged their products in the final retail packaging for their customers. The organization and management of these processes was primarily done through informal communication and historical precedent. Although McKenzie was pushing to standardize and document processes, employees often relied on their own methods for getting the work done.

Fresh Connections had over fifty employees working in its Burlington facility. Nearly all the employees worked in the plant and plant-related areas such as sanitation, quality assurance and maintenance. The remaining employees were the four executives and small administrative staff (see **Exhibit 8** for organization chart). The plant was organized into the following main areas: preparation, kettle, packaging, meat, smokehouse, warehouse, wok room (see **Exhibit 9** for plant layout).

It was not always clear which steps in the production process Fresh Connections would do themselves and which they would outsource. For example, when McKenzie took over at Fresh Connections, vegetables were being sourced in a completely unprocessed state:

> The people who ran the company before me were buying pure, raw vegetables for all their recipes. They were very creative but they didn't think about the business in terms of dollars and cents. Their rationale was, "well, the vegetables are cheaper that way." But they weren't taking the enormous labor costs into account! To clean, peel and cut vegetables to get them ready for use in recipes is very labor intensive. We did the numbers and found that buying already processed

---

[4] Fresh connections kept very few ingredients on its shelves, preferring to order items only when needed for a recipe. Although this enhanced the product's freshness and reduced inventory and spoilage, many suppliers were not familiar with the constraints of this operating system. For example, it was common practice in the industry to only guarantee delivery of ingredients within a few days.

[5] U.S. Department of Agriculture food safety regulations were very specific, and added significant complexity and cost to the business. On the other hand, they did provide some competitive advantage for Fresh Connections over smaller, unlicensed companies that could not produce meat products.

vegetables was much cheaper than spending all our labor dollars preparing them. So now we buy the vegetables partially processed and then we slice or chop them to the specifications of the recipes.

I think a lot of people don't understand that there is only so much that can be automated. A lot of our type of work has to be done by hand, and in fact even large food companies still have to do a lot of product preparation and assembly by hand.

Plant workers did periodic and routine tests to ensure food safety and quality control. The test kitchen chef did periodic tests to make sure taste and appearance were maintained. The kettle room cooks also brought issues related to quality to managers' attention when necessary during the actual cooking process.

The Kettles

The food preparation was primarily done in two stainless steel kettles. Each kettle held approximately 1,300 pounds of food, although production was based on 1,000-pound kettle batches. The kettles could accommodate batch sizes as small as 500 pounds, but levels below 750 pounds seriously impacted overall yields. This was due to the loss of product when the product was transferred out of the kettles to the packaging machines (see **Exhibit 10** for photograph of a kettle).

Fresh Connection's current output was approximately 150,000 pounds of product per week. At this level, the plant was only running at 30% of capacity with only one shift in operation. McKenzie's short-term goal was to raise production to 300,000 pounds per week with two shifts running, which would put the plant at approximately 60% of capacity. At current margin levels, this target level would put the company squarely in a positive financial position (see **Exhibit 11** for sales and production statistics).

The kettles were supervised by an area chief who had immediate responsibility for the hourly employees. This area chief—along with the purchasers and area chiefs from other areas—would negotiate a production schedule at the start of each week. They would reach consensus on their decisions based upon the number of orders, the required production processes, availability of ingredients, and ship dates. This could be a difficult process for the area chiefs, particularly when a customer called in an order change. Douglas Hyde, Fresh Connections' CEO, commented that "We're currently managing our schedule with more judgement than information." There were currently plans in place to upgrade their software package to improve their scheduling process.

Information Systems

Information systems (IS) at Fresh Connections were used primarily for two key functions, recipe storage and product yield measurement. Recipe storage was done in a standard database application. The inventory of over 5,000 recipes was constantly being updated and improved (see **Exhibit 12** for sample recipe). All the information the company accumulated on a particular product—including shelf-life test results, ingredient modifications, and changes in cooking temperature or time—were regularly updated in the database.

The second key IS function was product yield measurement. This was a crucial component of financial performance in the business. McKenzie explained:

The target product yield, or what percentage product output you expect for any given input of raw materials, is very important to us because we must build that into the price. For example, we would not expect 100% yield for a soup—perhaps 85% would be the right target figure. We need to know the yield with a lot of precision so we can build it into the price we charge customers. Every 1% we lose against the target yield is a big loss for us.

McKenzie was also concerned about the general lack of integration in the entire information system. This was a serious and costly problem:

> If I could turn back the clock, I would invest in an entirely new information system. What I envisioned was a fully-integrated information flow from recipe development to shipping. Unfortunately, I inherited the information system from Waterbury, which had tried to do it on the cheap with a new software firm.
>
> There are only certain segments of the system which actually function, so we are basically dealing manually with the information flow. Several of these items should be measured automatically in a manufacturing facility like ours, not the least of which is yield. To effectively track yield, you need to follow every link in the chain, both the stages where you pick up yield and those where you lose it. We need computer-integrated scales that weigh product and feed the information directly into the system.
>
> Without an integrated system, we have had to go through every product and manually calculate the yield from start to finish. This has obviously been time-consuming and very costly.

Financing

Fresh Connections was initially financed by a combination of bank debt, assumed from Waterbury, and equity from a local "angel network" of investors. In August of 1999, the company was in the process of designing an asset-based re-financing whereby a group of investors would buy the company's manufacturing plant and lease it back to the company.

> This deal would mean that we will have no debt, although we have the fixed costs associated with a lease. The sale/lease back should provide us with some additional working capital, reduce current operating costs and simultaneously position us to raise additional capital to support growth.
>
> We are evaluating the benefits of a broader-gauged financing—possibly bringing in new equity investors. I believe that may be necessary given the way the market is going. We are going to need a lot of money to compete.
>
> In the medium term of 6-12 months, we want to get our volume up, strengthen manufacturing processes, and develop a broader base of customer relationships. This will build the company's financial performance and market value, and give us leverage in the capital markets whatever financial course ultimately is chosen.

McKenzie envisioned a possible joint venture or inviting a larger company to acquire Fresh Connections at some point in the future, but she felt that the immediate task was to build the business.

Distribution

Mary Alice McKenzie explained that there was no "one-size-fits-all-answer" to the distribution process for Fresh Connections products.

> We do not have our own fleet of trucks to deliver product to our customers. Some customers have their own distribution network they wish to use. If so, we look at it and see if it will work for the product we are shipping. If it will not work, we ask the customer if there are other alternatives we can use. For example, if we are shipping a product that has a particularly short shelf life and all the customer is able to offer in the way of distribution is "slotting and picking"—which basically means storage in a warehouse with pick-up and final delivery some time after that—then we will look for other solutions. Perhaps they have a dairy distributor we can use to get the product on the shelf faster?
>
> In other cases, we will work with an independent shipping company, often called a common carrier. The thing that works the best is called cross-docking. This entails unloading directly from the shipping trucks to the store trucks which will deliver the product. That is the best solution for products like ours.

Even though they had customers as far west as Colorado, Fresh Connections usually shipped only as far as the Midwest due to the difficulties and the high cost inherent in transporting fresh products. This meant that Fresh Connections could not work with any customer whose warehouse system was located farther west than Illinois.

McKenzie had thought of a number of options that would allow the company to serve a broader geography. One option would be to set up smaller plants over a wider area. Another particularly intriguing idea that McKenzie was pursuing was to link up with an Internet grocery supplier that was getting into the fresh prepared foods business.

> I have been talking to a couple of Internet grocery companies which are just building infrastructure. These companies are setting up warehouses all over the United States where they store their groceries to ship to the local markets. They are just starting to plan for offering limited menus of prepared foods. Maybe we could link up with one of them. To do that, we would have to site small manufacturing facilities near or at their warehouses. It is an exciting idea for the future—we think that this will be a huge business in a few years.

Conclusion

There seemed to be so many pressing issues at Fresh Connections that McKenzie hardly knew where to begin. Her small company had come a long way in just a year, but there was a tremendous amount of work that still needed to be done. Numerous opportunities presented themselves, but prioritizing what to do first was crucial. Additionally, McKenzie couldn't lose sight of the long-term strategic issues that Fresh Connections faced. What business should they pursue? What segment of the food industry held the most promise? And how should customers be targeted within the segment? How should they compete? What were the capabilities necessary to survive and prosper in this rapidly growing, but turbulent, market? How fast could they grow? Could they get the necessary capital to finance their expansion?

McKenzie contemplated these questions, as she walked from her office into the cook room to greet another potential client. A prominent co-pack company was promising significant volumes if Fresh Connections would agree to produce one of their standard soups. While the deal would provide important production volume, McKenzie wondered if this was the direction that she wanted to take her company.

Exhibit 1 Fresh Connections Income Statement (fiscal year ending June 30)

	Actual	Pro Forma				
(figures in thousands)	Jun-99	Jun-00	Jun-01	Jun-02	Jun-03	Jun-04
Manufacturing Margin	1,951	2,646	3,589	4,858	6,318	8,221
Operating Expenses—Plant	1,205	1,680	1,848	2,033	2,236	2,460
Sales and Development Costs	229	240	288	345	415	498
General and Administrative	586	780	819	860	903	948
EBITDA	(69)	(54)	635	1,621	2,765	4,316
Depreciation and Amortization	298	222	239	459	625	657
Operating Income	(367)	(276)	397	1,162	2,139	3,659
Other Expense/(Income)	(88)	(54)	(29)	(8)	-	-
Interest Expense	192	49	80	123	144	141
Profit Before Taxes	(471)	(272)	346	1,048	1,995	3,518
Less:						
Income Taxes		(109)	138	419	798	1,407
Net Income	(471)	(163)	208	629	1,197	2,111

Source: Company financials.

Note: Figures disguised to protect confidentiality.

Exhibit 2 Fresh Connections Balance Sheet (all figures as of July 31, 1999)

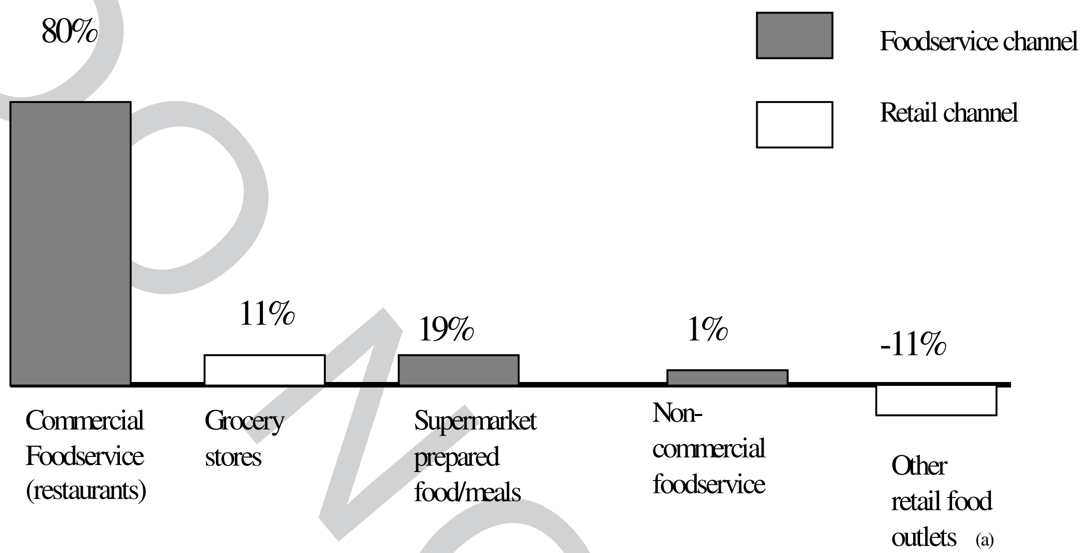
ASSETS			
Current Assets			
Cash		$59,805	
Accounts receivable	$389,022		
Less allowance for doubtful accounts	(121,631)	267,391	
Other receivables		47,892	
Inventory		511,686	
Prepaid expenses		38,237	
Total Current Assets			$ 925,011
Total Plant, Property and Equipment (net)			3,414,508
Total Start-up Costs (net)			85,550
Total Assets			$4,425,069

LIABILITIES AND STOCKHOLDERS' EQUITY			
Current Liabilities			
Accounts payable	$ 670,857		
Accrued payroll and taxes	77,133		
Accrued interest	12,022		
Other accrued expenses			
Current portion of long-term debt	224,400		
Current portion of other debt	82,124		
Current portion of capital lease	81,053		
Total Current Liabilities		$1,147,589	
Long-Term Debt			
Long-term debt	1,061,249		
Capital lease obligation	102,336		
Subordinated shareholder loans	125,000		
Total Long-Term Debt		1,288,585	
Total Liabilities			$2,436,174
Stockholders' Equity			
Common stock		1,500,000	
Preferred stock		1,150,000	
Retained earnings		(189,322)	
Net profit/(loss)—current year		(471,783)	
Total Equity			1,988,895
Total Liabilities and Stockholders' Equity			$4,425,069

Source: Company documents.

Notes: Figures disguised to protect confidentiality.

Exhibit 3 Growth in the U.S. Food Expenditures (1985-95)



Source: Refrigerated and Frozen Foods, June 1999. From McKinsey and Company report.

[a]Includes all retail food other than grocery stores (e.g., club stores, convenience stores, general merchandise stores, drug stores, bakeries, butchers).

Exhibit 4 Sample Product Offerings

SOUPS

CREAM OF BROCCOLI
TOMATO HERB
ROASTED VEGETABLE
CREAM OF MUSHROOM
SMOKED ONION
ROASTED TOMATO BEEF
SPICY COCONUT THAI
BLACK BEAN
CHEDDAR VEGETABLE
CHICKEN WILD RICE
CHICKEN NOODLE
CHILI SOUP
CLAM CHOWDER
CORN CHOWDER
MINESTRONE
NAVY BEAN KIELBASA
RATATOUILLE SOUP
SAUSAGE TORTELLINI
SPINACH TORTELLINI
SPLIT PEA WITH HAM
SPILT PEA - VEGETARIAN
TOMATO CHEESE
TOMATO GARLIC

SIDE DISHES

SMOKED TOMATO CONFIT
CARAMELIZED ONIONS
MARINATED MUSHROOMS
WILD RICE W/CITRUS VINAIGRETTE
MASHED POTATOES: TRADITIONAL, GARLIC, CHEDDAR
SPICED APPLESAUCE

SAVORY BREAD PUDDING
SAVORY POLENTA
VEGETABLE KRAUT
MAPLE BAKED BEANS
RICE PILAF
CREAMED SPINACH
ROASTED ONIONS
SMOKED BLACK BEANS

CENTER OF THE PLATE

BAKED PENNE
CRAB CAKES W/WILD RICE
POACHED SHRIMP W/ROASTED TOMATOES
FUSILLI W/ MARINARA
FUSILLI W/MARINARA u MEATBALLS
MEXICAN STUFFED PEPPERS
WINGS: BBQ, TERIYAKI, BUFFALO, SPICY PEPPER
BEEF TIPS TERIYAKI ON RICE
MEATLOAF
MACARONI u CHEESE
SPICED RIBS W/PEACH BBQ

DESSERTS

SWEET BREAD PUDDING
APPLE CRISP
MIXED FRUIT COBBLER
PEACH BROWN BETTY

SALADS

ORZO EGGPLANT
SZECHUAN BEEF W/VEGETABLES
TORTELLINI W/BASIL PESTO
THREE BEAN W/ONION DIJON
GRILLED CHICKEN PASTA
CHICKEN TERIYAKI SALAD
SESAME NOODLES
MIXED VEGETABLE
CRANBERRY ORANGE
ROASTED CORN W/CILANTRO VINAIGRETTE
ORZO W/SUMMER VEGETABLES

SAUCES AND GRAVIES

ALFREDO
PESTO CREAM CHICKEN GRAVY
ROASTED VEGETABLE GRAVY
BEEF GRAVY
MARINARA

Source: Company documents.

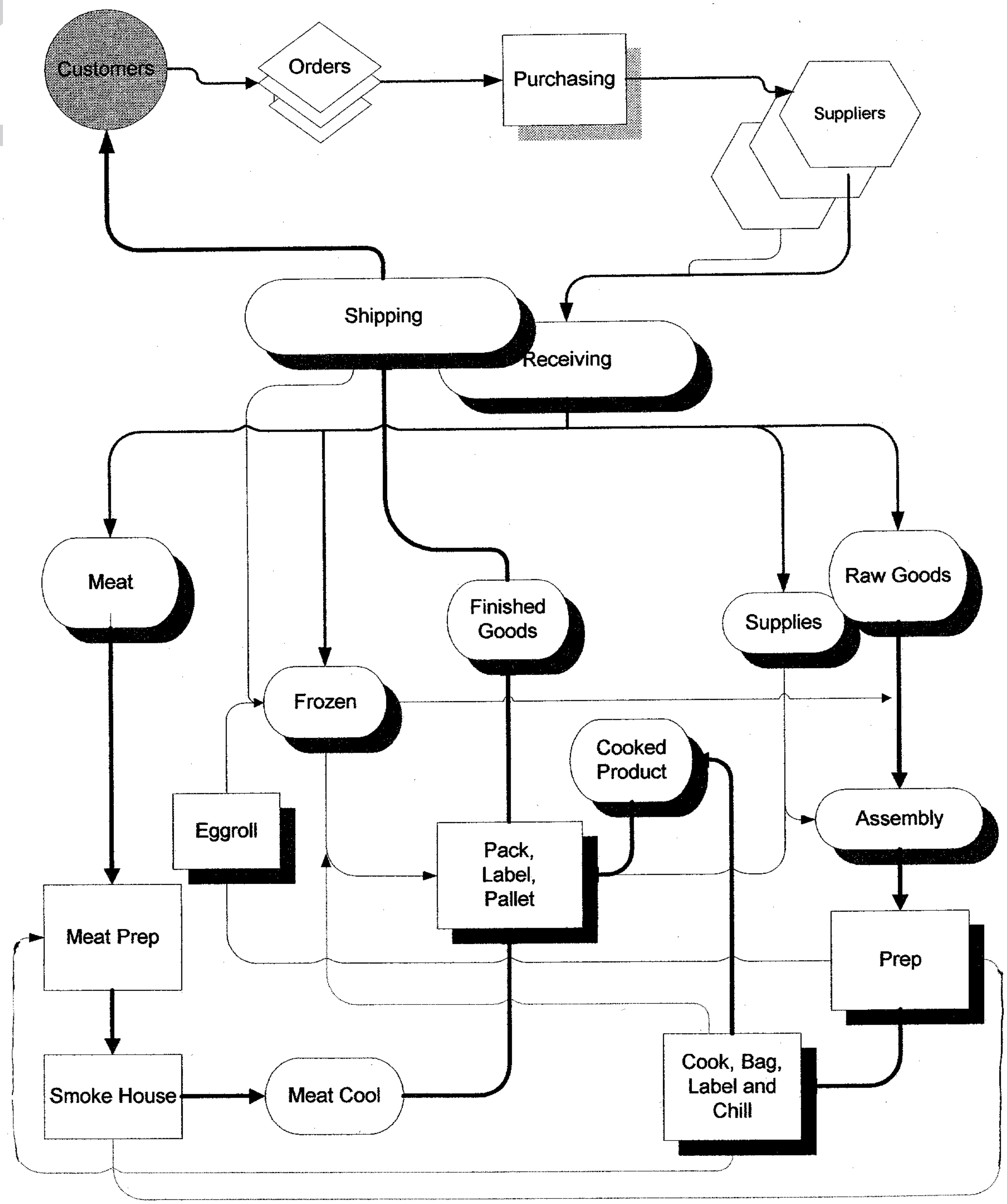
Exhibit 5 Sales by Customer

	1999 Sales ($000)
Morton's Deli	1,860
Riccardo's	1,347
Blue Ribbon	904
Gourmet Coop	834
Tsu's Deli	411
Green Elephant	251
Captain C's Seafood	237
Potato Palace	205
Discount Warehouse	135
Master Market	128
Jed's Chicken Hut	128
Healthy Choice	77
Other	24
Total	6,415
Meat Sales	1,486
Prepared Foods Sales	4,929

Source: Company financials

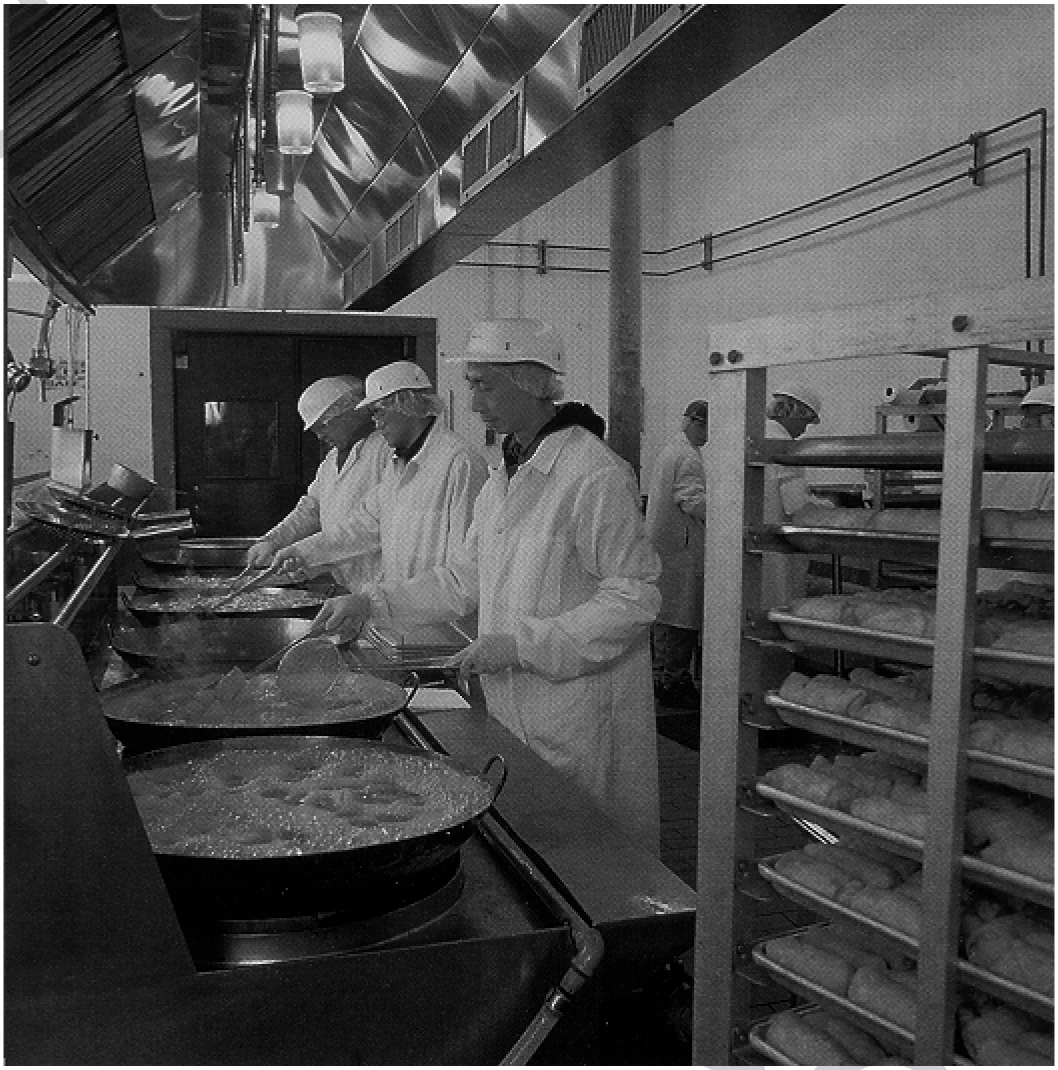
Note: Figures disguised to protect confidentiality.

Exhibit 6 Operations Flow Chart



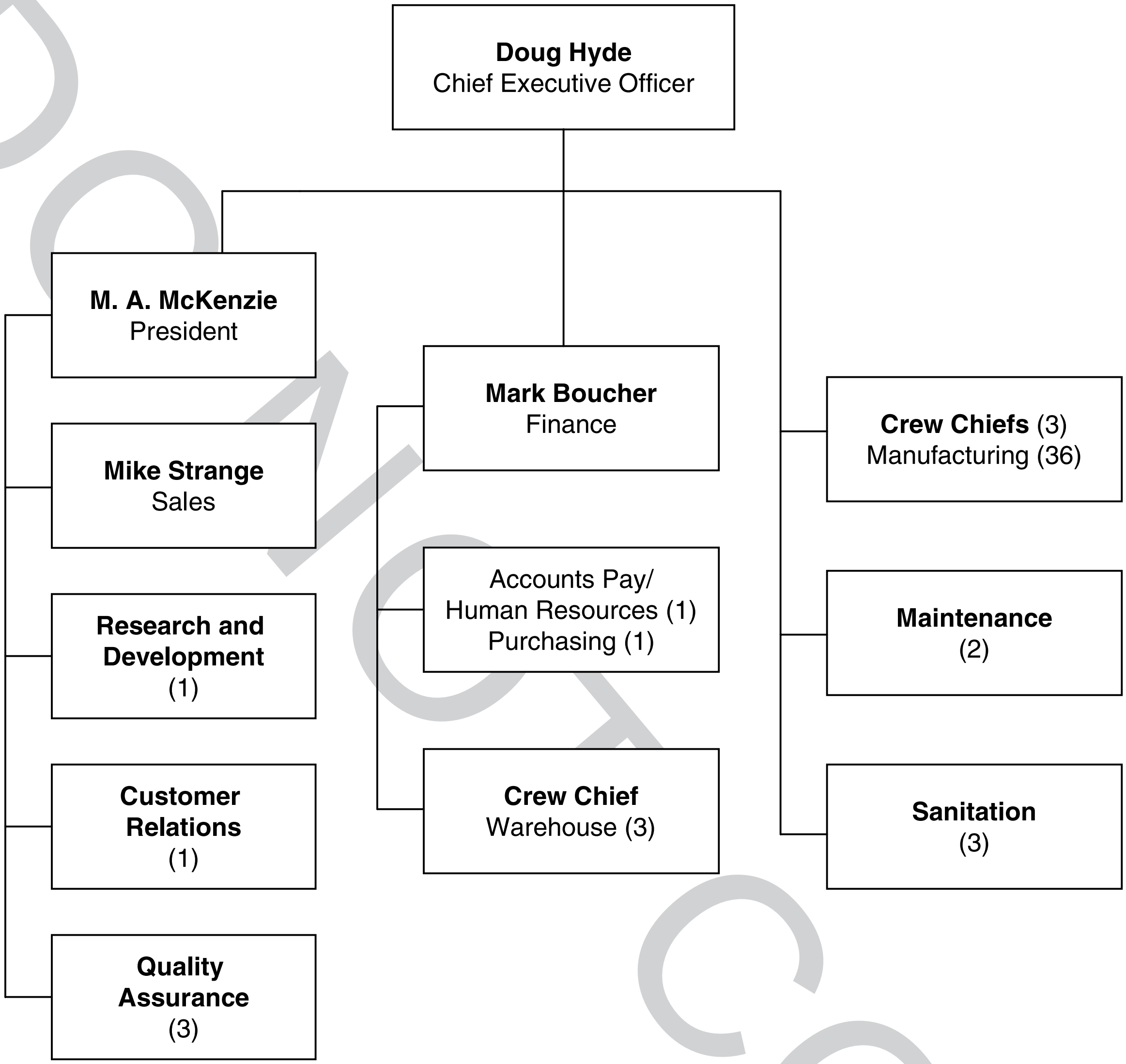
Source: Company documents.

Exhibit 7 Eggroll Production at Fresh Connections



Source: *Meat and Poultry Magazine*, June 1999 (Glenn Moody/Photography, Williston, Vermont).

Exhibit 8 Fresh Connections Organization Chart



Source: Company documents.

Exhibit 9 Plant Layout

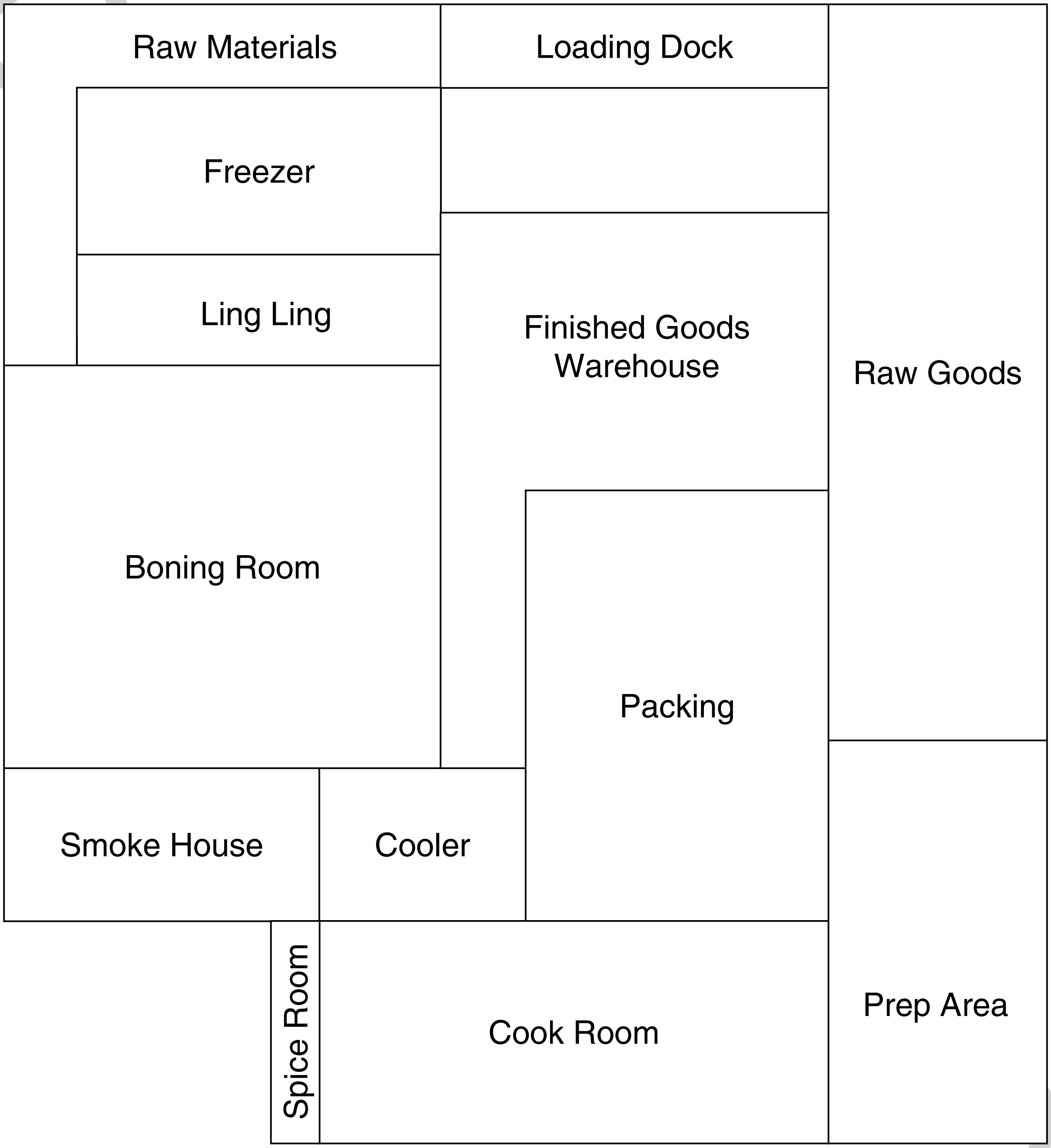


Exhibit 10 Photograph of a Kettle

Exhibit 11 Fresh Connections Sales and Production Statistics (fiscal year ending June 30)

	Actual	Pro Forma				
	Jun-99	**Jun-00**	**Jun-01**	**Jun-02**	**Jun-03**	**Jun-04**
Pounds (K)						
Smokehouses	3,860	5,018	6,524	8,481	11,025	14,333
Kettles	1,809	2,262	2,827	3,534	4,417	5,521
Eggroll	1,087	1,413	1,837	2,388	3,104	4,036
Salad/Other	681	851	1,064	1,330	1,663	2,078
Total	7,437	9,544	12,252	15,733	20,209	25,968
Sales ($K)						
Smokehouses	2,541	3,503	4,824	6,619	8,694	11,420
Kettles	2,103	2,787	3,716	4,935	6,351	8,165
Eggroll	715	985	1,282	1,668	2,168	2,818
Salad/Other	1,056	1,400	1,837	2,404	3,074	3,927
Total	6,415	8,676	11,659	15,625	20,286	26,330
Margin ($K)						
Smokehouses	867	1,195	1,664	2,310	2,999	3,906
Kettles	494	655	866	1,145	1,505	1,976
Eggroll	262	361	469	610	794	1,031
Salad/Other	328	435	590	793	1,020	1,308
Total	1,951	2,646	3,589	4,858	6,318	8,221
Price per Pound	$ 0.86	$ 0.91	$ 0.95	$ 0.99	$ 1.00	$ 1.01

Source: Company financials.

Note: Figures disguised to protect confidentiality.

Exhibit 12 Sample Recipe

ITEM CODE:	**90461**
PRODUCT NAME:	**HERB RUB FOR CHICKEN**
CLIENT NAME:	**JED's CHICKEN HUT**
QUANTITY ORDERED:	**500.00**
QUANTITY TO PREP:	**564.97**

Recipe Ingredients	Amount	%	Batch Lbs.	Cost/ Lb.	Cost/ Batch
Oil, Soy	66.112	77.23%	436.326	$0.54	$235.616
Salt, Sea	12.000	8.49	47.966	0.23	11.032
Thyme, Ground	5.070	3.33	18.814	2.62	49.293
Pepper, Black 26 Mesh	3.500	3.08	17.401	4.20	73.084
Sage, Ground	2.850	2.98	16.836	2.80	47.141
Rosemary, Ground	1.403	1.51	8.531	2.32	19.792
Marjoram, Ground	0.900	1.45	8.192	2.12	17.367
Nutmeg, Ground	0.762	1.20	6.780	3.03	20.543
Paprika, Asta 120	0.233	0.54	3.051	2.60	7.933
Cumin, Ground	0.056	0.19	1.073	4.06	4.356
Total	92.886	100.00%	564.970		$486.157

YIELD 88.50%

Yielded Amount:	**82.204**	**500.000**		$486.157
		Cost/lb.:		$0.972
		Labor:		
		Margin:		
		Pack:		
		Shipping:		
		Total:		$0.972
		Cost/oz.		$0.061

Source: Company documents.

Note: Figures disguised to protect confidentiality.