Assignment 21

Capstone Project

Due Date: TBD (submit on Blackboard)

As a financial consultant at Alexandra Anderson & Company, you and your team have been assigned to work on the WalterCola account, a Fortune 500 soft drink beverage producer. Max Prophet, CEO of WalterCola, has hired you because his managers have divergent opinions regarding WalterCola's proposed entry into the coffee business.

WalterCola's core products are soft drinks, where they currently have a 27% market share. However, soft drink sales are decreasing as consumers turn to coffee drinks. WalterCola's research team developed a can that will heat up its contents at the touch of a button, and recently purchased the right from SunDoes Coffee™ (a leading coffee brand) to use its coffee recipe in WalterCola products.

Preliminary test marketing shows that coffee drinkers are satisfied with the temperature and flavor of WalterCola's coffee product. If implemented, the plan is to sell the new coffee in vending machines and on store shelves alongside Walter Cola in order to leverage WalterCola's brand recognition.

In order to provide a recommendation, you have the collected the following information:

- A new plant would be constructed for $12 billion. Straight-line depreciation will be used. The plant will last 17 years, have a salvage value of $3 billion and a book value of $0 at the end of this time.
- R&D expenses to develop the can were $3 billion, including $1 billion of unpaid bills for R&D materials that are due one year from today. The right to use SunDoes recipe was purchased for $800,000.
- You expect to sell 1 billion cans of coffee the first year, 2 billion in the second, 2.5 billion in the third year. After the third year, sales are expected to grow at 12.5% until they flatten out at 4.004517 billion cans. Sales the first year are expected to be at $1.25 per can. After that, prices will increase with inflation.
- If the plant were operating today, you could produce the cans at a cost of $0.35 each (includes all operating costs). Economies of scale kick in at production levels over 2.5 billion cans at which point operating costs will fall by 15%.
- Accounts receivable will rise by 10% of sales beginning at the end of the first year. Accounts receivable due to the coffee sales will continue to be 10% of sales throughout the project's life. A/R will return to original level at the end of the project's life (i.e., you collect all A/R outstanding at t=17).
- Inventories will increase immediately by 10% of the coming year's operating costs (i.e., inventories rise at t=0 by 10% of the operating costs at t=1). Inventories resulting from this project will continue to adjust so that they are 10% of the coming year's total operating costs, and inventories associated with this project will be fully depleted at the end of the project's life (i.e. inventories associated with this project are zero at the end).

- Similar to inventories, accounts payable will increase immediately by 5% of the coming year's operating costs. A/P resulting from this project will continue to adjust so that it remains 5% of the coming year's total operating costs, and A/P will return to original levels at the end of the project's life (t=17).
- The company's tax rate is 42%, the market risk premium is 6%, and you decide to use a US treasury with 29-years until maturity for the risk free rate. The Treasury's annual coupon is 8.5%, it makes semiannual coupon payments, has a $10,000 face value, and currently sells for $9864.50.
- The risk of producing this product has similarities to both the coffee industry and the canned beverage industry. Half the project can be thought of as a "coffee" company and half as a beverage company. Your assistant gives you the following information on some pure play companies:

Company	Industry	$B_{Leveraged}$	D/E
StarDoes	Coffee	1.70	7%
Foglers	Coffee	1.80	37%
Pipsi	Soft Drink	0.80	43%
WalterCola	Soft Drink	0.75	50%
Dr. Salt	Soft Drink	0.90	47%

- WalterCola has bonds outstanding with $1,000 face value, 11% annual coupon, and 8 years to maturity. They sell for $945.38.
- Inflation is expected to be 3% annually and will increase both operating costs and sales prices accordingly.
- Currently, WalterCola has 200 million shares and a stock price of $84.
- WalterCola plans to finance the project with half equity and half debt.

Finally, you interview two WalterCola managers that disagree about the project's profitability, and they give you the following information. The first manager believes that the coffee product will reduce sales of WalterCola soft drinks, and that the free cash flow attributable to the coffee product should be reduced 30% to capture the loss of soda sales. The second manager thinks that soda sales will decrease whether or not WalterCola pursues the coffee product because its competitors might decide to do it.

Assignment

Write up a report with a recommendation. Your analysis should address both manager's opinions. Your recommendation must be to accept or reject this project. The write-up should not exceed 250 words. You should clearly state your recommendation (one sentence). Also convey whether your recommendation is a "slam-dunk" or not (one or two sentences). Finally, include the key factors or additional information that would sway your opinion (one paragraph). You do not need to have a long write-up: make it short and to the point. The bulk of the analysis should be in your tables (which you must also submit). The report should be a professional memo format.