Growing a Business - Final Report
BA 385T - 9:30am Section
Kelly Kamm

Growth and Value Creation - Sunflower Nutraceuticals

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Background of Company

Sunflower Nutraceutical

Sunflower Nutraceutical (SNC) is a direct-to-consumer retailer of dietary supplements based in Miami, Florida. The company was founded in 2006 as an internet-based distribution. SNC offers health centric products for women of all ages and currently has a selection of 50 third party brands. In 2012, SNC broke even with relatively flat annual sales growth. They operate with generally thin margins and are working-capital intensive. In the initial start up phase, our executive team, Casey Copeland and Sophia Scott, set a solid foundation for Sunflower Nutraceutical. From 2010-2012, SNC had an EBIT margin of 4.87% and a net profit margin of 1.51%. From 2012 - 2020, we invested in various opportunities in order to create value and grow SNC.

Our credit line is currently at 8% and can borrow up to $3.2M. Moving forward we are seeking funding beyond our initial current credit line of $3.2M. We have paid down all our initial debt and have outlined our 2012 - 2020 strategy for growth and added value. With our leadership and decision making skills, we know Sunflower Nutraceutical can become an industry leader.

Nutraceuticals is a relatively new industry experiencing ample growth, as products pick up in exposure, accessibility, and popularity. The industry is forecasted to grow at a compound annual growth rate (CAGR) of 8.9% from 2020 to 2028. SNC plans to capitalize on this projected growth and needs a larger credit line in order to expand our scope and continue growing.

Overview of Growth

The Past Ten Years

Beginning in 2012, as CEO, I knew it was imperative for SNC to improve the holistic health of the company to guarantee that we can continue to grow. My CFO and I evaluated investment opportunities every three years to increase total firm value and improve our margins. With each option we evaluated the expected cash flows for each project to determine the NPV, increase in working capital and operating margin. We invested in all projects with a positive NPV. Below are the projects we evaluated and selected in order to improve Sunflower Nutraceutical business strategy and our position in the market.

Projects Available

<u>Projects for Phase 1:</u>

Acquire a New Customer: Add Atlantic Wellness, a large and successful health good chain as a new corporate customer for its herbal nutraceutical product line. This opportunity would increase sales by $4M per year and EBIT by $260,000.

Leverage Supplier Discount: Partner with Nutrilife on a half-size contract for its herbal nutraceutical product line. This opportunity would increase sales by $2M per year. Along with this new contract, a supplier of Nutrilife would help lower SNC's account payable liability to $153,000 thereby realizing a 2% discount on raw materials.

Tighten Accounts Receivable: Drop accounts that exceed SNC's 90 day average collection period. This opportunity will decrease sales by $2M and improve days of sales outstanding.

Drop Poorly Selling Products: Eliminate slow-moving items from inventory. This would decrease sales by $1M, EBIT by $65,000, but lower the days sales of inventory to 86 days.

<u>Projects for Phase 2:</u>

Pursue Big-box Distribution: Partner with a national distributor with more than 2,000 stores across the country. This opportunity would increase sales in 2016 by 25%, 2017 by 10%, and 2018 by 5% as well as reduce DSO. However margins will drop from 6.5% to 6%.

Expand Online Presence: Work with Holden Years Nutraceuticals, a much larger online distributor. This opportunity would increase sales in 2016 by 10%, 2017 by 5%, and 2018 by 3% as well as reduce DSO.

Develop a Private-label Product*:* Develop a high-end organic nutraceutical line for Fountain of Youth Spas. This opportunity would increase sales in 2016 by 5%, 2017 by 4% , and 2018 by 3% as well as increase overall margin DSO and DSI.

<u>Projects for Phase 3:</u>

Acquire a High-risk Customer: Add a large customer, Midwest Miracles. However, the company has a significant amount of debt. This opportunity would increase sales by 30% in 2019 and EBIT by 1% but increase DSO significantly.

Renegotiate Supplier Credit Terms: Accept payment terms from main vendor Dynasty Enterprises. This opportunity would reduce cost of sales by $200,000 and accounts payable by $812,000. It would also help create more favorable terms with other suppliers.

Adopt a Global Expansion Strategy: Add a new client, Viva Familia, a family oriented retail chain in Latin America. This opportunity would increase sales by 3%; However, it would marginally decrease DSO and DSI.

My CFO took the time to evaluate the true impact of these projects to ensure we moved forward with the best decisions at each phase.

In Phase 1, we found that adding an additional new customer had a negative NPV and did not improve our operating margin. It would grow sales, but the problem is that the net margin is tight and the investment in the first year is very high. This project was declined as it would destroy **$224,000** worth of value. Renegotiating supplier credit terms had a positive NPV and would improve our operating margin. This project was accepted as it would generate **$27,860** in value. Tightening Accounts Receivable would increase working capital by **67.35%** in the first year, despite the decrease in sales, the project has a positive NPV and shortened SNC's collection period. The benefit of lowering our collection period will have more long-term benefits for our company compared to the short-term reward of more sales. This project was accepted as it would generate **$552,684** in value. Lastly, dropping poor performing products would decrease sales; however, it would increase working capital by **51.90%** in the first year and nothing after, the project also had a positive NPV. The project had the largest impact on decreasing the time inventory stayed idle within the company. The project was accepted as it would generate **$138,392** in value. The changes made for phase 1 resulted in increasing SNC's firm value by **$721,000,** with a total firm value of **$3,969,000.**

In Phase 2, as we analyzed our projects, we concluded that pursuing big box distribution would decrease our operating margin to **5.28%,** despite the marginal improvement we would see in sales the project required working capital investments for each of the years in phase 2 thus resulting in a negative NPV. The project was declined as it would destroy **$110,688** in value. Expanding SNC's online presence would have the largest effect on sales but requires an increase in working capital each year. The project was accepted as it would generate **$320,870** in value. Developing a private label does result in a substantially larger operating margin and increase working capital each year. The project was accepted as it would generate **$880,017** in value. The changes made for phase 2 resulted in increasing SNC's firm value by **$856,000** with a total value of **$4,825,000.**

In our final phase, we evaluated the potential of adding a high risk customer using a higher expected return (WACC) of **16%** due to the more unstable credit history of the company. The project would increase operating margin to **11.89%;** however, there was no growth in sales after the first year. The project was still declined as it destroyed **$203,710** in value. Negotiating supplier terms effectively decreased cost of sales by **$237,000** and accounts payable by **$923,000** every year**.** The project was accepted as it would generate **$412,680** in value. Globally expanding SNC increased sales in the first two years and resulted in a higher operating margin. The project was accepted as it generated **$99,642** in additional value. The changes made for phase 3 resulted in increasing SNC's firm value by **$257,000** with a total value of **$5,082,000**.

Analysis of Financial Performance

Historical (2010 - 2012):

We had a Price to Book ratio of **.4**, a Return on Assets of **2.64%**, and a Return on Equity of **9.35%**. Considering these figures are representative of our first 6 years of operations, they are relatively normal for companies in the start up phase. We see them as a solid starting point for the following 10 years, and plan to increase both ROA and ROE. We see a low ROA, as we are a capital intensive company and during start up had to invest in many assets before we saw the returns we wanted. Our starting cash conversion cycle averaged at **160 days**, accounts receivable turnover **112 days**, and inventory turnover **89 days**. Profit margins for this phase were slim at **1.51%**. A real focus of the next 10 years will be to increase these margins.

Phase 1 (2013 - 2015):

We chose to tighten accounts receivable, drop poor performing product lines, and leverage a supplier discount. These projects decreased the sales growth rate by **-3.33%**. However, the investments did improv our cash cycle, freeing up cash for the following phases to come. While sales decreased, profit margins increased, EBIT from **4.87%** to **6.91%**, and Net

Income from **1.51%** to **3.11%**. Despite a decline in overall sales, SNC had a larger NI for this phase, and our Price to Book ratio more than tripled from **.4** to **1.86**. ROA increased to **6.17%**, ROE increased to **12.16%**, and debt to equity decreased from **54%** to **30%**. We focused on improving our cash cycle. Cash Conversion cycle dropped to **137 days** and accounts receivable dropped to **90 days**. We created equity value by improving margins, decreasing debt, and increasing cash flow. Each of these 3 projects were crucial for the initial growth phase as we focused on restructuring SNC for sustainable performance.

Phase 2 (2016 - 2018):

We expanded our online presence and developed a SNC private label line. These two decisions increased sales by **9.61%**. We increased sales and profit overall, EBIT rose to **8.67%** and profit margin to **4.81%**. ROE rose to **14.79%**, ROA to **9.93%**, and price to book **2.27**. These three ratios show our continued, positive trend upward of SNC's overall financial performance. We really see our financial stability solidify in this phase, as debt to equity falls to **13%** and our interest coverage ratio rises from **4.4%** to **13.75%**, showing our ability to pay off our debts owed has greatly increased. Our cash cycle ratios stayed relatively stable, the last phase focused on improving the cash cycle, and phase 2 focused on sales growth. Cash flow went into the negatives as we switched strategies, tying up cash in working capital to expand sales by launching SNC's private label and improving online offerings. The phase 2 cash conversion cycle was **135 days**, accounts receivable **84 days**, and inventory **89 days**.

Phase 3 (2018 - 2020):

We renegotiated our supplier credit terms and adopted a global expansion strategy in order to further grow sales and reduce costs. Sales growth is at **2.33%**, ROA up to **12.56%**, and ROE at **13.65%**. Because we renegotiated credit terms, our cash conversion cycle is back up to **162 days**. A larger cash conversion cycle is no longer a large concern for SNC as profit margins, sales, and overall operations have grown. EBIT margin is now at **10.51%**, and Net Income margin at an all time high of **6.21%**. We are no longer operating with such slim margins and have created substantial equity for SNC. Our price to book is at **2.34**, grown from the initial **0.40**. Debt to Equity was **9%** in 2019, and we have become an all equity firm since 2020. As of now, we have no debt and no interest coverage.

Outcomes:

In order to add company value, it takes a variety of strategies and decisions. Sales will not always grow, sometimes it is important to prune the tree before you grow it, getting rid of non-lucrative branches. We did so in phase 1 and 3, by dropping poor performing products and skipping out on customers that were not positive NPV. Cash flows can be positive or negative depending on the strategy you are employing. For reference, phase 1 we have very positive cash flows as we freed cash and geared up for the coming years. Phase 2 and 3 had negative cash flows as we invested in company expansions. Cash flows are a reflection of the tactics you are pursuing, in all phases we increased margins and overall income, regardless of whether cash flows were negative or positive. If projects such as big box distribution in phase 2 or the high risk customer in phase 3 had larger expected rates of return, turning the project NPV positive, we may have accepted them. ROA and ROE consistently increased in each phase, net margins consistently increased, these ratio constant increases display our ability as CEO and CFO to create value. 2012 compared to 2021, we are a less risky investment and have created increased value for our shareholders, as price to book went up alongside the ratios mentioned previously.

Conclusion

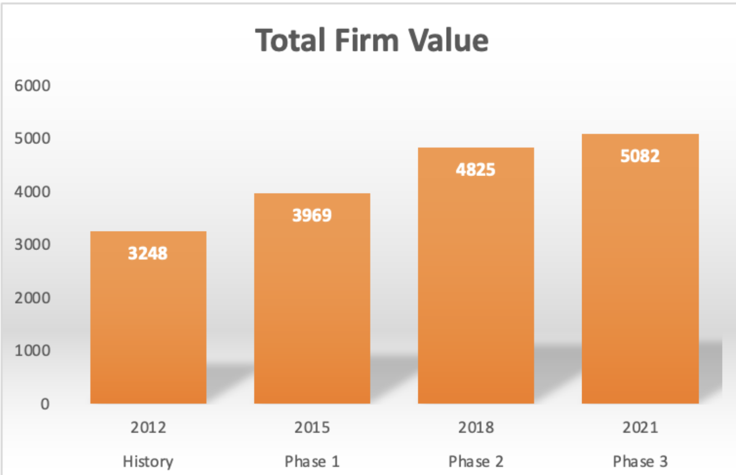
Since 2012, we have strategically taken on projects every three years that have resulted in SNC's total firm value to grow by **56%**, a cumulative added value of **$1,834,000**. SNC is no longer the new and unstable company it once was. SNC has a strong online presence with a nationwide reach and most recently has become a new entrant into the global market. SNC has grown in their relationships with their suppliers while also investing in their own private label as a way to bolster their own brand.

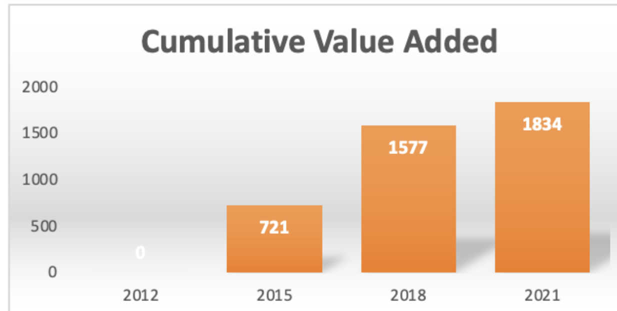
My CFO and I have worked fervently to not only expand this company but to also make it financially stable and prosperous. Back in 2012 the company was made up of almost **90%** debt. However, as we focused our attention on creating more value for our investors and decreasing the amount of leverage SNC held, our ROE increased over **4%** and our ROA increased about **10%** in our 10 year period. As a result our market to book ratio grew to be over **4 times** the original value thus showing the ample amount of value we have been able to add to this company in the eyes of its investors. We have positioned SNC to be an all equity firm; therefore a stronger and reliable company to invest with. The changes we implemented also increased sales by **27%** over the three phases despite not having any new sales in our last year of operation (2021). The growth in ROA and ROE also allowed SNC's net income margin to grow every year in our three phases, where the last year of operation had a net income of **$798,000** versus **$236,000** in 2012.

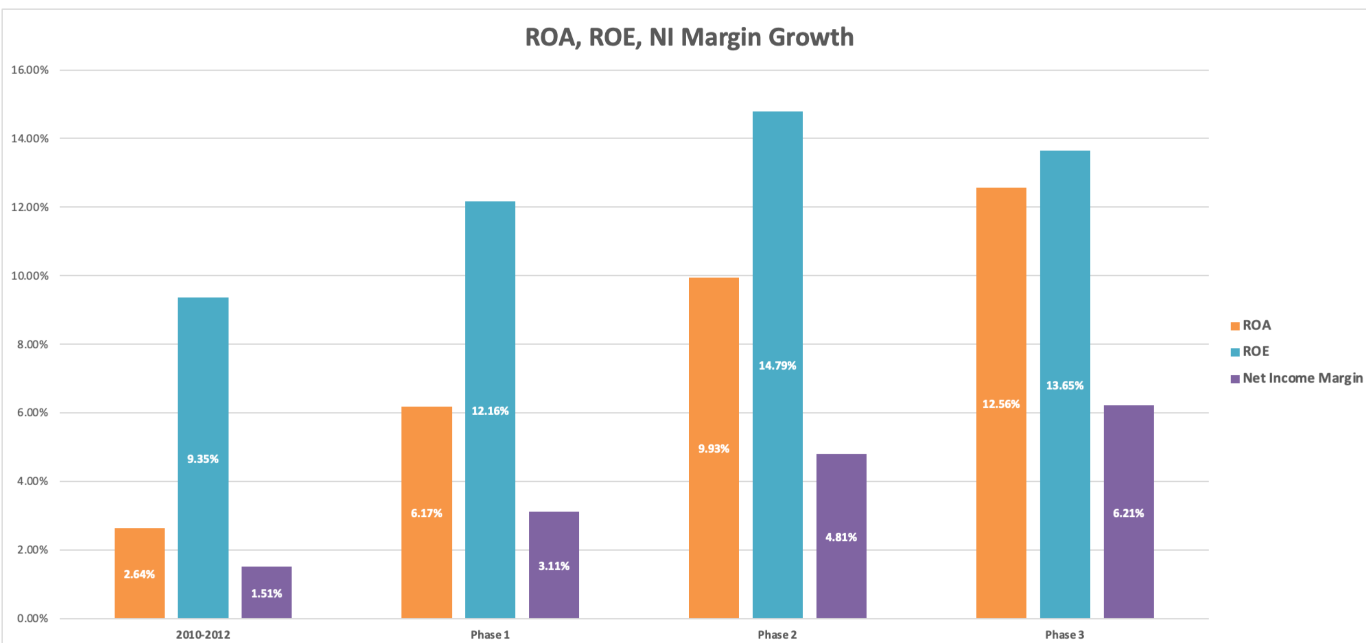
In the next five years, We believe SNC should focus their attention on growing their presence in the global market as well as invest more in their private label to be seen as a more reliable and independent company. If done correctly, SNC would be able to increase their sales as well as their net income margin as focusing more product sales in-house would help to decrease the cost of goods sold. Investing in product development would be a smart decision for this now well-established, equity-focused company as SNC has proven they can handle the responsibility of issuing debt to cover the initial research and development costs.

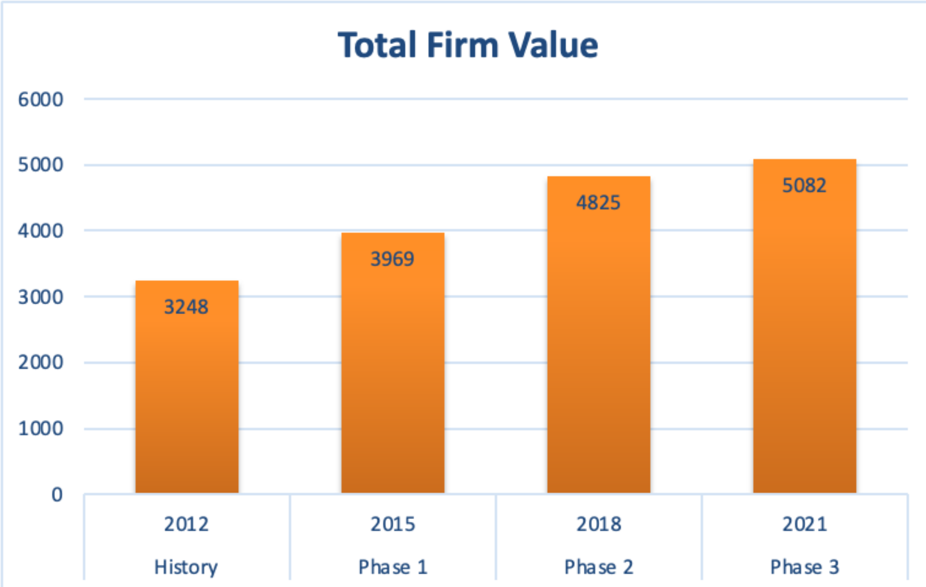
Exhibits

Overall Growth

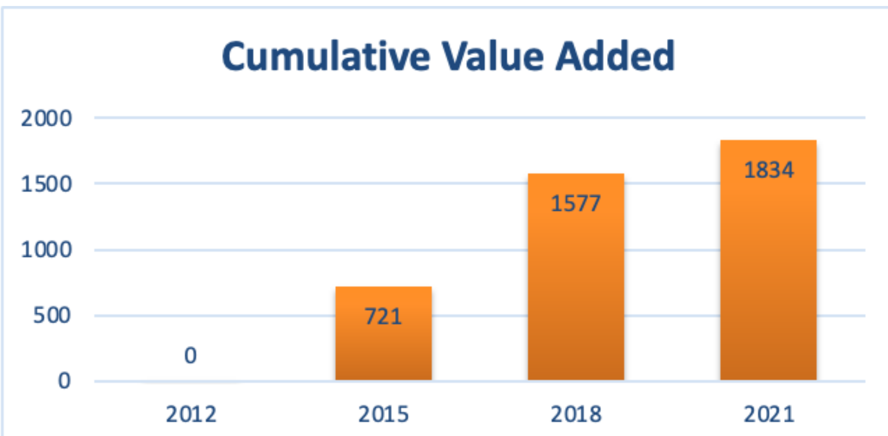




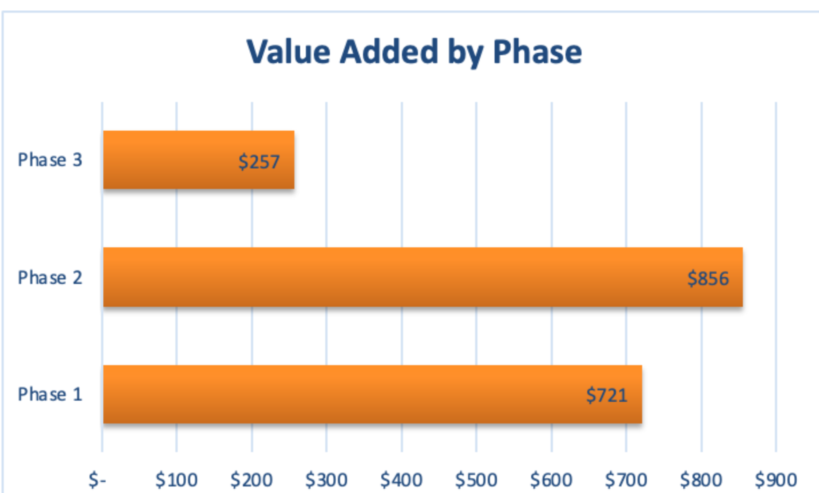




Total Firm Value
6000
5000
4000
3000
2000
1000
0
3248
3969
4825
5082
2012
History
2015
Phase 1
2018
Phase 2
2021
Phase 3

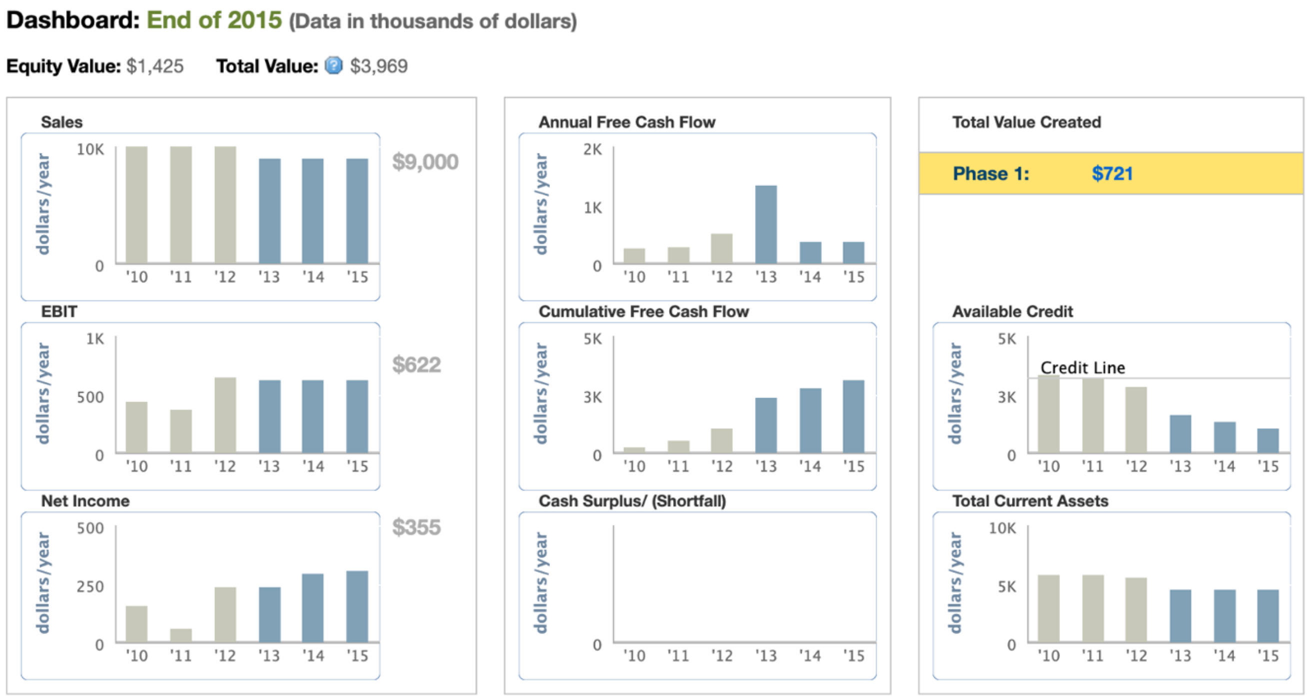


Cumulative Value Added
2000
1500
1000
500
0
0
721
1577
1834
2012
2015
2018
2021



Value Added by Phase
Phase 3
$257
Phase 2
$856
Phase 1
$721
$-
$100
$200
$300
$400
$500
$600
$700
$800
$900

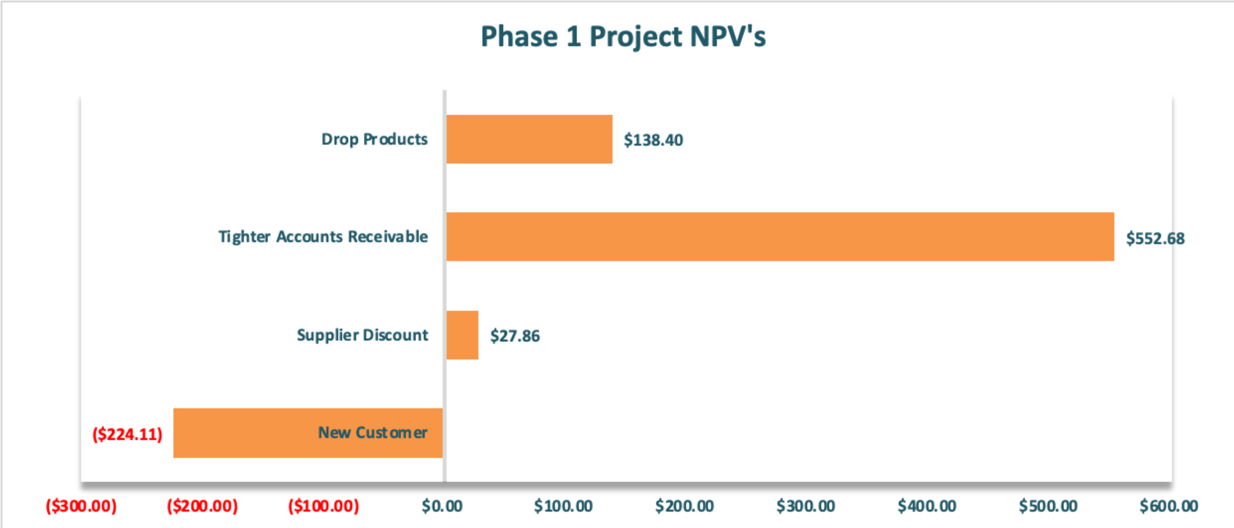
End of Phase 1 Dashboard

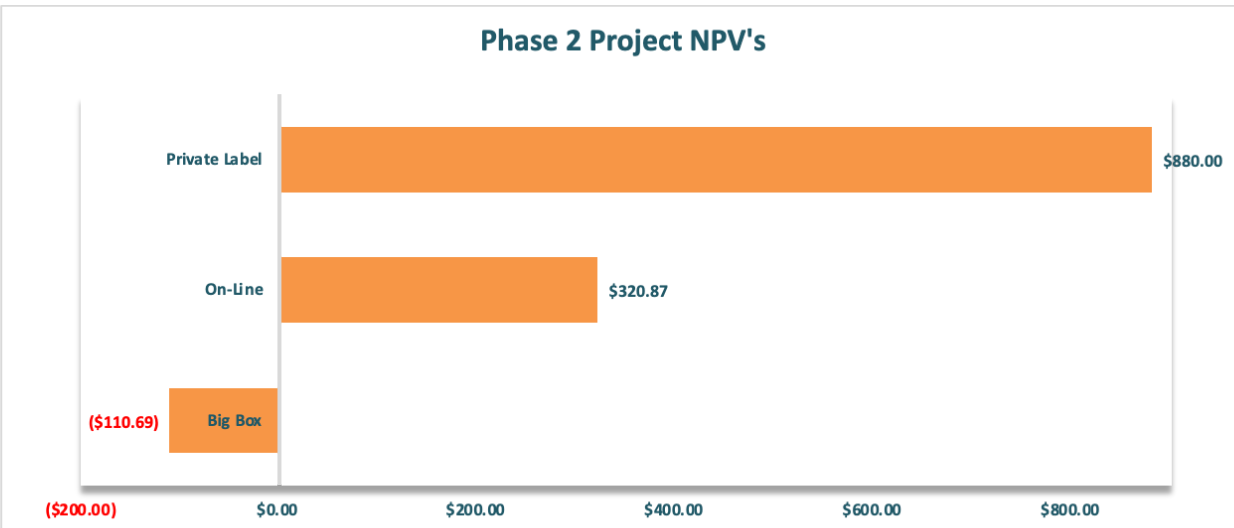


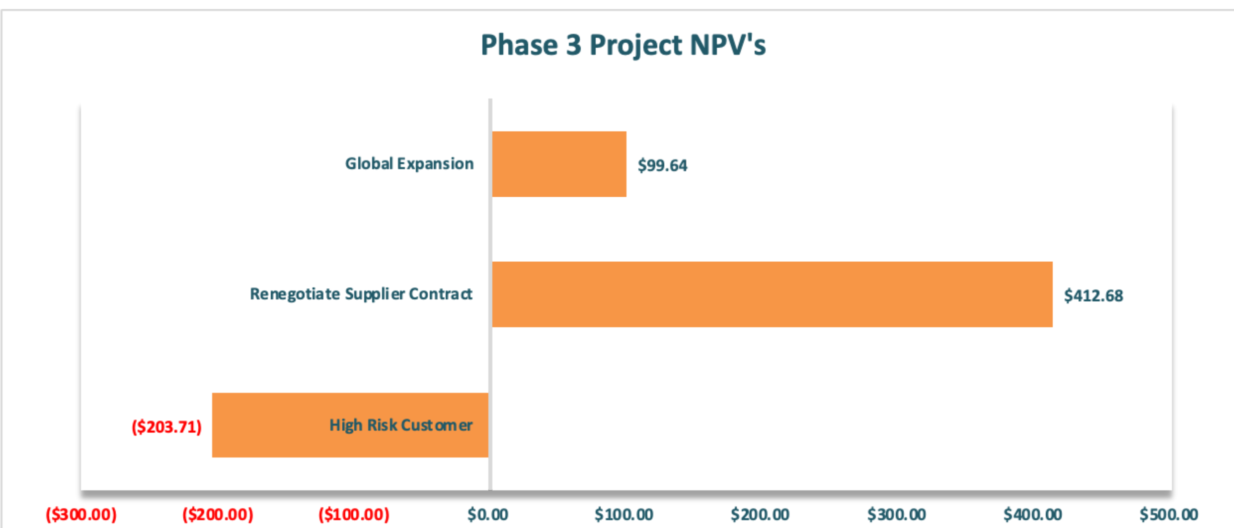
End of Phase 2 Dashboard

End of Phase 3 - Completed Dashboard

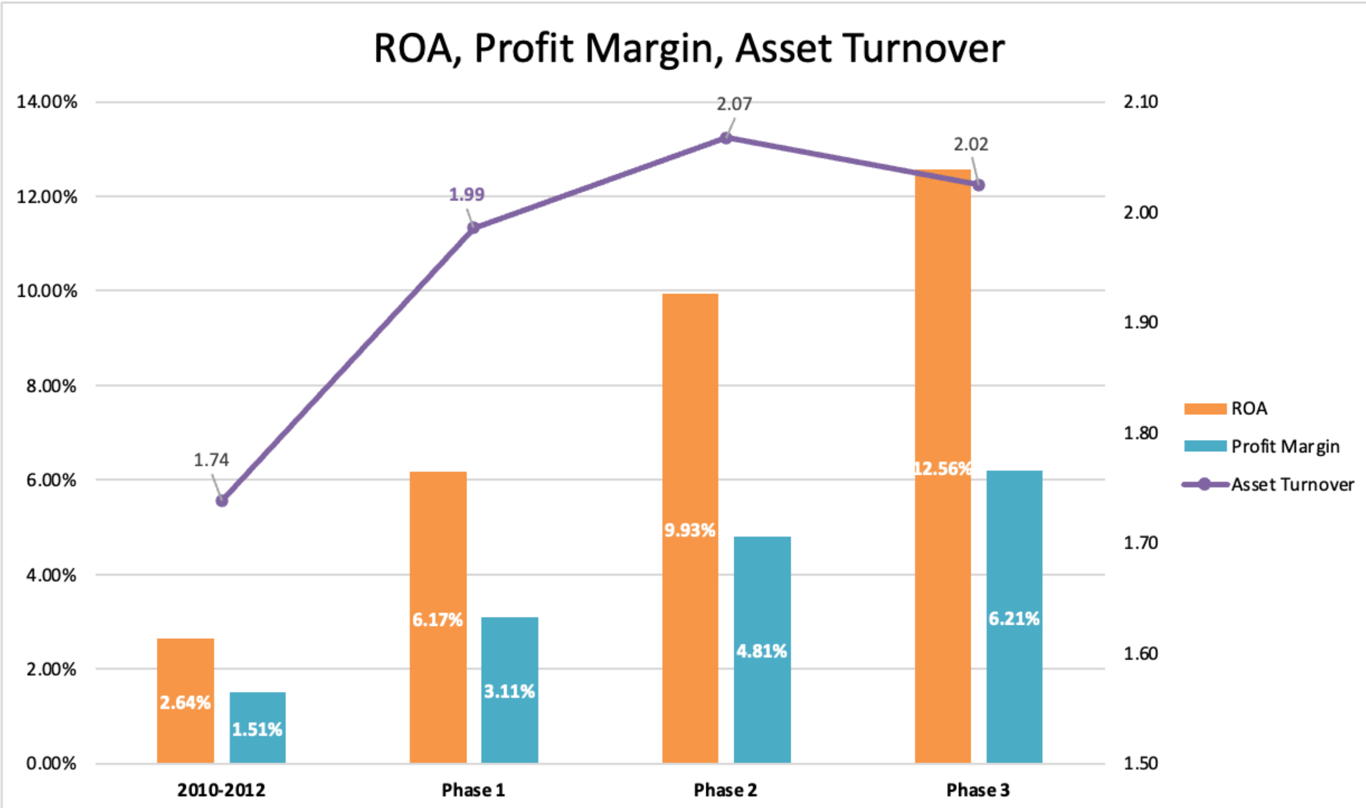
NPV Exhibits

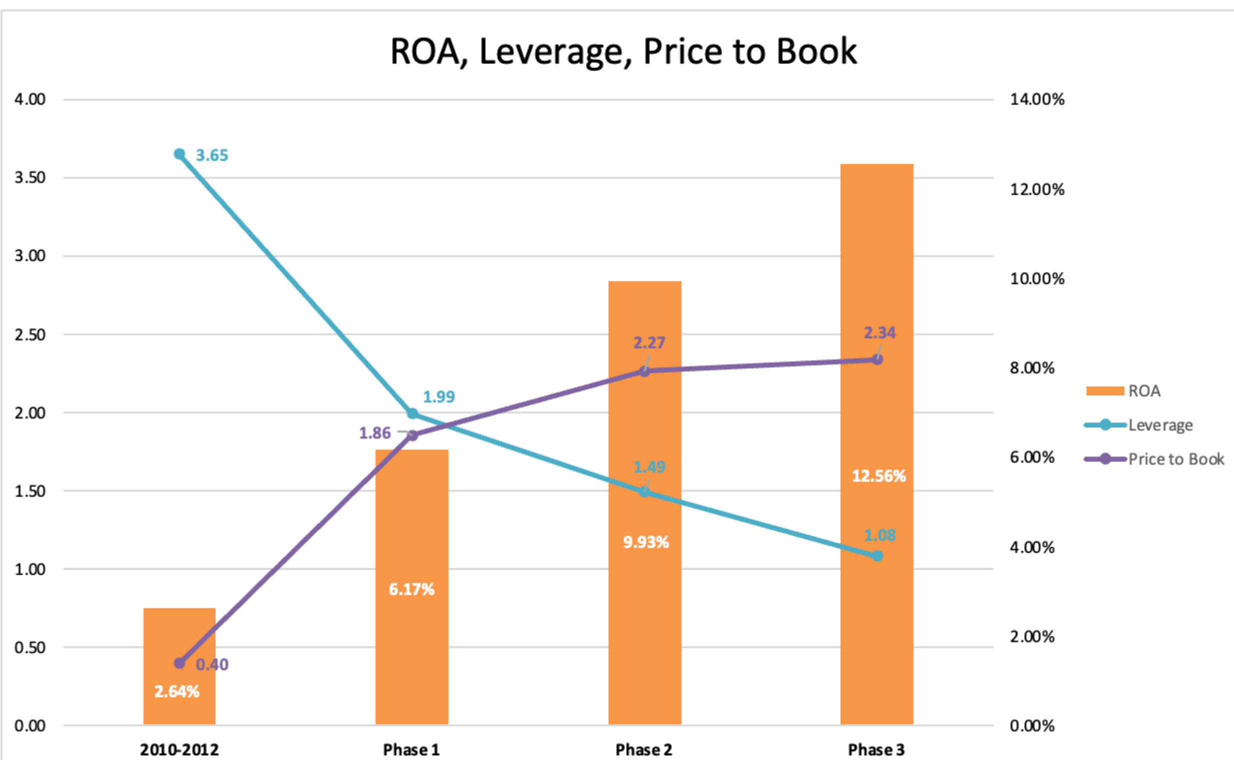


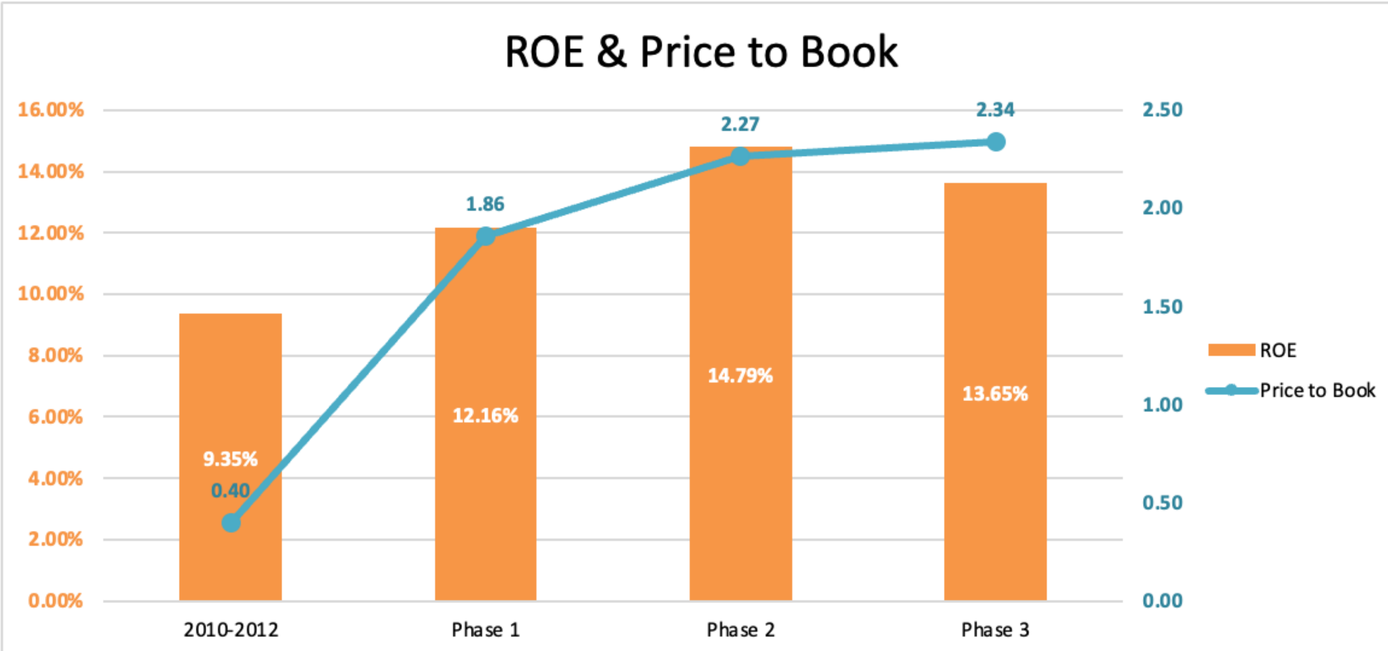


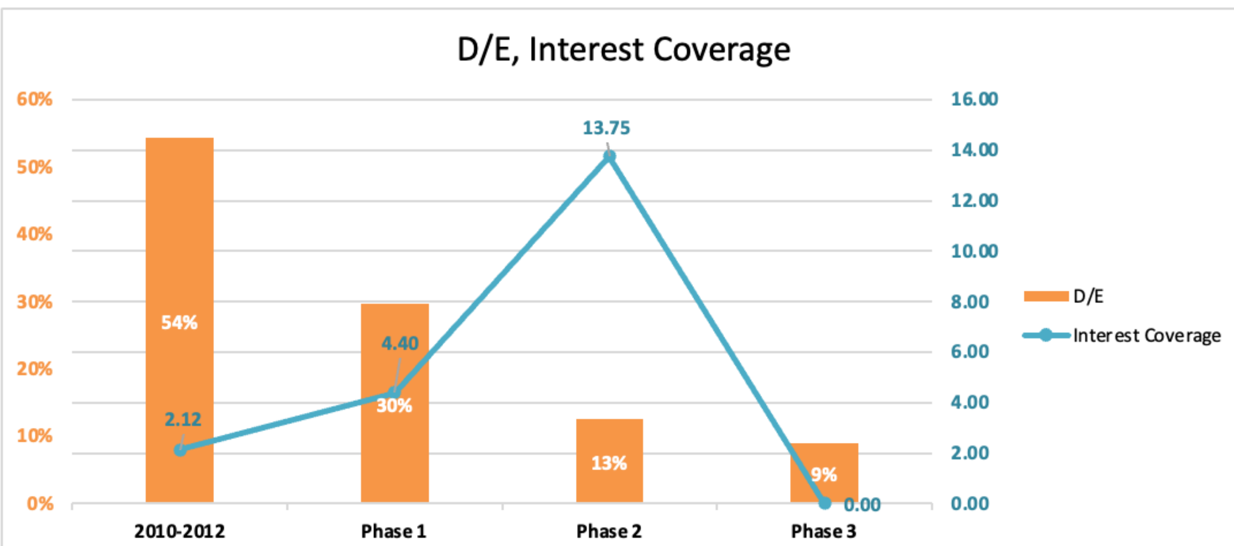


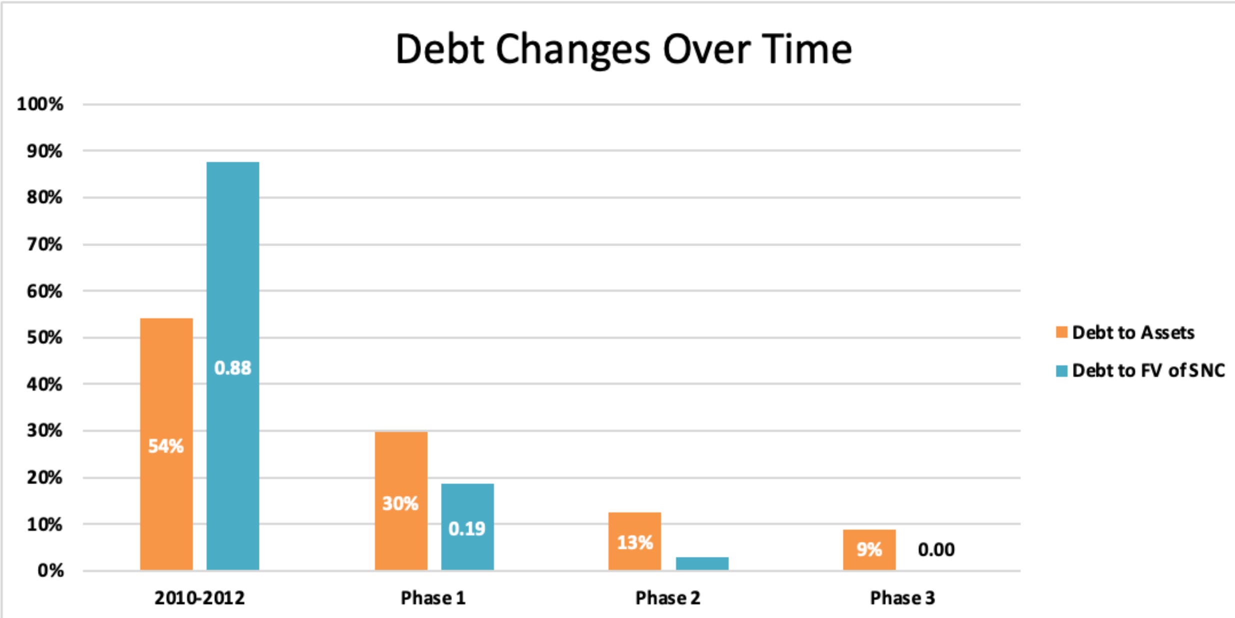
Balance Sheet Exhibits

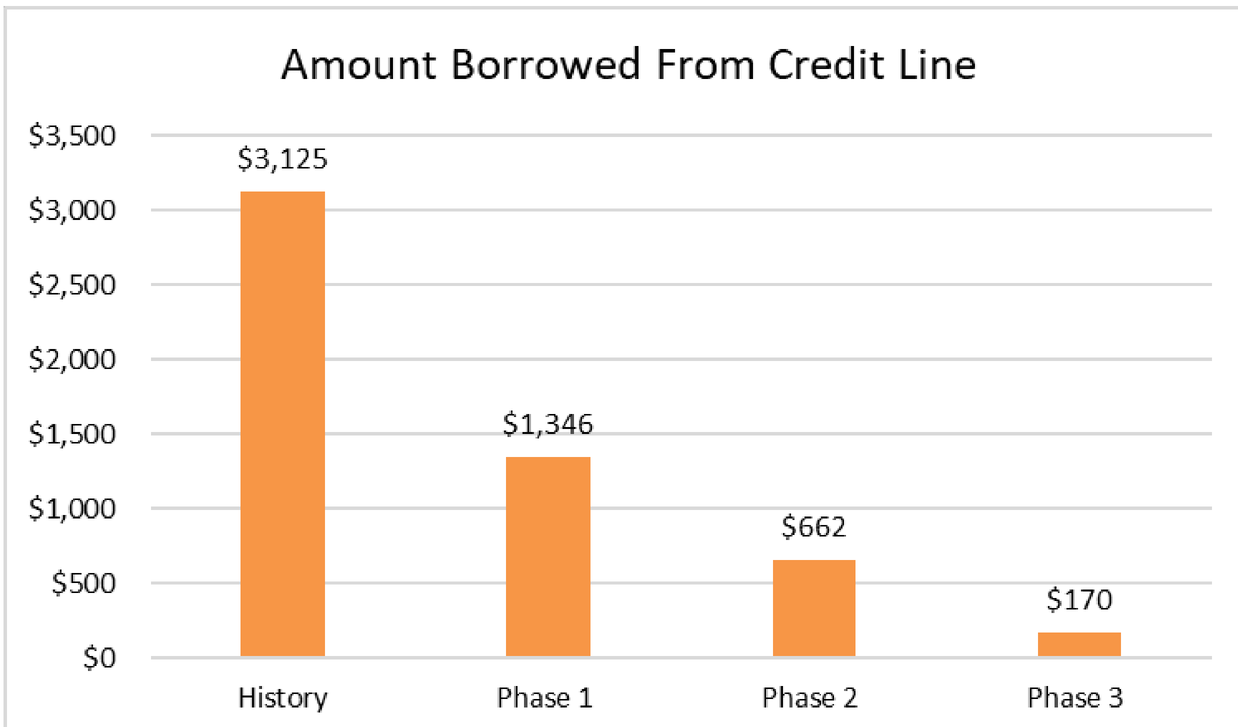




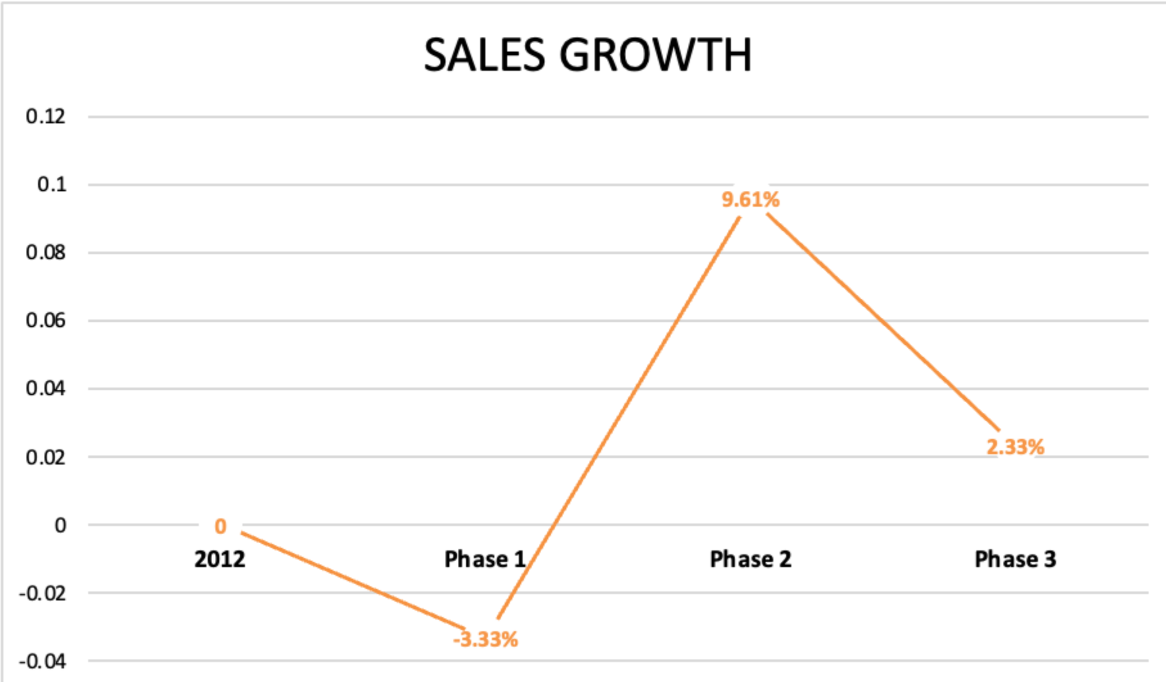

ROE & Price to Book
16.00%
14.00%
12.00%
10.00%
8.00%
6.00%
4.00%
2.00%
0.00%
2.50
2.00
1.50
1.00
0.50
0.00
9.35%
0.40
12.16%
1.86
14.79%
2.27
13.65%
2.34
2010-2012
Phase 1
Phase 2
Phase 3
ROE
Price to Book

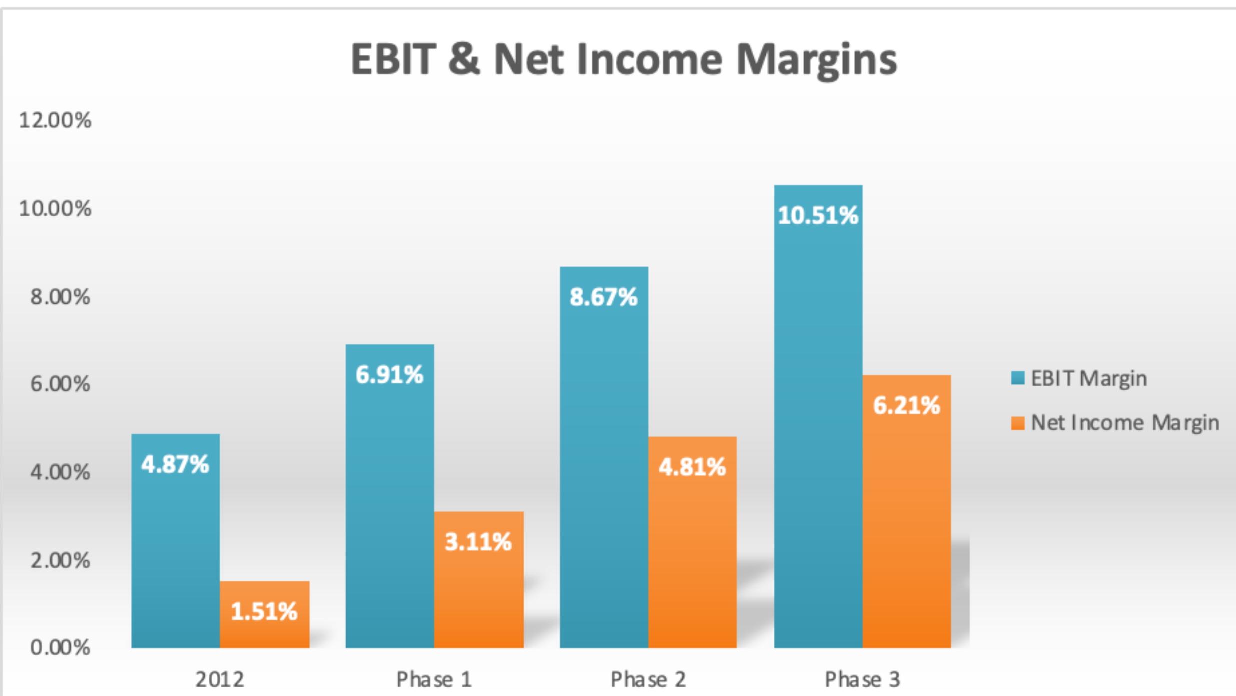

D/E, Interest Coverage
60%
50%
40%
30%
20%
10%
0%
16.00
14.00
12.00
10.00
8.00
6.00
4.00
2.00
0.00
54%
2.12
30%
4.40
13%
13.75
9%
0.00
2010-2012
Phase 1
Phase 2
Phase 3
D/E
Interest Coverage


Debt Changes Over Time
100%
90%
80%
70%
60%
50%
40%
30%
20%
10%
0%
54%
0.88
30%
0.19
13%
9%
0.00
2010-2012
Phase 1
Phase 2
Phase 3
Debt to Assets
Debt to FV of SNC


Amount Borrowed From Credit Line
$3,500
$3,000
$2,500
$2,000
$1,500
$1,000
$500
$0
$3,125
$1,346
$662
$170
History
Phase 1
Phase 2
Phase 3

Income Sheet Exhibits





Cash Cycle Exhibits