HARVARD | BUSINESS | SCHOOL

9-813-085
JANUARY 18, 2013

THOMAS EISENMANN
ALEX GODDEN

MuMaté

In their Seattle offices in May 2012, Sarah Maxwell and Angela Taylor, co-founders of the cult beverage company MuMaté, prepared to receive an email from Jonathan Cantor and Ed Rodriguez, associate and general partner, respectively, with the venture capital firm DuPage Ventures (DPV). The email would present Chicago-based DPV's proposed term sheet for the startup's first funding round, which was required to fuel national growth. Assuming that MuMaté's co-founders felt that DPV's proposal warranted further discussion, Cantor and Rodriquez would fly to Seattle in two days for face-to-face negotiations.

Background

Sarah Maxwell had entered Wharton's MBA program in 2007 with the goal of starting her own company. Based on her pre-MBA experience at Innocent, a UK-based company that sold an upscale "smoothie" drink, Maxwell recognized that affluent, overworked young professionals would pay a premium for convenient access to products that improved their frequently unhealthy lifestyles.

Targeting this opportunity, Maxwell moved to Seattle upon graduation in June 2009, where she assembled and operated a small fleet of commuter carts that sold healthy breakfasts, snacks and drinks in downtown locations. Maxwell bootstrapped her business, renting the carts and funding initial working capital from her personal savings and credit card debt. Within a few months, she was earning a modest profit. Maxwell had particular success in selling MuMaté, a vegan protein tea that had an intensely loyal customer base.

MuMaté was created in 2008 by Angela Taylor, a Seattle native who had left a successful career in public relations six years earlier to become a yoga teacher and freelance PR consultant to organizations promoting healthy lifestyles. On one of her frequent trips to India, Taylor discovered a bland beverage, popular among local yogis, with high levels of healthy fat and protein. The vegan drink was based on an indigenous local grain called tuwal. Taylor brought a supply of tuwal back to Seattle, where she experimented with brewing and mixing processes that combined the original drink with teas and spices for flavor and additional health benefits. The result was MuMaté (pronounced MOO-muh-tay: from Mudra—"channel energy to the heart" and Maté—"infusion"). Served cold, MuMaté was delicious, caffeinated and highly nutritious.

Professor Thomas Eisenmann and Research Associate Alex Godden prepared this case. The company mentioned in this case is fictional. HBS cases are developed solely as the basis for class discussion. Cases are not intended to serve as endorsements, sources of primary data, or illustrations of effective or ineffective management.

Maxwell met Taylor in September 2009 at a gym where Taylor was selling MuMaté after a yoga class. As a weight trainer, Maxwell immediately saw the benefits for athletes of a protein-based ready-to-drink beverage. She persuaded Taylor to let her sell the drink from her commuter carts, which could target customers heading to the office after a morning workout.

At that point, Taylor was working alone from her home, where she brewed and bottled the beverage, having secured necessary regulatory approvals. Taylor bicycled between yoga studios, hauling a folding table, a crate of bottles, and informational leaflets in a bike trailer. She leveraged her PR background and connections as a yoga teacher to find other opportunities to sell and promote MuMaté at alternative health fairs and yoga retreats. In response to the drink's growing popularity, yoga studios and gyms were now seeking out Taylor, asking her to sell MuMaté after yoga classes. Taylor was finding it hard to make enough of the drink to meet demand.

After briefly experimenting with a partnership in which Maxwell's carts took over the task of selling MuMaté at high-traffic gyms and yoga studios, in December of 2009, Maxwell decided to abandon her commuter cart business altogether in order to work full-time with Taylor on turning MuMaté into a scalable business. Maxwell, drawing on her Innocent experience, found a suitable local bottler, and Taylor optimized formulas for the three most popular varieties of MuMaté. To fund initial production, the pair needed cash, which raised the question of equity ownership. Reasoning that Taylor had contributed her invention and that Maxwell brought valuable business acumen, the two women agreed on a 50-50 equity split, with each investing equal amounts of additional capital in the form of interest-free loans. Principal repayments would be deferred until both founders agreed that the company had solid financial means. Maxwell, who would serve as CEO, funded her capital contribution by selling securities she had inherited; Taylor cashed out a portion of her 401k.

With manufacturing successfully outsourced, Maxwell began to persuade local retailers, cafes, and convenience stores to carry MuMaté. To stock a new beverage, some regional chains required "slotting allowances" in the form of free up-front inventory. Sales were strong, but the venture was constantly short of cash needed to pay suppliers. The cofounders were not able to pay themselves salaries for the first part of 2010.

Later that year, the cofounders hired their first team member, Jeremy Dank, whom Maxwell had met during her 2008 summer internship at Procter and Gamble (see **Exhibit 1** for management bios). Dank was granted a 10% equity stake to supplement his salary, taken equally from Taylor and Maxwell's 50% shares. Dank's eight years of brand marketing experience equipped him to take over MuMaté's channel marketing function. He began building a network of distributors to expand MuMaté's brand footprint.

Market and Business Model

Coke and Pepsi dominated the enormous US beverage industry, but new nonalcoholic entrants were continually trying to reinvent the market. The 1990s saw the rapid growth of bottled water and niche drinks like Snapple, Honest Tea, and Nantucket Nectars. The next decade introduced controversial energy drinks like Red Bull and beverages claiming health benefits, including vitaminwater and many brands based on coconut water and kombucha. Although the overall beverage market grew at roughly the same pace as the economy, revenues for specialty categories could expand rapidly (see **Exhibit 2)**. MuMaté filled a new gap in the beverage market, and tapped into the popularity of yoga (see **Exhibit 3)**. US consumers in growing numbers were avoiding foods and beverages with high sugar content—even "raw, natural" sugars such as honey and agave; these consumers saw high-protein diets and "good" fats as key to health. However, most drinks that touted health benefits—including iced teas, juices, and coconut water—were high in sugar. Likewise, high-protein shakes aimed at bodybuilders were shunned by many health-conscious consumers due to their highly processed ingredients such as animal products and artificial sweeteners.

It was challenging to create a drink that contained essential fatty acids and protein, because: 1) many people were intolerant of the proteins in dairy, soy, and nuts; and 2) it was difficult to translate most high-protein grains into a drinkable form. The unique quality of tuwal was its high fat and protein content, allied with the ease of creating a palatable, stable drink using mild heat and fermentation. As far as Taylor and Maxwell knew, no other companies were currently using tuwal or any similar approach to create competing products. However, the cofounders assumed that potential rivals could eventually replicate the trial-and-error approach employed by Taylor in perfecting MuMaté. While Maxwell had obtained a trademark for the MuMaté brand, an intellectual property attorney had told her it would be better to rely on her "secret recipe" than to try to secure patent protection for the basic concept of a tea-infused tuwal-based beverage.

MuMaté's key ingredient, tuwal, was not currently cultivated outside of South Asia, where it was grown on small farms and principally used to supplement animal fodder. If MuMaté ever became a big brand in the US, the required volume of tuwal would still be small in relation to the current annual harvest. For this reason, it would not be possible for MuMaté to lock up enough tuwal supplies to create a barrier to rival beverage entrants. However, the cofounders were gaining knowledge of the complex tuwal supply chain—in particular, which wholesalers and export agents were reliable—and considered this to be a source of competitive advantage, along with their strong relationships with tuwal farmers. Taylor and Maxwell had strengthened these relationships when they visited India in early 2011 to help farmers obtain organic certification for the crop. MuMaté's support of India's tuwal farmers and of fair trade practices was described on its product labels.

Marketing

In retail outlets, MuMaté was priced at a premium relative to most other beverages—$2.99 per ten ounce bottle. Weekly sales ranged from 10 to 50 bottles per retail location. By the summer of 2011 MuMaté had expanded beyond Seattle to San Francisco and LA, where yoga was very popular, and was being sold as far away as San Diego and Arizona, although it was a challenge to provide marketing support in distant regions.

MuMaté's early marketing efforts were based solely on word-of-mouth generated by Taylor's presence in the alternative health community and in Seattle's yoga studios—where MuMaté had become as essential to the lifestyle as the Manduka yoga mat and Lululemon pants. In 2011, the company also hired several part-time "Brand Ambassadors," identified through Taylor's network, to market MuMaté to key influencers. Paid advertising was limited to inexpensive campaigns in yoga journals and local liberal newspapers. MuMaté also distributed leaflets at health clubs, cafes, and appropriate events.

At a wholesale price per bottle of $1.92 and COGS of $1.38 in 2011, MuMaté's gross margin was 28%. Margins would decline in coming months as new outlets demanded slotting allowances, but eventually margins would improve as existing accounts accounted for a larger share of sales and as greater volumes yielded purchasing economies. Sales and marketing expense had been kept low at around $0.17 per bottle by relying principally on guerilla marketing efforts and word-of-mouth marketing. With G&A expenses of $0.37 per bottle, MuMaté had managed to break even by year-end 2011. Working capital at that time equaled 14% of 2011 revenue, and capital expenditures had been minimal, since bottling was outsourced.

Growth Opportunities and Funding Needs

In early 2012, several celebrities were photographed carrying MuMaté at exclusive Hollywood yoga studios, and the product became a craze, selling out wherever it was stocked. It was reported that one pop star had MuMaté flown in on a private jet when it wasn't available in New York, where she was performing.

After this wave of publicity, MuMaté was approached by several potential partners eager to stock the product:

- National distributors who worked with large grocery chains wanted to sell MuMaté on the East Coast, ramping up to nation-wide coverage within 18 months (see **Exhibits 4** for beverage distribution channels and **Exhibit 5** for grocery store figures**)**.
- A national coffee shop chain wanted to test MuMaté in a few key locations, with a view to stocking it in all 800 of their stores after three months if reactions were positive.
- A vending machine company that serviced 300 upscale gyms across the US wanted to sell MuMaté as part of a range of premium snacks and beverages that promised health benefits and/or improved athletic performance.

These potential partners would expect capacity and inventory guarantees, requiring a large increase in working capital. To support the deals, MuMaté also would need to hire additional operational, business development, and sales managers, supplementing the company's current staff of six. In addition, new partners would expect advertising commitments from MuMaté.

In April 2012, after estimating incremental sales from new partners, Maxwell and Dank prepared financial projections for MuMaté through 2015 (see **Exhibit 6**). The projections showed that the company required about $2.5 million of additional investment before achieving cash flow breakeven. It was time to get serious about a plan for raising capital. One call that Maxwell made was to Jonathan Cantor of DuPage Ventures (DPV).

DuPage Ventures

Maxwell had been introduced to Cantor in the fall of 2011 by a business school classmate. Cantor had just joined DPV as an associate with a mandate to invest in premium health brands with national potential. Prior to joining DPV, Cantor had worked for five years in a corporate M&A unit at Nestlé, where he helped the food giant previously known for milk powder and corn flakes move aggressively into sports foods and other specialty markets.

DPV was a mid-sized venture capital firm that focused on early-stage start-ups in high-end consumer markets—industries in which its general partners had extensive contacts and prior operating experience. Based in Chicago, DPV had achieved top-quartile investment performance since its founding in 1988; its six funds had averaged a 25% pretax IRR, before payment of fees and carried interest earned by DPV. DPV's initial commitment to a company averaged $1-5 million; factoring in follow-on rounds, DPV expected to invest between $3-10 million in successful companies—those that could reach revenues of $50 million or more within five to seven years. DPV generally preferred to lead a startup's Series A round, and its equity stake averaged 20-30% prior to an IPO or strategic sale.

Over the past few months, Cantor had visited MuMaté several times; Maxwell and Dank had reviewed their financial projections with him and valued Cantor's insights. On his last two visits, Cantor had been joined by Ed Rodriguez, a DPV partner with deep experience investing in niche, high-end brands, including some beverage companies. Maxwell and Taylor had been impressed with Rodriguez and liked him. When Maxwell called to say she was ready to seek funding, Cantor invited her and Taylor to Chicago to meet DPV's other partners. After a successful visit, Cantor called to say that he and Rodriguez would be sending a term sheet. If DPV led Series A, Rodriguez would serve as DPV's representative on MuMaté's board. DPV would also request board observer rights, allowing Cantor to attend board meetings in a non-voting capacity.

Preparing to Negotiate

The cofounders and Dank met to discuss their strategy for negotiating with DPV. They would need a point of view on an appropriate valuation for MuMaté. One way to value the company would be to apply acquisition transaction multiples (see **Exhibit 7**) for comparable beverage companies—proceeds divided by revenues or earnings—to MuMaté's projected results for 2015. Maxwell thought that looking further into the future might yield a fairer valuation of MuMaté. Based on similar niche drinks, she and Dank estimated that after they built a nationwide brand over the next three years, they might expect five additional years of rapid sales growth—in the range of 10% to 20% per year—before settling down to long-term growth in line with the overall beverage industry. There could be additional upside for MuMaté from a wider flavor range, brand extensions, and cost savings that might accrue to a strategic acquirer, but neither she nor Dank thought that those benefits could be reliably estimated at this early point. Still, it was encouraging that there were many examples of niche brands that had been snapped up at high prices by major beverage companies, such as Coke buying Odwalla and Honest Tea, or Pepsi buying Naked Juice.

A lot seemed to be riding on the financial projections she and Dank had prepared. How reliable were they? Maxwell felt she had a good handle on what MuMaté's costs would be under different scenarios for sales growth. Gross margins were fairly straightforward to estimate. Also, sales and marketing expense should equal 10 to 12% of sales over a wide range of volumes, due to commitments to channel partners. Finally, general and administrative expenses for a given year would remain largely fixed over a fairly wide range of sales volume scenarios.

Maxwell had less confidence in the sales projections she and Dank had developed. The projections had been built "bottom up" by estimating the weekly volumes MuMaté could achieve in different types of retail accounts, based on MuMaté's recent sales in existing accounts as well as information supplied by distributors about similar brands. This work was rigorous, but it assumed that MuMaté would sustain its momentum, and many fads fizzled out in the fickle world of consumer products. In fact, of the roughly 2,000 new beverage brands launched each year, only 3 or 4 could expect to reach sales of $100 million.[1] However, with $8 million of revenue projected for 2012 after three years of growth, MuMaté had already survived the most demanding phase of the new product winnowing process. This meant that the company's success odds were now far better than 4 in 2,000. But how much better? Was their projection of $50 million in sales for 2015 too conservative or too optimistic?

Maxwell and Taylor also needed to talk with Cantor and Rodriguez about control, and how much DPV might want to change things. How much influence would the co-founders have over the direction of the company, built as it was based on values and goals that were important to both of

[1] "*According to Beverage Marketing Corp, more than 20,000 new products were launched since the year 2000, but only 35 of them grew to more than $100 million in sales,*" Seth Goldman (founder of Honest Tea), "Changing Our Look Without Losing Our Brand," *Mission-Driven Business* (blog), *Inc.com*, September 8, 2011, http://www.inc.com/seth-goldman/working-title.html, accessed August 29, 2012.

them? For example, Taylor worried about coming under pressure to adjust her formulations to use cheaper ingredients that might not offer health benefits or protect tuwal farmers' interests.

The MuMaté management team knew that they needed capital to make the most of expansion opportunities while their brand was hot. But did this require a venture capital round? Would they be better off trying to get a loan, thereby avoiding equity dilution? Distributors had told Dank that commercial banks were highly unlikely to lend to young beverage companies. However, asset-based lenders would extend credit to such companies in amounts up to about 80% of receivables and 50% of inventory, at interest rates roughly 400 basis points above Libor. This implied a maximum borrowing capacity equal to roughly 50% of MuMaté's total working capital. Distributors had also mentioned that asset-based lenders could be quick to force a firm into liquidation if it broke loan covenants.

Likewise, MuMaté could seek funding from angel investors. The team knew that Honest Tea, a successful beverage startup with a mission and brand positioning similar to MuMaté's, had raised its first $2 million of capital almost entirely from large numbers of individual investors whose values were closely aligned with those of management: friends, family, angels, and fanatically loyal Honest Tea consumers. Raising funds this way would probably yield substantially less equity dilution, but it would be quite time consuming. Dank believed that national distributors would not sign contracts until MuMaté had secured enough new funding to cover expansion commitments.

A venture capital firm like DPV, by contrast, could offer capital quickly along with a lot of valuable advice, but was it worth the price in terms of equity dilution and loss of control?

Exhibit 1 MuMaté management

Sarah Maxwell – *CEO and Founder*

- Undergraduate: Cambridge University, 2003
- 2 years at Bain & Company, London as a strategy consultant
- 2 years in strategy and business development at Innocent, UK niche beverage company
- Wharton MBA; summer internship at P&G

Angela Taylor – *Inventor and Founder, Head of PR and Brand Development*

- Undergraduate: University of Washington, 1982
- Masters in PR and Communications: Univ. of California Davis, 1987
- 15 years in corporate PR at a major West Coast agency
- Teaching yoga and doing freelance alternative health PR since 2002

Jeremy Dank – *Head of Channel Marketing and Distribution*

- Undergraduate: Princeton, 2004
- 8 years at P&G in the Graduate Manager rotation and then in Marketing for a variety of US consumer brands

Source: Company documents.

Exhibit 2a US soft drinks industry retail sales: $ billion, 2006-10(e)

2006	2007	2008	2009	2010(e)	CAGR
$121.5	$125.9	$127.4	$125.7	$124.7	0.7%

Exhibit 2b US GDP: Indexed to 2006, 2006-10(e)

2006	2007	2008	2009	2010(e)	CAGR
1.00	1.05	1.07	1.05	1.09	2.2%

Exhibit 2c US soft drinks category % share of industry sales, 2004 and 2010

Category	2004	2010
Carbonates	46.8%	49.2%
Juices	14.9%	16.3%
Bottled water	18.4%	13.2%
Functional drinks	7.6%	12.9%
RTD tea & coffee	8.5%	7.1%
Others	3.9%	1.3%

Exhibit 2d US retail sales of RTD functional and natural beverages by category: $ million, 2006–2010

Category	2006	2007	2008	2009	2010	CAGR
Energy/Sport/Functional water	$ 14,090	$ 15,479	$ 16,703	$ 16,789	$ 17,403	5.4%
RTD tea/coffee	$ 3,987	$ 4,671	$ 4,652	$ 4,766	$ 5,076	6.2%
Yogurt/smoothies	$ 819	$ 902	$ 920	$ 934	$ 894	2.2%
Total	$ 18,896	$ 21,052	$ 22,275	$ 22,489	$ 23,373	5.5%

Source: Compiled from Datamonitor data, accessed July 2012.

Notes: Functional drinks are defined as non-alcoholic, ready-to-drink (RTD) beverages with non-traditional ingredients (e.g. herbs, vitamins, stimulants) believed to provide benefits that go beyond general nutrition.

Exhibit 3 Number of yoga studios in the US; % of population estimated to practice yoga

	2004	2008	
Practiced yoga in the past year (million individuals)	16.5	15.8	
% female	76%	70%	
% college educated	50%	70%	
% income >$75K	30%	44%	
Extremely interested in yoga but have not practiced this year (M)	9.0	18.3	
Total spend on yoga-related products ($ billion)	$3.0	$5.7	
Registered U.S. yoga teachers (2011 est.)			70,000
Yoga studios in the US (2011)			25,558

Source: Compiled from Yoga Journal, North American Studio Alliance, and CNN money, July 2012.

Exhibit 4 US soft drinks market distribution % share by volume 2010(e)

Channel	% Share
Supermarkets / hypermarkets	76.6%
On-trade (restaurants/bars)	8.9%
Convenience Stores	3.9%
Others	10.6%
Total	100%

Source: Datamonitor, accessed July 2012.

Exhibit 5 Number of US store locations for leading food retailers

Name	Number of US locations
Albertsons	462
Costco	429
CVS	7,182
Krogers	3,574
QFC	75
Raley	130
Safeway	1,694
Target	1,767
Trader Joe	365
Walgreens	8,300
Whole Foods	304

Source: Company websites.

Exhibit 6 MuMaté financials ($000: actual 2009-2011; projected 2012-2015)

	2009	2010	2011	2012F	2013F	2014F	2015F
Total revenue	$ 233	$ 379	$ 978	$ 8,345	$ 15,335	$ 29,493	$ 50,026
Cost of sales	$ 162	$ 286	$ 705	$ 6,331	$ 11,434	$ 21,311	$ 34,780
COGS % revenue	*70%*	*75%*	*72%*	*76%*	*75%*	*72%*	*70%*
Gross profit	$ 71	$ 93	$ 273	$ 2,014	$ 3,901	$ 8,182	$ 15,246
Gross profit % revenue	*30%*	*25%*	*28%*	*24%*	*25%*	*28%*	*30%*
Sales and marketing	$ 1	$ 12	$ 85	$ 920	$ 1,675	$ 3,481	$ 4,804
S&M % revenue	*0%*	*3%*	*9%*	*11%*	*11%*	*12%*	*10%*
General and administrative	$ 82	$ 90	$ 191	$ 990	$ 1,730	$ 4,032	$ 6,410
G&A % revenue	*35%*	*24%*	*20%*	*12%*	*11%*	*14%*	*13%*
EBIT	$ (12)	$ (9)	$ (3)	$ 104	$ 496	$ 669	$ 4,032
EBIT % revenue	*-5%*	*-2%*	*0%*	*1%*	*3%*	*2%*	*8%*
Income tax	$ -	$ -	$ -	$ 11	$ 168	$ 227	$ 1,371
Net income	$ (12)	$ (9)	$ (3)	$ 93	$ 328	$ 442	$ 2,661
NI % revenue	*-5%*	*-2%*	*0%*	*1%*	*2%*	*2%*	*5%*
Working capital (year end)	$ 21	$ 28	$ 138	$ 1,245	$ 2,153	$ 3,339	$ 5,003
WC % revenue	*9%*	*7%*	*14%*	*15%*	*14%*	*11%*	*10%*
Change in WC	$ 21	$ 7	$ 110	$ 1,107	$ 908	$ 1,186	$ 1,664
Cash flow	$ (33)	$ (16)	$ (113)	$ (1,014)	$ (580)	$ (744)	$ 997

Source: Company documents.

Note: CapEx is negligible, since bottling is outsourced and delivery vehicles are leased.

Exhibit 7 Selected acquisitions in the health and beverage markets, 2001 to 2012 ($ in million where applicable; "LTM" = last twelve months)

Target	Date Announced	Acquirer	Acquisition Value	LTM Sales	Value to LTM Sales	LTM EBIT	Value to LTM EBIT	Target Business Description
Importations DE-RO-MA	8/11	Smart Balance Inc	66	53.9	1.2	np	-	Canadian producer and wholesaler of gluten-free snack products
RNL Sammi Co Ltd	5/11	RNL Bio Co Ltd	31	26.4	0.8	0.9	33.5	Korean canned beverage producer.
Diedrich Coffee Inc	5/10	Green Mountain Coffee Roasters	316	66.3	4.8	np	-	US producer and wholesaler of specialty coffee products through office service distributors, restaurants and specialty retailers.
Refresco Holding BV	3/10	3i Group PLC	561	888.0	0.6	np	-	Dutch soft drink producer: fruits and vegetable juices, carbonated soft drinks, nectars, mineral water, ice tea, energy drinks and functional drinks.
Innocent Ltd	4/09	Coca-Cola Co	246	222.5	0.9	24.2	1.8	Maker of healthy food and drinks, including smoothies and juice, sold in supermarkets, coffee shops and other outlets across Europe.
Rubicon Drinks Ltd	8/08	AG Barr PLC	116	57.2	2.1	4.2	27.5	British company producing and wholesaling soft drinks, specializing in exotic tropical drinks including Passionade and Sparkling Mango Crush.
Honest Tea Inc	2/08	Coca-Cola Co	108	38.0	2.8	np	-	US bottled organic tea and juice beverage company.
Naked Juice	11/06	PepsiCo	450	150.0	3.0	np	-	US producer of 100% natural juices, juice blends and smoothies
IZZE beverage Co	9/06	PepsiCo	57	15.0	3.8	np	-	US producer of natural sodas and sparkling juices
Eight O Clock Coffee co	6/06	Tata Coffee Ltd	220	109.0	2.0	np	-	US coffee producer and retailer
Strathmore Mineral Water Co	5/06	AG Barr PLC	28	25.1	1.0	2.4	11.5	British producer and wholesaler of spring bottled water with traditional flavors such as dandelion and burdock.
Friggs AB	11/04	Wilh Sonesson AB	25	23.5	1.0	np	-	Swedish health food producer
Odwalla Inc	10/01	Coca-Cola Co	182	128.3	1.4	3.5	51.9	US juice, smoothie and shake manufacturer
					(Median = 1.4)		(Median = 27.5)	

Source: Compiled from Thomson One, company websites, equity analyst estimates, July 2012.