Coffee Shop Chain Case

A chain coffee shop company is considering adding a new line of business of offering small foods and snacks. The CEO of the company hired you as a financial analyst to help the company decide if it is economical to add foods and snacks to its business or not.

You have spent some time gathering information and talking to people in the company and you collected following information.

1) The coffee shop chain already offers 3 types of drinks, each comes in 2 sizes. The coffee shop wants to add a breakfast sandwich and classic oatmeal. Current sales information of the existing drinks and estimated sales information for new foods according to the marketing consultant are:

	Unit Price	sales
Small Coffee	$2.50	500,000
Large Coffee	$3.50	350,000
Small Tea	$2.00	120,000
Large Tea	$2.70	100,000
Small Hot Chocolate	$3.00	100,000
Large Hot Chocolate	$3.70	80,000
Breakfast Sandwich	$4.50	50,000 (estimate)
Classic Oatmeal	$5.00	60,000 (estimate)

2) Marketing consultant thinks that the market for the existing drinks is mature and the unit sales will not grow anymore. However, he believes that the sales of the 2 new products will grow by 5% per year for the next 10 years.
3) The company plans to increase the prices (for both the existing and new products) at the inflation rate which is estimated to be 2% over the next 10 years.
4) Looking at the financial statements of the company you estimate that average production cost (raw material, labor and …) is 40% of the revenue.
5) To add the food business line, the company has to hire a food manager whose salary will be $90,000 for the first year plus %28 overhead costs (insurance, retirement, benefits, …). Her salary will increase by inflation rate over the next 10 years.
6) The company pays $100,000 rent for its branches. The rent will increase by inflation rate every year.
7) The company paid $45,000 to its marketing consultant for providing all the marketing related information. You'll also charge the company $60,000 for your financial advice.
8) The company needs to buy new equipment for its branches to lunch the food business. The equipment plus the installation costs would sum up to $1,000,000. The company uses MACRS depreciation and the salvage value of the equipment after 10 years is estimated to be $50,000.
9) The company also has to invest 10% of its estimated first year production cost in working capital which will be recovered at the end of the 10-year period.

10) Looking at the financial information of the company you realize that he company's capital structure consists of 40% debt, 20% preferred stock and 40% common stock. All figures were calculated using market value.
11) The company has only one bond outstanding that matures in 10 years. It has 8% coupon rate with annual coupon payment and $1000 face value. The bond currently trades at $920.
12) The company's preferred stock pays $4 dividend per year and currently trades at $40 per share. Assume there is no floatation costs.
13) Looking at yahoo.finance.com, you see that the beta of the company is 0.9. As a financial analyst, your estimate for the risk free rate and the expected return on the market are 3% and 12% respectively.
14) The company has a 30% marginal tax rate.
15) Coffee shops have two types of costumers. Customers who sit in the coffee shop (40%) and to-go customers (60%). The company's marketing consultant thinks that offering food will increase the sales of the existing drinks to to-go costumers by 15% (they stop by for food and also buy a drink). However, since eating food takes a longer time and the spaces in the coffee shops are limited, offering food will lower the sales of the existing drinks to the first type of customers by 10% (some drink customers can't find a seat and just leave without buying anything).

<u>**Should the company add food business? Give your advice!!!**</u>