Delta beverage group, inc. essay sample

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Delta Beverage Group, Inc. is an independent bottler of Pepsi products in the United States. These products include franchised brands like Pepsi, Mountain Dew, Dr. Pepper, 7-up and more. These drinks are sold in a variety of containers but PET bottles and aluminum cans are used the most. Delta has concentrated most of its business in the South Central United States, which includes parts of Tennessee, Arkansas, Louisiana, and Mississippi. In 1993, Delta reached an agreement with its senior debt holders to avert defaulting on its debt. As a result, total debt decreased from 193 million to 140 million and the average maturity of the debt from 5. 0 to 6. 8 years. However, the sinking fund provision for this new debt meant that the debt repayment schedule started almost immediately. In the first half of 1994, aluminum cash prices on the London Metal Exchange (LME) had risen by 30. Because of this, John Bierbaum, CFO of Delta Beverage Group, Inc., wondered whether this increase in aluminum prices would affect the prices of the aluminum cans bought by Delta and therefore her profit margin. Bierbaum has to consider the financial implications this has regarding the company. Because of these, Delta needs to consider about having a new plan in order to deal with this challenge, one that includes new prices, new costs and maybe also further negotiations with the suppliers of the company.

Bierbaum has considered two options. The first one is an operational hedge. Under this option, Delta would try to alter its product mix, which is dominated by cans, to sell more drinks in PET bottles. Hereby, exposure to aluminum prices would be reduced. On top of that, PET bottles carried a higher profit margin compared to cans. However, Bierbaum concluded that this was no feasible option. The second option is a financial hedge on

aluminum. Under this option, Delta would purchase futures contracts to try to fix the higher costs in advance. The question concerning this case is whether hedging is the solution to the problem of aluminum contracts for coming years or that Delta should prove a buyout We will examine both these options by making calculations based on the data that is given in the case. The financial risk of the company is also an important section that the company should be able to manage in the future as the history has shown that Delta Beverage Group, Inc. had financial leverage problems in the previous years, so it needs to take precautions for the years to come.

In Exhibit 5 we can see that Delta cant actually risk losing revenues and also that there are many restrictions that the company has to take under consideration. These restrictions are translated into ratios for senior leverage, interest coverage, debt service and also for total leverage. In the table on the next page (table 1), the numbers show us that the company wasnt eventually able to manage all these restrictions regarding the ratios. The total leverage ratio and the interest coverage ratio do not comply with the restrictions. The solution to this problem is to increase profit margins. In this way, funds from operations should increase which results in lowering the total leverage ratio and increase the interest coverage ratio. Ratio (Table 1)Value (1k)LimitSenior leverage ratio105, 000 / 22, 730 4. 62Not in excess of 5. 00Total leverage ratio166, 572 / 22, 730 7. 33Not in excess of 6. 25Interest coverage ratio22, 730 / 16, 861 1. 35Not less than 2. 0Debt service coverage ratio16, 861 / 10, 648 1. 58Not less than 1. 25 The data of the following tables show net revenues in year 1993 (table 2. 2) and also the cost in (1k). In table 2. 3, we notice that the share of aluminum is about 9, 50

of CoGS. According to the Exhibit 12, which shows the aluminum cash and futures prices, the price goes up to 1461.