Hansson private label

Finance, Investment

Vent Consulting Expansion and Risk at Hansson Private Label, Inc. Evaluating Investment in the Goliath Facility HBS#4021 Vent Consulting takes pleasure in presenting our Hanson Private Label's (HPL) capital expansion executive summary. We carefully reviewed all applicable case materials and believe we have quantified your primary risks, benefits, and most attractive course of action. 1) HPL has performed exceptionally well since inception in 1992. Financial statements show that operating revenues have increased from $503. 4M in 2003 to $680. 7M in 2007.

During this time, gross operating profit increased by $24. 3M. This illustrates that the company is not sacrificing profits for top level growth. Capital replenishment matches or exceeds depreciation. Net income increased during the same time p by $9. 6M. The revenue gross margin has averaged 7. 8% growth and the gross margins have averaged 18. 6% over the last five years, while net income has averaged 5. 3%. Dividends have been paid to stockholders. Cash flow from operations has increased steadily. The cash from investing has fluctuated from a low of $5. M in 2006 to a high of $7. 8M in 2003, indicating an overall conservative strategy of controlled expansion. HPL used more cash in financing in 2006 and 2007 than in previous years, which may contribute to future growth. To reinforce the company's financial performance: •Total assets have grown over the years to a high of $380. 8M in 2007 •Long-term debt is at a five year low at $54. 8M •Net working capital is at a five year high of $102. 5M All four plants under HPL are operating at 90% capacity and a focus on conservative efficiency has led to strong financial performance.

Comparatively speaking, HPL's 9. 26% EBITDA ratio is stronger than industry competition, another indicator of strong earnings and management. 2) Vent Consulting's analytical summary is provided in Appendix 1. Note the calculated NPV of $4, 971 and IRR of 11. 1% at tab NPV-BASLINE. Given an accepted discount rate of 9. 38%, both the positive NPV and the positive 1. 7% IRR spread on this investing type project initially indicate a rewarding proposal. Additionally, the calculated profitability index of 1. 11 suggests the project should be pursued.

Note that the discounted payback period is just under 7 years, 4 years beyond the contractual commitment under consideration with HPL's largest retail customer. 3) Sensitivity analysis reveals interesting factors, however. Note in the additional tabs: •Ramping up capacity utilization to 85% in 3 years instead of the projected 5 years yields a full 2% IRR increase. •If aggressive marketing can capture secondary demand from competitors and increase capacity utilization from 85% to 95% in years 4 through 10, IRR is increased to 14. 8%. •The project is very sensitive to unit selling price.

If expected annual growth in sales price rises from 2% to just 3. 5%, IRR rises a full 6. 7% to 17. 8%. •The project is also very sensitive to commodity costs. A small . 5% increase in expected inflation from 1. 0% to 1. 5% annual raw material costs reduce baseline IRR calculations to 9. 5%, making the project unattractive compared to the 9. 38% discount rate. •Improved capital planning yields expected improved project returns. The last tab illustrates a potential improvement of 2. 5% IRR. Given this information, Vent Consulting has identified 3 courses of action (COA): 1) Accept the capital expansion proposal as written by Mr.

Gates 2) Accept the retailer ' s 3–year contract, but reduce capital risk by reducing the scale of expansion, improving the use of working capital and sub-contracting production shortfalls to other producers. 3) Maintain status quo and reject the retailer contract Despite the positive NPV, Vent Consulting recommends rejection of COA 1 due to the following uncontained risk factors: •Required capital expansion and associated financing does not match the proposed customer contract, adding uncontrolled capacity utilization risk.

This risk is compounded by a lack of customer diversification. •Difficult-to-predict sales price and raw material cost variables also add significant uncovered risk. Vent Consulting also recommends rejection of COA 3. This course of action would propagate HPL's growing " cash cow" business model, and sacrifice an ideal opportunity to improve company performance and steal market share in cooperation with one of the largest industry retailers. We strongly recommend COA 2, which apitalizes on market opportunity while minimizing the significant risk of the original proposal. Specifically: •Reduce capital expansion to 40% of proposed project. •Improve capital management •Dedicate primary capacity to key/primary retail customer(s) •Sub-contract production shortfalls to other producers for lessor retailers/customers Vent Consulting is eager to provide additional recommendations on how this is would be best accomplished -- for a fee -- once we've completed another few Themes.