

Example of speaker notes business plan

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Good morning, today we will talk about Custom Snow Boards Inc. a company that intends to expand its reach to Europe, after having successfully set up operations in the US. Custom Snowboards or CSI operates warehouses and distribution in Europe and Canada but the company feels that the time for further business involvement in Europe is now. This business involvement means putting up a production facility in Europe.

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The company is registered in Delaware and is owned by Jim Swartz, its founder and current majority shareholder.

The company is public and is traded at the Midwest Stock Exchange.

Currently, CSI's stock is valued at \$1.01/share.

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The company will put its processes in effect in Europe, having worked really well in the US. CSI's standard company procedures include:

Orders received through retailers

Approving authority is the company treasurer

New retailers are assigned a US\$50,000 credit limit

Data management in place

Order processing, deliveries and payments developed for efficient operations

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The company has been operating profitably but has suffered a decline in net

earnings in the last three years.

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The decline in net earnings can be explained by the company's GAE increasing in the course of three years. The increase comes from increasing salaries and executive compensation. This could be part of the corporate covenants that CSI have been made with CSI's managers. This is not to say that the company's managers are not working on improving the state of finance of CSI, its just that the rate of increase in sales revenues may have been affected by the global economic slowdown.

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The total asset base of the company has increased in the last three years. This has been financed more by short-term liabilities and an increase in stockholder equity.

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CSI has been holding on to more cash but made investments in year 13 and then liquidated these investments the year after. It did so to finance the purchase of furniture, fixtures and equipment in year 14. This means that the company is financing growth internally in the US in year 14.

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The vertical analysis shows that the company's biggest cost contributor are Cost of Goods Sold or COGs which make up approximately 70% of the the total cost while the rest is broken down into general administrative expenses (GAE of 16%), selling expenses (12%), interest, taxes and net earnings make up the rest.

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The company did better in terms of sales in year 12-13 than year 13-14 (increase in sales of 3. 21% vs. 1. 91%). This may have been a result of cost-cutting measures by CSI (reduction in transportations, commissions, advertising in year 13 - 14).

As mentioned earlier, management compensation increased in 13 - 14 than in the previous year. The data is limited to conclude whether this is a natural progression of management compensation or not.

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The combination of efficiency and standardization has created a very profitable organization. Compared with Winter Sports, the rival company, CSI has

- Can cover its obligations better (6. 85 vs. 4. 2)
- Has higher rate of inventory turnover which means it sells its products faster than its competitors (33. 33 days vs 30. 4 days)
- Has more efficient collection system (average of 11 days compared to 32 days)
- Uses debt for most of its investments which means it has very good reputational weight with financing institutions
- Enjoys a 30% GPM and a NPM of about 1. 6%. The lower NPM is due to its higher use of debt financing
- Higher earnings per share, higher return on assets, return on equity, better price-earnings ratio.

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The base Ratios presented by CSI shall be presented for the purpose of acquiring the loan. The following projections are made:

- Profitability – the company has somehow reached a plateau in terms of profitability. Thus, the growth of the company into foreign markets present a highly potential increase in revenue generation. The sales projection add at the very least 300, 000 dollars to the revenue of the company. The nominal pay-back period, assuming a steady 300, 000 additional revenue per year is around 3. 3 years with respect to a nominal loan value of 1 million.
- Liquidity - the company has adequate cash to pay for its debt obligations. Current times-interest is 2. 8 times which means that it can cover, based on its current annual operations 2. 8 times. Taking on additional debt will eat into the company’s cash flow through interest payments but a 2. 80 times coverage means that it would still be able to cover its interest payments for the loan sufficiently.
- Activity – the ratios show that CSI’s strength is its ability to manage its suppliers and retailers well. Their ROA and ROE is higher than its closest competitors which signal efficiency, as well as their ability to collect faster and use manage their inventories better.
- All of the ratios that were analysed are reflective of the high market valuation of CSI.

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Activity based Costing (ABC) takes a look at the manufacturing costs based on the activities associated with the production of a specific product. The table shows a comparison of regular and personalized boards. The table

indicates that:

- Traditional costing states that regular boards costs 119/piece while ABC indicates that it is only 105/piece
- Traditional costing states that personalized boards cost 162/piece while ABC indicates that it is 218/piece

These calculations show that the company should modify their marketing strategies to take advantage of higher margins from the realization that the cost of the boards are different. For regular boards, a strategy for improving revenue could be selling the boards at a discount to gain market share while for personalized boards, the price should be increased to cover actual production costs.

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Expanding into Europe will be a risky undertaking for an American company. However growth overseas is also one of the most viable strategies for growth since new markets are explored (Growth Business, 2012). To mitigate risks, the following will be undertaken by CSI. These risks mitigation strategies are based on what CSI will intuitively expose itself to upon expansion in Europe

Strategic Risks – CSI will mitigate strategic risks by bringing its competitiveness and efficiency to Europe. Competitiveness in this case is attributed to the ability of the company to deliver to the market high quality products and after-sales services. This capability of CSI will enable the company to stand toe-to-toe with other suppliers in the European market. Efficiency is based on the company's ability to use its resources well through the management of its cash and its relationship with suppliers and clients.

It will leverage on its core strengths to compete for growth and sustainability

Financial Risks – the US\$1 Million loan will be repaid through

Stable cash flows from European operations projected over the next five years.

Nominal pay-back is 4.5 years

Project has a positive NPV and an IRR that is greater than the interest rate for borrowings of 10%

The cash flows will improve, hence the cash flow are secure upon implementation of the recommendations herewith.

No ratio analysis was done on a post-merger scenario however it is surmised that the current ratios of the company are sufficient to address any financial risks that are required by the debtor to see.

Operational Risks – CSI will be able to manage the operational risks of working in Europe through acquiring a license with ESF. CSI is already working in Europe with a warehouse and the addition of the production facility and access to ESF's markets will mitigate the risk of operations in Europe.

Reputational Risks – although ESF produces inferior boards, its patented personalization process is an asset and a liability in that it may damage CSI's reputation for producing durable boards. CSI will mitigate this by using its own processes for ensuring product standards and by providing the quality of after-sales services that it is known for in the US.

Market Risks – this is a risk that is acceptable to the company since it will be competing in the market place. The company should include a full environmental scan to complete its expansion analysis.

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The impetus of going to Europe to compete in the snowboard market there in a bigger way comes from the projection of demand for snowboards, as shown in the graph. The economic data correlated with the production data shows a generally fluctuating sales trend but otherwise large enough to bet on putting up a production facility.

The historical analysis of the company's sales prior to year 14 indicate steady growth while the projections for years after the 14th shows erratic movement. However the projections also indicate that there will be sales growth for years moving forward from the 14th and no regression (decrease in sales volume) in the foreseeable future. Year 18 is an interpolation of the trend using the data from years 12 to 17. It must be noted however, that the uncertainty of the accuracy for this forecast is relatively small due to the variability in economic data and other factors.

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The financial performance of the company has been stable and efficient for the reviewed periods. This stability indicates that a loan of US\$ 1 million could be acquired and repaid using the current cash flows of the company, in a worst-case scenario, without any cash contributions from the planned expansion. The company's current level of profitability, its decreasing long-term debt, its cash holdings and ability to cover interest payments indicate that the company could service the proposed US\$ 1 million loan from current operations.

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Taken on its own, expanding into Europe would be a profitable undertaking. Based on market intelligence to derive annual sales projections, costs and other financial items, the net cash flow for the CSI's production facility in Europe is positive. The net present value (NPV) of the cashflow due to expansion was determined since it is a widely accepted investment evaluation approach (Investopedia, 2012).

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The net present value, given the investment of 1 million into the facility and working capital, will yield an NPV of 28, 437 at a hurdle rate of 10%. The IRR of the cash flow is 10. 8%. While the spread is only 0. 8%, this is a better alternative than a 0. 0% growth which will happen if the company does not expand and remains operations in the US.

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Two alternatives are present for CSI, they can lease the facility at which it would spend an NPV of 653 thousand or do a buy-back of the facility and spend 659 at NP values.

The lease option will be a less costly option by about 6 thousand dollars so the difference is not very material. CSI can lease or buy back the facility if it wishes to.

However, prudent cash flow management means that CSI should look for the lower annual expenditures which is achieved through the buy-back option.

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CSI can also merge with European Snowfun, a rival company operating in Europe. Snowfun has a stable market, with its personalized snowboard process giving them competitive advantage in the market. However the company does produce inferior quality boards.

The options are:

- Merge with CSI for which CSI will give 1 share for every 3 shares of SF
- Acquire SF at 2.4/share
- Or use SF's license and add \$40/board

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The earnings available for common stock are shown below, the number of outstanding stocks and the earnings and price per share. After the merger, the earnings per share of CSI will increase from 1.03 to 1.24. With a higher EPS, the market value for CSI will also increase.

If we multiply the EPS with the resulting number of shares (200,000 CSI + $\frac{1}{3} \times 300,000$ ESF = 300,000 shares) we will get an earnings of 372,000 which is the total earnings of the company for the year of the merger.

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The acquisition of the company will give CSI an NPV of 732,522. If we deduct the offer price of 720,000 to this NPV, the value of acquisition is 12,522 for CSI.

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If CSI uses the license of SF, it will generate an NPV of 527 thousand from its sales due to the capture of some of the market for custom boards. This means that the use of the license will generate positive cash flow for the company (the highest of the three options) and is the most logical business direction to take.

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This matrix puts the alternatives and expected outcomes in perspective. CSI may expand the business on its own and make 28 thousand in five years. This is under the assumption that the company will invest 1 million directly into the production facility. It may opt to lease or buy-back the facility, which would cost the company less (653 and 659 thousand versus 800 thousand for the facility). So Leasing and Buying-back are relatively at the same footing. However it is recommended that the company just lease the facility to reduce its cash exposure.

If it does not do that and instead goes into a different entry route, it can merge with SF, acquire it or just use its license. Of the three, using a license is the best financial move to make, giving out the highest NPV at 527 thousand.

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These are my recommendations

- There is no question about expanding to Europe. For CSI to grow, it should consider this seriously but minimize its exposure since it is already a highly leveraged company. One way of minimizing exposure is by asking for lower

interest rates for the loan. Since CSI has good reputation with lenders based on its highly leveraged position, it could work with these lenders in providing better rates for business loans given the fact the CSI's operations have been stable in the US in the last three years.

- However there are several ways of financing the expansion without taking a commercial loan.

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The net income and earnings per share based on the different options available given the EBIT projections of CS for years 9 to 13 are shown in the graphs above. The findings are as follows:

- The highest total income available for shareholders is the option of not using debt. However, the market will not take this favorably because this does not provide the highest earnings per share.

- The highest earning per share is projected to be acquired when the company finances its operations using 100% long term debt.

The most viable way for the company to finance expansion is through debt since debt is cheaper, it can be repaid through cash flows from operations and it provides the highest earnings per share in almost all relevant years.

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2. Is presented with two options for putting up a production facility and both are lower than CSI building the facility on its own. Of the two, CSI should lease the facility to manage its cash expenditures better until it can sufficiently have funds for owning its own facility. This is because leasing provides:

- Lower operating costs ((NPV of leasing is lower than NPV of building)
- CSI does not go through a liquidation process if the expansion fails.
- In the long-term, CSI should eventually build and own the facility.

However, the suggest approach is to buy ESF. Buying the company gives the company a production facility, a road to market, and already existing resources at its disposal. Acquisition is the better approach since CSI will take complete control over ESF's identity (Mastracchio, J. and Zunitch, M., 2002)