Bella Beverages Inc.

Overview

Bella Beverages Inc. (BB) is a Canadian company traded on the TSX Venture Exchange. BB's business is the development, production, distribution, and sale of non-alcoholic beverages. The company produces high-quality juice beverages and soft drinks, more than half of which are sold in Canada (55%) and the rest in the United States. Most end purchasers of BB products are health-conscious individuals aged 19-30.

The company was founded eight years ago by Hani Jafeer and Cindy Snin, former executives in the hospitality industry. Jafeer saw an opportunity to take advantage of the increasing consumer interest in health drinks by designing a company to focus on that niche market. He assumed the role of President and Chief Executive Officer (CEO). Snin joined him as Chief Financial Officer (CFO) and was instrumental in effecting the operational start-up, particularly in hiring the other key executives. Together, the founders worked well as a team.

Executive Team and Organizational Structure

A summarized organizational chart for the business is provided as Exhibit 1.

Hani Jafeer is President and CEO. Before founding BB, he was Vice-President, Marketing of a large hotel chain, having worked his way up from a front-desk role through various positions in sales, restaurant management, and conference coordination. At the time of incorporation, Jafeer was driven by his initial vision to see products developed, marketed, and sold in stores. However, since the achievement of this goal, he has shown less initiative to move forward. Now 54 years old, he seems content with the current business model and does not make decisions in haste. Reporting to him are both an executive and an administrative assistant as well as the CFO, and all of the vice-presidents.

Jafeer will be President and CEO until his planned retirement on March 31, 2013. He will continue to be Chairman of the Board thereafter. A new President and CEO will have to be found according to the specifications provided by the board of directors.

Cindy Snin has left BB to take an executive position with a hotel chain. Kerry Vance, CMA, was hired as her replacement on January 23, 2011. Reporting to the CFO are the director of Human Resources (HR), the controller, the manager of Management Information Systems (MIS), and the general (non-production) purchasing department.

Suzie Carpet is Controller. She has an undergraduate degree in biology and worked in the finance department for a large biotech company prior to coming to BB three years ago. She recently completed the CMA Professional Program. Reporting to her is the production facility's accountant who is assisted by two analysts.

Amy Lu is Director, Human Resources. She is a 16-year veteran in the HR field, having spent the last six years with BB. She has a Certified Human Resource Professional (CHRP) designation and fairly extensive experience with unions. Her department is responsible for payroll, hiring and terminating staff, as well as union relations.

Ronald Rone is the MIS Manager. He is considered a technology expert. He earned a community college diploma in computer science and gained progressively wider experience in four different companies before joining BB a year ago. The company's systems have been running reliably since his appointment as Manager.

Santina Marella, Vice-President (VP), Sales, has an MBA in Management. In her current role, her primary responsibility is to secure sales, which she does effectively by motivating the sales representatives to pursue orders aggressively in the retail environment. Reporting to her is the director of sales, who manages most of the day-to-day functions.

John Van Besmin, Vice-President, Marketing, holds an MBA degree majoring in Marketing from a Canadian university. He has had a great deal of experience, having worked in a variety of positions in the supermarket industry before being sought out by BB three years ago. His department's responsibility is to drive consumer, rather than store, demand for BB product. Reporting to him is the director of marketing, who manages most of the day-to-day functions.

Claude Lemieux, Vice-President, Bottling, is an experienced beverage industry executive. Prior to joining BB, he was employed by one of the large cola bottlers in a number of senior positions. He is a mechanical engineer by profession. Reporting to Lemieux is the manager responsible for production purchasing.

As Vice-President, Distribution, J.N. Garphite is responsible for the movement of BB product from the end of the production line to a final destination. The warehouse personnel in remote locations report to him through regional distribution heads. Garphite is not in favour of outsourcing any facets of the business, having lost his job when one of his previous employers embraced this type of strategy.

The President and CEO receive an annual salary of $250,000 as well as a bonus of 2% of pre-tax income. Each VP receives $160,000 plus a bonus based on personal performance relative to objectives. This remuneration is in addition to stock option grants.

The senior management team meets weekly to discuss operational and strategic issues.

Board of Directors

BB's board of directors consists of seven individuals and meets the independence requirements of the TSX Venture. Each director owns at least 20,000 shares of the company.

Hani Jafeer is Chairman of the Board.

Jason Lee is President of the General Canadian Insurance Company. He has been a member of the board since 2009.

Cynthia M. Boopell is Vice-President and General Counsel of Reed Paper Inc., a large pulp and paper company. She was elected to the board in 2009.

Jack Ross, formerly President and CEO of Tentail Communications Inc., a publicly traded telecommunications company, is retired. He became a member of the board in 2010.

Arturo Mindaro is President of Canada Restaurants Inc., a large, fast-food restaurant franchisor that is owned by a wealthy Canadian family. Mindaro was elected to the board in 2010.

Pierre Melançon is the founder and president of Wall Suppliers Inc., a chain of stores that sell high-end home decorating supplies. He was elected to the board in 2010.

Asha Sharma is a wealthy philanthropist and a member of one of the richest families in Ontario. She joined the board in 2011.

The board of directors meets quarterly and has formed three committees – audit, compensation, and environment. The audit committee consists of Lee, Boopell, and Sharma. The compensation committee consists of Mindaro, Ross, and Sharma. Jafeer, Melançon and Lee make up the environment committee.

Products

BB produces and sells four brands of juice and four brands of soft drink. The proprietary recipes for these eight products were developed by researchers on contract in the company's first year. All of the beverage names are trademarked in both Canada and the United States.

Pear Supreme™ consists primarily of concentrated pear juice, a hint of lemon juice, and other natural and artificial flavourings. Apple-Berry Special™ is a pure fruit punch, containing apple, cranberry, strawberry, and blackberry juices. Fruit Zest™ is a mixture of apple and pineapple juices. Caribbean Punch Plus™ is made from the juice of six different Caribbean fruits.

BB soft drink products are unique in the industry because they contain either real fruit juice or other natural ingredients. Mango-Plus Pop™ contains the juice of a particular type of mango, grown in a remote area of Mexico. Minnesota Spruce Beer™ is non-alcoholic and made from the outer twigs of the spruce tree, ginger root, and molasses. Limextreme™ contains a rare grade of lime juice, bought from a supplier in Mexico. Orangola Pop™ contains frozen concentrated orange juice, known as FCOJ in the industry.

The juice and soft drink recipes are kept strictly confidential in order to prevent duplication of the beverages by a third party. Ingredients, but not amounts, are listed on the product containers. Care is taken to avoid the mistake of listing all the ingredients and proportions in any document. Only three employees have access to the full recipes, including quantities.

In the early years, BB won product innovation awards, such as the 2004 Canadian Beverage Industry Association New Product Award for Pear Supreme™ juice brand and the North American Beverage Manufacturers' Healthy Innovation award in 2005 for Mango-Plus Pop™. In 2008, the company dropped one original product, Lemon Sour Supreme™, a soft drink that did not sell well. Currently, the company is not developing new flavours and has no department for research and development (R&D).

Most of the fruit juices and sweeteners that BB uses as raw ingredients are commodities with defined market prices. The company sweetens most of its drinks with liquid glucose/fructose. Diet versions of the soft drinks, comprising of approximately 25% of the sales volume, are sweetened with aspartame. Other important ingredients are carbon dioxide, natural flavours, sodium benzoate (to preserve freshness), and citric acid. For Mango-Plus Pop™, BB buys concentrated juice from whichever grower has the lowest price that particular season. In an effort to resolve some of their business problems, the 11 Mexican growers of that particular type of mango recently banded together to stabilize and increase the market price.

The company sells its products in plastic bottles of different sizes, ranging from 330 ml to 1 L. In total, there are 42 stock-keeping categories for the eight beverages. The bottles are manufactured by three different arm's-length entities. In jurisdictions in which the bottles are not recyclable, BB must contribute to the government or industry blue box program. This cost is included in the standard cost of the bottle.

Five years ago, a New York firm was contracted to design the bottles. The result was a very attractive, colourful, and memorable design that has good consumer recognition, is used for every size, and allows for a distinction in style between juice and soft drink bottles. The distinctive, stylized BB logo found on all bottles is trademarked in both Canada and the United States.

Labels are not imprinted on the bottles; printed plastic labels are used instead. All bottle labels state, "returnable for deposit where required by law", and all such regulations are observed. Bottles destined for the Canadian market carry bilingual labelling, as required by law.

Typically, the products are shrink-wrapped in cardboard flats of 12 or 24 bottles for shipping to the retailer. Generally, there is little loss due to puncture during transportation. The retailer can sell the beverages individually (at a higher price) or in any numeric combination, either chilled or unchilled.

The company's products are shelf-stable and do not require refrigeration. Although an expiry date of one year from bottling is printed on the labels, the products are drinkable for up to two years under normal conditions.

In a recent Canadian study, 11.3% of the consumers surveyed recognized the BB logo and could name one of the company's branded beverages. In consumer taste tests, all of the BB soft drinks and juices have been ranked in the top 20% of the products sampled.

For each product, the company aims to earn a gross profit on materials of at least 70%. Sales and cost data for 2011 are found in Table 1. All measures have been converted to 8-oz. (227-ml) servings for comparison purposes. The cost of materials represents a weighted average standard cost for the year and includes the cost of the juices, sweeteners, bottles, cardboard flats, and wrapping. Standard costs substantially approximate actual costs for the year.

Table 1 – Beverage Statistics for 2011

	8-oz. (227-ml) Servings Sold	Avg. Price ($)	Total Sales ($)	Average Materials Cost ($)	Material COGS ($)
BB Soft Drinks					
Mango-Plus Pop™	16,514,588	0.1863	3,076,668	0.0688	1,136,204
Minnesota Spruce Beer™*	13,789,456	0.1863	2,568,976	0.0532	733,599
Limextreme Pop™	15,478,956	0.1863	2,883,730	0.0543	840,507
Orangola Pop™	12,478,526	0.1863	2,324,749	0.0544	678,832
	58,261,526		10,854,123		3,389,142
BB Juices					
Caribbean Punch Plus™	14,845,333	0.2430	3,607,416	0.0587	871,421
Fruit Zest™	13,145,585	0.2430	3,194,377	0.0602	791,364
Apple-Berry Special™	14,785,895	0.2430	3,592,972	0.0586	866,453
Pear Supreme™	11,478,748	0.2430	2,789,336	0.0579	664,620
	54,255,561		13,184,101		3,193,858
Total	112,517,087		24,038,224		6,583,000
*branded in the U.S. as Manitoba Spruce Beer					

Sales

Sales of BB juices are strongest in Western Canada, Ontario, and Quebec. Sales of soft drinks are spread across the country, roughly corresponding to population density. U.S. sales are concentrated in the contiguous states that border Canada. The business is somewhat seasonal, with 40% of sales occurring from May to August.

The company has decided not to enter the beverage fountain market, which is dominated by the large cola companies, but currently sells bottled products to all areas of the retail market. The highest sales of soft drinks are made to supermarkets. Juices are sold primarily to club stores, although convenience store chains are also strong buyers of juice products. Customers may only return products that are defective.

Sales representatives are scattered across Canada and serve specific sales territories. Customers fax their orders to the central order desk at the head office, where the information is entered into the accounting system. Convenience stores without fax machines place orders by telephone to their respective sales representatives who, in turn, fax the orders to the head office.

Most major retailers try to earn a specific gross margin on beverages. This places pricing pressure on the manufacturers. BB has adjusted prices from time to time in response to competitive pressures but, rather than meet a competitor's price head on, prefers to offer additional marketing incentives to customers. The company sells all of its juice brands for the same price, even though there are differences in cost, because this simplifies the process for all concerned. The same is true for all lines of BB soft drinks.

Marketing

Consumers of all ages purchase BB beverages. However, the company has found that consumers aged 19-30 purchase larger amounts, primarily because of the trendy image of the drinks. As a result, this age group is considered to be the main target market.

The advertising budget allows for short advertisements on selected radio stations and full-page, colour advertisements in magazines aimed at the target market. These costs make up the company's indirect marketing expenditures.

Since BB does not sell directly to the consumer, the company provides stores with incentives to stock BB products and display them prominently. These direct marketing expenditures include the cost of in-store displays and flyer advertising. In general, convenience stores tend to require less marketing support. Various consumer promotions are also undertaken, such as bottle cap prizes and other giveaways. In addition, the company provides stores with product samples and organizes sampling booths at festivals and other events that draw large crowds.

Marketing initiatives sometimes originate at the local level. For example, in the spring of 2011, the company's juices were not selling very well in a certain large city in Western Canada. The sales representative, believing that a display program would be effective in pulling product through, sought approval for this type of initiative from the marketing department. For two months, there was much discussion on both sides as to whether or not this expenditure was justified, mainly because the budget is insufficient to cover these types of expenses. Finally, the marketing director verbally authorized the three largest retailers in the city to create prominent cardboard displays in conjunction with large orders of BB juices. The retailers were to deduct the costs of this initiative from their next payments to BB. The program was a success and sales of the juices increased.

Unfortunately, such initiatives can cause problems when authorization is poorly managed and the marketing expenses incurred by retailers are poorly tracked. Sometimes, because of a lack of communication, BB's Accounts Receivable (A/R) department first learns about the program when the related receivable is short paid. Often, retailers neglect to include the required copies of paid invoices to justify their deductions, causing difficulties for BB's controller. In addition, the sales representatives, whose remuneration includes a commission of 1.2% of sales, are unhappy with the approval process – both the time and effort involved and the lack of control – because it limits their ability to earn additional income.

Table 2 contains a summary of BB's direct marketing expenditures for 2011.

Table 2 – Summary of Direct Marketing Expenditures in 2011

Juices	Promotional displays	$ 187,485
	Flyer advertising	345,888
	Shelf space charges	354,789
	Other programs	102,485
		$ 990,647
Soft drinks	Promotional displays	$ 365,485
	Flyer advertising	378,548
	Shelf space charges	378,595
	Other programs	301,222
		$1,423,850

Head Office

BB's head office is located in an industrial park on the outskirts of a mid-sized city in central Canada. All functions except production, warehousing, and remote sales and distribution are housed here. The head office facility, including parking, occupies 39.2% of the 2.1-hectare (5.2-acre) site. Purchased nearly eight years ago, the land has a book value of $450,000 of which $176,400 is for the head office land and $273,600 is for the vacant land. Due to changes in the local area, the value of the land has increased a great deal and the municipal taxes paid by the company on the excess land are significant.

The company is currently holding this vacant land for capital appreciation. The company has classified this as an investment property (under IFRS) and therefore the vacant land is reported at fair market value at each reporting date. Any changes in the fair value are reported in the profit for the year. The vacant land had a market value of $2 million at December 31, 2011.

Production

The production facility is located 25 km away from the head office, just outside the city. The plant is a converted pea-canning factory that was built over 20 years ago and includes ample warehouse space.

BB’s production equipment includes storage tanks, freezers, bottlers, pasteurizers, palletizers, de-palletizers, conveyors, and case packers. A combination of new and used equipment was purchased when the company was founded.

The purchase of the production facility was financed with a loan from the Resident Bank of Canada. The loan is repayable over 15 years at $311,121 per annum and the interest rate on the loan is 6.4%.
The company tries to minimize inventory through just-in-time production and accurate prediction of volumes. Because the time required to produce the company’s products is rather short, inventory levels are fairly low compared with those of other manufacturers.

BB’s manufacturing team uses an MRP (Manufacturing, Resources, and Planning) system. This provides critical information for decision making with respect to production scheduling, re-ordering of raw materials, etc.

BB uses municipal tap water in its production process. Although the water is considered to be of very good quality, it is filtered by the company to improve its taste and purity. The facility has passed all government inspections in the last four years.

Production employees work from 8:00 a.m. to 4:00 p.m. and can produce approximately 130 million beverage servings per year. The plant has an excellent safety record, of which Lemieux is proud. Overtime is rare and is paid at time and a half.

The 2011 incurred costs of the facility are set out in Table 3. According to the plant accountant, the costs for management and indirect labour are fixed, as well as two-thirds of the facility expenses. The remaining facility costs vary in proportion to production volume.

Table 3 – Production Costs Incurred in 2011

Management salaries and benefits	$ 314,355
Supervisory salaries	547,635
Indirect labour	574,296
Depreciation of plant	47,957
Depreciation of equipment	382,483
Facility costs	814,500
Direct labour	3,081,869
Supplies	358,115
Total	$6,121,210

Distribution

BB has seven distribution centres across Canada and six in the United States. Each centre rents a small warehouse or a portion of a larger, third-party warehouse. A long-distance trucking company is engaged to ship the beverages from the plant to the warehouses.

Each distribution centre has operating leases for between one and five trucks in order to make regular deliveries. The accounting system prints out a time-minimized, daily delivery schedule as well as the orders. For smaller customers, such as convenience stores, the driver is required to both deliver and shelve the product. In larger stores, shelving is done by the store's employees.

Human Resources

BB's head count by department is set out in Table 4.

Table 4 – Head Count

	Number of Employees
CEO's office	3
Finance	21
Distribution	28
Sales	27
Marketing	18
Production	105
Total	202

In the region in which the production facility is located, there is a plentiful supply of labour. All production workers below the level of supervisor are represented by the United Food and Commercial Workers Union and, although they complain, are relatively content with their circumstances. They are paid reasonably well, given their skill level and the job base of the region. Relations with the union are neither good nor bad. However, four years ago there was a two-week strike. The current collective agreement expires on October 1, 2013. It is expected that the union will be demanding a pension plan in its next collective agreement.

Generally, the company's non-unionized workers are happy with their working conditions and pay. BB offers a standard benefit plan with life, long-term disability, accidental death, and health and dental insurance coverage. There is a growing expectation that the company will establish a pension plan – either a defined benefit plan or a defined contribution plan – in the near future. The director of human resources is considering going ahead with such a plan in lieu of raises for the next two years.

Financial Information

As required for Canadian publicly traded companies, Bella Beverages converted to international financial reporting standards (IFRS) with a transition date of January 1, 2010. Consequently, the company has reported using IFRS for 2010 and 2011. The major changes on adoption of IFRS are related to classifying the vacant land as investment property. The accounting for investment properties requires that the land be reported at fair value at each reporting period, with changes in fair value reported in the current period's profit or loss. As a result of this change, the value of the land was increased from its book value of $273,600 to $1,750,000 on January 1, 2010, along with a recognized deferred tax liability of $221,460. The net impact to retained earnings as at January 1, 2010 was $1,254,940. The deferred taxes are on the taxable capital gain portion of the increase in value and therefore the rate applied is 15% (50% of 30%). On December 31, 2010, the land value increased by $100,000 to $1,850,000, resulting in an increase in the related deferred tax liability of $15,000 and a net impact on profit of $85,000.

The TSX Venture regulations stipulate that the company must report its results quarterly to shareholders and the public. BB's quarter-ends are March 31, June 30, September 30, and December 31.

BB uses the Gold Standard™ accounting system for all financial reporting. The system has order-processing, accounts receivable, accounts payable, and general ledger capabilities.

Bella Beverages Inc. is the parent company of a U.S. subsidiary, Bella Beverages (U.S.A.) Inc. (BBU), incorporated in the state of Delaware. The subsidiary employs 27 people in sales and distribution. All sales to U.S. customers are recorded through BBU and its books and records are kept in Canada. Transfer prices between parent and subsidiary are based on an Advanced Pricing Agreement approved by the Canada Revenue Agency so that there is no risk of re-assessment. The operations, assets, and liabilities of BBU are consolidated with those of the parent company and inter-company sales are eliminated. In this document, all references to BB are to the consolidated business, except as otherwise noted. Both the subsidiary and the parent company have the same functional currency which is the Canadian dollar.

The finance department prepares an annual, flexible budget with a detailed, one-year outlook and a higher-level, three-year outlook. The budget is updated quarterly. Three years ago, the budget was overly optimistic with respect to the level of sales. The budgets for 2010 and 2011 were fairly accurate, but failed to anticipate the price change for certain juice inputs.

The company carries all standard insurance as well as product liability and tampering insurance. This last coverage protects a company in the event of deliberate interference with its product, such as in the Tylenol incident of 1982.

BB's policy is to invest in only those projects that are likely to produce an after-tax rate return of 10%.

BB uses a well-known third-party payroll service at a cost of pennies per employee per pay.

The year-end financials, as publicly distributed, are presented in Exhibit 2.

Statements of Financial Position

Cash consists of cash in the bank, less outstanding cheques.

Accounts receivable consist of trade receivables from customers. Generally, selling terms are net 30 days. However, the large retailers do not pay on a timely basis, and they ignore discounts and interest penalties because of their leverage.

Inventory consists of raw materials (primarily juice concentrates, sweeteners, and empty bottles) and finished products. There is no work in process at year-end because there is no production on December 31.

Prepaid expenses include such items as warehouse rent and insurance.

The amount reported for net property, plant and equipment consists of the head office, the plant building and its equipment, and computer hardware and software. These are reported net of depreciation, which is calculated using the straight-line method over the estimated useful lives of the assets.

Investment property represents the vacant land that is adjacent to the head office.

Accounts payable and accrued liabilities include trade payables and miscellaneous accruals such as vacation pay liabilities.

Deferred income taxes are primarily due to the difference between accounting depreciation and capital cost allowance.

Statements of Comprehensive Income

Revenues represent the net amount received from the sale of product.

Salaries are reported under the appropriate department headings. Cost of sales includes the cost of raw materials, direct labour, and factory overhead at standard cost, which closely approximates the actual cost. Marketing and promotional costs are expenditures (including salaries) related to sales, marketing, and product promotion. Distribution and selling costs are the costs and salaries associated with storing product outside of the production facility and delivering it to the customer. General and administrative costs of the company include all other costs and salaries that are not included in the amounts above.

Interest expense is shown as a separate item and includes bank fees, interest on line of credit and long-term loan.

Depreciation is calculated using the straight-line method, over the estimated useful life of the related asset.

The change in value of the land relates to the change in the fair value of the land over the year.

Earnings per share are calculated based on the weighted average number of shares outstanding. Diluted earnings per share consider the impact of stock options. Usually, the two types of earnings per share differ by less than half a cent. As a result, the reported values are the same.

The company’s consolidated income tax rate is effectively 30% for the future years.

Banking

Since inception, BB’s banker has been the Resident Bank of Canada and a good relationship has been maintained with the account manager. The company has both a Canadian dollar account and a U.S. dollar account with the bank in Canada, as well as a U.S. dollar account with the bank’s affiliate in the United States.

In the past, the Resident Bank has provided loans for equipment and a mortgage on the head office. At the present time, according to the bank, an $850,000 loan could be advanced against the mortgage-free head office facility alone (assuming the unused land was sold) and up to $2.4 million against both the facility and the land.

Currently, the company has $2.5 million of unused borrowing capacity in its operating credit facility. This is margined by 50% of inventory and 75% of collectible receivables, less statutory prior claims.

Shares and Stock Options

BB obtained its listing on the TSX Venture in April, 2006, through a $2.6 million initial public offering (IPO). The company was sponsored by Term Sheet Securities Inc., a TSX member and lead underwriter. The offering price was $1.10 per share and the funds were used to help purchase the production facility (previously rented), pay off the mortgage on the head office, fund marketing initiatives, and increase cash reserves.

BB is now considering whether or not to seek a listing on the Toronto Stock Exchange (TSX).
The share price increased during the first two years but has flattened since then (see Table 5).

Table 5 – Share Price

	2011	2010	2009	2008
Year-end share price	$2.80	$2.90	$2.60	$2.80

Only common shares have been issued (see Table 6). The shares held by the founders were released from escrow and became freely tradable three years after the IPO. Since the 2011 year-end, no new shares have been issued. Jafeer remains the largest shareholder.

There are 80,000 stock options outstanding, all held by VPs and at various exercise prices. The compensation expense related to these stock options is accounted for under the international financial reporting standards for stock-based compensation. However, the charges are minor and are captured under the annual expenses of the respective departments.

Table 6 – Shareholder Data at December 31, 2011

	Number	Dollars	Average Exercise Price/Share
Common shares issued and outstanding	4,578,555	$3,662,844	–
Number of shareholders	252	–	–
Stock options outstanding	80,000	–	$1.20

On a typical day, between 30,000 and 40,000 shares of BB stock change hands. This is a rather low trading volume and indicates little market demand. As a result, it is difficult for shareholders to liquidate their shares and employees have become less motivated to exercise their stock options.

Currently, no market analysts review the company's stock. Term Sheet Securities Inc. originally committed to do so but filed only two reports, because the stock traded very thinly after the IPO. BB has been unable to attract a lot of attention in the markets and issues an average of two press releases per year, apart from quarterly earnings announcements. The company has paid a dividend only once, in 2009.

Global Soft Drink Industry[1]

The global soft drinks market grew at a steady rate during the period 2005-2009, as a result of steady sales growth in the bottled water, functional drinks, and RTD tea and coffee categories. The overall market growth is expected to decelerate in the forthcoming five years.

The global soft drinks market generated total revenues of $440.3 billion in 2009, representing a compound annual growth rate (CAGR) of 3.5% for the period spanning 2005-2009. In comparison, the Americas and Asia-Pacific markets grew with CAGRs of 2.8% and 4.8% respectively, over the same period, to reach respective values of $188.3 billion and $91.1 billion in 2009. Market consumption volumes increased with a CAGR of 3.8% between 2005 and 2009, to reach a total of 398.7 billion litres in 2009.

Carbonates sales proved the most lucrative for the global soft drinks market in 2009, generating total revenues of $187.2 billion, equivalent to 42.5% of the market's overall value. In comparison, sales of bottled water generated revenues of $83.3 billion in 2009, equating to 18.9% of the market's aggregate revenues and this was followed by Juices which generated revenues of $71.4 billion, equivalent to a 16.2% of the market's aggregate revenues.

The Americas accounted for 43.9% of the 2009 global soft drinks market value. Europe accounted for a further 36.3% of the global market and Asia Pacific accounted for 19.8% of the global market

The performance of the market is forecast to decelerate, with an anticipated CAGR of 3.0% for the five-year period 2009-2014, which is expected to lead the market to a value of $511.6 billion by the end of 2014. Comparatively, the Americas and Asia-Pacific markets will grow with CAGRs of 2% and 5.2% respectively, over the same period, to reach respective values of $207.5 billion and $117.2 billion in 2014. The market's volume is expected to rise to 465.4 billion litres by the end of 2014, representing a CAGR of 3.1% for the 2009-2014 periods.

Supermarkets and hypermarkets form the most significant distribution channel in the global market. The presence of big supermarket chains increases buyer power. Players in this market may opt for an integrated business, in which they sell ready-to-consume drinks to retailers, or they may adopt a business model in which they sell raw materials (concentrates) to a network of bottling companies, which may be independent

[1] Datamonitor. (July 15, 2010). Soft Drinks. [Industry Profile]. Retrieved from Lexis Nexis database.

companies or owned to some extent by the players. New entrants must contend with the global reach and strong brands enjoyed by the incumbents, although niche markets such as smoothies can still be exploited. There is no great threat posed by the soft drinks' substitutes except from traditional coffee and tea or homemade juices.

The soft drinks market will be analyzed by taking manufacturers such as The Coca-Cola Company or PepsiCo as market players, distributors and retailers as buyers and producers of packaging, soft drinks ingredients and other raw materials as suppliers. The global food and drink retail market is concentrated in terms of distribution channels, with the key distribution channel being supermarkets/hypermarket (47.9% of the market volume). The leading players generate most of their revenue from the production of concentrates, which are sold to bottling companies. Some bottlers are independent, others are owned by the big-name manufacturers described usually as 'partners' and 'customers'. The bottlers are licensed to convert purchased raw materials into soft drinks, packaged with the manufacturers' branding, and distribute the ready for sale commodities to buyers within a particular sales territory. Although majority of bottlers are free to make their own business decisions, the close ties between manufacturers and bottlers means that food and beverage retailers are arguably the more significant buyers from the point of view of market players. The consolidation degree in the food and beverage retail markets varies considerably from country to country. The majority of the soft drinks market in Europe is highly concentrated. However, developing economies are characterized by fragmented food and beverage markets such as China. Consumers in this market are likely to be strongly influenced by brand as retailers are forced to stock brands popular among consumers. This is strengthened by the broad differentiation of the market's products.

Primary inputs for soft drinks manufacturers include concentrates, a range of natural and synthetic sweeteners such as corn syrup and refined sugar (sucrose), aspartame, and similar ingredients. Some of these commodities, although available from several sources, are subject to price fluctuations. Others (e.g. aspartame) are available from only one or two major players. However, even in these cases, there are usually substitutes available. For example, if aspartame becomes expensive or unobtainable then it can be substituted by saccharine and other similar products. Water, which is the major input, may raise the concerns of multinational players, especially in some countries, where water scarcity is a risk factor for their business. The power of packaging manufacturers is growing since there is a growing demand for more consumer friendly form of packages. Advertising and marketing agencies also play significant role in the brand building process in the soft drinks market. Years of consolidation have left the advertising industry highly concentrated in most countries. The consumers in the US and European countries are switching to low sugar and sodium products, which requires certain different production methods.

Players in the global soft drinks market try to distinguish their products to some extent by stressing their health benefits (especially for juices and functional drinks) and taste. Although it would be difficult for a new entrant to compete with the brand strength and reach of existing players, it may be possible to achieve small-scale success stressing a unique production method or nutritional benefits. Even if a new player opts for a business model in which much of the production process is performed by bottling partners under license, there will still be a need to invest in manufacturing capacity in order to produce the concentrates. This will generally be fairly capital-intensive and restrict market entry to players. However, market niches can be exploited by new entrants. For example, the UK company developed fruit smoothie products whose brand stressed purity and freshness of ingredients. There is also a trend of moving away the primary target audience such as the under 15 year olds and focus on all age groups, giving the new entrants the opportunity to fill the niche. This, together with the expected shift towards fruit juice, enhances the chance of market entry.

The substitutes for soft drinks primarily include traditional tea and coffee, and homemade juices to name a few. Leading players tend to have diverse product ranges, which reduces the threat posed by substitutes. For example, Nestle is a major player in the coffee market as well as a range of soft drinks, such as mineral water. Switching in the sense of allocating more shelf space to the substitutes may be advantageous in cost terms. This may be especially beneficial in countries where electricity is relatively expensive like in India.

The global soft drinks market is fairly fragmented, with the leading players such as The Coca-Cola Company, PepsiCo and Nestle collectively accounting for 42.7% of the market volume. This indicates that some smaller players may be still successful in this market. The ease of exit depends to some extent on the business model of the company. A company which manufactures ready-for-consumption soft drinks in a single integrated process will need to dispose of assets such as specialized equipment in order to exit the market. On the other hand, a company of the same size that operates in conjunction with a network of bottling partners will tend to have fewer assets, and exit is therefore easier. As this model is adopted by the two leading players, rivalry in the global market is correspondingly reduced.

Board of Directors’ Meeting

At the January 16, 2012 meeting of the board of directors, the year-end financial results were approved for release. However, the Board felt that a close look at the company’s strategic and operational issues was needed. With the imminent departure of Jafeer and a replacement not yet chosen, the Board recommended that a senior insider take a fresh look at the current issues. Therefore, the directors asked Kerry Vance and his team to develop a comprehensive report advising them about the strategic and operational issues facing BB.

The Board is concerned about BB’s earnings per share (EPS). Any proposal should examine the impact on the EPS, since the Board would like to commit to growing the EPS 10% annually.

Kerry Vance and his team have worked together with the senior management team of BB to formulate potential growth opportunities and have outlined the key operational issues facing BB. The following paragraphs summarize their notes from a series of interviews with the senior management team.

New Developments

Athlete Promotion

BB's marketing vice-president has been looking into the possibility of an endorsement campaign involving a high-profile athlete who is a good fit with the company's target market. This would be a major marketing effort. Van Besmin's team sent out a request for proposal in December 2010 and received replies from three large public relations/advertising firms. In an extensive review process involving many meetings, the proposal put forward by Loud Mouth Promotions Inc. (LM) was selected. The Marketing department has presented the LM program to senior management for approval. The cost of the program and the related financing are delaying the final decision. A summary of the proposal is contained in Exhibit 3.

Bottled Water Venture

On January 12, 2012, Jafeer was evaluating a 0.8-hectare (2-acre) parcel of farmland for a potential bottled water venture. This tract of land contains an excellent spring, known as Claravay Spring, that could support a water-bottling business. The property is located in central Canada, 212 km from the company's production facility, in an area that is primarily farmland. The owner currently takes water from Claravay Spring and allows local people to do so as well, without charge.

Chemical analysis revealed that the farm's spring water is exceptionally pure. The flow at the head of the spring is fairly consistent at the rate of 280-290 litres per minute. Twenty-five BB employees were asked to taste the water in a blind test, comparing the spring water with local tap water and 10 major brands of bottled water. Twenty-three of the employees rated the Claravay Spring water as "far superior" in taste.

A consulting firm was hired by BB to perform an analysis of the water-bottling venture in conjunction with one employee from each of the Marketing, Sales, and Bottling departments. The executive summary of their findings is presented in Exhibit 4.

Brand for Sale

In December 2011, the president of Wonder Snacks Inc. (WS) approached BB about purchasing its soft drink line for $2.8 million, all for the equipment. On analysis of the equipment, it was determined that the remaining life is only five years. The Wonder line is composed of four specific brands of naturally flavoured soft drinks. The sales volume of these brands has been steady for six or seven years.

WS is in the business of selling ice cream and other frozen snack products but purchased the line of soft drinks from a third party 11 years ago. Recently, the company examined its core competencies as part of the strategic planning process and decided that the drinks do not fit with the company's future direction. The larger beverage companies are not interested in purchasing the Wonder line because the brands lack fit with their current products and the size of the business is insignificant relative to their own operations. Non-beverage companies are not interested because they lack the necessary distribution channels.

Exhibit 5 contains information regarding sales volume, production costs, and promotion costs for the Wonder drinks in 2011. Santina Marella believes that the same level of sales could be achieved using BB's existing sales and distribution network. However, she does not favour brand diversification and believes that BB should work instead to maximize sales of its own products. Claude Lemieux determined that manufacturing costs in BB's plant would be comparable, but with a $250,000 set-up cost and ongoing maintenance. John Van Besmin says that promotional costs would be about $300,000 higher than Santina's data indicates. Garphite maintains that incremental distribution costs would be about 5%. Transaction costs for the purchase would be approximately $25,000.

Private Label Production

In January 2012, the company was approached by a large, east coast supermarket chain, Jeezy's Inc. The chain would like to have BB produce under private label three brands of juice labelled as Jeezy's Fruit Zest. Jeezy will provide the recipe and BB will produce and distribute the product.

The estimated annual volume is 4,000,000 servings and the length of the initial agreement would be one year, which could be renewed depending on how the product performs. The proposal is that Jeezy would pay $0.19 for each serving of the private label product. During 2011, BB's juice sales to Jeezy's Inc. amounted to 1,301,245 servings. BB estimates that it currently spends $50,000 on promotional costs related to Jeezy. Under the new arrangement, there would be a new manager that would work solely with Jeezy and would cost $150,000 annually.

Possible Sale of Bottling Plant

Lemieux has recently approached the other members of the BB management team with an offer to purchase the company's bottling facility for $5,000,000. This management buyout (MBO) would apply only to the assets and exclude any inventory. Lawyer transaction fees for BB if the sale went ahead, are estimated to be about $45,000.

Lemieux said that the new entity would provide BB with a long-term supply agreement. The new entity would select its own sources for the raw materials, but would maintain the current quality. The price for the same mix of container sizes would be based on total 2011 production costs (including depreciation but excluding raw materials) divided by 2011 production volume, less 25%, for the first 150,000,000 servings, and four cents per serving thereafter. This price would apply for three years. Lemieux would guarantee to provide volumes of up to twice the 2011 production level, with the minimum being 90% of the 2011 level.

Lemieux has arranged tentative financing to support the purchase. This involves term financing with a bank and some third-party private equity. Lemieux says he plans to be much more aggressive with the union and to increase production volumes in order to cover the fixed costs.

Other Developments

1. The board is concerned about the potential adverse market reaction to the news of Jafeer's imminent departure. The board feels that the HR department needs to accelerate their search for a new CEO to mitigate the risk of a share price decline. The board also wants to see a formalized plan on CEO selection and succession planning.

2. Amy Lu has recommended a change to BB's organizational structure. She believes that the current functional structure is a contributing factor to the stagnant growth that BB has experienced over the years. She believes that functional organizational structure has caused poor coordination between functional specialties, slow response to organizational problems, open conflict between departments and a neglect of customer needs. She believes that BB needs an organizational structure that will improve the coordination between the functional specialties and increase the response time to develop new products.

3. Recently, BB commissioned an appraisal of the production facility by a licensed commercial real estate appraiser and a commercial equipment appraiser. The land, plant, and equipment were valued at $5.05 million, assuming an orderly sale.

4. Some executives of the company would like to sell the soft drink line of products.

5. An executive with Fries Snacks approached BB with a proposal for a co-branding agreement. Under her proposal, consumers could buy one 330 ml bottle of Limextreme™ and one 70 g package of Fries Lime Chips for 60% less than the total of the regular prices for these products. The snack boasts an 11% market share in the exotic chips segment. The Limextreme™ bottles would carry a small sticker touting the offer and BB would pay $120,000 in advertising costs related to the program. The length of this agreement would be three months and the estimated sales volume is 400,000 units.

6. On November 13, 2011, a retail customer reported that a BB salesperson had failed to keep a delivery promise, which had resulted in severe inconvenience to the customer. On December 11, 2011, GrocCo. Inc. reported that a store manager had been suspended for accepting a $400 payment from a BB salesperson to place BB products on the best-positioned shelves in the beverage section of the store. As a result of these and a number of other incidents in 2011 and early 2012, BB's

management team has decided that something must be done about work ethics in the company.

7. Over the last year and a half, the cost to produce Mango-Plus Pop™ has been increasing with the price of the key input, mango juice from a special type of mango grown in Mexico. Currently, the mango juice costs 2.3 cents per serving. The sweetener is an additional 1.2 cents per serving.

8. The company is considering implementing a new pension plan for its management and employees. The Board would like to understand the impact on the financial statements depending on whether or not a defined benefit or a defined contribution plan is adopted. This information is also necessary to prepare for the upcoming union negotiations.

REQUIRED:

Assuming the role of Kerry Vance and his team, develop a comprehensive report to the Board of Directors, complete with analysis and recommendations as to the strategic direction the company should take to address their stagnant performance and to improve their profitability.

Exhibit 1
Summarized Organizational Chart

Bella Beverages Inc.

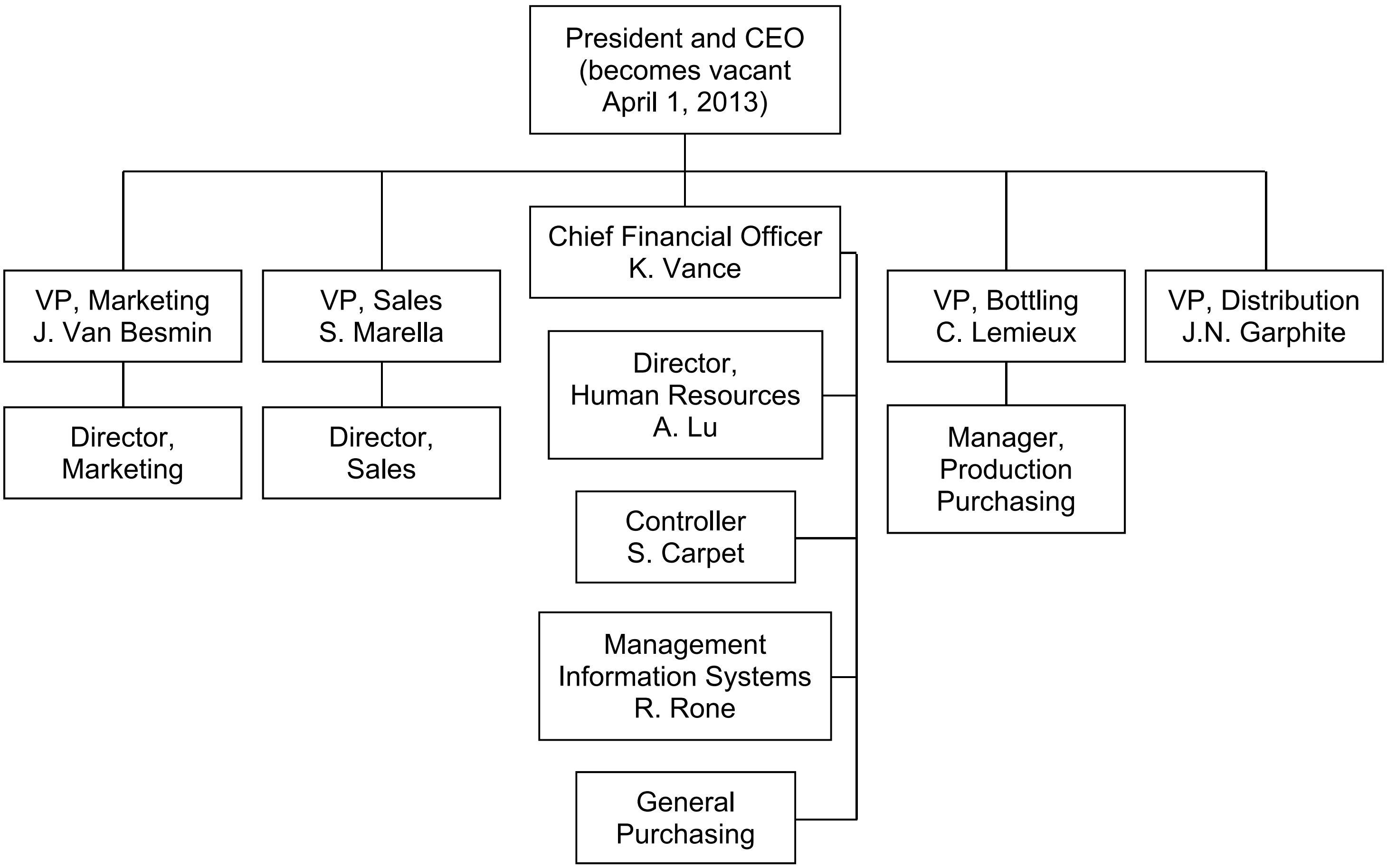

Exhibit 2
Historical Financial Information

Consolidated Statements of Financial Position
As at December 31

	2011 IFRS	2010 IFRS	2010 C-GAAP	2009 C-GAAP	2008 C-GAAP
Assets					
Current Assets:					
Cash and equivalents	$ 2,478,000	$ 901,222	$ 901,222	$ 48,444	$ 11,478
Accounts receivable	2,965,524	2,982,394	2,982,394	2,937,252	2,980,673
Inventory	1,334,486	1,328,446	1,328,446	1,326,501	1,389,356
Prepaid expenses and deposits	174,785	159,785	159,785	167,885	164,785
	6,952,795	5,371,847	5,371,847	4,480,082	4,546,292
Net property, plant and equipment	7,164,712	7,750,909	8,024,509	8,586,870	9,145,319
Investment property	2,000,000	1,850,000	0	0	0
Total Assets	$16,117,507	$14,972,756	$13,396,356	$13,066,952	$13,691,611
Liabilities and Shareholders' Equity					
Current Liabilities:					
Accounts payable and accrued liabilities	$ 1,728,079	$ 1,600,616	$ 1,600,616	$ 2,139,955	$ 2,208,070
Current portion of long-term loan	311,121	311,121	311,121	311,121	311,121
	2,039,200	1,911,737	1,911,737	2,451,076	2,519,191
Deferred income taxes	515,746	446,335	209,875	154,042	110,186
Long-term loan	3,733,446	4,044,567	4,044,567	4,355,688	4,666,809
Total liabilities	6,288,392	6,402,639	6,166,179	6,960,806	7,296,186
Shareholders' Equity:					
Capital stock	3,662,844	3,630,611	3,630,611	3,602,003	3,566,342
Retained earnings	6,166,271	4,939,506	3,599,566	2,504,143	2,829,083
	9,829,115	8,570,117	7,230,177	6,106,146	6,395,425
Total Liabilities and Shareholders' Equity	$16,117,507	$14,972,756	$13,396,356	$13,066,952	$13,691,611

Exhibit 2 (cont'd)

Consolidated Statements of Comprehensive Income
For the years ended December 31

	2011 IFRS	2010 IFRS	2010 C-GAAP	2009 C-GAAP	2008 C-GAAP
Revenues	$24,038,224	$23,978,444	$23,978,444	$23,850,488	$23,785,771
Cost of sales	12,589,873	12,588,683	12,588,683	12,497,656	12,392,387
Gross profit	11,448,351	11,389,761	11,389,761	11,352,832	11,393,384
Expenses:					
Marketing and promotion	3,557,657	3,356,982	3,356,982	3,315,218	3,377,579
Distribution and selling	3,004,778	3,021,284	3,021,284	2,957,461	2,949,436
General and administration	2,692,281	2,805,478	2,805,478	2,885,909	2,830,507
Interest expense	292,422	314,916	314,916	337,410	359,904
Depreciation	210,036	205,835	205,835	202,895	202,265
	9,757,174	9,704,495	9,704,495	9,698,893	9,719,691
Operating income	1,691,177	1,685,266	1,685,266	1,653,939	1,673,693
Change in value of land	150,000	100,000	0	0	0
Profit before taxes	1,841,177	1,785,266	1,685,266	1,653,939	1,673,693
Income taxes – current	545,002	534,012	534,012	535,023	481,827
Income taxes – deferred	69,410	70,831	55,831	43,856	103,966
Total taxes	614,412	604,843	589,843	578,879	585,793
Net Profit for the Year	$1,226,765	$1,180,423	$1,095,423	$1,075,060	$1,087,900
Earnings per share	$0.27	$0.26	$0.24	$0.23	$0.24
Diluted earnings per share	$0.27	$0.26	$0.24	$0.23	$0.24

Exhibit 3
Athlete Promotion

Executive Summary – Athletic Endorsement Proposal for Bella Beverages Inc.

Loud Mouth Promotions Inc. (LM) has developed this proposal based on the needs analysis submitted by BB.

BB is looking for a major advertising campaign to give its line of juices and soft drinks a high-profile connection to a successful, young, popular, and charismatic athlete in order to drive sales to the next level. BB has informed us that its primary target market is consumers aged 19-30 and management has asked for a one-year proposal.

After carefully considering the athletes with whom we have contracts, we propose Bobo Buckets as the centrepiece of the program. Bobo has been considered one of the top 10 athletes in his sport (soccer) in each of the last three years (according to the Sports Rag poll for 2009, 2010, and 2011). He is single, handsome, and 28 years old. He has never had negative press for any reason and has no other major endorsement contracts. Focus groups of individuals aged 19-30 (put together by LM) consistently raved about Bobo's personality and energy. Bobo is equally popular with males and females.

Our proposal includes additional spending on in-store product displays, billboard advertising, a one-year radio campaign, changes in BB's website and product labelling. The labelling costs would amount to about one half a cent per serving.

The costs of the program are as follows:

Fee to LM	$ 300,000
Athlete's fee	2,500,000
Promotional displays	400,000
Radio spot development	45,000
Radio spot fees	440,000
Billboards	650,000
Website changes	20,000
Total costs	$4,355,000

Based on our extensive experience with similar promotions and our analysis of BB's brands and business, we estimate that growth in sales volume of 20%-30% over the 2011 revenues can be expected in the first year of this program and 10% of this 2011 increase in revenues can be achieved in the following year. The company currently has the capacity to handle this estimated increase in sales.

Exhibit 4
Water Venture

Executive Summary – Analysis of Bottled Water Venture Based on Claravay Spring Purchase

We believe this to be an excellent opportunity for the company.

We looked at seven other springs currently for sale within 400 km of BB's plant. Considering only the flow of water in litres per minute, the cost of obtaining water from Claravay Spring is approximately one-third lower than the corresponding cost for water from the other springs. Proximity to the plant and the superior taste of the water are additional factors in Claravay's favour. The water was tested in a laboratory and no trace of biological or chemical contamination was found.

Unfortunately, the old house and farm buildings are decrepit and would have to be removed. We have discussed the situation informally at the appropriate levels and we believe that there would be no serious impediments to obtaining the necessary government approvals.

The venture's upfront costs are estimated as follows:

Cost of land	$1,840,000
Transaction costs	65,000
Drilling costs	48,000
Property cleanup	40,000
Collection and tanks	840,000
Legal and other	25,000
Total costs	$2,858,000

The collection and tanks equipment will qualify for capital cost allowance at the rate of 20%. The other costs are part of the land costs. It is expected that the equipment will last for 10 years.

To ensure that the same plant machinery could be employed for bottling juice, soft drinks, and water, the current bottle sizes (330 ml to 1 litre) would be used. Bottle colouring and labelling would be altered so that the product appears different from the juice and soft drink lines but is clearly recognizable as part of the BB brand.

Production and distribution costs, including the cost of an independent trucker delivering the water to the plant, are estimated as follows:

	Cost per Bottled Water
Bottle	$0.014
Bottling	0.033
Other packaging	0.010
Shipping and distribution	0.005
Total cost	$0.062

The bottled water could be sold through BB's existing channels to the same markets in Canada and the United States. The target market would be health-conscious individuals aged 20-60.

Our sales forecast is 50 million servings in the first year, at an average of CDN $0.16 per serving. About half the sales would be to the U.S. market. (We assume that the Canadian dollar will remain around par with the US dollar for the forecast period.) It is expected that number of servings sold each year will increase annually as follows over the forecast period:

Year 2	Year 3	Year 4	Year 5	Years 6 to 10
8%	6%	5%	5%	3%

The maximum number of servings that can be produced in a year by the plant is 70 million. A pessimistic estimate would be to only sell 40 million servings in year 1, with similar growth assumptions as above. (At this reduced level of production, costs would be the same as producing 50 million servings.)

It is expected that selling prices and costs of sales will increase at the rate of inflation estimated to be 1% annually over the forecast period.

We believe that this sales level of 50 million servings is achievable with our current customers and eight additional sales personnel at $80,000 per annum including benefits. The number of sales personnel will increase by 1 person for every additional 10 million servings produced and sold over the 50 million servings base. In addition, the annual salaries are expected to increase with inflation at 1% annually.

Other expenses for the forecast period are as follows:

1. Fixed site personnel – There will be eight site personnel required at an average salary of $40,000 (which includes benefits). The number of personnel will increase by one for every additional 10 million servings that are produced over the 50 million servings base.
2. Commissions will be 2.2% of revenues, higher than normal in order to drive sales of this new product.
3. Additional machinery costs will be initially $150,000.

4. Advertising costs will be $2.4 million in the first year; $2.424 million in year 2; decline to $1.5 million in year 3; $1.515 million in Year 4, and then equal to 15% of revenues for years 5 to 10.
5. Store promotion costs will initially be $1.5 million in the first year; $1.515 million in year 2 and then decline to $1.2 million in year 3 and $1.212 million in year 4. For years 5 and onwards, the store promotion costs will be 12% of revenues.

   All costs are expected to increase annually at an estimated inflation rate of 1%.

Initially, there will be an investment in inventory and accounts receivable of $70,000 and $500,000, respectively.

At the end of the 10 years, the land and the equipment are expected to have an after-tax salvage value of $2 million and nil, respectively.

The numbers are large, but we believe that there are sources of financing available to the company. The farmland itself could be mortgaged for $900,000, according to the Resident Bank of Canada account manager.

Since this is a new venture for the company in which the risk is higher, a 15% cost of capital should be used in assessing this proposal.

Exhibit 5
Wonder Brand Purchase

2011 Sales Volume

Brand	500 ml Bottles Sold
Prune Wonder	5,245,332
Ice Tea Wonder	5,405,277
Splite Wonder	5,114,577
Sports Wonder	5,263,767
Total	21,028,953

2011 Financial Data

Selling price per 227 ml serving	$0.16
Variable production cost	50%
Promotion costs	$1,908,745

The equipment is only expected to last five years, after which it will have to be replaced and modernized. It is expected that since sales have been steady in the past, all the brands except Sports Wonder will remain at the same sales volumes over the next five years. There is a 30% probability that Sports Wonder sales will increase by 2% per year and a 70% probability that its sales will remain at the same level as in 2011. The company has decided to leave the selling price at $0.16 for the first three years, and then increase to $0.17. Variable costs will remain at 50% of revenues for the forecast period. The equipment qualifies for 20% capital cost allowance. All other costs are expected to increase by 1% inflation each year.

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