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Capstone 1

J.R. Pets Inc. — Case

Candidates are expected to use the case facts from the Capstone 1 case to complete their analysis. It is not expected that candidates consider the impact of emerging current events in their response. However, candidates may choose to do so in a reasonable way. For instance, when conducting industry research, candidates may encounter and consider the implications of COVID-19 on the industry. However, the impacts of current events are not meant to be a significant part of candidates' analysis.

2023-06-29

Capstone 1

J.R. Pets Inc. — Case

CPA Evaluation — 2023

Due to timing of authoring of the Capstone 1 case, the interest and inflations rates here do not reflect actual rates. Candidates should use the case facts as presented.

It is May 8, 2023, and you are currently working as a CPA with Quinton and Sparks Consulting LLP (QSC). You have been assigned to develop a report for the board of directors (board) and management of J.R. Pets Inc. (JRP).

JRP has approached QSC with a request to assist it in strategic analysis and to set a new direction for the company. Based on JRP's 2022 results and future forecasts, the shareholders are concerned about the company's slowing revenue growth rate, declining margins, and future prospects. There are conflicting opinions amongst the four shareholders as to the company's future strategic direction. JRP has also asked for assistance with a variety of additional issues that have arisen, which it would like QSC to analyze and address.

You have been provided with the following information to review and analyze (all dollar values are in Canadian dollars unless specifically stated otherwise).

J.R. Pets Inc.

JRP is a private company owned by two friends and their spouses. Julia Hammond owns 40%, her husband Steve owns 10%, Richard Davidson owns 40%, and his wife Elaine owns 10%. JRP currently operates 20 pet stores in total, located in Nova Scotia, Quebec, and Ontario. The company operates in a segment of the pet retail industry, selling a selection of specialty pet foods and supplies and providing pet grooming and training services.

An organizational chart is provided in Appendix I. JRP's most recent financial statements for the years ended December 31, 2020, 2021, and 2022 (prepared under ASPE) are provided in Appendix II. Industry benchmarks are provided in Appendix III.

Pet retail industry information

Description

In Canada, the pet retail industry consists of the following:

- stores that sell only items related to pets ("pet stores")
- other retail stores that sell pet products in addition to other goods ("pet retailers")

The primary products and services in the pet stores include pet food and other supplies, pet-related services, and small animals. In 2020, the pet store industry had total revenues of $2.5 billion and is expected to grow at an annual growth rate of 1.7% to 2025.[1] (Note that this revenue is what has been earned by pet stores in total and does not include sales of pet products that are sold by pet retailers.) Increases in revenues are driven by increasing pet ownership rates. In 2018, based on survey results, 37% of Canadians owned a cat and 41% owned a dog, which approximates 8.3 million cats and 8.2 million dogs.[2] In more recent years, a shift to more employees working remotely from home has increased the demand for pets. Not only has pet ownership been increasing, but average annual pet expenditure per household has also been increasing.[3]

Value chain

Steps in the value chain for pet stores (which excludes training and training services) include the following:

1. Research and development: Manufacturers develop ideas for new pet foods or other supplies or improve current products.
2. Design: Food and other pet supplies are designed as planned, or updated for product improvements.
3. Manufacturing: Manufacturers produce food and other pet supplies.
4. Distribution:[4] Distributors purchase products from a variety of manufacturers and then sell them to pet stores with a markup. Distributors provide manufacturers with a broader distribution network, especially the smaller manufacturers. As well, distributors can offer better management of store relationships, particularly for smaller chains and independent pet stores who rely heavily on distributors for the following:
   - To increase the variety of types of products sold in their stores, since distributors can source from many different manufacturers. Using distributors allows pet stores to purchase in smaller quantities (that is, only three to four product types).
   - To manage replenishment of inventory, especially in cases where the pet store has multiple locations.
   - To supply their slower-moving products, as they can order only as needed.

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[1] Luci Couillard, "Pet Stores in Canada, Groomed Well; Rising Disposable Income Levels and Demand for Industry Products Will Likely Support Revenue Growth," IBIS World Industry Report 45391CA, August 2020.
[2] Canadian Animal Health Institute, "Veterinarians and Their Health Teams Play a Critical Role," accessed September 30, 2022, https://www.cahi-icsa.ca/preventative-animal-care.
[3] Luci Couillard, 2020.
[4] Liz Lippert and Andres Saenz, "EY-Parthenon Perspectives: Investing in the Pet Industry," February 2017, https://dokumen.tips/documents/ey-parthenon-perspectives-investing-in-the-pet-industry-brands-to-define-a-differentiated.html.

- To provide expertise on pet products.

  Independent pet stores may source 85% to 90% of their product through distributors, paying a higher per-unit cost for a product item than if the same product had been purchased directly from the manufacturer. However, in return, they are getting the benefits noted above.

5. Pet stores: Pet stores may purchase private-label products (products that are sold under their own brand name) and other brands directly from the manufacturers and through the distributors.
6. Pet owners: Pet stores sell directly to pet owners and to veterinarians.

The pet store industry has low capital intensity and is labour intensive. For every $1.00 spent on wages, $0.08 is spent on the replacement of store equipment including shelving, computers, and point-of-sale equipment.[5]

Product and services segmentation

The pet stores sector is broken down into the following products and services segments:[6]

Segment	**Percentage of total revenues**	**Description**
Pet food and treats	46.3%	Dry and wet food for dogs, cats, and birds; crickets and worms for reptiles; and other treats
Pet supplies	41.1%	Medicines, toys, food bowls, kennels, leashes, collars, life jackets, clothing, bedding, brushes and combs, shovels, cat litter, travel carriers, and other accessories
Pet services	7.8%	Grooming, washing, nail clipping, teeth brushing, pet therapy, training, nutritional consulting, boarding, spa, hotel, camps, portrait photography
Live animals	4.8%	Hamsters, birds, fish, reptiles
Total	100%	

<u>Pet food and treats</u>

Premium-priced dog food has been growing in popularity, and the Pet Food Association is now promoting healthy food that uses free-range meats and ingredients free of pesticides, genetically modified ingredients, and grain.[7] All-natural products are free from artificial colours, flavours, and preservatives and contain ingredients only from plants, animals, or naturally occurring minerals and vitamins. Premium-priced all-natural

[5] Luci Couillard, August 2020.
[6] Ibid.
[7] Olivia Ross, "Pet Stores in Canada, Groomed well; Higher Household Income Levels Have Boosted Demand for Industry Products and Services," IBIS World Industry Report 45391CA, July 2019.

food products are differentiated by their content. The demand for organic products and vegan products, a subset of natural food products, is increasing, and locally sourced food is also an important consideration. These natural products require refrigeration or freezing. Premium-priced pet foods are higher priced due to the higher input costs for the ingredients and the need for cold storage. Once customers find a pet food that their pet enjoys, they are reluctant to change.[8]

The larger pet stores also sell their own private-label products at slightly lower prices than comparable products, but on which they make higher gross profit margins. Private-label pet products can currently be found for food (representing the highest volume and revenues of food sales) and treats, as well as toys, clothing, litter, medicines, and grooming products. In an average pet store that is part of a national chain, up to 40% of all sales can be from the sale of private-label products.[9]

Pet supplies

This segment includes a large variety of goods as shown in the table above, and competition is high, not only from pet stores, but also from grocery and home improvement retailers. As noted above under food and treats, private-label products for pet supplies are also prevalent in the industry.

One subset of this segment that is currently small but growing is sales of pet pharmaceuticals and medications. As more pet pharmaceuticals and medications can be sold over the counter rather than solely by veterinarians, specialty pet stores are offering these products. Sales staff must be trained on these products so that they can advise customers properly on their use.[10]

Pet services

Pet services result in higher profit margins for pet stores and increase traffic into the stores, which increases sales of other products. The ongoing costs of providing these services is often a variable cost, since the typical business model is to split revenue between the contractor providing the services and the store.[11] For example, grooming revenues would be split on some basis between the groomer and the pet store. Similar arrangements would be made for the dog/cat washer, therapist, trainer, and so on.

Live animals

The revenue from this segment has been declining because some municipalities (and provinces/territories) have passed legislation prohibiting pet stores from selling cats,

[8] Caroline Jansen, "The State of the Pet Retail Industry," *Retail Dive*, July 24, 2019, https://www.retaildive.com/news/the-state-of-the-pet-retail-industry/559309/.
[9] Primary research by author in discussions with an owner of a pet retail store.
[10] Primary research by author in discussions with an owner of a pet retail store.
[11] Primary research by author in discussions with an owner of a pet retail store.

dogs, and rabbits.[12] Instead, most pet stores will partner with local animal adoption agencies rather than sell live animals.[13] In these cases, the pet store owners allow the animal shelters to bring rescued cats and dogs into the store for display to give customers the opportunity to see the animals and adopt them if they wish. The stores receive no compensation, and any adoption fees are paid to the adoption agency directly.

Customers

The pet retail industry identifies two customer segments for food and supplies specifically: the first-tier customers being the pet owner and the second-tier customers being the veterinarians who purchase pet supplies and food for their offices.

For pet owners, this customer segment can be further broken down by income level as follows:[14]

<table>
<tr><th>Income</th><th>Percentage of total industry revenue (rounded)</th><th>Comments with respect to the type of products purchased</th></tr>
<tr><td>Highest income quintile</td><td>29%</td><td>These customers purchase the premium-priced products.</td></tr>
<tr><td>Second-highest income quintile</td><td>21%</td><td rowspan="2">These customers have more disposable income and are health-conscious owners who tend to purchase the all-natural products.</td></tr>
<tr><td>Third-highest income quintile</td><td>20%</td></tr>
<tr><td>Fourth-highest income quintile</td><td>16%</td><td rowspan="2">At these lower income levels, fewer individuals own pets. Therefore, their lower contributions to revenue in the pet retail industry are due to fewer numbers owning pets. If they do own pets, they tend to shop at the mass merchandisers where the pet product costs are the lowest.</td></tr>
<tr><td>Lowest income quintile</td><td>14%</td></tr>
<tr><td>Total</td><td>100%</td><td></td></tr>
</table>

Another segmentation of the customer market is by age as shown in the table adapted from information provided by Euromonitor International Lifestyles 2019, below:[15]

The percentage of respondents who replied “yes” to each of two questions are provided below by age:

[12] Olivia Ross, 2019.
[13] Luci Couillard, August 2020.
[14] Olivia Ross, 2019.
[15] Caroline Jansen, 2019.

Age	"Do you own a pet?"	"Are pets beloved members of the family?"
15-29	60%	70%
30-44	62%	70%
45-59	56%	65%
60+	48%	63%

As shown in the table above, all age categories own pets, and a high percentage treat their pets as members of their family. Those in the first two age categories are increasingly acquiring pets as they delay major life decisions related to marriage and having children.

Competition

The industry is highly fragmented, with about 2,100 pet stores. The two largest national and global chains, PetSmart Inc. and Pet Valu, together represent 37.5% of the pet store sales in Canada.[16] Global Pet Foods and Mondou (which is only in Quebec) are two other large operators that have been increasing their market share over the past five years. These large pet stores have the scope and scale to purchase in bulk at lower prices and offer thousands of products. Large chains may use either a franchise model or a corporate-owned model, or use a combination of both for their pet stores.

Within the pet retail industry, there are four broad categories of retailers that sell pet-related products:

- Brick-and-mortar (pet stores): physical pet stores that sell only pet-related products
- Brick-and-mortar (other pet retailers): including the mass merchandisers, grocery stores, and home improvement stores that have a small offering of pet products in relation to total other product offerings
- Online (pet stores): pet stores that sell only pet-related products online (for example, Chewy.com)
- Online (other pet retailers): general retailers that sell small amounts of pet products in relation to total other product offerings (for example, Amazon.ca)

It is important to note that these broad categories are blurring as pet stores are moving toward "brick and click" strategies in which they offer both in-store and online shopping.

The landscape of brick-and-mortar pet stores is summarized in the table below:[17]

[16] Luci Couillard, 2020.
[17] Liz Lippert and Andres Saenz, 2017.

Type	Number of stores	Average size of store
Pet superstores (large national pet store chains)	>300 stores per company	>15,000 square feet
Regional chain pet stores	10 to 300 total stores per company	8,000 to 15,000 square feet
Independent stores (local pet store chains / single stores)	<10 stores per company	<8,000 square feet

The pet superstores have the space to offer a wide range of products that will also cater to a large range of customers. In contrast, independent pet stores offer a more select range of products and quality that will cater to their targeted customer segment and will usually have better customer service and loyalty. For all types of pet stores, sales staff training is provided on food ingredients and their implications, how to improve customer service, and pharmaceutical and medical-related products.[18]

Within the industry, there is strong price competition, with many pet stores providing guarantees to match a competitor's price. Competition is also based on quality and selection of products. The large national pet stores have a competitive advantage by offering a broad scope of products (thousands of different types) and by having exclusivity through licensing arrangements to sell the more well-known and sought-after brand names.[19] A key to their success is establishing relationships with distributors and manufacturers, which gives them access to low-priced, high-quality goods.[20] In addition, large national pet stores often sell their own private-label brand of products, which allows them to achieve higher gross profit margins while selling at a slightly lower price than other brands. The private-label products can also drive customer loyalty and brand recognition.

Due to the increased price competition from supermarkets and pet superstores, independent pet stores have been forced to consolidate, find a niche, or exit the market entirely.[21] Niche markets for premium-priced and natural food (such as vegan and organic foods) and other products and services (such as spas and hotel services) related to pet health allow independent pet stores to differentiate from larger retailers that will beat the competition based on price and product scope.[22]

Generally, for the pet store industry, keys to success include being located in high-traffic and visible areas to maximize traffic, having attractive and eye-catching product presentation and displays in the store that promote buying, and offering a wide range of

[18] Primary research by author in discussions with an owner of a pet retail store.
[19] Luci Couillard, 2020.
[20] Ibid.
[21] Ibid.
[22] Ibid.

products at various price and quality levels.[23] In addition, having experienced and knowledgeable staff to advise customers and consistent and good-quality products will ensure ongoing customer satisfaction and continued customer loyalty.[24] Finally, investment in good technology and information systems is critical to allow the company to control and record merchandising, distribution, sales, and stock markdowns.[25]

As with other types of retailers, customer reward loyalty plans are popular for pet stores also. Reward points are given for purchases. Alternatively, a free bag of food can be rewarded after the purchase of a fixed number of bags of food (for example, 12). The reward may be related to buying a specific brand or the retailer's own private-label brand.

The strategy for the large national and global pet stores is to provide a large product selection at low prices. Their focus is to provide a wide range of products and services at competitive prices with convenient locations, to target as many customer segments as possible. These companies can gain a competitive advantage with lower prices and product availability.

For the smaller independent and regional pet stores, a successful strategy is to provide niche products and/or services that allow them to charge premium prices for value-added products. These pet stores are more focused on providing products and services that are tailored to their local customers. Customer loyalty is important, and customers are attracted to these types of pet stores by products that satisfy their specific requirements as to quality and pet preferences and less by price and convenience. Customer service (providing good and helpful advice to customers on products and services) and relationships (understanding a customer's needs and working to meet these needs) help these pet stores gain a competitive advantage. The smaller pet stores may also focus on specific customer segments where it is easier to identify and meet the needs of a smaller group.

There is increasing competition from supermarkets and mass merchandisers (such as Costco and Walmart), primarily for pet food products.[26] These competitors have an advantage by offering one-stop shopping convenience that is appealing to customers who do not have the time to shop separately for their pets.[27] Historically, these retailers sold only the lower-priced dry dog and cat food that had little differentiation and therefore appealed to customers who had little disposable income for pet food and supplies. Supermarkets and mass merchandisers have the sales volumes to give them the buying power with distributors to purchase products at lower prices, which results in

[23] Olivia Ross, 2019.
[24] Ibid.
[25] Luci Couillard, 2020.
[26] Olivia Ross, 2019.
[27] Ibid.

lower selling prices to customers.[28] However, with the increased demand for premium-priced foods, some of these retailers have added these products to their inventory mix.

Home improvement centres are also entering the pet retail segment and selling not only dry food but also many of the common pet supplies.[29] Similar to supermarkets and mass merchandisers, home improvement centres have the advantage of purchasing power and being a one-stop shop for customers.

The pet specialty online pet stores (for example, Chewy.com) have an advantage in that they can carry a wider range of products than traditional brick-and-mortar stores.[30] These online pet stores also have lower labour and capital costs and do not need to invest in employee training on specific products. Online pet stores also sell their own private-label brand of pet food, increasing their margins and eliminating the distributor.

Online retailers (specialty and generalists like Amazon.ca) can also sell at lower prices to customers because they do not have the costs related to physical stores and therefore have lower overheads. Online purchasing appeals to people under 40 and customers who want the convenience and time saving of shopping from home.[31]

Pet stores are differentiating from the supermarkets, mass merchandisers, and online retailers by offering more premium-priced products and services (grooming, boarding, spa treatments) that increase traffic to the store.[32] Additionally, the pet stores collaborate with and support various animal charities, shelters, and adoption services in the community to increase customer awareness and store visits.[33] Finally, shopping at a pet store allows pet owners to consult with knowledgeable staff in deciding which products are best for their pet.

Regulation

There are regulations in Canada related to selling live animals, pet foods, and pet pharmaceuticals.

<u>Live animal sales</u>[34]

Provincial and territorial authorities have regulations concerning the transportation, handling, and sale of small pets. There are also environmental regulations about the generation, handling, storage, transportation, and disposal of waste and biohazard materials. Under the National Animal Health Program, dogs and cats are subject to importation rules. Some cities, such as Vancouver, have implemented bans on selling

[28] Ibid.
[29] Ibid.
[30] Luci Couillard, 2020.
[31] Olivia Ross, 2019.
[32] Luci Couillard, 2020.
[33] Olivia Ross, 2019.
[34] Luci Couillard, 2020.

dogs, cats, and rabbits. In other areas of Canada, groups are advocating for similar bans, but as of yet they have not been successful.

<u>Pet food and pet pharmaceutical manufacturers</u>

Other regulations must be followed by pet food manufacturers. Although pet stores are not directly subject to these regulations, they may become indirectly impacted if they are selling product that has been found to not to meet regulatory requirements. Pet food is regulated by the Consumer Packaging and Labelling Act and the Competition Act, requiring that prepackaged products have accurate and meaningful labelling.[35]

Similar to human pharmaceuticals, animal medications must meet strict requirements set by Health Canada or the Canadian Food Inspection Agency to be licensed for sale.[36] Pet pharmaceutical manufacturers must provide scientifically based evidence of the following factors in order to receive this approval:[37]

- It does what its label says it does (is efficacious).
- It is what the manufacturer says it is.
- It is safe for the animal and the person administering the medication.
- Its use doesn't harm the environment.
- It has science-based safeguards to ensure that the meat, milk, or eggs produced by a treated animal do not contain harmful residues.

Demand drivers

The three main demand drivers for pet retail sales are as follows:

- Per capita disposable income: The higher the disposal income, the more likely pet owners are to purchase premium-priced products to indulge their pets from specialty pet stores. When cash is a constraint, pet owners purchase the cheaper products available at supermarkets and mass merchandisers.[38]
- Population and demographics:[39] Generally, pet ownership declines as individuals work longer hours, frequently move or travel, or live in homes that do not permit pets. Pet ownership increases with an aging population, since pets provide companionship for older people who are living alone.

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[35] Ibid.
[36] Ibid.
[37] Canadian Animal Health Institute, "We Are Strictly Regulated," accessed September 30, 2022, https://www.cahi-icsa.ca/we-are-strictly-regulated.
[38] Olivia Ross, 2019.
[39] Ibid.

- Pet ownership rates: As the population grows, the number of pets also increases, increasing the demand for pet-related products and services.

Impact of a global pandemic on pet stores

With the occurrence of a global pandemic, the impact to the pet retail industry is minimal, since pet food and supplies are essential.[40] However, if disposable income levels decrease, customers tend to switch to lower-priced products and to online purchasing, which may negatively impact profit margins. Profit margins are also negatively impacted due to increased costs incurred for enhanced cleaning protocols, lower-margin product sales, and offering free delivery of product to customers.[41]

The increase in online sales during a global pandemic results in more pet retailers investing in e-commerce logistics, which should ensure sales of essential products continue to be made.[42] Pet care services will likely be impacted, with non-medical pet services such as boarding and grooming being the hardest hit for areas with in-person restrictions in place.[43] However, at times when restrictions are lifted, these services can be in higher demand than ever before.

The supply chain can be particularly hard hit during a global pandemic. With many workers sick, manufacturing cannot occur at the same pace, and there can be fluctuating shortages of pet food and other supplies.

During a pandemic when people are socially isolated, they tend to rely on their pets more than usual for comfort and security. As a result, the trend of treating pets as part of the family gains even more acceptance.[44]

Trends

Trends expected for the future include the following:

- Increasing trend of pet "parents," defined as those who treat their pets as family members and want only the best for their pets and are willing to spend to get it.[45] This is also known as "humanization" of pets.[46] With this trend, pet parents like to take their pets with them wherever they go and are more willing to purchase goods and services for their pets that would normally be reserved for humans.

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[40] Luci Couillard, August 2020.
[41] Ibid.
[42] David Lummis, "The Key Ways the COVID-19 Crisis Could Impact the Pet Industry," *Pet Product News,* March 23, 2020, https://www.petproductnews.com/archives/the-key-ways-the-covid-19-crisis-could-impact-the-pet-industry/article_f7fd1ec3-697e-55b7-aaf5-176a76c16bd5.html.
[43] Ibid.
[44] David Lummis, "What Will the Pet Industry Look Like After the COVID-19 Pandemic Subsides?" *Pet Product News,* June 30, 2020, https://www.petproductnews.com/archives/what-will-the-pet-industry-look-like-after-the-covid-19-pandemic-subsides/article_cdac37f4-bb29-5588-8cd0-0de35e5b54ea.html.
[45] Olivia Ross, 2019.
[46] "Pet Care Industry Analysis 2020 – Costs and Trends," *Franchise Help*, accessed September 30, 2022, https://www.franchisehelp.com/industry-reports/pet-care-industry-analysis-2020-cost-trends/.

- “Premiumization” is the trend in which pet owners demand higher-end or specialty products and services for their pets.[47] This includes premium-priced dog food and treats made from natural and organic ingredients that are high in protein and low in fillers, byproducts, and artificial additives.[48] High-tech medical therapies, luxury spas and services, and luxury boarding are niche services that are meeting these owners’ needs.
- As people become more concerned with their own personal well-being, this can include concern for the health and well-being of their pets. Customers are looking for nutritional consulting, dietary supplements, and other health-care products to ensure the health of their pets.
- There is increasing demand for health-care products related to skin care, and these are increasingly sold at pet stores rather than by veterinarians. As pet owners try to reduce their pet medical bills and costs related to prescription drugs, the preference is to purchase these at the store rather than the vet.[49]
- Dietary supplements are increasingly sold at pet stores as pet owners try to reduce increasingly expensive veterinary costs. These vitamins and minerals are used by owners of aging pets to prevent nutritional deficiencies or to treat specific illnesses due to joint, digestive, and cardiovascular issues.[50] One trend is the increasing demand for collagen in the form of nutritional toppers and supplements, which are added to food.[51]
- Many pet parents want to take their pets to enjoy social experiences with them when they travel or go for outings. There is a growing demand for social experiences that include and make concessions for pets to come along.[52] Pet-friendly hotels are an example of this.
- Pet subscription services for monthly deliveries of food, medicines, and treats are increasing. These monthly subscription boxes may also contain surprises for the pet such as toys, treats, and samples.[53] These subscription services are particularly appealing to pet owners aged 25 to 40, and subscriptions are expected to increase.[54]
- In a study, 88% of pet owners aged 25 to 40 interviewed thought that owning a pet was a way to prepare for being a parent.[55] This younger customer segment is quick to adopt new high-tech products related to pet ownership. In addition, because this

[47] Ibid.
[48] Olivia Ross, 2019.
[49] Ibid.
[50] Ibid.
[51] Stacy Wood, “Pet Industry Trends for 2020: What’s New in the New Year,” *Pet Food Experts*, January 2, 2020, https://blog.petfoodexperts.com/pet-industry-trends-to-look-out-for-in-2020.
[52] Sarah Stasik, 2020.
[53] Ibid.
[54] Luci Couillard, August 2020.
[55] Bookly, “The State of the Pet Industry: Pet Market Statistics and Future Trends,” accessed September 30, 2022, https://www.booking-wp-plugin.com/state-pet-market-statistics-future-trends/.

customer segment works long hours, they want to be able to easily book pet service appointments online, creating demand for friendly and intuitive online booking processes.

- Pet owners are searching for alternative therapies to help treat their pets, including massage, chiropractic therapy, acupuncture, and cannabidiol (CBD) oil or hemp products.[56] Massage and chiropractic therapies are thought to help pets in pain. Canine massages help improve circulation, relax contracted muscles, improve movement, release stress, and improve recovery from surgery or injury.[57]
- Pet parents are interested in luxury boarding facilities that provide similar amenities to what humans would want, including whirlpool tubs, treadmills, salons, mud baths, facials, and warm water therapy.[58]

General risks in the pet retail industry

General risks in the pet retail industry include the following:

- Store expansion and location risk: There is a risk that an existing store will not perform as it has historically due to increased competition and changing demographics in the local market, which could cause the store's sales to decline. There is also the risk that opening a new store may cannibalize existing stores' sales or not meet management expectations.
- Supplier risk: All pet retailers and pet stores rely on manufacturers and distributors to meet their supply demands for inventory product. If these shipments of specified products are not received in the quantities required or on time, or there are other disruptions in the supplier relationships, then product will not be available, and sales are lost.
- Technology risk: Disruptions in IT systems causing point-of-sale equipment to fail may result in lost sales. In addition, if the technology required for online selling is outdated, not user friendly, or not operating effectively, online sales could be lost.
- Customer risk: The demand for pet food and supplies is driven by customers' preferences for products. Should customer preferences change or competitors provide a better product in the eyes of the customer, sales will decline.
- Reputational risk: A pet retailer's or pet store's reputation is based on providing good customer service, selling quality products, and using truthful advertising related to products and services. If customers complain about the service or products sold or there is adverse publicity, this may tarnish the retailer's reputation and cause its sales to decline.

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[56] Ibid.
[57] K9 Central, "Canine Massage," accessed September 30, 2022, https://k9central.ca/canine-massage/canine-massage-47.
[58] Bookly, 2022.

- Regulatory risk: Currently, there are regulatory requirements for pet product manufacturers and sellers of live animals that must be followed. There is a risk that there may be unfavourable changes in these government regulations or new ones that pet retailers will be required to follow. This will increase costs or could hamper business if the requirements are not followed correctly.

Pet grooming and boarding industry information

The pet grooming and boarding industry includes animal shelters, obedience and guard dog training services, pet boarding, and animal grooming services. This does not include these services provided by pet stores, so it does not include any revenues earned by the pet stores industry as described above. In 2020, the pet grooming and boarding industry represented $626 million in revenues. Overall, the annual industry growth rate is expected to be only 1.3%, although the annual growth in the number of operators in this industry is expected to increase at 4.8% until 2025.[59]

Products and services

Total industry revenues can be broken down into the following segments:[60]

Segment	Percentage of total revenues	Total revenues (millions)	Description
Boarding	39.8%	$249.1	Overnight care including accommodation, food, exercise, and playtime
Grooming	29.6%	185.3	Cutting and shaving hair; trimming nails; cleaning hair, teeth and ears; massages; flea and tick removal
Training	7.5%	47.0	Providing obedience training and lessons for dogs, including guide dogs and guard dogs
Other	15.8%	98.9	Pet sitting, dog walking, adoption, daycare, pet funerals, and animal identification and marking services
Merchandise	7.3%	45.7	Treats, collars, leashes, clothing shampoos, food, and other
Total	100%	$626.0	

[59] Jonathan DeCarlo, “Pet Grooming and Boarding in Canada,” IBIS World Industry Report 81291Cam, April 2020.
[60] Ibid.

The demand for boarding, grooming, and training continues to increase as pet ownership and disposable income per capita increases. The demand for boarding is specifically impacted by international and domestic travel by pet owners.[61]

There has been a shift in how pet owners see their pets, and this change in behaviour results in owners wanting to give their pets a more affluent and comfortable lifestyle, resulting in more specialized offerings.[62] People want to either travel with their pets or be sure that they are well taken care of while they are away. Pet owners now expect the same type of service and experience for their pets as they would get if they stayed in a hotel.[63]

As customers demand higher-value-added and luxury services for their pets, pet boarders have introduced deluxe facilities with many amenities and added services such as pet-themed shows, wading pools, classical music, training, and grooming, which are available during a pet's stay.[64] At a minimum, customers are looking for boarding facilities that are clean, well ventilated, comfortable, and staffed with knowledgeable and caring people.[65] Luxury dog hotel facilities will have additional amenities including large, private rooms for each dog that have plenty of space, webcams to allow pet owners to check up remotely on their pets, heated pools or water fountains for playing, and ball pits for jumping in.[66] These luxury facilities are premium-priced, allowing boarding operators to earn high net profits of 15.8% on average.[67]

Customers

For the total pet grooming and boarding industry, customer segmentation by quintile is as follows:[68]

[61] Ibid.
[62] "Pet Care Industry Analysis 2020 – Costs and Trends," *Franchise Help*, accessed September 30, 2022, https://www.franchisehelp.com/industry-reports/pet-care-industry-analysis-2020-cost-trends/.
[63] Stuart Pallister, "Pet Hotels: The Ultimate 'Niche'?," *EHL Insights,* accessed September 30, 2022, https://hospitalityinsights.ehl.edu/pet-hotels.
[64] Jonathan DeCarlo, 2020.
[65] "The Rising Trend of Dog Hotels," *PetPlace*, August 23, 2017, https://www.petplace.com/article/dogs/pet-care/the-rising-trend-of-dog-hotels/.
[66] Ibid.
[67] Jonathan DeCarlo, 2020.
[68] Ibid.

Market segment	Percentage of total industry revenue
Highest income quintile	33%
Second-highest income quintile	23%
Third-highest income quintile	18%
Fourth-highest income quintile	15%
Lowest income quintile	11%
Total	100%

The highest quintile represents the highest percentage of the revenues, as people in this segment tend to travel more and therefore require more of these services. In addition, this segment tends to prefer the premium-priced services.[69]

Competition

To be successful, pet boarders (and groomers) must be situated close to highly populated and affluent areas. The following table (adapted from a graph) shows the percentage of these establishments in the provinces and territories in comparison to the percentage of population.[70]

	Estimated percentage of establishments in the total industry	Estimated percentage of Canadian population
Atlantic provinces	7.7%	8%
British Columbia	18.9%	12%
Ontario	40.1%	39%
Prairies	21.0%	18%
Quebec	12.3%	23%
Territories	Less than 1%	Less than 1%

The competition in the pet grooming and boarding industry is very fragmented, with no single company having more than 5% of the revenues and 98% of the current operators having fewer than 20 employees.[71] Keys to success in this industry include providing good customer satisfaction, since word of mouth recommendations are most important in customer selection; having effective quality control standards that are maintained at all times; having a well-trained and flexible work force; and being in close proximity to a large population.[72] In cases where remote deluxe pet camps are far away from local

[69] Ibid.
[70] Ibid.
[71] Ibid.
[72] Ibid.

cities and towns, the pet boarders will often provide a pick-up service to and from the city or town, saving the pet owners a trip.

There are some regulatory requirements, particularly for pet boarders, which include the following:[73]

- They need a business licence to operate.
- Kennels cannot be located in residential areas.
- Provincial and local governments have regulations related to animal care, hygiene, safety, security, and noise control.

There are national organizations that represent the industry, such as The National Groomer Association of Canada and the International Boarding and Pet Service Association (IBPSA).[74] The Canadian Veterinary Medical Association has written the Code of Practice for Kennel Operations, which must also be followed.

Company background

Julia Hammond has always loved dogs and grew up with dogs as part of her family. She went to school to become a veterinary assistant and after graduating worked for a veterinarian. In 2006, Julia had a dog named Tilly that was quite ill for a period of time until Julia was able to finally find a fresh pet food that Tilly could digest, called Truly Real Food for dogs. Richard Davidson was the sales representative of Truly Real Food and was the one who suggested she try this food. Truly Real Food is made from only natural ingredients and is sold fresh or frozen.

As Julia sought a food product Tilly could tolerate, and did months of research, she found out how little pet stores and their sales reps that came to the veterinarian office really knew about the food they sold, particularly its contents. In stark contrast, Richard was extremely knowledgeable about not only his product, but all of the competitors' products on the market.

From this research and experience with Tilly, Julia learned how important the right food was to the health of pets. As a veterinarian assistant, she was also surprised how often pet owners asked what the right food was to feed their pets.

During the next year, Julia and her husband, Steve, and Richard and his wife, Elaine, became very good friends. All four individuals had many common interests including a love of pets. Given their backgrounds, Julia and Richard both had a real worry that most of the pet foods available had little nutritional or health benefits for dogs and cats. At the same time, they determined there was a void in the pet store sector in Keltown, Nova Scotia, where they lived, to meet the needs of pet owners who wanted raw, fresh or frozen, unprocessed food for their pets. At the time, Keltown was a small affluent town

[73] Ibid.
[74] Ibid.

with about 40,000 people. After analyzing the market, Julia and Richard decided there was a real need for a pet store that sold a selection of healthier all-natural pet foods.

In 2007, JRP became incorporated and opened its first store in Keltown. Julia, Steve, Richard, and Elaine all became shareholders in the company. Julia and Richard quit their jobs and started to work for the company full time. Elaine, who was an accountant, kept her current job with a local consulting firm, but also became JRP's accountant. Steve, who sold commercial real estate, also continued in his current job.

The first store was 3,200 square feet and located in a strip mall with heavy local traffic. The merchandise consisted of higher-end pet products, including food, supplies, and treats. It was Richard's responsibility to select the products to be sold, which he did with care and extensive research. Any food items had to be made from 100% all-natural ingredients including fresh meat, fruits, and vegetables, with no additives, preservatives, or fillers. The company also sold a limited quantity of pet supplies that were high quality and made from durable and safe materials. The company's objective was not to carry an extensive inventory, but to select only superior-quality products that would appeal to their demanding clientele. Their customers were affluent and discerning in the type of food they fed their pets. The full line of Truly Real Food products initially made up a large percentage of the pet food inventory. The idea was that JRP would primarily sell pet food (to represent at least 85% of sales) and supplies would be minimal.

In early 2009 the shareholders determined it was now the time to open another store. Steve suggested a store be opened in a neighbouring town about two hours from Keltown. This town also had affluent neighbourhoods and Steve had found the perfect location in a strip mall. In late 2009, a second store was opened and a year later in 2010, a third store was opened in another town in Nova Scotia. Due to demand from its customers, JRP started to offer dog training classes at its stores after store hours.

In 2011, Elaine's firm asked her to move to Quebec to transfer to a new office. Richard, having business experience in Quebec, thought there might be a good market in Quebec for JRP stores. This turned out to be true, and during the next four years, seven new stores were opened throughout Quebec. In all cases, the towns selected had the characteristics of having an affluent population of less than 150,000. Locations were in strip malls that had heavy traffic from the local community. In 2013, Elaine left her firm and came to work for JRP full time.

In 2015, Julia and Steve moved to Ontario to be close to their extended family, and Steve came to work for JRP full time. By this time, the company had laid out a set of criteria to use to assess potential new locations. These criteria included population size (less than 150,000), an above average income level, appropriate location (strip malls with high traffic with reasonable rental rates and long-term leases), a currently underserved market for JRP's product type, and financial forecasts that achieved target sales per square foot within a three-year period.

During the next few years, JRP opened 10 stores throughout Ontario. Towns were selected based on the criteria that had proven to be successful and after careful market research to ensure that the new location would be successful. In 2016, the company added pet grooming services (washing, nails, and teeth) and a self-washing pet station to all its stores.

By early 2019, the company had 20 stores in total, with three in Nova Scotia, seven in Quebec, and 10 in Ontario. With the start of a global pandemic in 2020, the company decided to stop its expansion and not make any new investments until the economy was more certain. In 2023, JRP still has 20 stores. Although there was some reduction in sales during the pandemic, JRP's customers kept shopping for their favourite brands. When stores were forced to remain closed, JRP began offering curbside pick-up. Once pet stores were allowed to reopen for in-person shopping, JRP followed all health protocols required. Julia was pleased to see that their customers remained loyal throughout this tough period.

It was during these uncertain times of 2020 and 2021 that the shareholders decided to take a more prudent approach and re-evaluate what they wanted JRP to look like for the future.

Company overview

Currently, all the stores are corporate owned and managed by JRP employees. All stores are laid out in a similar format and size, averaging about 3,850 square feet. There is nothing unique about the layout or design of the stores except the customer service. JRP's target affluent customer represents the highest and second-highest income quintiles. From the start, Julia wanted to have high-quality customer service and therefore ensured that the store staff are well trained and knowledgeable about all the products. The company also has a loyalty rewards program for its customers. As a result, JRP has obtained a reputation for providing excellent customer service by caring staff. In recognition of this, JRP has won multiple awards in multiple years for being the "Best in Customer Service."

During the global pandemic, the company started selling its products online. However, this was done only to allow existing customers to place orders and receive local delivery during the pandemic. It was never intended for non-local customers to purchase product. As a result, little has been spent on this system, and in 2022 internet sales represented only 3% of all sales. Julia strongly believes that the success of the company is due to its face-to-face customer service, which cannot be replicated when new customers purchase products online.

JRP's product mix has also changed over time to become more extensive. Products are still high quality, including food products made from healthy ingredients and pet supplies made from durable and safe materials. Food and treats are made only from all-natural ingredients and sold as fresh or frozen, requiring in-store display and storage in refrigerators or freezers. These healthy food products contain no additives, fillers, or preservatives and are made solely from real meat, fruit, and vegetables. Over the years the available selection of these types of food has increased, and food products are now segmented by age, breed, level of activity, certified organic, and vegan. This wide range of food products appeals to JRP's demanding clientele.

The range of pet supplies significantly increased over the past five years as customers' demands for these products increased. Pet supplies include collars, leashes, beds, clothing, and toys. As a result, the percentage of pet supplies revenue has grown to over 30% of all sales revenue in 2022. Grooming services and dog training classes continue to be offered, and the self-washing stations are a standard in all stores. Pharmaceutical and medical treatments are not currently sold.

Each store has two managers (one full time and one part time) with extensive experience in retailing. The company has a policy of promoting from within where possible, so generally, existing store employees are given a chance to apply for managerial positions. Julia and the VP, store operations make the final decision on promotions and hiring of the store managers. The store managers are given responsibility for hiring and firing of their own store employees. Both managers and store employees undergo regular training on the products and services that JRP sells in addition to customer service. Employees are encouraged to remember customers' names and to greet every customer that comes into the store. They are also trained to always ask about the pet the customer is buying for and to try to understand the needs of the pet and the pet owner. Customers are encouraged to provide information for the store database that lists the customer's name, pet name, pet type and breed, and pet's birthday. Items sold are tracked by customer so that employees can look up previous purchases. Finally, employees are encouraged to get feedback on products from customers as to what they liked or did not like. All of these actions have been successful in promoting customer loyalty and long-term relationships.

JRP's philosophy is to pay wages and salaries higher than market to attract and retain good employees. This appears to have worked well, since employee turnover is low. Julia believes that if employees are happy in their jobs, they will be better ambassadors for the company and provide excellent customer service. Just as JRP wants loyal customers, it also wants to have loyal employees.

JRP not only supports internal loyalty, but it has also been loyal to its suppliers (both manufacturers and distributors) over the years and has exceptionally good relationships with them. In fact, JRP has often helped with product development and test marketing in its stores. JRP deals directly with manufacturers for all its pet food and treats products and with distributors for its other supply of products. JRP has arrangements with all its suppliers to ship directly to the stores, and therefore has no distribution warehouses.

In May 2023, the shareholders find they are at a point where they have to re-examine and perhaps revise their strategic direction. When they began, fresh food for pets was just beginning to enter the market. Since then, the number of products available and increased customer interest has increased the number of specialty pet stores similar to

JRP. In addition, the large national and online pet stores have also entered the fresh food market. The company's only point of differentiation from these new competitors is its loyal customers and excellent customer service. The shareholders are concerned that this may not be sustainable in the long run.

In addition, JRP's strategy has been to open new stores that are within a four-hour drive of one of the shareholder's homes. This has allowed the shareholders to be hands-on with every new store opening and very selective in the location. This hands-on approach has worked well in the past. But now, the shareholders are no longer interested in travelling to open new stores but are reluctant to trust someone else to find a new location and manage opening a new store. Consequently, no new store openings are planned. However, the markets for the current stores have now reached maturity and sales growth is forecasted to be low. To increase revenues and profits, a new growth strategy is required.

Corporate vision and mission

JRP's vision and mission statements and core values, approved by the board in 2019, are as follows:

Vision statement: *To create a better everyday life for pet owners and their pets by providing the highest quality of healthy, innovative, fun, and safe products for cats and dogs in stores that are staffed by pet-loving and knowledgeable people.*

Mission statement: *We are committed to meeting all the needs of pet owners and pets by providing superior products that will keep pets healthy and happy throughout their lives. We want to give our customers the most captivating shopping experience that will ensure life-long relationships and loyalty. We want to be relevant not only to pets and pet parents, but also to our communities by supporting local animal-related charities.*

Corporate values

JRP has six core values:

1. Have a positive impact on our pet parents and create lasting relationships.
2. Sell only the highest-quality products that will foster healthy and happy pets.
3. Provide pet parents with knowledgeable advice on products to help them make the right decision for their pets.
4. Value, develop, and reward contributions, service, and skills of our employees.
5. Act always with the highest ethical standards, integrity, and honesty.
6. Care about, be involved in, and give back to our local communities.

Future plans and objectives

In May 2023, the board met and set the following objectives for 2024, 2025, and 2026:

- Decrease the percentage of revenues from pet supplies sold to less than 15% of total revenues by 2026.
- Increase operating profit margin to at least 7% by 2026. Operating profit is defined to include operating income plus any investment income.
- Offer at least two additional types of pet-related services by 2026 in order to meet the service needs of JRP’s current customer target segment, as indicated by recent survey data.
- Increase the number of loyalty reward customers by 15% by 2026.

Company structure

The company has a board of directors that consists of Julia, Steve, Richard, and Elaine, who each have equal voting rights on board decisions. The board meets monthly. At each meeting, topics related to financial and budget reports, store issues, supplier contracts, new corporate policies, and election of corporate officers are discussed. There are no board committees.

Management team

JRP’s corporate management team is made up of the following individuals. All shareholders expect to stay with the company for another 15 years.

Julia Hammond, CEO and chair of the board

Julia is 48 years old. She was a veterinarian assistant before opening JRP’s first store, but she has always been a dog lover. Julia founded the company after determining that there was a demand for healthy and fresh pet food that was not being met by existing local pet stores. She identified early that there would be an increasing demand for this healthier choice of food and was able to enter this market several years ahead of other major competitors. She passionately believes in the food products that JRP sells and believes that this is what makes the company different. She also understands that customer relationships are vital to keeping customers loyal and returning to the store.

Julia’s strength is being able to articulate her vision for the company and instil at each employee level a need to embrace this vision and to be the best that each employee can be. Julia is also able to generate an atmosphere where employees want to come to work and enjoy helping customers. Julia works well with all levels of management. Her primary responsibility is working with Rashid Baid in managing the store operations. In the past, she visited every store at least twice per year and knew each store manager personally. However, in the past three years, she has not visited the stores, as the demands on her time have kept her in the office. It is Julia's belief in JRP's value proposition and products that have led to the success the company has achieved.

Julia wants to retain the small network of stores, since she likes being personally involved in each store and at 20 stores, this practice is still manageable. She does not want to expand beyond the current stores but thinks instead that the company should expand into other segments of the pet market. She is concerned that competition from national pet retailers and other pet specialty stores has now encroached into the product areas where JRP has been successful and profits will start to erode. She is confident that JRP can maintain and hold on to its existing customer base, and believes that opening new stores and gaining new customers will be much more difficult than it has been in the past. She wants the company to look at investing in a pet food that will rival or surpass anything currently on the market and target a very discriminating customer segment. In addition, similar to what she did with the healthy pet food choice in identifying an unmet demand early in its life cycle, Julia wants to invest in a new segment of pet services that is at the early stages of its life cycle and whose market is expected to increase significantly in the future.

Richard Davidson, VP product purchasing

Richard is 48 years old and is also a dog lover. He has a chemistry degree and worked as a salesperson for a variety of pet food manufacturers prior to starting the company with Julia. His strength is in research, and he spends hours researching the products before he decides that JRP should carry them in the stores. With his chemistry background, Richard understands ingredients, and extensive research has helped him understand how various ingredients are harmful to pets' health. He visits manufacturers regularly and also attends trade shows to learn what is happening in the pet food sector and to keep at the forefront of new products. Richard deals with JRP's pet food suppliers on a day-to-day basis, giving constant feedback on their products. He subscribes to multiple newsletters and magazines that are devoted to the pet industry. He is involved in training the employees on the products and highlights their benefits and why he has chosen these products. With this understanding, he believes the employees have the knowledge to advise customers. His strength is in the depth of knowledge that he has gained about pet products, and the company has come to rely solely on his expertise.

Richard wants to expand nationally and increase the number of stores across Canada. He believes JRP has a successful retail model that should be used to further expand. He wants to expand the number and type of health-related products and services sold to gain more market share while still maintaining knowledgeable staff, which is mandatory for differentiation.

Steve Hammond, VP real estate

Steve Hammond is 50 years old. After graduating with a political science degree, he began selling commercial real estate. Steve is responsible for site selection and completing the selection criteria on any new store locations. He completes all the due diligence on new sites including the local market analysis and presents the information to the board for approval. Generally, the directors support Steve's recommendations, as they know that he is thorough and makes a suggestion only once he is convinced it is the right place. Steve reviews and manages the lease agreements for the stores and head office and supervises all leasehold improvements and new equipment installations. Steve is also responsible for any issues arising on any properties that require significant expenditures and contact with the landlords. His strength is in negotiations, and he has been very successful in negotiating favourable contracts with suppliers and landlords. Steve likes to manage all aspects of JRP's real estate personally and does not feel he can trust a non-shareholder to make the right decisions in the best interests of the company or to manage new store openings.

Steve believes his success in selecting store sites has been due to being close geographically in the first year of operations of a new store. When the Quebec expansion took place, Steve stayed with Richard and Elaine while he found new sites and managed their openings. But Steve feels that it will be difficult now to find new sites in other provinces, and he does not want to travel for long periods of time to find an ideal location and then manage its opening. He also does not want to trust this work to someone else. He agrees with Julia that as competition in the retail sector for JRP's products has increased, now is the time to look for alternative investments. Steve believes that JRP should invest in a pet food manufacturer that will create an all-natural brand that will be better than products currently on the market and target a very discriminating customer segment. Alternatively, JRP could invest in a new emerging sector of the market where the future looks bright and profitable and yet there are few competitors.

Elaine Davidson, chief financial officer

Elaine is 48 years old, and prior to joining JRP on a full-time basis, she worked as an accountant for a consulting company and then as JRP's accountant. Her educational background is in international business, and she has extensive financial knowledge, although she is not a CPA. Since joining JRP full time, Elaine has full responsibility for all the accounting personnel and preparation of financial external and internal reports. She works closely with the store managers, reviewing their weekly and monthly reports, and with each of the department managers, reviewing their monthly reports. The head of the IT department also reports directly to Elaine. By meeting regularly with all managers at the stores and the various departments, Elaine has been able to keep on top of any cost or revenue issues that arise and has been able to deal with these quickly. At the same time, she has made sure that all JRP managers have some level of financial literacy so they can understand and interpret their own reports and spot any issues arising as early as possible.

Elaine believes that JRP's current retail model is sustainable with some changes in product mix and adding special pet services. She agrees with Richard that JRP should stay in retail, since the shareholders know this segment very well and it will be less risky than entering new segments where they have no experience. By being more selective on products, choosing products and services where premium prices can be charged and high gross profit margins made, she thinks this model can continue to be successful for years to come. The company already has a good reputation, which should be built upon. She supports expanding westward to increase the company's scope and believes that with the right people in place, this can be done. The company has reached a size where the shareholders themselves can no longer manage the growth and they must hire experienced and trustworthy individuals to take the company to the next level.

Cecilia Chang, VP legal and human resources

Cecilia Chang is 42 years old. After graduating with her law degree, Cecilia worked in the legal department of a large national pet store chain. In 2017, Cecilia joined JRP as its in-house lawyer and is involved in drafting and reviewing the company's contractual agreements with suppliers and lessors for the store locations. She is also responsible for the human resources department and all employee-related issues including bonus incentive plans and approving pay raises, terminations, and new hires.

Rashid Baid, VP store operations

Rashid Baid is 55 years old. Rashid has worked his entire career in retail. He started as a retail clerk in a menswear store and worked his way up through management and into the head office. He joined JRP in 2010 working at one of the stores. Rashid was promoted to store manager and then came to the head office to work in the purchasing department with Richard. Eventually, he was promoted to VP, store operations. His responsibilities are to manage the store managers and deal with any day-to-day store operational issues that arise. He is responsible for filling the store manager positions when vacant at the stores.

Human resources

The breakdown of wages by position in the organization is provided below:

Senior management — shareholders (each paid $250,000 annually)	$1,000,000
Other senior management	240,000
Store managers	1,720,000
Store staff — full time	2,040,000
Store staff — part time	906,000
Administration, marketing, IT, head office staff	750,000
Employee benefits	602,000
Total employees (186 employees)	$7,258,000

There are no additional benefits for store staff and store managers other than what is required by law. For senior management, there is a health plan. All employees may purchase items in the store at a 30% discount from the selling price.

The store managers and store employees are required to take five online courses a year to update themselves on pet products and improve their customer service. Each year, the company identifies the courses that must be taken. Some of the product manufacturers mandate that this training be taken to ensure staff are knowledgeable about their product. Other courses are required by the company to improve customer service skills. This training is important to the company to ensure that store employees are up to date and knowledgeable on products and able to give advice to customers. This annual training is key to maintaining excellent customer service. This training requirement is detailed in JRP's human resource policies along with its code of conduct and core values. The company reimburses the fees for any courses taken.

Store manager incentive program

Currently, the store managers participate in an incentive program that provides them a bonus based on net profit made in their store, after making adjustments for costs that the store managers have no control over. Elaine wants to amend this incentive plan to encourage store managers to promote the company's core value of caring about, being involved in, and giving back to the local communities.

Company operations

Store operations

JRP has 20 store locations with three stores located in Nova Scotia, seven in Quebec, and 10 in Ontario. The layout of the stores, and the product selection, displays, shelving, and pricing are all fairly consistent. Store managers have the authorization to stock up to 5% of products that are specific to their local community and customer base. Stores are open seven days a week and closed on holidays. Store managers also have some leeway in setting some prices, given local competitors' prices.

Revenue, inventory management, and cost of goods sold

Below is a summary of revenue and costs by product and service type for 2022 (in thousands of dollars):

	Pet food	Pet supplies	Pet services	Total
Revenues	19,725	12,850	5,925	38,500
Cost of goods sold	8,475	8,990	3,555	21,020
Gross profit	11,250	3,860	2,370	17,480
Gross margin percentage	57.0%	30.0%	40.0%	45.4%
Percentage of total revenues	51.2%	33.4%	15.4%	

Over the past three years, the percentage of total revenues for pet food has continued to decrease and the sale of pet supplies has increased. Additionally, the company has not raised its prices since 2019 to remain competitive. Due to limited retail space in the stores, the company has been unable to offer pet services other than grooming and training classes.

Generally, 75% of products sold are for dogs, with the remaining amount representing cat-related sales. The company does not sell any live animals or products related to other common pets such as birds, fish, or reptiles. Ten percent of the pet food and pet supply sales are made to veterinarians. These sales are made on credit terms of net 30 days. All other customers pay by cash or credit card at the time of sale.

The company has up-to-date point-of-sale (POS) equipment in all its pet stores that is linked directly to the inventory management software program. Inventory is managed at each store. Inventory is shipped directly from the supplier to the appropriate store. At the time of the sale, the inventory items are removed from inventory. Daily and weekly sales reports are produced, summarizing the number of units sold by product code. The inventory management software is state-of-the-art and is used to set reorder points, highlight slow moving items and markdowns, and display the current prices and current unit costs. The inventory management software also ties into the accounting software to properly recognize the month-end inventory balance and the cost of goods sold for the month. At the end of every month, spot checks are performed to compare the perpetual inventory listing to the actual inventory on hand. Store managers are responsible for this check in their stores.

The company has three-year supply contracts with the manufacturers of its pet foods and treats. As part of its manufacturing contract, the company receives a partial rebate to cover any losses incurred when these products are promoted at below normal selling prices. These rebates are deducted from the cost of goods sold. For its pet supplies, the company purchases from several different distributors. The cost of goods sold includes the cost of the inventory items, shipping costs, and rebates or volume discounts from its suppliers. JRP has been able to secure an exclusivity arrangement with one of its manufacturers, Truly Fresh Food. This arrangement gives JRP the right to be the only seller of the product within given geographic areas.

Pet services include grooming and training classes. For these services, the store retains 40% of the revenues and the remaining 60% is paid to the groomer or trainer. There are minimal additional variable costs related to these revenue streams.

Direct store costs

The direct store costs include items such as shelving and displays, supplies, staff training and hiring, and other supplies and miscellaneous costs.

Marketing and advertising

Due to having only 20 stores spread across three provinces, the company's marketing is done at the local level. JRP has found that more localized marketing works the best to bring customers into the store, since each community has its own characteristics. The company uses a variety of marketing and advertising methods, including in-store promotions, social media, email offers to customers, and sponsorships.

The company maintains a customer database that is also linked to its rewards loyalty program. Currently, the company has a database of 62,000 customers, of which 70% are members of its loyalty program. In the customer database, the company retains the customer's name, contact information including email address, the customer's type of pet, and the pet's name. Every time an item is sold, the customer database is updated with the purchase. The rewards loyalty program tracks a customer's purchase of packages of dog or cat food. Every time the customer purchases a package of food, it is added to the rewards program. When the customer has reached nine purchases, the tenth package of food is free. In addition, reward points can be earned on purchases of non-food products and services and available for later redemption for future purchases.

For promotions, generally in the third week of the month, an email offer is sent to customers outlining the items on promotion for that week. Birthday cards are also sent to pets on their birthdates with a 10% off coupon that can be used to purchase a treat or toy.

The company supports various animal-related charities in the local communities. Currently, funds are contributed to the local humane societies and animal adoption agencies. In addition, once a year, the company sponsors a veterinarian to come to each store, and JRP covers the costs of neutering and vaccinations for dogs and cats that are brought to the store that day. This support builds name awareness and allows the company to meet new pet owners.

Rent and occupancy costs

The rent and occupancy costs include costs for rent, maintenance and repairs, utilities, and property insurance. The property taxes are paid by the landlords at all the locations.

General and administrative

The general and administrative expenses include costs related to administrative and support functional areas, and professional fees. Also included are information technology costs for software maintenance, upgrades, and new hardware. This category does not include any salaries and wages.

Property, plant, and equipment and leases

The company leases all its properties. JRP invests in equipment, furniture, fixtures, and computers used in the stores and at head office. It also invests in leasehold improvements in each store location and its head office.

	Balance on December 31, 2022 (in thousands)	**Amortization method**
Equipment, furniture, fixtures, and computers	$5,214	Declining balance 20%
Leasehold improvements	3,886	Straight-line based on term of lease — 15 years
Total net book value	$9,100	

To sustain its existing capital assets, JRP should be spending a minimum of $1,500,000 annually in new replacement assets.

JRP leases all its locations under operating leases. The stores vary in size between 3,600 and 4,200 square feet, with the average being 3,850 square feet. In total, the company leases about 77,000 square feet for its stores. In general, the operating leases are for an initial 10-year term with a five-year renewal option at the current lease rates adjusted for inflation. Currently, the remaining leases will expire (assuming the five-year renewal is taken) between 2031 and 2036. As these leases are for premises in strip malls, they include a base rent and a variable rent up to 3% of revenues in excess of a base minimum amount.

The company's head office is located in Iberton, a small town in southern Ontario. On March 1, 2021, Uptown Leasing Ltd. (ULL) purchased this property. ULL is owned equally by Steve Hammond and his brother, Joshua. JRP now leases its head office building from ULL for $150,000 annually, which was specified under the original lease. At current market rates, the head office would rent for $160,000 annually.

Income taxes

In addition to each owning 40% of the shares of JRP, Julia and Richard each own 30% of the shares of Keto Magic Co. (KM). Julia's son and Richard's daughter each own one-half of the remaining 40% of KM shares. Julia's son and Richard's daughter run

KM. Because Julia and Richard as a group control JRP and also control KM, JRP and KM are associated. The board of JRP has agreed on an ongoing basis to allow KM to use 100% of the business limit and the full $1,500,000 available for immediate expensing of capital assets.

Data analytics

As noted above, JRP has a customer rewards loyalty plan and accumulates data related to its customers. It just completed an extensive survey of its customers and updated its customer database. The following information was gathered with respect to JRP's customers and their pets:

- Customer information: Name, address, age, how long they have owned pets, household income, years shopped at JRP store, reward loyalty membership status.
- Pet information: Type, breed, name, birthdate, age, medical issues, food purchased (fresh, frozen, organic, vegan), supplies purchased, other pet retailers used, veterinarian name, current pharmaceuticals used, tick/flea product used, other medications used, services currently used at JRP stores (grooming, training).
- Additional services: Customers were asked to indicate which of the following other services they would use if available — pet massages, pet chiropractic therapy, nutritional consulting, boarding, spa services, pet hotels, pet camps, and portrait photography.
- Customer value proposition: Customers were also asked to rank why they shopped at JRP — customer service, location, price, pet food available, hours of operation, convenience, long-time customer.

JRP plans to use this data to determine the appropriate mix of products in its stores and the other premium services it should provide.

Financial reporting and budgeting

JRP prepares its financial statements using ASPE. JRP has had the same auditors, Wiley & Zhang, LLP, since 2015. Annual audited financial statements are submitted to the JRP's bank, FrontStreet Bank. The audit for 2022 was completed in March 2023.

Historically, JRP has not paid any dividends. The shareholders' philosophy is that they should be paid a reasonable annual salary and any remaining net profits should be retained in the company for reinvestment. All four shareholders are relatively risk averse and want to keep interest-bearing debt as low as possible. They believe a strong balance sheet with relatively low amounts of debt outstanding and adequate cash on hand has been key to their success over the past years. With a strong balance sheet, the company has been able to withstand economic downturns.

Banking and financing

JRP uses FrontStreet Bank for its corporate banking, line of credit, and current term loan. JRP currently has excess cash on hand, given that Elaine likes to maintain a minimum cash balance of $400,000 available. The existing loan arrangements are described below:

1. Line of credit with FrontStreet Bank: The line of credit bears interest at prime plus 1.5% (prime is currently 2.5%). It is secured by the inventories, and the outstanding balance cannot exceed 55% of the current inventory balance. The line of credit is renewable every two years, and the current line will be renewed in May 2024. JRP must file monthly inventory reports with the bank to verify the amount of financing available. In any month, if the line of credit exceeds 55% of the inventory, then that excess portion must be immediately repaid. Currently, there has been no amount withdrawn.
2. Term loan with FrontStreet Bank: The 5% term loan is secured by the equipment, furniture, and fixtures. It is repayable in annual principal payments of $400,000 on May 1 and matures on April 30, 2024, when any remaining principal outstanding is due. This term loan has a debt covenant in that total interest-bearing debt to EBITDA cannot exceed 2.5.

   The company has found two alternative sources of funds for any new long-term investments. The terms and conditions proposed for each alternative are provided in Appendix IV.

Board meeting dialogue

The board met on May 5, 2023. Prior to the meeting, a briefing was distributed to the board members on four new potential projects:

- Purchase all the outstanding shares of Bella's Pet Friends Ltd. (Appendix V)
- Invest in Bonheur des Animaux au Lac Agathe (Appendix VI)
- Provide loan to Osler Farms Pet Kitchen Ltd. (Appendix VII)
- Change the format and product mix of the stores to provide additional pet services and eliminate pet supplies (Appendix VIII)

The meeting's agenda was announced as follows:

1. Consider the four proposed strategic alternatives.
2. Discuss any other business.

Excerpts from the discussions that took place are detailed below.

Richard: You all know my good friend Charlie Lonian, whom I met many years ago at a pet retail conference. Charlie is the sole owner of Bella's Pet Friends Ltd. (BPF), named after his own dog, Bella. Charlie's philosophy about pet products is the same as ours in that he is all about what is needed to keep pets healthy and happy. He has a chain of franchises throughout Western Canada and is looking to expand geographically as quickly as possible. Due to increasing competition at the retail level, he believes that to remain competitive, BPF needs to reach a larger critical mass of more than 70 stores nationwide to achieve economies of scale. He thinks combining our two companies will help reach this size sooner than he could on his own.

Elaine: I agree with Charlie. That is why this opportunity makes sense to me. Together, the two companies can achieve this critical mass, whereas alone, it would take far too long.

Steve: The most important concern for me is that BPF uses a franchise model and we do not.

Elaine: I will ask QSC to perform some research on franchising and provide us a summary of the advantages and disadvantages of a franchise model and what it takes to be successful franchisor, as well as compare BPF's key ratios to our ratios. This will be helpful information, regardless of the decision we make.

Julia: But with a franchise model, we lose control over the stores. Right now, our reputation is built on the level of customer service we give pet owners, and if we acquire another company, we want to keep this point of differentiation. I don't want to rely on franchisees to be as concerned about this as we are. I see this as destroying our reputation.

Elaine: Perhaps we could keep the two companies operating under separate brand names, since the stores are quite different.

Julia: This just seems to make everything more difficult. Then we have to choose where we spend our resources — growing JRP or growing BPF. I don't want to have to make this choice, since my passion is with JRP.

Richard: I am hoping that this acquisition would give us incentive to change up our product mix. BPF currently sells products that we have been considering. We could use Charlie's knowledge and experience in these markets to assist us with changes required.

Steve: If I understand the deal that is being considered, JRP would acquire 100% of BPF's outstanding shares and in return, Charlie would receive 25% of JRP's outstanding shares and cash of $5.5 million. This seems to undervalue the shares of JRP.

Richard: I should also mention that the reason Charlie wants to sell to us is that he wants to have more free time. Right now, as the sole shareholder of the company, he works long hours and has not been able to find the right people to employ to help him manage the growth. He has always been impressed with our company and feels that a merger would be beneficial for all parties.

Elaine: Charlie also mentioned that BPF has some loss carryforwards that we might be able to use to reduce our combined taxes payable. I think we should ask QSC about any tax issues that would arise on change of control of BPF.

Julia: Since I don't really know Charlie, I may not be prepared to have him as a shareholder in our business. I am also concerned about the voice that franchisees will have in our policies and procedures. We will also have to listen to their concerns, which will make operational changes and decisions more difficult and time consuming.

Steve: What about the reward loyalty programs — do we combine the two? I think that the current programs are quite different and BPF has only about 50% of its customers signed up.

Julia: I noticed that BPF has a high amount of debt. We have always been reluctant to take on debt and only added it when we really needed to. I am not sure that taking on this added risk is warranted. But let's move on to our next proposal. Steve?

Steve: All of you know my long-time friend Gord Ly and his wife, Irene. Gord and I have been discussing opening a premier dog camp for quite a while now. Gord is looking for a change and has also identified this as a need. After months of research, he found an ideal location. The camp is located in Quebec on a lake, in a beautiful setting. It is close to two of JRP's stores in Quebec, which are located in towns that represent about 25% of the potential customers that would use these facilities. Gord has been a veterinarian for 20 years and has operated his own boarding kennels during this time. The plan is for Gord and Irene to operate the camp. Irene is a dog trainer, specializing in search and rescue training.

Richard: Gord has been our veterinarian for our dogs for ages, so we know him well. He is really good at what he does, and his kennels are spotless and inviting compared to others that I have seen. But he has worked for himself for so long making his own decisions, I am not sure he would take direction well from us.

Julia: I think he is ready for a change and he is so excited about this idea. I would see us working together on this project, since he has a lot to bring to the table in the way of knowledge. I think it could be a win-win for all of us.

Elaine: It is a significant upfront investment cost. If the camp is not successful, it would likely take us a while to sell the property. I know the property Gord likes has been up for sale for about a year or so. If the camp is not initially successful, cash flow from the stores will have to be diverted to cover the losses. This is a riskier investment than our current operations.

Steve: Deluxe dog camps are becoming popular but currently there are no competitors in the surrounding area that we are considering. I think it is a case of getting into this market early, taking the risk, and it will pay off.

Julia: It also gives us another niche that make us different from the other retailing competitors.

Richard: What happens if Gord and Irene leave? We will be left with trying to manage the camp ourselves.

Julia: That is a good point. However, one advantage of a dog camp is that we can order all the food and supplies from our current suppliers. This will give us some economies of scale.

Steve: Gord already has some experienced people interested in working at the camp. This means we will be able to start with really experienced staff. And Gord and Irene both know the right people to contact to hire more.

Richard: This camp really does not do much to build our national reputation.

Julia: That may be true, but what is wrong with that, as long we make a good profit from the investment?

Elaine: I see the plan is also to provide dog owner accommodations. I am not sure we should do that, since we know nothing about running a hotel.

Steve: If we must, we can hire a person with this experience to run that part of the camp. But I think it is an important aspect to keep, since it will really differentiate us from some of the current operators who only have accommodation for the dogs.

Richard: What about cats? Would we ever expand this to also accept cats?

Steve: That is not currently in the plan, but of course could be considered later. Right now, I think there is more demand for this type of experience from dog owners. I also forgot to mention that if we go with this proposal, Gord is prepared to invest up to $3 million in preferred shares in JRP, the terms of which are included in the summary of financing alternatives (Appendix IV).

Julia: Now for the next idea I want to propose to the group. I have been approached by my good friend Lena about investing in her vegan organic dog food company called Osler Farms Pet Kitchen Ltd. (OFPK). JRP has been purchasing increasing amounts of Lena's food since last year, and we have customers who are constantly asking for this product. To meet this increased demand, Lena must expand her production facilities.

She has approached me about JRP advancing her a loan for $6 million to finance the new production facility. In return, she said that OFPK will pay JRP 20% of its total operating profits each year until the debt comes due in December 2032. She has also suggested that at some date between now and then, if both parties agree, this loan could be converted into common shares of OFPK, although this would not be part of the terms and conditions of this loan. The number of shares it could be converted into would ultimately be dependent on the valuation of the shares of OFPK at that date. She also said that she wanted me to come on as a director of OFPK during the period the loan is outstanding, since she values my opinion from a retail perspective. I think this is a unique opportunity for us to get into the manufacturing segment of this industry and to gain some inside knowledge. We can test the relationship, and if it works out and both parties agree, we can make an equity investment, and if it doesn't work out, we get our funds back.

Steve: I think it is a really good idea. OFPK has a lot going for it, since it grows many of the ingredients that are used in its food, giving it a reliable and guaranteed supply. And vegan organic pet food is being demanded more and more by our store customers. We can even expand our product mix to include more of this product, since it has been successful in the stores and especially considering the discount Lena is prepared to give us.

Richard: I have some real concerns with this proposal because the minimum return is only 3%, which is well below a reasonable return based on the risk. We are, in fact, sharing the risk of making the profits but will not have much control over the day-to-day activities to generate the profits. We will be relying solely on Lena for this. Also, our experience is in pet stores, and this is a dog food company. I am not sure if we understand what it takes to be successful in the dog food industry.

Julia: Lena is very well respected in the industry. And don't forget that she is also a canine nutritionist, so we know that her products will be well-balanced nutritionally. And I will be on the board and able to provide our input into decisions. As well, in addition to analyzing the proposal itself, we should have QSC complete some additional industry research into the pet food industry for us and provide us with a bit more background on the trends in this industry, especially as they relate to ingredients, to help us make this decision.

Elaine: We will need QSC to prepare a cash flow projection for OFPK, since I want to be sure there is sufficient cash flow to pay the amounts that we are owed each year and also when the loan comes due.

Steve: I like the idea that OFPK will give us a discount on any food that we purchase from it for the stores, since this will also increase our retail profits. But the amount of this discount also needs to be part of the terms of the agreement.

Julia: I don't think Lena will have a problem with this. I think she really wants to make this work like an alliance that may eventually evolve into our two companies being partners.

Richard: Even though they want you to be a director, how much say will you really have Julia, given that the other three directors are family? Although they might listen to you, I doubt they will take your advice.

Elaine: The success of OFPK is totally reliant on Lena. If something happens to her, or the company's reputation is tainted in any way, we won't receive much return on this loan. I am really against taking that amount of our resources and investing with no guaranteed returns. I think a more reasonable pre-tax return might be around 10%.

Julia: I think the idea is good. And I have also been thinking that we could use the stores for taste testing. Customers' dogs could come in and try the food and pet owners could see how they liked it prior to buying. I think this would help attract customers to the store and increase sales of the product.

Steve: Great idea. I know that other competitors are doing this to try to get customers to actually visit the stores, and this could help differentiate us from the other non-pet and online retailers.

Richard: I don't like the fact that there does not seem to be any way for us to get repaid earlier if it looks like the forecasts are not being met or we disagree with the direction that OFPK is going.

Elaine: What does operating profit include anyways? There are methods that can be used to lower operating profits in any year, so we would want to ensure that the definition is properly laid out. For example, the cost that is paid to the farm for the ingredients could easily be increased, transferring profit to the farm and lowering the profit for OFPK.

Steve: I like that they have a successful subscription model and online presence. I think this indicates that they know what they are doing and not only understand the trends in the market but have adapted their strategies to embrace them. Any investment has its risks, and I think this one is likely lower than some of the others we have been considering.

Julia: Let's move on to our last proposal. Elaine, I think you have the information on this?

Elaine: As you know, for a while now I have been suggesting that we renovate our stores to provide more pet services. I have drawn up some plans that show how we can use our store space more efficiently. If we move the food displays and eliminate all the pet supplies, we can add three treatment rooms. And this can be done in all our stores regardless of their size. My plan is to have treatment rooms that will be available for pet massages, chiropractic therapy, and nutritional counselling. These services will attract affluent customers who are concerned about the health of their pets, which is the segment we have experience in attracting and have been successful with in the past. Providing the services will help us differentiate from the online retailers, since this service can only be provided in person. I am going to ask QSC to prepare a contribution margin analysis and a payback period analysis for each of the new services and ignore any tax implications of capital cost allowance (CCA), as is our normal policy. Based on my research, we should accept this type of project if it pays back in less than three years.

Steve: I do not think we will attract any new customers, since we have already most of the target customer segment in the local market already. I also think that the assumptions for reaching capacity so quickly are unrealistic.

Julia: The proposal allows us to build on our current customer base, and they have already told us through the surveys that they are interested in us offering more pet services. We will be able to sell different types of services to our existing base, and there is nothing wrong with that. It will allow us to retain our existing customers and not lose them to competitors if we continue to adapt to their changing needs. Our customers will become even more loyal. I like the idea.

Richard: I am not sure we should do away with the pet supplies. The sale of pet supplies brings the customers into the store. I am also concerned about our existing distributors for these pet supplies. In some cases, we have contracts in which we have agreed to buy minimum quantities. If we break these contracts, there will be penalties, and this may tarnish our reputation. As well, I am not sure how it will impact the delivery of the treats and other products that we want to continue to purchase. This reduction in volumes will also increase our unit costs.

Elaine: Once these treatment rooms are built, we can always use the rooms for other types of services if it becomes warranted in the future, such as pet photography or veterinarian services. The redesign gives us lots of flexibility.

Richard: I think using contractors to provide this service is risky. We will be relying on them to show up for each appointment, and to provide exceptional customer service. Wouldn’t it be better to hire our own employees?

Elaine: I think we can manage these contractors. We can always let a contractor go if they are not performing up to our standards. We might have to sign them to year-long contracts to ensure that they are committed to growing the business.

Steve: Managing the contractors will be another responsibility for the store manager to monitor, since we are not at the stores. Somehow, we will need to get feedback from the customers about their satisfaction with the services they are receiving. I don’t think the managers currently have time for this.

Julia: I disagree. The managers have the time, and it is simple to ask customers how they found the service. We could even follow up with a phone call after the initial visits to see how it is going, which gives us another contact point with the customer and a chance to get immediate feedback.

Steve: The conversion of 10 stores in 2023 and 10 stores in 2024 is really aggressive, and I don’t believe this rate can be achieved. Perhaps we should slow it down to five stores a year instead. I don't think that I can manage 10 renovations at once. I am also not sure we can do this under some our existing lease arrangements.

Elaine: I think we need to be aggressive to stay ahead of the competition. During my research, I noticed that there were more of these pet services opening in our local markets. If we leave it too long, our customers will already be getting these services elsewhere, and it might be difficult to change. I have tentatively booked the builders that we regularly deal with in case we decide to go ahead with the renovations. I want their time slotted in so we can get right at it. If we decide not to renovate, I can cancel.

Richard: One concern I have is that I don't think there will be a lot of repeat business. Usually, these types of services are used when there is problem that needs to be resolved. As long as the problem persists, the pet owner will use the services, but once the problem is resolved, there may no longer be this need. Therefore, these services are not like grooming or pet food where customers need these items on a regular basis. This may make the revenues volatile and require more marketing costs to continuously generate.

Julia: I agree with Elaine that waiting too long is not an option. I also think that we could offer a discount on these services to loyalty reward customers. This would make more customers sign up and attract new customers from existing competitors that do not offer a loyalty rewards program.

Elaine: Before we make any final strategic decisions, we will want to understand the impact on our existing customer base and their needs. To help us, we recently completed our customer survey, for which we had an incredible 75% response rate. I suggest we ask QSC to assist us with analyzing this data. While we gathered a wide range of information with respect to JRP's customers and their pets, let's provide the relevant details to QSC for analysis on a selection of 1,000 customers; these details are included in the Excel file 'JRP.Surveydata'. The information should give us a good idea of what makes up our customer base — not only the pet parents but also the pets.

Julia: Yes, I agree. We should ask QSC to analyze the results to help us formulate a strategy going forward and determine what our product and service mix should be in the stores. I would also like to know if we are collecting and storing the customer data properly.

Elaine: I also need QSC's assistance with respect to security controls over inventory in our stores, since lately we are showing increasing inventory shrinkage in a couple of our stores. I would like QSC to provide some general recommendations and policies for controlling physical access and increasing physical security in our stores to prevent loss of inventory.

Julia: Great ideas! Are there any other matters we need to discuss?

Steve: As you know, ULL, a company owned equally by my brother Joshua and myself, recently purchased JRP's head office building as part of our portfolio of rental properties. I am wondering if QSC could review any accounting implications this might cause for JRP, since I am a shareholder in both companies.

Elaine: There is another issue that has arisen. As you know, in the past, we have asked store managers to sign themselves and their employees up for the required training courses each year. Managers use their own personal credit cards to pay for these courses, since we don't issue company-wide credit cards. Once the course is taken, the manager submits the certificates of completion for all the employees to head office. In return, we then reimburse the store managers for the fees paid after they have provided proof of payment. I have just learned from several store employees that one of our store managers, Scott Gilbert, who has been with us for five years as a manager, has been providing fake certificates and fake receipts of payment for courses for the past three years. As you know, many of our product manufacturers require that we take their training as part of their contracts so that we are knowledgeable about their products. We must report to these manufacturers that all our employees are up to date on their training programs annually. But now, we have a manager and his store employees that have not taken any training courses for the past three years and we have reimbursed for fees that were never paid. As well, we have lied to our manufacturers.

Julia: I am assuming you gathered the proof of this?

Elaine: I have interviewed all the store employees that are impacted, and they all say that none of them have had courses for the past three years. In my interviews, it appears that all the employees knew what was going on, but Scott had said he would fire them if they reported they were not getting their training. I wanted to discuss this with all of you to decide what our next steps should be.

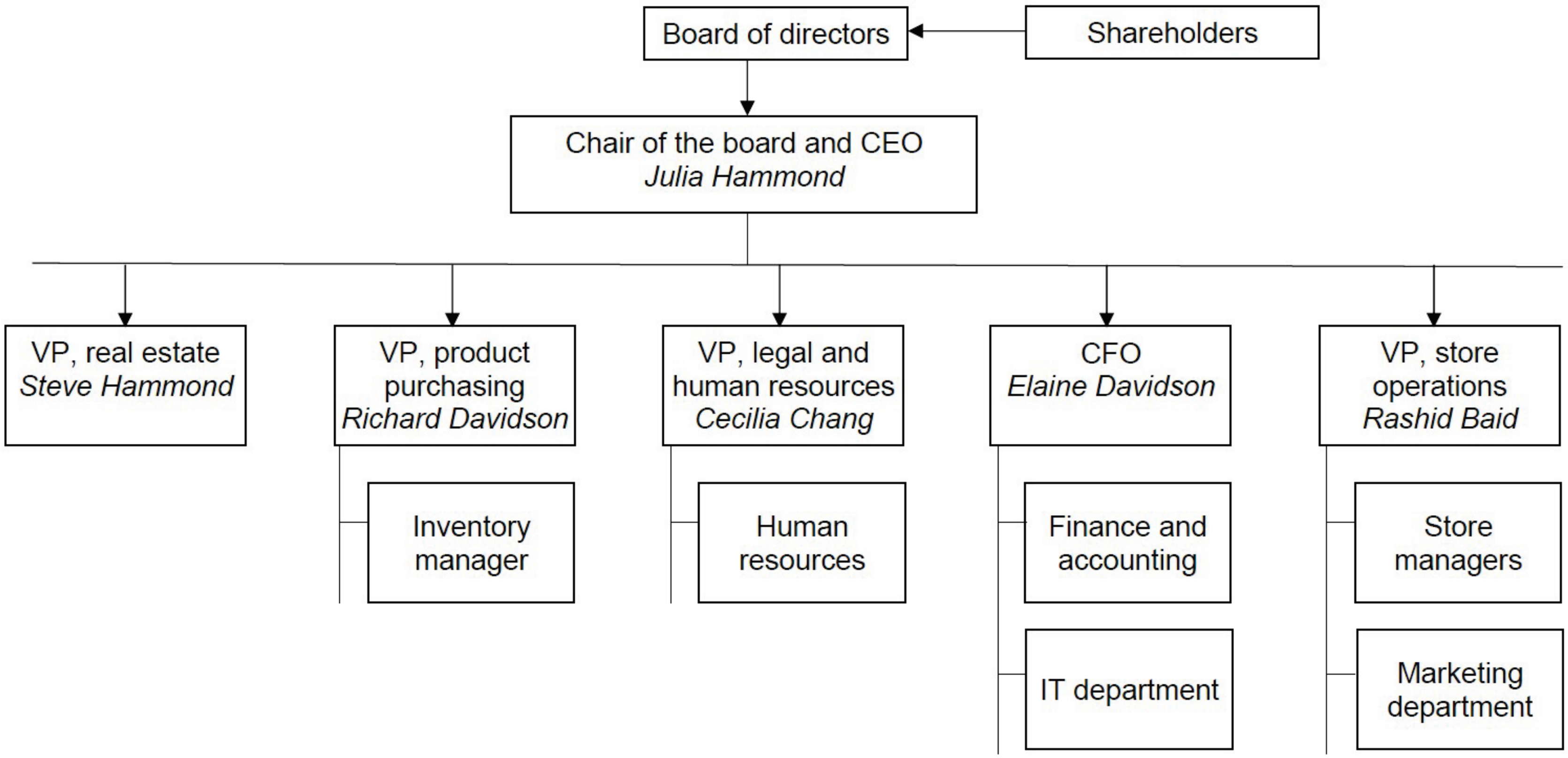
Julia: Let's ask QSC's opinion on this matter and advise on what our next steps should be.

Elaine: Good. I have one more request of QSC that relates to the bonus incentive plan we currently have for our store managers. I think we need to add a component that will encourage them to promote the company as being a good corporate citizen and embrace our core value of caring, being involved with, and giving back to the local community. Right now, as you know, it has been us, the shareholders, that have had to come up with the ideas and implement them across the company. I want to incentivize store managers to be creative and proactive and then be rewarded for these ideas and actions. I would like QSC to provide some analysis as to why this would be beneficial for our company and how the incentives might work. I would also like some examples of what could be done to give back to the community, how our progress could be measured, and what internal policy changes and rewards might be implemented.

Julia: I will add this to the list of items we want QSC to include in the report.

Table of appendixes

APPENDIX I
ORGANIZATIONAL CHART
Prepared by Elaine Davidson



APPENDIX II
J.R. PETS INC. FINANCIAL STATEMENTS
Prepared by Elaine Davidson

J.R. Pets Inc.
Statement of earnings and retained earnings
For the years ended December 31
(under ASPE)
(in C$'000s)

	AUDITED 2022 $	AUDITED 2021 $	AUDITED 2020 $
Revenue	38,500	36,780	37,800
Cost of goods sold	21,020	19,960	20,046
Gross profit	17,480	16,820	17,754
Expenses			
Amortization	1,599	1,503	1,598
Direct store costs	590	420	550
Marketing and advertising	2,090	2,300	1,975
Wages and salaries	7,258	6,980	7,210
Rent and occupancy costs	3,840	3,710	3,640
General and administrative	1,190	1,060	1,090
Total expenses	16,567	15,973	16,063
Operating income	913	847	1,691
Interest expense	116	137	157
Income before taxes	797	710	1,534
Income taxes	215	192	414
Net income for the year	582	518	1,120
Opening retained earnings	6,753	6,235	5,115
Dividends	-	-	-
Closing retained earnings	7,335	6,753	6,235

APPENDIX II (continued)
J.R. PETS INC. FINANCIAL STATEMENTS
Prepared by Elaine Davidson

J.R. Pets Inc.
Balance sheet
As at December 31
(under ASPE)
(in C$'000s)

	AUDITED 2022 $	AUDITED 2021 $	AUDITED 2020 $
Assets			
Current assets			
Cash and cash equivalents	1,091	1,342	1,120
Accounts receivable	285	280	250
Inventories	2,360	2,230	2,190
Prepaid supplies and expenses	347	170	140
Total current assets	4,083	4,022	3,700
Property, plant, and equipment — net	9,100	8,659	9,192
Total assets	13,183	12,681	12,892
Liabilities			
Current liabilities			
Trade payables and accrued liabilities	2,088	1,740	1,908
Income taxes payable	160	170	280
Current portion — term loan	400	400	400
Total current liabilities	2,648	2,310	2,588
Future income taxes	400	418	469
Long-term debt — term loan	1,800	2,200	2,600
Total liabilities	4,848	4,928	5,657
Shareholders' equity			
Share capital —1,000,000 common shares outstanding	1,000	1,000	1,000
Retained earnings	7,335	6,753	6,235
Total shareholders' equity	8,335	7,753	7,235
Total liabilities and shareholders' equity	13,183	12,681	12,892

APPENDIX II (continued)
J.R. PETS INC. FINANCIAL STATEMENTS
Prepared by Elaine Davidson

J.R. Pets Inc.
Statement of cash flows
For the year ended December 31
(under ASPE)
(in C$'000s)

	AUDITED 2022 $	**AUDITED 2021 $**
Operating activities		
Net income for the year	582	518
Amortization	1,599	1,503
Future income taxes	(18)	(51)
Change in working capital balances		
Accounts receivable	(5)	(30)
Inventories	(130)	(40)
Prepaid expenses	(177)	(30)
Trade payables and accrued liabilities	348	(168)
Income taxes payable	(10)	(110)
Total cash flow from operating activities	2,189	1,592
Investing activities		
Investment in property, plant, and equipment	(2,040)	(970)
Financing activities		
Repayment of term loan	(400)	(400)
Dividends paid		
Total cash flow from financing activities	(400)	(400)
Change in cash	(251)	222
Opening cash and cash equivalents	1,342	1,120
Closing cash and cash equivalents	1,091	1,342

APPENDIX III
INDUSTRY BENCHMARKS
Prepared by Elaine Davidson

Industry benchmark (pet retail)	Industry average
Annual revenue growth rate	2.3%
Current ratio	1.7
Days in receivable	32 days
Days in inventory	58 days
Days in payable	52 days
Total debt to assets	52%
Return on assets	10.5%
Gross profit margin	42%
Marketing costs as a percentage of revenue	3%
Wages and salaries as a percentage of revenue	14%
Rent and occupancy costs as a percentage of revenue	11%
Operating profit margin	5%
Net profit margin	4%
Revenue per employee	$194,000
Sales per square foot	$496.00

APPENDIX IV
FINANCING ALTERNATIVES
Prepared by Elaine Davidson

1. FrontStreet Bank term loan: FrontStreet Bank is prepared to renegotiate the existing term loan and issue another $5,000,000, increasing the term loan outstanding to $6,800,000. (The current balance is $1,800,000 after the May 2023 repayment.) The revised interest rate will be 8%, payable monthly, and the monthly principal amount due is $56,667 until the loan matures in 10 years. The loan will be secured by a general security on all assets. The company may repay 10% of additional principal on the anniversary date of the loan each year. The covenant remains in that total interest-bearing debt to EBITDA cannot exceed 2.5.
2. Gord Ly: Gord has offered to invest $3,000,000 into JRP in return for 30,000 preferred shares but only if his dog camp proposal is accepted. The preferred shares have a cumulative annual dividend of 3% but are convertible into common shares at 10% below current market value at the time of conversion. The preferred shares are convertible at the holder’s option any time after 2028. The preferred shares are also redeemable at $105 each any time after 2031 at the company’s option.

APPENDIX V
ACQUIRE BELLA'S PET FRIENDS LTD.
Prepared by Richard Davidson

Charlie Lonian is the sole owner of Bella's Pet Friends Ltd. (BPF), a pet store franchisor specializing in superior-quality pet food, supplies, and services to keep dog and cat pets healthy. BPF's most recent financial statements are provided below. BPF is a chain of 30 franchises located throughout Western Canada, including Manitoba, Alberta, British Columbia, Northwest Territories, and Yukon. Its customer base is affluent customers who care about the health of their pet. The stores are situated in suburban areas and big city centres.

With a global pandemic impacting the sale of franchises, the last franchise was opened in 2019. However, interest in owning franchises has now picked up again, and BPF management is currently reviewing and assessing applications for approval. Charlie is looking to expand geographically as quickly as possible and has a plan in place to expand BPF to 55 locations by 2026. Some of this expansion is potentially in Ontario, although the final sites have not been yet decided. When these BPF stores are added to the 20 currently owned by JRP, the combined entity would have 75 stores by 2026.

The stores, all owned by franchisees, offer similar pet food products as JRP. Currently, the percentage of franchisees' revenues by product and services is as follows:

- 35% pet food (fresh and frozen) and treats
- 20% pet supplies
- 15% pharmaceuticals and medications
- 30% pet services including pet massage, pet chiropractic therapy, and pet nutritional counselling

Sales that occur at the franchise level to customers are known as system sales. The average size of a store is 4,800 square feet.

BPF has a strong online presence that is operated by the head office, but the sales are allocated to the franchisees as part of their system sales. Any customer purchasing online must identify with a specific store prior to completing their order. The intent of this is to not undercut sales for the franchisees. BPF also has a customer rewards loyalty program. Currently, BPF has a total customer database of 110,000, of which 50% of are members of the loyalty program. This is in line with industry averages.

APPENDIX V (continued)
ACQUIRE BELLA'S PET FRIENDS LTD.
Prepared by Richard Davidson

Franchisees are selected after a rigorous application review. The franchise agreement requires the franchisee pay an initial fee of $50,000 per store location that is not refundable and covers initial set-up, training, and support. Ongoing annual franchise fees are 6% of total gross system store revenues. This gives the franchisee the right to use the BPF name, access the company's business processes and procedures, use the inventory management and POS systems, and access ongoing training and support as needed. In addition, there is an annual advertising fee of 2.5% on total annual gross system store revenues charged to franchisees to help cover corporate-paid regional marketing costs. The franchisee is responsible for paying for all the equipment and fixtures at the locations. The franchise agreement can be terminated by BPF if the franchisee does not comply with all the terms and conditions of the agreement.

BPF selects the store locations and signs the lease directly with the landlord. BPF then subleases to the franchisee under the same terms and conditions, so these lease costs are simply a flow-through cost for BPF.

BPF has agreements with manufacturers and distributors, and due to its volumes, can purchase products at reduced prices. Each franchisee must purchase at least 55% of their products for resale directly from BPF. BPF earns a 10% gross profit margin on the resale of these products to the franchisee. The franchisee, in turn, earns an average gross profit margin of 30% on the resale to the end customer.

Franchisee fees are payable monthly and are due within 20 days of month end. Franchisees must pay BPF for inventory product purchases within 14 days of receipt.

Based on current potential franchisee applications, Charlie estimates the number of new franchise stores to be added each year as follows:

	2023	**2024**	**2025**	**2026**
Opening number of franchises	30	38	45	50
New franchises in the year	8	7	5	5
Total franchises at the end of year	38	45	50	55

Based on past experience, system sales in the first year a new store is opened should average $950,000 per store. In the second year of operations, the average sales are $1,900,000 per store. By the third year, the store should reach mature sales of $2,500,000 per store. Note that these are sales in 2022 dollars, and revenues thereafter are expected to increase at the rate of inflation of 1.5% annually.

APPENDIX V (continued)
ACQUIRE BELLA'S PET FRIENDS LTD.
Prepared by Richard Davidson

Charlie has estimated that for each new franchisee that opens during the year, BPF incurs one-time marketing costs of $25,000 and one-time other costs of $30,000 to cover travel, training, installation of software, and so on.

Annual ongoing operating costs and forecast assumptions for BPF are as follows:

Direct costs related to servicing the franchisees (includes the net rent expenses)	4% of total gross system sales
Wages and salaries	$1,250,000 for 2023 and then increase annually at the inflation rate
Annual marketing costs	3% of total gross system sales
Head office occupancy costs	$670,000 for 2023 and then increase annually at the inflation rate
General, administrative, and IT costs	$560,000 for 2023 and then increase annually at the inflation rate

BPF spends $500,000 annually for furniture and fixtures and $650,000 for computer hardware and systems software. These assets qualify for the CCA declining balance rate of 20% and 55%, respectively, and are eligible for the Accelerated Investment Incentive. Assume the Accelerated Investment Incentive is in effect for all relevant years.

BPF owns land and buildings for its head office and a warehouse. The present value of the CCA tax shield on all existing assets is $750,000. The warehouse is used as a central point of distribution to its stores and online customers. Manufacturers and distributors ship to the warehouse for goods that are going to be resold to the franchisees. For all other products, the suppliers ship directly to the franchisees.

If JRP acquires BPF, BPF will be a wholly owned subsidiary of JRP, so JRP and BPF will be associated for tax purposes. As a result, after the acquisition, BPF will pay income tax at 27%. Based on her research and discussions with friends who are experts, Elaine has determined that an appropriate weighted average cost of capital is 15% for this company. The industry long-term growth rate is 2%.

APPENDIX V (continued)
ACQUIRE BELLA'S PET FRIENDS LTD.
Prepared by Richard Davidson

Bella's Pet Friends Ltd.
Statement of earnings and retained earnings
For the years ended December 31
(prepared under ASPE)
(in C$'000s)

	AUDITED 2022	**AUDITED 2021**
Franchisee total system sales	72,100	69,420
Revenue		
Total franchise fees	6,130	5,900
Product sales	27,750	26,730
Total revenue	33,880	32,630
Expenses		
Product purchases	24,975	24,057
Franchisee set-up costs	-	-
Direct operating costs — franchisees	2,970	2,860
Amortization	370	350
Wages and salaries	1,100	1,060
Marketing and sales	1,950	1,850
Head office occupancy	540	530
General, administration, and IT	430	390
Total expenses	32,335	31,097
Operating income	1,545	1,533
Interest expense	400	422
Income before taxes	1,145	1,111
Income taxes	106	105
Net income for the year	1,039	1,006
Opening retained earnings	3,802	2,796
Closing retained earnings	4,841	3,802

APPENDIX V (continued)
ACQUIRE BELLA'S PET FRIENDS LTD.
Prepared by Richard Davidson

Bella's Pet Friends Ltd.
Balance sheet
As at December 31
(prepared under ASPE)
(in C$'000s)

	AUDITED 2022 $	**AUDITED 2021 $**
Assets		
Current assets		
Cash and cash equivalents	50	210
Accounts receivable	1,970	1,950
Inventories	1,094	980
Prepaid supplies and expenses	410	390
Total current assets	3,524	3,530
Property, plant, and equipment — net	10,224	9,484
Total assets	13,748	13,014
Liabilities		
Current liabilities		
Trade payables and accrued liabilities	2,257	2,190
Income taxes payable	50	62
Current portion — term loan	360	360
Total current liabilities	2,667	2,612
Long-term debt — term loan	6,140	6,500
Total liabilities	8,807	9,112
Shareholders' equity		
Share capital — 100 common shares issued	100	100
Retained earnings	4,841	3,802
Total shareholders' equity	4,941	3,902
Total liabilities and shareholders' equity	13,748	13,014

APPENDIX V (continued)
ACQUIRE BELLA'S PET FRIENDS LTD.
Prepared by Richard Davidson

Bella's Pet Friends Ltd.
Statement of cash flows
For the year ended December 31
(under ASPE)
(in C$'000s)

	AUDITED 2022 $
Operating activities	
Net income for the year	1,039
Amortization	370
Change in working capital balances	
Accounts receivable	(20)
Inventories	(114)
Prepaid expenses	(20)
Trade payables and accrued liabilities	67
Income taxes payable	(12)
Total cash flow from operating activities	1,310
Investing activities	
Investment in property, plant, and equipment	(1,110)
Financing activities	
Repayment of term loan	(360)
Dividends paid	-
Total cash flow from financing activities	(360)
Change in cash	(160)
Opening cash and cash equivalents	210
Closing cash and cash equivalents	50

APPENDIX VI
INVESTMENT IN BONHEUR DES ANIMAUX AU LAC AGATHE
Prepared by Steve Hammond

Gord Ly, a friend, came to me about six months ago with a proposal for a premier pet camp. Gord is a veterinarian and his wife, Irene, has been involved in training dogs for the past 20 years. They have lived in Quebec all their lives. Gord and Elaine's plan is to run a high-end boarding facility for dogs. In the future, cat boarding may be also provided, but that is not part of the current plan. The difference between this and regular boarding facilities is that this facility would have a camp-like atmosphere, where the dogs spend most of their time outdoors swimming, running, playing, and taking optional training courses in search and rescue.

The camp would be open all year round and dogs would be booked for stays for a minimum of three days. Gord expects that the average stay will be 14 days. In addition, there would be facilities available for dog parents to come and spend some time if they wish. This would allow the dog parents time to be away with their pets, but also see what a dog's life is like at the camp. After seeing first-hand how the camp operates day to day, the pet owners would leave assured that their pets are well cared for. The plan is to build one camp first, and if successful, expand to other locations.

I was excited about the idea and agreed that JRP would look more closely at this proposal once Gord found a possible site and prepared a business plan. Since that time, Gord has travelled throughout Ontario and Quebec, looking at competitors' camps and possible properties. Last week, Gord called me and said that he had found the perfect remote property located about a one-and-a-half-hour drive away from affluent populated towns and cities. Based on purchasing this property, Gord and Irene have suggested naming the camp Bonheur des Animaux au Lac Agathe (BALA).

The property Gord identified currently operates as an exclusive children's overnight camp with superior facilities and amenities. The camp is located on 30 acres of land in northern Quebec. The property has a lake, fields, and wooded areas. Some of the existing cabins would be used to house the staff and dog owners who wish to stay overnight. The existing main camp building currently has the kitchen and dining room, as well as a large community room that would be used by the resident staff and pet owners. Additional buildings would be built for the dogs' sleeping quarters and indoor play facilities. Dog owners could also pay for grooming if they wished. There would be a full-service veterinary clinic on site in case the dogs need care while they are at camp.

Gord's proposal is that JRP would purchase the assets and incur other costs necessary to set up and operate the camp and would hire him and Irene to run the camp on a full-time basis. Gord has visited other similar locations and prepared his proposal by taking what he thinks are the best features from these other camps.

APPENDIX VI (continued)
INVESTMENT IN BONHEUR DES ANIMAUX AU LAC AGATHE
Prepared by Steve Hammond

Gord and Irene will be solely responsible for hiring the staff, which Gord wants to be highly experienced, dog-loving, and caring individuals. Since he would be giving up his current veterinarian practice, he has already talked to a few of his assistants who have indicated they are interested in coming to work at the camp.

The existing camp is available at a cost of $3,000,000, consisting of the following:

- Land: $950,000
- Existing buildings: $1,400,000
- Existing equipment: $650,000

Additional costs to be incurred include the following:

- Additional buildings: $800,000
- New equipment, including security cameras around the property: $350,000
- New fencing: $500,000
- New computers: $150,000
- Application software: $90,000

All the assets purchased would qualify for the Accelerated Investment Incentive. The CCA claim on applications software is limited to 100%.

	Buildings	Fences	Equipment	Computer equipment	Applications software
CCA rate — all declining balance	6%	10%	20%	55%	100%
Amortization rate — straight-line	20 years	14 years	8 years	4 years	4 years

At the end of the project life, expected to be the end of 2029, the land and buildings are expected to be sold (net of selling costs) for $1,150,000 and $1,400,000, respectively. The remaining assets will have little salvage value at this time. It is expected that there will still be balances remaining in the CCA classes when these assets are disposed of.

Gord has prepared the following estimates for future projections. He hopes that BALA would be operational by early January 2024. The camp will have a capacity to board 60 dogs and be open 365 days per year. The camp has 30 pet parent rooms available.

APPENDIX VI (continued)
INVESTMENT IN BONHEUR DES ANIMAUX AU LAC AGATHE
Prepared by Steve Hammond

Revenue projections are as follows:

	2024	2025	2026	2027	2028	2029
Daily rate for each dog	$105	$110	$115	$115	$115	$115
Occupancy rate	50%	60%	75%	80%	80%	80%
Daily rate per cabin for pet owners	$200	$200	$200	$200	$200	$200
Occupancy rate for the pet owner cabins	20%	20%	25%	30%	30%	30%
Training fees	$500,000	$500,000	$600,000	$600,000	$600,000	$600,000
Grooming fees	$65,000	$65,000	$85,000	$85,000	$85,000	$85,000

There would be initial inventory costs of $35,000. Gord has also estimated the operating costs as follows:

	2024	2025	2026	2027	2028	2029
Direct operating costs — food, supplies, medicines	15% of total annual revenues					
Wages and salaries	$680,000	$900,000	$1,020,000	$1,020,000	$1,020,000	$1,020,000
Marketing costs	$100,000	$100,000	$75,000	$60,000	$60,000	$60,000
Occupancy costs — heat, hydro, property taxes, etc.	$110,000	$110,000	$110,000	$110,000	$110,000	$110,000
General and administrative costs (Note 1)	$130,000	$150,000	$150,000	$150,000	$150,000	$150,000

Note 1: Elaine agreed that general and administrative costs would be handled by JRP's existing head office staff but would be allocated for budgeting purposes to BALA.

I also agreed to cover 50% of Gord's travel costs incurred to date to visit competitors' camps and find the appropriate site. The total costs incurred are $70,000.

Elaine suggested that 16% be used as the discount rate for this capital budget. JRP currently has an income tax rate of 27%.

The current plan is for JRP to directly purchase the assets and incur the costs to operate the camp.

APPENDIX VII
LOAN TO OSLER FARMS PET KITCHEN LTD.
Prepared by Julia Hammond

I have a good friend, Lena Baranski, who owns a farm along with her husband, Piotr, in southern Ontario. The farm has been in the family for generations. The farm is now certified organic. Lena is a trained nutritionist who specializes in canine nutrition.

About five years ago, Lena started to make small batches of “farm to pet bowl” vegan, organic dog food for sale. She started off selling at the local farmers’ markets, but the demand just kept increasing and so she incorporated Osler Farms Pet Kitchen Ltd. (OFPK) to produce the food on a larger scale. Today, at the farm, she has a large production facility and employs 30 employees. The ingredients used in the food are either grown on Lena’s farm or sourced locally and include blueberries, apples, strawberries, raspberries, broccoli, carrots, celery, and kale. Ingredients grown on the farm are sold at cost to OFPK. For the other ingredients, OFPK has supplier agreements that fix the price for a period. Plant-based proteins and fillers consisting of beans, peas, chickpeas, lentils, rice, and corn, where not grown on the farm, are sourced from other organic growers. There are no additives, colours, or other artificial ingredients. The packages are all nutritionally labelled. The food can be refrigerated for up to one week or frozen for up to four months. The fact that the food is certified organic commands a premium compared to other fresh dog food. In addition, customized food is also available to customers by request, which sells at an even higher premium.

OFPK sells to specialty pet stores, natural food stores, and directly to customers online. The company has a “farm to pet bowl” subscription service, where customers receive their pet food delivered weekly, direct to their home. Currently, 90% of OFPK customers are repeat customers, with the number of new customers growing each month.

Sales to stores are made with 30-day payment terms, although historically pet stores have not paid on time. Online sales and subscription sales are made by credit card, so there are minimal receivables. Inventory includes raw materials, packaging, and finished goods. Finished goods are in inventory for less than seven days, but the average of all inventories is 14 days on hand.

The pet food sold to pet stores is a line of five different products that OFPK manufactures. Pet owners who purchase directly from OFPK have the option of purchasing the already prepared and packaged food, or customizing their pet food depending on their dog’s breed, lifestyle, and age and selecting the ingredients they want from a long list of items. Those customers who choose the subscription model are given nutritional counselling for their pet by Lena. From this initial consult, Lena can prepare the food that will be best for the owner’s dog. Customer complaints, although very few, are handled immediately by Lena, who contacts the customer directly to rectify the issue as quickly as possible.

APPENDIX VII (continued)
LOAN TO OSLER FARMS PET KITCHEN LTD.
Prepared by Julia Hammond

When OFPK was incorporated, Lena and Piotr invested $3 million to purchase the common shares. The bank provided a 6% long-term loan that is repayable in annual principal payments of $640,000 paid evenly throughout the year. The existing plant and equipment are security for this loan. The bank has also offered a $1 million line of credit, at 4% interest, that is available if required.

Based on customer demand, OFPK needs more production capacity, and Lena needs to build a new facility for a cost of $6 million in 2023. I have been telling Lena that JRP is looking for new investments for the future. Based on this discussion, Lena approached me about JRP providing a loan of $6 million to finance the new expansion in 2023 with the loan being advanced by July 1, 2023. The loan would be fully repaid on December 31, 2032. Lena is prepared to pay JRP 20% of OFPK's total operating profits with a minimum of 3% annual return on the loan amount outstanding. Interest payments would be made by December 31, based on the operating profits earned for the year ended October 31. The first payment on December 31, 2023, would be equal to one-third (four months) of 20% of the operating profits earned for the year ended October 31, 2023. The amount payable for any year will be paid based on the audited financial statements. OFPK's amortization rate for capital assets is 5%. Even though forecasts are provided only to 2027, Lena expects that 2028 to 2032 results will be at least equal to those of 2027.

As part of the terms of the loan, Lena would like me to join OFPK's board of directors with voting rights to provide input on operating strategy, since I have a good knowledge of the pet food retail sector. Currently, only Lena, her father, and Piotr are directors.

Lena also expects that JRP will purchase a minimum of $500,000 of the OFPK food to sell in JRP's retail outlets. In 2022, JRP started to carry the OFPK food and has found it to be successful. To date in 2023, JRP has already purchased $400,000 of OFPK food for sale at its retail stores, so reaching the $500,000 minimum should not be a problem. Lena has also suggested that if JRP agrees to this arrangement, she would provide a discount to JRP on its purchases.

Lena has hired two scientists for her research and development who have degrees in food chemistry and nutrition. Lena believes that ongoing product development is key for success to have leading-edge and innovative products that will adapt as pet owner preferences change. The continuous introduction of new products will keep sales stable over time. The R&D department is also responsible for continuing quality control spot checks that are completed and reported daily.

APPENDIX VII (continued)
LOAN TO OSLER FARMS PET KITCHEN LTD.
Prepared by Julia Hammond

The most recent audited financial statements of OFPK are provided. With input from me, Lena has prepared forecast assumptions for the years 2023 to 2027, beyond which OFPK's operating profits are expected to grow at 2%. Property, plant, and equipment additions and working capital increases forecast for 2027 will continue in years beyond 2027.

Assumptions	**2023**	**2024**	**2025**	**2026**	**2027**
Sales in stores — annual percentage growth	20%	20%	15%	10%	5%
Online sales — annual percentage growth	30%	30%	20%	15%	5%
Subscription sales — annual percentage growth	35%	35%	30%	15%	5%
Cost of goods sold — percentage of total sales	54%	52%	51%	51%	51%
Advertising and marketing — percentage of total sales	10%	10%	9%	8%	8%
Shipping — percentage of total sales	3%	3%	3%	3%	3%
Research and product development — annual growth rate	8%	6%	3%	3%	3%
General and administrative — annual growth rates	6%	5%	3%	2%	2%
Additions to property, plant, and equipment ($'000s)	6,000	3,200	3,200	2,500	3,000
Increase in working capital ($'000s)	50	50	50	40	20

APPENDIX VII (continued)
LOAN TO OSLER FARMS PET KITCHEN LTD.
Prepared by Julia Hammond

Osler Farms Pet Kitchen Ltd.
Income statement
For the year ended October 31, 2022
(under ASPE)
(in C$'000s)

	AUDITED **$**
Revenues	
Sales in stores	3,260
Online sales	3,570
Subscription sales	1,960
	8,790
Cost of goods sold	4,480
Gross profit	4,310
Expenses	
Advertising and marketing	820
Amortization	983
Shipping	230
Research and product development	450
General and administrative costs	620
	3,103
Operating profit	1,207
Interest on long-term debt	979
Interest on line of credit	
Earnings before income taxes	228
Income taxes	62
Net earnings	166
Opening retained earnings	1,696
Closing retained earnings	1,862

APPENDIX VII (continued)
LOAN TO OSLER FARMS PET KITCHEN LTD.
Prepared by Julia Hammond

Osler Farms Pet Kitchen Ltd.
Balance sheet
For the year ended October 31, 2022
(under ASPE)
(in C$'000s)

	AUDITED **$**
Assets	
Current assets	
Cash	52
Accounts receivable	350
Inventory	196
Prepaid expenses	95
Total current assets	693
Property, plant, and equipment	24,650
Total assets	25,343
Liabilities	
Current liabilities	
Line of credit	-
Accounts payable	381
Accrued liabilities	100
Current portion of long-term debt	640
Total current liabilities	1,121
Note payable — JRP	
Long-term debt	15,360
Total liabilities	16,481
Shareholders' equity	
Common shares	3,000
Preferred shares	4,000
Retained earnings	1,862
Total shareholders' equity	8,862
Total liabilities and shareholders' equity	25,343

APPENDIX VIII
ADD PET SERVICES TO STORES
Prepared by Elaine Davidson

The proposal is to renovate the stores to use the space more efficiently and change the mix of product and services. The food displays will be moved, the pet supplies eliminated, and three treatment rooms added. This will allow the stores to offer additional new pet services in the stores. One-half of the retail floor space will be converted into three treatment rooms. There will be one room for pet chiropractic therapy, one for pet massages, and one for pet nutritional counselling. Pet supplies will no longer be offered for sale, but pet grooming, training, and pet food will continue to be offered. Currently, JRP holds 50 days of inventory for pet supplies.

The breakdown of the contributions per product or service type and the total fixed costs has been calculated and is provided below.

The proposal is to convert the first 10 stores in 2023. During July 2023, the construction will start in each of these stores and is expected to be finished in one month. In August, the new services will be offered. Grooming and training and pet food sales will continue during the construction period. The next 10 stores will be converted in January of 2024.

Contractors, rather than employees, will be used to provide the pet services. This will allow JRP to pay for only the services provided and save on benefits and ongoing training that these professionals must have annually to keep up to date and maintain their certification. The contractors will be responsible for cleaning after every pet and for ensuring that any required regulations have been followed.

The selling price per session for each of the services is as follows: pet chiropractic therapy: $115; pet massage: $65; and pet nutritional counselling: $80. There will be six sessions in each treatment room per day and a maximum of 280 booking days per year.

For the stores that are converted in 2023, the treatment rooms will be available 80 days during 2023, 240 days in 2024, and then at full capacity in 2025 and onwards. For the stores opened in 2024, there will be 180 days available in 2024 and then full capacity for 2025 and onwards.

APPENDIX VIII (continued)
ADD PET SERVICES TO STORES
Prepared by Elaine Davidson

The following represent the costs per session for each service:

	Pet chiropractic therapy	Pet massage	Pet nutrition counselling
Therapist/nutritionist (as a % of selling price — as industry practice)	$50.00	$30.00	$40.00
Supplies	$ 0.40	$ 1.50	$ 0.75
Cleaning supplies	$ 0.50	$ 0.50	$ 0.50

The capital costs per store for building the treatment rooms and to purchase the equipment are $150,000. These assets will have a useful life of 15 years.

It is believed that JRP's current fixed costs will not be affected by the decision.

	Pet food (variable costs) $	Pet supplies (variable costs) $	Pet grooming and training (variable costs) $	Fixed costs $	Total $	Total as per F/S $
Sales	19,725	12,850	5,925		38,500	38,500
Cost of goods sold	8,475	8,990	3,555	-	21,020	21,020
Amortization				1,599	1,599	1,599
Direct store costs	80	50	40	420	590	590
Marketing and advertising	385	250	160	1,295	2,090	2,090
Wages and salaries	2,000	1,000		4,258	7,258	7,258
Rent and occupancy costs			100	3,740	3,840	3,840
General and administrative			20	1,170	1,190	1,190
	10,940	10,290	3,875	12,482	37,587	37,587
Contribution	$8,785	$2,560	$2,050	–$12,482	$913	
Contribution margin	45%	20%	35%			
Average contribution per stores	$439,250	$128,000	$102,500			