Figure 1-Tea pot & cup; Note 1:Stock Image Microsoft, 2023

STRATEGIC ANALYSIS & RECOMMENDATIONS REPORT FOR: KINGSDALE TEA INC.

Written by: F & W Consulting LLP

ABSTRACT

A report that looks into strategic analysis & recommendations for Kingsdale Tea Inc. that have been prepared for the board of directors and management.

Prepared: April 28, 2023

Executive Summary

Kingsdale Tea Inc. (KTI) is currently facing several challenges that require immediate attention to maintain its position in the market and achieve sustainable growth. KTI is at a critical juncture as it grapples with stagnant revenues, declining profits, and a reliance on existing customers. The situation at KTI is further complicated by conflicting viewpoints among shareholders and operational issues.

To make an informed decision about its future growth strategy, KTI must explore four strategic options, each of which have been subjected to a comprehensive analysis. These options have been evaluated based on their strategic fit with KTI's corporate strategy, key objectives and examined using both quantitative and qualitative criteria.

Through this rigorous evaluation process, each option has been carefully assessed, and a well-rounded recommendation has been made for each. These recommendations are backed by robust and comprehensive analyses that consider a range of factors, including market trends, customer preferences, operational capabilities, and financial projections.

The following are the four strategic options for KTI's consideration:

The first option with *Home Taste Koffee Inc.* (HTK) has been evaluated and found to be profitable under both forecasted and minimum volumes, generating a positive net present value. This option presents an opportunity for KTI to expand its customer base through co-branding and promotes a KTI-branded product. However, this option fails to meet KTI's ethical standards and does not provide any significant benefits in terms of controlling or diversifying supplies.

Despite its potential benefits, this option requires a high initial investment and raises concerns about HTK's personnel conflicting with KTI's values. Furthermore, meeting the production schedule requirements presents additional challenges, reducing the option's overall viability. Based on a thorough evaluation of the proposal, it is recommended that KTI not pursue this option.

The second option is to produce *Kingsdale Branded Tea*, which presents a highly compelling solution to KTI's current challenges. This proposal not only fulfills financial objectives but also strongly aligns with KTI's vision. This option offers a unique opportunity to diversify tea suppliers by expanding into Kenya region, promote a KTI brand, and achieves payback period for the expected scenario.

Despite the potential risk of no return on investment by 2026, the benefits of this option far outweigh the drawbacks. Therefore, it is strongly recommended that KTI pursues this option as it provides a promising avenue to achieve long-term success. However, KTI must exercise caution as it enters the US market, where limited data analysis has been conducted and significant reliance on one person is required. By mitigating these risks, KTI can effectively navigate this expansion and reap the benefits of this strategic option.

The third option involves investing in *Sleeping Hills Tea Estates* (SHTE), which has been evaluated as a potential solution for KTI's challenges. However, upon careful consideration, this option is deemed unsuitable for several reasons.

While it offers potential benefits such as a solution to supply capacity and control, and provides transparency into farming, the supply is not diversified outside of the Sri Lanka region, and none of the financial objectives are met. Furthermore, the valuation of SHTE is higher than the purchase price with no market comparison, making it a less attractive investment option for KTI. Therefore, after analyzing these considerations, it is not recommended to pursue this option.

The fourth and final option is to manufacture *Ready-To-Drink* (RTD) tea-based products providing significant potential, as it meets KTI's corporate strategy and some industry objectives without requiring any capital investments. However, it falls short on all financial objectives, lacks controlling or diversifying supply, and faces a highly competitive market. There are additional concerns about lease terms and the facility owner's intentions, making this proposal unsuitable. Based on a thorough evaluation of the proposal, it is not recommended that KTI pursue this option.

To pursue the KTI Branded Tea strategic option, additional financing is required. The preferred shares issuance to Conrad is a cost-effective option that provides KTI with financial flexibility while keeping voting control among common shareholders.

In this report, we have identified and analyzed key operational issues for KTI, both through specific requests and analyses. Our findings and recommendations are as follows:

- A review of KTI's corporate strategy and suggested revision to align with future branding goals.
- Identification of ethical issues on dust particle concentration and lack of transparency, and recommendations for addressing these concerns.
- A recommendation for a balanced scorecard approach to performance management to improve organizational performance.
- Transition from centralized to decentralized structure.
- A discussion of governance issues, including weaknesses, implications, and recommendations for the board to address.
- Recommendations for succession planning in anticipation of the CEO's retirement.
- Identification and/or suggestions for financial reporting, finance issue, and taxation implications.

Appendices and exhibits containing external analysis, decision criteria, and qualitative analysis are provided to bring breadth to our recommendation for this strategic option. The visualizations reinforce our recommendation by highlighting important statistics and providing a clear direction for KTI.

In conclusion, this report recommends that KTI implement a range of strategies to achieve branding recognition, capitalize on customer preferences, align with shareholder's preferences, facilitate cost savings, improve ethical issues, and diversify tea supply. The evidence provided supports these recommendations and provides a clear direction for KTI to follow in order to achieve their future goals.

Table of Contents

Introduction

This report aims to offer KTI a comprehensive evaluation of four strategic options against key objectives, strategic fit, current operational issues, and relevant trend analysis. By considering these critical factors, the report will provide KTI with a robust foundation for informed decision-making and successful strategic planning.

Overall Situational Analysis

Vision

A vision statement should be future-oriented, inspirational and give direction towards a company's goal(s). At present, KTI is delivering high-quality tea with a pure, complex, and pleasant experience for customers, thanks to their ethical standard requirements solidified within farmers contracts and use of strictly certified organic and Fairtrade farms. Although KTI's vision has been achieved, it provides no future direction.

Mission

A mission statement should reveal KTI's primary reason for existence and high-level goals. KTI aligns by producing ethical tea achieving distinctive taste that exceeds expectations with prioritizing customer/farmers' treatment, and high-quality taste through building relationship loyalty and use of certifications. However, KTI does not align with their mission statement regarding bringing health benefits in all forms to individuals and creating end-consumer loyalty.

Core Values

1. *Produce extraordinary organic, Fairtrade tea.*

   MET. KTI only purchases tea certified as organic and Fairtrade.

2. *Build long-term relationships with farmers, suppliers, customers, and consumers.*

   NOT MET. KTI has developed loyalty with farmers, suppliers, and private-label customers; however, end consumers only have relationship with private-label tea suppliers instead of KTI directly. KTI needs to create brand recognition at the consumer level.

3. *Build a brand that is known to be ethical and respected.*

   NOT MET. KTI is known to be ethical and respected but hasn't built brand recognition. KTI is only known and respected by the farmers and the private-label tea customers that they produce for; not the end consumers who buy the tea.

4. *Treat all employees with fairness, honesty, and respect.*

   NOT MET. Although KTI ensures ethical standards for farm workers, dust concentration issue has not been adequately addressed; therefore, this core value is not aligned due to potential health hazards.

5. *Ensure ethical, sustainable, and environmental standards are adhered to and followed throughout all processes, from farm to table.*

NOT MET. Ethical standards are questionable related to dust particle concentration. Sustainability is uncertain due to constrained tea leaf supplies as KTI uses all its current supply. Environmental standards met with organic, Fairtrade certification. KTI cannot guarantee farm to table without more control of farm processes.

Key Success Factors

The following are key industry success factors for tea producers:

Key Success Factor		KTI Current Performance
Raw material quality	**MET**	KTI purchases high quality specialty teas. Farmers are required by KTI to meet internal standards relating to land use and organic practices.
Supplier contracts	**MET**	KTI has successful long-term relationships with its farmers; all currently holding contracts for multiple years.
Retailer relationships	**MET**	Seven current private-label customers been with KTI for a minimum of five years, all customers have multi-year contracts.
Retail product placement	**MET**	All four grocery retailers partnered with KTI have given premium retail space.
Product differentiation	**NOT MET**	Although KTI does offer green, black, and spiced teas, more diverse tea products are available.
Government regulations	**MET**	KTI meets Health Canada's requirements regarding labelling, pesticides, and soluble extracts.
Economies of scale	**NOT MET**	KTI doesn't benefit from advantages of lower costs realized in larger operations.

Key Stakeholder Preferences & Ownership

Michael Galinsky – Chief Executive Officer

- 70% ownership
- Prioritizes maintaining positive relationships with current long-term customers.
- Prefers to continue with current strategy of producing private-labels.
- Wants dividends paid out (nearing retirement).

Jason Galinsky – VP Marketing

- 15% ownership
- Wants to create KTI-branded products to increase recognition of KTI's name.
- Wants to move away from private-label products.
- Prefers excess cash kept within the company (no dividends).

Sabrina McLean – VP Research and Development (R&D)

- 15% ownership
- Wants KTI to make use of the R&D team and introduce new products.
- Agrees with Jason – KTI should create own branded products.
- Prefers excess cash kept within the company (no dividends).

Kathleen Galinsky – VP Legal and Human Resources

- 0% ownership – assuming future % ownership.
- Prioritizes KTI complies with laws and regulations.
- Concerned with continued profitability rather than strategy.

Governance Structure

The board of directors' members are as follows:

- Michael - Chair of the board
- Jason - Chair of ethical standards committee
- Sabrina
- Kathleen

The ethical standards committee are as follows: Jason, Kathleen, Hans Meindl, and Rashmi Gunapala.

Related concerns/issues:

- KTI's centralized structure may not be suitable for future.
- Executive management responsible for implementing decisions made by the Board, however, Michael counters board decisions.
- Lack of governance because no separation of power between Board and management (identical).
- Board has even number of votes creating possible stalemate.
- No ethics committee meeting regarding respiratory issues.

Current Strategy and Strategic Success/Failure

KTI produces ethically motivated private-label tea and prioritizes sustainability and ethical considerations in their supply chain. KTI maintains long-term relationships with seven core private-label customers, which has provided sales stability but has limited growth through new customer acquisition and increased customer concentration risk.

KTI's R&D division has innovated many new products, but there has been a failure to bring any new products to market; likely due to lack of customer adoption caused by flavor and price point mismatches.

Key Constraints

Qualitative Constraints

- Cash- KTI has limited funds to support shareholders' competing preferences of retirement vs. growth.
- Capacity- KTI currently utilizing all raw material supply for private-label teas. To increase production capacity, KTI must secure additional tea leaf suppliers.
- Farmer- KTI requires all farmers to be certified organic, Fairtrade, and environmentally sustainable. Limited number of farmers available.
- Contract- Currently, KTI has long-term revenue contracts, with fixed selling prices making it difficult to pass on increases in input costs.
- Customer Data- KTI has no data analytics program and/or access to primary data on consumers. KTI lacks available analysis to determine consumer information.

Quantitative Constraints

- Covenant- Current ratio must be greater than 2.0.
- Borrowing capacity cannot exceed the combined balances of Accounts Receivable (AR) and Inventory.

Key Objectives

KTI has the following targets to be met by 2026:

Financial

- Increase gross profit margin to 25% of revenue.
- 30% revenues from non-private-label product sales.
- 50% operating profits from non-private-label product sales.

Industry

- Promote KTI brand and market as a company known for ethical standards at consumer level.
- Increase control over sources of raw materials and diversity where the tea is grown.

Financial Analysis

See Exhibit I for Loan Covenant; Exhibit II for Horizontal and Vertical Analysis.

<u>Financial Ratios</u>

See Exhibit III for Financial Ratio Analysis.

<u>Liquidity</u>

KTI's current ratio decreased from 2.3 (2020/2021) to 2.1 (2022), below industry benchmark of 2.5, indicating KTI may be struggling to pay current liabilities. Accounts payable has increased from $3 million (2020) to $3.9 million (2022). This increase may be due to increased input costs from production inefficiencies/supplies. If ratio dips lower than 2, KTI may face liquidity issues and line of credit may be required to pay back debt for which KTI does not have the funds.

Return on assets declined from 12.3% to 8.0% (below industry of 10%), indicating KTI is able to generate profits from their capital investments, effectively utilizing resources in comparison to industry.

<u>Profitability</u>

KTI's revenue growth increased by 5.7% in 2022 and 3.2% in 2021 (using 2020 benchmark), higher than industry at 4.7%. This revenue growth indicates KTI had additional raw materials from farmers and sold more volume to customers with fixed selling prices.

The GP margin for KTI trending downwards (22% in 2020/2021; 20% in 2022) below industry average of 24%. This lower margin is mainly from KTI's long-term customer contracts with fixed selling prices and increases in input costs not being passed on to customers.

KTI's R&D % of revenue is steady at 1.8%, slightly lower than industry average of 2%. This indicates KTI spends less on R&D than industry; although KTI does develop new products, their private-label customers are uninterested in bringing new products to market.

KTI's marketing expense % of revenue is steady at 0.6%, significantly lower than industry average of 2.6%. This lower ratio indicates KTI spends less on marketing resulting from KTI having only private-label products.

KTI's general and administrative (G&A) % of revenue is steady at 11.4%, lower than industry average of 14%, indicating KTI spends less on G&A, possibly due to KTI treating all employees with fairness, honesty, and respect.

Operating margins significantly declined to 5.7% in 2022 (8.1% in 2021 and 8.3% in 2020), lower than industry average of 10.6%. Profit margins have significantly declined in 2022 to 3.4% from 5%, lower than industry average of 7%.

Solvency

KTI's total debt-to-asset ratio steady at 72% (double industry average of 40%). This higher margin indicates KTI's assets mainly financed by debtholders compared to industry. A high ratio means KTI is less stable, indicating poor overall financial health.

Asset management

In 2022, days in inventory remained constant at 31 days (industry average 45) and days in receivable increased slightly to 43 days (industry average 37). This indicates faster inventory turnover but slower collections due to private-label customers and larger customers with longer terms which differs from industry with selling their own brand.

Financing Options

Existing Financing

H&Y Bank: Line of Credit (LOC)

KTI's LOC has up to $2.5 million available borrowing bearing interest at prime of 2.0% plus 1.5%. This LOC has borrowing capacity based on being secured by AR and inventory balances. There is a covenant requirement where the current ratio must be greater than 2.0.

Keiser Investments Inc. (Keiser): Term Loan (TL)

KTI has a TL with $7.2 million balance with annual interest of 6%, and annual principal payments of $400k. The TL is also secured by AR and inventory and current ratio covenant (greater than 2.0), the same as the LOC; however, it is subordinated to the LOC.

Summary

On December 31, 2022, KTI has $1.02 million of cash-in-hand and $374k (Exhibit I) of unused short-term debt based on the terms and conditions of the debtholders.

External and Internal Analysis

See Appendix I for SWOT; Appendix II for PESTEL.

Strategic Option 1: Home Taste Koffee Inc. (HTK)

<u>Quantitative Analysis</u>

Based on analyses in Exhibits IV and V, the net present value (NPV) of the HTK contract is:

- $4.55 million for forecasted sales volumes of 100%.
- $2.31 million for minimum sales volume of 80%.

NPV is positive for forecasted and minimum sales and meets KTI's requirement.

The results of this analysis may be affected by the following assumptions:

- Estimated costs are constant.
- Estimated sales volume is probable due to HTK's customer contracts.
- Sales volumes will never exceed 120% of the forecast.
- Renewal of the additional four years.
- At the end of the five years:
  - No renewals will be signed.
  - Equipment will be sold.

<u>Key Financial Objectives</u>

See Exhibit VI. Results apply to both forecasted and minimum sales volumes.

Increase gross profit margin to 25% of revenue by 2026	**Not Met**
30% of revenues from non-private-label product sales by 2026	**Not Met**
50% operating profits from non-private-label product sales by 2026	**Met**

<u>Qualitative Analysis</u>

Pros

- HTK's successful experience in the coffee industry demonstrates stability and longevity, therefore success is probable.
- Access to HTK's large corporate/retail customer base (including premium retail space) and their gaining market shares, can help strengthen KTI on a brand, increase product differentiation, and align to key success factors (KSFs).
- Cobranded tea margins are better than private-label; therefore, improving financial health for KTI.
- KTI can realize their competitive advantage on product innovation with a contract requirement for annual changes of two flavors and aligns to a KSF and Sabina's preference.
- KTI is responsible for quality, which guarantees standards are met and negative impacts are minimized.

- Utilization of consumer sales data from HTK will help KTI align to consumer preferences.
- A minimum of 30 days of sales on hand and payments terms of 45 days aligns with KTI's practices.

Cons

- Raw materials are at capacity and no new farmers have been sourced, which will negatively affect private-label customers' supplies which can harm KTI's stable income and relationships.
- Misalignment of core value (CV) #4, due to HTK's poor reputation and KTI having no control over any hires on this production line.
- HTK has numerous approvals related to packaging, marketing, staffing, production, and equipment that could negatively impact KTI's CVs/standards, reputation, and profitability.
- Volume discount of 12% if sales volumes exceed 120% of forecasts would reduce profitability.
- KTI lacks experience in numerous requirements that could negatively impact working relationships, development, production, standards, and profitability.
- This proposal has a no cause-termination clause with 30-day notice from HTK, which does not give KTI enough time to find a secondary customer.
- All Cofte maker compatible pod production is restricted to HTK, capping KTI's growth to only what HTK purchases.

Key Industry Objectives

Promote KTI brand and market it as an ethical company	**Partially Met**
Increase control over source of tea leaves; diversify where tea is grown	**Not Met**

The contract with HTK would satisfy promoting the KTI-branded product through co-branding and gain a customer base. However, this proposal is not guaranteed to promote their ethical standards and does not increase control and diversity of raw materials.

Strategic Alignment

Vision	**Partially Aligned**	KTI retains control of quality of tea, managing many of the ethical considerations of production, and a large portion of the overall consumer experience.
Mission	**Aligned**	KTI is able to meet all components of their mission statement.
Values	**Not Aligned**	KTI will not be able to adequately ensure sustainability in all processes, as packaging and the purchase of equipment must be facilitated through HTK approved vendors. There are also concerns relating to the potential treatment of employees by HTK's personnel.

Overall Assessment

This proposal is profitable under forecasts and minimum volumes. There are some alignments that exist in their vision, mission, and KSF. There are shortfalls in key financial objectives relating to gross profit and revenues, as well as a lack of alignment with CVs and control of raw materials. There are also critical concerns relating to feasibility of the production timeline and initial capital required.

Financing Requirements

Financing is required for the initial investment and working capital until the proposal has a positive cash flow, which is $7.8 million for the forecasted volume or $7.4 million for the minimum volume. KTI should consider the following options:

- $1.02 million cash on-hand.
- H&Y Bank Line of credit (LoC) borrowing capacity available is $374k.
- Keiser Investments Inc. Term Loan (TL) for $6 million.
- Preferred share (PS) investment by Conrad Bolton for $8 million.

Financial Reporting Implications

Under IFRS 15, if it is probable that sales volumes exceed 120% of forecast, a volume discount (12%) should be applied to the transaction price immediately. However, estimated variable consideration should be performed frequently when contract prices are not fixed, and uncertainty exists.

Tax Implications

- Taxed at 26.5%.
- Tax impact of CCA of equipment (Class 53-100% write off) and building.
- No immediate tax consequence on disposal of equipment with assets remaining in the class.

Strategic Option 2: Kingsdale Tea - Branded Tea

Quantitative Analysis

Based on analysis in Exhibit VII, profitability and payback period is calculated with a sensitivity analysis comparing the below exchange rates:

- Expected: $1USD = $1.35CAD
- Worst-case: $1USD = $0.98CAD

Under the expected scenario, KTI recovers its investment in 2.41 years, meeting KTI's requirement of 3 years. Worst-case scenario, KTI will not recover the investment in any of the years.

The results of this analysis may be affected by the following assumptions:

- KTI will have monthly orders from customers; however, this is not guaranteed because no long-term contracts will be signed. Revenue may be overstated.
- KTI estimates of volumes may be overstated, due to the lack of U.S. market research, so they may not be able to sell as much tea as produced. Overstated volumes will result in overstated revenue.
- KTI has a fixed selling price per unit which is not subject to change.
- Exchange rates that have been provided will not fluctuate.

Key Financial Objectives

See Exhibit VIII.

Increase gross profit margin to 25% of revenue by 2026	**Met**
30% of revenues from non-private-label product sales by 2026	**Met**
50% operating profits from non-private-label product sales by 2026	**Not Met**

Qualitative Analysis

Pros

- Aligns with Jason and Sabrina's preferences to create KTI-branded tea.
- Kenyan tea farmers who have expressed interest in selling tea to KTI are certified organic/Fairtrade, which aligns with the mission statement.
- 30 customers are interested in buying the tea; therefore, a customer base exists, making sales probable.
- Alwynn's experience with the tea market will result in efficient decision making, saving money on costs.
- Branded tea margins are better than private-label, therefore improving financial health to KTI.

- Customers' tea choices are based on factors such as type, quality, and taste; and price is not specified as subject to the pressures of reduction, which makes profitability probable.
- Utilization of Research and Development (R&D) department's tea blends will increase employee morale.

Cons

- Alwynn's U.S. market responsibility limits KTI's control, risks reliance on one person, and poses a conflict of interest due to working for another tea producer.
- Sales are limited to tearooms and tea shops, reducing exposure of new tea blends to a variety of customers and markets.
- Moving away from private-label customers may damage relationships, harming KTI's stable income.
- Limited market research done for the U.S.; therefore, sales may be less successful than forecasted.
- Tea will be sold in small batches, resulting in inefficient use of machinery.
- No long-term customer contracts could result in unpredictable cash flows and unstable revenue.
- Misalignment with Michael's preference to prioritize private-label customers.

External Analysis

Tearoom customers enjoy unconventional tea blends, which aligns with this proposal, as the R&D department has developed tea blends that private-label customers are not interested in (Luff, n.d.). KTI should partner with tearooms that have a positive online business as these tearooms are successful (Jesson, 2017).

Key Industry Objectives

Promote KTI brand and market it as an ethical company	**Met**
Increase control over source of tea leaves; diversify where tea is grown	**Partially Met**

The proposal meets the first objective, as KTI will have branded tea and be ethically sourced. For the second objective, the proposal is partially met as there is no increased control, but tea is diversified by working with Kenyan and Sri Lankan farmers.

Strategic Alignment

Vision	**Aligned**	Tearooms provide a perfect environment for brewing every time, high-quality tea will be produced by farmers who are compensated fairly, and tearoom/tea shop customers will enjoy phenomenal taste and a pleasant experience.
Mission	**Not Aligned**	KTI will not be providing health benefits in multiple forms as they are only selling tea.
Values	**Not Aligned**	There will be no long-term customer contracts resulting in a misalignment with CV#2.

Overall Assessment

The proposal is successfully achieving two key financial objectives, promoting the KTI brand, and aligns to the vision statement. However, the proposal is falling short on one key financial objective, mission statement, and CVs.

Financing Requirements

Financing is required for the initial investment and ongoing operations until a positive cash flow, which is $6.2 million for the expected scenario or $7.3 million for the worst-case scenario. KTI should consider the following options:

- $1.02 million cash on-hand
- H&Y Bank -LoC borrowing capacity available is $374k.
- Keiser Investments Inc. TL for $6 million
- PS investment by Conrad Bolton for $8 million

Financial Reporting Implications

Under IAS 21, U.S. dollars (USD) will be translated to Canadian dollars (CAD), the functional currency. USD revenue from the U.S. customers will be converted to CAD on the recognition date. After being translated to CAD, the expected scenario's revenue increased, whereas the worst-case scenario's revenue decreased. If credit terms are offered to customers, a closing exchange rate translation is needed for subsequent measurement on the balance sheet date.

Tax Implications

- Taxed at 26.5%.
- CCA on the equipment and warehouse (Exhibit XVI) will reduce taxes paid.
- Non-capital losses will be carried forward, reducing taxes paid in future years and increasing net income.
- When selling in the U.S., U.S. tax rules must be followed such as filing returns in states where the product is sold, which increases complexity in tax filing.

- Tariff taxes on import of tea from Kenya/Sri Lanka will reduce net income.
- Eligible for GST input tax credits which will reduce taxes paid.

Strategic Option 3: Sleeping Hills Tea Estates (SHTE)

Quantitative Analysis

Based on analysis in Exhibit IX, using the capitalization of net profits approach with 45% of SHTE is valued at $2.8 million, which is lower than the purchase price of $3.1 million.

The results of this analysis may be affected by the below assumptions:

- KTI will purchase all of S&K's tea leaves.
- Exchange rates will not fluctuate.
- Key objective (KO) calculations for 2023 are normalized and valid for 2026.

Key Financial Objectives

See Exhibit X.

Increase gross profit margin to 25% of revenue by 2026	**Not Met**
30% of revenues from non-private-label product sales by 2026	**Not Met**
50% operating profits from non-private-label product sales by 2026	**Not Met**

Qualitative Analysis

Pros

- KTI will have guaranteed supply, increased supply control (KO) and reduced contract renewal risk with no additional farmers.
- KTI and Amasha's strong working relationship makes long-term success probable.
- Improves KTI's farming edge in contracts, operations, and attracting/selecting.
- SHTE and KTI report under IFRS, providing consistency.
- Allows for termination of the agreement with minimal financial consequences if unsuccessful.
- Reduces volatile auction prices by sharing profits and lowering input costs, thus improving financial metrics without affecting covenants.
- Technology is up to date, so no immediate capital investments are needed.
- Allows KTI to keep producing for private-labels and maintain long-term customer relationships, aligning with Michael's preference.

Cons

- No regional diversification of growth (KO), as it remains in Sri Lanka.
- KTI lacks investment experience which could have a negative impact on the success.
- SHTE is a family business, which KTI is not, causing potential resistance negatively affecting the success of joint venture (JV).

- KTI cannot own more than 50% due to Sri Lanka laws, so no additional shares can be purchased for full control.
- No recent sales of similar companies make it impossible to compare the market value, so a purchase price higher than the company's valuation may not be justifiable.
- A 30-day termination notice may not give KTI enough time to find new supplier(s), affecting their material supplies and private-label contracts.
- KTI must contribute cash to cover losses based on their ownership. If they lack the cash, KTI may need to secure additional financing with unfavorable terms.
- Misalignment with Jason's and Sabrina's preferences on product expansion and KTI-branded tea.

<u>Key Industry Objectives</u>

Promote KTI brand and market it as an ethical company	**Not Met**
Increase control over source of tea leaves; diversify where tea is grown	**Partially Met**

For the second objective, the proposal is partially met as there is an increased supply control, but tea is not diversified from the Sri Lanka region.

<u>Strategic Alignment</u>

Vision	**Aligned**	Partial ownership in the JV helps improve KTI's transparency and control that farmers are being *fairly compensated, and everyone involved in the process is treated with honesty, fairness, and respect* by having inside experience as farmers themselves.
Mission	**Partially Aligned**	This proposal gives KTI control and firsthand experience if they are *Do[ing] right by the farmers…*and tea is produced in an *Ethically responsible manner.* However, this proposal does not provide health benefits in multiple forms as they only provide raw materials.
Values	**Not Aligned**	This project does not align with CV#3 as JV does not help build KTI's brand.

<u>Overall Assessment</u>

This proposal results in SHTE being purchased for a higher amount than the company valuation. The JV partially meets the objective of controlling supply with improving KTI's capacity and vision aligned. There were no improvements on: regional diversification, KTI brand, and ethical marketing. None of the KOs were met.

Financing Requirement

KTI requires $3.1 million to finance the investment in SHTE - below are the available options:

- PS investment by Conrad Bolton for $8 million.
- Keiser Investments Inc. TL for $6 million.
- H&Y Bank LoC borrowing capacity available is $374k.
- Cash on hand of $1.02 million.

Financial Reporting Implications

KTI will obtain 45% shares of SHTE to form S&K, have 2 appointed board members out of 4, the rights to the net assets and all business decisions are made unanimously, therefore this investment in SHTE/S&K will be accounted for using equity method, as per IFRS 11. The investment needs to be recorded as a long-term asset that is initially recognized "at cost, and the carrying amount is increased/decreased to recognize [KTI's] share of the profit/loss of [S&K] after the date of acquisition. [KTI's] share of [S&K's] profit/loss is recognized in the [KTI's] profit/loss. Distributions received from [S&K] reduce the carrying amount of the investment (CPA Canada, 2021, IAS 28.10)".

Assurance Implications

Perform due diligence engagement of SHTE before investing in the JV. SHTE is unaudited so this process will help identify and evaluate risks/rewards, concerns, and liabilities regarding finances, operations, taxes, and legal matters. This will enable KTI to make an informed decision and mitigate risks.

Tax Implications

KTI will qualify for a foreign tax credit (FTC) on their annual income tax and calculations/exemption are based on the tax treaty between Canada and Sri Lanka. This FTC provides KTI with relief from double taxation on business income, dividend income, and capital gains (losses).

Strategic Option 4: Ready-to-Drink (RTD) Teas

Quantitative Analysis

In Exhibit XI, the following have been calculated:

	Weighted Average Contribution Margin	Break-even analysis
2024	$1.32	1.6 million
2025	$1.39	1.6 million
2026	$1.24	1.8 million

There will be breakeven in projected units throughout 2024 to 2026.

The results of this analysis may be affected by the following assumptions:

- Estimated sales volumes are uncertain for singles and six pack units.

Key Financial Objectives

See Exhibit XII.

Increase gross profit margin to 25% of revenue by 2026	**Not Met**
30% revenues from non-private-label product sales by 2026	**Not Met**
50% operating profits from non-private-label product sales by 2026	**Not Met**

Qualitative Analysis

Pros

- Conrad and Sabrina are good friends, making long-term success probable.
- BDC is located next to KTI, enabling efficiency and cost savings.
- KTI can leverage Conrad's network connections, expertise, and skills to increase the chance of success in making informed decisions.
- Conrad is known for treating his employees fairly, aligning to KTI's CVs.
- KTI can realize their competitive advantage on product innovation and introduce KTI-branded teas, aligning with Jason and Sabrina's preferences.
- RTD are sold at a premium price, improving financial health to KTI.
- KTI as organic and Fairtrade helps to differentiate the product thus reducing competition.
- RTD can be sold to various channels thus improving KTI's brand/marketing and customer data.

Cons

- Potential to be locked into a 10-year lease even if RTD is unsuccessful.
- Raw materials are at capacity and no new farmers have been sourced, which will negatively affect private-label customers' supplies and may harm KTI's stable income and relationships.
- Risk that Conrad may change his mind about retirement, which could have a negative impact on KTI's success.
- Misalignment with Michael's preference to maintain relationships with private-label customers.
- RTD products have different regulatory requirements, which negatively impact KTI's product, product release dates, and profitability.
- Limited market research on RTD; therefore, sales may be less successful than forecasted.
- Traditional one-year contracts with customers misalign KTI's practices.
- Audited reports are required, thus KTI's engagement cost will increase.

External analysis

KTI should focus on selling to multi-outlets, convenience stores and online channels, as they are expected to have the fastest growing rate (Grand View Research, 2022). To stand out in a competitive market, KTI can offer certified organic and fairtrade products and target the premium end market, which is projected to experience immense growth in Canada and U.S., due to consumers trading up products from a prosperous economy and higher disposable income (Beverage Industry, 2019). Consumers are increasingly seeking healthier and more varied tea options with unique blends and cleaner labels, providing KTI with an opportunity to develop and market a product (Muratoglu, 2014). KTI must adapt to changing health food trends by developing premium versions of existing tea varieties and expanding beyond green, white, and black teas to stay relevant in the market (Beverage Industry, 2019).

Key Industry Objectives

Promote KTI brand and market it as an ethical company	**Met**
Increase control over source of tea leaves; diversify where tea is grown	**Not Met**

The proposal meets the first objective as RTD promotes an ethical product that is KTI-branded and marketed; however, no regional diversification or supply control has been achieved.

Strategic Alignment

Vision	**Aligned**	KTI will produce premium high-quality RTD tea, where customers experience enjoyment every time.
Mission	**Aligned**	KTI will be providing health benefits in multiple forms with introducing RTD.
Values	**Aligned**	All CVs met.

Overall Assessment

The proposal is successful at achieving their objective for KTI-branded and marketing as ethical, in addition to aligning to KTI's vision, mission, and values. However, the proposal is falling short of meeting it objectives for gross profit, revenue, and operating profits with no regional diversification or supply control.

Financing Requirement

- In 2023, bi-annual management fee of $125,000, payable monthly.
- Until cash flow is positive, financing is required.

Performance Management Implications

BDC's performance management structure offers a bonus based on 2% of the total sale. However, this bonus may not be viable since it disregards production costs that Conrad has the power to manage/control.

Financial Reporting Implications

Under IFRS 16 *Leases:*

- KTI is the lessee, under the agreement, as it conveys the right of usage to KTI.

At the commencement date:

- Recognition of a right-of-use (ROU) asset and a lease liability at $7.0 million.

Subsequent adjustments to be recognized:

- A depreciation of ROU, based on the lease term.
- Interest expense (monthly).
- Carrying amount of lease liability adjusted by payments/interest.

Tax Implications

- Taxed at 26.5%.
- The lease payments paid during the year and interest expense are deductible for tax purposes.
- Depreciation is not tax deductible for tax purposes must be added back.

Assurance Implications

Annually, Conrad requires an audited report on the total sales and bonus paid by February 15 of the following year. There are two options:

1. KTI can use special report CAS 805: special considerations — audits of single financial statements: Assures only total sales and calculation of 2% bonus; less costly.
2. KTI can use CSAE 3530 attestation engagements to report on compliance: Assures accurate calculation and KTI's compliance with lease agreement; higher cost.

Recommendations

Refer to Appendix IV for decision criteria details.

★: Met; ⯨ : Partially met; ☆: Not met.

Decision Matrix					
Strategic Option	**Strategic Fit (V/M/CV)**	**Long-term Sustainability (F/P/LC)**	**Meeting goals/targets (KFO/KIO)**	**Upfront investment required; financing availability**	**Competitive Advantage and other considerations**
HTK Contract	V: ⯨ M: ★ CV: ★★★☆☆	F: ★★ P: ★★ LC: ★	KFO: ★☆☆ KIO: ⯨ ☆	$7.8-$7.4M required upfront; financing available	Product innovation through annual product changes of two flavors, increased premium retail space
KTI Branded Tea	V: ★ M: ☆ CV: ★★★★☆	F: ★☆ P: ★☆ LC: ★	KFO: ★★☆ KIO: ★⯨	$6-$7M required upfront; financing available	Create a premium branded tea to serve tea rooms and tea shops
SHTE	V: ★ M: ⯨ CV: ★★★★☆	F: ★ P: ★ LC: ★	KFO: ☆☆☆ KIO: ⯨ ☆	$3.1M required upfront; financing available	No need for new farmers and increased supply View into farming
RTD	V: ★ M: ★ CV: ★★★★★	F: ★ P: ★ LC: ★	KFO: ☆☆☆ KIO: ★☆	No financing required	Expand into a new market. Concern: Length of lease RTD highly competitive

Do not sign HTK contract

This proposal partially fulfills KTI’s financial and industry objectives, generates a positive NPV, and aligns partially with KTI’s mission and vision. This proposal is deemed unsuitable due to the initial investment and potential issues with HTK’s personnel, which directly contradict KTI’s values. Moreover, there are additional concerns regarding meeting the production schedule requirements, further reducing the proposal’s viability.

Produce KTI branded tea

This proposal is deemed suitable as KTI fulfills two financial objectives, partial industry objectives, and aligns with KTI’s vision. Moreover, it will diversity tea suppliers to include Kenya, promote the brand, and meet the three-year payback period under the expected scenario. Worst-case risk is no return on investment by 2026. KTI must be cautious as this proposal expands into the US market, where limited research has been performed and will be reliant on one individual.

Do Not pursue investment with SHTE

This proposal partially aligns with KTI’s mission and values, and offers potential benefits such as increased supply control, raw material capacity, and improved transparency into farmers, however, falls short in meeting the key financial objectives. Additionally, the valuation of SHTE is higher than the purchase price with no market comparison, making it an unsuitable option for KTI.

Do not manufacture RTD tea-based products

This proposal aligns well with KTI’s mission, vision, and values, and requires no initial capital investment, making it a strong strategic fit. However, this proposal is considered unsuitable because it does not meet any of the key financial objectives, faces significant competition in the market, and concerns about the lease terms and the intentions of the facility owner.

Overall Strategy

KTI should avoid partnering with HTK due to only one financial objective being met and unsatisfactory personnel fit. Investing in SHTE would be unwise since it is not consistent with financial objectives and no market valuation exists for comparability. Manufacturing RTD tea does not meet the financial objectives, and there are concerns about the lease terms. Conversely, producing branded tea under the KTI label aligns with most of KTI’s financial objectives and most of the industry objectives, making it an ideal fit for the company.

Implementation Plan

Project	Task	Time Frame	Champion	Cost	Other
Corporate Strategy	Revise vision & mission statements	Immediately	Michael Other stakeholders	N/A	Board approval before implementing
Governance	Implement a decentralized structure	Prior to BSC	Michael Kathleen	Promotional-based raise	
Governance	Increase governance over executives and external members	Immediately create a plan and recruitment & reorganization strategy for Board	Board	Remuneration of board member(s)	
Performance Management	Implement a Balanced Scorecard	After decentralized structure has been implemented	Executives Employees	Internal costs	Board approval
Ethical issue	Inform stakeholders of dust issue & fix cause to meet KTI's benchmark	Immediately notify stakeholders Fix Machine – within next 12 months	Michael Kathleen	$1 million	Conduct validation testing for new levels
Hedging	Create a hedging strategy, select counterparty, sign terms, and execute contracts	Immediately Ongoing	Andrew Li – CFO	Reduced COGS	USD and INR currencies
KTI Branded Tea.	Meet and obtain a signed contract with Kenya farmers	Prior to all other activities	Jason	Flights and accommodations	Essential for project success, must obtain

	Financing: Issue PS to Conrad	Immediately	Andrew	N/A	
	Obtain engineering plans, permits, and build additional warehouse	Start immediately Lead time of contractors/permits	Project management	$1.2 million	Final approvals from local authorities for permits
	Purchase equipment and operationalize	Immediately place order Lead time of supplier/contractors plus 1 month	Purchaser	$2.5 million	Perform final tests/specs Employee training
	Create training videos and manuals for the equipment	After supplier confirmation	Hans Supplier Operational employees	Negotiate into the purchase price	Train operational employees
	Create a marketing strategy for KTI brand	Start immediately Ongoing	Jason	Increase budget to match industry	
	Purchase necessary equipment for data collection	Obtain supplier quotes	Purchaser	TBA	
	Create a data collection strategy	Immediately Ongoing evaluation	Jason	TBA	
	Create a tea based on the data analysis and marketing strategy	Following the outcome of data-driven marketing efforts	Sabrina	Increase budget to match industry	Capitalize R&D expenses when development phase is identifiable

Financial Forecast & Financing Recommendation

Refer to Exhibit XIII & Exhibit XIV for pro-forma financial statements.

Key objectives and targets

See Exhibit XV.

Increase gross profit margin to 25% of revenue by 2026	**Met**
30% revenues from non-private-label product sales by 2026	**Met**
50% operating profits from non-private-label product sales by 2026	**Not Met**
Current ratio above 2.0	**Met**

Financing

KTI requires a minimum of $6.2 million for KTI's branded tea. If the exchange rate becomes U.S. $1 = CAD $0.98, the required financing increases to $7.3 million. The financing options available to KTI are as follows:

Option 1: Cash on Hand

On December 31, 2022, KTI has $1.02 million of cash-in-hand, however this amount is insufficient for the financing requirement of this strategic option.

Option 2: LOC

On December 31, 2022, KTI has $374k (Exhibit I) of unused short-term debt based on the terms and conditions of the debtholders, however this amount is insufficient for the financing requirement of this strategic option.

Option 3: Keiser: TL

The TL of $6 million will be advanced for three years, at which time the full principal amount is due. The loan is subordinated to all other loans and bears annual interest rate of 10%, with monthly interest payments of $50k and a bonus interest of 5% on the excess EBITDA above the base of $3 million paid annually. In the past three years, KTI's EBITDA was above the base of $3 million in 2021 and 2020, so bonus interest is probable.

Advantages

- This loan will be with the same lender as the current TL, saving on administrative efforts due to familiarity with their services and requirements.
- This TL would be classified as a long-term debt until due within 12 months, so KTI's current ratio temporarily unaffected.
- This proposal is unsecured, so no collateral is needed, which could aid in future collateral-based lending requirements.

Disadvantages

- Covenant on this TL has two limits: $500K as the maximum annual payable dividend and fixed salaries for shareholders, until the loan expires. Shareholders need to assess if these meet their preferences and living requirements, considering that they are lower than previous years.
- In 3 years, full principal is due, which may require a large sum of cash, negatively impacting KTI's financials or require unfavorable financing.
- This option has high risk so lending has a high financing cost that will negatively impact cash flows.

Option 4: Preferred share investment by Conrad Bolton

For this proposal, KTI will issue 80,000 PS to Conrad Bolton for $8 million.

Advantages

- Dividends paid only when declared by the board, giving KTI payment flexibility and more cash in hand.
- KTI has the right to redeem the shares, after January 1, 2027, at a cost of $100 per share (100% issued price), including any dividends in arrears. This gives KTI more flexibility to redeem shares if a more attractive financing option becomes available in the future.
- These PS are non-voting shares, which means common shareholders will retain voting power and control over KTI.

Disadvantages

- Annual 5% dividends ($400k) must be paid at year-end until shares are redeemed/retired. The dividends are cumulative, meaning unpaid portions from previous periods must be paid before common shares and upon redemption. No annual declaration of dividends is necessary.
- Dividends are recognized as an expense (IAS 32.35) on the income statement, not deducted from retained earnings statement, reducing net income.
- The PS are fully participating, meaning Conrad benefits from extra dividends and has higher seniority during liquidation, which reduces KTI's common shares' dividend payment.

Recommendation

It is recommended that KTI select the preferred shares investment. Compared to other options, PS are cost-effective choice over the next three years, and dividends are only paid when dividends are declared, providing KTI with financial flexibility. Furthermore, PS do not grant voting rights, making it a suitable fit for KTI.

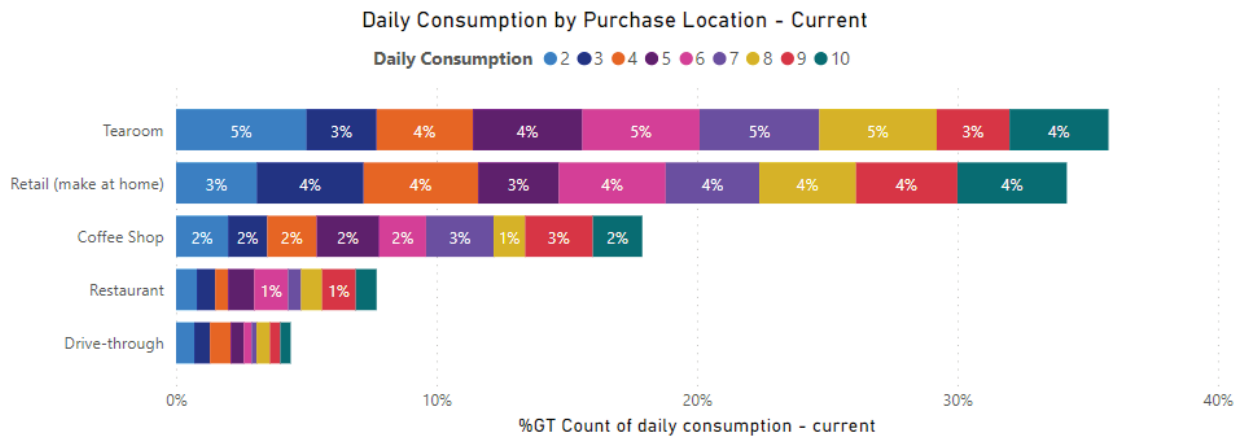
However, if the financing requirement exceeds $8 million due to a decrease in the foreign exchange rate, KTI will need to explore other financing options. It is suggested that KTI should use foreign exchange forward contract to hedge against any negative exchange risk. This ensures financing stays within budget and protects against unfavorable exchange rate fluctuations.

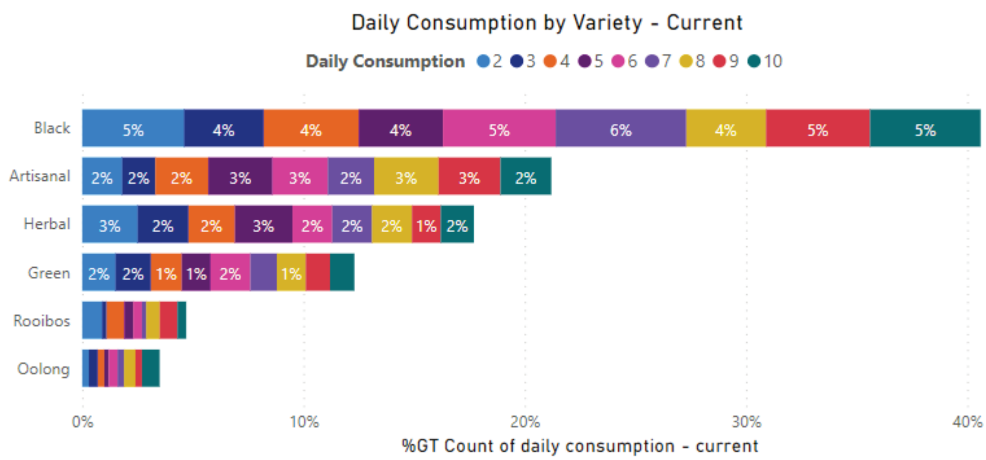
Accessibility note: To view the chart source data tables, refer to the "Chart reference tables" on page 51.

Data Analysis

Analysis/Recommendations

Consumption Patterns





Analysis

By location, tearooms have the highest daily consumption, followed by home consumption. Black tea is the most popular tea at 42%, followed by artisanal teas at 22%, and herbal teas at 19%.

Recommendation

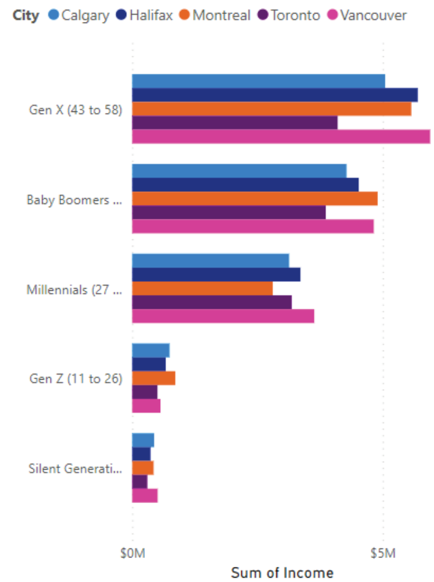
To target frequent tea drinkers, KTI should pursue tearooms, which aligns with the branded-tea proposal for tearooms and tea shops. KTI's R&D should focus on black teas, as they are consumed much more than others.

Accessibility note: To view the chart source data tables, refer to the "Chart reference tables" on page 51.

Consumer Demographics

Location by Generational Gender Income

Generation	Calgary	Halifax	Montreal	Toronto	Vancouver	Total
Gen X (43 to 58)	**$5,049,498**	**$5,698,906**	**$5,571,194**	**$4,100,201**	**$5,946,513**	**$26,366,312**
Female	$2,583,962	$2,513,756	$3,462,828	$1,916,426	$3,160,840	**$13,637,812**
Male	$2,465,536	$3,185,150	$2,108,366	$2,183,775	$2,644,709	**$12,587,536**
Other					$140,964	**$140,964**
Baby Boomers (77 to 59)	**$4,277,427**	**$4,521,699**	**$4,898,431**	**$3,863,091**	**$4,821,663**	**$22,382,311**
Female	$2,572,790	$2,580,861	$2,734,927	$1,600,077	$2,773,306	**$12,261,961**
Male	$1,704,637	$1,940,838	$2,163,504	$2,263,014	$2,048,357	**$10,120,350**
Millennials (27 to 42)	**$3,130,901**	**$3,357,760**	**$2,804,796**	**$3,183,527**	**$3,633,434**	**$16,110,418**
Female	$2,171,075	$1,674,143	$1,031,143	$1,700,826	$2,212,486	**$8,789,673**
Male	$959,826	$1,683,617	$1,657,716	$1,410,673	$1,275,493	**$6,987,325**
Other			$115,937	$72,028	$145,455	**$333,420**
Gen Z (11 to 26)	**$744,314**	**$668,428**	**$859,413**	**$503,117**	**$563,752**	**$3,339,024**
Female	$213,438	$440,194	$612,655	$206,660	$362,438	**$1,835,385**
Male	$445,671	$194,599	$246,758	$296,457	$201,314	**$1,384,799**
Other	$85,205	$33,635				**$118,840**
Silent Generation (78+)	**$437,202**	**$364,466**	**$425,979**	**$300,854**	**$506,913**	**$2,035,414**
Male	$276,628	$175,708	$277,663		$279,542	**$1,009,541**
Female	$160,574	$188,758	$148,316	$243,466	$227,371	**$968,485**
Other				$57,388		**$57,388**
Total	**$13,639,342**	**$14,611,259**	**$14,559,813**	**$11,950,790**	**$15,472,275**	**$70,233,479**



Generation	Female	Male	Other	Total
Gen X (43 to 58)	20.50%	17.30%	0.30%	**38.10%**
Baby Boomers (77 to 59)	16.60%	14.30%		**30.90%**
Millennials (27 to 42)	11.80%	9.20%	0.40%	**21.40%**
Gen Z (11 to 26)	3.50%	2.70%	0.20%	**6.40%**
Silent Generation (78+)	1.70%	1.40%	0.10%	**3.20%**
Total	**54.10%**	**44.90%**	**1.00%**	**100.00%**

Analysis

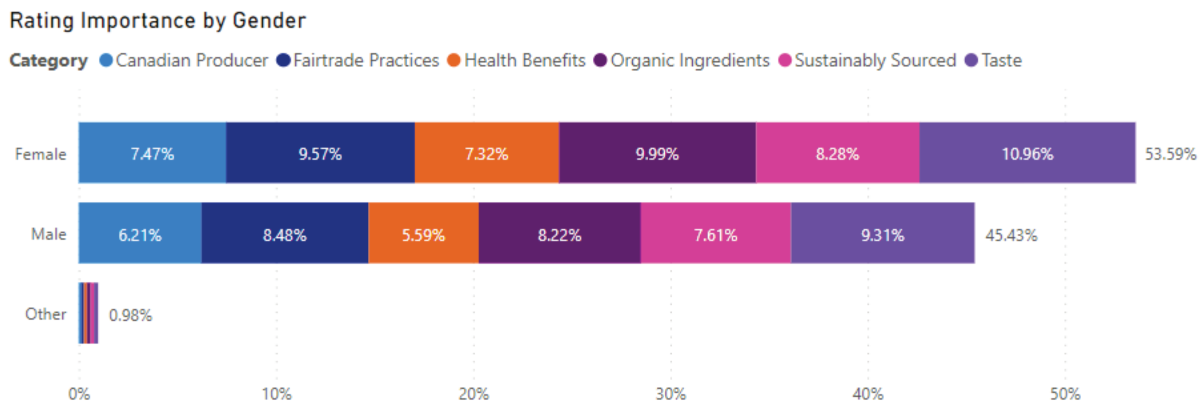
Tea consumers are mostly Generation X (X) at 38.10%, Baby Boomers (BB) at 30.90% and Millennials (M) at 21.40%. Vancouver has the highest generational gender income for X, Montreal for BB, and Vancouver again in M. For X consumers Vancouver, Halifax, and Montreal are the highest generational gender income overall exceeding $5 million. Females generally have a higher generational income than males.

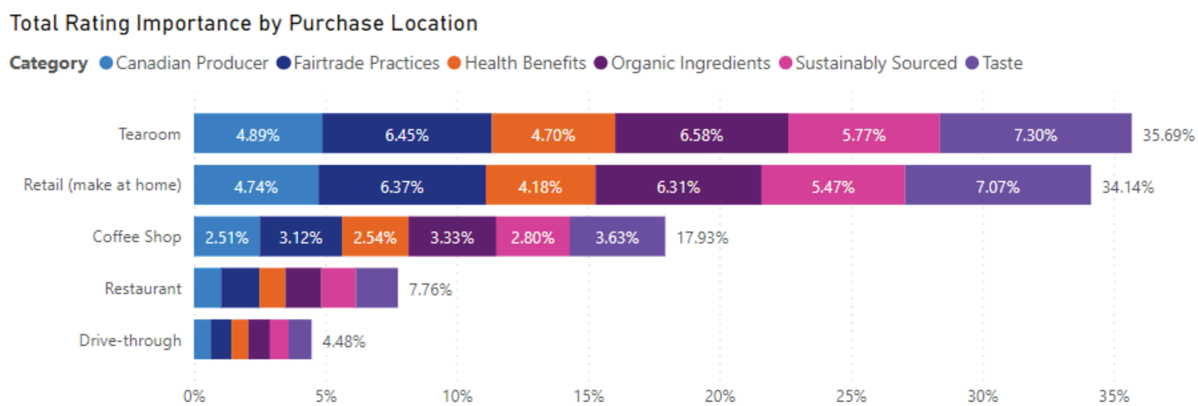
Recommendation

To maximize market communication, KTI should target Generation X female consumers, in Vancouver, Halifax, and Montreal, who have the highest tea consumption and income. As the branded-tea proposal appeals to consumers' quality, taste, and type preferences, it's appropriate to focus on demographics with highest consumption and disposable income, where price is not the only factor.

Accessibility note: To view the chart source data tables, refer to the "[Chart reference tables](#)" on page 51.

Buying Considerations





Analysis

The taste of the tea is the top priority for all buyers, at all purchase locations. Next in importance for each group are the following qualities:

- Females and tearooms - organic ingredients, fairtrade practices
- Males and retail - fairtrade practices, organic ingredients

Recommendation

KTI's department should prioritize taste when developing new teas and maintain their strategy of selling and buying certified organic and Fairtrade teas.

Collection

HBIA data is useful for KTI's strategic direction but has some data collection issues such as:

1. Duplicate IDs in the data may cause incorrect data interpretation.
2. Incomplete survey responses may cause incorrect interpretation.
3. Survey participants are from the HBIA engagement database, which may result in biased results. For instance, social media promotions may have contributed to X being the highest consumer demographic, while silent generation may not be engaged on social media.
4. The HBIA data is limited to Canadian participants, which restricts data analysis for KTI's pursuit of other markets.
5. Low participation rate of 8%, resulting in skewed data analysis.

If KTI is to collect its own data, it should ensure:

- Each survey participant must have a unique ID for validity checks.
- Users cannot skip questions; an option for "not applicable" should be available for each question and validity checks implemented.
- To expand survey participation, use various communication methods like social media, in-location surveys, mail-in, by phone, or in-person contact.
- To expand survey regional participation including but not limited to Canadian and US. To implement an efficient strategy for the branded-tea proposal, an analysis of the US market will be fundamental.
- Data collected with consumer consent for ethical practices.
- Data stored using appropriate technology, checked for duplicates and errors for efficient analysis, and stored with security protocols.

Storage

Suggested data storage guidelines for KTI:

- Train staff to identify phishing scams to prevent data loss to unauthorized parties.
- Encrypt data to protect it from data breaches and prevent privacy issues.
- Limit access to the data to authorized personnel only, to prevent misuse.
- Frequent information technology updates should be implemented to proactively identify and prevent threats.

Other Operational Issues

<u>Vision/Mission Update</u>

To align with KTI's new objectives, the vision statement should be revised to reflect a future-oriented perspective that promotes KTI's brand recognition.

Revised vision: *We envision a future where KTI tea is recognized and enjoyed by customers who have a pure, complex, and pleasant experience every time they drink a cup of our high-quality tea, which is produced by fairly compensated farmers, and everyone involved in the process is treated with honesty, fairness, and respect*.

Aligning with KTI's mission of exceeding consumer expectations and inspiring loyalty requires KTI to focus on their KO of achieving brand recognition at the consumer level. To ensure alignment, KTI should remove any reference to health benefits from their mission statement.

Revised mission: *We are committed to promoting ethical and sustainable tea practices throughout the entire supply chain, from farms to customer tables. Our unique taste is designed to exceed the expectations of our customers and inspire their loyalty to our cause.*

<u>Ethical issues</u>

Weakness:

One employee has a respiratory issue resulting from dust particles from a KTI machine, which are bordering on the acceptable level of the guidelines. KTI is delaying a $1 million fix until another complaint.

Implication:

By ignoring the dust problem, KTI violates its CV of being ethical and respected as a brand, harming their reputation, reducing sales/income, and ultimately changing the future success of KTI's brand.

Recommendation:

KTI should inform stakeholders about the dust problem to align with its fairness, honesty, and respect values, and fix the machine promptly to be ethical.

<u>Performance Management</u>

<u>Balanced scorecard (BSC)</u>

To enhance the measurement of organizational performance, it is advisable to use a BSC. A BSC sets objectives for both financial and non-financial categories, providing a comprehensive evaluation system. Below is a suggested BSC for KTI:

Balance Scorecard			
Perspective	**Goal**	**Measure**	**Target**
Financial	Increase profitability	Gross profit margin % of revenue	25% by 2026
	Increase non-private-label product sales	% Of revenue from non-private-label product sales	30% by 2026
	Increase operating profits from non-private-label product sales	% Of operating profits from non-private-label product sales	50% by 2026
Customer	Increase brand recognition	# Of social media platforms	3 social media accounts by 2024
		# Of social media followers	5k followers across all online platforms by 2025
		# Of visitors on online store	Create online store by 2025. Receive 1000 online visitors per month.
	Customer satisfaction	Ratings on customer surveys	Average score of 4/5 on customer surveys in all categories by 2026
	Increase market share	% Of market share of tea drinkers	Increase by 5% by 2026
Internal Business Process	Diversify tea leaf suppliers	# Of tea leaf suppliers by region	New regional supply contract by 2023
	Efficient use of manufacturing equipment	% Of normal capacity	90% by 2026
	Bring to market more high-quality tea flavors	# of new tea flavors brought to market	2 new tea flavors brought to market per year
Learning and Growth	Increase knowledge of tea industry	# Of industry seminars attended	Attend 1 industry seminar per year
	Increase knowledge of sustainable/ethical practices	# of sustainable/ethical training hours for all	2 hours per year
	Maintain # of staff	Employee turnover rate	Lower than 5% annually

Centralized vs Decentralized Structure

In a centralized structure, one or a few individuals makes all the decisions, whereas in a decentralized structure, decision-making is delegated to multiple individuals.

Centralized Structure

Pros

- Quick decision-making process, resulting in timely decision-making.
- Inexpensive to implement due to less delegation of tasks or required personnel.
- There is a clear line of communication which decreases confusion.

Cons

- Decrease employee morale due to lack of empowerment, which may result in increased employee turnover or decreased productivity.
- May lead to “group think” which can decrease innovation.
- Local knowledge and expertise may be lacking as decisions are made by a few individuals without deep understanding.

Decentralized Structure

Pros

- Empowering employees to make decisions increases motivation, morale, and initiatives, reducing turnover.
- Allows executives to focus on strategic goals.
- Expert decision-makers lead to greater chances of success.

Cons

- Managers’ conflicting performance metrics can lead to suboptimal decisions and reduced net income.
- Poor inter-departmental communication can result in uninformed decision-making.
- Segmented department loyalty can hinder collaboration and impede a company’s success.

Governance Issues

To enhance KTI’s decision-making and governance, we suggest:

- Implement a decentralized structure, delegate decision-making to several experts to improve alignment between operational and strategic goals.
- Increase board membership to an odd number to avoid voting stalemates. Majority voting will prevent individuals from going against board decisions.
- Diversify the board by adding external members to broaden knowledge and industry perspectives.
- Remove Michael as board chair due to conflict of interest as CEO.

- Include a CPA or financial expert on the board for improved financial discussion and review.

<u>Succession Planning</u>

It is important for Michael to receive dividends for his retirement and ensure that KTI has an effective hand off to his children. Kathleen has no current ownership in KTI, but Michael's retirement is an opportunity to transfer some ownership to her.

Upon retirement, Michael can transfer 15% of his ownership to Kathleen, creating equal ownership for Jason, Sabrina, and Kathleen. Michael can retain 55% majority ownership and receive dividends during his retirement.

Jason, the VP of Marketing, is experienced with managing customer contracts and finding new customers, making him an excellent successor to Michael. A separate CEO and chair of board would be needed, both with industry expertise.

<u>Financial Reporting</u>

<u>R&D costs</u>

Issue

Currently, KTI expenses all R&D costs. The issue is whether KTI is in a research or development phase, and if so, whether costs are eligible for capitalization.

Handbook/analysis

IAS 38 *Intangible Assets* should be consulted to identify the classification of phases and recognition criteria.

Based on the information provided, the research and development phase cannot be clearly distinguished at this time, so KTI should treat the expenditures as if they were incurred in the research phase and costs must be expensed. No capitalization test is needed.

Recommendation

All R&D costs should be expensed until there is clear identification between phases and recognition criteria can be performed.

<u>Finance issue</u>

KTI currently faces a currency exchange risk due to purchasing product in Indian Rupees (INR) from farmers in the highlands of Sri Lanka, without hedging any foreign currency payments. This can result in an increase in the costs of goods sold (COGS) if the exchange rate for CAD rises. To mitigate this risk, KTI should consider implementing a forward contract at a predetermined rate of C$1=₹54.503 with the bank. This will help to ensure that the COGS remains within budget and protect against unfavorable exchange rate fluctuations.

In addition, it is suggested to hedge the US currency received from US customers for KTI Branded Tea proposal, in a similar way as the IDR currency.

Taxation

Under IAS 12 income taxes, KTI will be required to recognize the following on the:

- Income Statement:
  - Total income tax expense:
    - Current tax- taxable income (difference between tax and accounting rules) at 26.5%
    - Deferred tax – deductible/taxable temporary differences (difference between Carrying amount and tax base of assets) at 26.5%.
- Statement of financial position:
  - Deferred tax:
    - Assets: Deductible temporary difference and carryforward of unused tax losses
    - Liabilities: Taxable temporary difference
  - Income tax receivable/payable
    - Current income tax expense
    - Instalment payments using the preceding year of tax payable

Appendices

Appendix I - SWOT

Strengths

- KTI maintains strong relationships with current customers and suppliers ensures ongoing contracts, providing a reliable source of revenue and supply.
- The board meets every month, demonstrating timely communication.
- KTI’s one-month inventory per customer allows for quick delivery, boosting reputation and quality.
- The loyalty and positive relationship of the farmers contracted by KTI ensures reliable supply of tea leaves.
- KTI’s high standards for farmer’s environmental responsibility and quality elevates KTI’s reputation for sustainable practices and quality tea.
- KTI has a one-year head start on its competitors in developing new products, which could give it a competitive advantage.

Weaknesses

- The lack of governance over the executives have led to decisions that oppose board decisions leading to misalignment on corporate strategies, confusion of corporate direction and lack of a succession plan. This is evident with KTI net earnings declining from $3.5 million in 2017 to $1.5 million in 2022. This is negatively impacting the uncertainty for future profitability of KTI.
- KTI underspent on upgrades for property, plant, and equipment in 2021 and 2022, increasing the risk of machines breaking down and losing out on advantages of other input cost savings which are negatively affecting production and margins. KTI’s contracts do not allow the increasing input costs to be passed onto customers, which directly impacts KTI’s margins.
- Production plant working conditions are at the highest levels of airborne dust particles. Potentially unsafe to employees and could negatively impact KTI’s reputation. Repairs would cost $1 million.
- KTI has limited marketing, thus decreasing its ability to find new customers.
- KTI’s capacity to increase production volumes is limited to the supply from the contracted farmers.
- KTI currently has no online presence and may be losing sales to competitors who have had an online presence.

Opportunities

- There is an increase in demand for a variety of tea options at food service outlets (Koronios, 2019). KTI's R&D team continues to create innovative teas, and this could be sold to food service outlets.
- A successful tea producer must be able to have differentiated products, and KTI's R&D team continues to create innovative teas which can be used to attract customers and gain market share (Koronios, 2019).
- Consumer interest in teas is increasing due to its health benefits thus, KTI's potential customer base is increasing (Zhueng, 2019).
- There is an increased demand for Fairtrade teas, and KTI's products are all Fairtrade, thus increasing its likelihood of being chosen by consumers (Koronios, 2019).
- Customers buy tea online, and currently KTI does not have an online presence. KTI can establish an online presence which may increase sales, brand recognition, and aid in data analytics.
- KTI does not hedge any foreign exchange risks to protect against unfavorable changes to currency. Hedging would be a positive impact to profits.

Threats

- Foreign exchange rate risk – appreciation will result in increased imports, thus increasing competition. Depreciation will result in increased exports, thus increasing foreign competition.
- Due to the consolidation of retailers , overall, there is less shelf space available to producers thus increasing competition (Koronios, 2019).
- The four largest tea producers in the Canadian industry continue to have an increase in market shares, therefore, KTI will have increased difficulties competing with these producers for customers (Koronios, 2019).
- Auction center tea price instability – globally, 70% of processed tea sold at auction. No futures market for tea; therefore, high volatility in pricing as large buyers can influence the prices at auction.
- Climate change threatens tea leaf supplies, potentially decreasing yields, causing shortages, and raising costs. KTI's risk is heightened as it exclusively relies on supplies from Sri Lanka, without diversification in other regions.
- The popularity of alternative beverages like coffee and energy drinks could lead to a decline in demand for tea-based products, resulting in a decrease in sales for producers of tea-based items.

Appendix II - PESTEL

Political

- Tea producers may collaborate with government agencies, where the agencies educate farmers in best practices.
- To be labelled as “organic,” certification with Canadian Organic Standards is required (Canada Organic Trade Association, n.d.).
- Compliance with government regulations is required to be successful (Health Canada for levels of extractives and caffeine in tea, Pest Control Products Act for levels of pesticide in products, Canadian Food Inspection Agency for ensuring prohibited substances are not used) (Koronios, 2019).
- Compliance with FLOCERT required for Canadian companies to be fairtrade.

Economic

- Tea exports are dependent on the Canadian dollar in comparison to the U.S. dollar (decreased Canadian dollar results in an increase in exports).
- Tea industry profit margins have increased 10.6% (Koronios, 2019).

Social

- Consumer preference shifting to sustainable materials in packaging.
- Tea consumption has increased due to a cultural shift to socializing in cafes and tearooms.
- Increased demand amongst consumers for Fairtrade and organic teas.
- Increased popularity for spiced-teas within the 18-to-35-year-old demographic.
- When per capita disposable income is increased, the demand for more expensive tea increases.
- Increased demand for tea products from grocery retailers due to consumers preparing tea at home.

Technological

- Use of online apps will increase demand for online platforms to purchase tea (Grand View Research, 2019).

Environmental

- There is an increased threat of climate change in tea-growing countries which will impact the supply of tea leaves.
- Increased practices amongst tea producers to be sustainable by reducing water/energy use, using renewable energy and recycled materials, and measuring emissions (The Hain Celestial Group, 2016).
- Some producers are promoting their eco-friendly packaging by disclosing proportion of recycled content.

Legal

- Compliance with government regulations and certifications must be followed. If a company fails to comply, they risk facing penalties or legal action.

Appendix III-KTI's Vision, Mission, and Core Values

Vision:

> *We envision an environment where a high-quality tea is produced by fairly compensated farmers, our customers enjoy a pure, complex, and pleasant experience every time they drink a cup of our tea, and everyone involved in the process is treated with honesty, fairness, and respect.*

This statement provides KTI's ultimate future goals. KTI's current operations align with this vision, but the key organizational focus of sustainability is not mentioned.

Mission:

> *Do right by the farmers and our customers and far exceed consumer expectations daily. We produce our tea in an ethically responsible manner, and its distinctive taste and high quality inspire loyalty in our consumers. We strive to bring the health benefits of tea in all its forms to individuals.*

This statement describes KTI's purpose. KTI is successful in high quality ethical tea production but falls short in bringing health benefits in all forms. They also are unable to inspire loyalty as brand recognition among consumers is lacking.

Core values:

1. *Produce extraordinary organic, Fairtrade tea.*
2. *Build long-term relationships with farmers, suppliers, customers, and consumers.*
3. *Build a brand that is known to be ethical and respected.*
4. *Treat all employees with fairness, honesty, and respect.*
5. *Ensure ethical, sustainable, and environmental standards are adhered to and followed throughout all of our processes, from farm to table.*

KTI also has a code of ethics and ethical standards that is incorporated into its contracts with farmers and customers.

Appendix IV-Decision Criteria

- Strategic fit: Consistent with KTI’s vision (V), mission (M), and values (CV) as detailed in Appendix III
- Long-term sustainability: Sustainable financially (F), profitable (P), and compliant with loan covenants (LC) in the long run.
- Meeting company goals/targets: Key Company and Industry objectives (KCO & KIO) are being met from part I.
- Upfront investment required and financing availability: Initial requirements and financing availability for strategic options.
- Competitive advantage and other considerations: Unique attributes or issues of the strategic project.

References

Beverage Industry. (2019, July 15). *2019 State of the Beverage Industry: Ready-to-drink tea, functionality drives demand in market*. Retrieved from Beverage Industry: https://www.bevindustry.com/articles/92246-2019-state-of-the-beverage-industry-ready-to-drink-tea-functionality-drives-demand-in-market

Canada Organic Trade Association. (n.d.). *Organic Certification*. Retrieved January 29, 2023, from https://www.canada-organic.ca/en/what-we-do/organic-101/organic-certification

CPA. (2023). *Volume 6: Finance.*

Grand View Research. (2019, August). *Tea Market Size, Share & Trends Analysis Report By Product (Black, Green, Oolong, Herbal), By Distribution Channel (Supermarkets & Hypermarkets, Specialty Stores, Online), By Region, And Segment Forecasts, 2019 – 2025.* Retrieved from https://www.grandviewresearch.com/industry-analysis/tea-market

Grand View Research. (2022, April). *RTD Tea And Coffee Market Worth $167.88 Billion By 2030*. Retrieved from Grand View Research: https://www.grandviewresearch.com/press-release/global-ready-to-drink-tea-and-ready-to-drink-coffee-market

Image, S. (n.d.). *Tea pot and cup.* Microsoft.

Jesson, T. (2017, November 1). *10 Tips for Tearoom Success*. Retrieved from World Tea News: https://worldteanews.com/tea-industry-news-and-features/10-tips-tearoom-success

Koronios, E. (2019). *Strong brew: The world price of coffee as fostered strong revenue growth.* IBISWorld Industry Report 31192CA: Coffee and Tea Production in Canada.

Luff, M. (n.d.). *How to Ren a Tea Room: A short guide to the complex blend of written and unwritten rules in the refined realms of tea*. Retrieved from BusinessForsale.com: https://canada.businessesforsale.com/canadian/search/tea-rooms-for-sale/articles/everything-you-need-to-know-about-running-a-tea-room.

Muratoglu, S. (2014, October 16). *Tea Trouble how formulations meet packaging needs no consumers.* Retrieved from Nosh: https://www.nosh.com/news/2014/tea-trouble-how-formulations- meet-packaging-needs-not-consumers

The Hain Celestial Group. (2016, March). *The Hain Celestial Group Climate Change Statement.* Retrieved from https://web.archive.org/web/20220120013605/https://www.hain.com/wp-content/uploads/2016/02/Climate-Change-HAIN-Statement-2016-2.pdf

Zhueng, Q. (2019). *Freshly brewed: A growing emphasis on healthy living will drive industry revenue growth.* IBISWorld Industry Report 31192B: Tea Production in the United States.

Chart reference tables

Daily consumption by location - current

Purchase location	Percent of grand total of count of current daily consumption 2	3	4	5	6	7	8	9	10	Grand Total
Tearoom	5%	3%	4%	4%	5%	5%	5%	3%	4%	36%
Retail (make at home)	3%	4%	4%	3%	4%	4%	4%	4%	4%	34%
Coffee Shop	2%	2%	2%	2%	2%	3%	1%	3%	2%	18%
Restaurant	1%	1%	1%	1%	1%	1%	1%	1%	1%	8%
Drive-through	1%	1%	1%	1%	0%	0%	1%	0%	0%	4%

Daily consumption by variety - current

Variety	Percent of grand total of count of current daily consumption 2	3	4	5	6	7	8	9	10	Grand Total
Black	5%	4%	4%	4%	5%	6%	4%	5%	5%	41%
Artisanal	2%	2%	2%	3%	3%	2%	3%	3%	2%	21%
Herbal	3%	2%	2%	3%	2%	2%	2%	1%	2%	18%
Green	2%	2%	1%	1%	2%	1%	1%	1%	1%	12%
Rooibos	1%	0%	1%	0%	0%	0%	1%	1%	0%	5%
Oolong	0%	0%	0%	0%	0%	0%	1%	0%	1%	4%

Location by generational gender income

Generation	Gender	Calgary	Halifax	Montreal	Toronto	Vancouver	Total
Gen X (43 to 58)	**Total**	**$5,049,498**	**$5,698,906**	**$5,571,194**	**$4,100,201**	**$5,946,513**	**$26,366,312**
	Female	$2,583,962	$2,513,756	$3,462,828	$1,916,426	$3,160,840	$13,637,812
	Male	$2,465,536	$3,185,150	$2,108,366	$2,183,775	$2,644,709	$12,587,536
	Other	$0	$0	$0	$0	$140,964	$140,964
Baby Boomers (59 to 77)	**Total**	**$4,277,427**	**$4,521,699**	**$4,898,431**	**$3,863,091**	**$4,821,663**	**$22,382,311**
	Female	$2,572,790	$2,580,861	$2,734,927	$1,600,077	$2,773,306	$12,261,961
	Male	$1,704,637	$1,940,838	$2,163,504	$2,263,014	$2,048,357	$10,120,350
Millennials (27 to 42)	**Total**	**$3,130,901**	**$3,357,760**	**$2,804,796**	**$3,183,527**	**$3,633,434**	**$16,110,418**
	Female	$2,171,075	$1,674,143	$1,031,143	$1,700,826	$2,212,486	$8,789,673
	Male	$959,826	$1,683,617	$1,657,716	$1,410,673	$1,275,493	$6,987,325
	Other	$0	$0	$115,937	$72,028	$145,455	$333,420
Gen Z (11 to 26)	**Total**	**$744,314**	**$668,428**	**$859,413**	**$503,117**	**$563,752**	**$3,339,024**
	Female	$213,438	$440,194	$612,655	$206,660	$362,438	$1,835,385
	Male	$445,671	$194,599	$246,758	$296,457	$201,314	$1,384,799
	Other	$85,205	$33,635	$0	$0	$0	$118,840
Silent Generation (78 plus)	**Total**	**$437,202**	**$364,466**	**$425,979**	**$300,854**	**$506,913**	**$2,035,414**
	Female	$160,574	$188,758	$148,316	$243,466	$227,371	$968,485
	Male	$276,628	$175,708	$277,663	$0	$279,542	$1,009,541
	Other	$0	$0	$0	$57,388	$0	$57,388
Total		**$13,639,342**	**$14,611,259**	**$14,559,813**	**$11,950,790**	**$15,472,275**	**$70,233,479**

Generation and gender percentages of grand total

Generation	Female	Male	Other	Total
Gen X (43 to 58)	20.50%	17.30%	0.30%	38.10%
Baby Boomers (59 to 77)	16.60%	14.30%	0.00%	30.90%
Millennials (27 to 42)	11.80%	9.20%	0.40%	21.40%
Gen Z (11 to 26)	3.50%	2.70%	0.20%	6.40%
Silent Generation (78 plus)	1.70%	1.40%	0.10%	3.20%
Total	**54.10%**	**44.90%**	**1.00%**	**100.00%**

Rating importance by gender

Gender	Taste	Organic ingredients	Fairtrade practices	Sustainably sourced	Canadian producer	Health benefits	Grand Total
Female	10.96%	9.99%	9.57%	8.28%	7.47%	7.32%	53.59%
Male	9.31%	8.22%	8.48%	7.61%	6.21%	5.59%	45.43%
Other	0.20%	0.19%	0.13%	0.18%	0.13%	0.15%	0.98%

Total rating importance by purchase location

Gender	Taste	Organic ingredients	Fairtrade practices	Sustainably sourced	Canadian producer	Health benefits	Grand Total
Tearoom	7.30%	6.58%	6.45%	5.77%	4.89%	4.70%	35.69%
Retail (make at home)	7.07%	6.31%	6.37%	5.47%	4.74%	4.18%	34.14%
Coffee Shop	3.63%	3.33%	3.12%	2.80%	2.51%	2.54%	17.93%
Restaurant	1.59%	1.36%	1.46%	1.33%	1.04%	0.99%	7.76%
Drive-through	0.88%	0.81%	0.79%	0.71%	0.64%	0.65%	4.48%