Situational Assessment and Strategic Option Evaluation for J.R. Pets Inc. (JRP)

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Prepared for: The Board and Shareholders of JRP

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Executive summary

In this report we will analyze and evaluate four possible strategic options against key objectives, strategic fit, and examine using both qualitative and quantitative criteria.

Through this evaluation process, each option has been assessed, and a well-rounded recommendation has been made for each. The recommendations are backed up by comprehensive analyses that consider factors such as, customer preferences, financial projections, and operational capabilities. The following four strategic options were evaluated:

The first option with BPF has been evaluated and found to be a valuable investment per the discounted cash flow, generating an equity value of $10.4 million to $11.5 million. This option presents an opportunity for JRP to expand its market share in Western Canada and provide a whole new customer segmentation with the online platform that BPF provides. However, this option does not offer two additional per related services and does not align with JRP's values of being involved in the community.

Despite its potential benefits, this option requires a high initial investment and the acquisition of BPF can risk breaching the loan covenant with FrontStreet Bank. Based on a thorough evaluation of the proposal, it is recommended that JRP not pursue this option.

The second option is to invest in a dog camp (BALA), which presents a potential solution to JRP's current issues. This proposal fulfills the key objective of adding two new pet related services and aligns with JRP's vision, mission and most of its core values. It provides JRP the opportunity to enter into another niche market, differentiating themselves from their competitors.

While it offers potential solutions for some of the issues facing JRP, it does not help alleviate all of their challenges. None of the financial objectives are met, and although the NPV for the next six years is positive, the investment will not provide a significant increase in revenue. Further, there is a significant risk with the investment, as it requires significant capital expenditures, and if this venture is unsuccessful, it could take time to sell the capital assets, exposing the company to cash flow risk. Therefore, after analyzing these considerations, it is not recommended to pursue this option.

The third option involves investing in a vegan organic dog food company (OFPK). This investment would align with JRP's vision, mission, and values as they create high quality food contributing to a higher quality of life for pets. However, upon careful consideration, this option is deemed unsuitable for several reasons.

While there is a high ROI for this option, there is a risk that OFPK will not be able to pay back the loan at the end of the term. The investment would cause JRP to use up its cash reserve, leaving them in a vulnerable position as they would need to access the line of credit to cover any unexpected costs. Based on a thorough evaluation, this proposal is not to be pursued by JRP.

The fourth and final option is for JRP to renovate its stores to provide more pet services, which provides a highly compelling solution to JRP's current challenges. This proposal not only fulfills financial objectives but also strongly aligns with JRP's values. The additional services provided help differentiate JRP and allow them to compete in the pet store market.

Further, the payback period will just be over two years, which is below the required payback period of three years. Therefore, it's recommended that JRP pursues this option as it provides a promising way to achieve long-term success.

Our report will also discuss other operational issues relating to JRP including:

- The review of JRPs mission and vision and suggested updates
- Ethical considerations regarding a manager providing fake certificates and payment receipts for training courses
- Recommendations to strengthen its marketing strategy
- Recommendation to implement a bonus incentive plan that aligns with JRP's values
- A discussion surrounding the controls to put in place for the loss of inventory at its stores
- Identification and/or suggestions for financial reporting

Appendices and exhibits containing our quantitative and qualitative analysis are provided to bring breadth to our recommendation for this strategic option. The data analysis reinforces our recommendations and provides strategies for JRP to follow to achieve their future goals.

In conclusion, this report recommends that JRP implements a range of strategies in order to achieve their future goals.

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Introduction

The purpose of this report is to provide J.R. Pets Inc (JRP) with an analysis of available strategic options it can pursue to increase its revenue growth, as well as a recommendation, expected results, and implementation plan for the recommended option. The options are:

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

We will review the strategic fit, pros and cons, and financial feasibility for each strategic option, and provide our recommendation.

We will also perform a situational assessment of JRP including an evaluation of JRP's current Mission, Vision, and values, as well as review of JRP's key success factors, key stakeholders and its strategy.

Part I - Situational analysis

Vision

A vision statement is used to set the direction of the company by stating what the ideal future position of the company is, and to inspire those within the company to work towards this idealized state. JRP's vision statement is "*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*." JRP's vision statement lays out the original aspirations of the company, however, it only focuses on products. JRP currently provides the services of grooming and training classes and one of the goals is to include at least 2 more services. It should be amended to incorporate services and align with the new strategic direction of the company.

Mission

A mission statement is used to declare the purpose of the company and set goals on a high-level. JRP is "*committed to meeting all the needs of pet owners and pets by providing superior products…"* and *"the most captivating shopping experience…"* to *"ensure life-long relationships and loyalty"* and to be *"relevant…to our communities by supporting local animal-related charities".* JRP's mission outlines the goals required to meet the company's vision. Similar to the vision statement, JRP's mission should include services. The goal of creating the most captive shopping experience does not reflect JRPs current business model and the wording should be reconsidered.

Core Values

- Have a positive impact on our pet parents and create lasting relationships

  Met. JRP trains its staff to be knowledgeable on the products and to personalize interactions with the clients and their pets resulting in customer loyalty and long-term relationships.

- Sell only the highest quality products that will foster healthy and happy pets.

  Met. JRP completes extensive research over the products it carries ensuring the ingredients are healthy and the supplies are made from safe and durable materials.

- Provide pet parents with knowledgeable advice on products to help them make the right decision for their pets.

  Not Met. JRP and many of its suppliers require the employees to go through regular training to ensure they are knowledgeable about the products they carry. However, due to management fraud, JRP employees at one location were not receiving the required education for the past 3 years.

Key Success Factors

Key Success Factor for industry	JRP's Current Performance
Distributor & manufacturer relationships	<u>MET:</u> JRP has been loyal to its suppliers and thus has developed exceptionally good relationships with them.
Product range & price points	<u>MET</u>: JRP offers pet food, pet supplies, training courses and grooming in each store, targeting 2 income quintiles.
Knowledgeable staff	<u>MET</u>:JRP has a low employee turnover rate, resulting in more knowledgeable employees. Additionally, JRP requires employees to take product knowledge

Key Success Factor for industry	JRP's Current Performance
Distributor & manufacturer relationships	MET: JRP has been loyal to its suppliers and thus has developed exceptionally good relationships with them.
	and customer service courses annually.
Consistent quality products	MET: JRP food products are made from healthy or all natural ingredients, no additives, fillers, or preservatives and are solely made from real meat, fruits or vegetables.
Investment in technology/information systems	NOT MET: JRP has not invested in an online purchasing system

Key Stakeholder Preferences

- Julia Hammond
    - Prefers to invest in organic dog food via Osler Farms proposal; and
    - To have a small network of stores to be involved in all of them
- Richard Davidson
    - Prefers to expand in their current retail space by combining with Bella's Pet Friends Ltd; and
    - To expand the number of health-related products to gain market share.
- Steve Hammond
    - Prefers to expand into a new market of premier dog camping facilities with Gord; and
    - Wants to personally manage JRP's real estate and doesn't feel he can trust a non-shareholder to make the best decisions.
- Elaine Davidson
    - Believes that JRP should renovate current stores to increase service capacity and eliminate pet supplies; and
    - To hire experienced individuals to help JRP be more successful.

Strategy

JRP's current strategy is to provide high quality pet food and services.

JRP has successfully targeted affluent communities, however, their location requirements have restricted expansion opportunities.

JRP’s excellent customer service and high-quality product mix attracts loyal customers while the market has reached maturity.

JRP’s strategy of paying higher wages has successfully resulted in low turnover.

Key Constraints

Qualitative Constraints

- Inventory: JRP currently has no distribution warehouse which limits inventory capacity available to customers.
- Contract: JRP has long-term contract with pet food company for fixed price and with pet supplies company for minimum purchase quantities which make it difficult to lower the inventory cost
- Limited retail space: Limited retail space restricts the services that JRP can provide.

Quantitative Constraints

- Covenant - Total interest-bearing debt to EBITDA must be lower than 2.5
- Maintain a minimum cash balance of $400,000 available
- In any month, the line of credit cannot exceed 55.0% of the inventory

Key Objectives

JRP has the following objectives to be met for the next 3 years until 2026

- Decrease revenues from pet supplies to less than 15.0%
- Increase operating profit to 7.0%
- Offer at least two additional pet-related services
- Increase loyalty reward customers by 15.0%

Financial Analysis and Assessment

- Exhibit 1.0 - Financial Ratio Analysis

Liquidity

JRP’s current ratio decreased from 1.7 (2021) to 1.5 (2022), which has fallen slightly below the industry benchmark of 1.7, however, JRP remains in a good position to repay current debts as days in accounts payable has stayed steady at 33 days (below industry benchmark of 52 days).

Solvency

JRP's debt-to-equity (DE) decreased from 0.8 in 2020 to 0.6 in 2022 (no industry comparison). Decreasing DE indicates lower portion JRP owes suppliers/debtholders/other creditors compared to shareholders equity. Further, the interest-bearing debt to EBITDA decreased from 1.1 in 2021 to 0.9 in 2022 (no industry comparison). The ratio cannot exceed 2.5, as the term loan with FrontStreet Bank has a debt covenant. JRP is not at risk of breaching the loan covenant as the covenant is much higher than the ratio in 2022.

JRP's total debt-to-asset ratio has declined yearly since 2020 and is at 36.8% in 2022. This is lower than the industry average of 52.0%. The lower margin indicates that JRP's operations have been funded more by the shareholders and not by debtholders. A lower ratio indicates that JRP is fairly stable and has stronger overall financial health.

Profitability

The GP margin for JRP is trending downwards, but still higher than the industry average of 42.0%. The higher margin indicates that the costs to acquire inventory are lower than industry due to the relationships JRP has built with the manufacturers.

Asset management

In 2022, the days in receivable remained steady at 3 days, which is much lower than the industry benchmark of 32 days. This is understandable as JRP's customers are paying at the point of sale. The days in inventory in 2022 remained steady at 40 days, 18 days below the industry benchmark of 58 days, indicating faster inventory turnover.

<u>Financing</u>

FrontStreet Bank

- Term Loan (Current)
  - Secured by PP&E
  - Annual payments - $400,000
  - Matures April 30, 2024
  - Debt Covenant - total interest-bearing debt to EBITDA cannot exceed 2.5.

- Term Loan - Extension (Alternative)
    - Additional $5,000,000
    - Revised interest rate of 8.0%
    - Secured by all assets
    - No covenant changes

Summary
On December 31, 2022, JRP had outstanding debt of $2,200 remaining on their term loan (400 current + 1,800 long-term). As of December 31, 2022 JRP is onside with their covenants (0 withdrawn from line of credit and total interest-bearing debt to EBITDA is 0.9 (Refer to Exhibit 1). JRP could take on $4,080 of debt before the covenant would be breached.

Financing Alternative

- Advantages
    - The term loan is with the same lender which simplifies the process, maintains current relationships, and customs are already established.
    - The Loan is payable over 10 years which helps to budget cash flow since payments would be lower than using short term financing such as the line of credit.
    - JRP has the option to pay down the loan faster by repaying up to 10.0% of additional principal every year. This will help reduce future interest expense on the term loan and pay the loan down faster.

- Disadvantages
    - The term loan interest rate increases to 8.0% from the current rate of 5.0%. Higher interest rates make loans more expensive since more of the monthly payment will be attributable to interest, not principal.
    - The loan covenant has a limit of total interest-bearing debt to EBITDA of 2.5. If JRP were to take on an additional $5 million in debt, this would put their loan covenants offside at 2.7 (6,800/2,512), assuming EBITDA for 2023 is consistent with 2022.
    - Loan is secured by a general security on all assets. This is a little risky since the collateral can be seized by the lender in any failure to pay.

<u>Internal/External Analysis</u>

See Appendix I and II.

Part II - Strategic Option Analysis

Strategic Option 1: Purchase of BPF shares

Quantitative Analysis

Ratio Analysis - Exhibit 1.1

- BPF's debt-to-equity ratio is 3x that of JRP's, resulting in a tougher time covering liabilities.
- Total debt-to-assets ratio is higher, indicating that its operations are funded more by debt than its shareholders, indicating weaker overall financial health.
- Return on assets is 7.8% for BPF compared to 4.5% for JRP, indicating that BPF is using its resources in a more effective manner than JRP.
- The interest-bearing debt to EBITDA is 3.2 for BPF in 2022, while compared to 0.9 for JRP. Acquiring BPF can risk breaching the loan covenant with FrontStreet Bank.
- Gross profit margin for JRP is higher than that of BPF, indicating that BPF spends more than JRP to acquire inventory.
- Operating margins of 4.6% are higher than JRP's of 2.4%, while the profit margin of 3.1% is higher than JRP's of 1.5%.

Valuation

Using the discounted cash flow valuation method (See Exhibit 1.2), we determined the equity value of BPF to be between $10.4 and $11.5M. To acquire BPF, JRP would be required to transfer 25% of its shares outstanding ($250K) and pay $5.5M in cash for a total price of $5.75M. The Equity value of BPF is higher than the cost paid for the shares which makes this an attractive investment option. However, the valuation is based on assumptions (as outlined in Exhibit 1.2), including the projected number of new franchises over the next 4 years, which was prepared by BPF and could be overstated.

Key Objectives - Exhibit 1.4

Decrease revenues from pet supplies to less than 15%	**Met**
Increase operating profit margin to 7%	**Not Met**

External Analysis - Franchising

Advantages:

- Franchising provides a good source of capital for expansion without the risk or loss of control that can come with bank or venture capital financing. (MacIver, A.)
- Franchisee owners are typically more invested in the business than an employee since they are financially invested. (Rainford, L.)
- Franchisees usually have ties to their local community and local networks can be an instrumental part of entering a market successfully. (MacIver, A.).
- Franchising reduces growth risk as less money is invested in each new location than if it was corporate owned. (Rainford, L.).

Disadvantages:

- There are costs to set up a franchise system such as developing: the franchise model, legal agreements, sales and marketing teams, training program, operations manual, etc. (MacIver, A.).
- Franchisees operate as independent businesses so there is less direct control of operations (Rainford, L.).
- Franchisors give up some of the profits that would have been theirs under a corporate owned model. (MacIver, A.).
- Franchisees compete with one another and may have different goals which can make it hard to work together for the benefit of the company as a whole (Rainford, L.).
- Less innovation – due to the reduced amount of control, it's harder to innovate than if the stores were corporate owned. (MacIver, A.).

To be a successful franchisor, you need to have a good communication system with the franchisees, be organized, have an effective business model, ensure there is uniformity across locations, and have a thorough selection process for franchisees. (Corne, S.). These traits can help mitigate the disadvantages that arise with the franchise system.

Qualitative Analysis

Key Objectives - see Exhibit 1.4

Offer at least two additional types of pet related services	**Not met**
Increase the number of loyal reward customers by 15%	**Met**

Pros:

- Charlie's philosophy about pet products is the same as JRP, therefore the acquisition would allow for JRP to continue to service their affluent customers with the best quality products.
- BPF has franchises throughout Western Canada, therefore JRP can provide services to a greater market share.
- BPF has a strong online presence, which could allow JRP to sell their products online and cater to a whole new customer segment.
- BPF has loss carryforwards available, this can help reduce the taxes payable for the two entities.

Cons:

- They use a franchise model and JRP does not, as such JRP will have less control over the stores.
- Increased participation from the franchisees in the policies and procedures of the business, which will make decision making more difficult and time consuming.
- JRP would have to assume the high amount of debt that BPF carries, which would not be ideal as the shareholders want to keep interest bearing debt as low as possible.
- While the percent of revenues from pet supplies will reduce to below 15% by 2026 on a consolidated basis, this is solely because BPF's sale of products to the franchises are not distinguishable between products (essentially just resale revenue). No actual reduction in supply sales will occur.

Strategic Alignment

Vision	**Partially Aligned**	Like JRP, BPF specializes in superior-quality pet products and services. However, there is less focus on knowledgeable staff.
Mission	**Aligned**	Provide superior products to meet the needs of their pet owners
Values	**Not aligned**	BPF is not involved in the community and does not possess the most knowledgeable staff to service its loyal and affluent customer base

Financing Requirements

If JRP acquires BPF they will need to transfer 25% of their common shares and pay $5.5 million in cash. This will require using the financing option of the renegotiated term loan with Front Street bank which will give them access to an extra $5M. The other $500K will be funded from the $400K excess cash JRP holds and $100K from the line of credit. The assumption of this extra debt will put JRP offside of their debt covenant in 2023 (See Exhibit 1.3) for calculation.

Financial Reporting Issues

This option requires JRP to acquire 100% of BPF's shares making them a wholly owned subsidiary. Per ASPE 1601, the investment in BPF would be accounted for using the consolidation method which requires the integration of all income statement and balance sheet accounts with adjustments to remove any equity, loans or sales between companies.

Tax Implications

- With the acquisition, BPF will pay income tax at 27%
- BPF annually spends $500,000 on furniture and $650,000 for computer software. These assets qualify for the CCA declining balance rate of 20% and 55%, and are eligible for the Accelerated Investment Incentive
- A deemed year end for tax purposes would occur for JRP immediately before JRP acquires BPF, and a new tax year starts the day of the acquisition
- If BPF is acquired, the loss carryforward can be applied to JRP as the losses are derived from a business that carried on for profit which was the same business which gave rise to the non-capital losses

Strategic Option 2: Invest in Bonheur des Animaux au Lac Agathe

Quantitative Analysis

Net Present Value

The analysis of Exhibit 2.1 reveals that JRP incurs a net gain of $58,962over a projected 6-year period starting from 2024. BALA is projected to generate a profit throughout the duration of the project based on forecasted revenue and expenses.

Key Financial Objectives

See Exhibit 2.2

Decrease revenue from pet supplies to less than 15%	Not met
Increase operating profit margin to 7%	Not met

Qualitative Analysis

Key Objectives

Offer at least two additional types of pet related services	Met Dog boarding and training will be added
Increase the number of loyal reward customers by 15%	Met

Strategic Alignment

Vision	**Partially Aligned**	Meets the need for both pet and pet parents by providing high-end boarding service
Mission	**Partially Aligned**	BALA will only provide boarding services for dogs in the current stage
Value	**Partially Aligned**	The proposal aligns most of the core values of JRP but does not have a plan for contribution to the local communities yet

Pros

- There is a growing demand for social experiences for pets. Steve and Julia believe BALA will expand a new trending market and differentiate JRP from the competitors.
- The dog camp is close to two of JRP's stores, therefore, JRP shareholders can be hands-on with the operation of the camp which align with JRP's operation strategy.

- Gord and Irene are experienced in the pet industry. They can help JPR save time and initial investment exploring the new business.
- BALA is targeting the two highest income quintiles where JRP already has a customer base in the current market, this will lower the pressure in the initial stage.

Cons

- Elaine believes the BALA does not align with JRP's risk averse strategy due to significant upfront investment
- Regulatory requirements were not mentioned in the meeting. JRP and Gord do not seem to have experience with these. The opening will be delayed if the requirements are not met.
- JRP will take all the risk for investment of the camp as Gord and Irene are only providing the idea and will be hired by JRP. If Gord decides to leave, it will pose a challenge to JRP to recommence the operation.
- JPR has no experience on running dog camps and pet parent accommodations, therefore the sales may be less successful than forecasted.

Financing requirements

The upfront investment requires $4.93 million, all available sources for financing are as follows:

- JRP has $700,000 available after maintaining a $400,000 cash balance.
- Preferred share investment by Gord Ly for $3 million.
- FrontStreet Bank term loan for 5 million

Financial reporting implications

As per ASPE 3061, property, plant and equipment shall be recorded at historical cost. For subsequent measurement, amortization shall be recognized systematically by their estimated useful lives. Lastly, the estimated useful life should be regularly reviewed.

Tax implications

- Income earned from BALA would be subject to a tax rate of 27%.
- Tax impact of CCA of application software is limited to 100%
- No immediate tax consequence on disposal of land and building with assets remaining in the class

Strategic Option 3: Osler Farms Pet Kitchen

Quantitative Analysis

Based on the calculations performed in Exhibit 3.1 the total return on investment is 111%. And it is determined that Osler will not generate sufficient cash flows to pay the full interest and principal amount. This means that JRP will have a great return on investment but risk not receiving full principal at the end of the loan term.

Trends in Ingredients

Recent studies have shown that over the duration of the pandemic many people, especially millennials, have obtained pets. More pet owners are purchasing fresh, human-grade pet food brands to supplement their dog's or cat’s diet. If Osler were to make human-grade pet food, Osler would need to make food that matches human trends. Today that means making pet food from plant-based ingredients. The making of a plant-based pet food requires twice the time in comparison to creating one from standard with time-tested ingredients.

An issue common to all pet food development is that pets don’t really vary their diet – most eat the same food everyday – so the nutrition must be complete. Creating that kind of food from a new category of ingredients is not easy. This means that costs of goods are always going to be higher for nutritious plant based food for Osler and will follow human food trends, i.e. should inflation increase, costs of the ingredients will also increase. Millennials, however, are willing to pay the price for these premium pet foods as they believe that the natural food gives them and their pets a happier lifestyle. See references below for source location (Avis, E).

JRP’s Objectives

If JRP were to pursue the Osler opportunity none of the key objectives would be met. However, there would be a small increase in operating profit as calculated in exhibit 3.2.

Strategic Alignment

Vision	**Aligned**	JRP’s vision is to provide better everyday life for pets and owners through products. This option provides pets better nutrition leading to a healthier lifestyle

Mission	**Partially Aligned**	Part of JRP's mission is to provide superior products - JRP is currently buying products from Osler. Osler can develop new types of food which can then be sold by JRP at later dates.
Values	**Partially Aligned**	JRP strives to sell only the highest quality products that will foster healthy and happy pets - JRP currently sells Osler products but by further investing in Osler, they can expand products in the future.

<u>Pro's</u>

- The proposal aligns with JRPs current vision/mission/and core values in that they want to provide superior products and encourage healthy lifestyles. This has a positive impact on JRP overall as they can further support their mission and protect their core values.
- The investment yields a high ROI which allows JRP to use interest to fund other future opportunities.
- JRP will be able to benefit from a discount on all Osler products should the project be funded. This will help to increase operating profits, a key objective of JRP.
- Julia will be a board member of Osler. For JRP this is good as Julia will be able to help steer Osler in the direction that aligns with JRPs vision and provides them benefits.

<u>Con's</u>

- The proposal only slightly increases operating profit and has no impact on all other key objectives that JRP has. This means JRP will have to come up with other ideas on how to achieve their objectives.
- JRP would not have significant control over Osler foods, which could result in a misalignment of key objectives between the two companies.
- After performing a quantitative assessment Osler would not have the funds to repay the loan back to JRP unless other financing was withdrawn by Osler to repay the funds. This may be a risky option for JRP to take on as it is a significant investment.

- If this option is funded, JRP might find themselves in violation with their bank covenant since more money would need to be withdrawn. If the bank covenant is violated, FrontStreet could recall the loan.

Financing

- JRP would need to loan Osler $6,000,000 in order to build the facility. As at December 31, 2022 JRP had $1,091,000 of cash on hand and therefore would need additional financing from FrontStreet (the additional $5,000,000 at 8%) bank to fund the expansion. If the financing were to be obtained, then JRP runs the risk of not meeting the bank covenants and would not be able to fund other opportunities.

Financial Reporting Implications

- JRP would need to properly categorize the loan to Osler food on the balance sheet. Under ASPE 3856 the initial amount would need to be recorded at its fair value and then subsequently increased using an appropriate discount rate. Additionally, impairment would need to be evaluated at the end of every reporting period.

Tax Implications

- The interest income earned would be considered under aggregate investment income which is taxed at a higher rate, however, interest paid for the financing of the investment would be deductible to decrease taxes payable.

Strategic Option 4: Renovate JRP existing stores

Quantitative Analysis:

· Contribution margin per type of service & Payback period for capital expenditures (exhibit 4.1)

- The contribution margin per chiropractic service is $64.10, per massage treatment is $33.00 and per nutrition consult is $$38.75
- The payback period is 2.11 years which is below the required 3 years
- The operating profit margin will increase by the 7% objective by 2026
- The debt covenant will not be breached

Qualitative Analysis:

Pros:

- Additional JRP services differentiate them from online retailers aligning with key objectives to offer additional pet-related services
- Current customers are interested in more pet services, potentially increasing revenue by adapting to customers' changing needs.
- Redesigning the rooms gives JRP ample flexibility for future services
- Offering discounts could increase loyalty reward membership, helping to reach the desired 15% increase.

Cons:

- Might not attract new customers as the services are geared toward existing customer base.
- Could break contracts with suppliers, resulting in penalties and tarnish reputation, and also impact delivery of current products.
- Reduction in volume from distributors will increase per unit costs, therefore reducing contribution margin per unit
- Increased workload to store managers to manage contractors could cause other areas of JRP stores to be ignored.
- Aggressive growth may be hard to achieve, and require breaking some leases, which could hinder revenues and potentially JRP’s reputation.

Key Objectives:

Offer at least two additional pet-related services	MET: Massage/Chiropractic therapy/nutritional consulting will be added
Decrease revenues from pet supplies to less than 15%	MET: This option will eliminate pet supplies completely
Increase operating profit to 7% - appendix 4.1	MET: This will occur by 2026
Increase loyalty reward customers by 15%	MET: Although not quantifiable at this time, it is expected that loyalty rewards customers will increase, especially if discounts on the services are offered to rewards members.

Strategic Alignment

Vision	Partially aligned	JRP's vision is to provide better everyday life for pets and owners through products. This option eliminates some products but not all.
Mission	Partially aligned	Part of JRP's mission is to provide superior products, this option eliminates some products but is adding services.
Values	Aligned	One of JRP's values is to have a positive impact on pet parents and create long lasting relationships. This option will positively impact the health of the pet and therefore the parent and also create long lasting relationships by offering discounts to loyal customers.

Financing Requirements

- The initial investment is $1.5M in both 2023 & 2024 for a total of $3M, which could be acquired from FrontStreet Bank. This assumes that the renovations will have no unforeseen costs.
- Per exhibit 4.1, JRP will be in compliance with the debt covenant for this option.
- The cost to renovate the stores is only one element to renovating. There will also be opportunity costs relating to missed revenue due to construction, potential sunk costs related to unforeseen renovation issues, and increased administration costs due to renovation management.

Financial Reporting Implications

Due to JRP customizing their rental property to earn revenues, this is considered a leasehold improvement. JRP would be able to amortize their investment over the lesser of the remaining term of the lease or the useful life of the improvement. Also JRP would be able to amortize removable assets that are not considered to be leasehold improvements, over their useful lives once they have been put into use.

Tax Implications:

To determine if the individuals that JRP has hired for services qualify as contractors and not employees the following 7 tests are applicable:

- Intent
  - The intent of the relationship is that of a contractor, as it is only the services they will be performing.
- Control
  - JRP has control as they can sign a 1 year contract or let a contractor go if they are not performing. However, there is not enough information to determine who has control to book services.
- Ownership of tools
  - Not enough case information to determine this.
- Subcontract the work or hire assistants
  - Not enough case information to determine this.
- Financial risk
  - There is shared risk, as JRP will not profit off the service if services are not performed and contractors will not be paid either. Also JRP assumes the financial risk of the cost to renovate.
- Responsibility for investment and management
  - JRP is responsible for the investment of the renovation as well as for the managing of contractors.
- Opportunity for profit
  - Opportunity for JRP and the contractor.

Per the above it is reasonable to assume that the hired individuals to perform the services would be considered contractors. This means that JRP will not have to pay wages or salaries and submit deductions on their behalf as they are responsible for that themselves.

Part III - Recommendations

Decision Matrix

See Appendix III for explanation of decision criteria.

Strategic Option	Strategic Fit	Long-term Sustainability	Meeting goals and objectives	Upfront investment and financing availability	Competitive advantage and other considerations
Buy shares of BPF	×	✓	×	$5.75M; Financing available	Achieve critical mass which can drive down costs
Invest in BALA	✓	×	×	$4.93M; Financing available	Early adopters of new trending market
Invest in OFPK	✓	×	×	$6M; Financing available for $5M	Receive discount on OFPK products, which would reduce costs
Renovate and drop supplies	✓	✓	✓	$1.5M in each year 1 and 2 for a total of $3M; Financing available	Offer new services to distinguish from other retailers

Recommendations based on decision matrix above:

Do not buy shares of BPF

- BPF is in alignment with JRPs vision and mission of specializing in superior-quality pet products and services; however, they do not have the same focus on customer service and staff knowledge that are so integral to JRP.
- BPF carries more long-term debt than JRP does and requires JRP to max out the extended term loan to finance the purchase which will cause JRP to go offside of their debt-covenant.
- As part of the purchase, JRP transfers 25% of their common shares, effectively giving up 25% of control of the company.
- BPF uses a franchise system which JRP is not familiar with and means that JRP would have less direct control over those stores.
- The purchase would add 30 stores and expand the geographic reach across Western Canada which means the shareholders will not have the same level of direct involvement.
- Like JRP, BPF is run by the owner who has not found trusted management that he is willing to give control to. This option creates more work for JRP's shareholders instead of reducing the workload.

Do not invest in BALA

- While the NPV for the next 6 years is positive, it does not provide a significant increase in revenue.
- BALA will add 2 new services to JRP, but it does not reduce revenue from pet supplies and is not expected to increase the operating profit margin to 7% by 2026.
- There is significant risk since it is a new trending market. While there is growing demand for the services, there is little understanding of how profitable this venture can be or how long it may last.
- This proposal requires significant capital expenditures including the purchase of land. If the venture is not successful, it could take time to sell the property and assets, exposing the company to cash flow risk.
- This proposal is for a 6-year time frame so will not improve profitability over the long-term

Do not invest in OFPK

- While there is a high ROI for this option, there is a risk that OFPK will not be able to pay back the principal portion of the loan at the end of the term.

- OFPK is in line with the vision, mission, and values of JRP as they create high quality food contributing to a higher quality of life for pets, however, none of JRPs goals would be met with this option.
- The investment would require JRP to max out the extended term loan and use up their cash reserve. This leaves JRP in a vulnerable position as they would need to access the line of credit to cover any unexpected costs.

Renovate stores and drop supplies

- This option is in line with JRP's vision, mission, and values by providing access to healthier lifestyle options, and it meets all of JRP's goals.
- The investment in the stores falls below the acceptable 3-year payback period at 2.11 years
- This option provides extra services that JRP's affluent client base are interested in and will help attract more customers who will come to the store for these specialty services. The increased traffic to the store is expected to increase sales of other products as well, based on what has been seen in the industry (pg.4, CPA J.R. Pets Inc.)
- Offering these new pet health focused services allows JRP to differentiate itself from other pet stores and online retailers. This additional point of differentiation is crucial for JRP to be able to compete in the pet store market.
- Dropping pet supplies will require JRP to break contracts with some suppliers which could result in some extra fees, however, this will be offset by the increased CM from the new services. JRP purchases its food directly from the manufacturer so those relationships should not be affected.

Overall Strategy

We recommend that JRP move forward with the store renovations as soon as possible and reject the other strategic options. The other strategic options do not allow JRP to achieve its goals and present greater risks to the company. Renovating the stores to add new services aligns with JRPs vision of improving the health and wellbeing of pets and is anticipated to meet the strategic goals set out by the shareholders. As an independent company, JRP cannot compete with the price and product selection of large retailers, so it needs to distinguish itself with a niche. JRP's excellent customer service is one factor of differentiation from other retailers, however, it is not believed to be enough to sustain the company long-term. The addition of these new services, which JRP's clientele desires, will add another point of differentiation and will be a critical factor in JRP's ability to remain relevant in the market.

Implementation Plan

Project	Task	Time Frame	Champion	Cost	Other
Corporate Strategy	Revise mission & vision statements	Immediately	All Stakeholders	N/A	Board approval for implementation
Ethical Issue	Notify manufacturers and establish whistleblower policy	Immediately	Policy: Cecilia Chang Notify: Richard Davidson	N/A	Conduct periodic reviews of certificates and vouch their authenticity
Bonus Incentive Plan	Base bonus structure on Initiating and implementing community involvement	Immediately	Bonus structure: Cecilia Chang Community Implementation : Individual store managers	5% of operating income	Board approval for implementation
Loss of inventory	Install surveillance equipment	Immediately	Individual store managers	Budget $5k per store - $100,000 total	
Renovate current stores	Obtain contractors for first 10 stores and start renovations	Immediately	Elaine Davidson	$1.5M	Board approval for contractors
	Obtain contractors for second 10 stores	Immediately Start work in 2024	Elaine Davidson	$1.5M	Board approval for contractors

	Meet with Front Street bank to obtain funds	Half Immediately, the rest in 2024	Julia Hammond and Elaine Davidson	$5.0M + interest @ 8% and annuity payment	Compliance with covenant
	Obtain permits, engineering plans	Immediately	Project manager	Included in capital costs for renovations	Approvals from local authorities for permits
	Hire contracted staff for services	1 month prior to services being available	Individual Store Managers	Industry competitive wages	Contracts agreed to by all parties for 1 year with right to terminate
	Sell remaining pet supply inventory	Up to one month from services being provided	Individual store managers	Discounts up to JRP's cost	
	End contracts with suppliers	Immediately	Richard Davidson	Penalties for broken contracts	
	Create/implement marketing strategy for new services	Immediately	Create: All Stakeholders Implement: Store managers	2.7% of revenue determined from current services (Grooming)	

Website	Develop Website/ app for digital bookings	Immediately	Board of Directors	$100,000 upfront; $5K per year maintenanc e	

Financial Forecast & Recommendation

Refer to Exhibit 5.1 for pro forma financial statements.

Key Objectives

Refer to Exhibit 5.3 for key objectives

Financing

JRP requires $3 million to finance the renovation of the stores. The financing options available to JRP are:

1 - Cash on Hand
As at December 31, 2022 JRP has just over $1 million of cash-on-hand. This is insufficient to finance the renovations.

2 - Line of Credit
As at December 31, 2022 JRP has no amount withdrawn from the line of credit and has $1.3 million available to withdraw (55% of inventory at 2022).

Advantages

- JRP would not have to adjust their term loan using this option as they already have the line of credit available to them.
- Interest rate is lower on the line of credit than on the term loan.

Disadvantages

- JRP will cut pet supplies under this proposal which will reduce inventory levels and reduce the amount of credit available to them.

- JRP will need to pay off the line of credit before January 2024 in order to fund the next round of renovation. Obtaining that amount of cash flow may be difficult and risky.

3 - Issue preferred shares to Gord
This financing option is no longer available as we suggest not to invest in dog camps.

4 - Extend Term Loan
FrontStreet bank is offering a $5 million dollar loan extension at a rate of 8%. This amount will fully fund the store renovations. The loan is secured by all assets and has a term of 10 years.

Advantages

- Provides the necessary funding to finance the store renovations and allows JRP to pay back the amount at lower monthly payments that are attainable with the cash flow.
- JRP will have extra cash on hand to fund any unexpected costs incurred from the store renovations since there will be an extra $2 million from the loan.
- JRP does not need to give up any equity in the company to obtain the funding.
- JRP can pay the loan down faster if their cash flow is favorable. (Up to 10% every anniversary).

Disadvantages

- The interest rate is higher on the new loan than the current loan, which increases financing costs
- No adjustment to the bank covenant. Since JRP will have a larger debt balance the pressure to be profitable increases.
- The loan is secured by all assets of JRP. This is risky as the bank can foreclose JRPs assets if unable to make the required payments.

Financing Recommendation

It is recommended that JRP extend the term loan and withdraw $5 million in order to finance the store renovations. This will allow JRP to pay back the full amount over a longer period, reducing pressure on their cash flow. The loan covenant has been calculated for the next 5 years and does not show signs of breaching as shown in exhibit 5.2.

Other Operational Issues

Vision/Mission Updates

To match JRP’s updated goals, the vision statement needs to be rephrased to embody a forward-looking viewpoint that encourages the future evolution of JRP's services.

To create a better everyday life for pet owners and their pets by providing superior quality nourishment and comprehensive care for our furry companions in stores that are staffed by pet-loving and knowledgeable people.

To align with JRP's strategy of removing pet supply and introducing new pet services, JRP needs to renovate stores and modify store displays. To reflect this alignment, JRP should incorporate the newly added services into the mission statement and remove any mention of the shopping experience.

We are committed to meeting all the needs of pet owners and pets by providing high-quality food and services that will keep pets healthy and happy throughout their lives. We want to provide our customers the most professional advice and services 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.

Ethical concern

Weakness:

For the past three years, one store manager has been providing fake certificates and payment receipts for training courses. This has resulted in failure to meet manufacturers' training requirements.

Implication:

JRP has unknowingly violated its CV of high ethical standards, causing damage to its reputation. The loss of trust with manufacturers could potentially impact the future success of JRP.

Suggestion:

JRP should immediately inform manufacturers of the fraud and the steps JRP is taking in response. JRP should also establish a whistle-blower policy which allows employees to report any issue to HR or VP. Furthermore, the fraud issue should be reported to law enforcement and the manager should be terminated.

Marketing strategy

JRP's marketing strategy centers around physical stores. To strengthen the market position, we suggest enhancing its digital presence, aligning with the increasing trend of online engagement.

- Build an online website: Develop a website presenting the store, products and service while also enabling customers to provide feedback on the service. Additionally, optimize the website for local search to ensure its visibility in relevant searches.
- Create digital platform (app) for service booking: Younger pet owners (25-40 years old) want access to online booking for services (pg. 12, CPA J.R. Pets Inc.). The app can also be used by the customer to track customer loyalty points and by JRP to advertise weekly promotions (currently done through email).
- Use targeted online advertising platforms such as Google or Facebook Ad to reach pet owners in the local area.
- Invite celebrities to share their positive experiences on social media.

Balanced scorecard

Balance scorecard outlines metrics and measurement tools aligning goals with JRP's mission, vision, key success factors and core values. It provides insights into the financial, customer, internal processes, and learning and growth aspects of JRP.

<table>
<tr><td colspan="4">Balanced Scorecard</td></tr>
<tr><td>Perspective</td><td>Goal</td><td>Measure</td><td>Target</td></tr>
<tr><td rowspan="4">Financial</td><td rowspan="2">Increase profitability</td><td>Operating profit margin</td><td>Increase by 7% by 2026</td></tr>
<tr><td>Net profit margin</td><td>Increase to 5% (industry benchmark)</td></tr>
<tr><td>Cost reduction</td><td>Reduction in Marketing cost</td><td>Decrease to 3%</td></tr>
<tr><td>Decrease revenues from pet supplies</td><td>% of pet supplies revenue</td><td>Decrease to less than 15%</td></tr>
</table>

Customer	Increase loyalty reward customers	# of loyalty customers	15% by 2026
	Customer satisfaction	# of customer surveys completed	Achieve 90% or higher customer satisfaction
	Increase market share	# of new customers acquired	5% increase in new customers
Internal Business Process	Employee's contribution on community	# of community service opportunities attended	Each employee volunteer at least once a year
	Enhancing the business	# of improved workflows/systems	Suggest/implement at least 1 new workflow to streamline the business.
	Average producing time of orders	Time taken to prepare orders	All orders prepared in 1 business day
Learning and Growth	Add new types of pet-related services.	# of new services	At least two by 2026
	Increase contribution to community	# of events held	At least one event monthly
	Increasing knowledge of animal nutrition/health	# of animal health/nutrition training hours for all	2 hours per year

The balance scorecard considers both financial and non-financial aspects to measure the performance. It is recommended to implement the scorecard for bonus determination rather than net profit.

Bonus incentive plan

Bonus incentive plans can help motivate store managers to actively contribute to the local community, therefore enhancing JRP's reputation and promoting the core value of caring and involvement.

Store managers who successfully initiate and implement community events that align with the company's values will be eligible for bonus based on impact and effectiveness of the event.

Here are some ideas of community events:

- Pet Adoption: Help rescue organizations by providing a platform for people to meet and adopt rescued animals.
- Volunteer days: Encourage employees to support animal support charities or pet caring community activities with pay.
- Community Outreach Programs: Collaborate with the local community to offer educational workshops for animal care tips and welfare.

The progress can be measured by the hours volunteered, number of pets adopted, and positive feedback received from the community. Besides the monetary bonus, the reward can also include recognition programs and team-building activities.

Policies that encourage community involvement should be implemented such as paid volunteer day and collaboration with local animal communities.

Loss of inventory

Increasing inventory shrinkage was found in a few stores. Some recommendations to prevent the loss of inventory is provided below:

Access control

- Use keys or other types of authentication to restrict store access.
- Regularly check if the access credentials are properly retained by authorized personnel only.

Surveillance

- Install video surveillance that covers the entrance, high-value merchandise area and stocking room.
- Install signage indicating the presence of surveillance cameras to deter potential thieves.

Inventory management procedures

- Implement inventory control procedures including regular stock counts performed by two or more employees, and report if any discrepancies are noticed.

Lease costs

Issue

JRP currently leases its head office building from ULL for $150,000 annually, while the market rate stands at $160,000 per year.

Analysis

As Steve and his spouse Julia have 50% share of JRP and Steve and his brother equally own ULL, these two companies are considered as related parties.

As per *ASPE 3840 Related Party Transaction*, a monetary related party transaction that has commercial substance, shall be measured at the exchange amount and disclosed when it is in the normal course of operations .

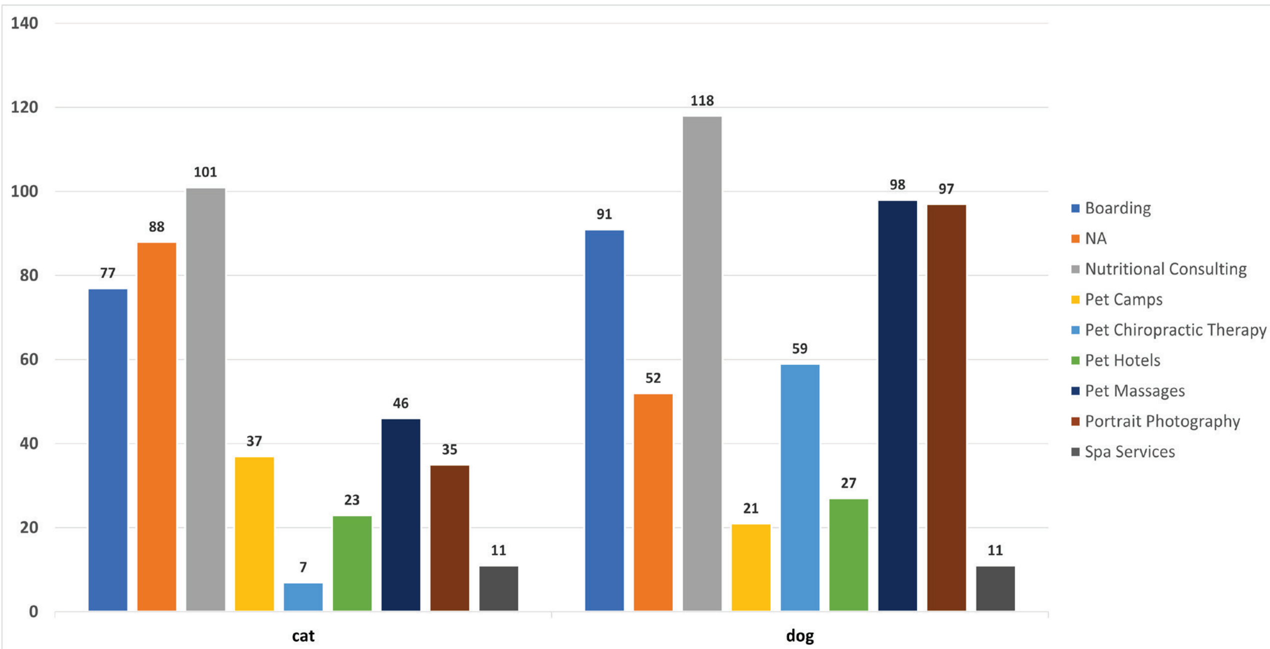
Recommendation

The lease cost for head office should be recognized at the exchange amount, $150,000 annually and disclosed in the financial statements including the description, amount, measurement basis, amounts due, and any contingencies of the transaction.

Data Analysis

Analysis Recommendations

Additional Services



Accessibility note: To view the source data tables, refer to the "Chart reference tables" on page 46.

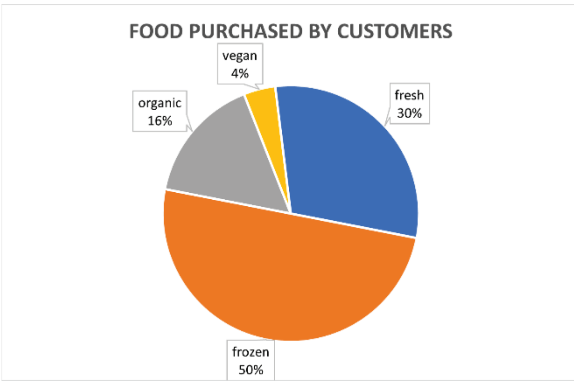
Analysis

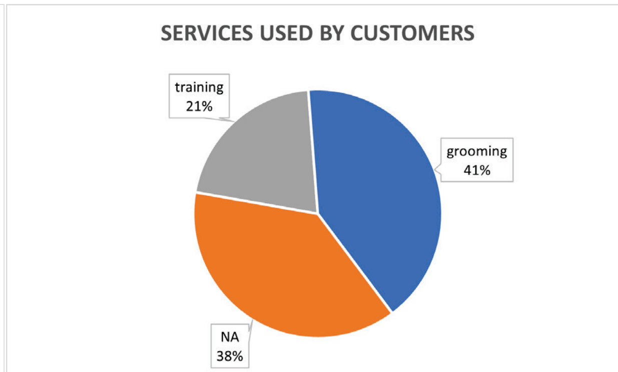
The graph above breaks down the additional services required for cats and dogs. Based on the customer information of the 1,000 customers surveyed, the greatest demand for both cat and dog owners is for nutritional consulting. With its expansion, JRP will include pet massages and pet chiropractic therapy, for which the demand is 15% and 7% respectively. Further, dog owners are more likely to get pet services for their pets compared to cat owners.

Recommendation

JRP should pursue the renovations and make the treatment rooms to serve the customer's service demands for their pets. With the treatment room they will be able to provide services such as nutritional consulting, pet chiropractic therapy and pet massages. Further, they will be able to meet their board objectives as they will offer at least two additional pet-related services by 2026.

Product & Service Mix





Accessibility note: To view the source data tables, refer to the "Chart reference tables" on page 46.

Analysis

The graphs above show the different types of foods and services currently purchased and used by customers. All the surveyed customers purchased food and the most purchased type of food was frozen food at 50%. About 38% of the customers are not currently using the services offered by JRP. Only 62% of customers are making use of pet-related services offered. Which could be due to the lack of different services offered by JRP.

Recommendation

JRP should pursue the renovations so they can diversify the services they provide and be able to serve a larger customer base with the different pet-related services. Further, they should continue to offer frozen foods as it makes up the largest sales of food types for JRP. Lastly, with the addition of nutritional consulting as a service, JRP should look into healthier food options and try to expand their organic and vegan food offerings.

Collection

JRP collects data by asking the customers questions, such as their name, pets name, pet type, breed, and pet's birthday. All items purchased by the customer are tracked so employees have access to look up prior purchases. Employees are encouraged to get feedback on products from customers to see what they liked or did not like. The collection practices that are currently in place seem to be working appropriately as they have a large database of 62,000 customers. These collection practices have been successful in promoting customer loyalty and long-term relationships.

Improvements for collection practices include:

- Expand survey participation by using various methods such as mail-in, by phone, or online.
- Collect the data with the customers consent, make sure they're informed that their data is being collected and stored.
- Provide each survey participant with a unique ID for validity checks.
- Offer discounts for survey participants

Storage

JRP currently does not have any guidelines or controls in place for its data storage. To store the data collected from customers we suggest they:

- Authorized specific personnel who are allowed to access the data, to prevent potential mishandling or data loss.
- Train staff appropriately to identify potential phishing scams.
- Apply updates and security patches to all software's as often as possible.
- Disable services that are not being used, to minimize the number of potential security holes.

Appendix I- Internal Analysis

SWOT analysis

Strengths:

- JRP has a reputation for providing excellent customer service by caring staff. JRP has won multiple awards for being the “Best in Customer Service”.
- High quality products, made from healthy ingredients and pet supplies made from durable and safe materials.
- Strong customer loyalty and long-term relationships with its customers.
- JRP has very low employee turnover due to its philosophy of paying higher wages than market.
- JRP is loyal to its suppliers and has helped them with product development and test marketing in its stores over the years.

Weaknesses:

- JRP has a limited online presence. The focus is still on face-to-face customer service. As such the online sales only represent 3% of the total sales. JRP is missing out on so many potential customers and new revenue
- JRP’s stores are all the same. JRP does not have any design differentiation, they all have the same layout and design elements. This could hinder attracting new customers
- JRP relies heavily on Julia Hammond. She is directly involved in the operations and decision-making process, including in store visits. This detailed level of involvement can be difficult to sustain and may limit expansion possibilities
- JRP leases all of its properties. As such, they are subject to potential rent increases and changes in lease terms during renewal negotiations. The lack of control over the properties could affect long-term stability and costs

Opportunities:

- There’s potential for growth in the pet services area. There’s an increase in demand for pet-related services IfJRP can integrate new services it can increase its revenue and customer loyalty by becoming a one stop shop for all of their customers’ pets needs
- JRP can invest into developing a robust online presence. JRP does not currently have much of an online presence, and this can help attract a new customer segmentation and help drive revenue growth

Threats:

- Increased competition. JRP has seen an increase in the rise of specialty pet stores and the entry of large national and online retailers into the fresh food

market. This increased competition can hurt customer retention and affect revenue
- The company's current stores have reached maturity, and the sales growth is not forecasted to be high. Without new stores or a new direction, JRP faces limited revenue and profit growth

Appendix II- External Analysis

PESTEL

Political factors:
- Government regulations regarding the treatment and care of animals can impact the operations of pet stores, especially in relation to the sale of live animals
- Pet stores are required to obtain licenses and permits to operate their businesses, which can vary across different provinces or territories
- Trade policies and the impact those have on duties, taxes for imports/exports can affect the availability and cost of the pet products and supplies

Economic Factors:
- The fluctuations in currency exchange rates can impact the cost of imported pet products and supplies
- Pet ownership tends to decline when individuals work longer hours, frequently move, or travel more
- Higher disposable income influences pet owners to purchase premium-priced products from specialty pet stores

Social factors:
- Pet ownership is on the rise. As the population grows, so do the number of pets, which drives an increase in pet-related products and services
- Growing trend of pet owners considering their pets as a family member and being willing to spend more on premium products and services for their pets
- Pet ownership is preparing people to become parents

Technological factors:
- There's been an increase in demand for online sales. The global pandemic has led to an increase in online sales
- Demand for high-tech products and services related to pet ownership, such as online booking processes and alternative therapies like massage and acupuncture

- Subscription for pet services for monthly deliveries of food, medicines and treats are increasing

Environmental factors:

- Global pandemic has had minimal impact on the pet retail industry since pet food and supplies are considered essential. Though there has been shifts in customer behaviour, such as increased online purchasing and demand for specialized services
- Supply chain disruptions due to the pandemic
- Sustainable manufactured pet supplies

Legal factors:

- Compliance with government regulations and certifications must be followed. Failure to comply can result in penalties or legal action

Appendix III Decision Criteria

Strategic Fit: In order for the option to fit strategically with JRP it needs to align with the vision, mission, and values of the company.

Long-term sustainability: JRP wants to increase the operating profit margin and needs another point of differentiation to distinguish itself from competitors in order to remain successful. The option chosen will need to have a positive impact on both the operating profit margin and JRPs ability to distinguish itself in the market over the long-term.

Meeting Goals and Objectives: The strategic option chosen should achieve the goals for JRP that were set out by the board:

- Decrease pet supply revenue to under 15% of total revenue by 2026
- Increase operating profit margin to a minimum of 7% by 2026
- Offer at least 2 new types of pet-related services by 2026
- Increase loyalty reward members by 15% by 2026

Upfront investment required and availability: How much money is required up front and whether there is financing available to allow the investment.

Competitive advantage and other considerations: Anything that may improve JRPs position as compared to competitors.

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Chart reference tables

Alternative Services

(See chart on page 38)

Pet Type	Boarding	NA	Nutritional Consulting	Pet Camps	Pet Chiropractic Therapy	Pet Hotels	Pet Massages	Portrait Photography	Spa Services	Grand Total
Cat	77	88	101	37	7	23	46	35	11	**425**
Dog	91	52	118	21	59	27	98	97	11	**574**
Total	**168**	**140**	**219**	**58**	**66**	**50**	**144**	**132**	**22**	**999**

Food purchased by customers

(See chart on page 39)

Food type	Percentage
Organic	16%
Vegan	4%
Fresh	30%
Frozen	50%

Services used by customers

(See chart on page 39)

Services type	Percentage
Training	21%
Grooming	41%
NA	38%