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Catalysts for Common Good

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June 20, 2023 7 pages

To: Rose Paul - Board Secretary, Plainfield Co-op, Plainfield VT
From: Don Moffitt - Inside the Numbers LLC
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PLAINFIELD CO-OP FEASIBILITY
REVISED FINAL REPORT

Thank you for the opportunity to explore with you the strategic options for Winooski Valley Cooperative Market, dba Plainfield Co-op, in Plainfield, VT.

This report is provided in digital format, file name “1 Final Report Plainfield Co-op 2023-0615.pdf.” Seven additional documents accompany this report and are described more fully below.

You’re currently operating a natural foods grocery store with 1,200 square feet of sales area. The four options under consideration include:

1. Remain at 153 Main Street with no facility expansion.
2. Remain at 153 Main Street and expand the store by 660 square feet.
3. Purchase a horse farm on Route 2 and build a new store from the ground up.
4. Purchase Plainfield Hardware on Route 2, convert the grocery section to products carried by Plainfield Co-op and operate the rest of the hardware store in its current format.

A future threat, particularly for remaining at 153 Main Street, is that Vermont DOT plans to replace the bridge on Main Street in 2028, which will eliminate that access from Route 2 for six months.

G2G Research performed an update to a previous market study to forecast the sales resulting from:

- Expanding the current location (item 2 above).
- Relocating to an unspecified location on Route 2.
- The planned bridge closure on the current location.

The market study updated accompanies this report (file name “2 G2G Sales Forecast Update Plainfield.pdf”).

The co-op also commissioned financial feasibility work performed by us (Don Moffitt and Sarah Lebherz). We met with your team on several occasions and provided you with the following work, which accompany this report digitally with the revised file names provided:

- "3 Transmittal - pro forma 2023-0501 Plainfield Co-op.pdf".
- "4 Expansion pro forma 2023-0428 Plainfield Co-op.xlsx".
- "5 No Build pro forma 2023-0515 Plainfield Co-op.xlsx".
- "6 Horse Farm pro forma 2023-0515 Plainfield Co-op.xlsx" (including construction of a new store from the ground up).
- "7 PHC pro forma 2023-0620 Plainfield Co-op.xlsx" (purchasing Plainfield Hardware Company, continuing to operate all ongoing departments of the hardware store except for grocery, which would be replaced by the co-op's products).
- "8 Report PHC acquisition 2023-0615.pdf".
- "9 Report PHC pro forma revisions 2023-0620.pdf".

THE PRO FORMA FOR THE ACQUISITION OF PLAINFIELD HARDWARE CONTAINS INFORMATION THAT IS CONFIDENTIAL AND PROPRIETARY TO THE OWNERS OF THE HARDWARE STORE; PRO FORMAS RELATED TO THE PURCHASE OF THE HARDWARE STORE SHOULD NOT BE DISTRIBUTED TO ANYONE WHO HAS NOT SIGNED A NONDISCLOSURE AGREEMENT.

To perform the financial feasibility work we relied upon:

- Financial performance of the co-op for 2020 through 2022.
- Plainfield Co-op's budget for 2023.
- Market study update by G2G Research.
- Financial performance of co-ops with similar sales volumes.
- Architect's estimated cost of construction of the expansion of the Main Street facility.
- General estimates of costs for constructing a new building on Route 2.
- Listing information for the horse farm.
- Financial performance of Plainfield Hardware for 2019 through 2022.
- Conversations with members of the co-op's board and owners of the hardware store.

In addition, virtual meetings by Zoom were held with Plainfield Co-op board members and/or managers were held on:

- February 23, 2023, for the initial information meeting.
- April 11, 2023, for delivery of the market study update.
- April 28, 2023, for delivery of the initial pro forma, for the 660 sq ft expansion.
- May 12, 2023, for delivery of the "no build" and "horse farm" pro formas.
- June 16, 2023 for delivery of the "PHC" pro forma and final report.

Assessment

Cash Flow

An analysis of the financial results of the past three years indicates that the co-op has a systemic operating problem that must be addressed for any of the options to be successful. On December 31, 2022 the co-op had $90,000 on hand. Contributing to this cash were:

- $75,000 in 2020, Paycheck Protection Program
- $24,000 in 2021 and again by $66,000 in 2022, increasing delays in vendor payments.
- $24,000+ in 2021 & 2022, increases in loans with the Cooperative Fund of New England.

This is a total of at least $189,000 in non-operating cash that cannot be repeated. The co-op would be insolvent today without the PPP, loans and ongoing delays in vendor payments.

Gross Profit / Gross Margin & Personnel Expense

Most expenses of the co-op are relatively fixed either as a dollar amount (e.g. utlitiies) or as a percentage of sales (e.g. credit card fees & store supplies). The two areas where the staff can have a significant impact on financial performance are Gross Profit and Personnel Expense.

Gross Profit is what remains after the goods sold are paid for (Sales minus Cost of Goods Sold equal Gross Profit). As a percentage of sales it's referred to as "Gross Margin." The factors that impact gross margin are the wholesale prices paid by the co-op, the retail prices paid by customers, and shrink (due to theft, mishandling, overordering, etc.). One common factor is that retail prices are too low because they have not been updated for the current wholesale costs.

Personnel Expense is the combination of the wages paid, the number of hours worked, payroll taxes and any benefits extended to staff, including staff discounts on purchases.

In 2022, after Cost of Goods Sold and Personnel Expense were subtracted from sales, a total of $3,828 remained to pay all other costs of operating the co-op. Even though other expenses were reduced, the operating loss in 2022 was $94,205.

Sales have been falling for at least the past three years. An increase in sales would have helped but it would not have fixed the problem. You could afford the current wages IF:

- Sales in 2022 were $1.35 million,
- Sales were growing steadily, and
- Gross Margin was 35% (typical for a co-op of your sales volume), instead of 31.7% of sales.

However, 2022 sales were *not* $1.35 million, but rather $1.07 million. Even had the co-op earned a typical Gross Margin of 35% there would not have been sufficient Gross Profit to pay the actual cost of Personnel Expense and all other expenses.

In short, sales are part of the profitability problem, as is the low Gross Margin. But Personnel Expense must also be addressed for the co-op to be financially sustainable.

To demonstrate the scope of the problem, with the actual Gross Profit in 2022, and with all other expenses accounted for, to be sustainable the total Personnel Expense needed to have been reduced by approximately one-third. Had the co-op achieved a more typical Gross Margin in 2022, Personnel Expense would still need to be reduced by 17% for the co-op to be sustainable.

Recommendations for Current Operations

1. Review all pricing to ensure that retail prices are current.
2. Consider increasing the target gross margin on some, perhaps most, products.

3. Find ways to increase work efficiency, to reduce the number of hours required for the sales level.
4. Work to increase sales.

It is not likely that the co-op will be able to remain solvent long enough to expand or relocate without rapid and substantial improvements in gross margin and reductions in personnel expense.

153 Main Street

A SWOT analysis of the current location would probably include:

- Strengths: History and a building that is paid for (no rent expense).
- Weaknesses: Poor receiving facilities, little parking, no visibility, difficult access, small size, condition of the building, high utility expense per square foot.
- Opportunities: Cleaning and refreshing the building (paint, floors, etc.), expansion.
- Threats: Growing alternative shopping locations, bridge closing.

The market study update includes the forecast of a sales reduction for the current location of between 12% and 17% in 2028 due to the bridge closure.

Expansion of 153 Main Street

The first option we studied is for the co-op to continue operating at 153 Main Street with an expansion of 660 square feet, all of which would be sales area. Coe + Coe Architecture estimates the construction cost to be $566,400. (This does not include any potential changes to the second floor.)

Using their construction estimate, we estimate the *total* cost of the project, including additional working capital and a cost contingency allocation, to be $1.06 million.

If the co-op can:

- fund the project <u>entirely</u> with grants and donations, *and*
- improve gross margin to 35% of sales, *and*
- reduce personnel expense to no more than 26% of sales,

we believe the co-op will be *marginally* sustainable after the expansion.

Note that with sales reduction due to the bridge closure in 2028, the co-op will have to substantially reduce the number of staff during that time to remain solvent.

We do not recommend this option. It is likely to be marginally successful at best, and **only** if the co-op is able to substantially improve gross margin while reducing personnel expense. We are not confident you will be able to obtain the financing required to fund the addition. Finally, we believe that the required staff reductions during 2028 may be too difficult of an undertaking for the co-op.

"No Build" at 153 Main Street

We then analyzed the likely outcome of continuing to operate at the current location without investing in the expansion project.

This option would not require further investment; no funds have to be raised.

Even if the co-op is able to improve gross margin to 35% of sales and if personnel expense remains at the level approved in the 2023 budget, we believe the co-op will still exhaust its cash in 2028.

If the co-op is able to increase sales beyond the levels forecast in the pro forma, enough to remain solvent, a significant reduction in staff will be required during 2028 due to the bridge closure.

We do not recommend this option. The likely outcome is that the co-op will become insolvent within a few years.

New Store on Horse Farm Property

A third option that the board requested we study is to purchase the horse farm on Route 2 and construct a new store there with 3,000 square feet of sales area in a building of 4,750 total square feet. We estimate the total cost of the project will be approximately $4.55 million.

The entire property contains buildings and grounds that will have to be maintained; no information about the proposed uses of the remaining property were provided to us.

If the co-op can:

- fund the project <u>entirely</u> with grants and donations, *and*
- improve gross margin to 35% of sales, *and*
- reduce personnel expense to no more than <u>24%</u> of sales,

we believe the co-op may be marginally sustainable after the expansion.

We do not recommend this option. We do not believe it is financially sustainable without substantial improvement to gross margin and personnel expense. It will be challenging to find $4.55 million in grants and donations, and this option cannot support any level of debt even with the improvements to gross margin and personnel expense. In addition, the remaining property will be a distraction (at best) to the management and a financial burden to the co-op.

Acquisition of Plainfield Hardware

The owners of Plainfield Hardware have expressed a desire to sell the property, equipment, trade name and inventory of the hardware store.

We projected potential financial outcomes based on the assumption that the co-op is able to continue to operate the hardware store current businesses while changing the grocery store products to reflect the co-op's mission and values.

This option carries substantial risk *and* potential reward for the co-op.

Risks include:

1. Current customers may be disenchanted with the move from the Main Street location.
2. The location of the hardware store is closer to competing shopping venues.
3. Merging the systems and cultures of two companies will be challenging at best. Accounting systems, POS systems, ordering, pricing, employee policies and more will all need to be merged, and there will be attendant friction and difficulty.
4. The owners of the business will leave, taking with them a great deal of the organizational knowledge. The co-op must arrange for a transfer and retention of the knowledge needed for the hardware store operations, to ensure a smooth transition and customer experience.
5. The process will require a clear understanding of what is being undertaken, and who will invest the time and energy to see it through to a successful conclusion.

Potential rewards include:

1. A very visible location on a highly traveled highway.
2. Acquisition of a reasonably successful business that will be synergistic with the co-op grocery business.

There is a separate report detailing the assumptions used in the pro forma, including improvements in the co-op's gross margin and personnel expense and no further capital investments following the acquisition.

Results in the pro forma are based on the grocery section having at least 2,500 square feet of sales area and the ability of the co-op to:

- Maintain and slowly grow the sales of the hardware store departments.
- Maintain the hardware store sales, gross margins on all departments other than grocery.
- Replace the owners' work time in the store with one full time equivalent.
- Operate the grocery section according to the assumptions in the market study (except for the size of the sales area).
- Improve gross margin on the grocery products to 35% and reduce the personnel expense on grocery to no more than 26% of sales.
- Operate a clean, well-maintained store with good customer service.
- Reduce the total combined staff over two years following the purchase, such that Total Personnel Expense (wages, payroll taxes & benefits) for the new business is no more than 25.39% of sales by 2026.

The total cost of this option is projected to be approximately $2.15 million.

The funding plan in the pro forma includes:

- $850,000 financed by the current owners.
- $340,000 loaned by the Cooperative Fund of New England.
- $1 million in preferred shares.
- $100,000 in donations.
- $15,000 in new member equity.

We believe that—if the co-op can purchase and operate the combined current hardware store operations and new grocery operations—the co-op can be financially sustainable, although it will not be easy.

We recommend that the board continue to study and plan for this option.

SWOT Analysis

We recommend the board convene a group in the near future to conduct a SWOT (Strengths, Weaknesses, Opportunities & Threats) Analysis for any options you choose to continue to pursue.

Planning

We recommend that you draft a written plan with a timeline for pursuing one or more options. The plan should include ensuring that the co-op has the committed management expertise required to successfully undertake the option selected.

It should be clear we believe the co-op cannot survive if Gross Margins are not quickly improved to at least 35% of sales and if Personnel Expense cannot be quickly reduced to no more than 26% of sales. We believe this is job number one. While you are working on long-term strategic alternatives you must be improving the operations of the current store.

We'd be happy to answer any questions you may have at this point. Even though this is the "final report" please rest assured that you can continue to call on us for help with the pro formas, general advice, and ongoing support as you continue to explore a sustainable future for the co-op.

With respect,

Don Moffitt

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