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Financing Your Value Added Farm or Food Business

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What Sustainable Food Companies Need

- A Business Model That Works
  - Ideas are only ideas until a business model that works takes them to the market.
- Appropriate Capital to fund their Growth
  - Businesses need both equity and debt to differing degrees as they grow.
  - Both can be either slow money or shark tank.

Drivers of Capital Requirements for Value Added Food Businesses

- Local market is often too small to support an economically sustainable business.
- Value added farm and food businesses always have low operating margins.
- Manufacturing equipment and bulk purchasing discounts create significant economies of scale.
- The dynamics of the food industry create significant working capital requirements to fund growth.
- Scarce free cash flows force food businesses to use outside financing to grow to scale.

Local food business models that work address these issues through what they do and how they are financed.

The Locavore's Dilemma

Take grass-fed beef…

- 568,593 - 2010 Madison Metro Region Population
- 240,343 - 2010 City of Madison Population
- 58.4 lbs/yr per capital consumption of beef
- 14,036,031 lbs/yr market in Madison
- 3% of beef consumption US = grass-fed
- 421,081 Lbs/yr; 7210 people = Madison grass-fed beef market
- 580 lbs/animal average yield
- **726 animals/yr – 29 local herds of 25 animals**
- 60% of beef consumed is ground that can come from dairy culls so number of beef herds significantly less
- **15 animals/day – rate small scale slaughter**
- **48 days of slaughter/yr**

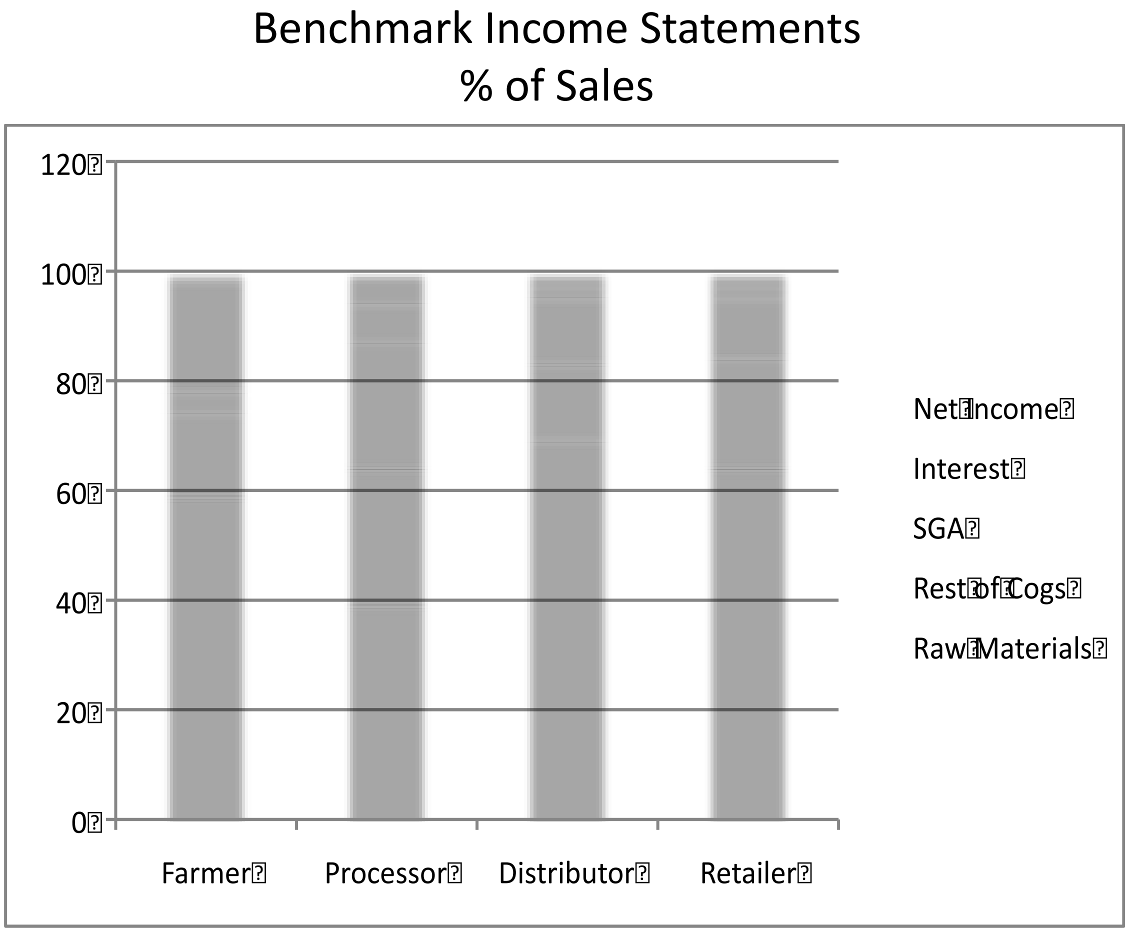
A market the size of Madison is not large enough to sustain many economically viable local food businesses; large metropolitan markets like Chicago or the Twin Cities are expensive and logistically difficult for remote producers to sell into; the best markets for sustainable high value foods are often on the coasts.

Getting Scale - How Big do I Need to Get to Positive Cash Flow?

- Farmer's Markets
  - $20K/yr
- Branded Retail
  - $225K/yr with $50K credit facility
- National Brand
  - $2.5M/yr with $500K credit facility
- Own retail plus branded wholesale
  - $600K/yr with $75K equipment loan
- Processor
  - $2M/yr sales with $400K in equipment loan and $400K credit facility

Cash Requirements					
	Farmers Market	Branded Retail	'anded National	Horizontal	Processing
Sales	20,000	200,000	2,500,000	600,000	2,000,000
COGS	7,000	140,000	1,500,000	375,000	1,300,000
Gross Margin	13,000	60,000	1,000,000	225,000	700,000
Sales % Mkt	500	50,000	250,000	2,000	100,000
Labor	0	5,000	250,000	175,000	175,000
Admin	250	1,000	25,000	500	2,500
Misc Exps	0	10,000	250,000	10,000	250,000
Interest	0		23,171		69,513
Net Income	12,250	-6,000	201,829	37,500	102,987
AR	0	33,333	277,778	0	222,222
AP	500	16,667	208,333	50,000	166,667
WIP	1,000	16,667	208,333	2,000	83,333
FG Inventory	0	16,667	208,333	0	166,667
Debt Service	0		25,000		214,027
Change in Cash	11,750	-56,000	-309,282	85,500	-416,596
Your Labor	10,400	20,800	50,000	50,000	50,000
Fully Loaded Cash Net	1,350	-76,800	-359,282	35,500	-466,596
			1		1
Payment			-48,171		-144,513
5%, 15 yr,			-23,171		-69,513
Credit Facility'			500,000		1.5M

Food is Always a Low Margin Business



Low margin businesses traditionally make money by staying focused & getting bigger; Local food companies are more likely to diversify to reach critical mass.

Free Cash Flow & Growth Stage Capital Requirements

Brand & Processing Free Cash Flow					
Year	1	2	3	4	5
sales	0	50,000	400,000	900,000	1,700,000
EBIT	-25,000	-8,000	48,000	108,000	204,000
Tax rate	0	0.40	0.40	0.40	0.40
AP	0	4,167	33,333	75,000	141,667
AR	0	4,167	33,333	75,000	141,667
I	0	4,167	33,333	75,000	141,667
Capex		50,000	250,000	50,000	30,000
Depreciation		10,000	35,000	45,000	50,000
FCFF	-25,000	-57,300	-273,700	-65,200	24,000

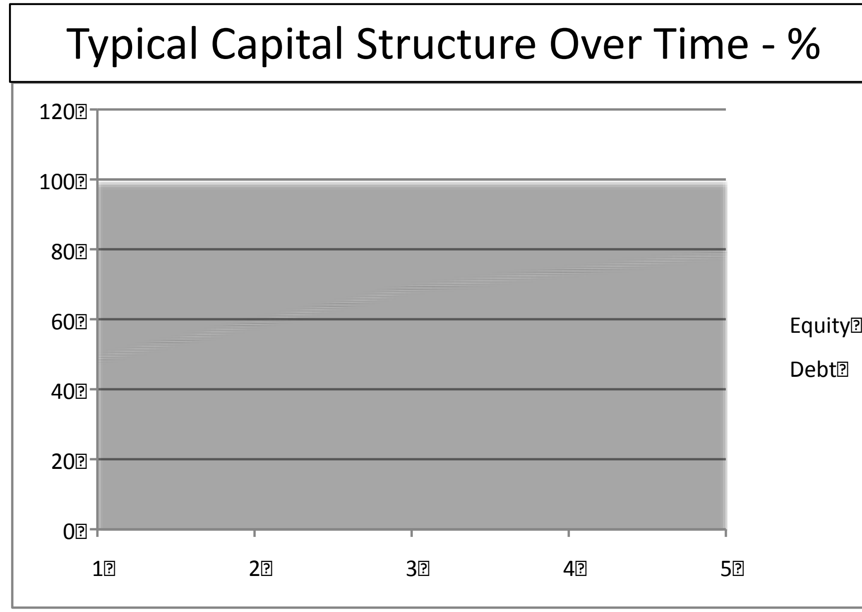
- Businesses can only organically grow as fast as their free cash flow.
- Anything that decreases free cash flow slows down the feasible organic growth rate of the company.
- This branded business (w/processing) needs $397,200 to get from $0 to $1.7 M in sales in 5 years.
- The lower the gross margin contribution and the faster the sales growth, the higher the supplemental cash requirements.
- These requirements are ideally met by a combination of debt and equity.

Free Cash Flow to the Firm   FCFF = EBIT(1-tax rate) – CapEx + Depreciation – Change WC

Effective Capital Structure

Debt is a contractual obligation to pay back funds lent to the company under a specific set of terms with specified recourse should the obligation not be met.

Equity is a claim to residual profits after all of the rest of the company's obligations are met.



An effective capital structure for a food business:
- Uses equity (or its equivalents) to provide sufficient cash for the business to grow during its early years, and to provide sufficient balance sheet strength to qualify the business for borrowing.
- Uses debt, often with guarantees, to fund collateralizable asset purchases and to fund inventory and receivables.

Funding Over Time

	Startup	Growth	Mature
Small	Equity – Owner, F & F, Crowd-funding, Prepayments Debt – Private lending, convertible notes, micro-lending	Equity – Owner, F & F, Crowd-funding, Prepayments Debt – Private lending, convertible notes, micro-lending	Prepayments and self-funding. Tend to carry very little debt
Horizontal	Equity – Owner, F & F, Crowd-funding, Prepayments Debt – Private lending, convertible notes, micro-lending	Equity – Owner, F & F, Crowd-funding, Prepayments Debt – Private lending, convertible notes, micro-lending	Convert to holding company and conventional debt as needed
Vertical with Processing	Equity – Owner, Investors, some convertible notes Debt – Guaranteed conventional or non-conventional for assets and WC	Equity – Owner, Investors Debt – Guaranteed conventional lender for assets and WC	Investor take-out with cash, conventional lending, or sale
National Brand	Equity – Owner, Investors, some convertible notes Debt – Investors, non-conventional lenders	Equity – Owner, Investors, some convertible notes Debt – Guaranteed conventional debt for WC	Investor take-out with cash, conventional lending, or sale

Early stage investor / lenders should think of the conversion to conventional bank financing as their "take-out" in all cases except high growth national brand companies. Any non-conventional lending that impedes this process should be avoided if at all possible.

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Non-Traditional Equity-Like Funding Sources

KICKSTARTER

LOCAL INVESTING OPPORTUNITIES NETWORK
LION

SLOW MONEY

CSA

Business Plan Competition

What if You Need Real Equity?

- Talk to an attorney – area with lots of regulations
- Documents you'll need:
  - Corporate filing – LLC, S-Corp, etc.
  - Operating agreement
  - Offering documents
  - Offering memorandum
  - Proformas

Questions?