Old Line Custom Meat Company

Old Line Custom Meat Company (OLCM) is the Mid-Atlantic region's largest producer of high quality, dry aged beef, selling to various wholesale and retail customers. The company is run by the founder who has a strong background in finance, the president/operations manager, and the owner's son, a former corporate marketing executive. The company has ten projects to consider, and a capital budget that will only support a few of the projects.

The projects are classified as: product line extensions; new product lines; operational improvements; or safety projects. Ideally the board will select projects to fund from at least three of these classifications.

Students are provided with project descriptions and financial data, including project cash flows, NPV, IRR, and payback calculations and are asked to consider the financial and strategic implications of each project and of groupings of projects. Students will represent the role of one of the leaders of OLCM during a simulated board negotiation to determine how to best spend this year's capital budget.

Old Line Custom Meat Company

In December 2021, Old Line Custom Meat Company's (OLCMC) leadership team met to discuss the capital budget for 2022. While COVID had been tough on the company, OLCMC weathered it well and was poised to continue to grow. While all ten projects under consideration had merit, to undertake all of the projects was not feasible given both capital and capacity constraints: there were not enough hours in the day to have the current workforce successfully undertake all of the projects. The total cost of the ten projects was nearly $1.5 million, and OLCMC proposed sticking to a capital budget of $300,000, a significant increase to the current asset base of $5.1 million. The products fell into the following categories, and OLCMC hoped to undertake at least one project in each of a minimum of three categories:

- Product line extension
- New product line
- Operational improvement
- Safety

Company Overview

Old Line Custom Meat Company is a veteran and family-owned and operated custom meat business, offering the finest beef and lamb products in Maryland and the Mid-Atlantic region. Founded in 2011, OLCMC is the merger of Geo. G. Ruppersberger & Sons, an 1868 legacy, family-owned meat processing company, and Roseda Black Angus Farm (Roseda Farm), a local, veteran and family-owned farm, specializing in beef genetics, founded in 1996.

OLCMC has both wholesale and retail customers and produces both kosher and non-kosher local **beef** (80%) as well as **lamb** (20%) products. Sales channels include retail grocery, farm store markets and certain ethnic markets; restaurants and foodservice/dining services; colleges/universities; local sports entertainment venues; and on-demand and online to individual and corporate gifting customers.

Located in Baltimore, Maryland the company has quietly become the largest producer of beef in Maryland and the Mid-Atlantic region, employing approximately 80 full time staff on one shift, Monday – Friday. Products include lamb (lamb loins, chops, and ground lamb), steakburgers, ground beef, all beef hot dogs, loins, steaks, roasts, and beef jerky. OLCMC was a vertically integrated, closed-ended system and able to source verify and trace its products *from farm to fork* via its genetic breeding process; partnering with a network of 40+ local cow/calf and feeder farms in the area that follow strict dietary and feeding protocols. Harvesting takes place at OLCMC, a wholly-owned, *glatt kosher* harvest and processing plant in Baltimore. The company incorporates a capital-intensive 14-21 day dry-aging process to ensure the optimum beef product that is both consistently tender and juicy.

The company has been growing steadily with a slight dip in profitability due to COVID pandemic related expenses (see Exhibit 1); previous funding had been heavily dependent upon owner financing; in recent years, the firm has begun repaying the owner while utilizing retained earnings and a line of credit to fund growth.

Resource Allocation

The leadership team at OLCMC prepared the capital budget annually and then discussed it to determine projects to fund. The leadership team consisted of three primary partners, namely the founder, his son, and the president/operations manager who all contribute to the list of projects under consideration, and capital budgeting decisions are made by majority rule.

Typically, the firm used both payback period and the internal rate of return (IRR) to evaluate projects. The hurdle rates, established in 1996, based on the type of project were as follows:

Table 1 Hurdle Rates

Project Type	**Minimum Acceptable IRR**	**Maximum Acceptable Payback (in years)**
Product line extension	25%	3 years
New product line	30%	2 years
Operational improvement	20%	3 years

There were no criteria for evaluating safety projects.

Hurdle rates were set based upon the perceived risk of each product category, with more risky projects expected to earn a higher internal rate of return (IRR) and to pay back more quickly.

OLCMC re-evaluated its weighted average cost of capital (WACC) annually, and having just concluded this analysis, the leadership team was using 10% as its WACC despite a WACC of 13% for the beef industry.

Project Expenditures

The following projects were up for consideration at the annual capital budget review committee meeting (Table 2):

Project	Expenditure ($000's)
1. Farm Store Expansion	100
2. Food Truck/Food Grilling	145
3. Website Marketing Expansion	115
4. Meatballs	45
5. Beef Deli Products	60
6. College/University Offering	139
7. Installation of a Second Shift	230
8. Delivery: Direct vs. Distributors	137
9. Plant Expansion	300
10. SQF Certification	75

PRODUCT/PRODUCT LINE EXTENSION

Farm Stores

Given the local movement and growth in farm store sales both at an existing OLCMC farm store and at other farm stores that carry OLCM beef, OLCMC was considering building another farm store location; the margins were very high on product sales, and although there were some start-up costs, the sales tended to grow due to word of mouth marketing. While OLCMC was considering the addition of one farm store, there was the potential for future growth through 3-4 more farm stores.

Food Truck/Food Grilling

With the proliferation of Food Trucks, OLCMC was considering a food truck/grilling unit that builds both revenue and its brand as the truck moves from location to location and business to business, grilling beef and serving food. Management believed the investment satisfies the sales and brand return, and there was the potential to add a second food truck/grilling unit if this first business is successful.

Employees to staff the food truck would need to be hired and a truck with an outdoor grilling unit purchased.

Website marketing expansion

OLCMC recently re-launched its website, roseda.com, including a more robust marketing and educational approach as well as an e-commerce component. The initial investment was $50,000 with a modest, monthly incremental spend for social media platforms. OLCMC was in the process of determining the most efficient additional digital and social media marketing advertising spend to maximize sales, which were yielding over 50% margins on the recent web site overhaul.

NEW PRODUCT LINE

Meatballs

Since the primary product OLCMC sells was steak and premium beef products, what remains after cutting steaks is ground beef and hamburger meat, known as trim. With roughly four times the quantity of trim to premium steaks, selling trim is both a competitive advantage (and challenge), yet necessary to extend its selling period year round. With more families eating at home, and as sales of premium beef have grown, OLCMC had more beef trimming for sale. The company was considering meatballs, either producing the product itself or supplying it to a co-producer in a co-branded approach or private label. The meatball would be priced as a premium product.

Offer Beef Deli Products

OLCMC had strong relationships with several grocery store chains. One opportunity was to offer brisket/corned beef to large retail grocers, for sale in the deli cases. This could require working with the existing grocery customers or working directly with deli providers (i.e. Boar's Head).

College/University Offering

OLCMC provided beef to a number of regional colleges and universities but was considering expanding this program. Colleges/universities offer a unique opportunity since the primary product purchased is burgers (trim), and colleges sell a lot of burgers. While OLCMC sold a good bit of hamburger through grille events in the summer months, colleges will purchase the trim products during the academic year, September – May, complementing current trim sales. Plus universities have a number of events throughout the year (parent and alumni events), and branding the products at the events also provides a marketing opportunity to build brand awareness.

The challenges with college/university customers were there is a longer selling cycle which is typically managed through large concessionaires with large national distributors with national contracts. With the *locavore* movement and student interest in working with local companies with fresh food and farm offerings, there seems to be more expectation for national distributors to partner with local firms for farm to table options.

Strengths and benefits of entering the space is that sales can be very strong in a countercyclical calendar for when trimming/ground beef/equivalents are used; and its reaches a younger demographic that allows marketing and brand recognition for the company and helps streamline production for the company, mitigating potential troughs in usage of these trimmings/equivalents.

OPERATIONAL IMPROVEMENT

As OLCMC's business continued to grow in revenue, there was a need to look at expansion of production capacity and other operational efficiencies, including in the following areas:

Installation of a Second Shift

With growth in the business, especially in the retail grocery space, OLCMC was considering an expansion to a second shift. There would be opportunities to streamline first shift production and set up the second shift for more straight-line burger production to make both fresh ground products and frozen burger pallets for the grocery stores and farm store customer. The challenge was hiring more meat cutters and employees for the second shift, which has been mitigated, recently. The second shift could generate an additional $3 million in revenue simply with retail grocery frozen business, which is not the most margin friendly product; however, it does increase capacity on more margin beneficial products, such as steak and whole loin cuts for wholesale, online, and farm store customers.

Delivery: Direct versus Distributors

OLCMC was considering outsourcing most of its delivery business to one or two distributors. The truck drivers are unionized, and the truck fleet is leased. OLCMC would retain a few direct customers that are high margin customers and strategic relationships but turn over delivery to other customers to a distributor. Distributors typically represent numerous companies whereas direct delivery allows OLCMC to maintain closer connections to customers.

Capital/Slaughter Plant Expansion at the Processing Plant

Expanding the processing plant offers significant operational efficiency for the company, with upside potential in refrigerated and dry-aging space, storage and transportation cost savings. Given OLCMC's current capitalization with owner investment, the company was limited with equity infusion to grow its operations by expanding its harvest/slaughter capacity on its current processing footprint. However, a partnership could provide the capital necessary to expand.

In order to create both additional space and operational efficiencies, there would need to be a significant capital investment, likely $3 - $5 million which would not come from the partners; however, these funds could come from either a key retail customer, distributor partner or passive strategic investment partner. The company considers this growth potential, knowing the move will shift the company. It would introduce an additional partner and would move OLCMC away from its current customer base to a model with potentially fewer customers but better-margined customers.

SAFETY PROJECT

OLCMC was contemplating seeking SQF Certification, Level II. SQF is a Food Safety Management Certification, created and managed by the SQF Institute. It is used to control food safety risks. Once your food safety management system is implemented, the system is audited and certified by a third-party certification body.

The Food Safety Certification requirements provide a rigorous system to manage food safety risks and provide safe products for use by companies in the food industry. Though not required, it is becoming an industry standard and is much desired by some of OLCMC's current customers and may potentially attract additional customers; statistics show that approximately 1 out of 4 certified companies are asking their suppliers to achieve certification.

The system, if implemented, will require the purchase of and use of scanners and thermometers and other appropriate documentation, from standard use of property, plant, and equipment and cleanliness/maintenance standards important in maintaining and presenting a high quality and environmentally conscious product to end users and customers. it will require an initial capital outlay and annual outlays. Certification can help OLCMC stay competitive and qualified to work with current and potential future customers.

As the leadership team gathered, it prepared to make decisions that could dramatically alter OLCMC going forward.

Exhibit 1

Old Line Custom Meat Company (OLCMC)
Summary Financial Data
(all values in US dollars, thousands)

Summary Financial Data	**2019**	**2020**	**2021**	**2022(projected)**
SALES	$16,864	$17,940	$22,518	$24,200
COST OF SALES	$10,774	$11,817	$14,880	
GROSS PROFIT	$6,089	$6,123	$ 7,639	
GP%	36.10%	34.10%	33.90%	
TOTAL EXPENSES	$5,549	$ 6,309	$ 6,877	
EBITDA	$521	$ 814	$ 762	
NET INCOME	$106	$ 420	$ 414	
Total Assets	$4,930	$ 4,138	$ 5,142	
Shareholders' Equity	$65	$ 378	$ 791	

PROJECT (000's)	**Farm Store**	**Food Truck**	**College Offering**	**Web site**	**Second Shift**	**Meat balls**	**Direct Delivery**	**Deli Meat**	**Plant Expansion**	**SQF Certification**
INVESTMENT										
Property	100	145	139	115	230	45	137	60	300	75
Working Capital			12				50		50	
Year initial outlay	-100	-145	-151	-115	-230	-45	-187	-60	-350	-75
1	-48	-55	-14	0	42	-15	26	30	-11	-125
2	9	-10	12	90	70	12	28	42	23	-125
3	34	60	48	260	93	24	36	55	40	-125
4	42	94	73		112	49	45	62	74	-125
5		122	96		134		48	71	86	-125
6			112		142		54		132	-125
7					154				312	-125
8					180				564	-125
9					240					-125
10										
Undiscounted Sum	-63	66	176	235	937	25	50	200	870	-1200
Payback (years)	N/A	5.45	4.33	2.10	3.13	3.49	5.26	1.71	6.40	N/A
Maximum payback accepted										

IRR	-16.46%	7.34%	17.35%	50.99%	37.11%	11.63%	6.34%	65.03%	20.67%	#NUM!
NPV at industry WACC (13%)	(86.11)	(36.05)	29.95	135.68	349.13	(2.19)	(37.52)	114.12	186.24	(716.46)
NPV at OLCMC WACC (10%)	(81.97)	(18.23)	54.94	154.72	440.94	2.78	(22.15)	129.74	290.73	(794.88)