Capstone 1

Phoenix Risen Incorporated (PRI) – Case

(All dollars are Canadian dollars unless specifically stated otherwise.)

It is May 12, 2016, and you, CPA, work for Phoenix Risen Incorporated (PRI) as a senior business analyst. You have been a go-to support for Martina Legault, the current CEO of PRI. She appreciates that you have a professional designation and asks you to work with the various teams at PRI to provide advice on a number of concerns to assist both PRI and the family in moving forward. Your primary focus will be on the Phoenix chain, but assistance may be required in other areas as well.

PRI has approached you with a request to assist it in strategic analysis and to help set a new direction for the company. PRI is concerned with its ability to stay current and continue to grow in the current retail environment. There are also several operational issues that it would like you to analyze and address.

You have been provided with the following information to review and analyze.

Phoenix Risen Incorporated (PRI)

Established in 1943, PRI is a Canadian privately held retailer, operating under a department store concept. The company was founded by two brothers, Pierre and Marcel Legault. The PRI family of stores continues to be owned and operated by the Legault family today. The Phoenix chain is the core of PRI. As a national department store chain, from the beginning Phoenix established itself as an icon in the Canadian retail sector and has high brand awareness.

Industry information

The department store concept

Department stores were once a staple of the Canadian shopping landscape. The concept emerged in the early 1900s when consumers began to share a culture of consumption. Fashions were changing and a rising middle class led to an increase in the number of people who shopped for pleasure as opposed to necessity. Additionally, at a time when women were expected to behave in particular ways, shopping was a

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pastime that was not only acceptable but could also be done without accompaniment. As a result, the department store became a social outing for the middle-class woman.[1]

Large-scale stores that allowed consumers to purchase all of the goods they needed in one location became cornerstones of the shopping world across Britain and North America. Department stores found success by luring customers into a store where everything could be found under one roof — large-size stores and wide selections catered to shoppers.

Today, department stores struggle to stay current. With the rise of specialty stores that focus on one area, such as large-scale stores that focus on electronics or business supplies, consumers are focusing on stores that can cater to their specific needs.

An age of convenience has also resulted in more and more consumers turning to online shopping as their new “one-stop shop.” Where the department store used to house everything in one location, the Internet now houses everything at the click of a mouse. This creates challenges where customers have become more attuned to comparison shopping and purchasing products from whichever retailer is selling them at the lowest price.

Canadian shopping market

The latest generation of shopper belongs to the millennial group. Millennials[2] are people born roughly between 1980 and 2000. They are just entering a time of having disposable income and more spending power, and they shop differently from their parents. Millennials, who are often labelled as entitled, are actually — and surprisingly — careful with their money[3]. They spend significant time researching products before purchasing, with the majority of that research occurring online. They tend to focus on buying items that have staying power, with an interest in quality and goods that will endure. They also socialize differently. Where the mall was once a common hangout for young adults, today coffee shops and other social places are the go-to gathering places.

This younger generation also tends to multitask and shop via computer or smartphone, allowing them the ability to shop wherever they are. By 2018, online sales are expected to double their current levels, capturing more than 6% of the total market[4]. That number is only expected to continue to increase as the century goes on.

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1 http://www.hbcheritage.ca/hbcheritage/history/social/CustomerExperience/departmentstore. Accessed January 12, 2015.

2 William Strauss, Neil Howe (2000). *Millennials Rising: The Next Great Generation*. p. 370. ISBN 0-375-70719-0. Accessed January 12, 2015.

3 http://www.businessweek.com/articles/2014-04-25/millennials-are-careful-frugal-shoppers-who-buy-for-the-long-term. Accessed January 12, 2015.

4 http://www.huffingtonpost.ca/2014/06/27/canadian-shopping-mall-retail-brands-dying_n_5534651.html. Accessed January 12, 2015.

In 2013, Industry Canada published a Consumer Trends Update on Canada's Changing Retail Market. Based on this report, a company like PRI has much to consider when it comes to its future, especially with the Millennials, followed by Generation Z.

Company background

Pierre and Marcel each invested $1,000 in shares to start PRI. The brothers also made an agreement which stipulated that future ownership of the company should include all descendants in a fair and equitable way (see Exhibit 1 for a summary of the family history).

When Marcel passed in 1970, his shares were redeemed by the company leaving 100% ownership with Pierre.

In 1972, an estate freeze was done, where Pierre froze the value of the company into Class A voting preferred shares. The shares were redeemed over a 10-year period allowing Pierre and Anne-Marie to live comfortably for the rest of their days.

James and Stephen then each acquired 50% of the common shares at a cost of $1,000 each.

Exhibit 2 contains the current organizational chart.

PRI's businesses

Phoenix

Phoenix was built on the belief that "strong values breed profits." The Legault brothers were advocates of stronger communities and they looked to provide a store that would unite people and generate goodwill.

Phoenix focuses on sourcing only the highest-quality products so that consumers will be satisfied with their purchases, believing this will build lifelong relationships and loyal customers. The majority of the products highlighted in the stores are Canadian made, not only because of their quality but also to promote Canadian entrepreneurs. Phoenix has earned the respect of other businesses and a reputation for being not only fair but also generous, with high morals and preference for ethically made products.

Cinder

Recognizing that department stores were becoming more of a niche market, Cinder was acquired with the view to expand PRI's customer base in the Canadian market. Cinder is a mass merchandiser that helps PRI to continue to be a go-to retailer for Canadians. It provides the option of a shopping experience that is different from Phoenix, but with the same level of trust that Phoenix has always provided.

Cinder focuses on supplying everyday consumer goods at an affordable price. With an aim to provide service to more Canadians, Cinder has stores across Canada primarily in small towns.

Corporate mission

PRI is a Canadian shopping experience that provides products for both the budget shopper and for those looking for superior products. Founded on the principles of treating customers, suppliers and employees with respect and integrity, PRI is a family-run business that treats its customers like family.

Vision: *"We make it easy for Canadians to shop with us*."

Mission: Our mission is to serve our customers through our stores by providing a high-quality home and fashion retail experience. The experience is tailored to meet the needs of Canadians by providing quality, choice and service that can be trusted.

Quality – Quality of service and excellent value. High end or mass market, PRI provides products to meet and exceed the expectations of our customers.
Choice – We aim to provide shopping alternatives to meet your various needs. The PRI family of stores offers a wide selection of products to satisfy Canadians.
Trust – PRI is a brand that can be trusted. We are committed to maintaining and strengthening the trust Canada has in us in our relationships with both our customers and our staff.

Phoenix	**Cinder**
From the beginning of PRI, the Phoenix brand of department stores across Canada offers a complete shopping experience with high-end products sure to meet the needs of even the most discerning shopper. Carrying a large selection of Canadian-made, high-quality products, Phoenix provides the experience your family has been accustomed to since the 1940s. There are 14 Phoenix stores.	Cinder is a budget shopping alternative for the consumer who demands competitive pricing and a large array of general merchandise. Low pricing and a selection of household brands are the cornerstone of the Cinder store. Cinder operates at a low price point while maintaining the corporate values of PRI and of the Legault family. There are 75 Cinder stores.

Corporate values

The Legault family places great emphasis on ensuring that their reputation with customers is high, by providing friendly service, easy returns and a general sense of doing their best for them at all their stores. PRI as a family of stores believes that the customer is always right and that keeping a customer happy means they will return.

PRI extends the same treatment to its staff. The business started out small and staff were family or close friends of the brothers. As it expands, PRI continues to treat staff with respect. The family believes that, for customers to be treated well, staff need to be treated well first. PRI has worked to retain its staff, offering industry-leading employment packages that allow staff the ability to work in retail as a career, not just a job. Staff are confident in their roles, as PRI provides stable work hours and considers their needs in planning operations.

Management team

Stephen and James Legault

PRI, and especially Phoenix, have been a core piece of James' life. Next to his children, it is the creation he values the most, and he is very proud to have been a part of the creation of a landmark in the Canadian market.

James has stepped away from the business now and he is happy to let the younger generation take over. He will leave the future decisions and profits to them. It is important to both Stephen and him that their families are cared for and that each of their offspring feel valued and appreciated. They have made allowances in their wills for the inheritance of their shares, but both Stephen and James would like to change this. They would like to pass on ownership of PRI now, rather than later. They would like to benefit from the growth in the company up until the end of fiscal 2016 in order to ensure that they have the means to live out the remainder of their lives as they have become accustomed to, but all future growth should accrue to the third generation of Legaults involved with PRI. James expects to stay out of the management of operations; however, together with Stephen, he would like to keep voting control of the company for a little while in order to help resolve any disputes that may arise as everyone settles into their new roles. They currently draw dividends from the company. This would cease upon the handover and no further dividends would be paid until their shares are redeemed.

They would like to minimize the taxes paid as much as possible and neither has used his lifetime capital gains exemption. Ideally they would like to redeem 25% of their shares evenly over the next five years, with the remaining 75% to be redeemed in the future as needed. The expectation is that the cash for the redemption will come equally from Phoenix and Cinder.

Both James and Stephen would like to address the need to honour Justine, who died very young. Her daughter, Maggie, is her legacy, and James and Stephen believe that one-third of the company their fathers built belongs to Justine. The only way to acknowledge this is to pass some ownership onto Maggie. However, they are not sure how to do this.

Martina Legault

Martina's focus is largely on Phoenix. She is proud of the store built by her father and grandfather. PRI has always put customers' needs first and provided them with a store that reflects the family values: quality, honesty and care. It is really important to her that the traditions of PRI and Phoenix are carried on in a way that is respectful to the legacy of her family.

Although George and Jennifer believe that significant changes must be made to meet the objective of regaining PRI's former glory, Martina does not. Martina struggles to stay true to her personal values, while her relatives attempt to change the business based on their previous experiences in younger markets. In her opinion, Phoenix has been making changes to address the needs that have been identified. In the past, the Phoenix stores have been predominately street-front stores in downtown locations, and she is happy that the family continues to maintain them today. She takes pride in the fact that PRI owns and cares for prominent buildings. To her, it is important that the goods carried are of a high-end quality and that PRI caters to a customer who cares to experience the store, not just obtain the lowest price. She believes they should continue to maintain these stores today.

Martina recognizes that the market and shoppers have changed over the last two decades. She is confident that, in keeping the Phoenix values, PRI has responded well by adding Cinder to the family of stores. Additionally, Phoenix has expanded geographically outside of the downtown core to both suburban malls and standalone locations in suburban shopping areas. PRI is trying to cater to the more budget-conscious but still high-end shopper, which is also an answer to the changing market. It is her belief that the downtown stores have maintained their high quality of product and higher margins, while more economical options, through a slightly different product mix, are available in the suburban areas. The economical options decreased the store margins; however, the expectation is that the volume sold would help to offset the lost margin. Phoenix's most recent financial results and information on store results are included in Exhibits 3 to 7.

Jennifer Legault

Jennifer believes that Phoenix requires a major overhaul. She disagrees with Martina's traditional objectives for PRI and believes there is more that could be done to make this company a success. It is time to move forward and update the company by infusing new methods of doing things. Jennifer is glad to have found an ally in George.

Based on her previous experience, Jennifer believes that you need to understand your market and focus on it, instead of trying to be everything to everyone. Jennifer disagrees with the approach Phoenix has taken of expanding stores to suburban areas with lower-quality products and lower margins. In her opinion, this confuses customers and is poor decision-making on the part of management.

Maggie Smith

Maggie is excited to be part of a vibrant family. She spends a lot of time on social media and the new job opportunity of VP of Social Media was a great fit for her. Her days are pretty relaxed. Phoenix doesn't have an audience that is into social media as most customers prefer an in-person experience. In her opinion, the Phoenix customer is keener on in-person experiences and she doesn't think a lot of her time should be spent trying to interact with them online. She has created a Facebook page and updates it with the latest flyer each week. Cinder does not currently have any online presence.

The majority of Maggie's time is spent networking with people on her own social media and making sure that the Phoenix name is out there. As an avid shopper who loves giving fashion advice to the world, she has started her own personal blog which earns approximately $80,000 a year from advertising revenue, and it continues to grow. She uses a lot of the time she spends in the corporate office to work on her blog and uses Phoenix's resources to pull together product information. Some of the marketing staff have helped her put together the website and work with advertisers. On her blog, Maggie provides advice on where to get the best deals on designer labels, as well as similar knock-off versions that can be found at cheaper retailers. She attempts to promote Phoenix whenever possible, but to be fair to her readers, if there are better deals or more fashionable items elsewhere, she discusses them instead.

Maggie would prefer to just work on her blog, as she has a busy social life and enjoys her free time. She simply needs enough money to live the lifestyle she is accustomed to and is not interested in running the business or making decisions.

George Legault

George's father was a great sculptor but was always totally hands off PRI. George has never really thought of it as his family's company; however, recognizing his grandfather's legacy, he is excited to get involved in the business.

Operations

Finance and accounting

Discontinued product line

In 2012, Phoenix created its own product line of pots and pans which was associated with a popular prime-time cooking challenge show seen on TV.

Phoenix purchased the rights to have the pots and pans produced through a high-end manufacturer with a prominent brand name. The rights cost $1.2 million and were capitalized as an intangible asset on the financial statements, and are being amortized over a 10-year period.

Sales of the pots began in 2013 with disappointing results. Unfortunately, at the same time as their release, a popular celebrity chef released his almost identical line of cookware produced by the same manufacturer. Phoenix believes it was deceived into purchasing rights that were of no value.

In 2013, the line of pots made a profit of $220,000. This slumped to losses in 2014 and 2015 of $75,000 and $325,000, respectively.

The remaining inventory of pots is currently being cleared out at a price of 50% below cost. Phoenix has taken action against the manufacturer and is suing it for misrepresentation.

Branding costs

Jennifer is keen to work on improving the Phoenix brand and thinks a new marketing approach is necessary in order to reach a wider audience. In July 2015 she signed a $1.5 million contract and paid a branding company a $500,000 deposit to undertake a study of the Phoenix brand and begin creating a marketing plan.

When Martina heard this she was shocked and immediately stopped the process. Although Jennifer did have the authority to sign the contract, traditionally an agreement of this magnitude would be approved by the board first. The $500,000 is non-refundable and no work has been completed to date.

Martina told Jennifer that the board will discuss whether a rebranding is necessary at a future date, after decisions are made on the other strategies that the company is currently considering. Martina is hoping the cost incurred to cancel the contract does not need to be expensed in the financial statements as potentially the rebranding may still occur.

Property, plant and equipment

Leasehold improvements

Phoenix owns four malls/shopping centres in addition to two stand-alone stores. These have had a successful history with high tenant occupancy and low turnover. This is primarily due to their locations and the success of the local markets.

In 2014, the Edmonton mall began to slump and Phoenix was finding it a challenge to keep all of its leases filled. This situation continued through 2015. Believing that the reason for the tenants leaving had much to do with refurbishments needed to the storefronts, Phoenix offered a promotion to tenants at the beginning of the current year. Tenants that sign a 10-year extension on their current lease term are provided with funds to complete leasehold improvements. Lease incentives are tailored to the nature and total sales revenue of the stores. Phoenix has never before provided a lease incentive to its tenants.

The Edmonton mall contains 71 stores. Sixteen stores agreed to extend their leases by 10 years and, in exchange, Phoenix issued a total of $700,000 in incentives for leasehold improvements. Approximately one-third of the funds will go towards improvements, such as lighting, which will remain Phoenix's property after the leases expire. The remainder is for shelving, signage, paint and items specific to the stores. This is expected to increase foot traffic to the mall by 20% and sales in Phoenix by the same amount.

George has done some estimations and believes that similar improvements are required in a number of Phoenix's properties in order to maintain them at the quality expected. The Legaults do not see this as an option but, with all of the demands on the company right now, they are unsure how they will come up with the cash since bank loans are coming due over the next few years. With the changes in the market since the last negotiation, any bank financing will come with a higher interest rate and stricter terms. George is not sure if that is the best option. To assess this, he would like to see what Phoenix's cash flow is anticipated to look like over the next five years. Financing options available are summarized in Exhibit 8.

Legault family and board meeting dialogue

The family and board met on March 14, 2016, to discuss PRI's future.

Excerpts from the discussion that took place at the meeting appear below.

Martina: At present I have been considering closing a number of stores. For example, some of the properties we own have significant value. Closing the store and selling the property or leasing the property to someone else may be more profitable. Many of our properties are valuable because of their location but could use some serious facelifts, so now would be the time to make a change if one is to be made.

I have even been considering closing our location in Vancouver. Maintaining it for our use would require significant additional capital investment to bring it back to its former glory. If we were to lease it to someone else, they would do much of the cosmetic work and we would only need to upgrade some minor structural items.

When the CEO of the retail space to which the flagship store is physically connected heard that we may close our store, he phoned me almost immediately. I was surprised! Apparently, he believes the prominence of our brand increases the foot traffic in his building and, therefore, the rents he earns from his tenants. He has made Phoenix an offer (**Exhibit 9**) that I would like to consider, in which they would buy our building from us and then lease it back to us at a reasonable rate. I admit the thought of selling the flagship does sadden me, so I am intrigued. An additional financing source is tempting, though I am a little unsure about giving up the title to the building.

George: Let's discuss the Real Estate Income Trust (REIT) idea I mentioned to you. Managing the real estate separately from the retail operations would help us.

Martina: Yes, another strategy I am open to considering is the spinoff of our real estate. We own six pieces of real estate across the country (Exhibit 7). I am not sure what that entails or if it is a good idea; however, it will be good to learn more about how it will impact our business and if it will be a good idea to implement.

George: We have a lot of value sitting in our real estate and I want to make sure we are managing this appropriately. I agree with Jennifer that we may need to assess closing down some of our Phoenix stores, but I also want to make sure that, if we were to choose to close our store and lease the space to someone else, it would not impact the rental income we earn from the tenants in the malls. I do not have information on how the store's foot traffic impacts the malls, but to me that seems like it would be important.

Martina: I like the idea of the sale and leaseback in that we can keep the store but can gain access to the capital tied up in the property. The sale and leaseback gives me what I want, but the lease rate seems a bit pricey. The CEO does seem eager to work with us, though.

Jennifer: Success in the industry depends on margin per square foot, and our current high and low margin approach is hurting PRI. We need to be clear on what we are and focus on ensuring that the market understands this. Cinder is the budget store — Phoenix should not be. Phoenix cannot continue to sustain 14 stores, and we need to be either suburbia or downtown — not both.

I think there may be a better way to hone in on the right clientele. I think the right way to do this is through acquiring another company. We need something to appeal to the younger market without being a bargain shop like Cinder. An opportunity has come up to discuss a potential acquisition of Sparky Limited. Sparky is a department store as well, but with a much smaller square footage per store — not the multi-floor palaces that Phoenix has. It targets a younger market, looking for quality products but on a lower budget. Acquiring the company would allow us to balance our need for growth, while also keeping with tradition with our other stores. I have included some preliminary information on the company (Exhibit 10) just to assess if it might be a fit.

George: I come to PRI with some different perspectives. To me, keeping things the way they have always been is not a great way to honour the past — it is a way to die out. I think we need to really look at our current strategy and consider where we want to be.

The acquisition of Sparky makes a lot of sense. I have always loved the way some companies have several stores that match different price points. The way I see it, with Cinder and Phoenix we have the means to cater to a wider array of Canadians. Sparky would get us that missing piece of the market we don't currently have — the young, trendy shopper who is likely to turn high end as their income increases. It may tap a market that can transition to Phoenix in later years. I am a little concerned, though, that

Sparky might be an easy way to go without actually being the right fit for us. I do, however, like its online presence, and wonder if this would be a good idea for Phoenix to adopt. I think we need to open up to the idea of attracting new types of customers, and online might be the way to do it. I am concerned, however, with the security breach that occurred at Sparky.

Martina: We should be more cautious with this type of store. We all know what happened to one of our competitors recently and the losses they suffered when they decided to leave the Canadian market. A higher rate of return of at least 6% should be expected for this type of investment. As well, I would like to ensure the valuation is reasonable based on several different valuation methods.

I know online shopping is a growing trend and, George, I can see why you would be pushing for it. I have heard of some stores being converted to warehouses for distribution. I guess that is an option too.

We'd need to make sure we can ship quickly and make sure the warehouses are set up in the right places. Being able to quickly respond and ship is the key to success in online sales. The demographic we currently serve, however, tends to be older and I just don't know that they would shop online. Why implement something that doesn't match our current customers?

Jennifer: That's exactly why I would like to see Phoenix online! What better way to capture the younger demographic? I believe that moving towards an online presence for Phoenix is the way to go and bring the company into this century. I have gathered preliminary information on the idea (Exhibit 11). This is a great fit for us and will ensure our ability to attract the younger customer transitioning from being a Sparky customer to a Phoenix customer. Also, many of our customers would prefer the convenience of their purchases being delivered to them. This is the world we live in and PRI needs to start living in it as well.

Martina: I'd be willing to review this; however, I would like to see a minimum of 8% return on investment over the next five years. I would like to see us implement a performance measurement tool to better keep track of our performance.

Maggie: I love shopping online! I wait by the door until my mail arrives and it's like Christmas almost every day!

Jennifer: There is a very strong shift in the way customers shop, young and old. We need to keep up with the customers.

Martina: We need to spend more time focusing on Cinder. Since we acquired it, it has been fairly stable. George took over the reins as COO when he joined PRI, but, as you know, we work closely as a team across the board. With recent changes in the market and the pressure of other large stores, Cinder has to figure out what its strategy is going

forward to maintain market share. I know George has some information for you on this and I would like to get your preliminary thoughts.

George: Cinder has always been the dominant store where it is located. We have traditionally been in small towns with one main retailer where we were the place where customers purchased the majority of their household needs. We have not had to compete with specialty-focused stores, such as home office supplies, because the towns are simply not large enough to support such retailers. Obviously the towns also had a grocery store as Cinder does not deal in groceries. A major national chain owns the majority of the grocery stores in the towns we operate in. With their recent expansion into the general merchandise market as well, our stores have taken a significant hit. People have to buy groceries! Now, while they are doing that, they are able to pick up a lot of the general products they would have come to us for just a few years ago — like dishes, toys, books, etc.

I know we need to figure out a way to compete and draw people back to us. I have been struggling with what strategy to employ for the discount brand. I have put together information on the market outlook for Cinder and the possibility of adding groceries to our Cinder stores. Although this will not give us a competitive edge, at least we will be able to compete with our competition and bring back some of the traffic we have lost. (Exhibit 12.)

Perhaps one way to improve our margins in the downtown stores is to consider the option of replacing some of our more expensive suppliers with less costly options. We have always sold store-brand Canadian-made winter coats. They are a staple product that truly represents our brand. These coats have always been made by a supplier in Yellowknife. Recently we were approached by another manufacturer with a proposal. I have compiled some information on this for you to review and consider (Exhibit 13).

James: As you know, Stephen and I would like to retire. Before we do that, we would like to know that PRI's ownership structure reflects everyone appropriately. The only way to do this is to pass some ownership onto Maggie. However, I am not sure how to do this. I don't want Maggie to have more ownership of the company than the others, but I do want her to receive her mother's share of the present-day value. I will need a recommendation on how to accomplish this, as well as advice on any of the tax consequences. The current valuation of the company has been appraised at $6.2 billion.

Exhibit 1 – Family History
The Legault Family

First generation

Pierre Legault (married Anne-Marie 1931)
(1912-1991)

Marcel Legault (married Isabelle 1940)
(1914-1970)

Pierre and Marcel started the Phoenix general store together in 1941. The store was extremely successful and the brothers built on this, developing it into one of Canada's most iconic department stores by the late 1950s.

Second generation

James Legault (son of Pierre, married Erica 1961, divorced 1970, married Heather 1975)
(1933-)

Justine Legault (daughter of Pierre, married Ryan Smith 1968)
(1945-1970)

Stephen Legault (son of Marcel, married Stephanie 1970)
(1942-)

Pierre and Anne-Marie had two children, James and Justine. Justine tragically died at the age of 25 in a boating accident. She left behind her husband Ryan and their then-infant daughter. Justine never took an active role in the business while she was alive.

James took over the business from the brothers not long after Marcel's death in 1970. James worked at expanding across the country and ensuring the brand remained in the forefront of the Canadian market. He prided himself in procuring only high-quality products and promoting "Canadian made" whenever possible. Recognizing the need for a lower-cost alternative and wanting to maintain PRI as the preferred choice, James made the move to acquire Cinder. This was done with the intention of expanding PRI to serve more of the Canadian market while maintaining the same core values of the organization.

Marcel and Isabelle had one son, Stephen. Stephen has never had an interest in the business and turned down a seat on the board. He prefers to focus on his artwork. A talented sculptor, Stephen has appreciated the flexibility that belonging to an affluent family has allowed him so that he could develop his creative side. James was happy to run the show and did not encourage any involvement from Stephen — allowing him access to profits through his share ownership in exchange for Stephen's support of his decisions.

Third generation

Jennifer Legault (daughter of James and Erica, never married)
(1969)

Martina Legault (daughter of James and Heather, married Bob 2005)
(1975-)

Maggie Smith (daughter of Justine and Ryan Smith, married Mark 1990)
(1970-)

George Legault (son of Stephen and Stephanie, married Melissa 2006)
(1975-)

The third generation of the Legault family have all taken an active interest in the business.

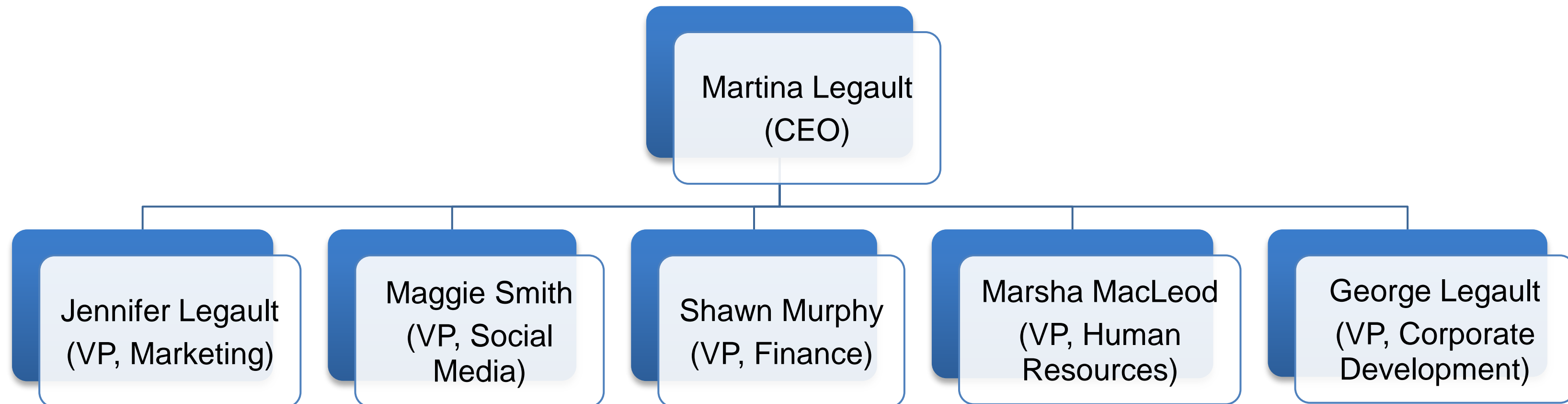
James and Heather's daughter, Martina, is the current CEO of PRI and the COO of Phoenix. James and Martina have a close relationship, and Martina respects the work her father has put into the company. She has worked with Phoenix her entire life and was groomed for running it by her father. While she oversees both Phoenix and Cinder, her primary focus is on the Phoenix brand.

James' daughter Jennifer, from his first marriage to Erica, is not as close with her father. She grew up at the other end of the country and, with the busy schedule of an entrepreneur, James saw little of her. Jennifer has just recently come on board with PRI as the VP of Marketing for Phoenix. Jennifer would like to shake things up at Phoenix and thinks the company needs to move into the new millennium. She has worked in marketing with a high-end yoga chain and a national juice franchise. Jennifer would like to target a younger crowd and believes she has the knowledge to do so.

After Justine's untimely death, Maggie Smith was raised by her father. She has always stayed close to the Legault family with her uncle James consistently watching out for her and ensuring she was a part of her mother's family. Maggie started working with PRI right out of high school. She wasn't interested in the work required to attend university. Maggie worked for many years on the front line of the retail business. Recently she moved into the head office and took over the newly created position of VP, Social Media. PRI does not really have a social media presence. Martina is being pressured by the board to create one, starting with Phoenix, and creating this new position relieves some of that pressure, while giving Maggie a more significant role in the organization.

Stephen and Stephanie’s son, George, is the most recent member of the family to come on board. Stephen had never been active in the business, so George grew up aware of, but not involved in, PRI. George obtained a business degree in his early 20s and has been working for a number of retail outfits since then, including some mid-sized chains aimed at young adults with a strong online presence. After settling down in his early 30s George decided to return to his roots and take an interest in PRI. He has taken over as the VP of Corporate Development for PRI, while also operating as the COO of Cinder. His other experiences and removal from the core family running PRI give him a unique perspective.

Exhibit 2 – Organizational Chart
Executive Organization



PRI Board of Directors:

- Martina Legault, Chair
- George Legault, Deputy Chair
- Jennifer Legault, Director
- Maggie Smith, Director
- Connor MacMillan, LLB, Independent Director
- Isla MacDonald, CPA, Independent Director
- Cate Nugent, Independent Director
- Heather Sceles, Independent Director
- Katie Brine, Independent Director

Currently there are no subcommittees, such as an audit committee, as part of the Board of Directors team.

Exhibit 3
Extracts from Phoenix Financial Statements

Phoenix Incorporated
Statement of Comprehensive Income
For the Year Ending December 31
(millions of Canadian dollars)

	Note	2015	2014	2013	2012
Retail sales	1	$ 267.6	$ 276.1	$ 273.3	$ 278.8
Cost of sales		$ (158.8)	$ (159.1)	$ (158.2)	$ (158.4)
Margin		$ 108.8	$ 117.0	$ 115.1	$ 120.4
Other income (leases)	1	$ 201.2	$ 189.3	$ 187.4	$ 193.0
Selling, general and admin		$ (191.3)	$ (186.5)	$ (186.0)	$ (190.2)
Operating income		$ 118.7	$ 119.8	$ 116.5	$ 123.2
Finance costs		$ (17.7)	$ (18.5)	$ (19.0)	$ (19.4)
Earnings before income tax		$ 101.0	$ 101.3	$ 97.5	$ 103.8
Income tax expense		$ 20.2	$ 20.3	$ 19.5	$ 20.8
Net earnings for the year		$ 80.8	$ 81.0	$ 78.0	$ 83.1

Phoenix Risen Incorporated – PRI
PRI Consolidated Statement of Comprehensive Income – Excerpt

	2015	2014	2013	2012
Margin	$ 371.20	$ 371.60	$ 367.00	$ 374.60
Operating income	$ 241.28	$ 241.54	$ 238.55	$ 243.49
Earnings before income tax	$ 129.92	$ 130.06	$ 128.45	$ 131.11
Net earnings for the year	$ 103.94	$ 104.05	$ 102.76	$ 104.89

<u>Notes</u>

1 – Retail revenue is recognized upon delivery of goods to the customer.

Lease revenue is recognized over the course of the lease as earned. Commissions on lease revenues are estimated and included in revenues as earned, with any adjustments to actuals being recorded when known. No lease revenue is recognized for retail space occupied by Phoenix stores.

Exhibit 4
Extracts from Phoenix Financial Statements

Phoenix Incorporated
Balance Sheet
As at December 31
(millions of Canadian dollars)

Assets	Note	2015	2014	2013	2012
Cash		$ 3.3	$ 2.4	$ 2.5	$ 3.1
Trade and other receivables		$ 5.1	$ 4.7	$ 5.5	$ 4.6
Inventories	1	$ 67.6	$ 61.8	$ 64.5	$ 59.7
Other current assets		$ 2.3	$ 1.7	$ 3.5	$ 2.8
Total current assets		$ 78.3	$ 70.6	$ 76.0	$ 70.2
Property, plant and equipment	4	$ 852.3	$ 832.1	$ 825.7	$ 828.9
Intangible assets	1	$ 15.8	$ 15.3	$ 16.0	$ 16.5
Pensions and employee benefits		$ 2.6	$ 3.2	$ 4.1	$ 3.8
Deferred tax assets	3	$ 15.0	$ 15.0	$ 15.0	$ 15.0
Total assets		$ 964.0	$ 936.2	$ 936.8	$ 934.4
Liabilities and shareholders' equity					
Line of credit		$ 1.5	$ 2.1	$ 1.4	$ 1.9
Loans and borrowings	2	$ 14.0	$ 14.0	$ 14.0	$ 14.0
Trade payables		$ 51.8	$ 57.5	$ 49.8	$ 53.2
Other payables and accrued liabilities		$ 18.3	$ 27.6	$ 24.5	$ 23.9
Deferred revenue		$ 7.5	$ 9.0	$ 8.5	$ 7.8
Provisions		$ 5.9	$ 6.8	$ 6.4	$ 6.7
Income taxes payable	3	$ 0.8	$ 7.0	$ 9.5	$ 8.3
Total current liabilities		$ 99.8	$ 124.0	$ 114.1	$ 115.8
Loans and borrowings	2	$ 332.5	$ 346.5	$ 360.5	$ 374.5
Provisions		$ 0.9	$ 1.7	$ 2.3	$ 1.4
Employee benefits		$ 4.8	$ 5.1	$ 4.9	$ 5.2
Other liabilities		$ 6.0	$ 8.1	$ 7.5	$ 7.9
Total liabilities		$ 444.0	$ 485.4	$ 489.3	$ 504.8
Shareholders' equity					
Share capital		$ -	$ -	$ -	$ -
Retained earnings		$ 520.0	$ 450.8	$ 447.5	$ 429.6
Total shareholders' equity	5	$ 520.0	$ 450.8	$ 447.5	$ 429.6
Total liabilities and shareholders' equity		$ 964.0	$ 936.2	$ 936.8	$ 934.4

Phoenix Risen Incorporated – PRI Consolidated
PRI Balance Sheet – Excerpt

Cash	$ 23.3	$ 21.4	$ 24.5	$ 21.1
Total assets	$ 1,631.6	$ 1,603.8	$ 1,604.8	$ 1,600.0
Total liabilities	$ 565.2	$ 628.8	$ 624.8	$ 650.1

<u>Notes</u>

Note 1:
Inventory: Inventories are valued at the lower of cost and net realizable value. Cost is determined, for the majority of inventory, using the weighted average cost method, based on individual items. Net realizable value is the estimated selling price determined at the item level using historical markdown rates for similar items in the ordinary course of business, less estimated costs required to sell.

Intangibles: Trade names with indefinite lives are measured at cost less any accumulated impairment losses and are not amortized.
Intangibles with definite lives are amortized straight-line over their useful life. Amortization taken in 2015 totals $1,300,000.

Note 2: Long-term loans and borrowings are mortgages on malls and retail locations. Interest is payable at the rate of prime minus 1%. Property, plant and equipment have been pledged as security and there are no covenants on the mortgages. Weighted average cost of borrowing is 5% per annum.

Note 3: Phoenix uses the deferred method of accounting for income taxes. Deferred tax asset includes $15 million in capital losses from prior years, with the remainder being made up of temporary differences between depreciation and capital cost allowance.

Note 4: Property, plant and equipment are stated at historic cost less accumulated depreciation.
See PPE detail.

Note 5: Retained earnings includes changes in net income and other appropriate adjustments.

Exhibit 5
Phoenix Sales Information by Store

Store	Sales	COS	Margin	Margin prior year	Space owned/ leased	Square footage ('000s)	Lease rate	Location
	('000s of Canadian dollars)							
1	$ 24,165	$ 13,530	$ 10,635	$ 11,485	Owned	179	$75/sq. ft.	Toronto; street front in downtown attached to a major retail centre also owned by Phoenix
2	$ 26,750	$ 14,890	$ 11,860	$ 12,920	Owned	214	$50/sq. ft.	Vancouver; flagship store; street front in downtown, attached to a major retail centre not owned by Phoenix
3	$ 38,500	$ 21,050	$ 17,450	$ 18,435	Owned	275	$40/sq. ft.	Calgary; street front in downtown attached to a major retail centre also owned by Phoenix
4	$ 15,400	$ 9,650	$ 5,750	$ 6,410	Leased	140	$20/sq. ft.	Halifax; stand-alone store in a suburban shopping area
5	$ 13,755	$ 8,600	$ 5,155	$ 5,675	Leased	131	$25/sq. ft.	Regina; stand-alone store in a suburban shopping area
6	$ 18,620	$ 11,720	$ 6,900	$ 7,500	Owned	190	$40/sq. ft.	Edmonton; in a suburban shopping centre
7	$ 11,760	$ 7,400	$ 4,360	$ 5,430	Leased	105	$30/sq. ft.	Quebec City; in a suburban shopping centre
8	$ 22,720	$ 12,800	$ 9,920	$ 10,750	Owned	160	$40/sq. ft.	Montreal; street front in downtown attached to mall network
9	$ 17,500	$ 9,700	$ 7,800	$ 8,300	Leased	125	$35/sq. ft.	Edmonton; street front in downtown, attached to a major retail centre not owned by Phoenix
10	$ 14,672	$ 9,300	$ 5,372	$ 5,225	Owned	131	$25/sq. ft.	Winnipeg; suburban shopping centre
11	$ 18,900	$ 12,000	$ 6,900	$ 7,150	Leased	140	$35/sq. ft.	Toronto; stand-alone store in a suburban shopping area
12	$ 15,015	$ 9,475	$ 5,540	$ 5,970	Leased	165	$25/sq. ft.	Montreal; stand-alone store in a suburban shopping area
13	$ 16,200	$ 10,200	$ 6,000	$ 6,450	Leased	150	$35/sq. ft.	Saskatoon; in a suburban shopping centre
14	$ 13,635	$ 8,455	$ 5,180	$ 5,300	Leased	135	$20/sq. ft.	Moncton; standalone store in a suburban shopping area

A lease rate is provided for leased and owned stores. For owned stores, Phoenix does not pay rent. This is the amount that would have to be paid if leased from a third party. Selling and operating costs, not shown here, approximate 20% of sales for leased stores and 40% for owned stores. The operating costs include items such as maintenance, property taxes and utilities.

Exhibit 6
Property, plant and equipment

	Cost	Accumulated depreciation	Net book value
Buildings	$ 931,450,000	$ 654,715,000	$ 276,735,000
Leasehold improvements	$ 542,536,000	$ 206,163,680	$ 336,372,320
Fixtures and fittings	$ 428,156,000	$ 235,485,800	$ 192,670,200
Other	$ 95,462,000	$ 48,939,520	$ 46,522,480
	$ 1,997,604,000	$ 1,145,304,000	$ 852,300,000

Buildings have a fair market value of $1,661 million. All other property, plant and equipment have a fair market value that approximates book value.

Exhibit 7
Real estate

Capital expenditures required	Planned improvements		Cost	Increase in sales
Toronto retail centre	2017	$	27,000,000	25%
Vancouver building	2016	$	2,400,000	20%
Calgary retail centre	2016	$	13,000,000	25%
Montreal store	2018	$	1,000,000	15%
Winnipeg mall	2019	$	30,000,000	20%

*If lease and buyback utilized, capital expenditure required by Phoenix would be $1.2 million.

Remaining mortgage		Balance		Annual payment	Balloon payment due
Toronto retail centre	$	100,000,000	$	5,000,000	2017
Vancouver building	$	-	$	-	-
Calgary retail centre	$	112,000,000	$	4,000,000	2033
Montreal store	$	530,000	$	60,000	2018
Edmonton mall	$	100,000,000	$	5,000,000	2029
Winnipeg mall	$	20,000,000	$	-	2016
Total	$	332,530,000	$	14,060,000	

Long-term loans and borrowings are mortgages on malls and retail locations. Interest is payable at the rate of prime minus 1%. Property, plant and equipment have been pledged as security, and there are no covenants on the mortgages. Weighted average cost of borrowing is 5% per annum.

Balloon payments are required to be paid at the end of the year in which they become due.

	Store makeup	Historic cost	Tenant commission rate*	Total tenant revenue
Toronto downtown building w/retail centre owned by Phoenix	Mixed retail centre with mid-high end shops	$ 120,000,000	1.0%	$ 900,000,000
Vancouver downtown building	N/A	$ 10,250,000	N/A	
Calgary downtown building w/retail centre owned by Phoenix	Mixed retail centre with mid-high end shops	$ 300,000,000	1.5%	$ 1,300,000,000
Montreal downtown building	N/A	$ 1,200,000	N/A	
Edmonton mall	Low-mid end shops	$ 375,000,000	0.5%	$ 1,400,000,000
Winnipeg mall	Mid range shops	$ 125,000,000	0.5%	$ 120,000,000

*Mall tenants pay a flat rate plus a percentage of revenues to Phoenix as part of their lease agreement.

Exhibit 7: Real Estate Addendum

Real Estate/ Mall/Retail Location	FMV	Balloon Payment For Mortgage
Toronto retail centre	$ 600,000,000	$ 95,000,000
Vancouver building	$ 157,500,000	$ -
Calgary retail centre	$ 500,000,000	$ 40,000,000
Montreal store	$ 3,500,000	$ 410,000
Edmonton mall	$ 300,000,000	$ 50,000,000
Winnipeg mall	$ 100,000,000	$ 20,000,000

Any increase in sales is 50% realized in Year 1, 80% in Year 2 and 100% in Year 3 and beyond.

Exhibit 8
Financing Options

	Term loan	Unsecured debenture
Amount	As needed	As needed
Loan period	10 years	10 years
Interest rate	6%	8% (Issue and YTM)
Payment requirement	Monthly - blended	Semi-annual coupon (June 30, Dec 31)
Collateral	PPE - buildings	None
Covenants	Current Ratio 1.00	None
	Debt-to-equity 1.20*	None

*Debt includes all liabilities.

Exhibit 9
Phoenix Flagship Store Lease Opportunity

Word of Phoenix considering closing its Vancouver flagship store spread recently, with Martina acknowledging the high cost of Vancouver real estate.

When this reached the ears of the CEO of the shopping centre Phoenix is physically connected to, alarm bells went off. While Phoenix is not a part of the mall, it does access it. Foot traffic from Phoenix therefore drives foot traffic in the mall itself. The possibility of the store being leased to another retailer could impact the mall's overall profitability if the new retailer did not align with the mall's clientele or did not draw foot traffic the way the current Phoenix store does.

The Vancouver Phoenix flagship store is a high-end shopping mecca. It was the first major department store in Vancouver and the primary store of Phoenix for many years. The store sees an average of 50,000 shoppers per week. Of these shoppers, approximately 50% continue on to the mall itself visiting on average three stores each. The conversion rate from foot traffic to sales in the mall is at approximately 20% with the average sale being $72.

The CEO of the shopping centre has proposed a solution to entice Phoenix to stay. He is willing to purchase the building from Phoenix and lease it back to them at an annual cost of $50/sq. ft. He would also cover 50% of the $2.4 million upgrade that Phoenix believes is needed for the store. The lease would have an initial term of 10 years and would be renegotiated after that. He is willing to offer fair market value to purchase the store.

Exhibit 10
Sparky Limited Acquisition Opportunity

Sparky Limited sells an assortment of general merchandise in its stores. Its goal is to provide trendy products to an ever-demanding consumer. Sparky recognizes the needs of young consumers who want to have all the latest fashion and home goods but who do not have the income to purchase high-end products. They fill the need of offering the same style of products but at a reduced cost.

Sparky is a privately held company founded and controlled by Charles Snookers. The company has 140 stores across Canada and the northeastern United States, largely in mid-priced shopping malls averaging 100,000 square feet per store. The shopping environment is very hip with the latest fashions displayed in eye-catching ways.

Sparky has a large online retail presence. All products can be purchased online and shipped to the consumer's home address. Approximately one-third of its sales occur online, which has been a major reason for the prominence of the brand. Sparky was the first general merchandise store in Canada to launch online shopping and achieve the traction to make it a success. This made it extremely popular with people outside of urban centres who cannot access the retail locations as easily, as well as those who simply like the convenience of goods being delivered to their door. Standard shipping on orders over $25 is free to the consumer.

2014 was Sparky's best year ever. It paired with a top celebrity designer and really tapped into the young professionals market — attracting consumers who are drawn to higher-end products but, at the beginning of their career, cannot yet afford them. It saw an increase in revenues in stores of 5% and online of 7% as a result of a major marketing push to this demographic. The cost of the campaign was $45,000.

In 2015, Sparky had a security glitch that allowed customer credit card information for online shoppers to be accessed by hackers. No actual fraud was committed by the hackers — they simply wanted to prove they could do it and they did! But this was extremely problematic and caused significant reputational damage to the store, with sales dropping initially by 23%, though they have since started to recover only moderately. To date, approximately 50% of the lost sales have been recovered. In addition, there was a class action suit filed against Sparky by irate consumers. The case is waiting to move forward and there is no indication yet as to how it will be settled.

The IT security breach has since been patched and the system is now secure. The costs of the patch were capitalized in the current year; however, the increase in technology costs on the income statement was a result of additional work performed in-house related to the breach. These costs will continue in the future to ensure that no further security issues occur.

Charles Snookers is a shrewd businessman. In starting Sparky his goal was to maximize profits. The products at Sparky are trendy and loved by consumers but, in order to achieve the look consumers desire at a price they can afford, most products are produced overseas. Sparky has many “exclusive to Sparky” labels, which are largely made in China and thus able to provide lower costs than what Canadian manufacturers can supply.

Sparky maintains a largely part-time employee base in order to limit the need to provide employee benefits. Charles has not been opposed to high employee turnover and finds it a good way to keep hourly wages low. Sparky’s employees have been trying to unionize for the past year. They argue that hours are very unstable and they need more job security and consistent full-time hours. At present, it is unclear if a union will form, but if Sparky wants to prevent this, it will need to look at how to improve employee satisfaction. Either way, i.e., the creation of a union or taking the steps necessary to avoid one, there would be an expected increase in employee wages and benefits of 20%.

Mr. Snookers has approached Phoenix with an offer to sell. Recent sales in the industry have been at 15 to 20 times EBITDA. Mr. Snookers believes this works for Sparky and would be willing to sell for a price of $1.8 billion. The price was set based on prior year earnings at the high end of the range due to the popularity of Sparky. Although 2015 was admittedly a much lower earning year, Mr. Snookers is adamant that it was a blip and Sparky will have no trouble returning to its previous earning levels; therefore, the purchase price should reflect as much.

If Phoenix were to acquire Sparky, Mr. Snookers would retire. He is very hands-on and is a senior person with significant retail experience. He would likely need to be replaced and currently draws a salary that reflects market rates.

Sparky’s IT system software was developed in-house. It has been used for Sparky’s online sales for five years. The website is extremely user friendly, allowing customers to easily find products and purchase them with little hassle and retyping of information. The IT system additionally links directly into Sparky’s inventory and accounting systems, reducing errors throughout.

Always looking to make money, Mr. Snookers has indicated that, in the event Phoenix is not interested in purchasing Sparky, he would be happy to allow for the purchase of a copy of Sparky’s software. However, Mr. Snookers is more interested in selling the company than in licensing the software.

Sparky Limited Acquisition Opportunity
Sparky Limited
Statement of Comprehensive Income
For the Year Ended December 31
(thousands of Canadian dollars)

		2015		2014
Retail sales	$	1,020,723	$	1,200,850
Online sales	$	394,748	$	563,925
Cost of merchandise	$	(1,026,216)	$	(1,263,579)
Margin	$	389,254	$	501,196
Fulfillment costs	$	31,580	$	45,114
Technology	$	40,697	$	37,668
Employee wages and benefits	$	89,009	$	90,432
Amortization	$	20,878	$	20,477
General*, administrative & other**	$	208,087	$	252,503
Earnings before income tax	$	(997)	$	55,002
Income tax expense	$	(279)	$	15,401
Net earnings	$	(718)	$	39,602

* Includes $45,000 of supplemental advertising in 2014
** Includes $15,000 of interest in 2015 and $18,000 of interest in 2014

Excerpts from notes to the financial statements

1. Sparky's financial statements are prepared in accordance with accounting standards for private enterprises (ASPE).

2. Revenues

Retail revenues are recognized at point of sale. Sales are made either on a cash basis or with a credit card, and there are no collection concerns. No allowance for returns is established. Returns are removed from sales in the period that they are returned.

Online sales are recognized at time of shipping. Shipments are normally made within one and two days of the online order.

Fulfillment costs

Fulfillment costs relate to the inventory storage costs for online orders, and the packing and shipping of these orders. All order fulfillment costs are expensed in the period incurred.

3. Technology

Significant technology costs include maintaining a team of IT personnel who perform regular maintenance as well as continuous security testing.

Other financial data

1. The capital expenditures related to maintenance of assets such as buildings and IT infrastructure are $20 million with a $2 million tax shield.
2. The present value of the tax shield on the existing assets is $15 million.
3. Total interest-bearing debt at the end of 2015 was $205 million.
4. The terminal growth rate is estimated at 2%.

Sparky's IT System

Sparky's online sales system allows customers to easily browse through a large selection of items. The system is linked to the perpetual inventory records, so customers are able to see if an item is in stock online and to check if it may be in stock at their local store. Sparky has found that many of its in-store customers have first looked at items online to assess features, compare to other products and check availability. This feature adds a lot of value for the customers.

The website allows customers to provide reviews on items by entering a name and filling out a comment box. Sparky has had some trouble with trolls, those who fill out reviews to advertise their own websites or to cause distractions from the other products. To address the issue, reviews can now only be provided by people who have created a customer profile on the site.

Customer profiles must also be completed to purchase items. Customers must provide their name, address and email address. Emails need to be confirmed, and the customer must receive the email in their inbox and click on a link to activate the account. Only active accounts can proceed through checkout. Customers have the option of including their credit card in their profile for ease of purchase, and many do since it facilitates future orders.

When an online sale occurs, customers must log in and confirm their billing address. The billing address postal code must match the postal code of the credit card used. This check is performed as part of the credit card authorization process. Customers enter the shipping address or select if it is the same as the billing address. They then select the preferred shipping method and enter their payment information. When the order is submitted, the credit card is cleared for authorization and the order is approved. At this time, a confirmation email is sent to the email account of the customer profile.

The system interfaces with Sparky's inventory and sales records. When an item is shipped, the transaction closes in the online sales system. The transaction is immediately recognized as revenue, the item is removed from inventory and COGS is recorded. Items purchased but not yet shipped are not removed from the accounting system but are marked as not available in the online system module. Since the system was custom designed for Sparky, this interface is seamless. Some work would need to occur to adapt the interface to a different system. Physical inventory counts are performed on a cyclical basis to confirm that the perpetual inventory is correct. Where the inventory is warehoused with tight controls, there is a low theft risk and inventory records are usually up to date with little adjustment required.

Security is an increasing risk for the system. Recently a security breach involved a hacker getting into Sparky's system. This allowed the hacker access to the stored credit card information. To prevent this access in the future, Sparky has installed extra security measures around the credit cards including additional firewalls on its system and improved encryption.

Sparky developed its IT software in-house over several years. It does not have a significant recorded value in the financial statements.

Exhibit 11
Phoenix E-Commerce

The following is information gathered by Jennifer.

The process of creating an e-commerce system for Phoenix is expected to take one year to implement until the website is live.

The online system will cost $10 million to set up with annual costs of $1 million to update and upgrade annually.

Initial net working capital investment required will be $19 million plus an additional $1 million annually.

Each store will require a section to be allocated for prepping and shipping products. The reorganizing and refurbishing of each store's back-room storage area will cost $75,000 per store. This section will not impact the retail floor space; however, an improvement in inventory organization is expected.

In order to successfully bring awareness to the new e-commerce side of the business, Phoenix will have to launch an aggressive marketing campaign at a cost of $5 million and $1.5 million annually thereafter.

Phoenix will outsource the order processing, fulfillment and shipping to a third party. They will operate out of the assigned space within each store. The cost will be 10% of online sales and a $5 shipping charge per order. Phoenix will only ship to Canadian customers.

Average online weekly visits are expected to be 280,000 in year 1 and to grow at 5% annually. Conversion rate is expected to be 10% in year 1 of operations, 15% in year 2 and 20% thereafter. Average order is expected to be $65. Incremental operational costs are expected to be $200,000 annually; this will cover additional support functions such as accounting, marketing and legal.

Cost of goods sold will be consistent with current retail sales. Seventy per cent of the incremental margin will be due to new customer purchases, while 30% will be due to current in-store customers switching to online shopping. Annual IT maintenance is expected to be $500,000.

Due to increasing concerns regarding IT security, Phoenix will have an annual cost of $300,000 for security system audits.

Exhibit 12
Cinder's Market Outlook

Cinder is a budget shopping alternative for the consumer who demands competitive pricing and a large array of general merchandise. A mass merchandise retailer, Cinder focuses on providing low-cost options to the Canadian market on a wide selection of household goods, while maintaining the same values as the entire PRI family.

The mass merchandise market has been dominated for quite some time by discount retailers competing on price. That competition has most recently been raised as a result of large grocery retailers expanding their product lines to include home goods, clothing, toys and other general merchandise. The large discount retailers have reacted by bringing groceries into their stores. Consumers are now able to choose whether to shop at a full-service grocery store with a wide range of general merchandise, or a full-service mass merchandiser with a wide range of everyday grocery items.

Cinder's focus on small towns has meant that, historically, they have been the primary choice for general merchandise for Cinder's market. Small towns tend to have one primary shopping area and, traditionally, have not had the capacity for numerous large retailers. The shift in the large grocery stores to carry general merchandise means that, for many of the locations where Cinder exists, one of the main grocery stores in town is now competing for the general merchandise market as well.

Cinder's profile is as follows:

Number of stores:	75
Average town population:	10,000
Average consumer age:	53 years
Average store size:	120,000 sq. ft.

Standard departments: Clothing, Pharmacy, Bedding and Bath, Kitchen, Small Appliances, Outdoor/Seasonal, Baby, Toys, Electronics and Entertainment, Sports and Recreation, Home and Pets.

The Home section has always included a small grocery section that provided dry snacks and other prepackaged goods, such as candy and granola bars. Additionally, at the front of the store, convenience items like pop and small containers of milk are displayed in refrigerators.

Adding a grocery department

George has gathered the following data for adding a full grocery department to the Cinder chain:

1. The grocery department will utilize 15% of the total store square footage with a margin of 13% of sales.
2. The new department cannot cannibalize more than 25% of the square footage of any existing department.
3. Slow-moving products will be eliminated first; as a result, the lost margin on the cannibalized square footage will be 10%.
4. The new department will improve traffic resulting in a 20% expected overall increase in store sales.
5. The expected grocery department sales are projected to be $1.115 million annually per store.
6. Expected operating costs will increase by $350,000 annually per store.

Department	Allocated square footage (%)	Revenue ('000s)	Cost ('000s)	Margin ('000s)
Clothing	15%	1,467.00	885.00	582.00
Pharmacy	8%	1,093.00	685.00	408.00
Bedding and Bath	5%	889.00	699.00	190.00
Kitchen	10%	933.00	745.00	188.00
Small Appliances	15%	887.00	635.00	252.00
Outdoor/Seasonal	12%	1,095.00	745.00	350.00
Baby	7%	1,020.00	802.00	218.00
Toys	10%	1,324.00	945.00	379.00
Electronics and Entertainment	5%	1,214.00	892.00	322.00
Sports and Rec	7%	1,011.00	745.00	266.00
Home and Pets	6%	1,067.00	899.00	168.00
		12,000.00	**8,677.00**	**3,323.00**

Exhibit 13
Canadian Parka Supplier

Since the early days of operations, Phoenix has sold a "Canadian Parka" that is recognizable as belonging to the Phoenix brand. From inception, it has been manufactured by Polar Tradition Inc. It is now time to renew the manufacturing contract, and an alternative manufacturer is vying for Phoenix's business. Winter Gear Ltd. has committed to providing the same quality of jacket at a much lower cost.

Polar Tradition Inc.

- Manufacturer of Phoenix's Canadian Parka since inception.
- 95% of the products manufactured by Polar Tradition are for Phoenix.
- Located in Yellowknife, NWT.
- Polar Tradition supports 50 direct employees, excluding suppliers of its materials.
- Coats manufactured are of high-quality Canadian-sourced synthetic materials.
- Coats are designed to be extremely warm but breathable while maintaining a sense of fashion.

Polar Tradition Inc. is a small operation with limits on capacity due to its manufacturing approach, which sources local materials and employs traditional craftspeople. While it does sell some coats locally under its own brand, 90% of its revenue comes from Phoenix, and it depends on this. Local sales are also at a reduced margin to support the community in which Polar Tradition operates.

Winter Gear Ltd.

- Manufacturer of several significant brands of coats, similar in appearance to Phoenix's Canadian Parka.
- Head office is located in Toronto, Ontario. Manufacturing would occur in China.
- Labour would not be dedicated specifically to Canadian Parka. Increased task specialization of employees working on multiple brands and increased automation would allow for reduced costs.
- The company will not disclose the sources for their materials.
- Coats would maintain the same design.

The rights to the design of the coat are held by Phoenix, and the change in manufacturer would not impact the appearance of the coat.

The Canadian Parka retails for $950. Polar Tradition Inc. supplies the parka at a wholesale cost of $600 and makes a profit of $200 per coat.

Winter Gear has put in a bid to provide the coats to Phoenix for $400 per coat.