CPA CHARTERED PROFESSIONAL ACCOUNTANTS PEP

CPA COMPTABLES PROFESSIONNELS AGRÉÉS PFP

Capstone 1 – Sample Case

Sample Candidate Response – Part 3

Recipient: Board of Directors, Rejuvenating Spa Inc.
Author: Rubinoff & Rubinoff LLP
Date: June 27, 2015
Re: Strategic Plan of Expansion

Chartered Professional Accountants of Canada, CPA Canada, CPA
are trademarks and/or certification marks of the Chartered Professional Accountants of Canada.
© 2016, Chartered Professional Accountants of Canada. All Rights Reserved.

Les désignations « Comptables professionnels agréés du Canada », « CPA Canada » et « CPA »
sont des marques de commerce ou de certification des Comptables professionnels agréés du Canada.
© 2016 Comptables professionnels agréés du Canada. Tous droits réservés.

05/01/16

Executive Summary

Rejuvenating Spa Inc. (RSI) is a privately owned day spa located in downtown Halifax, Nova Scotia that offers affordable massage and spa services to its clients. With plans of expansion, RSI purchased Lavish Spa Inc. (Lavish), a high end hotel spa that offers a complete selection of innovative spa services in 2014. RSI and Lavish both experienced growth in revenue and profit in the past year, and as such, the shareholders believe that now is a good time to expand further. The CEO, Sally Rice, has been tasked with managing this future expansion while also consolidating RSI and Lavish.

The success of the spa industry depends highly on the state of the economy due to spa visits being viewed as a luxury service. Since the 2008 financial crisis, 2012 is the first year that the number of spa establishments has increased. Looking forward, spas are overall confident that revenues will increase into the foreseeable future. Thus, opportunities exist for RSI to expand and capture market share in the spa industry. In addition, RSI needs to take initiative in capitalizing on the upward trend for healthy lifestyle before its competitors. Internally, RSI's corporate structure can be improved by joining with Lavish to present stronger financial statements. Additionally, since the two spas have similar support functions such as admin and accounting, joining the two companies can help RSI to realize cost savings in these expenses.

As a result of our analysis, we recommend RSI to:

1. Perform a financial consolidation and partial operational consolidation with Lavish
2. Pursue the partnership with Forevermore Fit Limited in Massage Therapy Centres (MTC)
3. Franchise RSI pending the successful launch of the MTCs
4. Forgo the opportunity to purchase Pure Substance Inc.

These recommendations will help RSI to achieve growth in profitability within the next 5 years and provide returns back to its shareholders.

Table of Contents

Introduction 5

Assess the Situation
Internal Environment Scan
a) Vision and mission 5
b) Goals and Stakeholder Preferences.. 6
Financial Analysis..6
External Analysis... 9

Major Issue Identification

Analyzing the Major Issues
Issue #1 Consolidation of RSI and Lavish.. 9
Issue #2 Franchising... 10
Issue #3 Partnership with FFL... 11
Issue #4 Acquire Pure Substances Inc... 13

Conclude and Advise
Decision Criteria... 14
Recommendation... 15
Financial Forecast and Financing... 15
Operational Issues... 16
Updated Mission and Vision..18
Balance Scorecard... 18

Conclusion.. 21

Appendix A – RSI Consolidated Financial Statements... 22
Appendix B– RSI Consolidation...25

Appendix C – RSI and LSI Financial Ratios 26

Appendix D – RSI Franchise 28

Appendix E – FFL 29

Appendix F – Pure.. 32

Appendix G – Implementation Plan 35

Appendix H – Financial Forecast Franchising...36

Appendix I – Financial Forecast...38

Appendix J – Balance Scorecard 40

Bibliography 41

INTRODUCTION

The purpose of this report is to discuss Rejuvenating Spa Inc.'s (RSI) strategic options and how it should proceed in order to meet its goals. This analysis will provide the management team with a clear understanding of RSI's current situation, analyze the strategic options available to the company and provide a recommendation on how to proceed.

INTERNAL ENVIRONMENT SCAN

Vision and mission:

Overall, the company's current vision and mission statements are as follows:

Vision: "To provide exceptional client-centred spa services in an atmosphere that is relaxing and in a manner that is environmentally friendly and sustainable."

Mission: "To provide professional quality services while developing relationships with our clients, our community and the environment."

RSI
"Our mission is to run a profitable business by providing affordable massage and other spa services in a warm and welcoming environment. We offer a variety of massage services, including deep tissue massage, sports massage and Swedish massage, as well as facials, body treatments, manicures and pedicures. Our staff is professionally trained. We provide individualized treatments tailored to our clients' needs, and clients are encouraged to provide feedback to help us improve our services and to encourage repeat business and referrals. We are mindful of the overall experience and use quality products. We aim to be respectful of the environment."

Lavish
"Our philosophy focuses on creating an atmosphere to help rebuild your strength, recapture your energy and reflect on what's truly important in your life. Taking time for you is crucial; otherwise, your health, family, work and spiritual needs will suffer. We're proud to offer you what your body and spirit need most: relaxation, revitalization and a chance to heal from the intensity of your daily routines. A visit to Lavish Spa is an investment in yourself and your future well-being. We provide you with the latest in treatments and the highest quality in products. By means of innovation, the passion of our employees, exceptional personalized service in a truly regenerating environment as well as informative teaching on wellness and prevention, we provide you with the pampering you truly deserve to improve your overall health and well-being."

A vision statement should define what an organization aspires to be, while a mission statement should cover the following elements of the organization:
- main purpose

- target market
- value proposition
- competitive posture

The missions of the spas are compatible with the overall vision. However, there are some differences:
- Lavish's mission does not reference the environment.
- Lavish and RSI do not include developing a relationship with the community.
- RSI appears focused on affordable services and health benefits.
- Lavish's focus is on "escape" and "pampering."

Key success factors:

- convenient location and clean facilities
- offers up-to-date and unique services
- uses only quality products
- competitive pricing
- good reputation

Goals and stakeholder preferences:

- Only three shareholders are actively involved in the business and regularly attend shareholder meetings. However, there are 10 shareholders in total who will vote on making major business decisions.
- Stakeholders disagree over the direction in which the company should proceed.

FINANCIAL ANALYSIS (appendices A to C)

Financial statements for RSI and Lavish have been prepared for income tax purposes and shareholders' use only. They have not been prepared in accordance with ASPE. There will be financing required for the growth initiatives, and ASPE financial statements and consolidated statements are now required.

RSI financial statements:
- Capital assets: CCA used, versus ASPE requirement to use a systematic and rational basis over expected useful life.
- There is a potential write-down of inventory.

Lavish financial statements:
- No accrual for loyalty program — it appears there should be a liability set up.
- There is a potential write-down of inventory.
- Contingent liability issues.
- Website — it does not appear it is being amortized and ASPE requirements are not considered.

Consolidated financial statements:

In preparation of the consolidated financial statements:

- Assets should be recorded at fair value at acquisition date, including intangibles.
- Intangible assets: customer list ($100,000), brand ($100,000), preferential lease ($320,000). Amortization should also be included.
- Fair value of liabilities (including contingent liability).
- Goodwill is approximately $493,996.

Analysis of financial statement ratios:

- Liquidity

  Both RSI and Lavish have acid (quick) and current ratios below 1. This is largely due to the current portion of long-term debt of each company. Lavish has a cash current debt coverage of 1.8 (1.7 in 2014), and RSI has a cash current debt coverage of 1.1 (0.8 in 2014). Despite the negative working capital and related ratios, it does not appear that either company has a liquidity problem. Both companies' positions significantly improved in 2014 compared to the prior year. They both generate significant cash flow from operations.

  Accounts receivable turnover and collection period appear good for both companies. RSI's collection period is longer, but this appears to be tied to insurance billings. RSI's insurance accounts for 2015 are up 50% over the previous year. This should be investigated to see if problems with the process are developing.

  Inventory appears to be a potential concern as it accounts for approximately 42% of current assets for RSI and 50% for Lavish. The turnover of 2.0 for RSI down from 2.4 in the previous year equates to 182.5 days in inventory. Lavish's turnover in 2015 was 3.3, down from 3.6 the previous year.

  Both companies appear to have strong cash flow generation.

  Lavish generated approximately $160,000 from operations in 2015. It invested much of this on equipment and in updating and adding to the functionality of its website. Lavish made net payments on debt of $50,000 and paid almost $100,000 in dividends to RSI. Free cash flow in 2015 was $62,100.

  RSI generated approximately $204,000 from its own operations and received almost $100,000 from Lavish (in the form of dividends). It invested $19,000 in equipment, made debt payments of just over $100,000 and paid almost $95,000 in dividends to its shareholders.

- Solvency

  Times interest earned ratio for Lavish was 7.3 and 6.4 for 2015 and 2014, respectively, while RSI's ratio was 3.1 and 1.4 for the same years. These ratios appear strong. Cash total debt coverage ratios indicate a high level of debt, as do the debt-to-total assets ratios.

  RSI's ratios reflect the interest on and the debt used to purchase the shares of Lavish.

  Both companies have a debt-to-asset ratio of close to 70%. This may make additional borrowing a challenge. The shareholders appear to understand that they will need to make additional investment themselves as part of the funding for the expansion plans.

- Profitability

  Both companies are very profitable, with strong gross profit margins, profit margins and return on assets.

- Financial strength

  Overall, RSI appears to be in strong financial health and, with the note above on the need for equity injection, should be in a good position to embark on a growth strategy as planned.

Quantitative constraints

Bank loan — $15 million available at a rate of prime (variable) plus 2.5% with a flat 0.5% fee on the amount borrowed. To receive a loan from the bank, RSI would need to meet the following conditions:

- Financial statements prepared in accordance with ASPE.
- Audit if debt exceeds $10 million; review is otherwise acceptable.
- Debt to equity maximum 1:1.
- Debt to assets maximum 1:2.
- No payouts to shareholders if interest coverage ratio is below 10 times.
- Bank may demand payment in full immediately in the event of default on payments.

Private loan with Blair Cummings — would offer RSI more room to negotiate rates, fees, repayment terms and other requirements.

Shareholder investment — if the private loan is taken, the shareholders will need to invest a significant amount to fund the expansion, as this option will likely provide fewer funds than the $15 million the bank can provide. As well, additional shareholders may be needed.

EXTERNAL ANALYSIS

Refer to Appendix D for SWOT and Appendix E for PESTEL analyses. The two analytical tools present a variety of internal and external points that will be used in the analysis of the feasibility of the strategic options.

MAJOR ISSUE IDENTIFICATION AND ANALYSIS OF STRATEGIC OPTIONS

The main issue that the board faces is how to expand RSI's operations and grow profitability in the future.

Strategic option #1: Consolidation of RSI and Lavish

The board is looking to consolidate RSI and Lavish operations under one brand identity as an opportunity for expansion.

Pros:

- Consistent with Sally's mandate to bring the two spas together under one brand identity and administration.
- The two operations have different visions and missions. Consolidating will strengthen the company by providing a cohesive strategy.
- Consolidation will result in cost savings (i.e., reducing employees) in administration, accounting, information systems and banking expenses. RSI can leverage Lavish's existing website and social media presence to market the joint operation.
- One company establishes a centralized decision-making structure for RSI going forward. This helps with expansion plans in case quick decisions have to be made.
- Consolidated financial statements present a stronger view of the company, making it easier to acquire funding and meet covenants. Bank financing terms also require consolidated financial statements under ASPE.

Cons:

- Lavish's manager is opposed to joining operations other than admin as the two companies' operations are different; the staff at Lavish could lack experience and skills to perform RSI's banking and accounting tasks, and vice versa. It is difficult to join the two reservation systems, as training and downtime are needed; this could result in loss of customers and decreased staff satisfaction.
- Lavish currently has an employee bonus program whereas RSI does not. The joint operation will need to implement a company-wide bonus program in order to

maintain fairness. RSI will risk losing former Lavish employees, if the bonus program is not as lucrative.

- The two companies currently have different accounting policies (i.e., AR, depreciation of equipment); thus it is difficult to integrate the accounting operations. Joint accounting policies under ASPE need to be agreed upon for the consolidated company.

- The two companies have different client base, services and atmosphere, allowing them to serve a diverse range of customers.

Quantitative analysis (appendices A-C)

The consolidated financial statements demonstrate that the two operations are more profitable individually than combined. This is primarily due to the financial treatment of amortization of intangible assets if the two companies are combined.

There is room for savings if the operational expenses are combined, such as administration and marketing.

Financing requirements

The financing requirements will be minimal. Investment will not be needed for this strategic option. All costs can be considered part of the cost of doing business.

Strategic option #2: Franchising

Developing a franchise of day spas modeled after RSI's operation and image is being considered by the board as an expansion initiative.

Pros:

- This strategic option is in line with the board's mandate for growth.

- Franchising is an effective method of capturing market share in a growing spa industry, which utilizes the capital of potential franchisees. Franchising allows RSI to expand into new geographical markets faster compared to financing the expansion itself.

- The majority of spas are individually operated single locations. RSI can capture market share by becoming a reputable brand name in the spa industry.

- Franchisees who are experienced in the spa industry may have knowledge of how to improve the operations of RSI. For example, the franchisees could have a highly popular treatment program that RSI can integrate into its own operations.

Cons:

- Franchisees may have different values than RSI, which could damage the brand's reputation. For instance, maintaining the same level of quality may be difficult for RSI to monitor across the franchises if it expands too quickly without proper controls established.

- The expansion may overwhelm the CEO of RSI, Sally Rice, who has no experience in managing an expansion of this magnitude. The other core shareholders, who are overseeing this expansion, have demanding full-time jobs. The initial stages of franchise expansion will require significant time investment in finding the right locations, establishing proper controls and procedures, and finding the appropriate sources of financing.

- RSI's location is ideal as it gets foot traffic from the surrounding areas. Ideal locations may not be available for all potential franchisees. Location is the most important determining factor in customers choosing a specific spa. Therefore, franchising may not be as lucrative as RSI perceives.

- The screening process for applicants can be time consuming and costly.

Quantitative analysis (appendices D-E)

The number of franchises required to break even with start-up costs is approximately eight; however, they do not all need to be opened in the first year. Ongoing costs can be covered with only five franchises. Franchise investment and profitability will depend on the number of therapists working at a location. Individual franchisee success is key to the success of this strategic option. Even with one therapist the franchisees will be profitable.

Financing requirements

The upfront costs of the franchise total $250,000 for operating manuals and marketing materials, plus $65,000 in costs for the first year's activity. This is not a large investment and RSI should be able to finance it. However, there may be costs it has not considered. This should be resolved before a final decision is made.

Strategic option #3: Partnership with FFL

A partnership with FFL would provide RSI with the opportunity for expansion by operating Massage Therapy Centres (MTC) in existing FFL fitness centres.

Pros:

- Allows RSI to expand its business without taking 100% of the risks, as some of the costs are shared or paid for by FFL. An example would be the rental space provided

by FFL as well as the initial financing for renovations at a rate that is lower than the bank rate.

- Allows RSI to access an existing customer base that is health conscious. This will allow RSI's new operation, MTC, to obtain greater exposure with FFL's customers. According to the industry trend, 74% of Canadians cited that convenient location is the reason for selecting a spa. This fits perfectly with MTC's strategy as the spa will be located within the fitness centres.

- RSI will have the opportunity to give its current therapists opportunities to train new therapists and create training manuals. This is aligned with RSI's goal to maintain staff retention by providing different opportunities and flexibility to its therapists.

- Provides diversity to RSI's current operations. This will assist with financial stability because if RSI's or Lavish's operations do poorly one year, the profits from the MTC partnership will help cushion the results.

Cons:

- RSI is not getting brand promotion through MTC, which is questionable considering the amount of resources RSI will be required to invest in this partnership. It would be in RSI's best interests to have an agreement with FFL that RSI's logo and name are visible at each location. This will help promote RSI's brand and business at its other locations.

- MTC's operations will depend significantly on FFL's financial stability and each FFL location's visitor volume. If some of FFL's locations become unprofitable and shut down, it is possible that RSI will lose its investment in this business. An audited financial statement from MTC in order to evaluate the financial stability of FFL is required.

- Additional expenses will be incurred based on the type of agreement set up by the two companies (partnership versus incorporation).

- Directors think this is an easy growth strategy with minimal involvement and risk, and no financing required; however, thorough due diligence must be performed by RSI to ensure that all information provided by FFL is correct and can be supported.

Quantitative analysis (Appendix E)

Profitability analysis was performed for both small and large centres. The projected first year profits are approximately 3x the initial year investment. However, it must be noted that the calculations may not be accurately provided by FFL and additional costs may need to be included as the operations start.

Financing requirements

This strategic option will require investment under $50,000 in financing from RSI for the first year. However, there is potential for a variety of additional costs that may impact the company, such as liability, tax implications, administrative costs, legal and more.

Strategic option # 4: Acquire Pure Substance Inc.

The purchase of Pure is an opportunity for RSI to grow profitability by acquiring a line of products already used by RSI.

Pros:

- Vertically integrating RSI's supply chain has the potential to reduce costs and improve efficiencies between RSI and Pure; gives control over value chain and costs while blocking access from competitors (key as 75% of product sales are supplied by Pure, and RSI and Lavish use Pure products almost exclusively).

- With the industry trending towards environmentally friendly products, RSI will now not only be able to say it sells these products, but also that it manufactures them, improving its brand image in the eyes of the growing environmental/health-conscious demographic.

- Growth potential through expansion into large retail chains that have expressed interest in carrying Pure products.

- Excellent opportunity to promote social and environmental responsibility by maintaining production of Pure's organic products in PEI while continuing and possibly growing Pure's current charitable work.

Cons:

- RSI has no experience in managing a manufacturing operation or expertise in the production of organic spa products. Acquisition could lead to increased costs if not implemented and operated properly.

- Increased foreign competition will put downward pressure on prices, hurting Pure's already falling profit margins.

- Costs to produce, specifically freight cost, relative to revenue have risen significantly.

- Matthew Chung wants the purchaser of Pure to keep operations in PEI, but the more profitable option may be to outsource production to a larger company. This raises significant ethical problems for RSI as Pure's management has made significant obligations to the staff.

Quantitative analysis (Appendix F)

In reviewing Pure's financial statements, the following observations can be made:

Revenue has been consistently decreasing over the last three years while COGS has been increasing. There has been a drastic decrease in cash between 2013 and 2014.

Financing required:

Range depending on purchase price and amount shareholders invest.

Ability of future earnings to cover interest on borrowing required to purchase the company, e.g., $6 million @ 6% = $360,000 per year.

DECISION CRITERIA

Strategic Option	Meets Vision and Mission (strategic fit)	Improves Brand Recognition	Meets Growth Target	Meets Constraints and Targets	Resources
Consolidate	☑	☑	☒	☒	☑
Franchise	☑	☑	☑	☑	☒
Partnership	☑	☒	☑	☑	☑
Acquisition	☒	☒	☑	☑	☒

The strategic options were ranked based on the following criteria:

- Meeting the vision and mission: The strategic option must be in line with the company's strategy and objectives.
- Improving brand recognition: The board would like to see the company grow. Further they would like to be in a position to sell RSI in the future. As such growing the company's brand recognition will improve both customer awareness facilitating growth and improve future company sale negotiations.
- Meeting growth objectives: The strategic option(s) implemented must be in line with the board's objective to grow the business.
- Meeting constraints and targets: The strategic option(s) must positively impact the financial results of the company. The bank has put specific covenants in place to ensure that the company remains financially viable. The option(s) selected must be in line with constraints and positively impact the company's profitability.

- Resources: RRI has limited resources in terms of management time. Only one shareholder is dedicated full time to managing the business.

RECOMMENDATIONS

The overall recommendations are to consolidate RSI's and Lavish's operations into one entity from a financial and operational perspective, but maintain the two brand names and spa styles; pursue the partnership with FFL; and franchise out RSI's brand on its own after one year pending on the success of FFL. These three recommendations combined will achieve the growth in profitability that shareholders seek.

As part of the consolidated entity, we recommend joining all support functions such as accounting, administration, information system and banking. We also recommend a standard employee bonus scheme for both RSI and Lavish employees (excluding franchisees and MTC).

The partnership with FFL is highly profitable and will be able to internally fund future expansions. In addition, the profits generated from the partnership can be used to minimize the debt required to fund the franchising expansion. As an agreement with FFL, the MTC's should be rebranded with RSI's name as well.

Although franchising takes advantage of the growing spa industry and has the potential to be lucrative, RSI should postpone franchising for at least one year to gain experience in their partnership with FFL. Currently RSI does not have the time or resources to ensure the success of the new franchises and there is a greater risk of the franchises causing harm to the RSI brand.

It is not recommended that RSI acquire Pure. Although this venture has the potential to be profitable well into the future while also diversifying RSI, the risks associated with the acquisition are too high. Purchasing a company that management has no experience operating, with deteriorating financials, at the same time RSI begins to roll out its franchise expansion and its partnership with FFL, is simply too much to take on. Pure owner, Matthew Chung, is looking for $8M-$9M when RSI's valuation puts the price tag significantly below that. Even if the owner were to drop his asking price to RSI's valuation, the time constraint, coupled with RSI management's inexperience, suggests that this opportunity is not in RSI's best interest.

Appendix G provides an implementation plan for the above outlined recommendation.

FINANCIAL FORECAST AND FINANCING

Financing Required	Year 1	Year 2
FFL	210,244	
Franchising		200,000
Total	210,244	200,000

RSI currently has an offer for maximum funding of $15 million from the bank. Based on our recommendations, however, RSI does not meet the bank's covenants and shareholders cannot be paid until the interest coverage ratio rises above 10. Since the ratio is below that, shareholders would not be able to withdraw any funds out of RSI until 2017 (one year later) depending on the success of the expansions. It is not recommended that RSI acquire funding from the bank if a better offer is available. Thus, acquiring funds from Blair Cummings is recommended if the proposed terms can be met. Although interest rate will likely be higher (by an estimated 4.5% at 10%) than the bank's and some shareholders will oppose bringing on additional shareholders, Blair would require less stringent covenants and shareholders can receive dividends every year based on the debt-service ratio proposed. As part of the convertible debt, RSI can also leverage Blair's finance background on the board if he chooses to convert his investment into equity and become a shareholder.

The pro-forma financial statements show that RSI's forecasted net income will increase drastically in 2016 due to the decrease in operational costs driven by the consolidation. Further profitability improvements will be driven by the net income generated by partnering with FFL and in the launch of franchises in 2018. RSI's performance will improve achieving the target results.

OPERATIONAL ISSUES

Corporate strategy

Corporate structure of the consolidated entity

Under the consolidated entity, Lavish will become a part of RSI financially, however, operationally, it will run as a separate business with shared support functions. The governance structure needs to be clarified for the combined entity. Since it was recommended that the two brands not be combined, it is important to retain the current managers as they have operational expertise in the two spas. To address Michael Bernard's concern about adapting Lavish's current operation to fit a new brand, our recommendation doesn't require Lavish to change its core operations (i.e., service offerings, target market and pricing). The change is only limited to support functions, such as administration and accounting, which don't impact the core business. Michael is supportive of merging administration, however, Sally needs to explain to him that, by joining other functions such as banking, accounting and information systems, it will facilitate the joint administrative process and will not impact the core business. In regards to RSI's operation, Emily Blais is supportive of franchising out RSI as long as she doesn't have to work excessive hours. Thus, the two managers should take on an oversight role and their responsibilities in daily operations (i.e., administration, accounting, information systems and banking) should be reduced so they can focus on the overall performance of the spas and reporting to Sally on the progress of the changes. This allows Michael to continue operating Lavish as its own brand and it gives both Emily and Michael reasonable work hour requirements as their responsibilities in daily operations are reduced. The managers should report to Sally biweekly for the first

year of the implementation process and monthly thereafter so Sally can monitor the change trends. Emily and Michael should both report on the profitability of the spas benchmarked against budget, employee turnover and competitive landscape trends. Emily should also report on the franchisee profitability and percentage of new applications vs. prior period as well.

Administrative functions

In terms of joining administration functions, one information system should be used across all spas as this allows sharing of key customer information, facilitates referrals between spas and reduces costs of running an additional system. A conservative 20% of the current administrative and information systems is estimated in savings from a reduction of duplicate responsibilities in current employee roles between the two spas and information systems. Some administrative employees might be opposed to learning a new system, thus training sessions should be held by Emily and Michael to express the importance of the combined entity. In addition, new employee incentives (discussed below) will be included as part of the consolidation entity, thus employees will be motivated and welcome the consolidation. One administrative team lead should be chosen from the current employees for each spa to guide the administrative team and report to Emily and Michael on a daily basis.

Accounting and financials

Upon consolidation, the accounting standards used by the two spas will need to be standardized as there are potential external funders involved. These funders will likely want an accurate depiction of the entity's operations, thus internal-use financial statements will not suffice. We recommend adopting ASPE as it is a widely accepted accounting standard for private companies. IFRS standards are too rigorous for RSI's business size at this time, however, in the future, if the company wants to become public, IFRS is required. Since the consolidated company is still a private company and ASPE is the recommended standard by the bank, it is the most appropriate accounting standard for the spas. RSI and Lavish's financial statements should be retrospectively changed based on the ASPE accounting policies. Since historical accounting information is needed to reflect the changes accurately, no adjustments were made to the consolidated statements at this time. In addition, banking should also be consolidated by transferring the assets from Lavish's bank account to RSI's. The combined assets in a bank account will improve future financing terms from the bank. RSI can also save on banking fees and other administrative costs.

Governance

Since the combined entity will be under financial scrutiny of external funders, adherence to ASPE standards will be strictly required. The current board lacks an individual with a strong financial background to give guidance on these accounting matters. Our proposed action is to speak with Blair Cummings and offer him the opportunity to be a

part of the board by converting his debt to equity in a few years. Blair can offer RSI the expertise required in the financial side of the business.

Updated mission and vision statements

The mission and vision statements of RSI and Lavish have been updated to illustrate the services that each spa provides and to include the impacts of expansion plans:

- RSI's new vision is *"to become the reputable leading spa for Canadian spa goers by growing RSI's brand geographically."*
- RSI's new mission is *"to provide exceptional client-centred spa and therapy services to enthused clients in an atmosphere that is relaxing and in a manner that is environmentally friendly and sustainable."*

Balanced scorecard

Outlined in Appendix J are a number of key initiatives that will be the focal drivers of RSI's future success. Implementing this balanced scorecard properly will help to align the business activities and operations of RSI with the strategic goals of the shareholders. It is imperative, however, that, in order to extract the value out of this balanced scorecard, it must be incorporated in your management discussions throughout the expansion process. It will keep the management team focused on delivering on the measures that will drive RSI's success, ultimately allowing the company to provide shareholders with income well into the future. Some of the proposed performance metrics include: percentage of revenue from new sources, number of complaints received by corporate, utilization rate and attendance at workshops.

Employee bonus scheme

Under the consolidated entity, the employee bonus scheme offered should be standardized between the two spas and broken down into two levels: manager and above, and below manager. As Emily Blais suggested, manager and above employees should receive equity ownership incentives to retain key talents. For therapists, RSI should offer flexible work time incentives and extra vacation time to avoid employee burnouts. In addition, the current Lavish's employee bonus structure based on revenue should be kept to avoid upsetting current Lavish employees. The monetary and vacation bonus outlined in the balanced scorecard (Appendix J) will promote the alignment of employee goals with the long-term goals of RSI shareholders. The cost of these bonus programs is estimated to increase RSI's wage and benefit expense by 30% and Lavish's by 15%. Since talent retention is one of key success factors of this industry, the increase in these expenses can be justified through long-term profitability that comes with customer satisfaction provided by RSI's staff.

Franchising

RSI should delay franchising for at least one year so the company can allocate the appropriate amount of resources to ensure the successful launch of the franchises. The risk of hurting RSI's brand through failed franchising expansion is far too grave as it can permanently damage RSI's current operations and profitability. In the upcoming year, the partnership with FFL will serve as an intermediary step towards franchising whereby RSI can first gain experience in expansions with a well-established business partner. If the partnership with FFL is a success, RSI can use the knowledge gained from operating the MTC's to gain a better understanding of the resource requirements and best practices needed for operating franchises. Should the partnership with FFL fail, this would indicate RSI is not in a position to pursue a more complicated and larger scale franchising effort.

In 2017, four franchises should be opened and eight in 2018. In the first year, there will be a loss due to the initial costs, however, by 2018 the venture will be profitable covering the loss in 2016.

Emily has expressed her interest in being part of the expansion effort and with the centralization of administrative work, she can be given more responsibilities without increasing her workload. Thus, given Emily's experience with RSI operations, she can assist Sally in screening potential locations and franchisees. For instance, for existing franchises wanting to transition to the RSI brand, Emily will have experience in determining if the spa has a "successful track record." If Emily does not want to leave her role as the manager at RSI, an outside manager with experience in the spa industry should be hired to help Sally with the start-up phase of the franchise.

Once franchises become operational, RSI will need to establish strong internal controls to ensure franchises are adhering to RSI's values and processes that made them a success. As RSI continues to expand, internal controls will become increasingly important since monitoring each franchise will be difficult. With a lack of controls, RSI risks the degradation of brand value or exposure to litigations. As the number of franchises increase, RSI should hire a controller with a CPA designation. This controller will oversee the establishment and adherence of controls and report to Sally and the board each quarter. Although the hiring of a controller will increase wage expenses, the benefits far outweigh the cost.

Massage Therapy Centre

We would recommend MTC to be implemented as a partnership during the initial stages of operation. This is due to the lower cost of start-up compared to incorporation. A partnership will also be significantly less complex from both an administrative and regulatory point of view. Overall, the initial start-up of MTC will most proceed more smoothly with a partnership as there are fewer requirements to set up a partnership versus a corporation. In addition, if the scenario of net loss from MTC occurs, the partnership will allow RSI and FFL to use income splitting, reducing the taxes payable

from other parts of their respective operations. However, we recommend that RSI and FFL consider incorporation as the partnership grows and expands into more FFL locations. This is due to the significant tax advantages of a corporation, especially as taxable income increases. Along with business growth, there will also be an increase in the liability and increase in potential litigation against the partnership. As a result, incorporation in the later stages of partnership will help protect RSI and FFL's individual assets from MTC's liabilities. Another benefit of incorporating MTC as it matures would be the ability for RSI to sell its share in MTC and maintain whatever portion of control it desires. This allows RSI much greater flexibility in what it can do with its shares of MTC, compared to transferring a portion of a partnership which is much harder.

There is also a possibility for integration between RSI's goal to improve employee retention rate and the MTC partnership. MTC will give RSI's employees the opportunity to become instructors, supervisors or spa manual authors. This will give RSI and Lavish employees the opportunity to rotate to other less stressful tasks compared to their current therapy jobs. This will also offer employees a change in scheduling and work atmosphere when desired.

When drafting the final agreement, RSI should bring up the point of including RSI's brand image or logo at every MTC location. This should not be an issue for FFL as it does not negatively impact the partnership in any way. This point is very important as exposure of the RSI brand will help promote brand awareness and value for RSI.

When forming the management group for FFL, we would recommend approaching Lisa Wiley as the first choice for RSI's representation at MTC. This is because she is currently a shareholder of RSI and as a result would be a trustworthy candidate to represent RSI's interests at MTC. Lisa has leadership experience through her position as the department head at Regional Health and the President of a school breakfast club. If she is interested in taking this role, we would recommend her to take some management courses at a local community college. In addition, she should be paid a salary similar to what a general manager of that position would be paid in the area. If Lisa is not interested in taking this role, we would recommend RSI to hire another employee with management experience in this industry to represent RSI at MTC. This is because all of the other experienced managers at RSI and Lavish do not have enough capacity to take on a role within MTC. RSI should clearly communicate to the new manager its business expectations for MTC and the goals/values of RSI. When jointly choosing the third general manager for MTC, RSI needs to ensure that this person does not have ties or connections to FFL. It is important to ensure that the manager is neutral and not bias to either party. This is important because, if the manager favours FFL's interest more, RSI may lose some control of the day-to-day management decisions and benefit less from the partnership.

Conclusion

This report evaluated the major business opportunities that are currently available to Rejuvenating Spa Inc. and recommends that the company consolidate with its subsidiary, Lavish Spa, pursue the partnership with Forevermore Fit Limited and franchise out RSI's brand on its own. This strategy will ensure that the board's goals are met and RSI continues to grow and prosper.

Appendix A – Consolidated Financial Statements

RSI Consolidated Statement of Financial Position
December 31

	2015				2014			
	RSI	**Lavish**	**Elimination**	**Consolidated**	**RSI**	**Lavish**	**Elimination**	**Consolidated**
Assets								
Current assets								
Cash	$ 12,401	$ 14,600		$ 27,001	$ 3,000	$ 2,500		$ 5,500
Accounts receivable	63,012	15,125		78,137	45,430	11,377		56,807
Prepaid expenses	3,150	3,781		6,931	2,181	2,617		4,798
Supplies and linens	7,562	27,500		35,062	9,540	26,935		36,475
Inventory	62,125	59,400		121,525	45,430	55,798		101,228
Other	1,000	1,000		2,000	1,000	1,000		2,000
Total current assets	$ 149,250	$ 121,406		$ 270,656	$ 106,581	$ 100,227		$ 206,808
Land	$ 140,000			$ 140,000	$ 140,000			$ 140,000
Building	900,000			900,000	900,000			900,000
Leasehold improvements		350,000		350,000		350,000		350,000
Accumulated depreciation — leasehold improvements		(145,833)		(145,833)		116,667		116,667
Equipment	225,000	586,000		811,000	206,000	508,000		714,000
Accumulated depreciation	(315,000)	(248,000)		(563,000)	259,127	174,000		433,127
Net book value	$ 950,000	$ 542,167		$ 1,492,167	$ 986,873	$ 567,333		$ 1,554,206
Intangibles								
Logo		$ 58,500		$ 58,500		$ 38,500		$ 38,500
Customer list			$ 60,000	60,000			$ 80,000	80,000
Brand identity			100,000	100,000			100,000	100,000
Favourable lease rate			160,000	160,000			240,000	240,000
Goodwill			493,996	493,996			493,996	493,996
Total intangibles — Lavish acquisition			786,216				886,216	
Investment in Lavish Spa Inc.	$ 1,000,000		(1,000,000)	-	1,000,000		(1,000,000)	-
Total assets	**$ 2,099,250**	**$ 722,073**		**$ 2,635,318**	**$ 2,093,454**	**$ 706,060**		**$ 2,685,730**

Appendix A – Consolidated Financial Statements (cont'd)

Liabilities and shareholders' equity								
Current liabilities								
Accounts payable and accruals	$ 60,295	$ 58,275		$ 118,570	$ 74,613	$ 55,125		$ 129,738
Income tax payable	8,678	2,865		11,543	4,544	2,725		7,269
Current portion of long-term debt	93,839	80,000		173,839	93,839	80,000		173,839
Total current liabilities	162,812	141,140		303,952	172,996	137,850		310,846
Long-term debt								
Long-term debt — Lavish (net of current portion $80,000; 2014 $80,000)		$ 350,000		$ 350,000		$ 400,000		$ 400,000
Mortgage on building (net of current portion $25,714; 2014 $25,714)	$ 488,566			488,566	$ 514,280			514,280
Term loan bank — purchase of Lavish (net of current portion $68,125; 2014 $68,125)	545,000			545,000	613,125			613,125
Due to shareholders — Lavish shares	250,000			250,000	250,000			250,000
Total long-term liabilities	$ 1,283,566	$ 350,000		$ 1,633,566	$ 1,377,405	$ 400,000		$ 1,777,405
Contingent liability			$ (27,780)	$ 27,780			$ (27,780)	$ 27,780
Total liabilities	**$ 1,446,378**	**$ 491,140**		**$ 1,965,298**	**$ 1,550,401**	**$ 537,850**		**$ 2,116,031**
Shareholders' equity								
Common shares	$ 200,000	$ 1,000	$ (1,000)	$ 200,000	$ 200,000	$ 1,000	$ (1,000)	$ 200,000
Preferred shares	200,000			200,000	200,000			200,000
Retained earnings	252,872	229,933	(212,784)	270,021	143,053	167,210	(140,564)	169,699
Total shareholders' equity	$ 652,872	$ 230,933		$ 670,021	$ 543,053	$ 168,210		$ 569,699
Total liabilities and shareholders' equity	**$ 2,099,250**	**$ 722,073**	-	**$ 2,635,318**	**$ 2,093,454**	**$ 706,060**	-	**$ 2,685,730**

Appendix A – RSI Consolidated Financial Statements (cont'd)

RSI Consolidated Statement of Earnings
December 31

	2015				**2014**				**Annual change**
	RSI	**Lavish**			**RSI**	**Lavish**			
Revenue									
Spa services	$ 504,100	$ 1,375,000		$ 1,879,100	$ 454,300	$ 1,282,600		$ 1,736,900	8%
Product sales	248,500	440,000		688,500	227,150	424,000		651,150	6%
	752,600	1,815,000		2,567,600	681,450	1,706,600		2,388,050	8%
Expenses									% of Revenue
Wages and benefits	$ 191,054	$ 618,750		$ 809,804	$ 177,177	$ 538,692		$ 715,869	43%
Cost of products sold	124,250	198,000		322,250	109,032	199,280		308,312	17%
Administration and other expenses	142,103	257,119		399,222	131,694	254,775		386,469	21%
Marketing	37,630	116,875		154,505	30,665	102,608		133,273	8%
Depreciation building	55,873			55,873	58,968			58,968	3%
Depreciation leasehold		29,167		29,167		29,167		29,167	2%
Depreciation equipment		74,000		74,000	-	66,800		66,800	4%
Amortization of intangibles (preferential lease and customer list)			100,000	100,000			100,000	100,000	5%
Rent		300,000		300,000		300,000		300,000	16%
Interest — equipment loan		30,100		30,100		33,600		33,600	2%
Interest — mortgage	29,314			29,314	32,400			32,400	2%
Interest — Lavish shares	48,431			48,431	61,313			61,313	3%
Earnings before other income	123,945	190,989	(100,000)	214,934	80,201	181,678	(100,000)	161,880	33%
Other income — dividends Lavish	99,619		(99,619)	-	-		-	-	
				-					
Earnings before income tax	223,564	190,989	(99,619)	214,934	80,201	181,678	-	161,880	33%
Income tax	18,592	28,647		47,239	12,030	27,252		39,282	20%
Net earnings	**$ 204,972**	**$ 162,342**	**$ (99,619)**	**$ 167,695**	**$ 68,171**	**$ 154,426**	**$ -**	**$ 122,598**	**37%**
Earnings as % of revenue	27%	9%		7%	10%	9%		5%	
Tax rate				22%				24%	

Appendix B – RSI Consolidation

Calculation of Goodwill and Amortization of Intangibles for Consolidation		
Purchase price	$	1,000,000
Net assets acquired at fair value		
Beginning of 2014		
Common shares		1,000
Retained earnings		12,784
Net assets at carrying value		13,784
Adjustments to carrying value to bring to fair value		
Equipment (unable to value)		
Contingent liability		(27,780)
Identifiable intangibles		
Preferential lease rate		320,000
Customer list		100,000
Brand		100,000
Goodwill	**$**	**493,996**
Amortization of increase in fair value of capital assets		
Equipment		
Leasehold improvements		
Contingent liability		
Amortization of intangibles		
Preferential lease rate (4 years remaining from date of purchase)		80,000
Customer list (5 years)		20,000
Brand (not amortized — indefinite life)		
Goodwill (not amortized — indefinite life)		
Total amortization of intangibles	**$**	**100,000**

Appendix C – RSI and LSI Financial Ratios

	RSI financial ratios		Lavish Spa Inc. financial ratios		Consolidated RSI ratios		
	(based on year-end balances)						
Liquidity	**2015**	**2014**	**2015**	**2014**	**2015**	**2014**	**Bank covenant**
Acid test	0.5	0.3	0.2	0.1	0.3	0	
Current ratio	0.9	0.6	0.9	0.7	0.9	0.7	
Receivables turnover	11.9	15.0	120	150	32.9	42.0	
Average collection period	30.6	24.3	3.0	2.4	11.1	8.7	
Inventory turnover	2.0	2.4	3.3	3.6	2.7	3.0	
Days in inventory	182.5	152.1	109.5	102.2	137.6	119.8	
Solvency							
Times interest earned	3.1	1.4	7.3	6.4	3.0	2.3	
Cash total debt coverage	0.2	0.1	0.5	0.4	0.0	0.0	
Debt to total assets	68.9%	74.1%	68.0%	76.2%	74.6%	78.8%	50.0%
Debt to equity	2.2	2.9	2.1	3.2	2.9	3.7	1
Interest coverage ratio	2.6	1.9	7.3	6.4	3.0	2.3	10
Profitability							
Gross profit margin on product	50.0%	52.0%	55.0%	53.0%	53.2%	52.7%	
Gross profit margin on services	62.1%	61.0%	55.0%	58.0%	56.9%	58.8%	
Profit margin	27.2%	10.0%	8.9%	9.0%	6.5%	5.1%	
Return on common shareholders' equity	31.4%	12.6%	70.3%	91.8%	25.0%	21.5%	
Return on assets	9.8%	3.3%	22.5%	21.9%	6.4%	4.6%	
Return on assets (excluding dividends and investment — Lavish)	9.6%				18.2%	15.0%	
Asset turnover	0.4	0.3	2.5	2.4	1.0	0.9	
Payout ratio	46.4%	0.0%	61.4%	0.0%	37%	0.0%	

Appendix C – RSI and LSI Financial Ratios (cont'd)

	RSI reconciliation of cash	Lavish reconciliation of cash
Cash provided by operations		
Net earnings	$ 204,972	$ 162,342
Depreciation	55,873	103,167
Accounts receivable	(17,582)	(3,748)
Prepaid expenses	(969)	(1,164)
Supplies and linens	1,979	(565)
Inventory	(16,695)	(3,602)
Other	-	-
Accounts payable and accruals	(14,319)	3,150
Income tax payable	4,134	140
	$ 217,392	$ 259,720
Investing		
Equipment purchased	$ (19,000)	$ (78,000)
Website and logo		(20,000)
Financing		(98,000)
Mortgage payments	$ (25,714)	
Payments on loan — Lavish shares	(68,125)	
Net advances equipment financing		(50,000)
Dividends	(95,152)	(99,619)
	$ (188,991)	$ (149,619)
Total	$ 9,401	$ 12,100
Cash — beginning	3,000	2,500
Cash — ending	12,401	14,600
	$ 9,401	$ 12,100

Appendix D – RSI Franchise

Franchise – Evaluation of Profit and Return on Investment

Number of therapists	Per therapist		1		3		5		**RSI 2015**	
Revenue										
Average rate	70									
Number of hours	1,920									
Utilization rate	70%									
Spa services	94,080		$ 94,080		$ 282,240		$ 470,400		$ 504,100	
Product sales (% of therapy revenue)	28,224	30%	28,224	30%	84,672	30%	141,120	30%	248,500	49%
Other										
Total revenue	$ 122,304		$ 122,304		$ 366,912		$ 611,520		$ 752,600	
Expenses										
Wages and benefits (% of spa services revenue)	37,632	40%	37,632	40%	112,896	40%	188,160	40%	191,054	38%
Cost of product sold (% of product revenue)	14,112	50%	14,112	50%	42,336	50%	70,560	50%	124,250	50%
Administration and other costs	24,000		24,000	20%	60,000	16%	96,000	16%	126,600	17%
Franchise fee	5,645	6%	5,645	5%	16,934	5%	28,224	5%		
Marketing fund	235	0.25%	235	0.19%	706	0.19%	1,176	0.19%	37,630	5%
Marketing — local media	1,646	1.75%	1,646	1.75%	4,939	1.75%	8,232	1.75%		
Occupancy and communication costs	22,000		22,000	18%	55,000	15%	88,000	14%		
Depreciation									55,873	7%
Interest										
Other										
Total expenses	$ 105,270		$ 105,270		$ 292,811		$ 480,352		$ 535,407	
Earnings before income tax	$ 17,034		$ 17,034		$ 74,101		$ 131,168		$ 217,193	29%
% of revenue	14%		14%		20%		21%			
Investment required										
Signage	5,000		$ 5,000		$ 5,000		$ 5,000			
Equipment	7,500		7,500		22,500		37,500			
Uniforms and linens	2,500		2,500		7,500		12,500			
Working capital	15,000		15,000		15,000		15,000			
	$ 30,000		$ 30,000		$ 50,000		$ 70,000			
Return on investment			57%		148%		187%			

Appendix E – FFL

Franchise Break-even Calculation

Start-up fees — weighted average new and existing	$	32,500
Start-up costs		
Marketing material development		200,000
Operating manual and training material development		50,000
Total development costs	$	250,000
Number of franchises required to cover start-up costs		7.7

	Start-up	Ongoing		
	Fixed	Fixed	Variable/ Franchise	Total
Revenue				
Start-up fees new				
Start-up fees existing				
Assume % new				
Ongoing franchise fee				
Advertising fund				
Expenses				
Marketing material development	$ 200,000			
Marketing material (annual updating starting in year 2)		$ 20,000		
National advertising — equal to the total assessed franchisees				
Operating manual and training material development	50,000			
Operating manual and training material (annual updating starting in year 2)		5,000		
Training costs per franchise unit			$ 2,500	
Quality control per franchise unit			2,500	
Sales, administration and other		40,000		
Total expenses		65,000	5,000	
Ongoing franchise fee — 6%				
Franchisee revenue required to convert		1,083,333	83,333	$ 1,166,667
Revenue per franchisee (average 3 therapists)				282,240
Number of franchises required to break even				4.13

Appendix E – FFL (cont'd)

Forevermore Fit Limited Massage Therapy Centres
Projected Financial Results

		Large centre	Small centre	Total	Notes
# therapists		4	1		
# weeks		52	52		
Hours per week		35	35		
Rate per hour		80	75		
% of hours charged		75%	70%		
Therapy revenue		$ 436,800	$ 95,550		
Product sales — % of therapy revenue	15%	65,520	14,333		
Membership discount	10%	(25,116)	(5,494)		10% discount assumed on 50% of service
		$ 477,204	$ 104,388		
Expenses					
Wages and benefits — % of therapy revenue	45%	$ 196,560	$ 42,998		industry average 39% — have this higher as part of strategy to attract and retain quality staff, which is key
Cost of product sales	50%	32,760	7,166		
Marketing	5%	23,860	5,219		
Supplies (including product and laundry)	5%	21,840	4,778		
Administrative and other costs (including utilities, insurance and communication)		50,000	5,000		fixed; small centres little incremental cost part of FFL; large centres dedicated staff person plus other incremental costs
Equipment lease		6,941	1,735		assume 60 months and 10% down 9% interest
Interest					on funds for renovations
Allocation of MTC management		?	?		manager that will be hired and admin support, etc.
Cost of points earned and used		?	?		
Total expenses		$ 331,962	$ 66,896		
Net earnings		$ 145,242	$ 37,492		shared 50/50
					operating cash flow distributed quarterly

Appendix E – FFL (cont'd)

Investment required							
Renovations							
Equipment	7,500	$ 30,000	$ 7,500			to be leased by MTC
Uniforms and linens	2,000	8,000	2,000			
		$ 38,000	$ 9,500			
Financing		27,000	6,750			lease equipment
FFL and RSI	10%	3,000	750			down payment on leased equipment
		8,000	2,000			uniforms and linens
	12	27,663	5,575			working capital — one month's expenses
		$ 38,663	$ 8,325			
Profit						
Initial year		2	2			
Profit to RSI	50%	$ 145,242	$ 37,492	$ 182,735		
All centres		7	18			
Profit to RSI	50%	$ 508,348	$ 337,431	$ 845,779		
Investment required from RSI and FFL						
Initial year total		$ 77,326.95	$ 16,649			
RSI	50%	$ 38,663	$ 8,325	$ 46,988		
All centres		270,644	149,844			
RSI	50%	$ 135,322	$ 74,922	$ 210,244		

Appendix F– Pure

Pure Substance Inc.
Sample Valuation

Financial information		2014		2013		2012		2011		2010
				96%		95%		93%		97%
Product revenue		$ 19,500	4%	$ 18,720	5%	$ 17,784	8%	$ 16,539	3%	$ 16,043
Cost of goods sold		14,235	9%	13,104	8%	12,093	8%	11,247	3%	10,909
		73%	4%	70%	3%	68%	0%	68%	0%	68%
Administration		3,120	11%	2,808	13%	2,489	7%	2,316	-10%	2,567
		16%	7%	15%	7%	14%	0%	14%	-13%	16%
Marketing		195	4%	187	5%	178	8%	165	3%	160
		1%	0%	1%	0%	1%	0%	1%	0%	1%
Community support — percentage of prior year net earnings		61	-25%	82	6%	78	16%	67	-10%	75
		7%	0%	7%	0%	7%	0%	7%	0%	7%
Other		390	4%	374	5%	356	8%	331	3%	321
		2%	0%	2%	0%	2%	0%	2%	0%	2%
Depreciation — building		16	-4%	17	-4%	18	-4%	18	3%	18
Depreciation — equipment		695	-34%	1,050	-5%	1,104	10%	1,003	27%	788
Depreciation — total (= CCA)		711	-33%	1,067	-5%	1,121	10%	1,021	27%	806
Earnings before income tax		788	-28%	1,098	-25%	1,469	6%	1,392	16%	1,205
Income tax	20%	158	-28%	220	-25%	294	6%	278	16%	241
Net earnings		630	-28%	878	-25%	1,175	6%	1,114	16%	964
Earnings as % of revenue		3%	-31%	5%	-29%	7%	-2%	7%	12%	6%
Dividends	25%	$ 335		$ 486		$ 573		$ 534		$ 442
Increase (decrease) retained earnings		$ 295		$ 392		$ 602		$ 580		$ 522

Appendix F– Pure (cont'd)

Current assets					
Cash	$ 38	$ 62	$ 83	$ 39	$ 100
Accounts receivable	2,438	2,340	2,223	2,067	2,005
Inventory	2,373	2,184	2,016	1,874	1,818
Other	138	154	134	142	131
Total current assets	$ 4,987	$ 4,740	$ 4,456	$ 4,123	$ 4,055
Land	$ 100	$ 100	$ 100	$ 100	$ 100
Building	2,310	2,310	2,310	2,310	2,310
Accumulated depreciation	1,918	1,901	1,884	1,866	1,848
Equipment	10,425	9,825	9,005	8,210	7,500
Accumulated depreciation	9,850	9,156	8,106	7,003	6,000
Net book value	1,067	1,178	1,425	1,751	2,062
Total assets	**$ 6,054**	**$ 5,918**	**$ 5,880**	**$ 5,874**	**$ 6,117**
Current liabilities					
Accounts payable and accruals	$ 842	$ 772	$ 708	$ 659	$ 713
Income tax payable	13	18	24	23	21
Current portion of long-term debt					
Total current liabilities	$ 855	$ 790	$ 732	$ 682	$ 734
Long-term debt due to shareholders	$ 384	$ 608	$ 1,020	$ 1,666	$ 2,437
Total liabilities	$ 1,239	$ 1,398	$ 1,752	$ 2,348	$ 3,171
Shareholders' equity					
Common shares	$ 100	$ 100	$ 100	$ 100	$ 100
Retained earnings	4,715	4,420	4,028	3,426	2,846
Total shareholders' equity	$ 4,815	$ 4,520	$ 4,128	$ 3,526	$ 2,946

Appendix F– Pure (cont'd)

Total liabilities and shareholders' equity		**$ 6,054**	**$ 5,918**	**$ 5,880**	**$ 5,874**	**$ 6,117**
Check		(0)	(0)	0	(0)	(0)
Return on assets		0	0	0	0	0
Investment in equipment		$ 600	$ 820	$ 795	$ 710	$ 750
Depreciation —						
equipment additions	2010			188	375	188
	2011		178	355	178	
	2012	199	398	199		
	2013	205	205			
	2014	90				
	Prior	201	270	362	450	600
		$ 695	$ 1,050	$ 1,104	$ 1,003	$ 788

Appendix G– Implementation Plan

Implementation Plan for the Recommended Strategic Options

Strategic option	Detailed items	Personnel responsible	2016	2017	2018	2019	2020	2021
Consolidate entity	Onboard Michael and Emily	Sally Rice						
	Establish managerial responsibilities	Sally, Michael, Emily						
	Do analysis on costs and savings	Accounting staff						
	Communicate to rest of staff re consolidation, new bonus structure, responsibilities, etc.	Michael and Emily						
	Staff training	Staff						
	Monitoring of consolidated entity	Sally						
Partnership with FFL	Acceptance of final proposal	Core shareholders						
	Negotiate and sign agreement with FFL	Core shareholders						
	Onboard Lisa Wiley as proposed manager of MTC	Sally						
	Work with FFL to hire another manager	Lisa						
	Monitor MTC's progress	Lisa, Sally						
Franchising RSI	Onboarding Emily	Sally						
	Hire a controller	Sally						
	Finding ideal locations	Emily and Sally						
	Interviewing franchisee candidates	Emily						
	Training	Staff						
	Monitoring of franchises	Controller						
	Performance reviews	Controller						

Appendix H– Financial Forecast Franchising

Franchising Projections
December 31

	Year 1	Year 2
Number of franchises (4)	4	8
Revenue	**Inputs**	
Start-up fees — new	$40,000	50%
Start-up fees — existing	$25,000	50%
Franchising fee	6%	
Advertising	0.25%	
Expenses (one-time)	**Year 1**	**Year 2**
Marketing material development	$200,000	
Expenses (per year)		
Operating manual and training material update	$5,000	$5,100
Sales, admin and other **(1)(3)**	$40,000	$40,800
Expenses (per year/per franchise)		
Training cost **(1)**	$2,500	$2,550
Quality control **(1)**	$2,500	$2,550
Gross revenue/franchise		
Spa gross revenue **(2)**	$366,912	$396,265

	Year 1	Year 2
Revenue		
Start-up fees — new	$80,000	$50,000
Start-up fees — existing	$50,000	$0
Franchising fee	$3,669.12	$7,925.30
Advertising	$88,058.88	$190,207.18
Total revenue	$221,728	$248,132
Expenses		
Marketing material development	$200,000	$0
Operating manual and training material update (no update in year 1)		$5,000
Sales, admin and other	$40,000	$40,800
Training cost	$10,000	$20,400
Quality control	$10,000	$20,400
Total expenses	$260,000	$86,600
Net income	-$38,272	$161,532

Appendix H– Financial Forecast Franchising (cont'd)

(1) Assuming expenses increase at 2% a year in line with inflation.
(2) Assuming 3 therapists per franchise. 8% growth as per Appendix A.
(3) An additional $25,000 expense has been added in year 1 for costs associated with the setup of the initial franchises (i.e., costs for travelling to scout ideal locations).
(4) Assume 4 new franchises are opened each year for the next 5 years with a 50% split between new and existing owners.
(5) Assume the net income was achieved from cash transactions.
(6) The rate used for the NPV is the average bank rate.

Appendix I – Financial Forecast

RSI Consolidated Statement of Earnings
December 31

	2015	2016	2017	2018
Revenue **(1)**				
Spa services	$ 1,879,100	$ 2,032,942	$ 2,199,379	$ 2,379,442
Product sales	688,500	$ 727,992	$ 769,750	$ 813,903
	2,567,600	2,760,934	2,969,129	3,193,345
Expenses **(2)**				
Wages and benefits	$ 809,804	696,624	749,155	805,728
Cost of products sold	322,250	277,212	298,116	320,628
Administration and other expenses	399,222	343,426	369,323	397,213
Marketing	154,505	132,911	142,934	153,727
Depreciation building **(3)**	55,873	55,873	55,873	55,873
Depreciation leasehold	29,167	29,167	29,167	29,167
Depreciation equipment	74,000	74,000	74,000	74,000
Amortization of intangibles (preferential lease and customer list)	100,000	100,000	100,000	100,000
Rent	300,000	300,000	300,000	300,000
Interest — equipment loan **(4)**	30,100	30,100	30,100	30,100
Interest — mortgage	29,314	29,314	29,314	29,314
Interest — Lavish shares	48,431	48,431	48,431	48,431
Earnings before other income	214,934	643,876	742,717	849,164
Operating income FFL **(5)**		182,735	365,469	730,939
Operating income franchise **(6)**			(38,272)	161,532
Earnings before income tax	214,934	826,611	1,069,914	1,741,635
Income tax	47,239	181,676	235,150	382,783
Net earnings	**$ 167,695**	**$ 644,935**	**$ 834,764**	**$ 1,358,852**
Earnings as % of revenue	7%	23%	28%	43%
Tax rate (assumed consistent)	22%	22%	22%	22%
Growth		**74%**	**23%**	**39%**
Interest coverage ratio	**3.0**	**7.0**	**7.9**	**8.9**

Appendix I – Financial Forecast (cont'd)

Assumptions

(1) Regular business revenue growth assumed to be at rate changes of 2014-2015 levels.
(2) 2016 expenses assumed to be at 2015 percentage of revenue level with 20% savings from consolidation. 2017-2018 based on new 2016 percentage of revenue.
(3) Depreciation and amortization assumed straight-line.
(4) Interest expense assumed consistent.
(5) Assume 2 of each type of store in year 1, doubling each year. As per Appendix E.
(6) Franchise in year 2, 2017, as per Appendix H.

Appendix J – Balanced Scorecard

Goal	Measure	Target	Initiative
		Financial Perspective	
Grow sustainable income streams	% of revenue from new sources	25% by 2018	Franchise RSI Partner with FFL
Increase use of customer loyalty program	% of customers participating in loyalty program	50% of customers are members by 2018	Create, implement and promote customer loyalty program
Reduce operating costs per customer	Operating cost per customer visit	5% decrease by 2018	Track customer profitability, attract the more profitable customers
		Customer Perspective	
Enhance customer well-being	After visit surveys	80% of respondents	Tailor treatment programs on an individual basis
Reduce customer complaints	No. of complaints received by corporate	<5 complaints/year per franchise	Test the franchise services prior to opening
Create a loyal and repeat customer base	No. of repeat customers	Increase repeat customers by 5% quarterly	Implementation of customer loyalty program
		Internal Perspective	
Increase therapist efficiency	Utilization rate	Increase 2% by 2018	Have therapists attend training workshops: minimum – annually
Develop consistency and uniformity within franchisee operations	"Secret shopper" will attend spas to judge	90% approval	Having RSI employee disguise as a patron to assess uniformity
Keep and attract top talent therapists	Internal survey for employees	80% employee satisfaction	Implement incentive plan with extended vacation and a revenue-based bonus
Increase manager engagement with RSI	Ability for managers to meet yearly goals	75% success rate	Implement bonus plan with equity ownership plus bonus based on % increase in gross margin and % increase in employee satisfaction
		Learning and Growth Perspective	
Promote intercompany relations between RSI and Lavish employees	Team building events attended	Fully accepted and integrated by 2017	Host quarterly team building events with RSI and Lavish
Promote attendance to learn new massage/spa treatments and programs	Attendance at workshops are tracked	All therapists attend at least one workshop a year	Workshops provided by corporate

Bibliography

AFA, What is your business worth? (n.d.). Retrieved June 9th, 2015, from http://cafa.ca/pdf/cafa_news_2_en.pdf

Bain & Company study finds 70 percent of merging companies overestimate cost savings from scale-derived benefits. (n.d.). Retrieved June 21, 2015, from http://www.bain.com/about/press/press-releases/bain-study-finds-70-percent-of-merging-companies-overestimate-cost-savings-from-scale-derived-benefits.aspx

Brickley, J., & Dark, F. (1987). The choice of organizational form The case of franchising. *Journal of Financial Economics, 18*(2), 401-429.

"Chief Executive Officer (CEO) Salary (Canada) Canada Home Change Country Don't See What You Are Looking For? Get A Free Custom Salary Report." Chief Executive Officer (CEO) Salary (Canada). N.p., n.d. Web. 25 June 2015.

D'Aveni, R., & Ravenscraft, D. (1994). Economies of Integration Versus Bureaucracy Costs: Does Vertical Integration Improve Performance? *Academy of Management Journal, 37*(5), 1167-1206.

Erfurt-Cooper, P. and Cooper, M. (2009), *Health and Wellness Tourism: Spas and Hot Springs*, Channel View, Bristol.

ISPA 2014 US Spa Industry Study. (n.d.). Retrieved May 30, 2015, from http://experienceispa.com/images/Media/2014-industry-study-executive-summary.pdf

Ivey Business Journal. (n.d.). Retrieved June 21, 2015, from http://iveybusinessjournal.com/publication/merger-synergies-through-workforce-reduction

"Partnerships." *Springer Reference* (2011): n. pag. *Upper Law Society of Canada*. Web. 21 June 2015. <http://rc.lsuc.on.ca/pdf/ht/partnerships.pdf>.