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TEACHING NOTES

HORIZON LIMITED:- UNRAVELLING THE FINANCIAL PERFORMANCE OF AGRIBUSINESS PRODUCING NATURE BASED PRODUCTS

THE CASE ISSUES:

This case is about a unique business model company called Horizons Ltd. Operating from rural Kenya in a small town called Naro Moru. Horizon Ltd add value to the transformation of products from biodiversity and waste forest materials into unique products, predominantly nature based oils, with a quest to become a dominant competitor in this market which is an increasingly attractive investment area in Africa.

After five years of operation Horizon Ltd is not achieving a satisfactory level of growth. The company realizes that it is unique in its formation as it is owned by an NGO, Help Self Help Centre (HSHC) and is in producing unique products, such as biodiesel, which could be produced in large quantities and even be exported as happens in Brazil. But its fundamental constraint is capital needs to increase its supply of raw materials, its production machinery and to expand in product varieties such as using by-products out of production lines as additional products to sell. In addition, due to these constraints it cannot develop to sell in national markets (such as in supermarkets in Nairobi or in petrol stations countryside). Supplies are dwindling due to drought and environmental changes, and these unique products could attract funding from donors interested in biodiversity forest conservation programs or in initiatives to address the problem of global warming.

The case investigates, examines, and explores searchingly into the financial statements information to figure out which performance areas of the company would provide needed expansion opportunities. These are considered against the aspirations of the founder members, (also flagged by its MD, Mr. Bernard Muchiri) which are to grow the firm to become a competitive force among a number of environmental stewardship and sustainability companies emerging in Kenya. The issues of primary concern in this analysis are that although current operations in each of its five oil products, biodiesel oils from croton seed, capechestnut oils,

canola oils, sunflower oils and castor oils are generating profits, the profit generated may not be sufficient to allow the company to increase its production capacity and/ or allow it to research into the market potential for bi-products.

The company is at crossroad and has to decide on its future growth direction as well as how growth activities will be financed:

Should they finance these ambitions by itself or in partnership with external invitee, or should Horizon Ltd sell off production of one of its most attractive operations?

CASE OVERVIEW:

Horizon was started in 2007 by its parent institution called Help Self Help Centre (HSHC) which was founded in 1993 by five individuals working in various fields of government, NGOs and businesses. They formed HSHC as a service delivery organization, providing marketing service for produce of local farmers. After successfully providing such marketing services they, as a civil society organization (CSO) in 2007 boldly embarked on establishing a commercially based company, Horizons Ltd. focusing on three program areas: agribusiness, nature based enterprises and renewable energy and climatic change based enterprises .

The company Horizon Ltd started as a bio-diesel production company (first company in Kenya to harvest business potential of local oilseed) and also managed to commercialize a forest-based essential oil (cape chestnut and canola oil) using a business model that is meant to maximize returns and motivate local people to conserve the forest providing a concrete income stream to local farmers. At the same time it also started the production of the other five types of oils. The company realizes its unique potential and would like to take advantage of the window of opportunity presented by developments in the world such as biodiesel as alternative to petrol diesel; chestnut oil not just for cosmetics but also for health reasons; canola oil being cold hard pressed oil which has free cholesterol health contents similar to virgin olive oil; and more; and yet it is not able to tap on all this due to a shortage of capital and liquidity and problems in securing adequate supplies of raw material inputs. So far, it has overcome teething problems and has survived profitably but this is not enough. It has NGO mentality in its entrepreneurial mode and would like to be advised on how to increase profitability, improve its and expand its capital base. Mr. Bernard Muchiri, the MD for Horizon Ltd since inception, is convinced that, as he juggles between board members expectations and his quest to partner with a donor for capital investment, he can unlock the potential value of his unique business model company Horizon Ltd. Thus he would like to make presentations to his board members on the following questions:

- Decision 1. Which are the best product(s) to continue producing as justified by the profitability analysis of the value chain and which product to drop or sell to external interested parties.
- Decision 2: What are the potential sources for financial growth of the company: internally generated finances and thus being patient, donor funding, or sale of most profitable line of biodiesel and concentrate on capechestnut, canola, sunflower, and castor oils.

Decision 3. What are the ethical issues and how can they be resolved; in light of the passion of the board members on nature based products, agribusiness based and providing market for the produce and forest collections of its local community members. For instance, should they abandon buying from the local farmers directly and buy through brokers who could access the materials in more places than just Naro Moru? Should the company let go long term benefits of producing biodiesel for short term capital gains?

Case Analysis

The case study on Horizons Ltd. provides data to use financial management techniques and analyze the financial data to obtain information on:

1. Break even analysis of its various products; See Workings 1

TABLE 8

STATISTICAL DATA FOR 2011	1	2	3	4	5	6
	Croton Oil	Capechestnut	Canola Oil	Sunflower Oil	Castor Oil	T
Sales In Litres Per Annum	1,800,000	400,000	120,000	120,000	36,000	2
Sales Price Per Litre Inshs.	110	300	160	160	100	
Sales:Shs,	198,000,000	120,000,000	19,200,000	19,200,000	3,600,000	3
Variable Costs	93,600,000	51,200,000	12,300,000	12,300,000	1,800,000	1
Contribution Margin	104,400,000	68,800,000	6,900,000	6,900,000	1,800,000	1
Manufacturing Overhead	20,250,000	4,000,000	1,260,000	1,260,000	405,000	2
Cost Of Goods Manufactured	113,850,000	55,200,000	13,560,000	13,560,000	2,205,000	1
Gross Profit	84,150,000	64,800,000	5,640,000	5,640,000	1,395,000	1

Total Fixed Costs For 2011						
Manufacturing Overhead	20,250,000	4,000,000	1,260,000	1,260,000	405,000	2
Selling and marketing				212,754		
Professional fees				228,587		
Depreciation and amortization expenses				46,602		
Other general and administrative expenses				22,009,900		
Total selling, general, and administrative expenses				22,497,843		2

TOTAL FIXED COSTS FOR 2011					
	Croton Oil	Capechestnut	Canola Oil	Sunflower Oil	Castor Oil
SALES IN LITRES PER ANNUM	1,800,000	400,000	120,000	120,000	36,000
SALES MIX (using litres sold) (1)	73%	16%	5%	5%	1%
CM PER UNIT (2)	58	172	57.5	57.5	50

HORIZON LTD.: WORKINGS FOR BREAK EVEN POINT SALES			BEP SALES IN LITRES
1 CM PER UNIT	2 SALES MIX RATIO	1x2 WEIGHTED AVERAGE	
58	73%	42.34	
172	16%	27.52	
57.5	5%	2.875	
57.5	5%	2.875	
50	1%	0.5	
	100%	76.11	
TOTAL FIXED COSTS=	49,672,843=	652,645.42	
WEIGHTED AVERAGE CONTRIBUTION MARGIN:	76.11		

HORIZON LTD			.		
BREAK-EVEN INCOME STATEMENT TO CONFIRM					
	BEP SALES IN LITRES	SELLING PRICE PER UNIT	SALES VALUE/Shs.	LESS: VC	EQUALS CONTRIBUTION MARGIN
CROTON OIL	476,431.16	110	52,407,427.31		27,633,007.28
CAPECHESTNUT	104,423.27	300	31,326,980.21		17,960,802.44
CANOLA OIL	32,632.27	160	5,221,163.37		1,876,355.53

SUNFLOWER OIL	32,632.27	160	5,221,163.37		1,876,355.53
CASTOR OIL	6,526.45	100	652,645.42		326,322.50
TOTALS	652,645.42		94,829,379.68		49,672,843.28
LESS: TOTAL FIXED COSTS					49,672,843
NET PROFIT					-----0-----

2. Profitability of the firm by using profitability, activity and liquidity ratios; See Workings 2

WORKINGS 2: FINANCIAL STATEMENTS ANALYSIS					
SIGNIFICANT ACCOUNTING RATIOS					
	2011	RATIO IN 2011	2010	RATIO IN 2010	COMMENTS
<u>Profitability Ratios:</u>					
Sales to Plant Assets	360000000 / 300000000	1.2	303856000 / 310500000	1.0	Poor since typically 2-3 low capacity utilization; 4-5 average; and 6-7 for well managed companies
Fixed Assets to sales	(519,700,000/ 360,000,000)%	144.361111	(530500000/ 303856000)%	17	SALES CAN PAY FOR FIXED ASSETS AT 1.44 TIMES IN 2011 GOOD
Current Assets to sales	25,315,430	0.070320639	28,191,673	0.078310203	
	360,000,000	7%	360,000,000	8%	WEAK
Return On Total Assets	97,225,229	0.178389865 =17.84%	125,276,626	0.224232134 =22.4%	FALLING/ UNSATISFACTORY
	545,015,430	18%	558,691,673	22%	NOT SATISFACTORY
Return On Total Equity	97,225,229	0.371809602	125,276,626	0.456143038	
	261,491,980	37%	274,643,293	46%	
<u>Liquidity Ratios:</u>					
CURRENT RATIO=	Current Assets / Current Liabilities=	25315430/34023450= 0.7	28191673/28678380=1	Measures short term debt paying ability	

QUICK RATIO=	<u>Liquid Assets /</u> Current Liabilities=	17815430/3402 3450= 0.5	19691730/2867 8380= 0.7	Measures short term debt paying ability
<u>Capital Gear Ratio:</u>	249500000/261 491980	95%	255370000/ 274643293	93%
Fixed-Interest or Loan Capital to Equity Capital. If high the company's capital is said to be high-gearred; low-gearred where the reverse applies.				

3. Understand the impact of the financial statement as a visible face of its assets and the financing of such assets and the implications of adding capital from various sources. See the comment below.

From an investment analyst's point of view regard is paid more to the proportion of available profit required to service prior capital, a high-gearred company being one where the proportion is high, a low-gearred company one where the proportion is low.

Interesting enough Horizons has diversified its investment by investing in complementary business of buses travelling between Mombasa and Nairobi. This is a busy route and high cash flows daily. Banks are also very ready to loan on such businesses.

4. Understand and appreciate financial statements in recording value adding production processes into one statement, the income statement.
5. The importance and absence of budget in the company.

Horizon has only a cash budget reserve to pay the farmers and other collectors the raw material supplies. Lack of all budgets, capital budgets to show intended capital investments and master budget of income statement, balance sheet and especially budgeted cash flow may reflect low financial management and financial strategy.

Also, after applying the techniques above, the case information and analysis provides a robust basis for discussing critical issues:

- a. Whether Horizon Ltd should seek a donor or external investor, but it was tried before with Solarix without obtaining the capital required though they received a small loan.
- b. Whether Horizon Ltd should research to make use of by products by developing new products to sell in the market in order to increase sales revenues.
- c. Whether to increase marketing activity outside Nora Moru. This option requires capital investment in the long-term and detailed analysis of product cost structures so as to increase sales revenues; as well as increase the capacity.

The participants are encouraged to debate and discussion in the classroom on the importance of maintaining financial records to facilitate analysis and basing management decisions on options on such financial information for growth with foundation.

SUPPORTING MATERIAL

There is limited pedagogical support. However the charts provided will support the presentation.

FINANCIAL PERFORMANCE DATA FOR CASE ANALYSIS:

TABLE 1: Cost of Producing Capechestnut oil

TABLE 2: : Cost of Producing Canola oil

TABLE 3: : Cost of Producing Sunflower oil

TABLE 4: : Cost of Producing Croton oil

TABLE 5: : Cost of Producing Castor oil

TABLE 6: Income Statements

TABLE 7: Balance Sheets

CHART 1: Organizational chart.

Target Audience

The case can be used in training and teaching a broad range of audiences including undergraduate and MBA students, and specifically entrepreneurs in agribusiness. The case highlights the issues and struggles of an agribusiness firm involved in nature based and climate change friendly themes and products.

Targets:

1. Entrepreneurs in Agribusiness – entrepreneurship, social entrepreneurship, financial management in emerging global trends products and donor local partnerships.

The Horizon Ltd. case is an excellent example of how an NGO can innovate itself into an entrepreneurial firm , employ agricultural experts and engineers to manage production and sale of raw materials that would otherwise decay in the forests. It is also an example of social entrepreneurship with a community assisting purpose and the challenges faced in growing such a firm.

2. MBAs: student in business, entrepreneurship, finance and accounting.

The Horizon case will provide practical application and thus deepen understanding of the challenges faced by such unique business models and through analysis of financial data provide options and alternatives in a real world context.

Objectives

Agribusiness financial management. Ethical and corporate social responsibilities of society members who can provide vision and entrepreneurship in biodiversity and nature alternatives to dwindling resources and potentially harmful products and chemicals by formulating, growing and effectively managing a viable and profitable firm.

Suggested Assignments

Analyzing financial performance for sustainable growth of a value adding firm

Objectives;

Understanding the financial information in the financial statements and analyzing such information and interpreting it.

Group Presentation Questions:

1. What do you think about the Horizon business and the production of its products?
2. How are the production costs in relation to break even for each product and for the whole firm? Assess which product(s) are profitable?
3. Apply the various financial analysis techniques to evaluate the profitability, liquidity and growth potential of the firm.
4. How would you advise the MD on financing the three capital expansion ambitions of the firm: expanding the production base; expanding the product market; and expanding the research for forest based products and their by-products.

Suggested Presentation and timing

This case will be presented to participants at the beginning of the module or session for participants to read, assimilate and understand. After presentation of the financial statements and studying tools of analysis of financial data then each group will make presentation of its findings, each group having discussed and analysed each of the first three questions above. In the final plenary session and wrap up the participants can address the action plan and proposal to answer last question above.

Horizon Oils: Epilogue

Horizon Oils is still grappling with these issues. In 2011 it was contemplating selling the bio diesel production facilities to a potential new partner. The management realizes that board members, who are founder members have still not embraced in full the model of social entrepreneurship.