Capstone 1

Marmani Inc. — Case

***CPA Evaluation* — 2019**

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

It is May 9, 2019, and you, CPA, have recently been hired as the corporate controller at Marmani Inc. (Marmani). Previously, you were employed at Tomkins, Klein, and Associates LLP (TKA) as a member of the small business financial services group, providing consulting and business services to many clients. Roberto Marmani, the company founder, made the decision to outsource processing of Marmani's payroll transactions and month-end adjustments to TKA in 2009. You had been assigned to Marmani for the last two years, working closely with Roberto and his staff for an average of eight days per month, bringing some much-needed financial stewardship to Roberto's business. Your role was to help with payroll transactions and reporting, the timely completion of bank reconciliations, general ledger maintenance, and tax compliance, allowing Roberto to spend more time on operations.

More recently, Roberto recognized the need to focus more on developing the strategic direction of Marmani, which led to hiring you as the corporate controller. The partners at TKA had been very pleased with your job performance over the years and were happy for you to take this next step in your career path. Roberto realized that if Marmani is going to take advantage of any of the growth opportunities presented, then he must lead the company in a new, more professional direction. You have been tasked with performing a strategic analysis and recommending which direction Marmani should take, as well as addressing numerous operational issues that have been highlighted.

While you have gained familiarity with the company over the last two years, you have been provided with the following information to review and analyze in order to refresh and expand on your understanding of the company, and to assist you in your new role.

Company overview

Marmani, a Canadian privately held company located in Toronto, Ontario, is a medium-sized retail specialty line apparel company. Italian-born designer Roberto Marmani founded the company in 1994. Marmani currently operates in the adaptive apparel industry. Its main product is the SIDEAWAY Pant, a flexible alternative to the traditional hospital gown. The SIDEAWAY Pant has experienced continuous demand from health care, long-term care, and retirement facilities in Canada. More detail on this product can be found in Appendix I.

Industry information

Fashion

Fashion is a US$1.2 trillion global industry, with more than US$250 billion spent annually on fashion in the United States.[1] On a per-capita basis, Canadians spend the second-highest amount on apparel, averaging US$831 annually, topped only by Australians who spend an average of US$1,050 annually.[2] Many apparel companies offer their products for sale through online venues as well as through retail stores, and there has been a significant increase in consumers making online apparel purchases.

While Canadians are spending a significant sum on apparel, the Canadian fashion industry itself is struggling, as Canadian fashion brands face fierce global competition combined with the challenge of selling within a smaller domestic marketplace.[3] Statistics Canada data show that the total value of apparel made in Canada continues to decrease while apparel imports increase. Since 2011, apparel imports have increased by $3.4 billion, or an average of 8.3% annually, to total $12.5 billion in 2015.[4]

Within the apparel industry, diversification is key to success. Once a company has an established brand and product base, it is critical for it to expand to multiple sources of revenue by offering additional products and product lines or by expanding its customer base, in order to drive future growth. The industry is sensitive to shifts in trends and consumer perceptions and preferences, and the ability to respond to these shifts and/or having multiple product lines to absorb a decrease in popularity of one line can be crucial to a company's continued success. Creating a desirable brand in an underserved niche and then effectively marketing that brand — coupled with efficient distribution, constant innovation of the design process, control over the supply chain, expansion into other products, and consumer involvement — is imperative to success in this industry.[5]

Consumers in this industry can also be very sensitive to prices — whether they be too high, too moderate, or too low. Some consumers are interested in a more exclusive product and are attracted to the elitism that comes with a product that is priced quite high and is known for being better quality (a designer-type product). These consumers would shy away from products that are reasonably priced. Other consumers are more price-conscious and are looking for a good-quality product at a reasonable price. Still others are more focused on the bottom line and are willing to sacrifice a bit of quality for getting a lower-cost product. It is important that companies price products appropriately for their target consumer. It is also possible for companies to have a few different

[1] http://www.newmobility.com/2017/03/adaptive-clothing-shakes-up-world/
[2] http://wwd.com/business-news/financial/apparel-spending-list-10203626/
[3] http://www.huffingtonpost.ca/greg-hewitt/canadian-fashion-brands_b_6120858.html
[4] https://ic.gc.ca/eic/site/026.nsf/eng/h_00070.html
[5] http://smallbusiness.chron.com/important-factors-competition-clothing-market-81643.html

product lines, offered at the various price points, to cater to a wider range of consumers.[6]

Pricing and quality are not the only variables. Consumers may also be sensitive to how environmentally friendly or socially conscious a company is, considering where the products are made, and from what materials and how they are made, in making a purchase decision.

There have also been many technological advances within the industry that have helped to reduce the costs of inputs and increase quality. The ability of companies to capitalize on these technological advances and achieve more control over the supply chain — either in their own production processes or by purchasing the inputs at a lower cost from suppliers that utilize advanced technology — can be an important factor in the companies' continued success. Employing an experienced and versatile labour force that is adaptable to new manufacturing techniques can also help a company remain competitive in this industry. Digital technology adoption is increasing, with Canadian apparel manufacturers taking a multi-channel approach to sales.[7]

Adaptive clothing

A small and lesser-known facet of the fashion industry is the adaptive clothing segment. Adaptive clothing "refers to clothing designed for people with physical disabilities, the elderly, and the infirm who may experience difficulty dressing themselves due to an inability to manipulate closures, such as buttons and zippers, or due to a lack of a full range of motion required for self-dressing."[8] Examples of adaptive apparel include open-backed blouses and sweaters that can be put on without wearers having to raise their arms, open-backed pants, and extra-wide slippers for wearers with swollen feet.[9]

The adaptive clothing industry is a unique segment of the apparel industry in that it may not be as sensitive to changing trends and whims of the consumers, and constant innovation may not be as critical to future growth. It is estimated that by 2024, persons aged 65 years and older will account for 20.1% of the Canadian population.[10] The aging population, combined with the increased proportion of the senior demographic, can lead to a natural increase in the consumer base for adaptive apparel.

To date, very little money spent in the fashion industry has been focused on adaptive clothing or the needs of people with disabilities.[11] However, this segment of the fashion

[6] Ibid.
[7] https://ic.gc.ca/eic/site/026.nsf/eng/h_00070.html
[8] http://www.apparelsearch.com/definitions/clothing/adaptive_clothing.htm
[9] http://business.financialpost.com/entrepreneur/help-us-tailor-a-solution-for-adaptive-clothing-maker-silverts/wcm/616ec3e6-ac1f-491c-9d78-be83575eaf6c
[10] http://www.statcan.gc.ca/daily-quotidien/150929/dq150929b-eng.htm
[11] http://www.newmobility.com/2017/03/adaptive-clothing-shakes-up-world/

industry is starting to gain more traction and there is increasing competition, domestically and especially globally.

Snap and zippered closures are still the most commonly used closures. However, magnetic buttons for clothing are emerging for those with diminished dexterity. Magnets are placed behind decorative buttons and are strong enough to stay closed on shirts, pants, dresses, and skirts.

There is a continuing transformation occurring in Canada related to adaptive clothing. In the summer of 2014, the Royal Ontario Museum unveiled "Fashion Follows Form: Designs for Sitting," an exhibition honouring a well-known Canadian fashion designer who created "a revolutionary line of fashionable and functional clothing for the growing demographic of men and women who use wheelchairs."[12]

Adaptive clothing for special needs or people with disabilities is an evolving industry. "The right fit is not only important when it comes to looking good; it also helps people feel good. Studies show that feeling comfortable in certain clothing or fashion pieces can significantly boost confidence and self-esteem."[13] However, often the alternatives for people who use wheelchairs or have other disabilities are unattractive and/or uncomfortable clothing options.[14] Adaptive clothing attempts to address these issues with the appearance of traditional clothing.

There is limited competition in adaptive clothing in Canada. "There have been several small companies that have attempted to address the fashion needs of people with disabilities, but their success has been sporadic at best."[15] According to one designer, "finding the right pants is so hard for someone in a wheelchair… There's length, if it cuts into your hips, risk of pressure sores if pants have back pockets with rivets, and on top of all that, finding the right fit."[16]

While many trends come and go in the fashion world, only a few have been focused on the needs of people with disabilities. However, more designers are beginning to develop adaptive fashion solutions and bring adaptive fashion into the public's view.[17]

Company background

Roberto moved to Canada with his family in the late 1980s and became a Canadian citizen. After graduating from a fashion college in Oakville, Ontario, in 1991, Roberto worked as a creative director at a large Canadian sporting goods retailer. However, Roberto always knew that he wanted to run his own business, and in his spare time he focused on developing his own designs. Three years later, in 1994, Roberto had the

[12] https://www.rom.on.ca/en/exhibitions-galleries/exhibitions/past-exhibitions/fashion-follows-form
[13] http://www.newmobility.com/2017/03/adaptive-clothing-shakes-up-world/
[14] Ibid.
[15] Ibid.
[16] Ibid.
[17] Ibid.

design idea that would enable him to leave his job and start the business of his dreams — one with a culture of creativity and a healthy spirit of co-operation.

The company began when Roberto designed one key item, the ICON Tearaway Pant (ICON Pant), for both men and women. This style quickly became a leader in the field of fitness performance training wear. What made this item special was the unique “dome” snaps that went down the outside of each leg of the pant. Roberto outsourced the manufacturing of this innovative design and high-quality pant to a technologically advanced industrial production facility located in Toronto.

For six years, Marmani enjoyed doing business as a successful wholesale startup, selling the ICON Pant to the majority of the large North American sporting goods retailers, and the product flew off the shelves. Steady year-over-year growth drove double-digit annual sales increases to a high of $20 million at Marmani’s peak in the year 2000.

By 2007, the Canadian active wear industry had clearly begun to change, moving more toward velour track suits and yoga pants. Sales of the ICON Pant had consistently decreased each year since 2000 due to this shift in demand by consumers, and while Marmani was still marginally profitable, cash flow was becoming an issue. The cash balance began to fluctuate monthly between negative and marginally positive. As a result, Marmani had to cut many marketing and public relations initiatives.

In order to increase sales and profitability, Roberto and his team needed to find a way to create new demand for the pant. With a mandate to expand the use of the ICON Pant, Marmani focused on the value proposition of the item: its adaptability and convenience. After much research, Roberto and design manager Sonya Valencia became convinced of the importance of producing well-designed, attractive, and functional clothing for people with limited mobility. Roberto saw the opportunity with adaptive clothing to change the world of health care by serving the common good of hospital patients, the elderly, and people with disabilities, as well as their caregivers and the medical community at large, by providing high-quality apparel — all while making a profit and expanding his business with a team of people he valued greatly. Roberto and Sonya realized that by lowering the technical quality of the ICON Pant, the innovative design could be used to make cost-effective pants for the health care industry.

Roberto and Sonya spent much of 2007 and 2008 focused on creating, researching, designing, and developing the new product. In 2009, Marmani was ready to relaunch its product under the name “SIDEAWAY Pant.” Marmani then engaged TKA to help develop a financially sound selling strategy to market directly to health care facilities such as hospitals and rehabilitation centres, and to long-term care facilities. The response was overwhelming, and by 2009 the SIDEAWAY Pant was selling as a functional alternative to a hospital gown. The focus then shifted toward growing sales via a network of sales agents and marketing the SIDEAWAY Pant in this new market segment: health and wellness.

From 2009 to now, the SIDEAWAY Pant has become a popular standard outfit of hospital patients, people with disabilities, and the elderly. It provides independence in dressing and undressing, as well as allows wearers to feel clean, fresh, and well-groomed, which helps keep them in a more positive state of mind. This new and improved dignified patient clothing has received overwhelming praise from the medical community and caregivers. Marmani's experience in technical athletic design provides the attention to detail that these garments require in order to meet the special needs of these customers.

Along with the SIDEAWAY Pant, Marmani also designed, developed, and produced the Flexible T, a T-shirt that utilizes the same snap technology as the SIDEAWAY Pant to provide its wearers with more movement and flexibility. This product, while not as popular as the SIDEAWAY Pant, was still a success and continues to sell well.

Current operations

By 2018, Marmani was well known for its SIDEAWAY Pant, which is in constant demand by various health care, long-term care, and retirement facilities. Marmani's sales for 2018 were almost $41 million, a milestone for the entrepreneurial company. Continued success led Marmani to purchase its own 15,559-square-foot industrial warehouse and production facility, in the building located adjacent to its current office and warehouse space in the north end of Toronto. Roberto funded the purchase by taking a loan from his cousin for $6.6 million. Marmani also purchased three state-of-the-art programmable laser-cutting and assembly machines for use in the production facility, totalling $1.2 million. This purchase was also funded with an additional $1 million loan from the same cousin and the remainder with cash reserves.

The move away from outsourcing production resulted in higher fixed expenses and the need to hire additional staff, but Roberto believed this would pay off. Marmani now has control over the entire process, from production through to sales, including more oversight over the important aspects of product quality and timing. There is currently excess capacity at the production facility and 3,500 square feet of the space is unused. Utilizing this area could increase production by 10,000 direct labour hours. Labour continues to be Marmani's constraining resource, as the new equipment does not currently complete all stages of production and skilled employees are difficult to find.

Raw materials continue to be purchased from the same vendors Marmani has been working with for years. All products are produced using ethical production practices, an important consideration for Roberto. Soft, machine-washable fabrics in a variety of cheery colours are sourced from a well-known ethical supplier in southern China that uses sustainable manufacturing practices. Roberto has resisted the temptation to decrease the quality of the fabrics used in making his apparel. While this would save money, Roberto's passion for quality simply won't allow him to make that move.

Currently, all of Marmani's sales occur through sales agents, who interact with the customers on behalf of Marmani. The company does not have any online presence.

Maximizing profitability is now largely driven by how efficiently the production facility has been able to operate by specializing in one line of business. However, Roberto realizes that he needs to explore how to best utilize the excess capacity of the production facility, with a continued focus on efficiencies and profitability. Roberto is averse to business risk, as he wants to avoid the hard times that Marmani went through, but realizes that the best way to do this is by exploring new opportunities and growing the company in a diversified manner.

Vision statement

"Our vision is to be a leader in the apparel industry by creating products that perform beyond expectation for our customers and make people's lives better."

Mission statement

"We accomplish our vision by designing and selling technical clothing that offers optimal functionality while still being attractive."

Marmani has not updated its vision or mission statements since 2009, when the SIDEAWAY Pant was launched.

Values

Marmani's and Roberto's current core values and beliefs include:

- passion for everyone to stay active and lead a healthy lifestyle
- quality, a high level of service, and value for customers
- innovative clothing designs and production practices
- ethical and environmentally sustainable operations

Company structure

Marmani is owned 100% by Roberto Marmani, who incorporated the company in 1994 and is the current CEO. Roberto is compensated solely by salary. Marmani's poor cash flows in 2007 significantly impacted his family finances and it is now his preference to keep his personal finances separate from the company's. Since 2010, he has not advanced Marmani any shareholder loans. Roberto would like to limit his investment to the original amount invested when Marmani was incorporated.

Marmani has no formal board of directors, though TKA has provided some business advice in the past, primarily related to the launch of the SIDEAWAY Pant in 2009. Most decisions must flow through Roberto, and the other members of the management team have very little control or decision-making power.

Management team

Marmani's management team is composed of the following individuals:

Sonya Valencia, design manager

Sonya has been with Marmani since 1999. She joined mainly to learn from Roberto, given his reputation as a highly creative designer with a great ability to see the finished product, even before he puts it on paper. Sonya is confident in her own drawing and sewing skills, but realizes that she needs to be more of a team player in order to capitalize on the talents of others in expanding the adaptive clothing product line. She hopes Roberto remembers her contributions to making the SIDEAWAY Pant successful — specifically, she was responsible for selecting the fabrics and sourcing the materials; she wants to remain valued and needed.

Sonya feels strongly about continuing in the adaptive clothing industry, and has been devoting much of her time to developing a more diversified collection of designs. She has a family member who was recently moved into a long-term care facility and she has seen first-hand the difficult job caregivers have, including the limitations and risks associated with dressing patients. This has increased her passion to turn her design ideas into reality.

Karen Zenkovic, communications and marketing manager

Karen joined Marmani in 2004 with a mandate to help drive sales of the ICON Pant. She came from a very structured working environment at a public relations agency, and has had a difficult time working for an entrepreneur. Roberto makes important decisions quickly and with little information. Karen has been trying to set out a clear marketing strategy, but with a very small marketing budget. She is still trying to make the company a customer-centric organization. Karen has requested an investment in IT infrastructure to support a digital marketing strategy, but Roberto has not agreed to it.

Karen's role has evolved over the years, and she now spends a lot of time overseeing the sales agents, serving as their first point of contact. Karen tries to get as much detailed customer data as she can, but the agents aren't quick to share too much and the IT system doesn't capture sufficient data on customer inquiries and orders to support a detailed analysis. She has been tasked by Roberto to review and approve all press releases, press interviews, and customer communications; however, he often forgets to include her in pertinent meetings. She wants to support Roberto, but she sometimes wonders how her day-to-day work has drifted so far away from her true area of expertise.

Don Baker, supply chain manager

Don has been with Marmani since its inception, being the first employee hired. He is very loyal to his boss, and tries to help out with whatever needs to get done. With the

move to the new production facility, Don feels he has taken on many more shipping and receiving duties than before. He tries to keep to himself, and not get too much in Roberto's way, so he is fine with his employees getting their answers directly from Roberto.

Wayne Croxton, production manager

Wayne recently joined the company, with the primary responsibility to oversee the production facility and its workers. Previously, he worked in a large apparel factory in Montreal and he has been trying to set up a costing system at Marmani similar to the one he used there. However, the machines purchased by Marmani are brand new and very high-tech compared to the old machines he was used to. They need to be programmed, especially the laser cutter, which only needs one worker to attend to it. He is not confident in his costing analysis. Data on garment specifications, when programmed, can be integrated with other software to facilitate procurement of raw materials and production scheduling, but the IT system would need to be upgraded to capture this information. This level of IT system expertise is beyond Wayne's capabilities.

Ronald Wu, accountant

While not a management member, Ronald has been a key employee. He has been with Marmani for 19 years, and is now reporting to CPA, the new corporate controller. Ronald has worked independently on the day-to-day accounting tasks related to banking, calling customers for payment when they are overdue, and paying vendors, both by cheque and letter of credit, as required. He has worked closely with CPA in the contract work performed by TKA, and felt relieved when CPA was hired.

The company's current organizational chart is included in Appendix II, along with the company head count.

Other stakeholders

Ray Cirello, Roberto's cousin, has been financing the growth of Marmani off and on over the past 20 years. Ray made his own entrepreneurial success in the beauty and cosmetics industry with a very lucrative distribution business. He started out by securing exclusive rights to a high-end hair care line out of the United States and brought it into Canada, selling to hair salons across the country. Ray has since travelled the world to find other exclusive brands, continuing the same business model of bringing these global brands into Canada and selling them to salons and other beauty retailers. Ray has always encouraged Roberto to follow in his footsteps of entrepreneurship and find his own niche, so he was willing and able to provide financing, as needed, with fair and reasonable terms.

Financing and banking

Initially, Roberto started Marmani with his own money, which he had been saving since his first part-time job in the hopes of opening his own business one day. Over the years, he has received several loans from his cousin, Ray, and repaid all or some of the outstanding balance when he felt that Marmani had enough cash. The most recent increase in the loan was for $7.6 million in 2018, used to finance the purchase of the production facility and equipment. There are no covenants or security required. Marmani pays Ray annual interest at 4% on the outstanding loan balance.

Historically, Roberto's belief was that growth should only be financed by internally generated funds combined with financing from family members, and he has always been hesitant to take on debt. Roberto knew he could always rely on Ray for financial help, and, for a long time, he was content to grow Marmani at a very slow pace, with minimal risk. Marmani went through sharp cash fluctuations when the demand for the ICON Pant diminished, beginning in 2001. Due to the lack of diversification of his business, Roberto was lucky Ray was there for him, providing Marmani with cash as needed. Marmani made principal repayments when it could until Ray agreed that any loan repayments would not be needed until he retired. The responsibility of owing money to a family member has been a lot for Roberto to deal with.

Late in 2018, Ray advised Roberto that he had decided to retire within the next two years, and would be requiring repayment of all loans to begin in 2020. Marmani will need to make principal repayments to Ray in the amount of $200,000 per month, in addition to the annual interest payments, until all loans and interest have been paid. These terms have been verbally agreed upon.

For the last 25 years, Marmani has banked with Hurley Bank of Canada (Hurley). Marmani has always been pleased with the banking services provided. Marmani has four bank accounts, and deals with foreign exchange letters of credit for the raw materials it buys overseas.

Now that Marmani cannot rely on Ray for financing and must begin to make loan repayments, Roberto wants to proceed with obtaining a $600,000 operating line of credit from Hurley to ensure Marmani has access to funds as needed, for future expansion or as a safeguard against sales fluctuations.

In his recent meetings with Hurley, Roberto has been told that any short-term borrowing would need to be secured by Marmani's accounts receivable and inventory, along with a personal guarantee from the shareholder. Hurley recommended a $600,000 revolving credit facility, and requested the following information to determine Marmani's credit worthiness:

- a complete set of financial statements, prepared in accordance with accounting standards for private enterprises (ASPE), reviewed or audited (preferably audited)

- a strategic business plan for the next five years, including forward-looking financial projections incorporating the impact of any planned strategic objectives
- complete details of the accounts receivable and inventory accounts for the current year
- other personal financial information from Roberto

The interest rate would be 6%. The banking agreement would also include a covenant requiring a minimum return on assets of 8% (calculated using after-tax income and the year-end balance of total assets).

Financial reporting and budgeting

A few years into operations, Roberto hired Ronald Wu, an accountant, to keep the records. Ronald would create simple reports for Roberto to understand how the company was doing. Initially, all reports were prepared primarily in Microsoft Excel, as the company did not use any formal accounting software. Roberto managed the finances and what was spent by the company on a cash basis, using an Excel daily cash report Ronald prepared for him. This helped them decide when to release cheques and when to pay the bills. Even though payments were sometimes made late, Marmani's vendors always knew they would get paid. Marmani has therefore built up an honourable business reputation within the vendor community.

In 2010, following TKA's recommendation to improve monthly reporting, Marmani purchased an off-the-shelf accounting software package, but Ronald only ever used the general ledger module and continued to operate on a cash basis. Over the years, shipping, procurement, receiving, and production have automated some functions and generate various reports (such as raw materials requisitioned). There is no integration of these reports with the accounting software. Ronald posts entries to the general ledger weekly.

Ronald is not an expert in preparing payroll, tax returns, or government compliance filings. While he has done his best, his efforts have resulted in Marmani paying late penalties and interest to the government from time to time. In 2009, Marmani engaged TKA to assist with payroll, provide tax advice, and prepare corporate federal, provincial, and GST (now HST) tax returns and filings, in addition to providing strategic advice related to the new SIDEAWAY Pant. Marmani's corporate income tax and government compliance filings have all been made accurately and on time ever since. TKA has also taken over Roberto's personal tax work, providing him with personal tax advice and estate planning.

Marmani has never prepared any formal financial statements beyond minimal compilation work needed for tax purposes, since Ray was its only lender and has never asked to see any company financial information. Over the years, TKA has recommended budgeting or forecasting be done. Roberto has resisted this, however, since he has been involved in every facet of the company and felt he had a good-

enough understanding to make any necessary decisions. Since Roberto is involved in most areas of the company, there has been very little attention to developing effective internal controls.

Management meeting

Roberto held a meeting with his management team on May 7, 2019, explaining this was to be a strategic planning session for the business, looking forward to the next five years, as well as an opportunity to address some important operational issues.

Excerpts from the discussions that took place follow:

Roberto: Thanks to all of you for being here and welcome to CPA, who is attending our management meeting for the first time!

Management team: Welcome, CPA!

Roberto: You are all aware of the increasing competition we are facing in our current industry. While I am comfortable that the sales levels that we have now achieved are sustainable into the near future, I am concerned that, given the increased competition, Marmani will not be able to realize any substantial growth going forward if we stay small and focused on only a limited line of products. Therefore, it is important that we proactively seek out solutions to ensure the company's continued growth and profitability. The last 25 years, while enjoyable, have been difficult and stressful at times. I don't want to remain stagnant and I would like to achieve annual revenue growth of 8% to 10%. Current industry long-term growth is projected to be 4% per year. There are a number of strategic alternatives for us to consider.

Don: I am not looking forward to making changes. I have always loved working here, and we're busy with new orders. We make great products, and we always have!

Roberto: I hear what you're saying Don, but we don't want to face another situation like we did back in 2007, where demand for our main product was declining and we had to scramble to find a new direction. We are in a good financial position and demand for our products remains strong, so now is an opportune time to proactively think about where we want the company to go in the future. CPA will be performing the analysis of all of the options we discuss here, and will prepare a report outlining the best strategic alternatives for Marmani to take. I agree that Marmani is known for its high-quality products, so whatever direction we decide to pursue, it is important that we maintain our commitment to quality.

One potential strategic option is to consider selling Marmani. I was recently approached by Witherspoon's Mobility Ltd. (Witherspoon's) about the possibility of selling Marmani. It is a large, U.S. retailer of medical supplies, and they are impressed by our adaptive clothing designs. I know everyone is shocked by this option, but it could be a means to an end. I have provided more details about the offer (see Appendix III). Frankly, I'm

shocked by the selling price proposed. I didn't think Marmani was worth that much! I would like CPA to perform an analysis of the offer and evaluate the selling price for my shares based on the value of the company. Maybe Marmani is worth even more? I have promised to get back to Witherspoon's soon, as I know they are interested in completing a sale by the end of June.

Don: This June? That seems really quick.

Roberto: Yes, this June. They also mentioned something about needing to complete due diligence, which I didn't quite understand. CPA, would you be able to explain what this means and what it could entail for Marmani? As well, I wasn't sure if there would be any tax implications that I should personally consider before deciding whether to move ahead with the sale. I have not claimed any capital gains exemptions to date related to the sale of small business shares.

CPA: Yes, I would be happy to include this information in a separate report for you.

Karen: What would happen to our jobs?

Roberto: Well, there could be an option to negotiate for some or all employees to stay on. If I can net $25 million on the selling price of my shares after tax, I would consider taking the money to start another business. Essentially, I would be continuing to build on my initial investment in Marmani.

Sonya: We have been so successful in the adaptive apparel industry, enjoying a favourable margin, and there is still such growth potential. I don't really see the point of moving into a different industry where we don't have any experience.

Roberto: It would actually be an industry that is very similar to the one Marmani started out in — athletic apparel. I have continued to follow the athletic apparel industry and there is a new trend developing called "athleisure." One of my former classmates, who is now the head designer for a high-end apparel retailer, called me up to talk seriously about this up-and-coming trend. He wanted to know if I would be interested in designing, producing, and selling wholesale athleisure products to the large North American sporting goods and clothing retailers. Some of the retailers are the very same that sold our ICON Pant. My friend also expressed interest in coming to work for Marmani as a designer, should Marmani move in this new direction. We have both already come up with some designs. My primary area of interest has always been the athletic fashion world and it is intriguing to consider moving back in that direction. I'm excited to see if I would be able to design and develop another "runner" apparel product as a pure-play athleisure brand with the same success as our original ICON Pant!

I have provided some preliminary background information about the athleisure industry (Appendix IV). Even if I don't sell my shares of Marmani, there is the option of adding an athleisure division alongside adaptive apparel to utilize our excess capacity. I have pulled together some financial details about the possibility of moving in this direction

using our manufacturing data and my preliminary designs (see Appendix V). Wayne provided the facility information, as diversification into athleisure would require more production capacity than our current plant. I have also researched outsourcing production. CPA, I would like you to perform an analysis of this option to include in your report.

Sonya: There is so much we don't know about the athleisure industry. Is this a trend or fad, or could this be a mega-trend in fashion that is here for a long time? Who are the key competitors? Who are the target customers and how do we best sell to them? I think there is more to consider than just the financial results.

Roberto: You are right, Sonya. It is important we think carefully before moving in this direction. CPA will perform some additional research about this industry and consider some of these qualitative points before providing a recommendation. I know how passionate you are about the work we are doing with adaptive clothing.

Sonya: Yes, I think everyone knows athleisure is a big deal right now, but I feel the bubble is going to burst pretty soon. My heart is in designing products to truly improve the quality of the lives of our current customers. Marmani is developing clothing that is making a real difference, and I think that is where our success lies. I think there is a lot of potential within our current industry and there are many improvements we could make to our current operations that will have a significant positive impact on future results. One area that we need to understand better is how to maximize our sales volume. We are in a growing industry as people age and as people with disabilities become more aware of our products. And we haven't made many changes to our marketing recently.

Karen: I have to agree; there is potential to expand and change our marketing strategies. I have documentation for CPA on some sales options to better connect us with our customers (Appendix VI), and I would like CPA's advice on both of these issues. CPA should proceed under the assumption that both issues are strategic and that Marmani is not sold, regardless of whether the athleisure expansion occurs. First, we need to decide whether to continue with our strategy of using sales agents to sell our products or to hire our own sales force. In listening to Roberto's expansion ideas, it occurs to me that there may be significant differences between adaptive clothing and athleisure apparel when it comes to our target market and how we reach them. Second, there is also an opportunity to reach smaller health care facilities that our sales agents currently do not visit by developing some digital marketing for Marmani. Aside from many other benefits, reaching more customers could increase our existing product revenue by 1% per year.

Roberto: We would be selling wholesale to the athletic retailers, so I don't see the need to waste valuable financial resources on digital marketing. The products should speak for themselves, just as the ICON Pant did.

Karen: No matter how we sell our products, we need to continue to build the Marmani brand by understanding our consumers. I am wondering whether there are other marketing initiatives that Marmani should adopt? I haven't devoted any time to new marketing strategies, given how much time I spend interacting with the sales agents. CPA, as part of your report, can you also address this issue and let me know where I should start on the marketing and branding of the company?

CPA: I can definitely look into these issues and provide my findings.

Roberto: Sonya, I believe you had mentioned there was a strategy you wished to present?

Sonya: I believe the best way to grow Marmani and increase profitability is to concentrate our collective efforts in our current industry. We can increase market share by introducing new products and selling more adaptive clothing to our existing customer base.

I wanted some specific feedback about the designs I have been developing for clothing with back snaps, shoulder-opening clothing, side-opening pants, front-zipper dresses, diabetic shoes, and other footwear. I am also working with the latest mineral-based technology that allows clothing to improve stability and balance. I ran several focus groups with target customers about the importance of wearing clothing that made dressing effortless instead of a chore to see how successful my new design ideas may be. I have provided the results of the customer focus groups (Appendix VII).

Roberto: This is very exciting, and I am impressed with your initiative, Sonya. The development and formulation of new designs could turn into an entire collection.

Sonya: Definitely! But, at this point, we are not ready to move forward with most of the new designs — they are still in the research stage. We would need to think of our production capacity if we decide to develop and produce more items. However, there are also existing products that we can purchase and resell to our customers, such as sandals, slippers, and orthopedic footwear, that would not impact our capacity. Wayne and I have done some preliminary analysis regarding the two products I would like to begin selling over the next year: adaptive sleepwear and medical compression socks (Appendix VIII). For now, we have estimated revenues based on selling to our existing customer base. I am not sure how to make a decision on which products to make or buy, considering our limited capacity.

Wayne: Yes, I think expanding our current product line is the way to go. The products proposed could be made and stocked using our excess space and capacity. We could test the market to see if the product line can be expanded. We are familiar with the products and it would secure all of our jobs.

Karen: Both sleepwear and socks would be of interest to consumers whom we could market to directly, instead of only selling to health care, long-term care, and retirement

facilities. These products would allow us to grow by tapping into new customer segments we have not previously sold to. Once our assortment is large enough, we could eventually even consider new sales channels like online marketplaces such as Amazon.

Sonya: Our sales agents have been critical to the adaptive clothing line's success. Their presentations really show the benefits of our products to patients and staff. It is helpful for buyers in health care, long-term care, and retirement facilities to feel, touch, and try the various products. And the buyers appreciate the knowledge and personal contact of the sales agents.

Roberto: Sonya, your passion for our business is wonderful. Let's start by asking CPA to review and further analyze the information you've gathered and make some recommendations. I would like this analysis performed regardless of the recommendations made on other strategic options, as I am not sure what direction I will end up taking and am curious about the results. I agree that there is the potential to expand our current product line, especially given the excess capacity we have at our production facility. As well, if volume gets too high, we can always explore outsourcing some of the production back to the third-party factory Marmani has always dealt with, though this could result in higher costs than if we produced it internally. I know our loyal customers would be interested to see what other products and designs we can come up with.

Sonya: Great!

Roberto: CPA, as you know, I am looking into obtaining a bank operating line of credit, now that my cousin will no longer be in a position to advance Marmani any additional funds. In addition to a five-year projection, the bank has requested either reviewed or audited financial statements. What does this mean? Which would be better for us and why?

I am also wondering if there are other financing alternatives available to us and if we should be pursuing these instead of, or in conjunction with, the operating line of credit. I'm not sure how much funds we will need to complete the strategic initiatives we have discussed here. Could you let us know how much financing would be required, given your recommendations, and also present some financing options? Taking on bank long-term debt might be one option. I don't like the idea of taking on a lot of new debt — I'm just not comfortable with it, especially given that we have to repay Ray. Are there any equity options?

CPA: I will be happy to provide this information, in addition to the five-year projection requested by the bank. I will be sure to incorporate the impact of my recommendations into the projection to present a complete picture of the expected future of the company.

Roberto: Does anyone have any other issues they'd like to address?

Wayne: I do. I'm concerned about the accuracy of the cost of sales I have provided to Ronald weekly for posting to the general ledger. The machines used in the production process are able to gather data to better allocate indirect costs. I have never allocated the costs to this level of detail before. I have prepared some details on our current job costing system and other cost data (Appendix IX).

Roberto: Production is entirely new to me and most of our staff, so it is important that we fully understand the cost of manufacturing different products and orders, as it can impact what our selling prices should be. CPA, could you please have a look at the information Wayne provided and let us know if there are any issues with our current costing process and any recommendations for improvement?

CPA: Of course!

Roberto: I have a few other concerns I would like to address. Most of you have been with the company for quite some time, and most of our employees are quite long-term. I understand it has been difficult for you to be effective managers because all the staff come directly to me with their questions. This is mostly my fault, as I have liked to be involved in every aspect of the business and encouraged employees to come to me. However, as we move forward and continue to grow and embark on new initiatives, it will become increasingly important for me to take on much more of an oversight role and focus on strategic planning and monitoring our financial results. I would also like to be able to evaluate how the company is progressing toward the strategic goals we are now developing. I want to be in a position to be alert to any operational changes that need to be made, but the ongoing operations should be run by this management team. Our organizational chart needs to be updated to reflect better reporting lines and roles and responsibilities, to help create a more professional and formal organizational and reporting structure.

CPA: I can take care of this for you.

Roberto: Thanks. I am also interested in learning more about the value of creating a board of directors. I will always remain the CEO and founder of Marmani, but Ray has mentioned to me many times all the benefits he realized in his business once he had a formal board in place. TKA had suggested a board too, but I really need to see the value for my business. Could you please explain what some of these benefits are for Marmani given our planned strategies, who the board should be comprised of, and what the board would be responsible for? If you notice any other governance issues that we should be addressing, please discuss them in your report as well.

CPA: Certainly.

Wayne: I notice that we are talking about making a lot of potential changes. But what does all of this mean for us as managers? If we are taking on more work, will we be compensated accordingly?

Don: I'm concerned about this as well. Right now, I do a bit of everything, not just what is in my job description. It would be nice to be recognized for everything I do around here, especially if I'm going to be taking on new work as a result of any of these new strategic initiatives.

Roberto: These are valid concerns. I would like to offer a better compensation scheme to reward all employees for their loyalty and hard work. I am happy that Marmani has such low employee turnover, particularly within the management team. Most of the employees feel like family to me! However, it is important that any bonus motivates employees to achieve the goals and strategic objectives of the company.

CPA: Sounds good. I will provide some advice on performance measures and incentive plans for employees.

Karen: One other thing I've noticed is that we've always emphasized and marketed Marmani as a "steward of the environment." However, I've noticed limited sustainability formally incorporated into the day-to-day business operations. I know there is a lot of information on the internet on this subject, and I'm wondering whether we could formalize policies that provide clear direction to employees and perhaps other stakeholders.

CPA: I can perform some research on this topic and let you know. It may be possible that some sustainability initiatives will positively affect the production facility.

Roberto: CPA, I know that our accountant Ronald is very happy to have you on board. He has mentioned you have already set up a few more modules to integrate with the general ledger that he has been using in the accounting software package.

CPA: Yes, I did, but there is more work to do. It is important that Marmani have an accounting system to accurately track transactions and prepare important reports that can be used to analyze performance. I was able to create a draft set of financial statements for 2018 with comparatives from the prior year. I used these financial statements to build some projections based on the current operations (see Appendix X). I have also included some industry metrics for both the retail and wholesale apparel industry in Canada (Appendix XI). As you can see from the cash flow projections, it may be difficult to meet the repayments to Ray and sustain our expected capital expenditures if we are considering other expansion opportunities as well. These projections will need to be updated to reflect the recommended initiatives and operating issues.

Roberto: Our current IT system is quite old. Should we consider upgrading our IT and accounting systems, now that we are focused on future growth? If so, then why? And what are some elements that would be important to consider?

CPA: Yes, this would be a good idea, as we can leverage technology to obtain more information and be more efficient in our business processes. I will provide you with some details on this in my report.

Roberto: Thanks, everyone, for your input. It's time to focus on our future!

Table of appendices

Appendix I
Press release on the SIDEAWAY Pant
Provided by Sonya Valencia

FOR IMMEDIATE RELEASE

The SIDEAWAY Pant

Marmani Inc. Enters the Healthcare Market with its First Innovation in Patient Apparel

Toronto, Canada, June 30, 2009: Earlier this year, Marmani Inc. introduced a brand new product called the "SIDEAWAY Pant" designed to transform the patient experience, making hospital wear more dignified. It is more comfortable, flexible, and convenient than that dreaded hospital gown. The lightweight pant comes in a variety of colours, features snaps down the outside of the leg and allows for freedom of movement.

That hospitals should avoid insisting on the gowns when possible was the overwhelming sentiment of the many physicians Marmani consulted when designing the innovative new product. One doctor described the standard-issue hospital gown as the hospital's version of a prison jumpsuit.[18]

The thinking in the past was that the design of the standard hospital gown was a necessary evil. Not only do they provide doctors and nurses easy access to the patient's body, but the one-size-fits-all garments are easy to launder and reasonable to purchase, noted Dr. Todd Lee, the internal medicine specialist at Montreal's Royal Victoria Hospital.[19]

These facts were seriously considered by Roberto Marmani, founder and CEO. "Marmani's goal is to improve the comfort and convenience for patients with a lightweight and cheery garment that can easily fit almost any patient because of the built-in snap flexibility," he says. "The pant comes in unisex sizes from small to extra large."

With the help of physicians at hospitals in Vancouver, Toronto, Montreal, and Halifax, a total of 154 patients in various departments were interviewed. "The doctors treating them deemed that 57% were eligible to wear lower-body garments, and almost all the patients said that would be their preference. Yet only 11% were doing so, with the rest wearing the classic open-back gowns, though some hospitals have recently adopted more modest designs."[20]

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[18] http://nationalpost.com/health/the-dreaded-hospital-gown-described-as-health-cares-prison-jumpsuit-often-imposed-on-patients-needlessly-study/wcm/5f64fe86-0803-4cc0-93bb-383997ad682e
[19] Ibid.
[20] Ibid.

Appendix I
Press release on the SIDEAWAY Pant (continued)

"Alies Maybee does not need to be convinced of that argument. She spent three days in hospital after an operation two years ago and could see "no earthly reason" why she had to wear a flimsy, open-backed hospital gown the whole time. After all, the surgery she underwent was on her elbow."[21]

"The SIDEAWAY Pant is also perfect for rehabilitation centres, long-term care facilities, and other health facilities. The pant still allows surgeons, doctors, and nurses easy access to the body, while preserving the patients' dignity when they are walking around. The pant also makes a great staple for senior citizens, as it addresses restrictions in their daily lives," says Roberto.

Features and benefits of the SIDEAWAY Pant include the following:

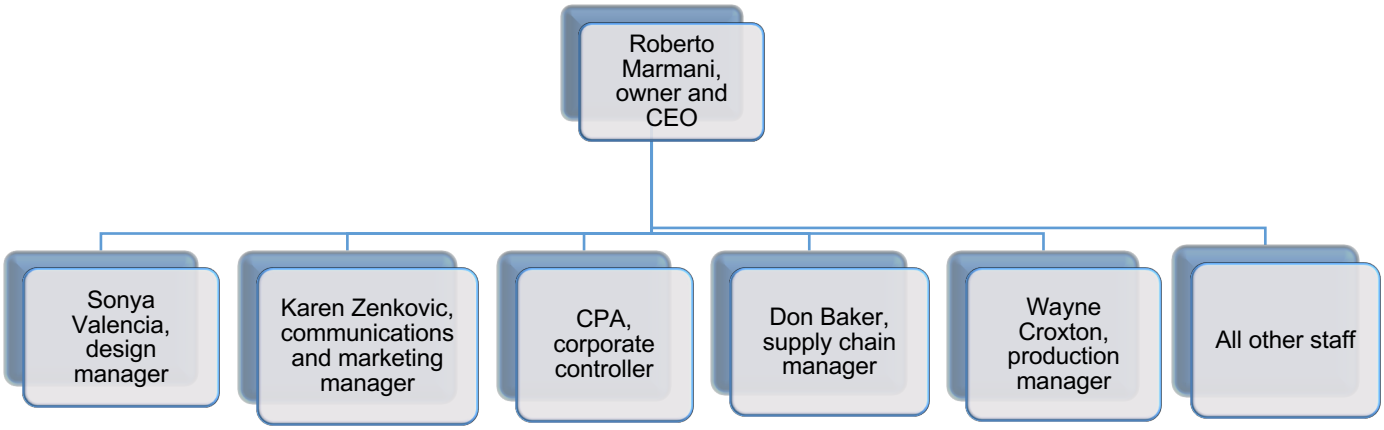
- made of high-quality, soft material that is durable and easily washable, with easy-snap technology down the outside of the leg
- designed for men and women in unisex sizes, striking a perfect balance of function and form
- available in multiple cheery colours
- can be paired with patients' own T-shirts
- perfectly comfortable to wear with dignity and modesty

Marmani Inc. is headquartered in Toronto, Canada, with the ability to sell around the globe.

For more information, contact:
Marmani Inc.
Karen Zenkovic, communications and marketing manager
416-123-4567; kzen@marmani.ca

[21] Ibid.

Appendix II
Organizational chart and company head count



Head count as of April 2019:

Department	**Employees**
Management	6
Administrative support	2
Accounting and finance	1
Information technology	2
Human resources and payroll	2
Marketing and communications	1
Production (pattern layers, cutters, sewers, and so on)	16
Graphic design	2
Shipping/receiving	2
Quality control	2
Total	**36**

Salary details:

- Roberto's salary is $425,000.
- Other members of the management team earn $105,000 with no other incentives.
- The average salary for all other employees is $63,000.

Appendix III
Offer to purchase Marmani
Prepared by Roberto Marmani

Witherspoon's is a large U.S. retailer of medical supplies that has been in business for 35 years. It specializes in providing home care equipment at an affordable cost for those dealing with wellness or mobility issues who wish to retain a level of independence. Witherspoon's is known for its high-quality products and excellent customer service. Its mission is to support "active independent living." It has retail stores throughout the United States and some parts of Canada.

Witherspoon's has been considering expanding outside the medical supplies industry and sees the adaptive apparel industry as a logical next step. It is interested in acquiring an apparel company in order to produce its own private-label line of adaptive apparel. As Witherspoon's has no previous business experience in design or production of apparel, it is interested in acquiring the experience and expertise it lacks. The CEO of Witherspoon's, Jeff Powell, believes that owning apparel factories and investing in technology is the best way to make better apparel and thus meet the needs of the highly valued customers to whom he feels a genuine responsibility.

The following are some highlights of Witherspoon's:

- It is a public company with a reputation for strong corporate governance and corporate social responsibility, and this is a reflection of management's values.
- Its board of directors foster the highest levels of ethics and integrity.
- It has maximized its market share penetration in North America's mass-market retail channel for its products.
- It is a full product line supplier of:
  - health and medical supplies
  - bedroom and sleeping accessories
  - exercise and fitness products and aids
  - wheelchair and walker accessories
- All products are manufactured in a co-owned, high-tech facility in Shanghai, China.
- It has made several successful acquisitions in the past, which has involved moving members of its own management team into the companies to help facilitate a smooth transition. Typically, some employees have been laid off.
- It has high demand from existing customers to expand its product line into adaptive apparel, but has proceeded slowly into this new line of business due to the technical design complexities of adaptive apparel. However, Witherspoon's does have an extensive network that would enable it to produce apparel in Asia if it so chooses.

Appendix III
Offer to purchase Marmani (continued)

Witherspoon's has approached me to discuss the potential acquisition of Marmani, and wishes to purchase my shares as opposed to just Marmani's assets. Witherspoon's has suggested a value of $26 million as a starting point for negotiations. It is particularly interested in Marmani given our proven innovation, advanced technology, skilled design team, and niche products. Witherspoon's would want to retain me as an advisor for at least a year to help expand Witherspoon's current business and to help it transition into this new industry. Witherspoon's would pay me $200,000 annually in exchange for my agreement to provide them with services for 30 hours per week. Witherspoon's would also require a non-complete clause to be included in the agreement.

I have discussed the potential acquisition with TKA, who has provided the following information for consideration:

- TKA suggests that a discounted cash flow approach should be used, based on the projected 2019 through 2023 results, and offered to perform the valuation. Given the increasing volumes, I think annual working capital investment will be required as CPA forecasted (see Appendix X).
- After some research and discussion, TKA determined that an appropriate weighted average cost of capital for Marmani is 10%.
- TKA has calculated the present value of the existing tax shield to be $250,000.

Appendix IV
Background information on the athleisure industry
Prepared by Roberto Marmani

Athleisure refers to casual clothing designed to be worn for exercising and general use, and is about wearing clothing that is comfortable enough to work out in but also fashionable enough to wear for other aspects of one's life.[22] Athleisure is often about looking stylish while exercising, as there is now commonly a social element to fitness.[23] The look is overall sporty, such as leggings, yoga pants, and muscle T-shirts, and often uses performance materials and fabrics, including sweat-wicking and anti-odour materials.

The growth in athleisure attire is the result of two shifts in fashion: the casualization of attire and cultural shift in the workplace (such as the emergence of a "casual Friday" and the acceptance of wearing sneakers and sweatpants to the office) and the increased health consciousness of consumers.[24] "Sports apparel and footwear sales have jumped 42% to [US]$270 billion between 2007 and 2015. It's the kind of winning streak that raises … investor skepticism. Is the sportswear sector due for a fall? In fact, prospects for growth are getting stronger, not weaker, as health and fitness trend for adults and sports participation for youth goes global, according to a recent report from Morgan Stanley Research, 'Global Athletic Wear: Very Bullish Five-Year Outlook' ...The report estimates that the industry could add [US] $83 billion in sales by 2020, or more than 30% growth."[25]

[22] https://www.scmp.com/magazines/style/fashion-beauty/article/1983046/brand-new-lifestyle-luxury-fashion-brands-are
[23] Ibid.
[24] https://www.forbes.com/sites/greatspeculations/2016/10/06/the-athleisure-trend-is-here-to-stay/#2dae748128bd
[25] http://www.morganstanley.com/ideas/global-athletic-wear-geared-for-growth

Appendix V
Athleisure division/company expansion
Prepared by Roberto Marmani

There is the potential to begin an athleisure division within Marmani or, if I sell my shares in Marmani, begin a new company focusing on athleisure attire. I believe the high-potential markets for athleisure attire are in Western Canada and the western United States. I have identified three possible alternatives for the production of athleisure attire:

New production facility — Richmond, British Columbia

By focusing selling efforts and having a sales presence in Western Canada, I believe Marmani could realize $4 million in incremental sales in 2020, with the potential to increase by 3% in the subsequent year as recognition of the Marmani brand grows. Sales are then projected to increase with inflation each year.

Marmani contracted with a property management firm in British Columbia to source and evaluate several location options, and then negotiate with the landlord. I feel that the fee of $30,000 we paid for the report and expertise was worth the expense and saved valuable management time. There is the potential to lease a 20,000-square-foot facility in Richmond, British Columbia, for a fixed cost of $4.50 per square foot, per month, with a five-year lease term. This building has a fair market value of $8 million. The property management firm negotiated with the landlord to waive the first and last months' rent as an incentive to sign the lease. I'm not sure if this has any accounting implications, but I always like to get a good deal!

We would need to spend approximately $450,000 on improvements to the facility to tailor it to our specifications/requirements, and another $100,000 to purchase new manufacturing equipment to equip the facility. Working capital would be required to initially stock the facility with the materials to use in production, prior to operations. Based on our operations in the current Toronto facility, I estimate we would need initial inventory equal to the equivalent of half a month of revenue. Another $15,000 would be required to furnish and equip the rest of the facility, plus $20,000 for an IT system to ensure compatibility and functionality with our headquarters in Toronto.

An additional 12 employees would need to be hired at a total cost of $600,000 per year, and other costs of production would equal 35% of revenues. Shipping costs would approximate 3% of revenues. Marketing costs are estimated at $50,000 in the first year, decreasing to $20,000 in 2021. Other selling, general, and administrative expenses are estimated to be 10% of revenue. Except as otherwise noted, costs are expected to increase with inflation, which is forecasted at 1.5% each year.

Appendix V
Athleisure division/company expansion (continued)

At the end of the lease term, Marmani would be responsible for returning the premises back to its original condition, which is estimated to cost $50,000 at that time. The equipment is not expected to have any residual value. There is currently no renewal option included in the lease, but the lessor has indicated it may be possible to renegotiate at the end of the lease, depending on the terms.

Existing production facility — Toronto, Ontario

Alternatively, it is possible for Marmani to negotiate good shipping terms and service the Western Canada and U.S. market from the existing Toronto facility. This option would utilize the excess capacity of the current production facility; however, half of the production would still need to be outsourced.

Internal production costs for 2020 would be approximately $500,000; this amount would only increase with inflation, as there would be no further excess capacity to accommodate increased sales volume. Outsourcing production costs would approximate 25% of revenue for 2020; this would increase to 26% of revenue for 2021 and 27% of revenue for 2022, levelling out for subsequent years.

$20,000 in shelving and other miscellaneous furniture would need to be purchased, along with some small parts costing $50,000 that are needed to modify the current manufacturing equipment to accommodate the athleisure product line. In order to handle the additional workload, we would need to add a shift with about five more employees at a similar cost per employee as the Richmond option.

The shipping cost would be double for the Toronto option. However, with no sales presence out west, the expected revenue would be about half what was estimated for the Richmond facility and marketing expenses would be at least 30% higher. Inventory and selling, general, and administrative expenses are expected to be proportional to the estimates prepared for the Richmond expansion. Except as otherwise noted, costs are expected to increase with inflation.

Outsourcing all production

If I sold Marmani and I wanted to stay located in Toronto, then I could rent warehouse space in Toronto and go back to outsourcing 100% of the production. Office and warehouse space of approximately 4,000 square feet in Toronto could be rented for a fixed cost of $10 per square foot, per month, on a month-to-month basis. Rent would increase with inflation. Approximately 75% of the space would be warehouse.

Appendix V
Athleisure division/company expansion (continued)

As with the Toronto facility, with no sales presence out west, the expected revenue would be about half what was estimated for the Richmond facility. Shelving would cost $30,000, office equipment and furniture $20,000, and computer system equipment $12,000. Outsourcing production costs would be 51% of revenue annually. As with Marmani's Toronto location, shipping would be double the cost estimated for the Richmond expansion, marketing costs would be 30% higher, and other selling, general, and administrative expenses would be 10% of revenues.

TKA suggested a discount rate of 15% would be appropriate for this analysis.

Appendix VI
Sales options
Prepared by Karen Zenkovic

Current sales strategy

Marmani's default sales strategy has always been the use of sales agents. These sales agents are independent and often represent several different companies, as long as the companies are not Marmani's competitors. I work closely with these agents and know which are the most effective. The best sales agents are those who work very closely with me, providing important customer insights, since the agents are the ones dealing directly with the health care, long-term care, and retirement facilities that will purchase wholesale and in larger volumes.

This feedback from customers assists me in preparing the marketing material packages that I provide to the agents to assist in their selling presentations. The feedback is also useful for Sonya's designs and material choices. However, I often have to request information repeatedly from the sales agents and then I receive the details in bits and pieces, which is very time consuming and doesn't always provide me with the complete picture I need.

For the last few years, most of the sales agents have been requesting regular increases to their commissions. Currently, they are paid a commission of 5% of gross sales, but most are asking for at least 8%. If we want to retain our sales agents, we will most likely need to increase the commissions to 8%, though this is not reflected in my current projections. If we agree to increase the commission percentage, it will need to be for all agents, as word will get out.

Hire our own sales team

Given the possibility of expanding our adaptive clothing line, we could hire our own sales team instead. With additional products, we will need a committed sales strategy to introduce the products to the customers and obtain their feedback. We could pay each member of the sales team a salary plus commissions. Marmani could consider hiring the best sales agents on a full-time basis and make one of them the sales manager. I have already approached Rory Shain, whom I consider the most successful agent, with the proposal to come on board as sales manager and help Marmani grow its sales. He offered his services on a full-time basis for $135,000 per year. The salespeople at market value today would get $40,000 base salary plus 2% commission. We currently use nine sales agents.

Appendix VI
Sales options (continued)

Digital marketing strategy

Digital marketing includes internet marketing, text messaging, social media, display advertising, search engine marketing, and any other form of digital media.[26] Studies have shown that technology will continue to impact traditional retail operations and result in a shift in consumer purchasing habits, driven by the emergence of eCommerce and mobile technology. Other studies show that online retail sales are already outpacing the traditional retail channels.

Depending on which products Marmani chooses to offer, the marketing department may need to evaluate how Marmani should best connect with its target customers. Marmani could integrate its marketing strategies using the latest technological tools. As a starting point, Marmani should use digital strategies to foster product awareness and engage customers directly to provide any additional information required about the products. If customers are able to interact with Marmani digitally, then there is the opportunity to use web analytics to obtain more information about customer demographics. In addition, we could add quick surveys for customers, similar to the focus group work Sonya has conducted to gather design information. To promote consistency, the same message should be provided both digitally and by Marmani's sales agents or salespeople. Interacting with customers digitally also requires safeguards for the protection of the privacy of consumer data. A breach of consumer data would negatively impact the Marmani brand.[27]

Marmani's current information system will not support the move to the digital marketing environment. The key deficiency is that our systems all operate independently and are not interfaced. In making new IT investments, Marmani should consider how sales will integrate through all back-end systems such as manufacturing systems, warehouse management, and distribution. Marmani lacks the IT personnel resources to support a digital strategy. While CPA will be helpful in determining the impact on other business processes, Marmani will require more expertise to ensure our enterprise architecture supports all operations.

[26] http://lexicon.ft.com/Term?term=digital-marketing
[27] https://blog.centrify.com/breaches-negative-impact-brand-reputation/

Appendix VI
Sales options (continued)

I recommend that we hire a consultant to:

- help establish a digital marketing vision
- work with CPA to understand the current business processes and identify ways to adapt them to a digital strategy
- prioritize IT initiatives to support the development of digital marketing strategies
- develop an initial mobile app
- lead the selection process for required hardware, system software, and customer relationship management software for data analytics
- facilitate future app development as required

I believe Marmani would see sales impacts beginning in Year 3. My research on preliminary cost estimates and timing is provided below:

Expenditure	Timing	Amount
Consultant	Year 2	$ 75,000
	Year 3	25,000
	Years 4-6	10,000
IT server	Year 1	60,000
System software	Year 1	15,000
Computer hardware — workstations	Year 1	12,000
Furniture and equipment	Year 1	8,000
Website development	Year 1	25,000
Customer relationship management software	Year 2	13,000
Ongoing costs all adjusted annually with inflation		
Website hosting, domain, and ongoing software licence costs	Years 2-6	7,000
Additional IT staff (3)	Years 2-6	210,000
Additional marketing staff (1)	Years 2-6	70,000

Appendix VII
Customer focus group results
Prepared by Sonya Valencia

Background

Marmani markets the SIDEAWAY Pant to consumers and also to hospitals, long-term care facilities, and rehabilitation centres. Occupational health and safety studies show that the use of adaptive clothing has proven to be effective in both reducing the risk of injury to caregiver staff and the time spent dressing residents of care facilities.[28] Fastening snap closures, for example, is accomplished without rolling or lifting residents. When adaptive clothing is used, there is less movement required of residents' joints, increasing the ease of dressing.

Summary of project

The aim of this project is to better understand the shared experiences of the target market that buys adaptive clothing and accessories. This knowledge will enable Marmani to determine the potential strengths it possesses to service this demand by leveraging its past experiences in the athletic business, and to design additional products to better serve this component of the health and wellness industry.

Participant demographics:

- patients from hospitals, long-term care facilities, and rehabilitation centres
- the infirm, the elderly, and people with disabilities
- caregivers, doctors, and nurses

Outcomes

Outcome 1:

- Garments must be easy to care for.
- Fabrics need to be long-lasting to withstand rigorous usage and cleaning.
- Water- and oil-repellent coatings should be used to help prevent obvious signs of spills and stains, to help people feel more secure and hygienic.

[28] http://www.phsa.ca/Documents/Occupational-Health-Safety/ReportAdaptiveClothingProjectFinalReport.pdf

Appendix VII
Customer focus group results (continued)

Outcome 2:

- It must be affordable — quality clothing at competitive prices; however, people are willing to pay more for good value.
- It should provide easy dressing and comfortable living, but still look like traditional clothing.
- The clothing shouldn't stand out as being "different," but should still be versatile enough to meet a range of mobility restrictions.

Outcome 3:

- The garments must promote independence in dressing and personal care by having the right fabric features. The garments must also be comfortable.
- Adaptive clothing does not only entail adding some extra zippers, Velcro straps, or snaps — it needs to be more involved than that.
- It's all about adjusting the design of the garments to address the problems that the elderly and people with disabilities face every day.

Conclusions

This segment of the consumer market has been largely neglected in terms of apparel that meets their needs related to fashion, comfort, and functionality, and that is of good quality, durable, and a reasonable price.

Appendix VIII
New product line extension proposal
Prepared by Sonya Valencia

Adaptive sleepwear and medical compression socks both complement our current product line and are desired by our customers. Therefore, I recommend these products as the best two options to begin expanding our adaptive clothing line.

We have the option of either buying these new products and reselling them or making them in our production facility. We have the necessary expertise to manufacture both products. Unfortunately, due to capacity constraints, we cannot produce both new products at this time. As well, although it is possible, I do not think that Marmani should pursue buying medical compression socks and reselling them. Many wholesalers already do this and we would not have a competitive advantage or the opportunity to make much, if any, profit from this alternative. I have an innovative sock production design that will allow Marmani to attract customers and also demand a higher price should we produce the medical compression socks ourselves. There is a high demand for adaptive sleepwear, so this is a viable option whether we make the sleepwear or buy it.

Below are the projected revenues and current costs for manufacturing adaptive sleepwear and medical compression socks. For reference, we achieve a contribution margin of approximately $11 per unit on the existing products.

	Adaptive sleepwear	**Medical compression socks**
Financial projections (in ’000s)		
Revenues	$2,050	$2,400
Direct materials cost	530	900
Direct manufacturing labour	425	450
Variable manufacturing	100	165
Other variable costs	65	210
Fixed manufacturing costs	100	50
Production estimates		
Units	41,000	60,000
Direct labour hours, annually	12,300	13,200

If Marmani purchases sleepwear from a third party, then the total cost for 41,000 units would be $992,000. Volumes are expected to increase by 5% annually.

If we choose to manufacture the socks, we will need to purchase an additional machine at a cost of $45,000. If we manufacture the sleepwear, we’ll require two different machines for a total of $70,000. Shelving and furniture required for all options will cost $20,000. Selling, general, and administrative expenses, including marketing, will be 8% of revenues.

Appendix IX
Cost of sales data
Prepared by Wayne Croxton

The current job costing system we use has two direct cost categories: direct materials and direct manufacturing labour. It also has one indirect cost pool: manufacturing overhead, which is allocated to each job based on direct labour hours. The indirect cost allocation rate of the current system was $62.50 per direct labour hour for 2018. I'm not sure if there is a more accurate way to allocate costs for each job — I'm concerned we aren't reflecting costs properly, which could be negatively impacting how we price our products.

I have spent a bit of time looking at the production process and have summarized the different activities that I think directly attribute to the cost of a job, in addition to direct materials and direct labour, which replace the indirect manufacturing overhead. However, I'm not quite sure how to use this information or whether it is relevant:

Activity area	Cost driver	Cost allocation rate
Materials handling	Number of parts	$0.10 per part
Pre-production	Number of turns	$0.05 per turn
Laser cutting	Machine hours	$5.00 per hour
Assembly	Number of parts	$0.20 per part
Quality control testing	Number of units per order	$2.66 per unit

Marmani's production equipment is very technologically advanced and is able to gather all of the data necessary related to each of these activities. It makes tracking very easy and increases our ability to rely on the numbers produced. I have provided a summary of the data gathered for two representative orders recently produced in our facility:

	Order #71	Order #89
Direct materials cost	$2,425.00	$32,438.60
Direct labour cost	$690.30	$9,495.40
Direct labour hours	23.01	316.51
Parts per order	1,085	15,038
Turns per order	5,000	15,000
Machine hours per order	37.5	262.5
Units per order	350	4,820

I have heard about activity-based costing and am wondering about the impacts on Marmani of adopting this costing method, using Order 71 and Order 89 as examples, compared to our current costing system.

Appendix X
Draft financial statements and projections
Prepared by CPA

Marmani Inc.
Income statement
For the year ended December 31
(In C$'000s)

	Notes	Draft 2017*	Draft 2018	Based on current operations Projected 2019	2020	2021	2022	2023
Revenue								
Bottoms — SIDEAWAY Pant		30,113	31,923	33,200	34,528	35,909	37,445	38,939
Tops — Flexible T's		8,393	9,065	9,450	9,900	10,350	10,700	11,150
Total revenue		38,506	40,988	42,650	44,428	46,259	48,145	50,089
Cost of sales		24,413	23,763	24,500	25,710	26,743	27,808	28,907
Gross margin		14,093	17,225	18,150	18,718	19,516	20,337	21,182
Expenses								
Selling, general, and admin.	[1]	12,171	12,911	13,632	14,185	14,755	15,343	15,949
Other		105	114	200	200	300	300	400
Depreciation		121	425	700	600	600	500	400
Total expenses		12,397	13,450	14,532	14,985	15,655	16,143	16,749
Operating income		1,696	3,775	3,618	3,733	3,861	4,194	4,433
Interest expense	[2]	(148)	(300)	(452)	(404)	(308)	(212)	(116)
Income before taxes		1,548	3,475	3,166	3,329	3,553	3,982	4,317
Income taxes (25%)		387	869	792	832	888	996	1,079
Net income		1,161	2,606	2,374	2,497	2,665	2,986	3,238

* Derived from the 2016 and 2017 financial results

Appendix X
Draft financial statements and projections (continued)

Marmani Inc.
Balance sheet
As at December 31
(In C$'000s)

	Notes	Draft 2017*	Draft 2018	Based on current operations Projected 2019	2020	2021	2022	2023
Assets								
Current assets								
Cash and equivalents		129	2,145	4,216	4,113	4,178	4,464	4,952
Receivables		4,816	5,652	6,000	8,200	10,000	11,100	12,600
Inventories		4,347	5,023	6,400	8,300	9,900	13,100	15,400
Other current assets	[3]	50	500	500	500	500	500	500
Total current assets		9,342	13,320	17,116	21,113	24,578	29,164	33,452
Property, plant, and equipment, net	[4]	2,159	10,134	10,034	10,034	10,034	10,134	10,334
Total assets		11,501	23,454	27,150	31,147	34,612	39,298	43,786
Liabilities								
Current liabilities								
Accounts payable		5,311	6,998	8,250	12,100	15,250	19,300	22,900
Customer deposits	[5]	770	830	900	950	1,000	1,050	1,100
Current portion of long-term debt	[2]	—	—	2,400	2,400	2,400	2,400	1,700
Total current liabilities		6,081	7,828	11,550	15,450	18,650	22,750	25,700
Long-term debt	[2]	3,700	11,300	8,900	6,500	4,100	1,700	—
Total liabilities		9,781	19,128	20,450	21,950	22,750	24,450	25,700
Common Shares	[6]	100	100	100	100	100	100	100
Retained earnings		1,620	4,226	6,600	9,097	11,762	14,748	17,986
Total equity		1,720	4,326	6,700	9,197	11,862	14,848	18,086
Total liabilities and equity		11,501	23,454	27,150	31,147	34,612	39,298	43,786

* Derived from the 2016 and 2017 financial results

Appendix X
Draft financial statements and projections (continued)

Marmani Inc.
Cash flow statement
For the year ended December 31
(In C$'000s)

	Draft 2017*	Draft 2018	Based on current operations Projected 2019	2020	2021	2022	2023
Operating activities							
Net income	1,161	2,606	2,374	2,497	2,665	2,986	3,238
Depreciation	121	425	700	600	600	500	400
Change in working capital							
Receivables*	(628)	(836)	(348)	(2,200)	(1,800)	(1,100)	(1,500)
Inventories*	(589)	(676)	(1,377)	(1,900)	(1,600)	(3,200)	(2,300)
Accounts payable*	451	1,687	1,252	3,850	3,150	4,050	3,600
Customer deposits*	(100)	60	70	50	50	50	50
Other current assets*	(100)	(450)	—	—	—	—	—
Cash flow from operations	316	2,816	2,671	2,897	3,065	3,286	3,488
Investing activities							
Capital expenditures	(226)	(8,400)	(600)	(600)	(600)	(600)	(600)
Cash flow from investing activities	(226)	(8,400)	(600)	(600)	(600)	(600)	(600)
Financing activities							
Net borrowings	—	7,600	—	(2,400)	(2,400)	(2,400)	(2,400)
Cash flow from financing activities	—	7,600	—	(2,400)	(2,400)	(2,400)	(2,400)
Net cash flow	90	2,016	2,071	(103)	65	286	488
Beginning-of-year cash balance	39	129	2,145	4,216	4,113	4,178	4,464
End-of-year cash balance	129	2,145	4,216	4,113	4,178	4,464	4,952

* Derived from the 2016 and 2017 financial results

Appendix X
Draft financial statements and projections (continued)

Notes:

1. Included in selling, general, and administrative expenses are the 5% commissions paid to sales agents. Fixed costs comprise 85% of the remainder of selling, general, and administrative expenses (after deducting the commission cost), with the remaining 15% being other variable costs.
2. Interest expense relates to the loan from Ray Cirello, a related party to the shareholder. The loan is unsecured and bears interest at 4%. For fiscal 2017 and 2018, there were no fixed terms of repayment. Monthly principal payments of $200,000 are required beginning January 1, 2020.
3. Other current assets consist of marketable securities with a net realizable value of $500,000, net of taxes and selling costs.
4. The annual expected expenditures on capital equipment is estimated to be $600,000 for 2019 onward.
5. Customers are charged a deposit of 10% of the order total on all orders exceeding $100,000. It is deducted from the final invoice when the order is shipped.
6. The amount for common shares is the price Roberto paid for the common shares when he incorporated Marmani in 1994.

Appendix XI
Industry metrics
Prepared by CPA

	Textile, clothing, and footwear merchants, wholesaler	Other clothing stores, retailer
Gross margin	27.8%	41.2%
Return on assets	5.9%	9.5%
Current ratio	2.0	1.6
Collection period for accounts receivable (days)	58.2	23.3
Accounts receivable turnover	6.3	17.0