

Development Lessons Learned: Taking Chances at Valley Natural Foods

BY NICK SEEBERGER

In 2017, Valley Natural Foods (VNF) formed Valley Natural Meats (VNM) and launched a meat processing plant in nearby Northfield, Minn. VNF is a consumer cooperative founded in 1977 in Burnsville, Minn., a suburb of the Twin Cities. A single-store operation, VNF had been exploring opportunities for growth and expansion for years.

Since 2011, VNF had wholesaled local, pasture-based meat products from its retail location to other area co-ops, grocers, and restaurants. In 2016, VNF purchased a meat processing facility to expand its existing wholesaling and to provide additional processing options to area farmers who shared concerns over the welfare of their animals.

In purchasing the meat processing plant, the co-op's intent was to expand its commitment to local producers. By purchasing and slaughtering livestock from small local farms and wholesaling to VNF and other businesses, VNM would fill a niche left vacant by existing processors. Additionally, fee-based processing at the new plant would supplement meat wholesaling income and ensure steady revenue. Circumstances seemed favorable to undertake an endeavor that supported local, sustainable food in our greater community.

A history of expanding services

A willingness to explore new opportunities for serving our owners is a part of VNF's history. In 2009, the co-op opened Down in the Valley Floral, a sustainably grown flower wholesaler. Although the floral business was not successful, we continued to explore new prospects. In 2010, the co-op started Down in the Valley Bakehouse (now Valley's Own Bakehouse), a certified gluten-free bakery. After some early struggles and a rebranding, the bakehouse is now exhibiting strong growth, with sales trending toward \$500,000 for the year. Over half of these bakehouse sales are to other co-ops and retail outlets.

When we were considering purchasing the processing facility, the existing VNF meat wholesale program was generating \$368,000 in yearly sales. In 2011, VNF secured a Minnesota Department of Agriculture license that allowed us to package and sell product processed at our retail location to other retailers. VNF was able to offer a local meat program at a reasonable margin to co-ops and grocers that were too small to meet other distributors'



volume requirements on their own.

Growth of the wholesale program was limited by the on-site processing space of only 300 square feet. Our experience with start-up programs, along with our existing meat wholesale operation and its need for more space, provided the incentive to move forward with the purchase of the meat processing facility.

Opportunity knocks

The purchase price and retrofit of the facility was \$1.715 million.

An additional \$235,000 in working capital went into launching the project. The meat-processing project was financed through a \$1.3 million bank loan for the property, building, and equipment; a \$100,000 technology loan; and \$550,000 of the co-op's own cash.

Projections showed VNM realizing \$1.26 million in revenue and a net income of \$134,000 in its second year of operations. Cash flow was projected to be \$360,000 in year two. The VNF business development manager and the meat manager worked on the business plan with input from the general manager. The numbers looked good, and the project aligned with our mission of a healthy community. In summer 2016, VNF purchased the plant and began renovations.

Renovations were complete by March 2017, and operations began. We hired the existing co-op meat manager into the role of Valley Natural Meats CEO. The VNM services included livestock and game processing, wholesale packaged meats, and box meat lines. The plant was built with the capacity to branch into smoked and value-added products in the future. VNM signed contracts with a hog farmers group and two beef ranchers. We had a steady supply of livestock and an established customer base. It seemed like all the pieces were in place for a successful business.

A few months before the start-up of the processing facility, an opportunity arose to purchase the property adjacent to VNF's 15,000-square-foot retail facility. The co-op's board and management had been searching for a suitable second-store location for expansion. But the price was right for the adjacent property, and the co-op moved forward with the purchase and plans for expansion of its retail operation.

Launching a new business with the meat processing plant, coupled with planning a significant store remodel, was

challenging for an organization with revenues around \$16 million. Leadership was stretched to provide the support necessary for both projects. At this same time, Susan McGaughey, the general manager of VNF for 37 years, announced her plan to retire at the end of summer 2017. (A McGaughey profile appeared in CG193.) Several impactful changes were coming to Valley Natural Foods, all at once.

Challenges arise

In September 2017, Nick Seeberger, former operations manager at Seward Co-op in Minneapolis, was hired to succeed McGaughey. With a store expansion budget ballooning to more than \$10 million, construction had been scheduled. Shovels were slated to hit the ground a week after Seeberger's start.

However, as the budget crept higher, it became apparent that market study numbers wouldn't support repayment of the debt. Valley Natural Foods hired a representative to advocate for the co-op's interests in facilitating the expansion project and to help rein in costs. Ultimately, the project went back to the drawing board, and costs were brought closer to \$7 million.

Meanwhile, Valley Natural Meats was not realizing its projected revenues, and its cost of goods was substantially higher than sales. With a more realistic store expansion budget in the works, attention shifted to turning around the financial performance at VNM. Seeberger and the CEO of VNM developed a correction plan that initially focused on reducing cost of goods.

We devised criteria to help us meet monthly financial goals and bring VNM into alignment with the pro forma within three months. We also established a budget to keep total purchases in line with sales, and we conducted "cut tests" to ensure performance was up to industry standards. By the end of October 2017, a half year after opening the meat plant, we noticed substantial improvement, with sales exceeding cost of goods for the first time in VNM's history.

Valley Natural Meat's improved performance allowed us to focus on the expansion of the retail space—specifically, to secure financing so construction could begin. However, the lender which financed the VNM purchase and retrofit held a negative pledge agreement on the VNF property: unless funding included



Valley Natural Foods Co-op works in partnership with the South Metro community to support health and well-being through education and expertise in local, sustainable food and wellness services.

— Mission Statement of VNF

Valley Natural Meats, above. PHOTOS COURTESY OF VALLEY NATURAL FOODS

refinancing of the existing VNM debt, any traditional financing the co-op might seek would be subject to the existing lender's approval.

With VNM's performance well below projections, store expansion financing would have to come from our current lender and be contingent on a financial turnaround and elimination of VNM's debt. Nevertheless, we were confident that we had made meaningful improvements at the plant and would be able to proceed with expansion financing.

Unfortunately, VNM's November 2017 financials showed our worst month to date; total losses for the month were more than \$90,000. We had underreported expenses and cost of goods in October, while overstating both in November. The bank backed away from their financing offer, and expansion was tabled until the following spring.

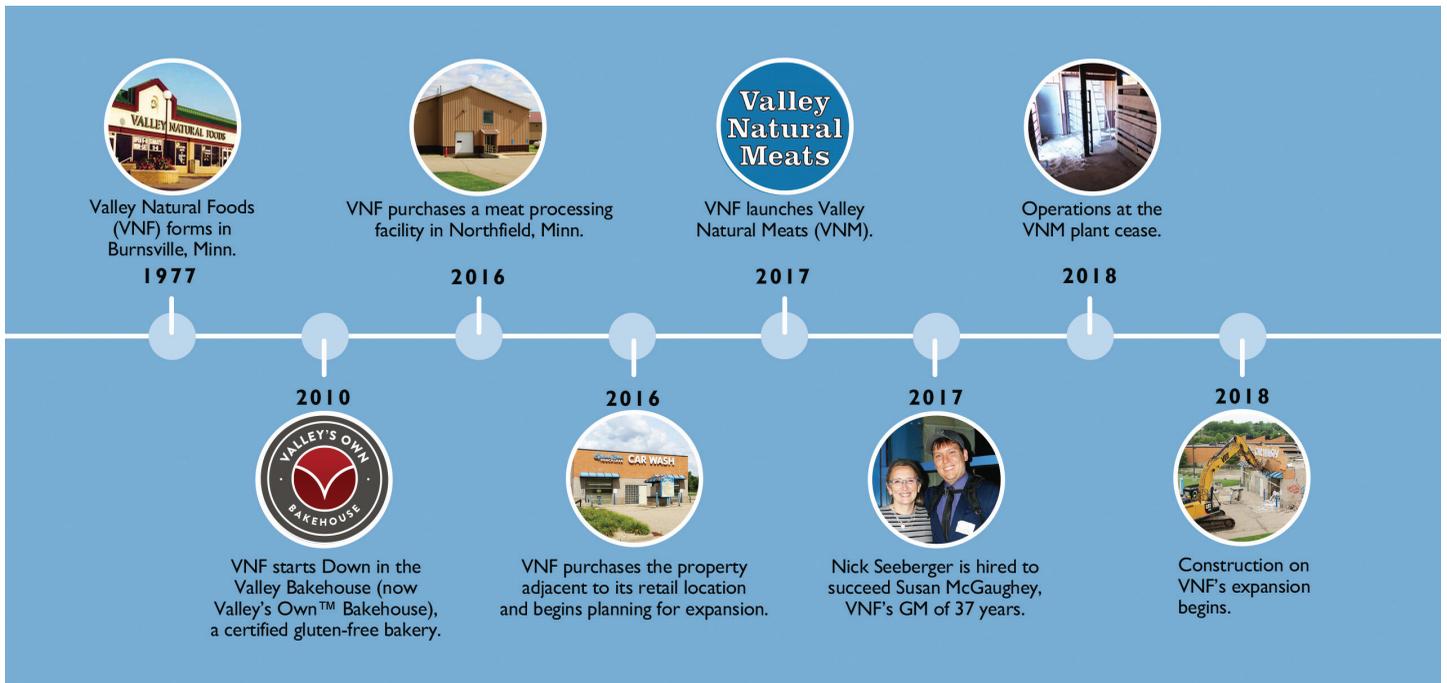
Lessons learned

In December 2017, VNF hired former owner of Thousand Hills Cattle Company and current member-owner of Valley Natural Foods, Todd Churchill

of CFO Insights, to evaluate the existing VNM business plan. Churchill reviewed the feasibility of the plan and provided recommendations for avenues toward VNM's sustainability. Internally, we began an invoice audit to determine why cost of goods remained higher than sales.

We discovered we had not correctly calculated product costs and therefore had been operating under incorrect costs in our wholesaling since the program's inception. When Churchill's report came back, we were faced with a difficult choice: create a new business plan that corrected our previous assumptions—and be prepared to invest another \$1 million into the plant just to break even—or pursue a different objective, which included selling the plant and property. Given our financial position, we could either expand existing retail operations or fully commit to the meat processing facility—but not both.

After much deliberation, the board of directors decided the best use of resources and greatest alignment with the co-op's mission was investment in our retail location. Operations at VNM ceased in January 2018. The co-op and the VNM CEO amicably parted ways, and Valley Natural Meats staff were offered positions and comparable pay at Valley Natural Foods.



In June 2018, construction on the store expansion began, and the meat plant was put up for sale. Our 8,000-square-foot addition and full sales floor remodel is on track to be complete by the end of November. An updated look and feel, along with a significantly expanded dining area and revamped classroom will allow us to better establish the co-op as a community center in the south Twin Cities metro area. A big thanks to everyone in the co-op community who invested in our expansion or shared their expertise as we undertook this significant project.

As we look back on the experience, we learned a few lessons that we will apply as we consider growth opportunities moving forward:

- For opportunities outside of core competencies, bring in experienced professional advisors.
- Leadership capital is necessary for project success. Ensure you have enough leadership capital to support the projects you undertake.
- Make difficult decisions when they need to be made.

Valley Natural Foods' mission of health and well-being through local, sustainable foods would have been well-served by a local meat supply chain, wherein farmers and consumers connected through a cooperative business. As disappointing as the closure of Valley Natural Meats is, we remain optimistic about our prospects. Valley's Own Bakehouse is growing and distributing to more retailers across the Upper Midwest.

As construction progresses on VNF's retail location, our owners are excited to see an expanded and revitalized store come to fruition. We are taking our lessons learned with us as we continue to ask ourselves how we can best create community at Valley Natural Foods. •

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