February 19, 2020
Policy B1 – Financial Condition & Activities, last revised: June 14, 2016
I report compliance with all parts of this policy unless otherwise noted below.
Unless indicated otherwise, this data is accurate as of February 19, 2020
I certify that the information contained in this report and any attachments is true.

General Manager
Attachments:

1. Q4 2019 P & L
2. Q4 2019 Cash Flow
3. Q4 2019 Balance Sheet
4. Q4 2019 Budget vs. Actual
5. FY 2019 P & L
6. FY 2019 Cash Flow

Policy Language
With respect to the actual, ongoing financial conditions and activities, the General Manager must not cause or allow the Cooperative to be unprepared for future opportunities, the development of fiscal jeopardy, or key operational indicators to be below average for our industry.

Interpretation & Operational Definition:
This policy empowers and authorizes the General Manager to manage the financial affairs of the Co-operative in working towards the achievement of the Co-op's Ends. The policy requires the General Manager to accomplish these Ends while diligently exercising fiscal responsibility. Fiscal responsibility has been clearly defined by the Board in the sub-policies below.

Per our operating agreements with National Co-op Grocers, some financial key indicators have targets/minimums that are established by NCG.

Data: Compliance with the primary points of all the sub-policies will demonstrate compliance.

Policy Language

The GM must not:

B1.1 Allow sales growth to be inadequate.

Interpretation & Operational Definition:

The General Manager must ensure that sales growth is adequate to meet the needs of the business and the long-term goals of the organization. We compare sales against the same period of the previous year. In the case of sales decline or stagnancy, the General Manager will provide information on all the possible causes and any proposed solutions. Furthermore, the General Manager will work with management to develop and implement an action plan in order to course correct.

Sales Growth

Formula: (sales from this period – sales from the equivalent period last year)/ (sales from the equivalent period last year)

Definition: When measuring quarterly sales, this measure will compare to the same quarter of the previous year. When comparing annual sales, it will use the current and previous year performance.

Analysis: Sales growth is a key measure of health in a business. **The minimum growth required by NCG for compliance is 3%**

Data:

- National Co-op Grocers Q4 system-wide growth was flat compared to Q4 2018. About 43% of Co-ops nationwide saw sales decline in Q4.
- We experienced a sales decline in Q4, posting **Sales Growth of -2.3%** compared to Q4 2018. We continue to be **out of compliance** on this metric. Sales were down in every department with the exception of Bakery, Produce and Campus.

Action Plan/Steps to bring us into compliance:

- None of the previous action plans have had much impact on the decline in sales. I've clarified my expectations around managing every aspect of our operation to ensure we're excellent at retail, including customer service and staff treatment. I've also clarified my expectation that we're effectively managing both labor and margin in order to run a profitable business even during a recession.

Data indicates noncompliance.

Policy Language

B1.2 Allow operations to generate an inadequate net income.

Interpretation & Operational Definition:

This sub-policy directs the General Manager to inform the Board if sales do not generate adequate net income to finance operating expenses. There is the possibility that sales may not cover operating expenses even if the Co-op experiences positive sales growth. Adequate net income is defined here as enough income to cover operating expenses.

Net Income %

Formula: (income statement total) / (net sales)
Definition: Measures income generated by each dollar of sale. This ratio includes other income, other expenses, and taxes.
Analysis: A low net income could indicate (among other things) low sales compared to fixed expenses, low gross profit dollars, and/or high variable expenses such as a portion of your personnel expense. To assess a co-op's finances, you will want to consider whether the net income is increasing or decreasing. **NCG requires 0.5% for compliance.**
*Note: patronage dividends may affect this ratio.

EBITDAP

Formula: Net income before interest expenses, federal, state, county, and city income taxes, depreciation, amortization, and patronage rebates.
Definition: Measures the core earnings of a business, regardless of debt, tax levies, depreciation/amortization, and patronage rebates. EBITDAP is essentially net income with interest, taxes, depreciation, amortization and patronage added back to it. This ratio can be used to analyze and compare profitability between co-ops by eliminating the effects of financing and accounting decisions.
Analysis: Allows you to make better comparisons with peer co-ops, regardless of the amount of loans, taxes, depreciation, and patronage rebates. Consumer and worker co-ops that pay a patronage dividend will show less net income, so EBITDAP is an important profitability measure. **NCG requires 1.50% for compliance.**

Prior to opening a full-sized second location, we need to achieve an EBITDAP above 4% for at least 4 consecutive quarters.

Margin Minus Labor (MML)

Formula: (gross margin/net income) – (gross personnel/net income)
**Gross Personnel is wages plus benefits plus taxes
Definition: The percent of revenue available to pay all other expenses, after paying for the cost of goods and gross wages.
Analysis: In addition to being a good profitability indicator, this ratio is also useful for comparing companies that have different product mixes. It is a better comparison than either margin or personnel expense alone.

Prior to opening a full-sized second location, we need to achieve a stable MML of 14% or higher.

Data:

- Q4 2019 **net income** = -2.0% thus we are **out of compliance** with NCG requirements.
- Q4 2019 **EBITDAP** = 1.22%, thus we are **out compliance** with NCG.
- Q4 2019 **MML** = 14.75%. There is no minimum for compliance with NCG on this metric.

Action Plan/Steps to bring us into compliance:

- We missed the 0.5% net income required by NCG for compliance. This was due to several controllable factors:
    - We elected to reduce our PTO liability and paid out an extra $6000 in accrued PTO so as to reduce the accrual cap. This was a one-time expense.
    - Prepared Foods Departments racked up nearly $9000 in overtime wages due to poor planning and excessive turnover. Plan: department managers are expected to manage labor to budget, no excuses. They're also working to reduce overall annual turnover by 40%.
    - Bakehouse set-up expenses. Plan: now that the Bakehouse is operational, I've asked them to plan for 10% growth, including a 10% or better increase in production. This will generate additional income.

Data supports non-compliance.

Policy Language

B1.3 Allow liquidity (the ability to meet cash needs in a timely and efficient fashion) to be insufficient.

Interpretation & Operational Definition:

This sub-policy requires the General Manager to keep the Board informed of the Co-op's relative liquidity and its ability to meet cash needs. Liquidity can be measured in two useful ways: Quick Ratio (cash assets in relation to the claims upon them) and Current Ratio (non-cash assets in relation to the claims upon them). The Co-op's Net Income (addressed above) is the best measure of our ability to meet cash needs. However, Days of Cash and Cash on Hand are also important metrics to watch.

Quick Ratio

Formula: (current assets – inventory) / current liabilities
Definition: Measures short-term debt-paying ability. The quick ratio, often referred to as the acid-test ratio, is obtained by subtracting inventories from current assets and then dividing by current liabilities.
Analysis: 1.0 ratio means the company has $1.00 in current assets less inventory to cover each $1.00 in current liabilities. **The NCG requires a quick ratio above 0.7 for compliance**. The Moscow Food Co-op's long-term goal is 1.88.

Current Ratio

Formula: current assets / current liabilities
Definition: Measures debt-paying ability. Current assets are the sum of assets that typically convert to cash within 12 months. Current liabilities are the sum of amounts owed by the company and due within 12 months.
Analysis: 1.0 ratio means the company has $1.00 in current assets to cover each $1.00 in current liabilities. Look for a current ratio above 1.0 **The NCG requires a current ratio above 1.25 for compliance.** The Moscow Food Co-op's long-term goal is 3.22.

Days Cash on Hand

Formula: Calculated by taking the average cash for 2 quarters. Divide that by the average daily amount of Cash Expenses. Cash Expenses are calculated by adding together COGS + cash operating expenses – depreciation/amortization + interest expense + taxes.
Definition: Measures the approximate number of days of cash the co-op currently has on hand.
Analysis: Days Cash on Hand, another liquidity measure, provides an indication of vulnerability. If too few days are on hand, a co-op may not be able to weather an emergency, such as a competitor opening up next door or the loss of utilities for a week. The **NCG requires a minimum of 10 days of cash for compliance**. Cash savings are critical for future growth opportunities.

Inventory Turnover

Formula: cost of goods sold (annualized) / average inventory
Definition: Number of times that you turn over (or sell) inventory during the year. Measures inventory liquidity.

Analysis: Generally, a high inventory turnover is an indicator of good inventory management. But it can also mean there is a shortage of inventory. A low turnover may indicate overstocking, or obsolete inventory.

There is no NCG-established minimum for compliance on this metric. In general, we'd like to see inventory turns between 18 and 24 per year, the standard range for grocery stores.

Data:

- Q4 2019 **Quick Ratio** = 1.3, **exceeding the NCG minimum for compliance**
- Q4 2019 **Current Ratio** = 1.93, **exceeding the NCG minimum for compliance**
- **Cash on Hand** = $815,966 (no NCG target)
- Q4 2019 **Days of Cash** = 26.97, **exceeding the NCG minimum for compliance**
- Q4 2019 **Inventory Turns** = 15.59 (no NCG target)

Data supports compliance.

Policy Language

B1.4 Allow solvency (the relationship of debt to equity) to be insufficient.

Interpretation & Operational Definition:

This sub-policy directs the General Manager to maintain the appropriate balance of debt to equity so that the needs of the business are met. The Board-established target for Debt-to-Equity is 1 and is interpreted as *in compliance* if the Moscow Food Co-op has a Debt-to-Equity ratio of less than 1.

Debt to Equity

Formula: (debt/equity)

Definition: Shows the ratio between capital invested by the owners and the funds provided by lenders and other creditors.

Analysis: Comparison of how much of the business was financed through debt and how much was financed through equity. A higher debt/equity ratio means that a company has been aggressive in financing its growth with debt. Too much debt can put your business at risk, but too little debt may mean that you are not realizing the full potential of your business and may actually hurt your overall profitability.

The NCG-established target for compliance is a Debt-to-Equity ratio of less than 3.

Data:

- Q4 2019 debt-to-equity = 0.65, this meets the Board's target for compliance, as well as the NCG requirement for compliance.

Data supports compliance.

Policy Language

B1.5 Allow growth in ownership and owner paid-in-equity to be insufficient.

Interpretation & Operational Definition:

This sub-policy requires that the General Manager work to increase cooperative ownership and to ensure that invested owner equity dollars are sufficient to pay for some capital equipment expenditures.

Data:

- Ownership numbers continue to grow. In Q4 2019, we welcomed 220 new owners.
- The rate at which we recruit new owners continues to be slower than in previous years.
- Total paid-in-equity grows year-over-year. Owner Equity Dollars are calculated as they are paid in through the POS system. Currently there is neither a Board-established target nor an NCG-established target for this.

Data supports compliance.

Policy Language
B1.6 Default on any terms that are part of the Cooperative's loans.

Interpretation & Operational Definition:
This sub-policy requires the General Manager to confirm that the Co-op has not defaulted on the terms of any loans, and that all loan payments are current.

Data:
- All Adaama loan payments are current.

Data supports compliance.

Policy Language
B1.7 Allow late payment of contracts, payroll, loans or other financial obligations.

Interpretation & Operational Definition:
This sub-policy requires the General Manager to confirm that payments of any contracts, payroll, and other payables are met in a timely fashion. The General Manager will provide the Board with a report in the event that the Co-op is unable to meet any financial obligation.

Data:
- All financial obligations have been met in a timely fashion.

Data supports compliance.

Policy Language
B1.8 Incur debt other than trade payables or other reasonable and customary liabilities incurred in the ordinary course of doing business.

Interpretation & Operational Definition:
This sub-policy prohibits the General Manager from incurring any debts for the Cooperative other than payables, payroll, and other reasonable liabilities encountered in the regular operation of the business. Should the General Manager believe incurring debt is necessary to the health of the organization, a proposal would be made to the Board of Directors.

Data:
- No new debt has been incurred.

Data supports compliance.

Policy Language
B1.9 Acquire, encumber or dispose of real estate.

Interpretation & Operational Definition:

This sub-policy explicitly states that the General Manager is not authorized to enter into any agreements regarding real estate without explicit Board approval. This includes renting and purchasing buildings or property. Approval for such authorization would be requested and approved in Executive Session.

Data:

- No new lease agreements or rental contracts have been executed.

Data supports compliance.

Policy Language

B1.10 Allow tax payments or other government-ordered payments or filings to be overdue or inaccurately filed.

Interpretation & Operational Definition:

This sub-policy directs the General Manager to ensure that the Moscow Food Co-op pays taxes and other government payments/filings accurately and in a timely fashion.

Data:

- According to internal Moscow Food Co-op procedures, and in compliance with various taxing authorities, all Moscow Food Co-op taxes have been paid in a timely manner and filed accurately.

Data supports compliance.

Policy Language

B1.11 Use restricted funds for any purpose other than that required by the restriction.

Interpretation & Operational Definition:

This sub-policy further directs the General Manager to solicit express consent from the Board before using any restricted funds for purposes other than the intended use. Restricted funds would be those that have been set aside for an intended purpose.

Data:

- Moscow Food Co-op funds have not been earmarked or restricted.

Data supports compliance.

Policy Language

B1.12 Allow financial record keeping systems to be inadequate or out of conformity with Generally Accepted Accounting Principles (GAAP).

Interpretation & Operational Definition:

This sub-policy requires the General Manager to ensure that the Co-op's financial systems conform to GAAP. Regular appraisal of our accounting practices is provided by the Co-op's tax accountant. The Finance Manager also regularly utilizes the network of other NCG Finance Managers. As of January 2018, NCG requires an annual financial review of all business units.

Data:

- Our 2016 financial audit results were presented to the Board at a retreat in October 2017. The auditor reported that they did not find anything concerning in our work.
- Per NCG Operating Agreements, all NCG Co-ops must have a financial review each fiscal year. We continue to comply with this operating standard.
- Our 2017 financial review was completed by Wegner CPAs. Nothing concerning was discovered or reported.
- Our 2018 financial review was completed by Wegner CPAs. Nothing concerning was discovered or reported.
- We've engaged Wegner CPAs to perform a financial review of our 2019 financials later this year.

Data supports compliance.