1.3.3 Green Parrot AG Case Background

Unit: Unit 1 – Treasury Strategy

Module: Module 1 – Corporate strategy

Date: 1 September 2016

Summary: Background information on Green Parrot AG, a case study for a series of exercises throughout the course

Keywords: seasonality, raw materials, competition, risk management, financial risk, market risk, credit risk, liquidity risk, sensitivity analysis

Company overview

Green Parrot AG, which is headquartered in Switzerland, manufactures quality chocolate and confectionery products and is also a leading snack food company. Principal product groups include confectionery and snack products; gum and mint refreshment products; and food and beverage enhancers such as baking ingredients, peanut butter, toppings and beverages. In addition to traditional confectionery products, the company also offers a range of products specifically developed to address the nutritional interests of health-conscious consumers.

The time now is September 2016.

Selling and marketing organization

The company's selling and marketing organisation is comprised of the European Commercial Group, the International Commercial Group and the Global Growth and Innovation Group. This organisation is designed to:

- Leverage marketing and sales leadership in Europe;
- Focus on key strategic growth areas in global markets; and
- Build capabilities that capitalise on unique consumer and customer trends.

European Commercial Group

The European Commercial Group has responsibility for continuing to build confectionery leadership in Europe, while capitalising on scale in this region. This organisation leverages the ability to capitalise on the unique consumer and customer trends within each country. This includes developing and growing the business in the chocolate, sugar confectionery, snacks, refreshment, food and beverage enhancers, and food service product lines.

International Commercial Group

The International Commercial Group markets confectionery products and food and beverage enhancers worldwide and has responsibility for pursuing profitable growth opportunities in key markets primarily in North and Latin America and Asia. This group is responsible for international subsidiaries that manufacture, import, market, sell and distribute chocolate, confectionery and beverage products in Japan, North America, Mexico and Brazil.

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Global Growth and Innovation Group

The Global Growth and Innovation Group has responsibility for building global brands, developing benefit-driven growth platforms for the short-term and long-term, and strengthening marketing capabilities worldwide. This organisation develops superior capabilities in consumer insights, product development, and innovative marketing communications. The Global Growth and Innovation Group is also responsible for brand positioning, portfolio strategy, integrated business intelligence, and health and wellness initiatives.

Products

The primary chocolate and confectionery products sold worldwide are as follows:

- Cockatoo white chocolate bar
- Giant Parrot wafer bar
- Heaven-sent dark chocolate bar
- Chunky-choc milk chocolate droppings
- Too-yummy toffee bar
- Jolly Feathers candy bar
- Kea peanut caramel bar

The following line of premium chocolate and confectionery premium product offerings are also major Green Parrot brands:

- Screech Drinking cocoa mixes
- Midnight delight high-cocoa dark chocolate drink
- Green Parrot handcrafted chocolate gifts
- Green Parrot Organic chocolate products

Snack products include the following:

- Parrot-pecks chocolate drops
- Olde McCaw's trail mix
- Honey glazed and roasted peanuts
- Green Parrot Original Honduran cookies

Product innovation is essential, including new products, effective retail execution, appropriate advertising and marketing campaigns, and the ability to secure adequate shelf space at retail locations. Furthermore, success depends on responsiveness to consumer trends, consumer health concerns, including obesity and the consumption of certain ingredients, and changes in product category consumption and consumer demographics.

Customers

Full-time sales representatives and food brokers sell the products to the customers. The customers are mainly wholesale distributors, chain grocery stores, mass merchandisers, chain drug stores, vending companies, wholesale clubs, convenience stores, concessionaires, department stores and natural food stores. The customers then resell the products to end-consumers in retail outlets in Europe and other locations worldwide.

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The largest customer accounted for more than 25% of total net sales in 2015 reflecting the continuing consolidation of the customer base.

Marketing strategy and seasonality

The foundation of the marketing strategy is strong brands, product innovation, the consistently superior quality of products, manufacturing expertise and mass distribution capabilities. The company also devotes considerable resources to the identification, development, testing, manufacturing and marketing of new products and has a variety of promotional programmes for wholesale customers as well as advertising and promotional programmes for consumers. Sales of certain products are stimulated with promotional programmes at various times throughout the year and sales are typically higher during the third and fourth quarters of the year, representing seasonal and holiday-related sales patterns.

Product distribution

In conjunction with sales and marketing efforts, an efficient product distribution network helps to maintain sales growth and provide superior customer service. Optimum stock levels are planned and the company works with customers to set reasonable delivery times. The distribution network provides for the efficient shipment of products from manufacturing plants to distribution centres and field warehouses strategically located throughout sales areas. The company primarily uses contract carriers to deliver products from these distribution points to customers.

Price changes

The company changes prices and weights of products when necessary to accommodate changes in manufacturing costs, the competitive environment and profit objectives, while at the same time maintaining consumer value. Price increases and weight changes help to offset increases in input costs, including raw and packaging materials, fuel, utilities, and transportation, and employee benefits.

Raw materials

Cocoa is the most significant raw material used to produce chocolate products. The company buys a mix of cocoa beans and cocoa products, such as cocoa butter, cocoa liquor and cocoa powder, to meet manufacturing requirements. Cocoa beans are grown principally in Far Eastern, West African and South American equatorial regions. West Africa accounts for approximately 70% of the world's crop of cocoa beans. Cocoa beans are not uniform, and the various grades and varieties reflect the diverse agricultural practices and natural conditions found in many growing areas.

Civil unrest in the world's largest cocoa-producing country, the Ivory Coast, has resulted in volatile prices. However, it is believed that a significant disruption of cocoa supplies from the Ivory Coast is unlikely. In the event such disruption would occur, cocoa from other producing countries, and from current physical cocoa stocks in consuming countries, would provide a significant supply buffer. Historically there have been instances of weather catastrophes, crop disease, civil disruptions, embargoes and other problems in cocoa-producing countries that have caused price fluctuations, but have never resulted in total loss of a particular producing country's cocoa crop and/or exports.

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The company's costs will not necessarily reflect market price fluctuations because of forward purchasing and hedging practices, premiums and discounts reflective of varying delivery times, and supply and demand for specific varieties and grades of cocoa beans. As a result, average futures contract prices are not necessarily indicative of average cost of cocoa beans or cocoa products.

The company attempts to minimise the effect of future price fluctuations related to the purchase of major raw materials and certain energy requirements primarily through forward purchasing to cover future requirements, generally for periods from 3 to 24 months. Futures contracts are entered into to manage price risks for cocoa, sugar, corn sweeteners, natural gas, fuel oil and certain dairy products. Currently, active futures contracts are not available for use in pricing other major raw material requirements.

Competition

Many of the company's brands enjoy wide consumer acceptance and are among the leading brands sold in the marketplace. These brands are sold in a highly competitive market with many other multinational, national, regional and local firms. Some competitors are much larger than the company and have greater resources.

Trademarks, service marks and license agreements

The company owns various registered and unregistered trademarks and service marks and has rights under licenses to use various trademarks that are of material importance to the business.

The company also has license agreements with several companies to manufacture and/or sell certain products and rights under these agreements are extendible on a long-term basis at the company's option.

Backlog of orders

The company manufactures primarily for stock and fills customer orders from finished goods inventories. While at any given time there may be some backlog of orders, this backlog is not material in respect to total annual sales, nor are the changes from time to time significant.

Research and development

The company engages in a variety of research and development activities. New products are developed, the quality of existing products is improved, production processes are improved and modernised, and new technologies are developed and implemented to enhance the quality and value of both current and proposed product lines.

Food quality and safety regulation

The manufacture and sale of consumer food products is highly regulated by various European and local authorities in the various jurisdictions where products are sold.

Environmental considerations

Investments were made in 2012 to comply with environmental laws and regulations. These investments were not material with respect to capital expenditures, earnings or competitive position.

Employees
As of December 31, 2015, the company employed approximately 8,000 full-time and 1,500 part-time employees worldwide. Collective bargaining agreements covered approximately 3,500 of these employees and employee relations are considered by the company to be good.

Risk management
Due to its global activity, the company is exposed to a number of risks: strategic, operational and financial. Within the scope of the annual risk management process, the individual risk positions are classified into these 3 categories, where they are assessed, limited and assigned to authorities.

In view of the existing and inevitable strategic and operating risks of the core business, management‘s objective is to minimise the impact of the financial risks on the operating and net profit for the reporting period.

Financial risk management
The company is exposed to financial risks. These are divided into the following categories: market risks (exchange rates, interest rates and commodities), credit risks, and liquidity risks. The central treasury department (Corporate Treasury) is responsible for the coordination of risk management and works closely with the operational companies. The de-centralised structure gives strong autonomy to the individual operational companies, particularly with regard to the management of exchange rate and commodity risks. The risk policies issued by the Treasury Committee of the Board serve as guidelines for the entire risk management process.

Centralised systems, specifically for the regular recording and consolidation of the group-wide commodity positions, as well as regular internal reporting, ensure that the risk positions can be consolidated and managed in a timely manner despite the group’s de-centralised management system. The group only engages in derivative financial transactions if a highly probable forecast transaction or a recognised asset or liability exists.

Market risks
Exchange rate risks
The group’s reporting currency is the Swiss Franc, which is exposed to fluctuations in foreign exchange rates, primarily with respect to the Euro, the various dollar currencies and Pound Sterling. The group uses forward and option instruments in order to hedge against foreign exchange risks from existing or expected future assets and trade payables for goods and services. Such hedging activity is coordinated by the Treasury Committee. The operational Group companies enter into spot, forward and option instruments directly with Corporate Treasury, which hedges net positions by means of financial instruments with credit-worthy financial institutions.

Specifically, the Group buys all its cocoa in GBP, thereby generating a significant requirement to purchase GBP; commodity hedging is undertaken on the London exchange (ICE). The company monitors its foreign exchange exposures via weekly meetings of its Treasury Committee, taking action in the market based on the outcome of each meeting and

manages its FX risks based on the time horizon of a financial year, as this ties in with its budget and forecasts to the market.

At the time of writing, the group executes all OTC instruments with its relationship banks under agreed uncommitted un-margined facilities. No bank has insisted on the margining of these instruments and Green Parrot, to date, is also happy to leave the instruments un-margined and leave the exposure to the banks open. The Group has adopted the EMIR regulations as though it was headquartered in Europe.

In order to build a comprehensive view of its exposures, the company evaluates its FX risks from the following three perspectives:

1. Sensitivity analysis
2. Scenario analysis
3. Value at Risk

(Note: Sensitivity Analysis, Scenario analysis and Value at Risk are techniques for the evaluation of risks and are covered in detail in module 4 as risk is explored further. They are included here for completeness and students may have encountered the techniques at work or in other qualifications.)

Interest rate risk
Corporate Treasury monitors and minimises interest rate risks from a mismatch of quality, maturity period and currency of the liquid funds on a continuous basis. Corporate Treasury may use derivative financial instruments such as interest rate swaps in order to manage the interest rate risk of balance sheet assets and liabilities and future cash flows.

In order to minimise financing costs and to manage interest rate exposure, from time to time, the company will enter into interest rate swap agreements.

The fair value of interest rate swaps equals the difference in the present values of cash flows calculated at the contracted interest rates and at current market interest rates at the end of the period. As of December 31, 2015, the company was not a party to any interest rate swap agreements.

Commodity price risk
The Group's products are manufactured with raw materials (commodities) that are subject to strong price fluctuations due to climatic conditions, seasonal demand and market speculation (see below). In order to mitigate the price and quality risks of the expected future net demand, the operational companies enter into contracts with suppliers for the future physical delivery of the raw materials. In exceptional market conditions, commodity futures are also used; however, they are only processed centrally by Corporate Treasury.

The cost of cocoa beans and prices for related futures contracts historically have been subject to wide fluctuations attributable to a variety of factors. These factors include:

- The effect of weather on crop yield;
- Imbalances between supply and demand;

- Currency exchange rates;
- Political unrest in producing countries; and
- Speculative influences.

Costs will not necessarily reflect market price fluctuations because of the company's forward purchasing practices, premiums and discounts that reflect varying delivery times, and supply and demand for specific varieties and grades of cocoa beans.

The company attempts to minimise the effect of future price fluctuations related to the purchase of raw materials by using forward purchasing to cover future manufacturing requirements generally for 3 to 24 months. Futures contracts are used, in combination with forward purchasing of cocoa and other commodities, primarily to provide favourable pricing opportunities and flexibility in sourcing raw material and energy requirements and fuel oil futures contracts are used to minimize price fluctuations associated with transportation costs. Commodity procurement practices are intended to reduce the risk of future price increases and provide visibility to future costs, but also may potentially limit the ability to benefit from possible price decreases.

The company makes or receives cash transfers to or from commodity futures brokers on a daily basis reflecting changes in the value of futures contracts. These changes in value represent unrealised gains and losses and associated cash transfers and they are reported as a component of other comprehensive income. The cash transfers offset higher or lower cash requirements for the payment of future invoice prices of raw materials, energy requirements and transportation costs. Futures held in excess of the amount required to fix the price of un-priced physical forward contracts are effective as hedges of anticipated purchases.

Further information on the cocoa market can be found at www.icco.org.

Accounting policies and market risks associated with derivative instruments

The company uses certain derivative instruments, including interest rate swaps, foreign currency forward exchange contracts and options, and commodities futures contracts, to manage interest rate, foreign currency exchange rate and commodity market price risk exposures. Interest rate swap agreements and foreign currency contracts and options may be entered into for periods consistent with related underlying exposures.

These derivative instruments do not constitute positions independent of those exposures. Commodities futures contracts are entered in to for varying periods and are intended to be, and are effective as, hedges of market price risks associated with anticipated raw material purchases, energy requirements and transportation costs. The company does not hold or issue derivative instruments for trading purposes and is not a party to any instruments with leverage or prepayment features. In entering into these contracts, the company assumes the risks that might arise from the possible inability of counterparties to meet the terms of their contracts however significant losses from counterparty defaults are not expected.

Credit risks
Credit risks occur when a counterparty, such as a supplier, a client or a financial institution is unable to fulfil its contractual duties. This risk is minimised since group companies have implemented standard processes for defining lending limits for clients and suppliers, and monitor adherence to these processes on an ongoing basis. Due to the geographical spread of the turnover and the large number of clients, the debtor risk of the group is limited. Financial credit risks are limited by investing (liquid funds and/or derivative financial instruments) with lending institutions holding an A1/P1-rating only.

Liquidity risks
The Group's liquidity is ensured by means of regular group-wide monitoring and planning of liquidity as well as an investment policy coordinated by Corporate Treasury. For extraordinary financing needs, adequate credit lines with financial institutions have been arranged.

Sensitivity analysis
Sensitivity analysis reflects market risk to a hypothetical adverse market price movement, based on net commodity positions at dates spaced equally throughout the year. Net commodity positions consist of the amount of futures contracts held over or under the amount of futures contracts needed to price un-priced physical forward contracts for the same commodities.

Inventories, priced forward contracts and estimated anticipated purchases not yet under contract are not included in the sensitivity analysis calculations. The definition of a loss, for purposes of determining market risk, is the potential decrease in fair value or the opportunity cost resulting from the hypothetical adverse price movement. The fair values of net commodity positions reflect quoted market prices or estimated future prices, including estimated carrying costs corresponding with the future delivery period.

Sensitivity analysis disclosures represent forward-looking statements which are subject to certain risks and uncertainties that could cause actual results to differ materially from those presently anticipated or projected. Factors that could affect the sensitivity analysis disclosures include:

Significant increases or decreases in market prices reflecting fluctuations attributable to the effect of weather on crop yield:

- imbalances between supply and demand
- currency exchange rates
- political unrest in producing countries
- speculative influences
- changes in our hedging strategies

Segmental information: According to geographic segments
A business segment is a group of investment and business activities which offers or manufactures products or services, the risks and income of which is different from other business segments. A geographic segment – usually a separate division within a company –

provides products or services within a specific economic environment that are subject to risks and returns that are different from those segments operating in other economic environments.

The group is active in a single business segment: the production and sale of premium chocolates. The segmental reporting is therefore represented from the geographical viewpoint and is based on the management structure and internal reporting procedures. Separating the carrying values and the capitalised earnings values according to geographical segments depends on where assets are situated. The location of clients does not diverge significantly from the location of the assets. The three geographical segments are: Europe and Middle East, North and Latin America and the “Rest of the World”. The segment Europe and Middle East also contains the revenue generated in the countries of the Middle East because these are made through European subsidiaries. The group considers the operating result as the segment result. Transactions between segments are valued and recorded in accordance with the cost plus method.

Financial statements – Extracts from year ended 31 December 2015.
Green Parrot AG reports in Swiss Francs (CHF).

Segmental income

	Europe and Middle East		**North and Latin America**		**Rest of The World**		**Total**	
CHF Million	**2015**	**2014**	**2015**	**2014**	**2015**	**2014**	**2015**	**2014**
Sales	1,919.1	1,697.7	637.9	526.1	174.3	148.7	2,731.3	2,372.5
% Sales Between Segments	143.6	124.8	2.1	0.7	-	0.1	145.7	125.6
Third parties sales	1,775.5	1,572.9	635.8	525.4	174.3	148.6	2,585.6	2,246.9
Operating Profit	224.1	192.9	43.2	30.9	29.6	24.8	296.9	248.6
Net financial result							(2.5)	(2.9)
Income before taxes							294.4	245.7
Taxes							(85.4)	(73.0)
Net income							**209.0**	**172.7**

Consolidated balance sheet

	31 Dec 2015	31 Dec 2014
	CHF millions	CHF millions
ASSETS		
Property, plant & equipment	671.5	615.4
Intangible assets	11.4	8.6
Financial assets	21.5	21.4
Deferred tax assets	7.1	7.5
Total Non-current assets	**711.5**	**652.9**
Inventories	358.5	314.8
Accounts receivable	742.4	688.0
Other receivables	48.0	41.7
Accrued Income	7.3	6.2
Derivative assets	6.1	1.3
Marketable securities	34.3	35.5
Cash and cash equivalents	223.0	167.7
Total Current Assets	**1,419.6**	**1,255.2**
Total Assets	**2,131.1**	**1,908.1**
LIABILITIES		
Shares and participation capital	22.2	22.0
Treasury stock	(8.3)	(6.4)
Retained earnings and other reserves	1,141.9	955.5
Total Shareholders' Equity	**1,155.8**	**971.1**
Bond	99.6	99.3
Loans	0.9	1.3
Deferred tax liabilities	31.4	31.2
Pension liabilities	143.4	136.0
Other non-current liabilities	10.1	8.6
Provisions	33.4	36.3
Total Non-current liabilities	**318.8**	**312.7**
Accounts payable to suppliers	209.4	185.1
Other accounts payable	33.0	35.9
Current tax liabilities	34.6	20.3
Accrued liabilities	330.1	292.7
Derivative liabilities	2.6	7.7
Bank and other borrowings	46.8	82.6
Total Current Liabilities	**656.5**	**624.3**
Total Liabilities	**975.3**	**937.0**
Total Liabilities and Shareholders' Equity	**2,131.1**	**1,908.1**

Consolidated income statement

	2015	2014
	CHF millions	**CHF millions**
Income		
Sales	2,585.6	2,246.9
Other income	9.7	9.0
Total Income	**2,595.3**	**2,255.9**
EXPENSES		
Material costs	(772.1)	(686.5)
Changes in inventories	9.3	17.8
Personnel expenses	(546.7)	(493.1)
Operating expenses	(904.9)	(769.0)
Depreciation and amortisation	(84.0)	(76.5)
Total Expenses	**(2,298.4)**	**(2,007.3)**
Operating profit	296.9	248.6
Net financial result	(2.5)	(2.9)
Operating profit before taxes	294.4	245.7
Taxes	(85.4)	(73.0)
NET INCOME	**209.0**	**172.7**
Attributable to shareholders	209.0	172.7
Non-diluted earnings per share/10PC (CHF)	947.4	788.2
Diluted earnings per share/10PC (CHF)	921.2	768.2

Consolidated cash flow statement

	2015	2014
	CHF millions	**CHF millions**
Net income	209.0	172.7
Depreciation and amortisation	84.0	76.5
Changes in provisions and value adjustments	8.4	(0.5)
Non-cash effective items	11.2	8.5
Cash Flow from operations before changes in Net-current Assets	**312.6**	**257.2**
Decrease (+) / Increase (-) of accounts receivable	(44.0)	(86.6)
Decrease (+) / Increase (-) of inventories	(48.7)	(36.6)
Decrease (+) / Increase (-) of prepayments and other receivables	(7.4)	(4.9)
Decrease (+) / Increase (-) of accrued income	(2.0)	6.1
Decrease (+) / Increase (-) of accounts payable	21.5	18.9
Decrease (+) / Increase (-) of other payables and accrued liabilities	44.6	35.1
	(36.0)	**(68.0)**
Cash Flow from operating activities	**276.6**	**189.2**
Investments in property, plant & equipment	(140.9)	(126.1)
Disposals of property, plant & equipment	1.1	0.8
Investments in tangible assets	(5.5)	(2.8)
Disposal of financial assets	0.6	0.5
Investments (-) / disposals (+) in marketable securities	4.3	(5.5)
Cash Flow from Investment Activities	**(140.4)**	**(133.1)**
Proceeds from borrowing	-	31.2
Repayments of borrowing	(36.8)	-
Proceeds from loans	-	1.3
Repayments of loans	(2.1)	-
Repayment of bond	-	(96.7)
Capital increase (including premium)	12.1	13.4
Purchase of treasury stock (shares/PC)	(3.5)	(6.4)
Sale of treasury PCs	-	3.0
Dividends paid to shareholders	(50.1)	(39.9)
Cash Flow from Financing Activities	**(80.4)**	**(94.1)**
Net Increase (+) / Decrease (-) in cash and cash equivalents	**55.8**	**(38.0)**
Cash and cash equivalents as at 1 January (after FX gains/losses)	**167.2**	**205.7**
Cash and cash equivalents as at 31 December	**223.0**	**167.7**
Interest received from third parties*	8.7	6.4
Interest paid to third parties*	10.9	12.9
Income tax paid*	69.9	66.5

*Included in Cash Flow from operating Activities