December 18, 2020
Policy B1 – Financial Condition & Activities, last revised: May 4, 2020
I report compliance with all parts of this policy unless otherwise noted below.
Unless indicated otherwise, this data is accurate as of December 18, 2020
I certify that the information contained in this report and any attachments is true.

General Manager
Attachments:

1. Q3 2020 P & L
2. Q3 2020 Cash Flow
3. Q3 2020 Balance Sheet
4. Q3 2020 Budget vs. Actual

Policy Language

The GM must not:

B1.1 Through inattention or inaction cause or allow the development of fiscal jeopardy.

Interpretation & Operational Definition:

The General Manager must regularly monitor and analyze to the financial conditions of the Co-op and be prepared to make swift changes as necessary to ensure the future of the organization and the business.

Regular monitoring – for the purposes of this policy, regular monitoring is interpreted as meaning at least weekly.

Fiscal jeopardy – for the purposes of this policy, fiscal jeopardy is interpreted as a situation where the Co-op would be out of business within 10 days' time if no changes are made. There are many key financial indicators included in this report that the GM and Board must review in order to monitor the financial health of the organization. However, there is one indicator that stands out as a fiscal jeopardy litmus test, so to speak.

Days Cash on Hand (Cash is King)

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.

If the Co-op has 10 or fewer days of cash on hand, we would consider ourselves in fiscal jeopardy.

Data

- Sales, margin and labor are reviewed weekly by the GM and all other managers.
- Sales, margin, labor, net income, and cash are monitored monthly by the GM and the Finance Manager. Department Managers receive department financial reports monthly.
- Q3 2020 **Days of Cash** = 36, **exceeding the NCG minimum for compliance**

Data supports compliance.

Policy Language

B1.2 Allow key operational indicators to be below average for consumer grocery cooperatives.

Interpretation & Operational Definition

The General Manager must review the Co-op's key indicators as they compare to peer Co-ops across the NCG system.

For this sub-policy, I will use data provided quarterly in the CoMetrics Benchmarking report. **These numbers may differ from all the other numbers contained in this report because they**

are reported as a 12-month rolling average. Although the policy states that these indicators should be above the average, the comparison data demarcates the Upper Quartile (top 25%) instead of benchmarking the average. This report compares our performance to 18 other Co-ops in our size (annual sales volume) grouping.

We will consider the Co-op in compliance if we meet or exceed the upper quartile benchmark for each indicator. Please note that the value of the benchmark will change from quarter to quarter.

	Moscow Food Co-op	Upper Quartile
Sales Growth	-8.2%	1.7%
SPLH	$ 73.60	$ 98.00
Margin	38.2%	38.6%
Labor	19.4%	17.0%
Turns	14.50	15.70
MML	11%	15.6%

***Highlighting indicates non-compliance on key operational indicators.*

Explanation/Action Plan:

- Sales Growth – Similar to what we experienced last quarter, our COVID-19 experience in Q3 seems to have been harder than that of some of our peers. This metric has improved compared to Q2 2020. It is impossible to accurately predict when our sales will recover. It seems likely that we won't fully recover until September 2021 should COVID be under control. Offering curbside service increases overall sales and does help with sales growth.
- SPLH(Sales-per-labor-hour) – this is a measure of our efficiency while at work. SPLH is calculated by dividing total sales by the number of hours worked during the same period of time. We're significantly less efficient than our peer co-ops across the country. We've been working with department managers on using scheduling tools to impact this metric. This metric improved compared to Q2 2020.
- Margin – we're working on price increases in some key areas where we are falling short of overall margin
- Labor % - we're well below our peers on this metric and continually working to improve. Appreciation Pay costs and wage increases impacted this metric.
- Inventory Turns – This metric is less crucial during the pandemic. We're not currently addressing our shortfall.
- Margin Minus Labor – our MML falls short of the upper quartile because our labor is high. This will improve as we make both margin corrections and labor efficiency improvements. This metric improved from Q2 2020.

Data indicates noncompliance.

Policy Language

B1.3 Allow sales growth to be inadequate relative to market conditions.

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. Business expenses increase over time as wages increase, cost of benefits increases, rent and utilities expenses increase, and cost of goods increases. 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 Q3 system-wide growth was 5% compared to Q3 2019. Western Corridor Q3 system-wide growth was 3%.
- We experienced a sales decline in Q3, posting **Sales Growth of -8.2%** compared to Q3 2019. Although this was an improvement over the sales decline we experienced in Q2, we continue to be seriously **out of compliance** on this metric.

Explanation/Action Plan:

- Sales have not recovered since COVID-19 hit us full-force in April. Prepared Foods Departments continue to bear the worst of the effect of the pandemic. It is unlikely that we will see sales growth begin to recover before fall of 2021, and that's really only if COVID-19 is under control, if people can once again gather, and if the Co-op can host in-person events.

Data indicates noncompliance.

Policy Language
B1.4 Allow operations to generate net income that is inadequate to pay current obligations.

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 in the quarter.

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:

- Q3 2020 **net income** = -4.5% thus we are **out of compliance** with NCG requirements.
- Q3 2020 **EBITDAP** = -2.4%, thus we **out of compliance** with NCG.
- Q3 2020 **MML** = 11%. There is no minimum for compliance with NCG on this metric.

Explanation/Action Plan Net income continues to be negative. Prepared Foods Departments continue to struggle under the pandemic and are costing more money to operate than they are currently bringing in. For example, the Deli/Kitchen gross profit was down by $121,398 in Q3 but their expenses were only reduced by $4,875 for that same period. The Bakehouse gross profit was down by $32,512 while their expenses increased by $1,376. To date, we are systematically reducing labor expenses through attrition (not hiring when someone leaves unless the department can afford the labor). A reduction in labor expenses will lead to a positive net income, a positive EBITDAP, and an improvement in MML.

Data indicates noncompliance.

Policy Language

B1.5 Allow liquidity 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.

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:

- Q3 2020 **Quick Ratio** = 1.0, **exceeding the NCG minimum for compliance**
- Q3 2020 **Current Ratio** = 1.4, **exceeding the NCG minimum for compliance**
- September 30, 2020 **Cash on Hand** = $1,078,340. (no NCG target)
- Q3 2020 **Inventory Turns** = 14.5 (no NCG target)

Data supports compliance.

Policy Language

B1.6 Allow the debt to equity ratio 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:

- Q3 2020 debt-to-equity = 1.1, just missing **the Board's target for compliance, but meeting the NCG requirement for compliance.** This increase in our debt-to-equity ratio is due to the PPP loan the Co-op took on in Q2. Although this loan is forgivable, it is still considered debt until such time as it is forgiven.

Data supports noncompliance.

Policy Language

B1.7 Allow growth in owner paid-in equity to stagnate without cause.

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.

Per the Co-op's Annual Operating Plan, our goal for FY2020 is 3% growth in ownerships.

Data:

- Ownership numbers continue to grow. In Q3 2020, we welcomed 388 new owners. COVID can clearly be considered a reasonable cause for stagnation.
- Total paid-in-equity grows year-over-year, but very slowly in 2020. 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

B1.8 Allow an event of default under the Cooperative's loan agreements.

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

B1.9 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
B1.10 Incur debt other than trade payables or other reasonable and customary liabilities incurred in the ordinary course of doing business without prior Board Approval.

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:
- We received $553,000 in PPP funding and are awaiting forgiveness.

Data supports compliance.

Policy Language
B1.11 Acquire, encumber or dispose of real estate without prior Board Approval.

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
B1.12 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
B1.13 Use restricted funds for any unauthorized purpose.

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
B1.14 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 2019 financial review was completed by Wegner CPAs. This report was shared with the Board at the August 2020 Board Meeting.
- Nothing concerning was found.

Data supports compliance.