

Hill Country School Fund Co. Financial Case Solution & Analysis

3 Recapitalizations

	2019	2020	2021	2022	2023
Revenue	100	100	100	100	100
Expenses	80	80	80	80	80
Net Income	20	20	20	20	20
Capital Expenditures	10	10	10	10	10
Free Cash Flow	10	10	10	10	10

Further Analysis

	2019	2020	2021	2022	2023
Revenue	100	100	100	100	100
Expenses	80	80	80	80	80
Net Income	20	20	20	20	20
Capital Expenditures	10	10	10	10	10
Free Cash Flow	10	10	10	10	10

Final Recommendation

	2019	2020	2021	2022	2023
Revenue	100	100	100	100	100
Expenses	80	80	80	80	80
Net Income	20	20	20	20	20
Capital Expenditures	10	10	10	10	10
Free Cash Flow	10	10	10	10	10

Persuade to Change

Key points to persuade the board to change their mind:

- Revenue growth potential
- Market expansion opportunities
- Operational efficiencies
- Strategic investments

Company Culture

Key elements of company culture:

- Values and mission statement
- Leadership style and communication
- Employee engagement and retention
- Performance metrics and incentives
- Work-life balance and flexibility
- Continuous learning and development

Background

Company background and history:

- Founded in 1985, Hill Country School Fund Co. has a long history of providing educational services to the community.
- The company has a strong track record of financial performance and operational excellence.
- Our commitment to quality education and student success is the foundation of our business.

Hill Country
Snack Food Co.
Harvard Case
Solution &
Analysis

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Persuade to Change

Key points to persuade the board to change their mind:

- Revenue growth potential
- Market expansion opportunities
- Operational efficiencies
- Strategic partnerships
- Competitive advantages

Company Culture

Key elements of company culture:

- Values and mission statement
- Leadership style and communication
- Employee engagement and retention
- Work-life balance and flexibility
- Professional development and training
- Transparency and accountability
- Collaboration and teamwork
- Customer focus and service excellence

Background

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Background

Located in Austin, Texas, Hill Country Manufactures, Markets and Distributes:

- tortillas, pretzels, popcorn, churros, salsa, and frozen treats
- at supermarkets, C-stores, wholesale clubs, schools, etc.

Had consistently strong growth in both sales and net income
ROA has steadily grown, hitting 10% as a high

	2015	2014	2013	2012	2011
Revenue	1,000,000	950,000	900,000	850,000	800,000
Net Income	100,000	95,000	90,000	85,000	80,000
Operating Assets	1,000,000	950,000	900,000	850,000	800,000
ROA	10%	10%	10%	10%	10%

	2006	2007	2008	2009	2010	2011
Sales	\$1,027.0	\$1,059.9	\$1,099.5	\$1,180.4	\$1,261.7	\$1,364.6
Operating income (EBIT)	\$97.4	\$79.1	\$82.8	\$108.2	\$126.7	\$151.3
Net income	\$64.6	\$52.6	\$53.8	\$68.1	\$79.9	\$97.6
Earnings per share	\$1.91	\$1.56	\$1.59	\$2.01	\$2.36	\$2.88
Dividends per share	\$0.45	\$0.45	\$0.45	\$0.60	\$0.70	\$0.85
Cash & cash equivalents	\$108.1	\$107.6	\$106.4	\$139.8	\$164.8	\$181.1
Total assets	\$668.5	\$727.3	\$770.4	\$824.9	\$894.7	\$979.9
Debt	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0	\$0.0
Owners' equity (book value)	\$529.7	\$567.4	\$606.3	\$654.6	\$710.9	\$780.1
Common shares outstanding (in millions)	33.7865	33.8076	33.8278	33.8581	33.8633	33.8834
Annual growth rate of sales	n/a	3.2%	3.7%	7.4%	6.9%	8.2%
Annual growth rate of E.P.S.	n/a	-18.3%	1.9%	26.4%	17.4%	22.0%
Dividend payout ratio	23.6%	28.8%	28.3%	29.9%	29.7%	29.5%
Net profit margin	6.3%	5.0%	4.9%	5.8%	6.3%	7.2%
Return on assets ^a	9.7%	7.2%	7.0%	8.3%	8.9%	10.0%
Return on equity ^a	12.2%	9.3%	8.9%	10.4%	11.2%	12.5%



Company Culture

Does this increase stockholder value?

- focused on at every level the organization and in every operating decision
- 1/6 of the company owned by management (5.65 million shares)
- Strong commitment to efficiency and controlling costs

Managerial Philosophy

- Risk Aversion
- Use Caution
- Low risk growth from extensions on existing products

CEO, Howard Kleener

- CEO 15 yrs
- Speculation on retiring (62 yrs old)
- Does not like debt. Period.



Pressures to Change

Hill Country Snacks and CEO Howard Kleener

- Facing pressures from both analysts and shareholders to take a more aggressive capital structure
 - Large cash reserves with no debt financing, and large equity balance made it difficult for a company in a mature industry to earn a high rate of return on equity

"What is the optimal capital structure for Hill Country Snack Foods, and how large are the payoffs associated with a change to a more leveraged capital structure?"



3 Recapitalizations

	20%	40%	60%
	Debt-to-Capital	Debt-to-Capital	Debt-to-Capital
	Ratio	Ratio	Ratio
Excess cash	\$55.0	\$55.0	\$55.0
Debt issued	\$145.0	\$290.0	\$435.0
Total stock repurchase	\$200.0	\$345.0	\$490.0
Price per share repurchased	\$47.92	\$50.00	\$52.09
Shares of common stock repurchased	4,173,623	6,900,000	9,406,796
Owners' equity (book Value)	\$580.1	\$435.1	\$290.1

Pro Forma 2011 Financial Information for Alternative Capital Structures

	20%	40%	60%
Operating Income	100	100	100
Interest Expense	0	145	435
Income Before Tax	100	55	55
Income Tax Expense	30	16.5	16.5
Net Income	70	38.5	38.5
Debt Issued	0	145	435
Debt Repayment	0	0	0
Debt Balance	0	145	435
Equity Repurchase	200	345	490
Equity Balance	380.1	88.1	100.1
Debt-to-Capital Ratio	0%	16%	41%

Calculating The WACC

Cost of Eq.	Fall Year			2020			2021			2022		
% of Eq.	200	400	600	200	400	600	200	400	600	200	400	600
0.0%	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
0.20%	0.40	0.80	1.20	0.40	0.80	1.20	0.40	0.80	1.20	0.40	0.80	1.20
0.40%	0.80	1.60	2.40	0.80	1.60	2.40	0.80	1.60	2.40	0.80	1.60	2.40
0.60%	1.20	2.40	3.60	1.20	2.40	3.60	1.20	2.40	3.60	1.20	2.40	3.60
0.80%	1.60	3.20	4.80	1.60	3.20	4.80	1.60	3.20	4.80	1.60	3.20	4.80
1.00%	2.00	4.00	6.00	2.00	4.00	6.00	2.00	4.00	6.00	2.00	4.00	6.00
1.20%	2.40	4.80	7.20	2.40	4.80	7.20	2.40	4.80	7.20	2.40	4.80	7.20
1.40%	2.80	5.60	8.40	2.80	5.60	8.40	2.80	5.60	8.40	2.80	5.60	8.40
1.60%	3.20	6.40	9.60	3.20	6.40	9.60	3.20	6.40	9.60	3.20	6.40	9.60
1.80%	3.60	7.20	10.80	3.60	7.20	10.80	3.60	7.20	10.80	3.60	7.20	10.80
2.00%	4.00	8.00	12.00	4.00	8.00	12.00	4.00	8.00	12.00	4.00	8.00	12.00
2.20%	4.40	8.80	13.20	4.40	8.80	13.20	4.40	8.80	13.20	4.40	8.80	13.20
2.40%	4.80	9.60	14.40	4.80	9.60	14.40	4.80	9.60	14.40	4.80	9.60	14.40
2.60%	5.20	10.40	15.60	5.20	10.40	15.60	5.20	10.40	15.60	5.20	10.40	15.60
2.80%	5.60	11.20	16.80	5.60	11.20	16.80	5.60	11.20	16.80	5.60	11.20	16.80
3.00%	6.00	12.00	18.00	6.00	12.00	18.00	6.00	12.00	18.00	6.00	12.00	18.00
3.20%	6.40	12.80	19.20	6.40	12.80	19.20	6.40	12.80	19.20	6.40	12.80	19.20
3.40%	6.80	13.60	20.40	6.80	13.60	20.40	6.80	13.60	20.40	6.80	13.60	20.40
3.60%	7.20	14.40	21.60	7.20	14.40	21.60	7.20	14.40	21.60	7.20	14.40	21.60
3.80%	7.60	15.20	22.80	7.60	15.20	22.80	7.60	15.20	22.80	7.60	15.20	22.80
4.00%	8.00	16.00	24.00	8.00	16.00	24.00	8.00	16.00	24.00	8.00	16.00	24.00
4.20%	8.40	16.80	25.20	8.40	16.80	25.20	8.40	16.80	25.20	8.40	16.80	25.20
4.40%	8.80	17.60	26.40	8.80	17.60	26.40	8.80	17.60	26.40	8.80	17.60	26.40
4.60%	9.20	18.40	27.60	9.20	18.40	27.60	9.20	18.40	27.60	9.20	18.40	27.60
4.80%	9.60	19.20	28.80	9.60	19.20	28.80	9.60	19.20	28.80	9.60	19.20	28.80
5.00%	10.00	20.00	30.00	10.00	20.00	30.00	10.00	20.00	30.00	10.00	20.00	30.00
5.20%	10.40	20.80	31.20	10.40	20.80	31.20	10.40	20.80	31.20	10.40	20.80	31.20
5.40%	10.80	21.60	32.40	10.80	21.60	32.40	10.80	21.60	32.40	10.80	21.60	32.40
5.60%	11.20	22.40	33.60	11.20	22.40	33.60	11.20	22.40	33.60	11.20	22.40	33.60
5.80%	11.60	23.20	34.80	11.60	23.20	34.80	11.60	23.20	34.80	11.60	23.20	34.80
6.00%	12.00	24.00	36.00	12.00	24.00	36.00	12.00	24.00	36.00	12.00	24.00	36.00
6.20%	12.40	24.80	37.20	12.40	24.80	37.20	12.40	24.80	37.20	12.40	24.80	37.20
6.40%	12.80	25.60	38.40	12.80	25.60	38.40	12.80	25.60	38.40	12.80	25.60	38.40
6.60%	13.20	26.40	39.60	13.20	26.40	39.60	13.20	26.40	39.60	13.20	26.40	39.60
6.80%	13.60	27.20	40.80	13.60	27.20	40.80	13.60	27.20	40.80	13.60	27.20	40.80
7.00%	14.00	28.00	42.00	14.00	28.00	42.00	14.00	28.00	42.00	14.00	28.00	42.00
7.20%	14.40	28.80	43.20	14.40	28.80	43.20	14.40	28.80	43.20	14.40	28.80	43.20
7.40%	14.80	29.60	44.40	14.80	29.60	44.40	14.80	29.60	44.40	14.80	29.60	44.40
7.60%	15.20	30.40	45.60	15.20	30.40	45.60	15.20	30.40	45.60	15.20	30.40	45.60
7.80%	15.60	31.20	46.80	15.60	31.20	46.80	15.60	31.20	46.80	15.60	31.20	46.80
8.00%	16.00	32.00	48.00	16.00	32.00	48.00	16.00	32.00	48.00	16.00	32.00	48.00
8.20%	16.40	32.80	49.20	16.40	32.80	49.20	16.40	32.80	49.20	16.40	32.80	49.20
8.40%	16.80	33.60	50.40	16.80	33.60	50.40	16.80	33.60	50.40	16.80	33.60	50.40
8.60%	17.20	34.40	51.60	17.20	34.40	51.60	17.20	34.40	51.60	17.20	34.40	51.60
8.80%	17.60	35.20	52.80	17.60	35.20	52.80	17.60	35.20	52.80	17.60	35.20	52.80
9.00%	18.00	36.00	54.00	18.00	36.00	54.00	18.00	36.00	54.00	18.00	36.00	54.00
9.20%	18.40	36.80	55.20	18.40	36.80	55.20	18.40	36.80	55.20	18.40	36.80	55.20
9.40%	18.80	37.60	56.40	18.80	37.60	56.40	18.80	37.60	56.40	18.80	37.60	56.40
9.60%	19.20	38.40	57.60	19.20	38.40	57.60	19.20	38.40	57.60	19.20	38.40	57.60
9.80%	19.60	39.20	58.80	19.60	39.20	58.80	19.60	39.20	58.80	19.60	39.20	58.80
10.00%	20.00	40.00	60.00	20.00	40.00	60.00	20.00	40.00	60.00	20.00	40.00	60.00