The Simply Good Foods Company Investment Analysis

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BUS350: Principles of Finance

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September 27, 2020

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The Simply Good Foods Company is a developer, marketer and seller of branded nutritional foods and snacking products. The company, which is headquartered in Denver, Colorado, "is a highly-focused food company with a product portfolio consisting primarily of nutrition bars, ready-to-drink shakes, sweet and salty snacks and confectionary products marketed under the Atkins, Quest, SimplyProtein and Atkins Endulge brand names" (The Simply Good Foods Company, 2020a). Quest, the most recent acquisition of the brands, completed integration in November 2019 and provided good return on the initial $1 billion investment. While the company's last earning report stated $635.5 remaining on the principle of the Quest loan, the acquisition contributed over 71% to net sales growth (The Simply Good Foods Company, 2020b). Entering 2020, the company anticipated significant growth and exceeded expectations. However, COVID-19 impacted the company who noted, "Since March, however, retail foot traffic has been volatile with positive spikes in the beginning of the month followed by a significant slowdown in the second half of the month" (The Simply Good Foods Company, 2020b). Adapting to customer trends based on COVID-19 combined with the historical concerns of consumer trends based on current fitness/diet programs will help to control the company's risk.

Profit Margin

To best understand The Simply Good Foods Company's profit margin, we must establish what the profit margin represents, how it is determined and what it conveys. "While there are several types of profit margin, the most significant and commonly used is net profit margin, a company's bottom line after all other expenses, including taxes and one-off oddities, have been removed from revenue" (Segal, 2020). Simply put, we are establishing the income per dollar of sales generated as a percentage. In the case of The Simply Good Foods Company, as we review the 10k report dated May 30, 2020, we can take the EBIT (Earnings Before Interest and Taxes) which was $30,749 and divide by sales which was $215,101 resulting in a 14.30% operating profit margin. This means that for each dollar of sales generated, The Simply Good Foods Company had a net income of $0.14. A large contribution to this evaluation was based on the company posting an increase of over $75 million in net sales. Of that, “The Quest acquisition contributed 62.5%” (The Simply Good Foods Company, 2020c). This also compensated for the Legacy Atkins product(s) which saw their volume decline by almost 10%. Comparing the data derived from The Simply Good Foods Company 10k report, we find that the EBIT was $20,412 and the sales were valued at $139,468. Dividing the $20,412 of EBIT by the sales $139,468, we get a 14.64% operating profit margin for the company. Even through the acquisition of Quest, COVID-19 implications (manufacturing, shipping, and consumer demand) and competitor products, the company has sustained a profit margin equal to that of 2019. Such levels of consistency provide insight as to the sustained focus of the company which allowed for such loans as that utilized in the Quest acquisition as well as assuring investors (as well as debt holders) that the company will honor commitments.

Total Asset Turnover

Having a clear and accurate understanding of the asset turnover ratio helps to provide insight into the company’s use of assets to generate revenue. “The higher the asset turnover ratio, the more efficient a company is at generating revenue from its assets. Conversely, if a company has a low asset turnover ratio, it indicates it is not efficiently using its assets to generate sales” (Hayes, 2020). In The Simply Good Foods Company’s case, we determined the Total Asset

Turnover by establishing sales of $215,101 and total assets which were stated at $2,040,144 as of May 30, 2020. Applying this data to the formula of Total Assets Turnover = Sales/Total Assets, we derive the value of 0.11. This value indicates that the company is not utilizing assets in the most efficient manner to generate revenue for the company. Looking back to the 10k from May 25, 2019, we can see a distinguishable difference in sales of $139,468 and total assets which were stated at $1,141,650. However, when we apply this data to the formula of Sales/Total Assets = Total Asset Turnover, we get a value of 0.12 which closely resembles the 0.11 of the 2020 10k. With the impact of COVID-19, increased inventory through the additional products within the Quest acquisition, along with existing brand(s) inventory, the company will need to use effective research and advertising to identify what products are most desirable. Potential points of focus could be adding additional products within some lines, eliminating products that are not selling well within others, and making consumer products easier to access and purchase.

Equity Multiplier

Stockholders play a significant role in any publicly traded company. "The equity multiplier is a financial leverage ratio that measures the portion of the company's assets that are financed by stockholder's equity" (Ganti, 2020). As such, having a clear understanding of the equity multiplier will help to gain insight to the financial leverage of The Good Foods Company. Referring to the company's 10k report dated May 30, 2020, we can derive the total assets of $2,040,144 as well as the total equity which was stated as $1,215,649. Applying this data to the equity multiplier formula of Equity Multiplier = Total Assets/Total Equity, we get the value of 1.68. Although there is not a specific value to which a company should "target," a value of two would indicate that half of the assets within a company were financed through debt and the rest through equity. We then compared values from the 10k dated May 25, 2019 to gain perspective while identifying any trend(s). Once again, we see values that are less than those of the most recent statements as total assets were valued at $1,141,650 and total equity was stated as $837,444. Inputting this data into the formula of Equity Multiplier = Total Assets/Total Equity, we derive the value of 1.36. Comparing the two values, we see that The Good Foods Company increased its debt-financed assets over the past year, yet this is not unexpected or unreasonable with the $2 billion dollar loan noted earlier to acquire Quest.

Recommendation

Before determining the appropriate recommendation of The Good Foods Company, we applied two additional profitability ratios: Return on Assets (ROA) and Return on Equity (ROE). The ROA not only offers a different outlook on management effectiveness, it also, "reveals how much profit a company earns for every dollar of its assets" (McClure, 2020). Applying the ROE can help show effectiveness of company use of investment money. "ROE shows whether management is growing the company's value at an acceptable rate" (McClure, 2020). To determine the ROA, take the profit margin determined earlier at a value of 14.30% and multiply it by the previously calculated total asset turnover valued at 0.11 for a total Return on Assets of 1.51%. To determine the ROE, take the previously derived profit margin (14.30%) multiplied by the total asset turnover (0.11) and the previously calculated equity multiplier (1.68) for a ROE of 2.53%. Using the same formulas with values from the 2019 10k, we come up with a ROA of 1.79% and ROE of 2.44%, both of which are comparable year over year like the other measurements. While the values remain consistent year over year, the values fail to meet recommended values for clearly supporting investing. Thus, we do not recommend investing in The Good Foods Company to clients of Equity Edge Investments.

Limitations

While we based this analysis and recommendation on factual data derived from the financial 10k statements over the past two years, we measured the results against the company and standardized acceptable values. To better measure the evaluation of The Simply Good Foods Company, determining the same values and measurements of multiple companies of similar size and within the same classification would have provided a better indication of the performance. The most recent 10k was derived prior to peak summer season for the fitness and nutrition focus. Additionally, the same recent 10k was generated during the height of the COVID-19 pandemic. While expectations and indications projected exceptional performance after acquiring Quest and prior to the pandemic, trends remained consistent rather than declining. Applying data derived in January/February prior to necessary reevaluation might have altered values and provided a different outlook as to expected performance post-pandemic.

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