

RED WHISK

Investment
Retail

Medium difficulty
Candidate-Led

This case focuses on making an investment recommendation for a client in the retail industry. It is candidate-led and tests all elements of the case interview scorecard, with emphasis on strong structuring, judgment and insights.

Problem definition

Our client is BigCart, a national grocery supermarket retailer in the USA. BigCart operates approximately 5,000 stores across the USA, as well as an online business that delivers groceries to customers' homes. BigCart has recently unveiled a new five-year strategic plan that vows to provide "a great food option for every meal occasion".

The rationale for this strategy is that fewer Americans are cooking from scratch at home, and are instead purchasing pre-made meals, meal kits, or getting hot meals delivered to their homes via UberEATS or Postmates. BigCart has recently launched a venture fund with a mandate to invest in businesses that are (a) profitable investments and (b) advance their core business strategy.

Red Whisk has approached BigCart with an opportunity to invest in its business. Red Whisk is a subscription meal kit company that provides customers with a weekly box containing the recipes and ingredients for them to cook meals in under 30 minutes at home.

BigCart has hired you to recommend whether or not to invest in Red Whisk.

Structuring

Additional information

If asked at this stage or later, inform the candidate that:

- This is the first investment that BigCart's venture fund is investigating.
- Red Whisk has the largest market share in the subscription meal kit market, but there are many competitors.
- Determining the price of the acquisition is out of scope. We are only looking at whether the acquisition makes strategic sense.

Possible answer

BigCart should make an investment in Red Whisk if:

1. *Driver 1: The market for subscription meal kits is attractive*
 - a. *Size and growth*
 - b. *Competitive landscape*
2. *Driver 2: Red Whisk operates a sustainable business with a path to profitability*
 - a. *Topline*
 - i. *Sales volume*
 - ii. *Price*
 - b. *Bottom line*
 - i. *COGS*
 - ii. *Last Mile*
 - iii. *Marketing*
3. *Driver 3: There are synergies / strategic upsides available if BigCart and Red Whisk were to partner*
 - a. *Synergies for Red Whisk*
 - i. *Joint sourcing*
 - ii. *Joint last mile*
 - iii. *Joint marketing*
 - iv. *New sales channel (via BigCart websites or stores)*
 - b. *Synergies for BigCart*
 - i. *New product offer for customers*
 - ii. *Learn the subscription business model*

Driver 1: Is the market for subscription meal I

Additional information

The internal strategy team at BigCart has done research into the subscription meal kit and has produced Exhibit 1. (Share with Candidate)

Guidance for interviewer

Market attractiveness: A good candidate will be able to observe the trend in market growth. A strong candidate will reinforce this observation and illustrate numerical literacy by calculating a rough figure for market growth rate from Year - 4 to Year 0 (This year). A strong candidate will provide hypotheses about growth patterns, for instance, provide a rationale for why market growth is slowing. An excellent candidate will query what this means for our client and hypothesize about whether the growth in meal kits is coming at the expense of our client's core business.

Competitive landscape: A good candidate will make 1-2 observations about the competitive landscape. A strong candidate will make all 3 observations about the competitive landscape. An excellent candidate will discuss why competition is growing and the implications of this competition

Possible answer

Market attractiveness

From the chart I can observe that the market is growing very quickly. I can see that the market has grown more than 4.5 times between Year -4 and Year 0 (this year) (7,000/1500).

However, I can also observe that the rate of growth is slowing. I don't think this is a serious red flag because it is to be expected that the rate of growth will slow down as the market matures.

Since my client is a supermarket chain, it is relevant where this growth is coming from. If meal kits are stealing share from grocery chains (like our client BigCart) this might provide additional rationale for entering this market.

Competitive Landscape

From the chart, I can also observe that this market is quite competitive and becoming increasingly competitive. In particular, I can see the following:

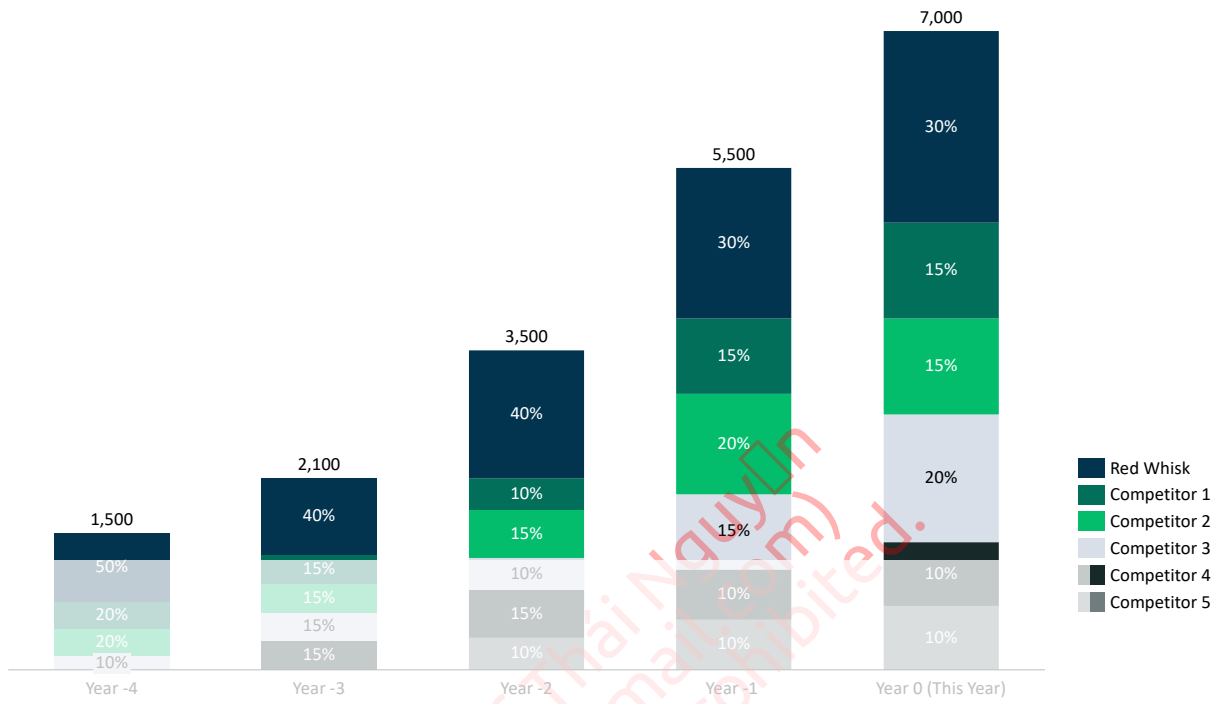
- New entrants to the market (for example, 4 players in Year -4 but 6 players in Year -2)
- Red Whisk is losing share as new competitors enter
- Market positions switch each year (for example, competitors gain and lose share of the market)

There may be some implications of growing competition on Red Whisk:

- Barriers to entry for this market might be low, and this means that Red Whisk will consistently face challenges to maintain share
- This might be a “hot” market for venture capital, and this means that Red Whisk might be facing competitors who can accommodate losses to capture share
- If competition remains high, there is likely to be a price war and a resulting pressure on margins for Red Whisk
- Based on the share changes, customers don't appear to be very loyal, and Red Whisk might struggle to retain share

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Exhibit 1: Market size for subscription meal kits



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Driver 2: Does Red Whisk operate a sustainable business with a path to profitability?

Additional information

- This year (Year 0), Red Whisk gained 1,428,571 new customers:
- Customers on average order 3.5 boxes per month.
- The gross margin earned on each subscription box sold is \$5.
- Cost of Goods Sold includes the cost of raw materials (vegetables, proteins, spices, etc.), packaging, and last-mile delivery (i.e., delivering the subscription box to the customer's home. Raw materials represent the largest share of COGS.
- Product, technology, general and administrative expenses include all head offices expenses (primarily team costs), investment in recipe development, and investment in technology.
- Red Whisk's largest marketing expense is providing significant discounts for first-time customers, for example, "first three boxes free" coupons.
- All Red Whisk's competitors are operating with negative net income.
- Customer acquisition cost (CAC) reflects the cost (on average) of acquiring a new customer. $CAC = \text{marketing expense in a period} / \text{number of new customers acquired in that period}$.
- Lifetime Value (LTV) reflects the average value of a customer (in terms of sales) between acquisition and churn. $LTV = \text{average customer lifespan} \times \text{average number of orders per month} \times \text{gross margin per order}$.
- A healthy subscription business would have a CAC:LTV ratio of approximately 1:2.

Guidance for interviewer

Share Exhibit 2 once the candidate starts exploring Driver 2. Share Exhibit 3 only when the candidate has identified that marketing expenses are the primary risk / an area for further investigation. If the candidate struggles to interpret the chart, inform them that this chart demonstrates the percentage of customers who stop using Red Whisk over the course of a year based on how long they've been using Red Whisk at the start.

Please share the definition and formula for customer acquisition cost (CAC) and lifetime value (LTV) if the candidate requests it.

Good candidates will identify from the chart that marketing expense is the area requiring further investigation. Strong candidates will be able to interpret Exhibit 3 and realize through CAC and LTV comparisons that past growth has likely been bought.

An excellent candidate will not only observe from _____ that the chairman is _____ but also provide a hypothesis as to why this might be the case and whether this represents a short-term or structural risk for investment in Red Whisk.

Possible answer

From the table, I can observe that Red Whisk currently has negative net income (that is, costs are outstripping revenue). However, I can see that net income has improved as a percent of sales between Year -2 and Year 0 (This Year) which is a good sign. To understand this better I should look at topline and bottom-line drivers of profitability to see if Red Whisk has a positive path to profitability.

Topline

I will deprioritize the investigation of this lever as Red Whisk is exhibiting strong growth. This is unlikely to be a deal breaker or cause for concern.

Bottom line

I observe that COGS is the largest cost driver for Red Whisk. While COGS has grown in absolute terms, COGS is trending down as a % of sales. This means that gross margin is improving, calculated as follows:

| | | Year -2 | Year -1 | Year 0 (This year) |
|---------------------------|-----|------------------------------|-------------------------------|-------------------------------|
| Revenue | \$M | 1400 | 1650 | 2100 |
| Cost of Goods Sold (COGS) | \$M | 1120 | 1237.5 | 1470 |
| Gross Margin | % | $= (1400-1120)/1400$ =20% | $= (1650-1237)/1650$ = 25% | $= (2100-1470)/2100$ = 30% |

This might be because Red Whisk has negotiated better trade terms on raw materials (vegetables, packaging, etc.) or last mile costs as they have grown, and as they continue to grow, they will continue to see COGS as a % of sales improve. This suggests a positive path to profitability as Red Whisk scales.

From the table, I observe that product, technology, and general and administrative expenses are declining both in absolute terms and as a percentage of sales. This probably does not require further investigation, though I wonder whether Red Whisk cutting down on human and technology investment is damaging to the long-term success of the business.

I am most concerned about marketing expenses. Marketing expense as a share of sales is growing:

| | | Year -2 | Year -1 | Year 0 (This year) |
|---------------------------------------|-----|--------------------------|---|-------------------------------|
| Revenue | \$M | 1400 | 1650 | 2100 |
| Marketing Expenses | \$M | 280 | 495 | 735 |
| Marketing Expense as a share of sales | % | $= 280/1400$ $= 20\%$ | $= \sim 500/\sim 1600$ $= \sim 30\%$ | $= \sim 700/2100$ $= 35\%$ |

This gives me cause for concern because marketing expenses will continue to scale with the **business**, and it could be that Red Whisk has “bought” their recent growth. This is evidenced by the fact that marketing expenses have grown faster (+\$240 million) than gross margin (+\$217.5 million).

I need to dig deeper into marketing expense to diagnose whether this is a deal breaker for the investment. To do so, I want to compare Red Whisk’s CAC:LTV ratio with an industry benchmark.

CAC:

Customer acquisition cost = marketing expense / # customers gained

Customer acquisition cost in Year 0 (This Year) = $735,000,000/1,428,571 = \515 per customer

LTV:

Lifetime Value = average customer lifespan x average number of orders per month x gross margin per order

Average customer lifespan: From Exhibit 3, we know that 83% of new customers churn in the first year and that half of those who churn do so roughly after month 4. Given that the percentage of those who churn in a month decreases each month, these 83% of customers have an average lifespan of around 5 months. Using historic cohort data, we can estimate that $(1-83\%) \times 70\% = 12\%$ of new customers churn in the second year and that half of those who churn do so roughly after around 3 months (this may be a little conservative as churn rates are increasing). Given that the percentage of those who churn in a month decreases each month, these 12% of customers have an average lifespan of around $12 + 4 = 16$ months (taking into account that they stay loyal for the whole first year)

We know that the remaining $1 - 83\% - 12\% = 5\%$ of a 30 months lifespan for these this means that the average lifetime of a customer is $83\% \times 5 + 12\% \times 16 + 5\% \times 30 = 4 + 1.9 + 1.5 = \sim 7.5$ months

Lifetime value = $7.5 \times 3.5 \times \$5 = \131.25

Therefore, based on this, CAC:LTV is closer to 4:1. The client is spending significantly more to acquire a customer than the margin they generate from that customer, which is very concerning.

I can also see from Exhibit 3 that the churn rate is deteriorating each year. This might be because earlier cohorts (e.g., Year -4 cohorts) were more native customers who are inclined to like the product whereas later cohorts might have only joined because of the free trial deals and would never become loyal customers. Based on what we saw in Exhibit 1, it also might be that the churn rate has deteriorated because there is more competition in the market and it is harder to retain customers in that environment.

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(thaicnh0729@gmail.com)
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Exhibit 2: Red Whisk Profit & Loss Statement

| | | Year -2 | Year -1 | Year 0 (This year) |
|--------------------------------|-----|---------|---------|-----------------------|
| Revenue | \$M | 1,400 | 1,650 | 2,100 |
| Cost of Goods Sold (COGS) | \$M | 1,120 | 1,237.5 | 1,470 |
| Marketing Expenses | \$M | 280 | 495 | 735 |
| Product, Tech, General & Admin | \$M | 420 | 400 | 400 |
| Net income | \$M | -420 | -482.5 | -505 |

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 (thaicnh0729@gmail.com)
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Exhibit 3: Red Whisk customer churn data by c

% of consumers who churned last year by the end of each month

| | Month 1 | Month 2 | Month 3 | Month 4 | Month 5 | Month 6 | Month 7 | Month 8 | Month 9 | Month 10 | Month 11 | Month 12 |
|--------------------|---------|---------|---------|---------|---------|---------|---------|---------|---------|----------|----------|----------|
| Year 0 (Last year) | 11% | 23% | 32% | 43% | 50% | 57% | 64% | 70% | 73% | 79% | 82% | 83% |
| Year -1 | 13% | 25% | 39% | 44% | 47% | 59% | 60% | 62% | 63% | 65% | 67% | 70% |
| Year -2 | 11% | 13% | 15% | 29% | 35% | 37% | 38% | 42% | 47% | 48% | 51% | 55% |
| Year -3 | 12% | 22% | 24% | 26% | 28% | 30% | 33% | 35% | 39% | 43% | 45% | 48% |
| Year -4 | 9% | 13% | 17% | 21% | 25% | 28% | 29% | 31% | 32% | 35% | 38% | 40% |

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Driver 3: Are there any synergies / strategic upsides if BigCart and Red Whisk were to partner?

- Additional information**
- BigCart is the largest buyer of raw food (e.g., fruits, vegetables, and meat) in North America. They have strong relationships with suppliers and typically receive preferable terms to their competitors to reflect their buying power.
 - BigCart has an online business that delivers groceries to customers' homes (last mile delivery).

- BigCart owns their own fleet of trucks and employs drivers to support last mile for their business.
- Red Whisk currently delivers subscription boxes to customers once a week, every Tuesday.
- BigCart has a large loyalty program with thousands of customers receiving a weekly newsletter.
- BigCart previously attempted to launch a range of meal kits in their stores. This pilot went very poorly and was abandoned because it was not profitable.
- BigCart has a line of pre-made meals under their own brand. These pre-made meals are a strategic priority because they offer a convenient food option for customers who might otherwise order delivery food. A big challenge facing BigCart is inventing new recipes for these pre-made meals because customers look for new options and inspiration.

Guidance for interviewers

A weak answer will be in the form of a laundry list of potential synergies. A good candidate will categorize synergies, ideally revenue and cost synergies. A great candidate will also include their ease of implementation.

After brainstorming and discussing various synergies together, you may share that synergies **will not** increase the top line, but will reduce COGS by 5% and marketing expense by 20%. A good/great candidate will identify that this would not be sufficient for the business to break even.

Possible answer

Synergies for Red Whisk:

There are a number of potential benefits to Red Whisk that would accrue if they worked with BigCart. Some of these benefits could include:

Cost:

- *Joint sourcing – Since Red Whisk and Big Cart share suppliers (e.g., produce, bread, spices, packaging), Red Whisk might benefit from Big Cart’s preferable trade terms.*
- *Joint last mile – Since Big Cart operates their warehouses and delivery trucks, in a partnership, Red Whisk might be able to access this last mile solution at cost, thereby saving money on third party logistics.*
- *Joint marketing – Big Cart has a large loyalty program which Red Whisk might leverage to advertise to customers. This advertising might be more targeted, and cost-effective, than existing sales channels and reduce marketing expenses. In-store and online marketing might also be a great way to lower the customer acquisition cost.*

Revenue:

- *New sales channel– Red Whisk could grow sales by selling meal kits to new customers via Big Cart’s stores or website.*

However, I need to overlay feasibility analysis over this investment. The operational levers – such as joint sourcing and joint last mile – might be challenging or costly to execute. For example, Red Whisk delivers all their subscription boxes on a Tuesday. BigCart might not have the capacity to support this level of delivery on a single day of the week.

It also might be operationally challenging to launch meal kits in stores. This is a departure from the subscription model that Red Whisk pioneered and might increase the cost profile of the meal kit products.

Synergies for BigCart:

I recall that BigCart’s strategic objective is to provide “a great food option for every meal occasion”. With this in mind, investing in a meal kit company might be an effective way to serve a customer’s need for simple and convenient home cooking.

However, I question whether the meal kit market is simply cannibalizing BigCart’s existing supermarket business, and therefore does not represent a net new revenue stream. However, Exhibit 1 suggests this cannibalization is happening regardless of BigCart’s investment, and so it is important that BigCart ranges a product with the ability to meet this customer need.

[Interviewer shares that synergies will not increase the top line but will reduce COGS by 5% and marketing expenses by 20%.]

Based on the information you have shared it appears that the synergies we have identified would not be sufficient for the business to break-even. This is because:

Reducing COGS by 5% will save us ~75 million (0.05×1470).

Reducing marketing expenses by 20% will save us ~\$150 million (0.2×735).

The total savings is therefore $75 + 150 = \sim\$225$ million, which means net income improves from -500 million to $\sim-\$275$ million. Red Whisk would still have negative net income with the synergies.

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(thaicnh0729@gmail.com)
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Synthesis

Possible answer

We were asked by BigCart to evaluate the potential target “Red Whisk” and make a recommendation about whether to invest.

We think you should not invest in Red Whisk for three reasons.

Firstly, while the meal kits market is growing rapidly, we are concerned about customer retention given the level of competition. Competition has been growing (for example, 4 players in Year -4 but 6 players in Year -2) and Red Whisk is losing share.

Secondly, Red Whisk is currently a negative net income business on a deteriorating trajectory. Red Whisk's marketing expenses have been growing as a share of sales. And their CAC:LTV ratio is 5:1, meaning that they are burning an increasing amount of cash to acquire customers who fail to generate sufficient margin to cover the expenses.

Thirdly, while synergies could unlock ~\$225 million, it is still not enough for Red Whisk to break even and they will operate with a negative net income of ~\$275 million.

Given the strategic importance of the subscription meal kits market to BigCart, we recommend BigCart waits 1-2 years to evaluate whether Red Whisk has been able to reduce its losses. If Red Whisk can improve their net income position to losses of \$225 million or less, we could then acquire Red Whisk and bring them to profitability through the synergies we have identified above.

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(thaicnh0729@gmail.com)
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