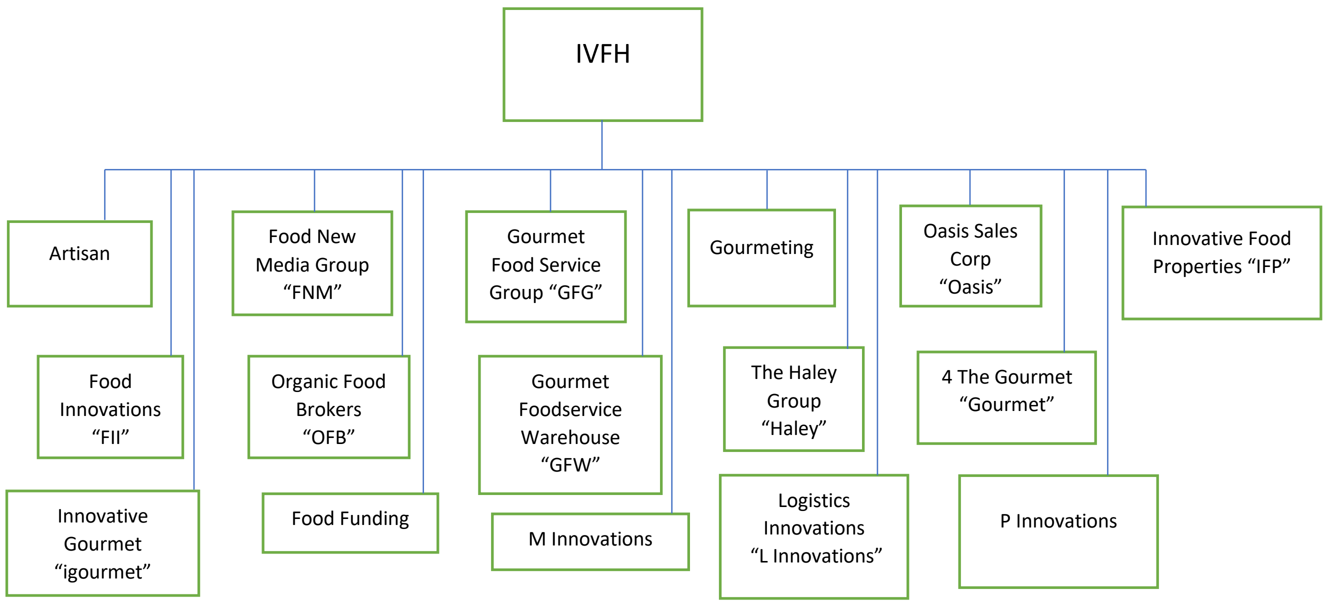
Innovative Food Holdings (IVFH)

Innovative Food Holdings (IVFH) is a supplier of fresh and prepared foods for both professional cooks and home consumers. The company distributes something like 7,300+ perishable and specialty food products, including seafood, meat, poultry, game, cheeses, oils and vinegars, etc. Basically, if there's something that a chef might need, IVFH can supply it.

IVFH comprises several companies, which are wholly owned subsidiaries. Below is a simple org chart for IVFH:



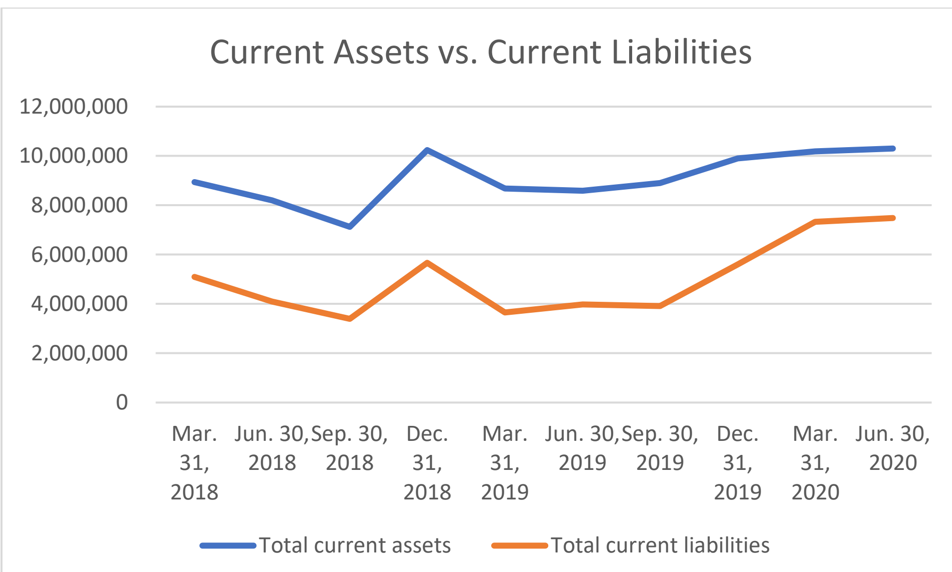
So we can see there are lots of separate little entities that make up the whole of IVFH. A couple notes on some of these companies:

- IFP was formed to hold IVFH's real estate holdings. IVFH recently purchased a large warehouse facility in Pennsylvania. More to come on this later.
- P Innovations is focused on leveraging the company's acquired assets in order to drive sales to and expand IVFH's subscription-based e-commerce business. In 2019, acquired certain assets of The GiftBox, a subscription-based e-commerce business.
- L Innovations provides 3rd party warehouse and fulfillments services (logistics)
- Haley is a foodservice consulting and advisory firm
- OFB and Oasis function as outsourced sales and brand management for emerging consumer packaged goods (CPG) companies
- igourmet is engaged in e-commerce, providing direct-to-consumer (D2C) specialty food through its website and other channels (Amazon, eBay, WalMart, etc.). Additionally, igourmet offers a line of business-to-business (B2B) specialty foodservice items.

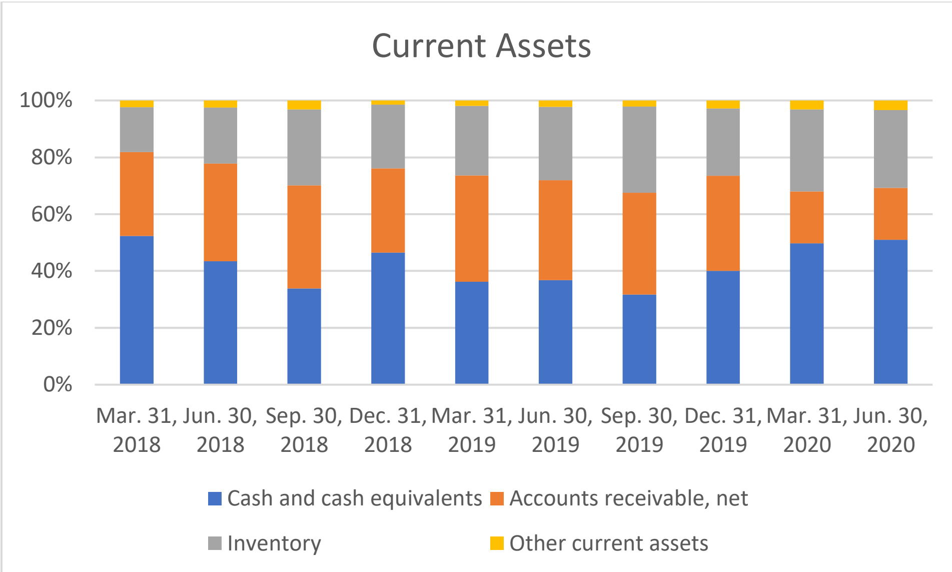
- In 2018, M Innovations purchased certain assets of Mouth Foods Inc "Mouth". Mouth is an online retailer of specialty foods, monthly subscription boxes, and curated gift boxes for both consumers and corporate customers. Mouth also has a private label brand.
- Gourmet is an e-commerce business which provides specialty foods through its website as well as other e-commerce channels. GFG focuses on expanding these offerings to other customers.
- Artisan supplies over 500 customers (chefs, restaurants, etc.) in the Chicago area with unique specialty foodservice items. Artisan also serves as a national fulfillment center for some of IVFH's other companies.
- FII is in the business of providing fresh, perishable food as well as healthcare products to premium restaurants, hotels, country clubs, hospitals, catering companies, and national chain accounts.

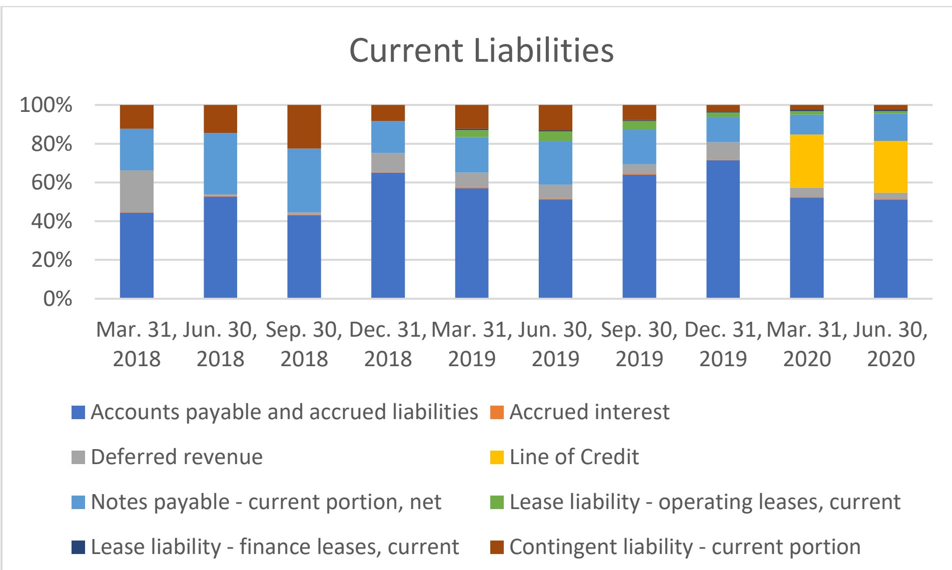
As you can see, there are several companies providing similar services and lots of synergies. There are probably some opportunities to save on overhead here, but this is a minor point and I won't really get into that.

Now let's look at some recent financial performance. I've pulled in data from the last 10 quarters for IVFH in an attempt to get a sense of what's been going on in the short-to-medium term. First up, current assets vs. current liabilities:

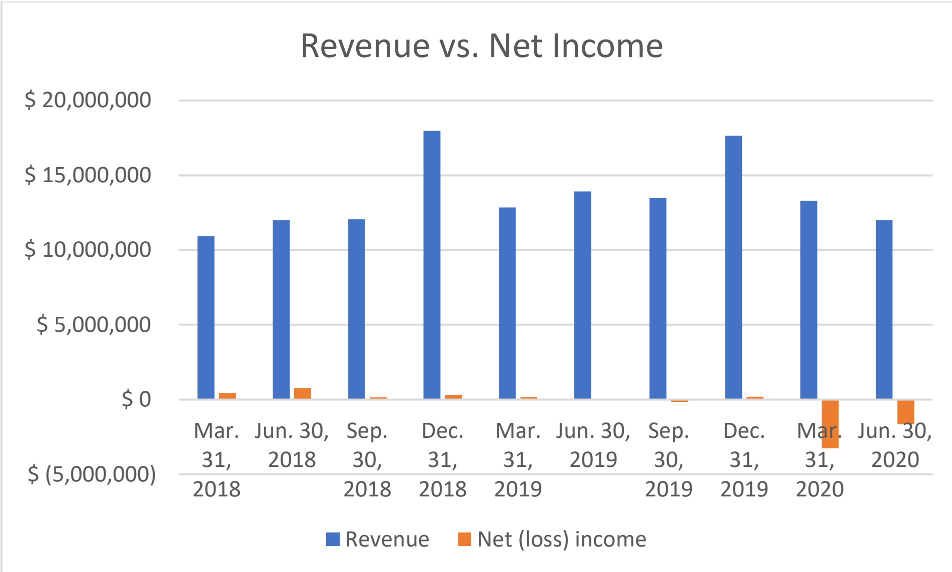


Current assets and current liabilities generally have been moving in concert with each other. To make a little sense of that, here's a look at what makes up current assets and current liabilities:





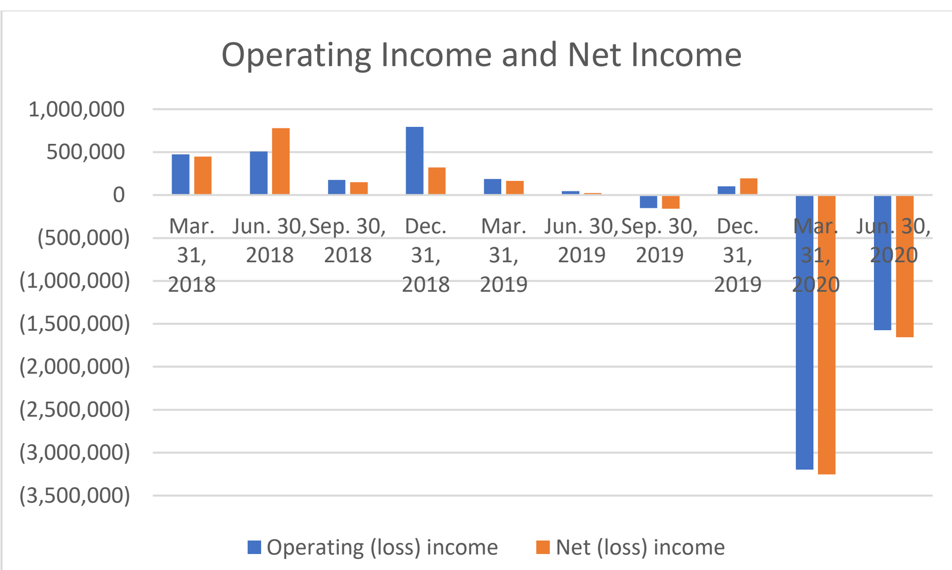
So what does this tell us? To my eye, I'm seeing cash and AR as the dominant portions of current assets, which isn't surprising. What is a little surprising is that over the last two quarters, the AR contribution to current assets has significantly decreased (-43% from 12/31/19 → 6/3/20) and the cash contribution to current assets has significantly increased (+33% over the same time period). If we look at liabilities, AP/accrued liabilities is the major factor, which makes sense. What's interesting is that during Q1 2020, IVFH fully drew down a $2MM line of credit. So, during the same period in which AR decreased significantly and cash increased significantly, the line of credit was tapped. This tells me that the line of credit is being used to sort of prop up the left side of the balance sheet a little bit. Another factor: in Q2 2020, the company received a PPP loan in the amount of$1.65MM. This number is also feeding into the cash asset and is also reflected on the right side of the balance sheet under notes payable. Ok, so what supports the argument that recently loans are being used (at least in part) to prop up the balance sheet? Well let's look at revenue and net income:



So what we can see is that net income has represented somewhere around 2% of total revenue during the period we're looking at, until we get to 2020. In 2020 it drops precipitously to -24% and -14%. Obviously this is due to COVID-19 and the impact of the pandemic. Think about it: restaurants, country clubs, etc. suddenly closed toward the end of Q1 2020 and the closures continued into Q2. So even with that huge swing in net income from positive to very negative, the company was able to increase their cash position. Enter the aforementioned PPP loan and line of credit.

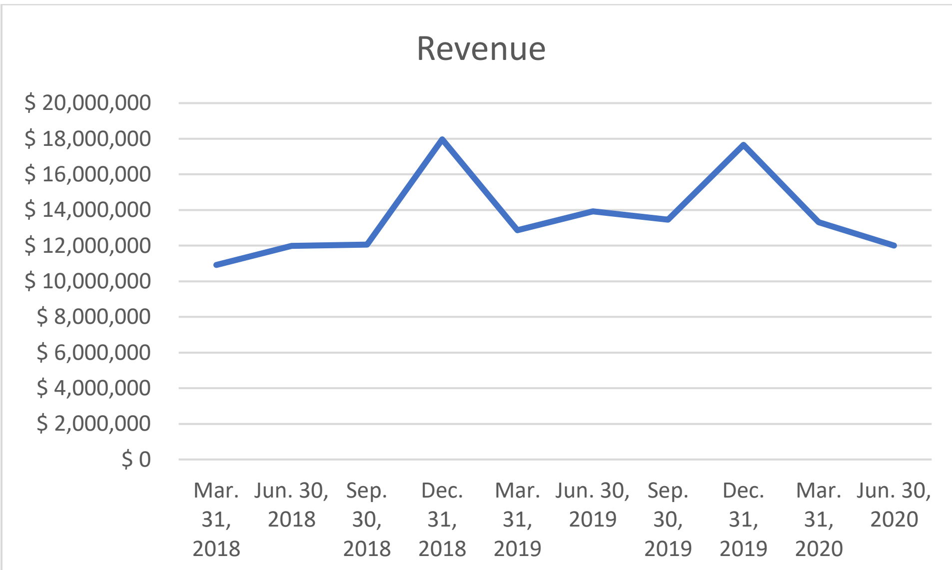
Obviously this isn't super advanced forensic accounting we're doing here, but I do think it's important to simply recognize what's going on. Very often investors tend to focus on the left side of the balance sheet without paying as much attention to the right side. If you're seeing those assets increase, you've gotta try to figure out why that is. Ok, enough about that.

Let's take a look now at the income numbers. I want to start by examining operating income and net income:



So what's going on here? In 8 out of 10 quarters we're looking at, net income has been lower (or net loss has been greater) than operating income (operating loss). What's that mean? It means that after accounting for typical operational costs, there are other sources of income or other costs consistently impacting the profitability of the business. What are those costs? For IVFH, they are things like: other leasing income, interest, taxes, a gain on sale of fixed assets, and gain on settlement of contingent liabilities. Again, nothing super special about this but very often people ignore these "other" items which can significantly impact profitability.

Let's dig into those revenue numbers a bit now. Here's what revenue looks like over our period:



What can we tell from this chart? Well, first thing I notice is that there appears to be some seasonality in the business. This is to be expected in the foodservice industry. Restaurants, clubs, hotels, etc. all see major spikes in business around holiday time and it follows that suppliers would see a similar spike. So those revenue increases for Q4 make sense. The second thing I notice is YoY growth. March 2018 to March 2019 represented 18% YoY growth for Q1. June 2018 to June 2019 represented 16% YoY growth for Q2. September 2018 to September 2019 represented 12% YoY growth for Q3. There was a small dip in YoY Q4 numbers, down about 2%, but nothing major. When we look at Q1 2020 vs. Q1 2019, we have 3% growth. Remember that the end of Q1 2020 is when we started seeing the effects of COVID-19 and the associated shutdown. Q2 2020 represented a big step back of around 14% from Q2 2019. In fact, Q2 2020 revenue was almost exactly in line with Q2 2018 revenue. So after 10 quarters, we're basically right back where we started when it comes to revenue. What might be interesting, though, is to see how that revenue is broken out. What exactly is contributing to revenue? Let's take a look at the overall revenue from above with the individual contributing factors broken out:

Look at that – even though after 10 quarters revenue has returned back to where it started, the revenue mix has drastically changed. In Q2 2018, e-commerce revenue was almost $1.4MM and specialty food service was just over $10MM. By the time we get to Q2 2020, e-commerce revenue has grown to nearly $7.5MM and specialty food service is down to around $4.1MM. What a drastic shift to make in 2 years' time. The move to e-commerce is part of the bull case for IVFH. I think that a lot of these e-commerce customers will prove to be sticky and as restaurants, etc. start to open up again (whatever that may look like – 50% capacity, outdoor dining, whatever), specialty food service revenues should pick up a little bit as well. I don't expect specialty food service revenue to return to 2019 levels, but I do think it will grow from where it is in early 2020. Similarly, I don't necessarily think e-commerce revenue will go up in a straight line from where it is in Q2 2020 (obviously, those numbers are helped by people being stuck at home), but I think they'll grow over time.

Ok. So aside from the income statement stuff we've talked about above and the shifting revenue mix, there's something else that needs to be considered when talking about IVFH: hidden assets. I'm not usually a huge fan of sum of the parts investing (SOTP), but sometimes it does make sense. In the case of IVFH, there's some real estate on the balance sheet. The company is carrying almost $7.4MM in property and equipment assets on the balance sheet. Of that amount, the company has paid roughly $6.2MM for three separate facilities (about $5MM is on the balance sheet for buildings and is depreciable and about $1.2MM is for land). The remaining balance is some equipment, furniture and fixtures, etc. Note that this $7.4MM is after depreciation of nearly $1.7MM. Of note is that the most-recently purchased building for which the company paid $4.5MM has been appraised at $6.15MM "as-is" and at around $8M with scheduled improvements. While not as dramatic, it stands to reason that the firm's other owned properties are also worth a fair amount more than they are valued on the balance sheet. Let's conservatively say these three buildings are worth $10MM today. It should also be noted that the new warehouse facility is significantly larger than any space the company has previously been using and generates some revenue via warehouse/logistics services as well as a mobile phone tower lease. I think there is potential for either ongoing revenue gains via leasing out excess space or a one-time gain via sale of an appreciated smaller property. Depreciation, combined with intangibles amortization, has been a real drag on earnings – to the tune of a little more than $2MM for the six months ended 6/30/2020.

My calculations (and these are very rough numbers so don't jump down my throat here) put us somewhere in the neighborhood of $10MM in equity vs. about $6.3MM reported on the most recent Q. Note that I'm including all liabilities, not just current. I'm talking bottom line what's the equity for shareholders. That $10MM gets us to right around $0.26/share, just in equity. I guess you'd call this book value. The company is trading right around $0.30/share right now so something like 1.15x book.

This is getting long and I'm getting tired so I'm going to start wrapping this up. Here's my basic thesis: the company has a bit of a checkered past (you can read filings or look up some history online). Recently they've started to clean up their act and have attracted some good investors (again, look it up online). You can buy this company right now for right around liquidation value and get all of the upside for free. What upside? Expenses will decrease as they get into their new facility and realize some synergistic gains. Additionally the new warehouse space will give the growing e-commerce business some breathing room and space to expand. I believe that segment will keep growing over the next 12-24 months. COVID-19 may have something to say about how that goes, who knows. As expenses come down and revenues stabilize and grow, I see the firm returning to profitability and a valuation somewhere around $.50 - $1 isn't unreasonable to think about.

I know I rushed through this and left a lot out and generalized, but there you go. I'm cautiously optimistic about the prospects for this little company. I'm always happy to hear any questions or comments you might have.

Disclosure: I own a bunch of shares and am long IVFH.