

Pulling Scrawny Rabbits Out of Shop-Worn Hats

Prepared For

CTDA

Prepared By

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Objectives of the Session

- Review the Unpleasant Profit Structure of the Industry
- Identify the Two Key Factors That Will Cause Grief in the Future
- Develop an Action Plan to Get Through the Economic Challenges

Exhibit 1

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Mountain View Officially Hits the Skids

| <u>Income Statement</u> | | <u>Partial Balance Sheet</u> | |
|-------------------------|------------------|------------------------------|------------------|
| Net Sales | 10,000,000 | Cash | 200,000 |
| Cost of Goods Sold | <u>6,400,000</u> | Accounts Receivable | 924,658 |
| Gross Margin | 3,600,000 | Inventory | 1,828,571 |
| Payroll & Fringes | 2,000,000 | Other Current Assets | <u>20,000</u> |
| All Other Expenses | <u>1,500,000</u> | Total Current Assets | 2,973,229 |
| Total Expenses | <u>3,500,000</u> | Fixed Assets | <u>1,026,771</u> |
| Profit Before Taxes | 100,000 | Total Assets | 4,000,000 |
| | | | |
| Fixed Expenses | 2,800,000 | Variable Expenses | 7.0% |
| Variable Expenses | 700,000 | | |

Return on Assets = Profit Before Taxes/Total Assets

Exhibit 2

Profit Planning Group

The Recent Trend in Return on Assets

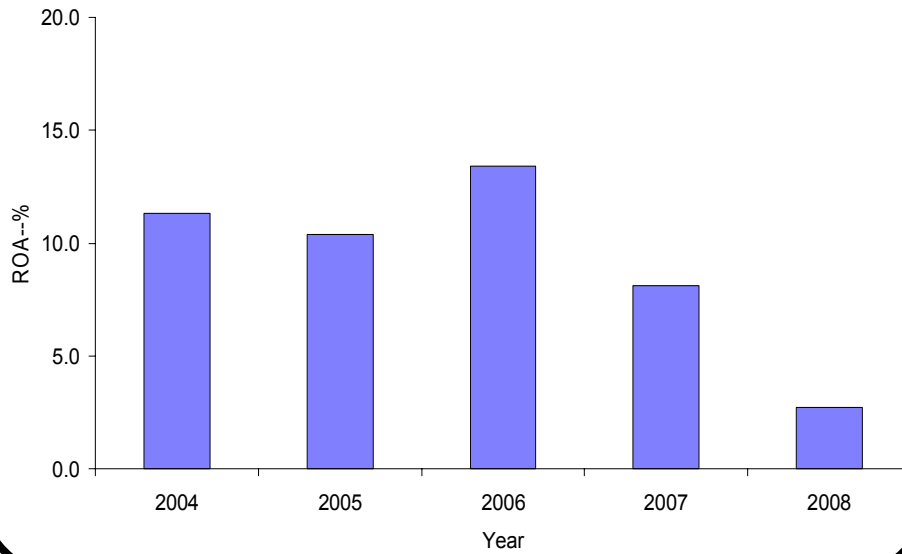


Exhibit 3

Profit Planning Group

The Recent Trend in Sales Growth

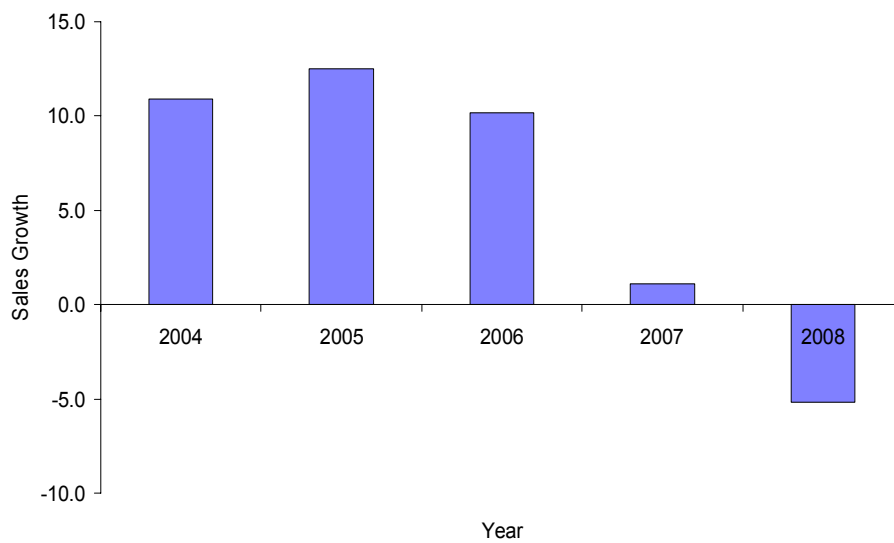


Exhibit 4

Profit Planning Group

The Recent Trend in Gross Margin and Operating Expenses

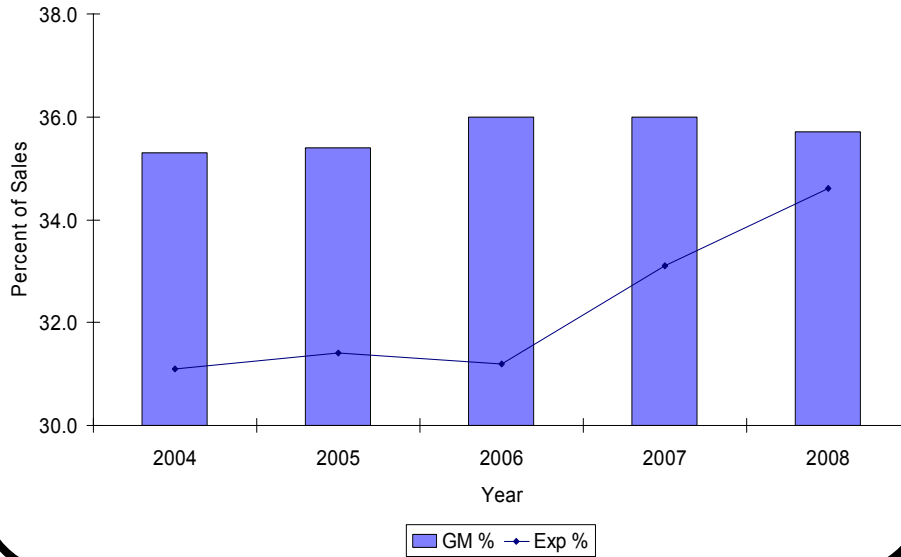


Exhibit 5

Profit Planning Group

A Few Incredibly Boring, but Important Comments About Financial Integrity

| Ratio | Conservative Guideline | Typical CTDA Results | Financial Gap |
|--|---------------------------|----------------------------|------------------|
| Debt to Equity (times) | 1.0 | 0.6 | 0.4 |
| Defensive Interval (Days) | 15.0 | 16.5 | 1.5 |
| Cash to Current Liabilities (%) | 20.0 | 22.0 | 2.0 |
| Break Even Point (% of Current Sales) | 80.0 | | |

Exhibit 6

Profit Planning Group

The Increasingly Two-Tiered Nature of Industry Performance

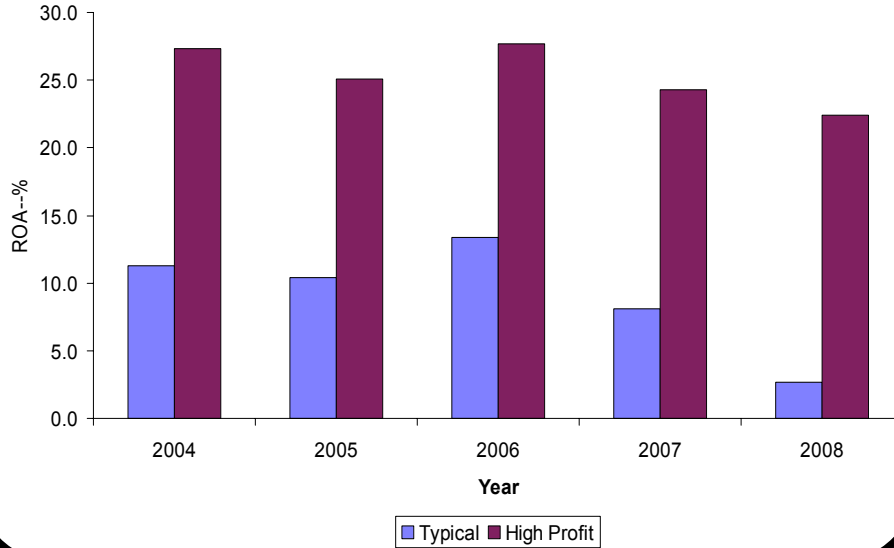


Exhibit 7

Profit Planning Group

A Tale of Two Firms

| | You Are <u>Here</u> | You Need To <u>Be Here</u> |
|---------------------|------------------------|-------------------------------|
| Net Sales | 10,000,000 | 10,000,000 |
| Cost of Goods Sold | <u>6,400,000</u> | <u>6,400,000</u> |
| Gross Margin | 3,600,000 | 3,600,000 |
| Payroll & Fringes | 2,000,000 | 1,600,000 |
| All Other Expenses | <u>1,500,000</u> | <u>1,300,000</u> |
| Total Expenses | <u>3,500,000</u> | <u>2,900,000</u> |
| Profit Before Taxes | 100,000 | |
| | | |
| Net Sales | 100.0 | 100.0 |
| Cost of Goods Sold | <u>64.0</u> | <u>64.0</u> |
| Gross Margin | 36.0 | 36.0 |
| Payroll & Fringes | 20.0 | 16.0 |
| All Other Expenses | <u>15.0</u> | <u>13.0</u> |
| Total Expenses | <u>35.0</u> | <u>29.0</u> |
| Profit Before Taxes | 1.0 | |

Exhibit 8

Profit Planning Group

How Much Worse Can It Get?

| | | |
|------------------------------|---|--|
| Gross Margin | = | 36.0 |
| Fixed Expenses | = | 2,800,000 |
| Variable Expenses | = | 7.0 |
| Sales Required to Break Even | = | $\frac{\$ \text{ Fixed Expenses}}{\text{Gross Margin \%} - \text{ Variable Expense \%}}$ |
| | = | $\frac{2,800,000}{29.0}$ |

Exhibit 9

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What Happens in a Do-Nothing Model?

| <u>Summary</u> <u>Income Statement</u> | <u>Current</u> | <u>Break Even</u> | <u>Percent</u> <u>Change</u> |
|---|------------------|-------------------|---------------------------------|
| Net Sales | 10,000,000 | 9,655,172 | -3.4 |
| Cost of Goods | <u>6,400,000</u> | <u>6,179,310</u> | -3.4 |
| Gross Margin | 3,600,000 | 3,475,862 | -3.4 |
| Fixed Expenses | 2,800,000 | 2,800,000 | 0.0 |
| Variable Expenses | <u>700,000</u> | 675,862 | -3.4 |
| Total Expenses | <u>3,500,000</u> | | |
| Profit Before Taxes | 100,000 | 0 | -100.0 |

Exhibit 10

Profit Planning Group

With Any Luck, Things
Can Get Even Worse

| | | |
|---------------------------------|---|--|
| Gross Margin | = | 34.0 |
| Fixed Expenses | = | 2,800,000 |
| Variable Expenses | = | 7.0 |
| Sales Required to Break Even | = | $\frac{\$ \text{ Fixed Expenses}}{\text{Gross Margin \%} - \text{ Variable Expense \%}}$ |
| | = | $\frac{2,800,000}{27.0}$ |

Exhibit 11

Profit Planning Group

There is Only One Way
Out of the Box

| | | |
|---------------------------------|---|--|
| Gross Margin | = | 36.0 |
| Fixed Expenses | = | 2,520,000 |
| Variable Expenses | = | 7.0 |
| Sales Required to Break Even | = | $\frac{\$ \text{ Fixed Expenses}}{\text{Gross Margin \%} - \text{ Variable Expense \%}}$ |
| | = | $\frac{2,520,000}{29.0}$ |

Exhibit 12

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A Report From the Field:
The First Half was Rather Ugly

| | |
|---------------------|-------|
| Net Sales | -24.6 |
| Operating Profit | -32.3 |
| Employee Head Count | -23.8 |
| Accounts Receivable | -21.7 |
| Inventory | -2.9 |

Exhibit 13

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Karnac (Recklessly) Predicts
How 2009 Will Look

| | <u>2008</u> | <u>2009</u> | <u>Percent Change</u> |
|---------------------|------------------|------------------|---------------------------|
| Net Sales | 10,000,000 | 8,500,000 | -15.0 |
| Cost of Goods Sold | <u>6,400,000</u> | <u>5,476,000</u> | -14.4 |
| Gross Margin | 3,600,000 | 3,024,000 | -16.0 |
| Payroll & Fringes | 2,000,000 | 1,700,000 | -15.0 |
| All Other Expenses | <u>1,500,000</u> | <u>1,245,000</u> | -17.0 |
| Total Expenses | <u>3,500,000</u> | <u>2,945,000</u> | -15.9 |
| Profit Before Taxes | 100,000 | | |

Exhibit 14

Profit Planning Group

Sales Growth Revisited:
Comparisons to Other Industries

| | |
|------------------|------|
| CTDA | -5.2 |
| Comparison One | 8.7 |
| Comparison Two | 3.0 |
| Comparison Three | 0.7 |
| Comparison Four | -6.1 |

Exhibit 15 Profit Planning Group

The Two Mistakes We Will Make Together
And The One We Have Already Made

- .
- .
- .

Exhibit 16 Profit Planning Group

Getting Around the Problem With Fred

Build a Two Percent Sales Growth to Payroll Growth Gap

| Sales Growth | Payroll Growth |
|--------------|----------------|
| 5 | 3 |
| 10 | 8 |
| 15 | 13 |

Exhibit 17

Profit Planning Group

Where Do the Payroll Dollars Go?

| <u>Payroll Category</u> | <u>Percent of Sales</u> | <u>Percent of Payroll</u> |
|-------------------------|-------------------------|---------------------------|
| Owners/Officers | 2.5 | 14.2 |
| Sales Force | 6.5 | |
| Warehouse/Delivery | 2.8 | 15.9 |
| All Other | <u>5.8</u> | <u>33.0</u> |
| Total | 17.6 | 100.0 |

Exhibit 18

Profit Planning Group

The Sales to Payroll Gap:
The Recession Ends With a Whimper

| Summary Income Statement | <u>Current</u> | <u>Potential</u> | Percent <u>Change</u> |
|-----------------------------|------------------|------------------|--------------------------|
| Net Sales | 10,000,000 | 10,500,000 | 5.0 |
| Cost of Goods | <u>6,400,000</u> | <u>6,720,000</u> | 5.0 |
| Gross Margin | 3,600,000 | 3,780,000 | 5.0 |
| Payroll & Fringes | 2,000,000 | 2,060,000 | 3.0 |
| All Other Expenses | <u>1,500,000</u> | <u>1,575,000</u> | 5.0 |
| Total Expenses | <u>3,500,000</u> | <u>3,635,000</u> | 3.9 |
| Profit | 100,000 | 145,000 | 45.0 |

Exhibit 19

Profit Planning Group

The Sales to Payroll Gap:
The Recession Ends With a Whimper and an Oh No

| Summary Income Statement | <u>Current</u> | <u>Potential</u> | Percent <u>Change</u> |
|-----------------------------|------------------|------------------|--------------------------|
| Net Sales | 10,000,000 | 10,500,000 | 5.0 |
| Cost of Goods | <u>6,400,000</u> | <u>6,720,000</u> | 5.0 |
| Gross Margin | 3,600,000 | 3,780,000 | 5.0 |
| Payroll & Fringes | 2,000,000 | 2,140,000 | 7.0 |
| All Other Expenses | <u>1,500,000</u> | <u>1,575,000</u> | 5.0 |
| Total Expenses | <u>3,500,000</u> | <u>3,715,000</u> | 6.1 |
| Profit | 100,000 | | |

Exhibit 20

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The Recession Ends With a Bang, But We Still Find a Way to Mess It Up

| <u>Summary Income Statement</u> | <u>Current</u> | <u>Potential</u> | <u>Percent Change</u> |
|-------------------------------------|------------------|------------------|---------------------------|
| Net Sales | 10,000,000 | 11,500,000 | 15.0 |
| Cost of Goods | <u>6,400,000</u> | <u>7,475,000</u> | 16.8 |
| Gross Margin | 3,600,000 | 4,025,000 | 11.8 |
| Payroll & Fringes | 2,000,000 | 2,260,000 | 13.0 |
| All Other Expenses | <u>1,500,000</u> | <u>1,725,000</u> | 15.0 |
| Total Expenses | <u>3,500,000</u> | <u>3,985,000</u> | 13.9 |
| Profit | 100,000 | | |

Exhibit 21

Profit Planning Group

The Only Thing You Ever Need to Know For Successful Price Management

-
- Examples
 - Heart Surgery
 - Watches

Exhibit 22

Profit Planning Group

Marketing Polarity

Gorillas

Lower Prices
and
Fewer Services

Victims

Undifferentiated

Firms

Guerillas

Higher Prices
and
More Services

Exhibit 23

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Marketing Positioning: A Reality Check

| Marketing Tools | Price Firm | Me Too | Service Firm |
|-----------------------|------------|--------|--------------|
| Price | | | |
| Breadth of Assortment | | | X |
| In-Stock Position | | X | |
| Order Accuracy | | X | |
| Delivery Speed | | | X |
| Sales Force Knowledge | | | X |
| Return Policies | | | X |
| Credit Programs | | | X |

Exhibit 24

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Specific Pricing Actions You Can Take Now

- Find blind items
- Educate the sales force
- Set margin goals
- Develop rough cost to service guidelines

Exhibit 25

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Final Thoughts: Reading Messages From Customers

Prices Are Too High

- Gross Margin % Up, Sales Down
- Lots of Legitimate Price Complaints
- Growing Slower Than the Market

Prices Are Too Low

- Gross Margin % Down, Sales Up
- Customers Congratulate Your Efficiency
- Almost No Price Complaints
- Growing Much Faster Than the Market
- New Customers Show Up Unannounced
- Prices Increasing Less than Inflation

Exhibit 26

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Summary and Conclusions

Exhibit 27

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Seldom Right, but Never in Doubt

Dr. Albert Bates is founder and Chief Sophist (whatever that means) of the Profit Planning Group, a research and education firm headquartered in Boulder, Colorado. The firm works mostly in the area of financial planning.

He makes approximately 100 presentations each year on topics such as Improving the Bottom Line, Doing More With Less and Pricing for Profit. He also heads the firm's investigation into profitability research for over fifty different trade associations.

Al received his doctorate from Indiana University. He is married and has three daughters. All four of the ladies in his life have black belts in Tae Kwon Do, so don't criticize his presentation too much.

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Exhibit 28

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