

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

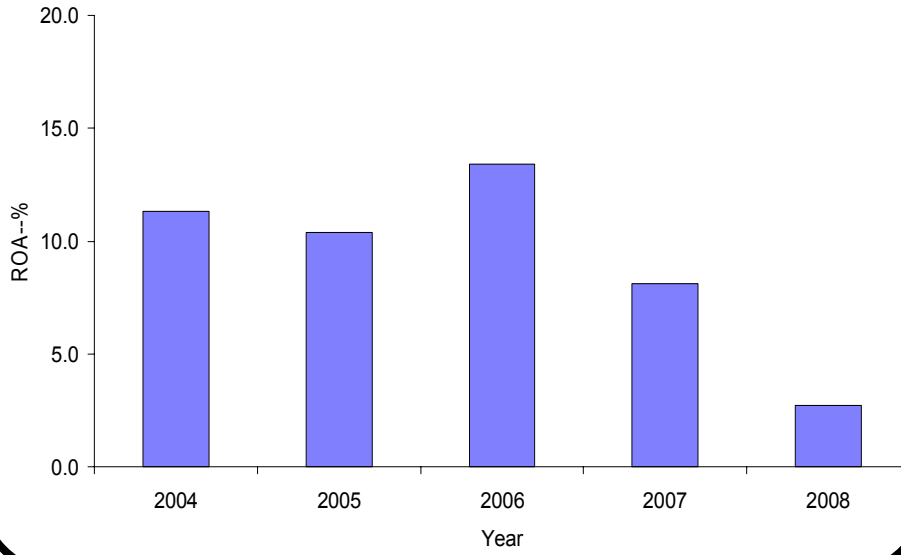


Exhibit 3

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The Recent Trend in Sales Growth

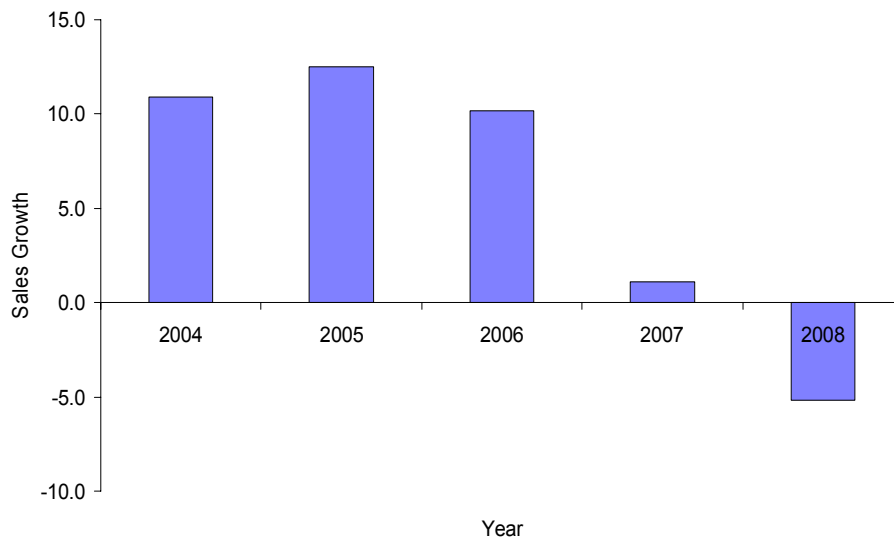


Exhibit 4

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The Recent Trend in Gross Margin and Operating Expenses

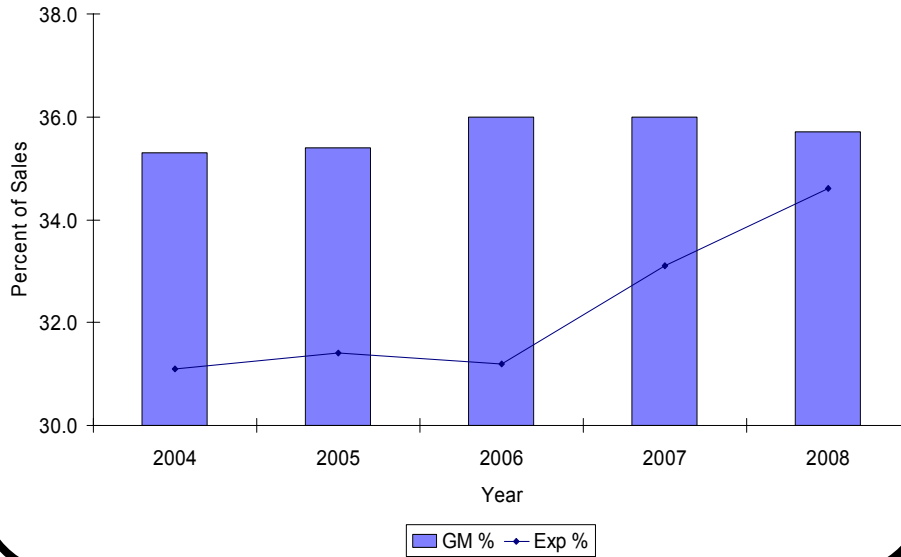


Exhibit 5

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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

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The Increasingly Two-Tiered Nature of Industry Performance

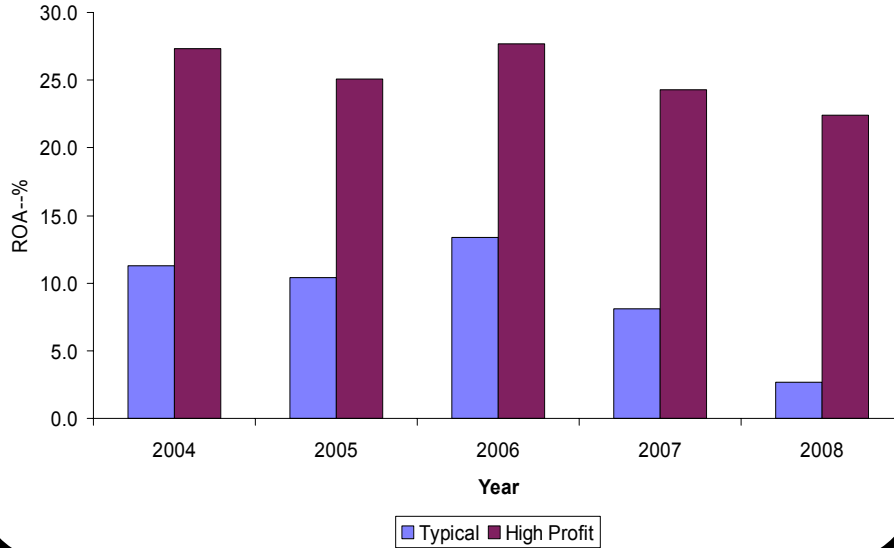


Exhibit 7

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A Tale of Two Firms

	You Are Here	You Need To Be Here
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

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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

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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

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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

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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

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- .
- .

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

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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

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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

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

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- Examples
 - Heart Surgery
 - Watches

Exhibit 22

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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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