

# Getting Back To The Good Old Days

Prepared For

ALA

Prepared By

The Profit Planning Group  
1790 38th St., Suite 204  
Boulder, CO 80301  
303-444-6212  
[info@profitplanninggroup.com](mailto:info@profitplanninggroup.com)

September 14, 2009

## Objectives of the Session

- Review the Profit Structure of the Industry
- Identify the Profit Pressure Points in a Down Market
- Indicate What to Do and What Not to Do in a Period of Economic Recovery

Exhibit 1

Profit Planning Group

## Typical Financial Results Across the Business Cycle

<u>Income Statement</u>		<u>Partial Balance Sheet</u>	
Net Sales	4,000,000	Cash	135,000
Cost of Goods Sold	<u>2,320,000</u>	Accounts Receivable	219,178
Gross Margin	1,680,000	Inventory	773,333
Payroll & Fringes	960,000	Other Current Assets	<u>6,750</u>
All Other Expenses	<u>600,000</u>	Total Current Assets	1,134,261
Total Expenses	<u>1,560,000</u>	Fixed Assets	<u>215,739</u>
Profit Before Taxes	120,000	Total Assets	1,350,000
Fixed Expenses	1,240,000	Variable Expenses	
Variable Expenses	320,000		

Return on Assets = Profit Before Taxes/Total Assets

Exhibit 2

Profit Planning Group

### The Break-Even Point

Gross Margin	=	42.0
Fixed Expenses	=	1,240,000
Variable Expenses	=	8.0
Sales Required to Break Even	=	$\frac{\$ \text{ Fixed Expenses}}{\text{Gross Margin \%} - \text{ Variable Expense \%}}$
	=	$\frac{1,240,000}{34.0}$

Exhibit 3

Profit Planning Group

### What Happened There?

<u>Summary</u> <u>Income Statement</u>	<u>Current</u>	<u>Break Even</u>	<u>Percent</u> <u>Change</u>
Net Sales	4,000,000	3,647,059	-8.8
Cost of Goods	<u>2,320,000</u>	<u>2,115,294</u>	-8.8
Gross Margin	1,680,000	1,531,765	-8.8
Fixed Expenses	1,240,000	1,240,000	0.0
Variable Expenses	<u>320,000</u>	291,765	-8.8
Total Expenses	<u>1,560,000</u>		
Profit Before Taxes	120,000	0	-100.0

Exhibit 4

Profit Planning Group

### The Recent Trend in Sales Growth

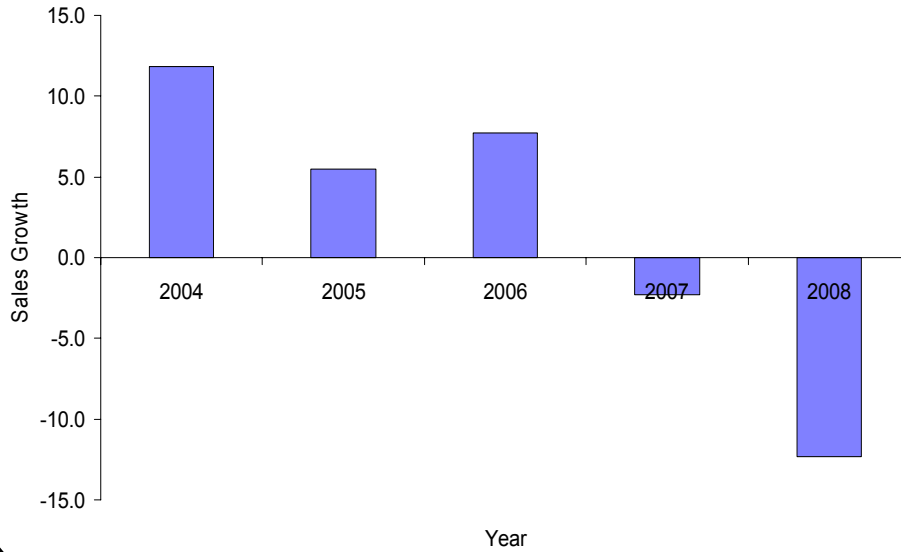


Exhibit 5

Profit Planning Group

### Actual Results Compared to The Theoretical Model

	Current	Sales and Expense Decline	Percent Change
Net Sales	4,000,000	3,600,000	-10.0
Cost of Goods Sold	<u>2,320,000</u>	<u>2,125,000</u>	-8.4
Gross Margin	1,680,000	1,475,000	-12.2
Payroll and Fringes	960,000	870,000	-9.4
All Other Expenses	<u>600,000</u>	<u>597,800</u>	-0.4
Total Expenses	<u>1,560,000</u>	<u>1,467,800</u>	-5.9
Profit Before Taxes	120,000	7,200	
Net Sales	100.0	100.0	
Cost of Goods Sold	<u>58.0</u>	<u>59.0</u>	
Gross Margin	42.0		
Payroll and Fringes	24.0	24.2	
All Other Expenses	<u>15.0</u>	<u>16.6</u>	
Total Expenses	<u>39.0</u>	<u>40.8</u>	
Profit Before Taxes	3.0		

Exhibit 6

Profit Planning Group

### The Break-Even Point When Things Change

Gross Margin	=	40.0
Fixed Expenses	=	1,240,000
Variable Expenses	=	8.0
Sales Required to Break Even	=	$\frac{\$ \text{ Fixed Expenses}}{\text{Gross Margin \%} - \text{ Variable Expense \%}}$
	=	$\frac{1,240,000}{32.0}$

Exhibit 7

Profit Planning Group

### The Break-Even Point When Things Change

Gross Margin	=	42.0
Fixed Expenses	=	1,116,000
Variable Expenses	=	8.0
Sales Required to Break Even	=	$\frac{\$ \text{ Fixed Expenses}}{\text{Gross Margin \%} - \text{ Variable Expense \%}}$
	=	$\frac{1,116,000}{34.0}$

Exhibit 8

Profit Planning Group

### Making It All Work Out--Maybe

	<u>Current</u>	Sales and Expense <u>Decline</u>	<u>Making It Up Via Pricing</u>	
			Reasonable Profit	Original Profit
Net Sales	4,000,000	3,600,000	3,652,800	3,712,800
Cost of Goods Sold	<u>2,320,000</u>	<u>2,125,000</u>	<u>2,125,000</u>	<u>2,125,000</u>
Gross Margin	1,680,000	1,475,000	1,527,800	1,587,800
Payroll and Fringes	960,000	870,000	870,000	870,000
All Other Expenses	<u>600,000</u>	<u>597,800</u>	<u>597,800</u>	<u>597,800</u>
Total Expenses	<u>1,560,000</u>	<u>1,467,800</u>	<u>1,467,800</u>	<u>1,467,800</u>
Profit Before Taxes	120,000	7,200	60,000	120,000
Net Sales	100.0	100.0	100.0	100.0
Cost of Goods Sold	<u>58.0</u>	<u>59.0</u>	<u>58.2</u>	<u>62.8</u>
Gross Margin	42.0	41.0	41.8	37.2
Payroll and Fringes	24.0	24.2	23.8	20.7
All Other Expenses	<u>15.0</u>	<u>16.6</u>	<u>16.4</u>	<u>13.4</u>
Total Expenses	<u>39.0</u>	<u>40.8</u>	<u>40.2</u>	<u>34.1</u>
Profit Before Taxes	3.0	0.2	1.6	3.1

Price Increase Required for This to Happen:

Exhibit 9

Profit Planning Group

### Getting Better and Staying Better

Build a Two Percent Sales Growth to Payroll Growth Gap

Sales Growth

Payroll Growth

5

3

10

8

15

13

Exhibit 10

Profit Planning Group

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

Summary <u>Income Statement</u>	<u>Current</u>	<u>Potential</u>	<u>Percent Change</u>
Net Sales	3,600,000	4,140,000	15.0
Cost of Goods	<u>2,125,000</u>	<u>2,443,750</u>	15.0
Gross Margin	1,475,000	1,696,250	15.0
Payroll & Fringes	870,000	983,100	13.0
All Other Expenses	<u>597,800</u>	<u>687,470</u>	15.0
Total Expenses	<u>1,467,800</u>	<u>1,670,570</u>	13.8
Profit	7,200	25,680	256.7

Exhibit 11

Profit Planning Group

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

Summary <u>Income Statement</u>	<u>Current</u>	<u>Potential</u>	<u>Percent Change</u>
Net Sales	3,600,000	3,780,000	5.0
Cost of Goods	<u>2,125,000</u>	<u>2,231,250</u>	5.0
Gross Margin	1,475,000	1,548,750	5.0
Payroll & Fringes	870,000	896,100	3.0
All Other Expenses	<u>597,800</u>	<u>627,690</u>	5.0
Total Expenses	<u>1,467,800</u>	<u>1,523,790</u>	3.8
Profit	7,200	24,960	246.7

Exhibit 12

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	3,600,000	3,780,000	5.0
Cost of Goods	<u>2,125,000</u>	<u>2,231,250</u>	5.0
Gross Margin	1,475,000	1,548,750	5.0
Payroll & Fringes	870,000	930,900	7.0
All Other Expenses	<u>597,800</u>	<u>627,690</u>	5.0
Total Expenses	<u>1,467,800</u>	<u>1,558,590</u>	6.2
Profit	7,200	-9,840	-236.7

Exhibit 13

Profit Planning Group

Where Do the Payroll Dollars Go?

<u>Payroll Category</u>	Percent <u>of Sales</u>	Percent <u>of Payroll</u>
Owners/Officers	4.3	21.4
Sales Force	10.2	
Warehouse/Delivery	3.5	17.4
All Other	<u>2.1</u>	<u>10.4</u>
Total	20.1	100.0

Exhibit 14

Profit Planning Group

Impacting Gross Margin  
With Product Mix

Velocity Code	<u>Sales</u>	<u>GM%</u>	<u>Gross Margin</u>	Potential <u>Sales</u>	<u>Gross Margin</u>
A	2,160,000	36.0	777,600	2,160,000	777,600
B	720,000	41.0	295,200	720,000	295,200
C	540,000	51.0	275,400	540,000	275,400
D	<u>180,000</u>	<u>70.4</u>	<u>126,800</u>		
Total	3,600,000	41.0	1,475,000		

Exhibit 15

Profit Planning Group

Impacting Gross Margin  
With Blind-Item Pricing

Velocity Code	<u>Sales</u>	<u>GM%</u>	<u>Gross Margin</u>	Potential <u>Sales</u>	<u>Gross Margin</u>
A	2,160,000	36.0	777,600	2,160,000	777,600
B	720,000	41.0	295,200	720,000	295,200
C	540,000	51.0	275,400	540,000	275,400
D	<u>180,000</u>	<u>70.4</u>	<u>126,800</u>		
Total	3,600,000	41.0	1,475,000		

Exhibit 16

Profit Planning Group

### Most Firms Don't Have Control Over Sales Force Pricing

Summary		Unnecessary
<u>Income Statement</u>	<u>Current</u>	<u>Price Cut</u>
Net Sales	3,600,000	3,420,000
Cost of Goods Sold	<u>2,125,000</u>	<u>2,125,000</u>
Gross Margin	1,475,000	1,295,000
Commissions            10.0% of G. M.	147,500	
Other Variable Expenses    3.9% of Sales	140,500	
Fixed Expenses	<u>1,179,800</u>	<u>1,179,800</u>
Total Expenses	<u>1,467,800</u>	
Profit Before Taxes	7,200	

Exhibit 17

Profit Planning Group

### A Draconian Commission Plan

Summary		Unnecessary
<u>Income Statement</u>	<u>Current</u>	<u>Price Cut</u>
Net Sales	3,600,000	3,420,000
Cost of Goods Sold	<u>2,125,000</u>	<u>2,125,000</u>
Gross Margin	1,475,000	1,295,000
Commissions            10.0% of G. M.	147,500	
Other Variable Expenses    3.9% of Sales	140,500	
Fixed Expenses	<u>1,179,800</u>	<u>1,179,800</u>
Total Expenses	<u>1,467,800</u>	
Profit Before Taxes	7,200	

Exhibit 18

Profit Planning Group

### The Impact of a Five Percent Supplier Price Increase

	<u>Current</u>	3% Passed <u>Along</u>	5% Passed <u>Along</u>
Net Sales	3,600,000	3,708,000	3,780,000
Cost of Goods Sold	<u>2,125,000</u>	<u>2,231,250</u>	<u>2,231,250</u>
Gross Margin	1,475,000	1,476,750	1,548,750
Fixed Expenses	1,179,800	1,179,800	1,179,800
Variable Expenses	<u>288,000</u>	<u>296,640</u>	<u>302,400</u>
Total Expenses	<u>1,467,800</u>	<u>1,476,440</u>	<u>1,482,200</u>
Profit Before Taxes	7,200	310	

Exhibit 19 Profit Planning Group

### 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 20 Profit Planning Group

### The Impact of Commoditization on Return on Assets

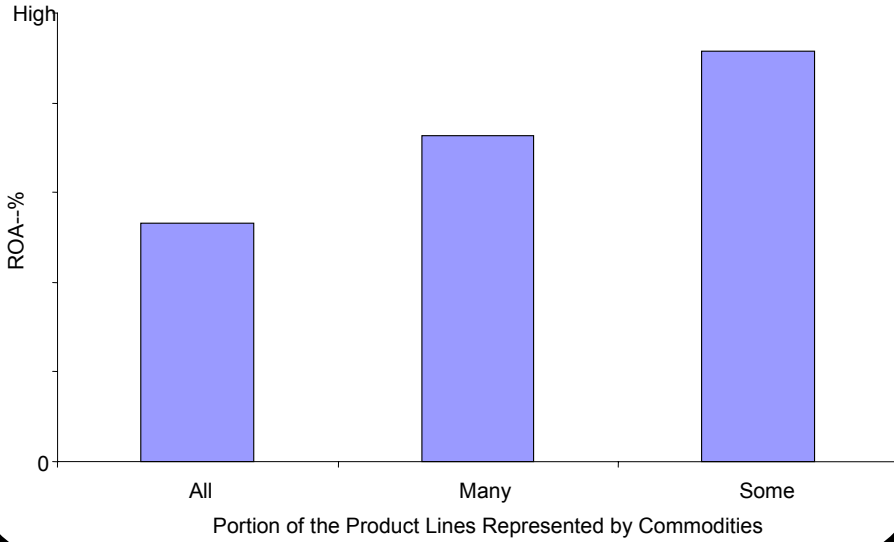


Exhibit 21

Profit Planning Group

### Marketing Polarity

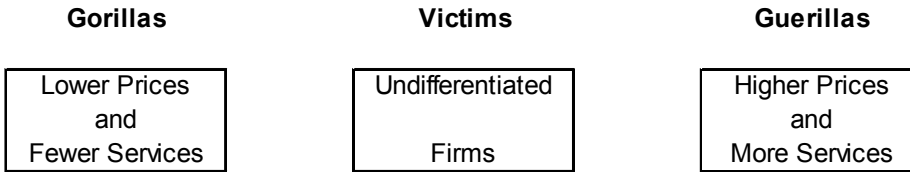


Exhibit 22

Profit Planning Group

**The Mandate for Change  
During Each of the Next Five Years**

Sales Increase %	5.0
Gross Margin %	0.4
Sales to Payroll Gap	2.0
Other Expense %	-0.3
Inventory Turnover	0.0
AR Collection Days	0.0

Exhibit 23

Profit Planning Group

**The Impact of Making  
The Mandated Changes**

	2009	2010	2014
Net Sales	3,600,000	3,780,000	4,594,614
Cost of Goods	<u>2,125,000</u>	<u>2,216,130</u>	<u>2,620,206</u>
Gross Margin	1,475,000	1,563,870	1,974,407
Payroll & Fringes	870,000	896,100	1,008,568
All Other Expenses	<u>597,800</u>	<u>616,350</u>	<u>694,042</u>
Total Expenses	<u>1,467,800</u>	<u>1,512,450</u>	<u>1,702,610</u>
Profit	7,200	51,420	271,797
Cash	121,500	127,575	155,068
Accounts Receivable	197,260	207,123	251,760
Inventory	708,333	738,710	873,402
Other Current Assets	<u>6,075</u>	<u>6,075</u>	<u>6,075</u>
Total Current Assets	1,033,169	1,079,483	1,286,305
Fixed Assets	<u>181,831</u>	<u>190,923</u>	<u>232,068</u>
Total Assets	1,215,000	1,270,406	1,518,373
Return on Assets	0.6%	4.0%	17.9%

Exhibit 24

Profit Planning Group

## Summary and Conclusions

Exhibit 25

Profit Planning Group

## He's Back!

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.

He can be reached at Profit Planning Group, 303-444-6212, 1790 38th St., Suite 204, Boulder, CO 80301, [info@profitplanninggroup.com](mailto:info@profitplanninggroup.com).

Exhibit 26

Profit Planning Group