

# Financial Trends in Distribution

Prepared For

**AHTD**

Prepared By

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## Objectives of the Session

- Review the Profit Structure of the Industry
- Compare Results to Other Meaningful Lines of Trade
- Identify the Two Key Profit Pressure Points for AHTD Distributors

Exhibit 1

Profit Planning Group

## Financial Results for Mountain View, Inc.

<u>Income Statement</u>		<u>Balance Sheet</u>	
Net Sales	15,000,000	Cash	93,750
Cost of Goods Sold	<u>10,875,000</u>	Accounts Receivable	2,054,795
Gross Margin	4,125,000	Inventory	1,087,500
Payroll & Fringes	2,745,000	Other Current Assets	<u>18,750</u>
All Other Expenses	<u>1,005,000</u>	Total Current Assets	3,254,795
Total Expenses	<u>3,750,000</u>	Fixed Assets	<u>495,205</u>
Profit Before Taxes	375,000	Total Assets	3,750,000
Income Taxes	<u>112,500</u>		
Profit After Taxes	262,500	Accounts Payable	1,042,808

Return on Assets = Profit Before Taxes/Total Assets

Exhibit 2

Profit Planning Group

### What If There Were No Price Increases?

<u>Summary</u> <u>Income Statement</u>	<u>Current</u>	<u>No Price</u> <u>Increases</u>
Net Sales	15,000,000	14,250,000
Cost of Goods	<u>10,875,000</u>	<u>10,331,250</u>
Gross Margin	4,125,000	3,918,750
Payroll & Fringes	2,745,000	2,690,100
All Other Expenses	<u>1,005,000</u>	<u>974,850</u>
Total Expenses	<u>3,750,000</u>	<u>3,664,950</u>
Profit	375,000	253,800
 Profit Margin	 2.5%	

Exhibit 3

Profit Planning Group

### The Recent Trend in Return on Assets

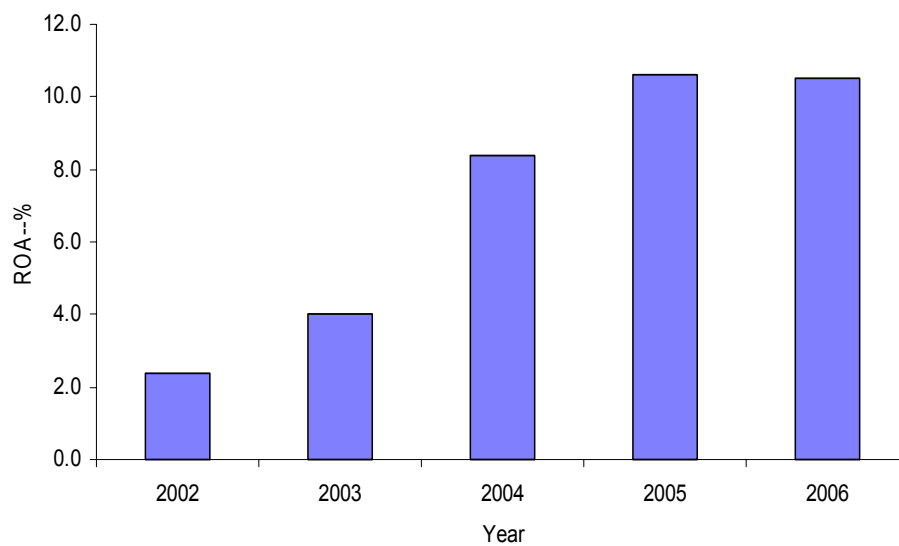


Exhibit 4

Profit Planning Group

### The Recent Trend in Sales Growth

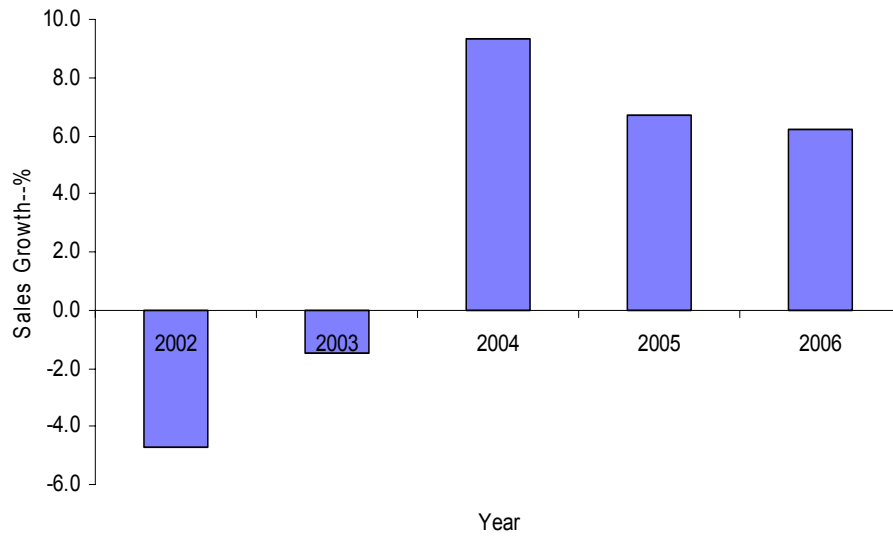


Exhibit 5

Profit Planning Group

### The Two Levels of the Business at Which Profits Are “Managed”

- **Strategic Level**--Some industries are inherently more profitable than others. Ideally, the nature of the high-profit industry can be duplicated.
- **Operational Level**--Given that it is necessary to play it as it lays, there are specific actions that can drive higher profits regardless of industry structure.

Exhibit 6

Profit Planning Group

### The Variation in Return on Assets by Industry

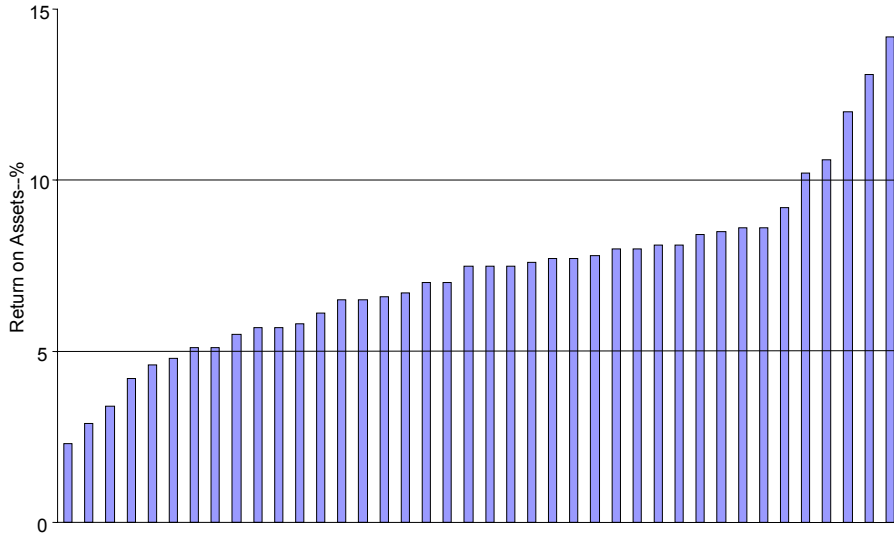


Exhibit 7

Profit Planning Group

### The Inter-Industry Variation in Return on Assets

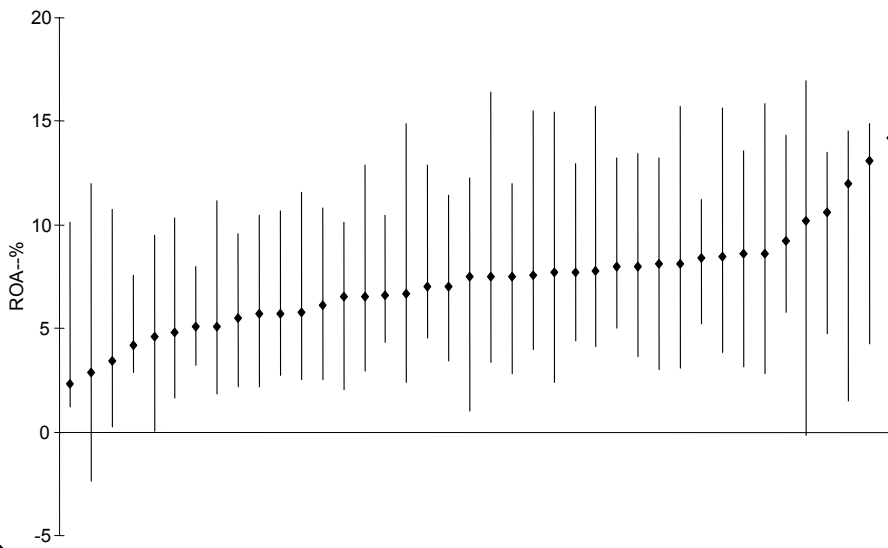


Exhibit 8

Profit Planning Group

### The Three Key Strategic Characteristics of High-Profit Distribution Industries

- Self Containment/Barriers to Entry
- Control of the Commodity Component of the Business
- Expanded Service Profile

Exhibit 9

Profit Planning Group

### The Impact of Barriers to Entry on Return on Assets

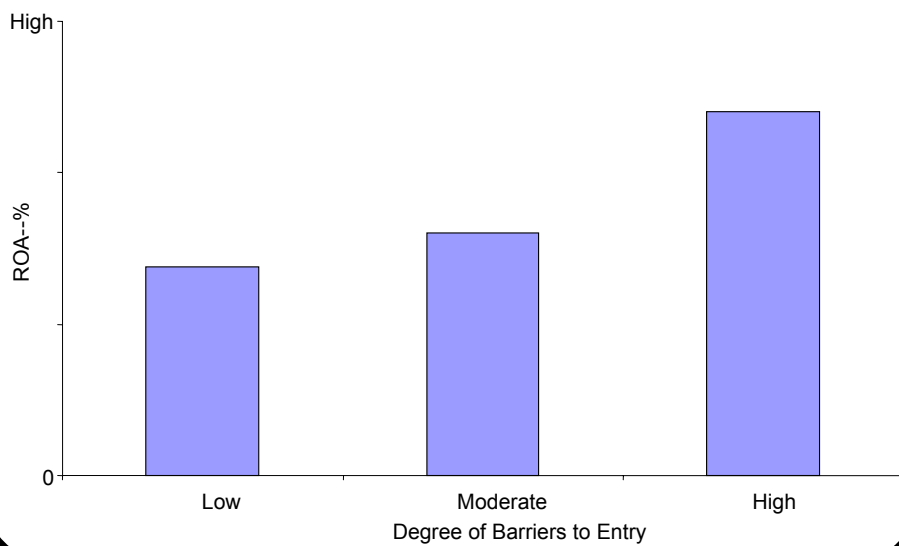


Exhibit 10

Profit Planning Group

## Marketing Polarity

### Gorillas

Lower Prices  
and  
Fewer Services

### Victims

Undifferentiated  
  
Firms

### Guerillas

Higher Prices  
and  
More Services

Exhibit 11

Profit Planning Group

## The Differential Economics of Gorillas and Guerillas

	<u>Current</u>	<u>Gorilla</u>	<u>Guerilla</u>
Net Sales	10,000,000	20,000,000	5,000,000
Cost of Goods Sold	<u>7,400,000</u>	<u>17,000,000</u>	<u>3,500,000</u>
Gross Margin	2,600,000	3,000,000	1,500,000
Expenses			
Payroll	1,640,000	1,350,000	850,000
All Other	<u>930,000</u>	<u>1,162,500</u>	<u>500,000</u>
Total Expenses	<u>2,570,000</u>	<u>2,512,500</u>	<u>1,350,000</u>
Profit Before Taxes	30,000	487,500	150,000
 Profit Margin--%	 0.3%	 2.4%	 3.0%

Exhibit 12

Profit Planning Group

### The Impact of Exclusivity on Distributor Profitability

	<u>Exclusive Distribution</u>	<u>Universal Distribution</u>
Net Sales	\$10,000,000	\$10,000,000
Cost of Goods Sold	<u>7,300,000</u>	<u>7,750,000</u>
Gross Margin	2,700,000	2,250,000
Expenses		
Payroll	1,400,000	1,320,000
All Other	<u>900,000</u>	<u>780,000</u>
Total Expenses	<u>2,300,000</u>	<u>2,100,000</u>
Profit Before Taxes	\$400,000	\$150,000
 Profit Margin--%	4.0%	1.5%

Exhibit 13

Profit Planning Group

### The Impact of Commoditization on Return on Assets

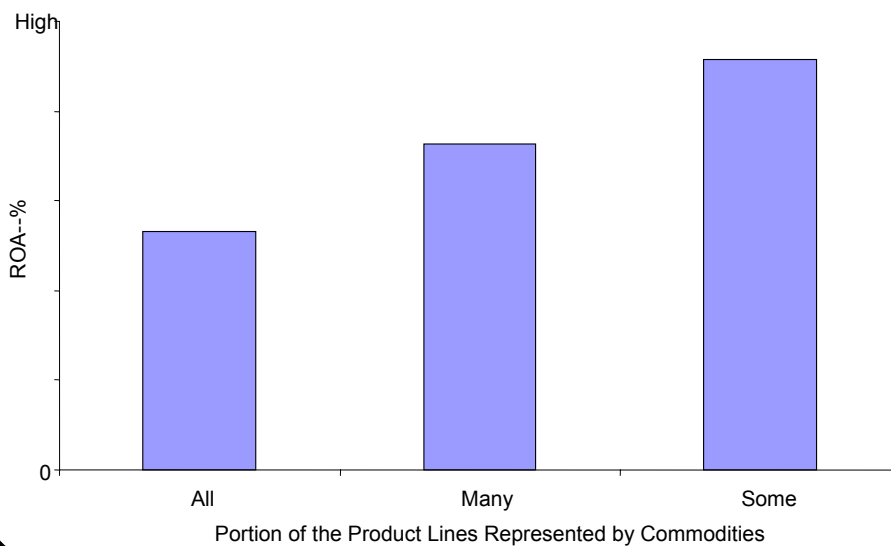


Exhibit 14

Profit Planning Group

### Non-Product Revenue Sources For Distributors

- Service and Repair
- Rental
- Training
- Consultation
- Fee-Based Services

Exhibit 15

Profit Planning Group

### The Impact of Service on Distributor Profitability

	<u>The Firms That Service</u>	<u>The Firms That Sell</u>
Net Sales	\$10,000,000	\$10,000,000
Cost of Goods Sold	<u>6,000,000</u>	<u>7,500,000</u>
Gross Margin	4,000,000	2,500,000
Expenses		
Payroll	2,500,000	1,550,000
All Other	<u>1,200,000</u>	<u>800,000</u>
Total Expenses	<u>3,700,000</u>	<u>2,350,000</u>
Profit Before Taxes	\$300,000	\$150,000
Profit Margin--%	3.0%	1.5%

Exhibit 16

Profit Planning Group

### A Tale of Two Firms

	You Are <u>Here</u>	You Need To <u>Be Here</u>
Net Sales	15,000,000	15,000,000
Cost of Goods Sold	<u>10,875,000</u>	<u>10,725,000</u>
Gross Margin	4,125,000	4,275,000
Payroll & Fringes	2,745,000	2,500,000
All Other Expenses	<u>1,005,000</u>	<u>1,005,000</u>
Total Expenses	<u>3,750,000</u>	<u>3,505,000</u>
Profit Before Taxes	375,000	770,000
Profit Margin	2.5%	5.1%

Exhibit 17

Profit Planning Group

### The Only Two Issues That Distributors Need to Worry About (And a Barrier To Success)

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- 
- 

Exhibit 18

Profit Planning Group

The Relative Impact of  
A One Percent Improvement

<u>Improvement Area</u>	<u>Profit Increase--%</u>
Pricing	38.0
Buying	29.0
Unit Sales	9.0
Fixed Costs	8.0
Inventory	0.3
Accounts Receivable	0.4

Exhibit 19 Profit Planning Group

The Personnel Productivity Ratio--PPR

The Percent of Each Gross Margin Dollar  
That Must Be Devoted to Payroll

Salaries and Fringe Benefits  
Gross Margin

=

2,745,000  
4,125,000

=

Exhibit 20 Profit Planning Group

## How Everybody Can Win At The Same Time

Build a Two Percent Sales Growth to Payroll Growth Gap

Sales Growth	Payroll Growth
5	3
10	8
15	13

Exhibit 21

Profit Planning Group

## The Relationship Between a Sales to Payroll Gap and Return on Assets

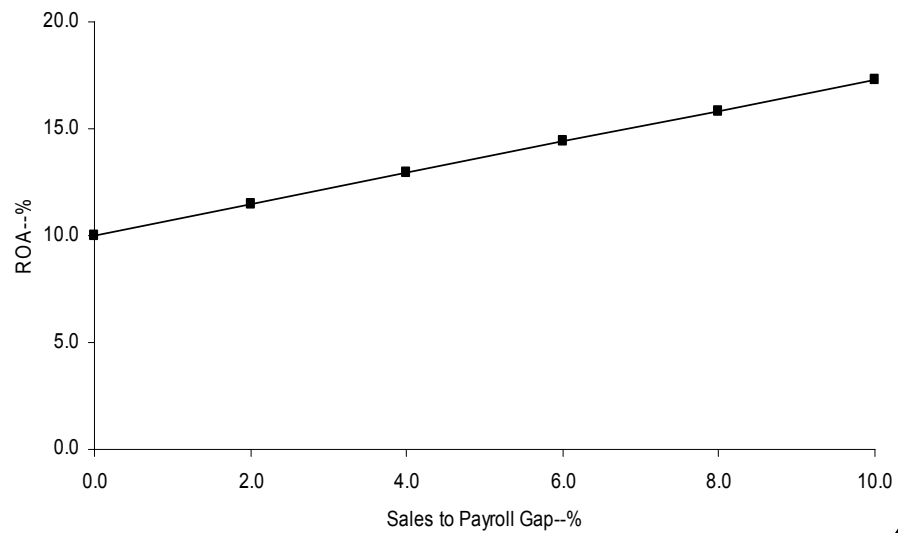


Exhibit 22

Profit Planning Group

The Sales to Payroll Gap:  
A Positive View

Summary Income Statement	<u>Current</u>	<u>Potential</u>	Percent <u>Change</u>
Net Sales	15,000,000	15,750,000	5.0
Cost of Goods	<u>10,875,000</u>	<u>11,418,750</u>	5.0
Gross Margin	4,125,000	4,331,250	5.0
Payroll & Fringes	2,745,000	2,827,350	3.0
All Other Expenses	<u>1,005,000</u>	<u>1,055,250</u>	5.0
Total Expenses	<u>3,750,000</u>	<u>3,882,600</u>	3.5
Profit	375,000	448,650	19.6

Exhibit 23

Profit Planning Group

The Sales to Payroll Gap:  
A Negative View

Summary Income Statement	<u>Current</u>	<u>Potential</u>	Percent <u>Change</u>
Net Sales	15,000,000	15,750,000	5.0
Cost of Goods	<u>10,875,000</u>	<u>11,418,750</u>	5.0
Gross Margin	4,125,000	4,331,250	5.0
Payroll & Fringes	2,745,000	2,937,150	7.0
All Other Expenses	<u>1,005,000</u>	<u>1,055,250</u>	5.0
Total Expenses	<u>3,750,000</u>	<u>3,992,400</u>	6.5
Profit	375,000	338,850	-9.6

Exhibit 24

Profit Planning Group

### Profitability in Relationship to Workload

	<u>Total Firm</u>	<u>Per Order</u>	<u>Per Line</u>
Net Sales	15,000,000	700.00	350.00
Gross Margin	4,125,000	192.50	96.25
Total Expenses	3,750,000	175.00	87.50
Profit Before Taxes	375,000		

Exhibit 25

Profit Planning Group

### Producing a Real Sales Gain

#### Assumptions

Average Order Value	\$700.00
Lines per Order	2.0
Average Order Line	\$350.00

#### The Real Sales Gain Pressure Points

	<u>Current</u>	<u>Potential</u>
Net Sales	15,000,000	_____
Average Order Line	350.00	_____
Order Lines	_____	_____
Lines per Order	2.0	_____
Orders	_____	_____

Exhibit 26

Profit Planning Group

### The Increase in Dollar Sales Required to Exactly Offset a Price Reduction

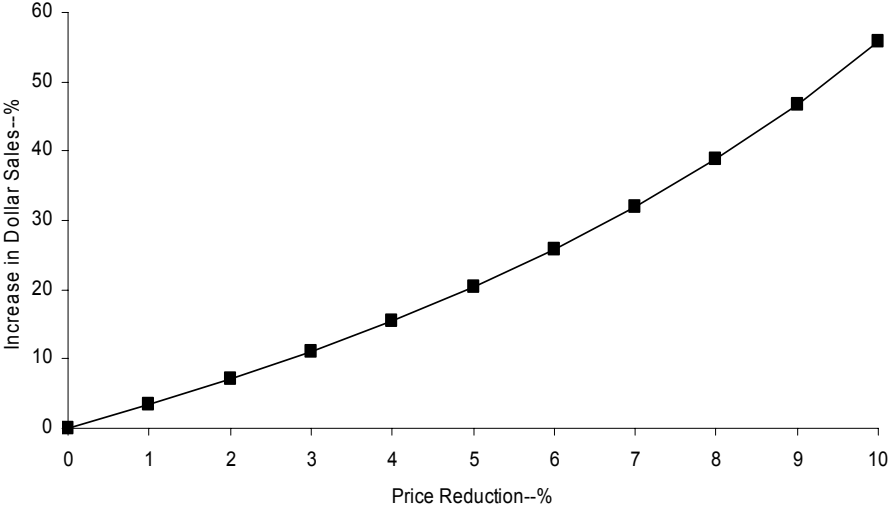


Exhibit 27 Profit Planning Group

### The Relationship Between Gross Margin and Return on Assets

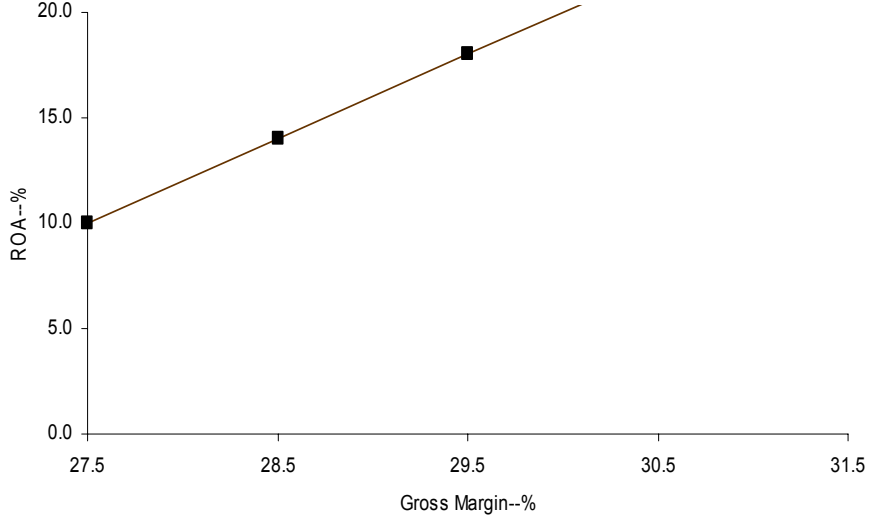


Exhibit 28 Profit Planning Group

### The Impact of Gross Margin on the PPR

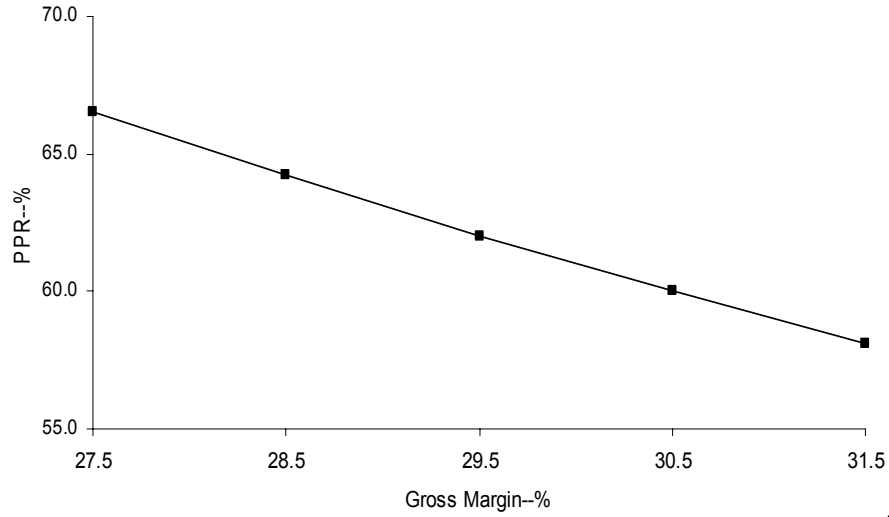


Exhibit 29

Profit Planning Group

### Why Does the PPR Fall?

Summary			
<u>Income Statement</u>	<u>Current</u>	<u>Potential</u>	<u>Percent Change</u>
Net Sales	15,000,000	15,000,000	0.0
Cost of Goods	<u>10,875,000</u>	<u>10,725,000</u>	-1.4
Gross Margin	4,125,000		3.6
Payroll & Fringes	2,745,000	2,745,000	0.0
All Other Expenses	<u>1,005,000</u>	<u>1,005,000</u>	0.0
Total Expenses	<u>3,750,000</u>	<u>3,750,000</u>	0.0
Profit	375,000		40.0
Gross Margin	27.5%	28.5%	
PPR	66.5%	64.2%	

Exhibit 30

Profit Planning Group

Impacting Gross Margin  
With Product Mix

Velocity Code	<u>Sales</u>	<u>GM%</u>	<u>Gross Margin</u>	<u>Potential Sales</u>	<u>Gross Margin</u>
A	9,000,000	22.0	1,980,000	9,000,000	1,980,000
B	3,000,000	28.0	840,000	3,000,000	840,000
C	2,250,000	40.0	900,000	2,250,000	900,000
D	<u>750,000</u>	<u>54.0</u>	<u>405,000</u>		
Total	15,000,000	27.5	4,125,000		

Exhibit 31

Profit Planning Group

Impacting Gross Margin  
With Blind-Item Pricing

Velocity Code	<u>Sales</u>	<u>GM%</u>	<u>Gross Margin</u>	<u>Potential Sales</u>	<u>Gross Margin</u>
A	9,000,000	22.0	1,980,000	9,000,000	1,980,000
B	3,000,000	28.0	840,000	3,000,000	840,000
C	2,250,000	40.0	900,000	2,250,000	900,000
D	<u>750,000</u>	<u>54.0</u>	<u>405,000</u>		
Total	15,000,000	27.5	4,125,000		

Exhibit 32

Profit Planning Group

### Improving Gross Margin By Controlling Sales Force Pricing Decisions

<u>Summary Income Statement</u>	<u>Current</u>	Unnecessary 5% <u>Price Cut</u>
Net Sales	15,000,000	14,250,000
Cost of Goods Sold	<u>10,875,000</u>	
Gross Margin	4,125,000	
Commissions            10.0% of G. M.	412,500	
Other Variable Expenses    2.3% of Sales	337,500	
Fixed Expenses	<u>3,000,000</u>	
Total Expenses	<u>3,750,000</u>	
Profit Before Taxes	375,000	

Exhibit 33

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	15,000,000	15,450,000	15,750,000
Cost of Goods Sold	<u>10,875,000</u>	<u>11,418,750</u>	<u>11,418,750</u>
Gross Margin	4,125,000	4,031,250	4,331,250
Fixed Expenses	3,000,000	3,000,000	3,000,000
Variable Expenses	<u>750,000</u>	<u>772,500</u>	<u>787,500</u>
Total Expenses	<u>3,750,000</u>	<u>3,772,500</u>	<u>3,787,500</u>
Profit Before Taxes	375,000	258,750	

Exhibit 34

Profit Planning Group

### The Relationship Between Inventory Turnover and Return on Assets

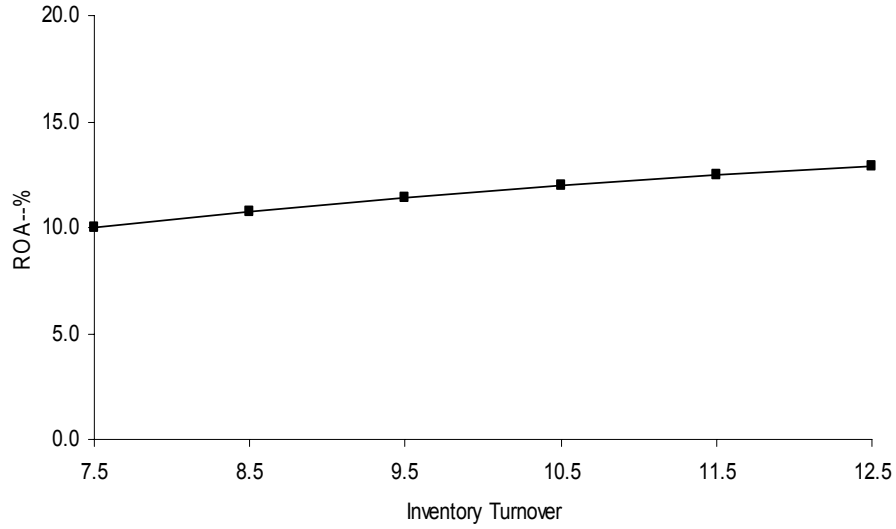


Exhibit 35

Profit Planning Group

### The Relationship Between The Collection Period and Return on Assets

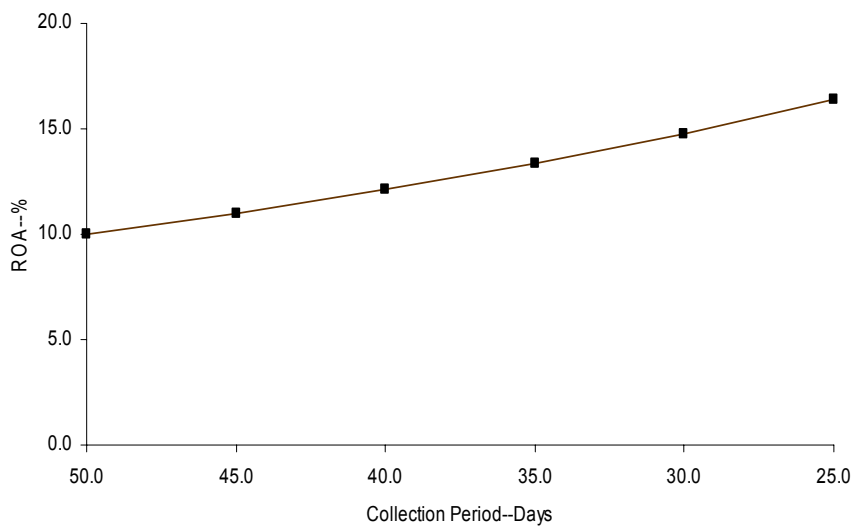


Exhibit 36

Profit Planning Group

The Mandate for Change  
During Each of the Next Five Years

Sales Increase %	5.0
Gross Margin %	0.2
Sales to Payroll Gap	2.0
Other Expense %	0.0
Inventory Turnover	0.0
AR Collection Days	0.0

Exhibit 37

Profit Planning Group

The Impact of Making  
The Mandated Changes

	<u>2007</u>	<u>2008</u>	<u>2012</u>
Net Sales	15,000,000	15,750,000	19,144,223
Cost of Goods	<u>10,875,000</u>	<u>11,387,250</u>	<u>13,688,120</u>
Gross Margin	4,125,000	4,362,750	5,456,104
Payroll & Fringes	2,745,000	2,827,350	3,182,207
All Other Expenses	<u>1,005,000</u>	<u>1,055,250</u>	<u>1,282,663</u>
Total Expenses	<u>3,750,000</u>	<u>3,882,600</u>	<u>4,464,870</u>
Profit	375,000	480,150	991,233
Cash	93,750	98,438	119,651
Accounts Receivable	2,054,795	2,157,534	2,622,496
Inventory	1,087,500	1,138,725	1,368,812
Other Current Assets	<u>18,750</u>	<u>18,750</u>	<u>18,750</u>
Total Current Assets	3,254,795	3,413,447	4,129,710
Fixed Assets	<u>495,205</u>	<u>519,966</u>	<u>632,022</u>
Total Assets	3,750,000	3,933,413	4,761,731

Return on Assets

10.0

12.2

Exhibit 38

Profit Planning Group

## Summary and Conclusions

Exhibit 39

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## 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 40

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