

# Selling a Business: Financial Perspectives

Prepared For

AHTD

Prepared By

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

April 3, 2008

## Objectives of the Session

- Put a First-Pass Value on the Business
- Identify How To Increase The Value In A Relatively Short Time

Exhibit 1

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## 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

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### A Tale of Two Firms: So What?

	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
Cash	93,750	170,000
Accounts Receivable	2,054,795	1,849,315
Inventory	1,087,500	937,500
Other Curr. Assets	<u>18,750</u>	<u>18,750</u>
Total Current Assets	3,254,795	2,975,565
Fixed Assets	<u>495,205</u>	<u>424,435</u>
Total Assets	3,750,000	3,400,000
Return on Assets	10.0%	22.6%

Exhibit 3

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### So What Are They Worth?

Profit Before Taxes	\$375,000	\$770,000
Earnings Multiplier	5.0	5.0
Value of the Firm		
Difference		

Exhibit 4

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The Factors That Can Change The Value:  
Not All Of Them Are Good

Excessive compensation

Inventory Value

Accounts Receivable Value

Exhibit 5

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Why Not Just Liquidate?

	<u>Book</u> <u>Value</u>	<u>Multiplier</u>	<u>Net</u> <u>Value</u>
Cash	93,750	100.0	93,750
Accounts Receivable	2,054,795	85.0	1,746,575
Inventory	1,087,500	65.0	706,875
Other Current Assets	18,750	0.0	0
Fixed Assets	<u>495,205</u>	100.0	<u>495,205</u>
Total	3,750,000		3,042,406
Less: Liabilities			<u>1,593,641</u>
Net Value			1,448,765

Exhibit 6

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### A Three-Year Transition Plan

	<u>2007</u>	<u>2010</u>
Net Sales	15,000,000	18,000,000
Cost of Goods Sold	<u>10,875,000</u>	<u>12,870,000</u>
Gross Margin	4,125,000	5,130,000
Payroll and Fringes	2,745,000	3,156,750
All Other Expenses	<u>1,005,000</u>	<u>1,180,875</u>
Total Expenses	<u>3,750,000</u>	<u>4,337,625</u>
Profit Before Taxes	375,000	792,375
Business Value	1,875,000	

Exhibit 7

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### The Four Things That Must Be Done

Clean up the inventory to drive higher sales

Improve sales force effectiveness

Re-think the accounts receivable

Drive a higher gross margin

Exhibit 8

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### Pareto's Law and Inventory Planning

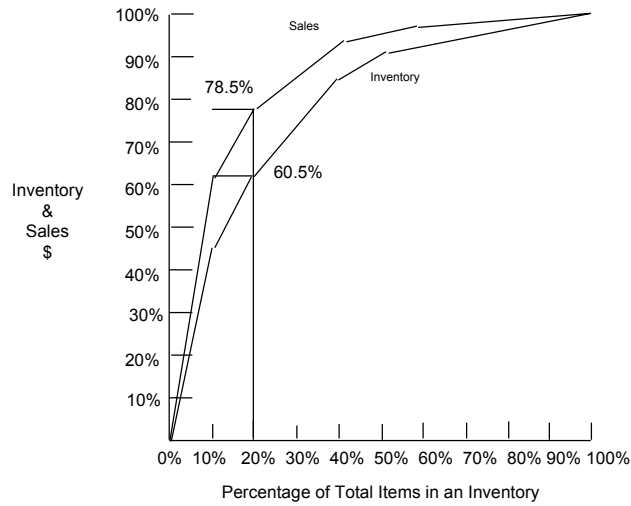


Exhibit 9

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### Inventory Management in Action

<u>Item Category</u>	<u>Sales</u>	<u>Inventory</u>	<u>Service Level</u>	<u>New Inventory</u>	<u>New Service Level</u>
A	9,000,000	489,375	85	652,500	95
B	3,000,000	163,125	90	163,125	90
C	2,250,000	217,500	95	145,000	85
D	750,000	217,500	99	126,875	75
Total	15,000,000	1,087,500	90	1,087,500	92

Exhibit 10

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### Taking a Closer Look at Sales Costs

All Sales Payroll	9.4	Inside Sales	2.1
Warehouse & Delivery Payroll	0.6	Technical Support	1.4
Officers' Payroll	2.4	Outside Sales	
All Other Payroll	3.2		
Total	15.6		

Exhibit 11

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### Some Thoughts From The Compensation Report

Annual Compensation		Margin Dollars Generated	
Base Salary	38,000	Highest Producer	
Commission	40,000	Lowest Producer	200,000
Total	78,000		

Exhibit 12

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### Measuring Accounts Receivable Performance

Collections per Day      Amount Received Each Day From  
Prior Credit Sales

$$\frac{\text{Annual Credit Sales}}{365 \text{ Days}}$$

$$\frac{15,000,000}{365}$$

Collection Period      Number of Days The Typical Credit  
Customer Takes to Pay

$$\frac{\text{Accounts Receivable}}{\text{Collections per Day}}$$

$$\frac{2,054,795}{41,096}$$

Exhibit 13

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### The Impact of Accounts Receivable On Profitability

<u>Item</u>	<u>Calculation</u>	<u>Amount</u>
1 Collections per Day		41,096
2 Collection Period		50.0
3 Accts. Receivable	(1 X 2)	2,054,795
4 Target Collect Period		45.0
5 Target Accts. Rec.	(1 X 4)	1,849,315
6 Reduction	(3 - 5)	205,479
7 Carrying Cost		8.0
8 Profit Impact	(6 X 7)	16,438

Exhibit 14

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### What If Collections Causes Sales to Fall?

Profit Improvement  
From Faster Collections  
16,438

	<u>Current</u>	<u>Sales Decline</u>	
		5%	1%
Net Sales	15,000,000	14,250,000	14,850,000
Cost of Goods Sold	<u>10,875,000</u>	<u>10,331,250</u>	<u>10,766,250</u>
Gross Margin	4,125,000	3,918,750	4,083,750
Fixed Expenses	3,000,000	3,000,000	3,000,000
Variable Expenses	<u>750,000</u>	<u>712,500</u>	<u>742,500</u>
Total Expenses	<u>3,750,000</u>	<u>3,712,500</u>	<u>3,742,500</u>
Profit Before Taxes	375,000	206,250	341,250
Change in Profit		-168,750	-33,750

Exhibit 15

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### Measuring the Break-Even Point For a Sales Decline

New Sales Equals:

Fixed Expenses + Current Profit - Gain From Collections  
Gross Margin % - Variable Expense %

3,000,000	+	375,000	-	16,438
		27.5%		5.0%
<u>3,358,562</u>	=	14,926,941	=	
		22.5%		

Exhibit 16

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The Sales Increase Required  
to Offset a Bad Debt Loss

**Dumb Answer**

**Smart Answer**

Accounts Receivable Loss  
PBT %

Accounts Receivable Loss  
GM% - Variable Expense %

25,000  
2.5%

25,000  
22.5%

Exhibit 17

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The Sales to Payroll Gap:  
A Positive View

Summary Income Statement	<u>Current</u>	<u>Potential</u>	<u>Percent Change</u>
Net Sales	15,000,000	18,000,000	20.0
Cost of Goods	<u>10,875,000</u>	<u>13,050,000</u>	<u>20.0</u>
Gross Margin	4,125,000	4,950,000	20.0
Payroll & Fringes	2,745,000	3,156,750	15.0
All Other Expenses	<u>1,005,000</u>	<u>1,180,875</u>	<u>17.5</u>
Total Expenses	<u>3,750,000</u>	<u>4,337,625</u>	<u>15.7</u>
Profit	375,000	612,375	63.3

Exhibit 18

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### The Impact of Price Changes On Overall Gross Margin

<u>Product Category</u>	<u>Sales</u>	<u>Gross Margin</u>	<u>G.M. %</u>	<u>Price % Change</u>	<u>Sales</u>	<u>Gross Margin</u>	<u>G.M. %</u>
A+	1,500,000	330,000	22.0	-5.0			
A	7,500,000	1,650,000	22.0	0.0	7,500,000	1,650,000	22.0
B	3,000,000	840,000	28.0	0.0	3,000,000	840,000	28.0
C	2,250,000	900,000	40.0	0.0	2,250,000	900,000	40.0
D	750,000	405,000	54.0	0.0	750,000	405,000	54.0
Total	15,000,000	4,125,000	27.5				

Exhibit 19

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### The Relationship Between Price Reductions on A + Items Only and Overall Gross Margin

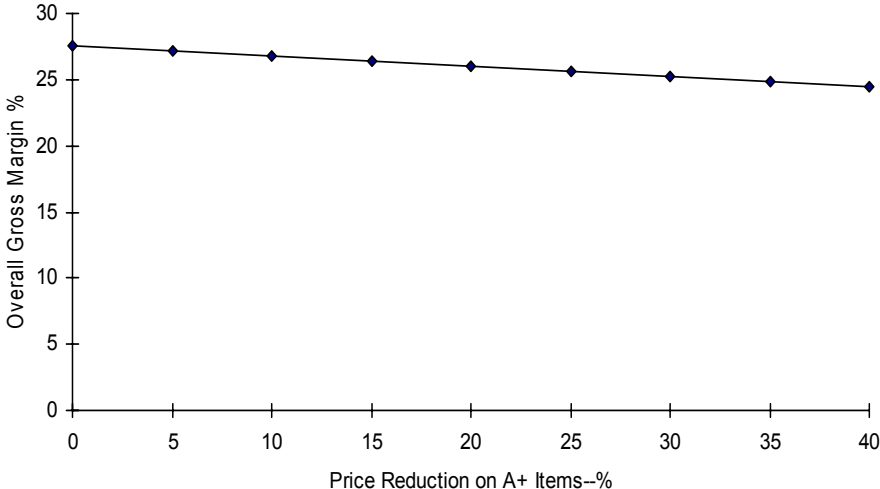


Exhibit 20

Profit Planning Group

### The Impact of Price Changes On Overall Gross Margin

Product Category	Sales	Gross Margin	G.M. %	Price % Change	Sales	Gross Margin	G.M. %
A+	1,500,000	330,000	22.0	-5.0	1,425,000	255,000	17.9
A	7,500,000	1,650,000	22.0	-5.0	7,125,000	1,275,000	17.9
B	3,000,000	840,000	28.0	0.0	3,000,000	840,000	28.0
C	2,250,000	900,000	40.0	0.0	2,250,000	900,000	40.0
D	750,000	405,000	54.0	0.0	750,000	405,000	54.0
Total	15,000,000	4,125,000	27.5		14,550,000	3,675,000	25.3

Exhibit 21

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### The Relationship Between Price Reductions On All A Items and Overall Gross Margin

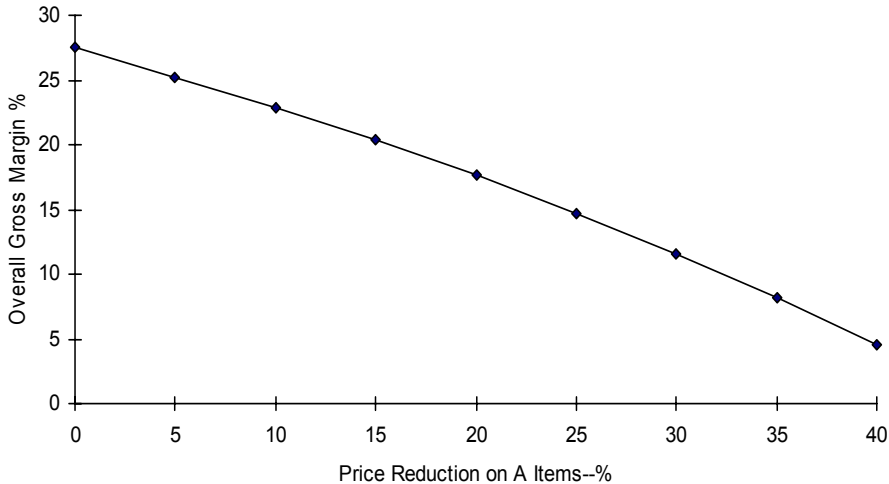


Exhibit 22

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Holding the Line on Overall Gross Margin  
When Some Prices Are Forced Down

<u>Product Category</u>	<u>Sales</u>	<u>Gross Margin</u>	<u>G.M. %</u>	<u>Price Change</u>	<u>Sales</u>	<u>Gross Margin</u>	<u>G.M. %</u>
A+	1,500,000	330,000	22.0	-5.0	1,425,000	255,000	17.9
A	7,500,000	1,650,000	22.0	0.0	7,500,000	1,650,000	22.0
B	3,000,000	840,000	28.0	0.5	3,015,000	855,000	28.4
C	2,250,000	900,000	40.0	1.0	2,272,500	922,500	40.6
D	750,000	405,000	54.0	5.0	787,500	442,500	56.2
Total	15,000,000	4,125,000	27.5		15,000,000	4,125,000	27.5

Exhibit 23

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Increasing Overall Gross Margin  
When Some Prices are Forced Down

<u>Product Category</u>	<u>Sales</u>	<u>Gross Margin</u>	<u>G.M. %</u>	<u>Price Change</u>	<u>Sales</u>	<u>Gross Margin</u>	<u>G.M. %</u>
A+	1,500,000	330,000	22.0	-5.0	1,425,000	255,000	17.9
A	7,500,000	1,650,000	22.0	0.0	7,500,000	1,650,000	22.0
B	3,000,000	840,000	28.0	0.5	3,015,000	855,000	28.4
C	2,250,000	900,000	40.0	1.0	2,272,500	922,500	40.6
D	750,000	405,000	54.0	11.0	832,500	487,500	58.6
Total	15,000,000	4,125,000	27.5		15,045,000	4,170,000	27.7

Exhibit 24

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### The Impact of Gross Margin

Summary Income Statement	<u>Current</u>	<u>Potential</u>	Percent <u>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>	<u>-1.4</u>
Gross Margin	4,125,000	4,275,000	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>	<u>0.0</u>
Total Expenses	<u>3,750,000</u>	<u>3,750,000</u>	<u>0.0</u>
Profit	375,000	525,000	40.0

Exhibit 25

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### A Three-Year Transition Plan

	<u>2007</u>	<u>2010</u>
Net Sales	15,000,000	18,000,000
Cost of Goods Sold	<u>10,875,000</u>	<u>12,870,000</u>
Gross Margin	4,125,000	5,130,000
Payroll and Fringes	2,745,000	3,156,750
All Other Expenses	<u>1,005,000</u>	<u>1,180,875</u>
Total Expenses	<u>3,750,000</u>	<u>4,337,625</u>
Profit Before Taxes	375,000	792,375
Business Value	1,875,000	3,961,875

Exhibit 26

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## Summary and Conclusions

Exhibit 27

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## Not Again?!

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. When he is not traveling conducting seminars he enjoys skiing and tennis. He is not particularly good at either one.

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 28

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