

Planning For Profit

Prepared For

Manufacturing For Growth

Prepared By

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Objectives of the Session

- Review the Profit Structure of the Industry
- Develop a Philosophy of "Profit-First" Planning
- Appreciate That Pricing is the Name of the Game
- Develop an Action Plan to Improve Pricing Performance

Exhibit 1

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Financial Results for Mountain View, Inc.

<u>Income Statement</u>		<u>Partial Balance Sheet</u>	
Net Sales	20,000,000	Cash	600,000
Cost of Goods Sold	<u>14,800,000</u>	Accounts Receivable	3,500,000
Gross Margin	5,200,000	Inventory	4,700,000
Payroll & Fringes	2,500,000	Other Current Assets	<u>60,000</u>
All Other Expenses	<u>1,900,000</u>	Total Current Assets	8,860,000
Total Expenses	<u>4,400,000</u>	Fixed Assets	<u>3,140,000</u>
Profit Before Taxes	800,000	Total Assets	12,000,000
Fixed Expenses	3,400,000	Variable Expenses	5.0%
Variable Expenses	1,000,000		

Return on Assets = Profit Before Taxes/Total Assets

Exhibit 2

Profit Planning Group

The Conceptual Planning Process

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- Forecast Sales
- Nudging Gross Margin
- Calculating Expenses
- Target Investment Levels

Exhibit 3

Profit Planning Group

Step One: Setting a Profit Target

1 Net Profit Before Taxes	\$ <u>800,000</u>
2 Total Assets	\$ <u>12,000,000</u>
3 Return on Assets [1 / 2]	<u>6.7</u> %
4 Improvement in ROA [2% to 3%]	<u> </u> %
5 Target Return on Assets [3 + 4]	<u> </u> %
6 Target Profit [2 x 5]	\$ <u> </u>

Exhibit 4

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Let's Make It Up With Volume

Summary <u>Income Statement</u>	<u>Current</u>	<u>Worst Case</u>	<u>Possible Case</u>
Average Transaction	10,000	9,500	9,500
Cost of Goods per Transaction	7,400	7,400	7,400
Number of Transactions	2,000	2,000	2,585
Net Sales	20,000,000	19,000,000	24,557,500
Cost of Goods Sold	<u>14,800,000</u>	<u>14,800,000</u>	
Gross Margin	5,200,000	4,200,000	
Variable Expenses	1,000,000	950,000	1,227,875
Fixed Expenses	<u>3,400,000</u>	<u>3,400,000</u>	<u>3,400,000</u>
Total Expenses	<u>4,400,000</u>	<u>4,350,000</u>	<u>4,627,875</u>
Profit Before Taxes	800,000	-150,000	

Exhibit 5

Profit Planning Group

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

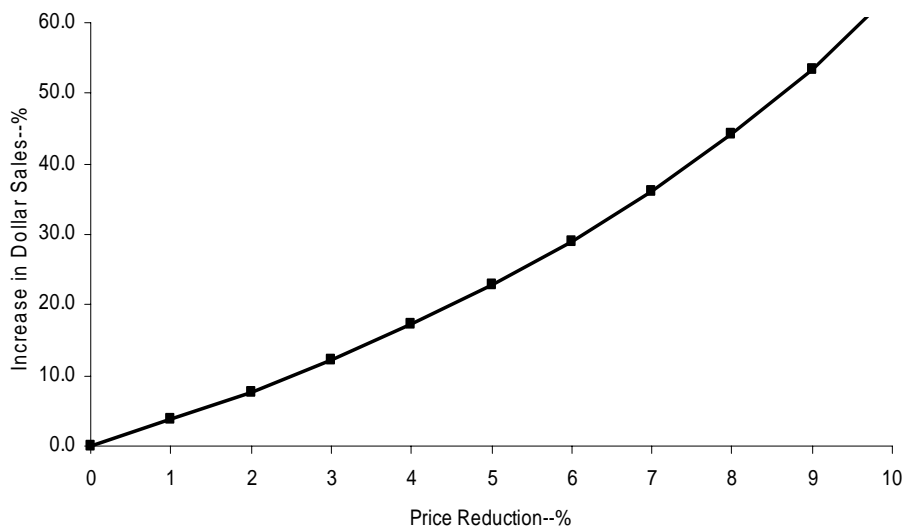


Exhibit 6

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

-
- Examples
 - Branded Items are Easy:
 - Qualitative Differences are the Key:

Exhibit 7

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The Pricing Triangle

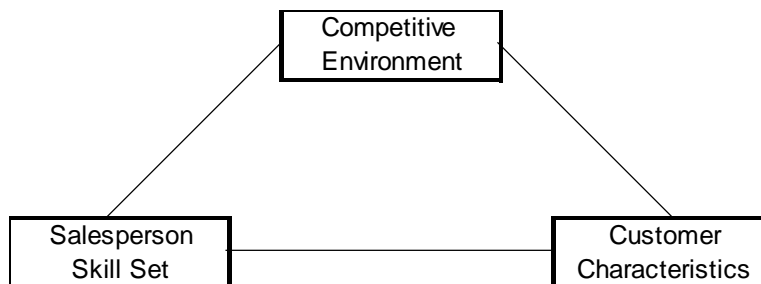


Exhibit 8

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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	12,000,000	21.0	2,520,000	12,000,000	2,520,000
B	4,000,000	26.0	1,040,000	4,000,000	1,040,000
C	3,000,000	36.0	1,080,000	3,000,000	1,080,000
D	<u>1,000,000</u>	<u>56.0</u>	<u>560,000</u>		
Total	20,000,000	26.0	5,200,000		

Exhibit 9

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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	12,000,000	21.0	2,520,000	12,000,000	2,520,000
B	4,000,000	26.0	1,040,000	4,000,000	1,040,000
C	3,000,000	36.0	1,080,000	3,000,000	1,080,000
D	<u>1,000,000</u>	<u>56.0</u>	<u>560,000</u>		
Total	20,000,000	26.0	5,200,000		

Exhibit 10

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Alternative Ways to Reach The Margin Goal

Target Gross Margin	26.4
Velocity <u>Code</u>	Price <u>Increase</u>
A	
B	
C	
D	10.0

Exhibit 11

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Common Characteristics of Blind Items

- Low Sales Level
- Not Heavily Promoted
- Bought Only When Needed
- Low Price
- Repair Parts
- Unusual
- Non-Seasonal
- Unbranded

Exhibit 12

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A Traditional Approach To Controlling Sales Force Pricing Decisions

<u>Summary</u> <u>Income Statement</u>	<u>Current</u>	Unnecessary 5% <u>Price Cut</u>
Net Sales	20,000,000	19,000,000
Cost of Goods Sold	<u>14,800,000</u>	<u>14,800,000</u>
Gross Margin	5,200,000	4,200,000
Commissions 10.0% of G. M.	520,000	
Other Variable Expenses 2.4% of Sales	480,000	
Fixed Expenses	<u>3,400,000</u>	<u>3,400,000</u>
Total Expenses	<u>4,400,000</u>	
Profit Before Taxes	800,000	

Exhibit 13

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Overcoming the Profit Challenge: A Draconian Commission Plan

<u>Summary</u> <u>Income Statement</u>	<u>Current</u>	Unnecessary 5% <u>Price Cut</u>
Net Sales	20,000,000	19,000,000
Cost of Goods Sold	<u>14,800,000</u>	<u>14,800,000</u>
Gross Margin	5,200,000	4,200,000
Commissions 10.0% of G. M.	520,000	
Other Variable Expenses 2.4% of Sales	480,000	
Fixed Expenses	<u>3,400,000</u>	<u>3,400,000</u>
Total Expenses	<u>4,400,000</u>	
Profit Before Taxes	800,000	

Exhibit 14

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The Impact of a Five Percent Supplier Price Increase

	<u>Current</u>	<u>3% Passed Along</u>	<u>5% Passed Along</u>
Net Sales	20,000,000	20,600,000	21,000,000
Cost of Goods Sold	<u>14,800,000</u>	<u>15,540,000</u>	<u>15,540,000</u>
Gross Margin	5,200,000	5,060,000	5,460,000
Fixed Expenses	3,400,000	3,400,000	3,400,000
Variable Expenses	<u>1,000,000</u>	<u>1,030,000</u>	<u>1,050,000</u>
Total Expenses	<u>4,400,000</u>	<u>4,430,000</u>	<u>4,450,000</u>
Profit Before Taxes	800,000	630,000	

Exhibit 15

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Something So Powerful, Yet So Potentially Destructive That Nobody Should Know It

Cost of Goods Percentage	74.0%
x	
Vendor Price Increase	5.0%
=	
Required Outbound Price Increase	3.7%

Exhibit 16

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The Typical Relationship Between Customer Size and Gross Margin Percentage

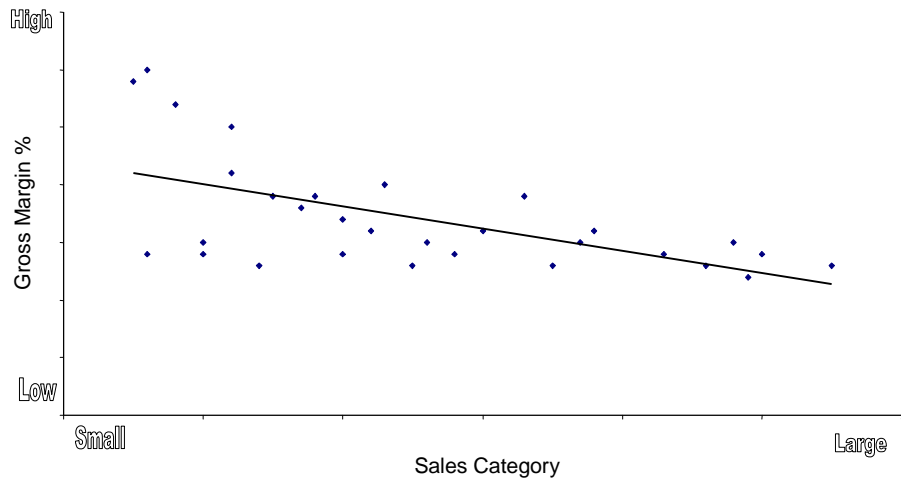


Exhibit 17

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The Needed Relationship Between Cost to Serve and Gross Margin Percentage

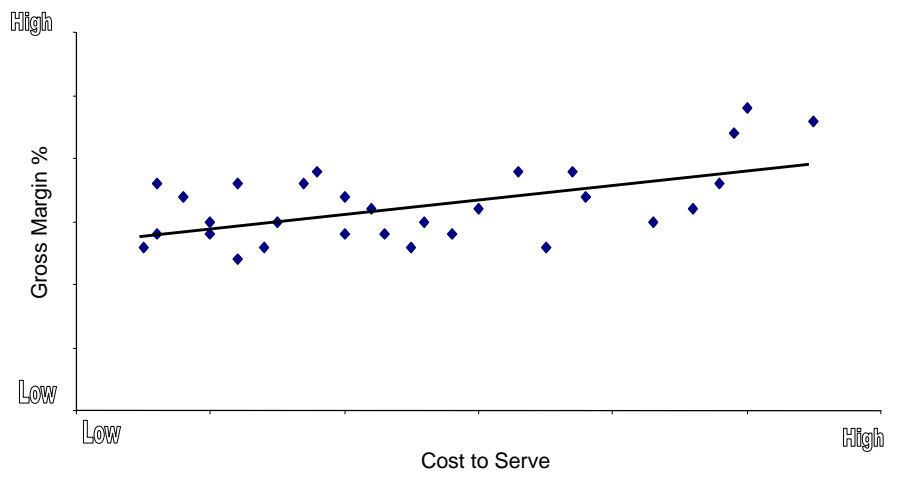


Exhibit 18

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Summary and Conclusions

Exhibit 19

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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.

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Exhibit 20

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