

Improving the Bottom Line

Prepared For

AFAA

Prepared By

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Objectives of the Session

- Set a Realistic Profit Target
 - How Much
 - How Fast
- Develop an Action Program to Reach the Profit Target
 - Priorities for Action
 - Realistic Improvements

Exhibit 1

Profit Planning Group

The Two Requirements of Any Business Proposition

- Adequate Salary--Hours Worked
- Adequate Profit--Risk Taken

Exhibit 2

Profit Planning Group

The Range of Owner's Compensation

Weekly Hours Worked	<u>Realistic Hourly Wage Rate for the Owner</u>				
	<u>15</u>	<u>20</u>	<u>25</u>	<u>30</u>	<u>35</u>
40	31,200	41,600	52,000	62,400	72,800
45	37,050	49,400	61,750	74,100	86,450
50	42,900	57,200	71,500	85,800	100,100
55	48,750	65,000	81,250	97,500	113,750
60	54,600	72,800	91,000	109,200	127,400
65	60,450	80,600	100,750	120,900	141,050
70	66,300	88,400	110,500	132,600	154,700

Exhibit 3

Profit Planning Group

The Annual Income You Will Enjoy at Retirement (In Constant Dollars)

Age Now	Current Salary 50,000				
	<u>Percentage Add-On in the Retirement Plan</u>				
	<u>3</u>	<u>6</u>	<u>9</u>	<u>12</u>	<u>15</u>
30	10,871	21,743	32,614	43,485	54,357
40	5,745	11,489	17,234	22,978	28,723
50	2,597	5,195	7,792	10,389	12,986
60	665	1,330	1,995	2,660	3,325

Exhibit 4

Profit Planning Group

Financial Results for
Mountain View, Inc.

<u>Income Statement</u>		<u>Balance Sheet</u>	
Net Sales	2,000,000	Cash	30,000
Cost of Goods Sold	<u>1,040,000</u>	Accounts Receivable	246,575
Gross Margin	960,000	Inventory	86,667
Payroll & Fringes	500,000	Other Current Assets	<u>3,000</u>
All Other Expenses	<u>380,000</u>	Total Current Assets	366,242
Total Expenses	<u>880,000</u>	Fixed Assets	<u>233,758</u>
Profit Before Taxes	80,000	Total Assets	600,000
Income Taxes	<u>24,000</u>		
Profit After Taxes	56,000	Accounts Payable	113,973

Return on Assets = Profit Before Taxes/Total Assets

Exhibit 5

Profit Planning Group

Financial Results for
Mountain View, Inc.

<u>Income Statement</u>		<u>Partial Balance Sheet</u>	
Net Sales	2,000,000	Cash	30,000
Cost of Goods Sold	<u>1,040,000</u>	Accounts Receivable	246,575
Gross Margin	960,000	Inventory	86,667
Fixed Expenses	700,000	Other Current Assets	<u>3,000</u>
Variable Expenses	<u>180,000</u>	Total Current Assets	366,242
Total Expenses	<u>880,000</u>	Fixed Assets	<u>233,758</u>
Profit Before Taxes	80,000	Total Assets	600,000

Exhibit 6

Profit Planning Group

An Improvement Path For Return on Assets

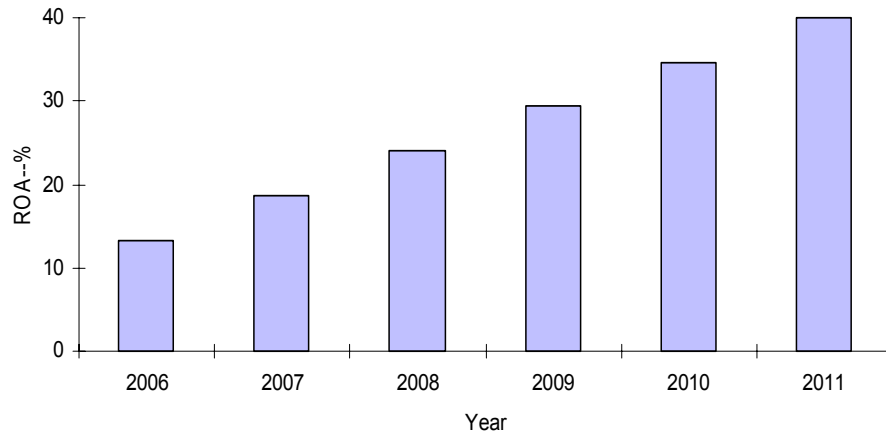


Exhibit 7

Profit Planning Group

Step One: Setting a Profit Target

1 Net Profit Before Taxes	\$ <u>80,000</u>
2 Total Assets	\$ <u>600,000</u>
3 Return on Assets [1 / 2]	<u>13.3 %</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 8

Profit Planning Group

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

-
-
-

Exhibit 9

Profit Planning Group

The Relative Impact of
A One Percent Improvement

<u>Improvement Area</u>	<u>Profit Increase--%</u>
Pricing	22.8
Buying	13.0
Unit Sales	9.8
Fixed Costs	8.8
Inventory	0.1
Accounts Receivable	0.2

Exhibit 10

Profit Planning Group

That Can't Be Right

Summary <u>Income Statement</u>	<u>Current</u>	<u>Pricing</u>	Unit <u>Sales</u>
Net Sales	2,000,000	2,020,000	2,020,000
Cost of Goods	<u>1,040,000</u>	<u>1,040,000</u>	
Gross Margin	960,000	980,000	
Fixed Expenses	700,000	700,000	700,000
Variable Expenses	<u>180,000</u>	<u>181,800</u>	<u>181,800</u>
Total Expenses	<u>880,000</u>	<u>881,800</u>	<u>881,800</u>
Profit Before Taxes	80,000	98,200	

Exhibit 11

Profit Planning Group

That Still Can't Be Right

Summary <u>Income Statement</u>	<u>Current</u>	<u>Buying</u>	Fixed <u>Expenses</u>
Net Sales	2,000,000	2,000,000	2,000,000
Cost of Goods	<u>1,040,000</u>	<u>1,029,600</u>	<u>1,040,000</u>
Gross Margin	960,000	970,400	960,000
Fixed Expenses	700,000	700,000	693,000
Variable Expenses	<u>180,000</u>	<u>180,000</u>	<u>180,000</u>
Total Expenses	<u>880,000</u>	<u>880,000</u>	<u>873,000</u>
Profit Before Taxes	80,000	90,400	87,000

Exhibit 12

Profit Planning Group

I'm Telling You Man,
That Can't Be Right

<u>Summary</u> <u>Income Statement</u>	<u>Current</u>	<u>Inventory</u> <u>Reduction</u>	<u>A/R</u> <u>Reduction</u>
Net Sales	2,000,000	2,000,000	2,000,000
Cost of Goods	<u>1,040,000</u>	<u>1,040,000</u>	<u>1,040,000</u>
Gross Margin	960,000	960,000	960,000
Fixed Expenses	700,000	700,000	700,000
Variable Expenses	180,000	180,000	180,000
Change in Costs	<u>0</u>	<u>-95</u>	<u>-148</u>
Total Expenses	<u>880,000</u>	<u>879,905</u>	<u>879,852</u>
Profit Before Taxes	80,000	80,095	80,148
Inventory	86,667	85,800	86,667
Accounts Receivable	246,575	246,575	244,110

Exhibit 13

Profit Planning Group

Different Management Actions
That Produce The Same Profit

<u>Improvement Area</u>	<u>Improvement %</u>
Pricing	1.0
Buying	1.8
Unit Sales	2.3
Fixed Costs	2.6
Inventory	190.9
Accounts Receivable	123.0

Exhibit 14

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

=

500,000
960,000

=

Exhibit 15

Profit Planning Group

The Profitable Sales Response: A Rapid Growth Plan

<u>Summary</u> <u>Income Statement</u>	<u>Current</u>	<u>Potential</u>	<u>Percent</u> <u>Change</u>
Net Sales	2,000,000	2,200,000	10.0
Cost of Goods	<u>1,040,000</u>	<u>1,144,000</u>	<u>10.0</u>
Gross Margin	960,000	1,056,000	10.0
Payroll & Fringes	500,000	528,880	5.8
All Other Expenses	<u>380,000</u>	<u>418,000</u>	<u>10.0</u>
Total Expenses	<u>880,000</u>	<u>946,880</u>	<u>7.6</u>
Profit	80,000	109,120	36.4
PPR	52.1%	50.1%	
Other Expenses	19.0%	19.0%	

Exhibit 16

Profit Planning Group

The Profitable Sales Response:
A Moderate Growth Plan

Summary <u>Income Statement</u>	<u>Current</u>	<u>Potential</u>	Percent <u>Change</u>
Net Sales	2,000,000	2,100,000	5.0
Cost of Goods	<u>1,040,000</u>	<u>1,092,000</u>	<u>5.0</u>
Gross Margin	960,000	1,008,000	5.0
Payroll & Fringes	500,000	504,840	1.0
All Other Expenses	<u>380,000</u>	<u>399,000</u>	<u>5.0</u>
Total Expenses	<u>880,000</u>	<u>903,840</u>	<u>2.7</u>
Profit	80,000	104,160	30.2

Exhibit 17

Profit Planning Group

The Profitable Sales Response:
A Downsizing Response

Summary <u>Income Statement</u>	<u>Current</u>	<u>Potential</u>	Percent <u>Change</u>
Net Sales	2,000,000	2,000,000	0.0
Cost of Goods	<u>1,040,000</u>	<u>1,040,000</u>	<u>0.0</u>
Gross Margin	960,000	960,000	0.0
Payroll & Fringes	500,000	480,800	-3.8
All Other Expenses	<u>380,000</u>	<u>380,000</u>	0.0
Total Expenses	<u>880,000</u>	<u>860,800</u>	<u>-2.2</u>
Profit	80,000	99,200	24.0

Exhibit 18

Profit Planning Group

The Relationship Between a PPR Reduction and Return on Assets

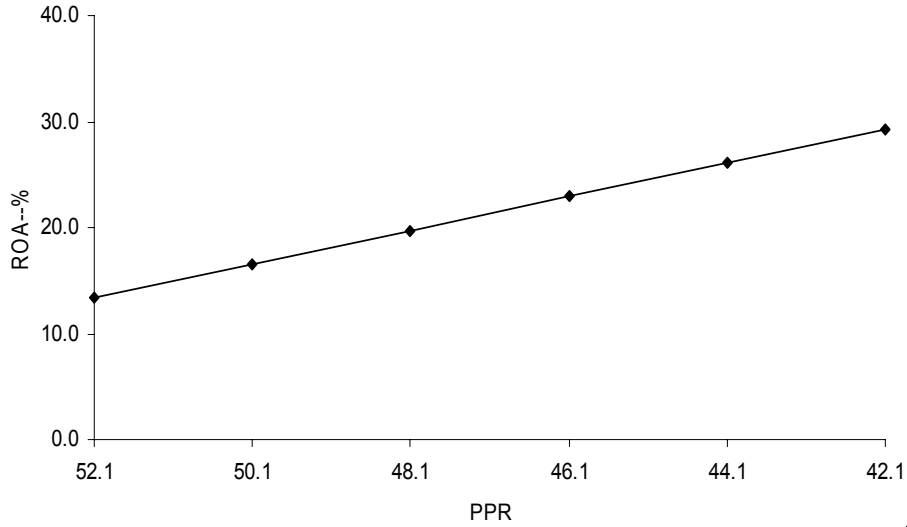


Exhibit 19

Profit Planning Group

Sales Volume Sensitivity: A Negative View

Summary <u>Income Statement</u>	<u>Current</u>	<u>Potential</u>	<u>Percent Change</u>
Net Sales	2,000,000	2,100,000	5.0
Cost of Goods	<u>1,040,000</u>	<u>1,092,000</u>	5.0
Gross Margin	960,000	1,008,000	5.0
Payroll and Fringes	500,000	545,160	9.0
All Other Expenses	<u>380,000</u>	<u>399,000</u>	5.0
Total Expenses	<u>880,000</u>	<u>944,160</u>	7.3
Profit	80,000	63,840	-20.2
PPR	52.1%	54.1%	
Other	19.0%	19.0%	

Exhibit 20

Profit Planning Group

Profitability in Relationship to Workload

	<u>Total Firm</u>	<u>Per Job</u>
Net Sales	2,000,000	2,500.00
Gross Margin	960,000	1,200.00
Total Expenses	880,000	1,100.00
Profit Before Taxes	80,000	100.00

Exhibit 21

Profit Planning Group

Producing a Real Sales Gain

Assumptions

Average Job	\$2,500.00
Close Rate	50.0%

The Real Sales Gain Pressure Points

	<u>Current</u>	<u>Potential</u>
Net Sales	2,000,000	_____
Average Job	_____	_____
Number of Jobs	_____	_____
Close Rate	50.0%	_____
Prospects	_____	_____

Exhibit 22

Profit Planning Group

The Impact of a 5% Price Cut

Summary <u>Income Statement</u>	<u>Current</u>	<u>Worst Case</u>	<u>Possible Case</u>
Average Transaction	2,500	2,375	2,375
Cost of Goods per Transaction	1,300	1,300	1,300
Number of Transactions	800	800	906
Net Sales	2,000,000	1,900,000	
Cost of Goods Sold	<u>1,040,000</u>	<u>1,040,000</u>	
Gross Margin	960,000	860,000	
Variable Expenses	180,000	171,000	
Fixed Expenses	<u>700,000</u>	<u>700,000</u>	
Total Expenses	<u>880,000</u>	<u>871,000</u>	
Profit Before Taxes	80,000	-11,000	

Exhibit 23

Profit Planning Group

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

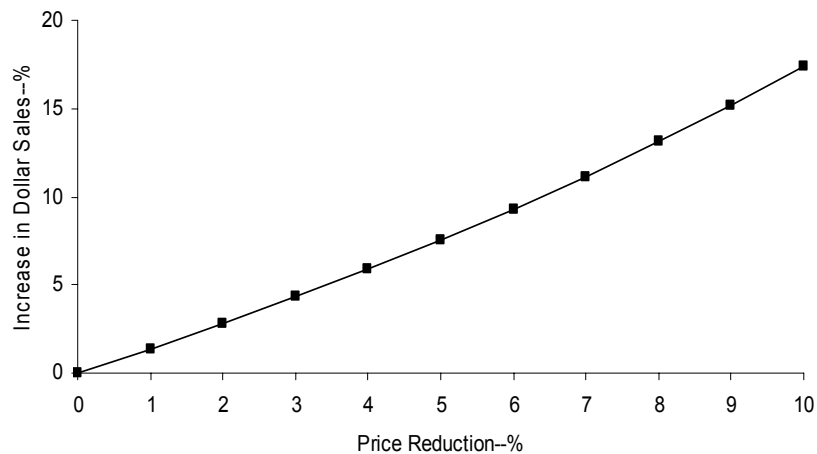


Exhibit 24

Profit Planning Group

An Illustrative Gross Margin Improvement

<u>Summary Income Statement</u>	<u>Current</u>	<u>Buying Potential</u>	<u>Pricing Potential</u>
Gross Margin %	48.0	48.5	48.5
Net Sales	2,000,000	2,000,000	
Cost of Goods Sold	<u>1,040,000</u>		<u>1,040,000</u>
Gross Margin	960,000	970,000	
Variable Expenses	180,000		
Fixed Expenses	<u>700,000</u>		
Total Expenses	<u>880,000</u>		
Profit Before Taxes	80,000		

Exhibit 25

Profit Planning Group

The Relationship Between Gross Margin and Return on Assets

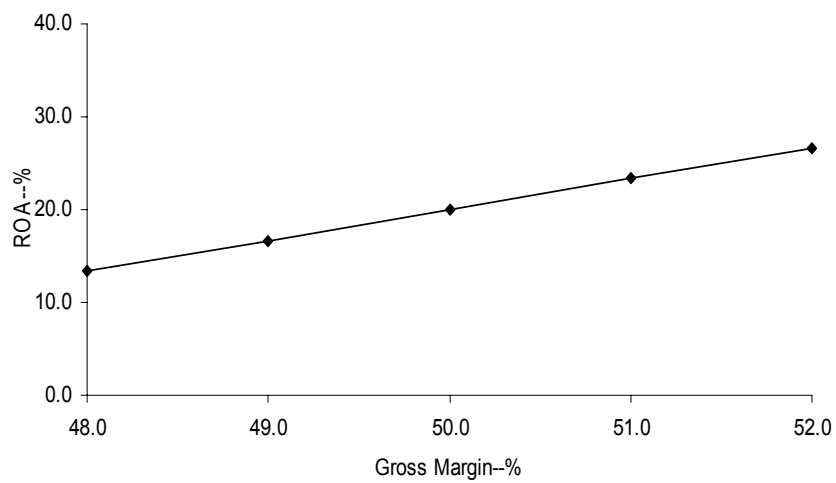


Exhibit 26

Profit Planning Group

The Impact of Gross Margin on the PPR

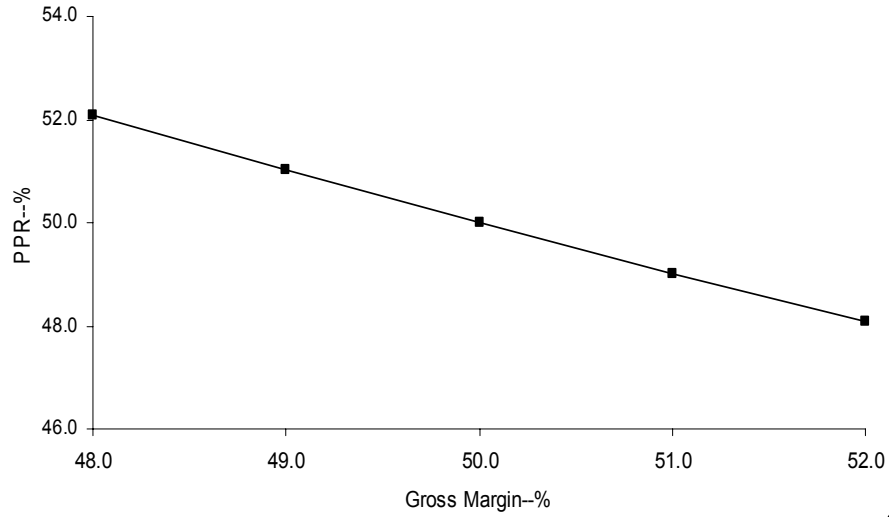


Exhibit 27

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	2,000,000	2,000,000	0.0
Cost of Goods	<u>1,040,000</u>	<u>1,020,000</u>	-1.9
Gross Margin	960,000	980,000	2.1
Payroll & Fringes	500,000	500,000	0.0
All Other Expenses	<u>380,000</u>	<u>380,000</u>	0.0
Total Expenses	<u>880,000</u>	<u>880,000</u>	0.0
Profit	80,000	100,000	25.0
Gross Margin	48.0%	49.0%	
PPR	52.1%	51.0%	

Exhibit 28

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	1,200,000	45.0	540,000	1,200,000	540,000
B	400,000	48.0	192,000	400,000	192,000
C	300,000	55.0	165,000	300,000	165,000
D	<u>100,000</u>	<u>63.0</u>	<u>63,000</u>		
Total	2,000,000	48.0	960,000		

Exhibit 29

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	1,200,000	45.0	540,000	1,200,000	540,000
B	400,000	48.0	192,000	400,000	192,000
C	300,000	55.0	165,000	300,000	165,000
D	<u>100,000</u>	<u>63.0</u>	<u>63,000</u>		
Total	2,000,000	48.0	960,000		

Exhibit 30

Profit Planning Group

Common Characteristics of Blind Items

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

Exhibit 31

Profit Planning Group

Improving Gross Margin By Controlling Sales Force Pricing Decisions

<u>Summary</u> <u>Income Statement</u>	<u>Current</u>	Unnecessary 5% <u>Price Cut</u>
Net Sales	2,000,000	1,900,000
Cost of Goods Sold	<u>1,040,000</u>	
Gross Margin	960,000	
Commissions 10.0% of G. M.	96,000	
Other Variable Expenses 4.2% of Sales	84,000	
Fixed Expenses	<u>700,000</u>	
Total Expenses	<u>880,000</u>	
Profit Before Taxes	80,000	

Exhibit 32

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	2,000,000	2,060,000	2,100,000
Cost of Goods Sold	<u>1,040,000</u>	<u>1,092,000</u>	<u>1,092,000</u>
Gross Margin	960,000	968,000	1,008,000
Fixed Expenses	700,000	700,000	700,000
Variable Expenses	<u>180,000</u>	<u>185,400</u>	<u>189,000</u>
Total Expenses	<u>880,000</u>	<u>885,400</u>	<u>889,000</u>
Profit Before Taxes	80,000	82,600	

Exhibit 33

Profit Planning Group

Inventory Turnover at the Item Level

Yearly Sales	1,000	Units
Selling Price	\$80	
Purchase Price	\$60	
Average Units on Hand		
March	170	
June	210	
September	250	
December	170	
Average	200	

Turnover = $\frac{\text{Units Sold}}{\text{Units on Hand}}$ = _____

$\frac{\text{Cost of Goods}}{\text{Inventory}}$ = _____

Exhibit 34

Profit Planning Group

Measuring Inventory Performance

Inventory Turnover The number of times during the year
the inventory physically sells out

$$\frac{\text{Cost of Goods Sold On Stocked Sales}}{\text{Average Inventory During the Year}}$$

$$\frac{520,000}{86,667}$$

Weeks of Inventory Number of Weeks of Supply on Hand

$$\frac{52 \text{ Weeks in a Year}}{\text{Inventory Turnover}}$$

$$\frac{52}{6.0}$$

Exhibit 35

Profit Planning Group

The Impact of Inventory on Profitability

<u>Item</u>	<u>Calculation</u>	<u>Amount</u>
1 Stocked Sales		1,000,000
2 Cost of Goods		520,000
3 Turnover		6.0
4 Required Inventory	(2 / 3)	86,667
5 Target Turnover		7.0
6 Target Inventory	(2 / 5)	74,286
7 Inventory Reduction	(4 - 6)	12,381
8 Carrying Cost		11.0
9 Profit Impact	(7 X 8)	1,362

Exhibit 36

Profit Planning Group

Pareto's Law and Inventory Planning

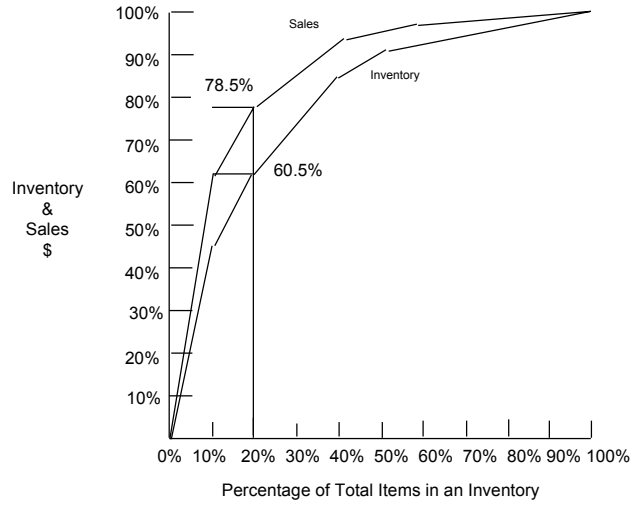


Exhibit 37

Profit Planning Group

The Relationship Between Inventory Turnover and Return on Assets

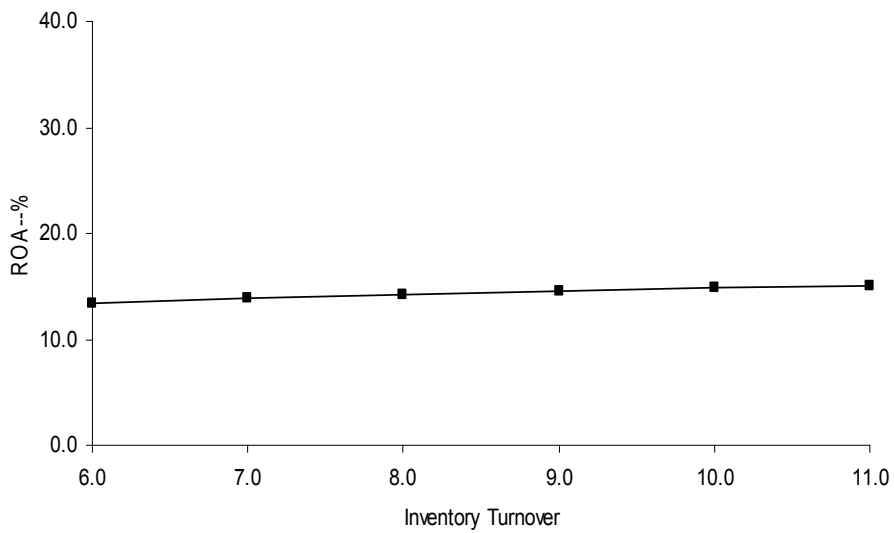


Exhibit 38

Profit Planning Group

Measuring Accounts Receivable Performance

Collections per Day Amount Received Each Day From
Prior Credit Sales

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

$$\frac{2,000,000}{365}$$

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

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

$$\frac{246,575}{5,479}$$

Exhibit 39

Profit Planning Group

The Impact of Accounts Receivable On Profitability

<u>Item</u>	<u>Calculation</u>	<u>Amount</u>
1 Collections per Day		5,479
2 Collection Period		45.0
3 Accts. Receivable	(1 X 2)	246,575
4 Target Collect Period		40.0
5 Target Accts. Rec.	(1 X 4)	219,178
6 Reduction	(3 - 5)	27,397
7 Interest Rate		6.0
8 Profit Impact	(6 X 7)	1,644

Exhibit 40

Profit Planning Group

What If Collections Causes Sales to Fall?

Profit Improvement
From Faster Collections
1,644

	<u>Current</u>	<u>Sales Decline</u>	
		<u>5%</u>	<u>1%</u>
Net Sales	2,000,000	1,900,000	1,980,000
Cost of Goods Sold	<u>1,040,000</u>	<u>988,000</u>	<u>1,029,600</u>
Gross Margin	960,000	912,000	950,400
Fixed Expenses	700,000	700,000	700,000
Variable Expenses	<u>180,000</u>	<u>171,000</u>	<u>178,200</u>
Total Expenses	<u>880,000</u>	<u>871,000</u>	<u>878,200</u>
Profit Before Taxes	80,000	41,000	72,200
Change in Profit		-39,000	-7,800

Exhibit 41

Profit Planning Group

Measuring the Break-Even Point For a Sales Decline

New Sales Equals:

$$\frac{\text{Fixed Expenses} + \text{Current Profit} - \text{Gain From Collections}}{\text{Gross Margin \%} - \text{Variable Expense \%}}$$

700,000	+	80,000	-	1,644
		48.0%	-	9.0%
<u>778,356</u>	=	1,995,785	=	-0.2%
39.0%				

Exhibit 42

Profit Planning Group

The Sales Increase Required to Offset a Bad Debt Loss

Dumb Answer

$\frac{\text{Accounts Receivable Loss}}{\text{PBT \%}}$

$\frac{25,000}{4.0\%}$

Smart Answer

$\frac{\text{Accounts Receivable Loss}}{\text{GM\% - Variable Expense \%}}$

$\frac{25,000}{39.0\%}$

Exhibit 43

Profit Planning Group

The Relationship Between The Collection Period and Return on Assets

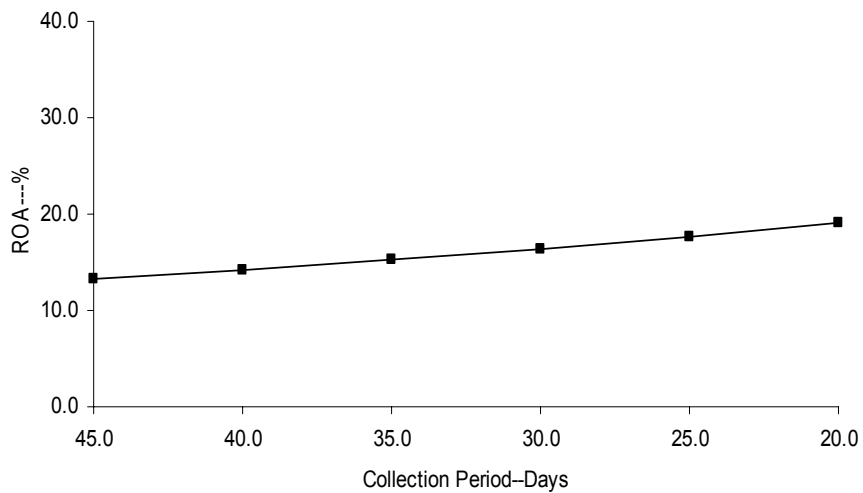


Exhibit 44

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

Sales Increase %	5.0
Gross Margin %	0.5
PPR	-2.0
Other Expense %	-0.2
Inventory Turnover	0.0
AR Collection Days	0.0

Exhibit 45

Profit Planning Group

**The Impact of Making
The Mandated Changes**

	<u>2006</u>	<u>2007</u>	<u>2011</u>
Net Sales	2,000,000	2,100,000	2,552,563
Cost of Goods	<u>1,040,000</u>	<u>1,081,500</u>	<u>1,263,519</u>
Gross Margin	960,000	1,018,500	1,289,044
Payroll & Fringes	500,000	510,099	542,473
All Other Expenses	<u>380,000</u>	<u>394,800</u>	<u>459,461</u>
Total Expenses	<u>880,000</u>	<u>904,899</u>	<u>1,001,934</u>
Profit	80,000	113,601	287,110
Cash	30,000	31,500	38,288
Accounts Receivable	246,575	258,904	314,700
Inventory	86,667	90,125	105,293
Other Current Assets	<u>3,000</u>	<u>3,000</u>	<u>3,000</u>
Total Current Assets	366,242	383,529	461,281
Fixed Assets	<u>233,758</u>	<u>245,446</u>	<u>298,341</u>
Total Assets	600,000	628,975	759,622
Return on Assets	13.3	18.1	

Exhibit 46

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Summary and Conclusions

A PDF file of this seminar will be available for one month
on our web site: www.profitplanninggroup.com
Go to the seminars section

Exhibit 47

Profit Planning Group

Who Is This Guy?

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.

Exhibit 48

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