

A Simpler Path to Profitability – The Team Approach to Significantly Improve Financial Performance

NTMA St. Louis Chapter

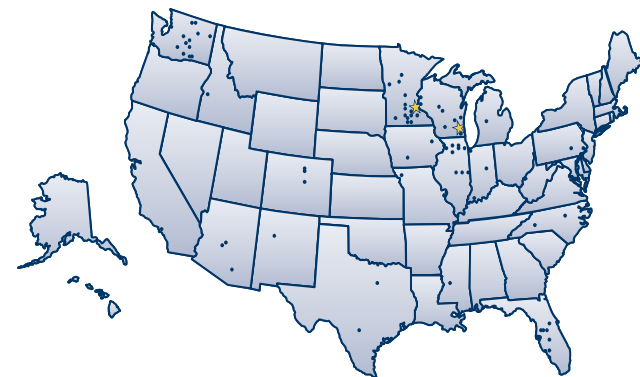
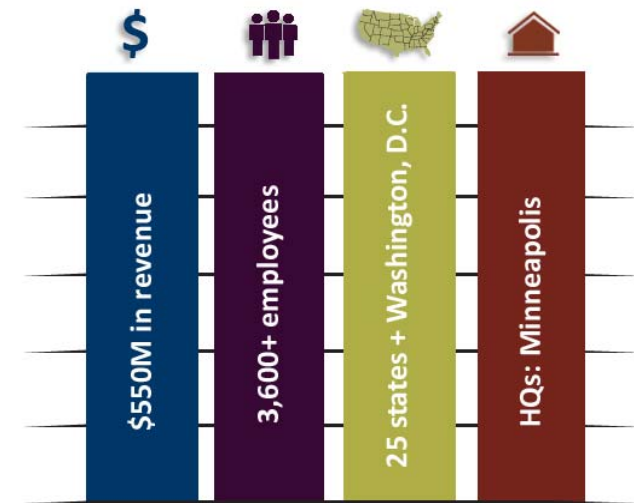


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About CliftonLarsonAllen LLP

- Professional services firm ***focused on privately held businesses and their owners / leaders.***
- ***Three integrated service lines:***
 - Audit, tax and advisory
 - Wealth advisory
 - Outsourcing
- ***Industry specialized*** – we serve over 5,500 Manufacturing and Distribution businesses.



A Seamless Approach to Serving Clients

We *simplify the complex* and help business owners and leaders:

- *Improve profitability*
- *Reduce risk*
- *Build business value*
- *Plan for transition*

Why this topic?

Profitability is critical to long-term growth and sustainability. The industry struggles with profitability yet has:

- Available capacity
- Revenue concentrations
- Growing sales with no growth in profitability
- Workforce development struggles

**Our biases about how we make money
impacts all of the above!**

Common signs of significant opportunity...

- “I don’t know how my competitors can produce it so cheaply. They must be losing their shirts on it.”
- “We tend to focus on the complicated, highly engineered products, because we can’t make money on the easy stuff.”
 - “We won’t take any business that doesn’t have at least a XX% gross margin.”
- “We need to keep investing in bigger and faster equipment to drive costs down.”
- “Monthly financials are hard to interpret and never seem to correlate with activity on the floor.”
- “Sales, finance and operations all seem to have different opinions on what is profitable work.”

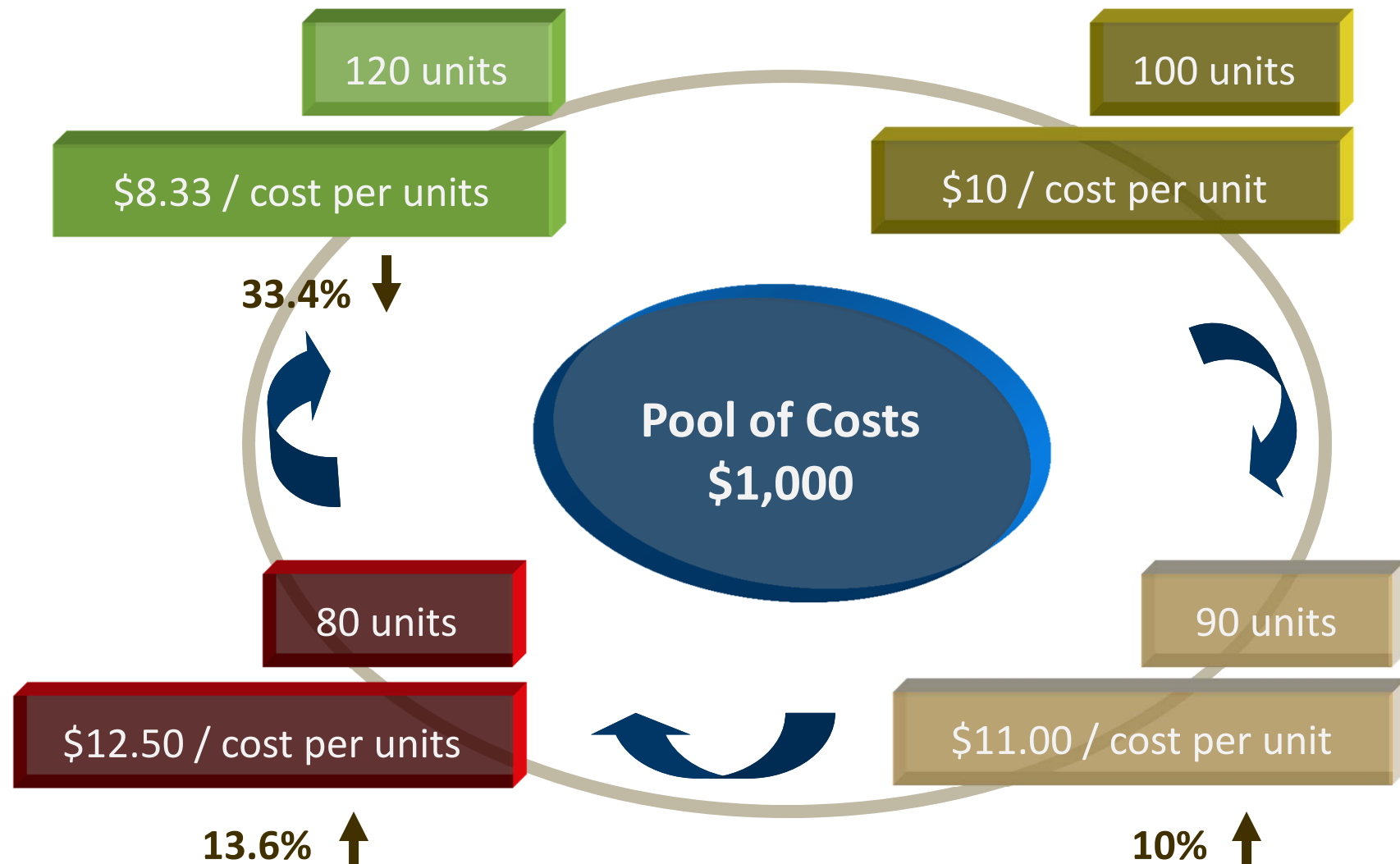
There are 3 drivers of profitability

- Cost structure **(Finance)**
- Capacity **(Operations)**
- Pricing **(Sales)**

To improve profitability, you must **actively manage** all 3 areas!

We have built in leadership in all 3 areas – ***working together*** can create great outcomes!

Job Costing vs. Profit Management



**But Erik, the previous example
is far too simple. In the real
world, things are much more
dynamic and complex!**

Let's get real...

- \$31M multi-capability precision metal fabricator
- Located in a rural community
- High mix, low volume work
- Recent losses and significant variability in profitability
- Sophisticated costing system allocated costs by process / capability
- One customer accounted for 24% of volume, ***and that customer was beginning to ask a lot of questions...***

What would you do?

	Quarter 1	Quarter 2	Quarter 3	Quarter 4	Annual Total
Sales	\$ 7,644,000	\$ 8,360,000	\$ 8,128,000	\$ 7,056,000	\$ 31,188,000
Cost of Goods Sold	(7,114,000)	(7,094,000)	(6,991,000)	(6,571,000)	(27,770,000)
Gross Margin	530,000	1,266,000	1,137,000	485,000	3,418,000
Margin %	6.9%	15.1%	14.0%	6.9%	11.0%
Selling, General & Admin Expense	(917,000)	(903,000)	(935,000)	(882,000)	(3,637,000)
Net Income	\$ (387,000)	\$ 363,000	\$ 202,000	\$ (397,000)	\$ (219,000)

Key Observation: Does this information give you the insight you need to make significant pricing, customer or operational decisions?

To improve profitability, we need to understand and manage:

- Our cost structure
- Our capacity
- Our pricing

First, let's understand the Cost Structure...

	Quarter 1	Quarter 2	Quarter 3	Quarter 4	Annual Total
Sales	\$ 7,644,000	\$ 8,360,000	\$ 8,128,000	\$ 7,056,000	\$ 31,188,000
Materials and Subcontract	(2,984,000)	(2,975,000)	(2,897,000)	(2,407,000)	(11,263,000)
Value-Added Revenue	4,660,000	5,385,000	5,231,000	4,649,000	19,925,000
% of Revenue	61.0%	64.4%	64.4%	65.9%	63.9%
All Other Costs	5,047,000	5,022,000	5,029,000	5,046,000	20,144,000
Net Income	\$ (387,000)	\$ 363,000	\$ 202,000	\$ (397,000)	\$ (219,000)

Key Observation: Value-added revenue as a % of revenue is fairly consistent, and all other costs don't vary much with activity.

Next, let's understand capacity...

Hours Applied Each Quarter	71,000	80,000	78,000	71,000	300,000
Hours of Capacity Available	87,500	87,500	87,500	87,500	350,000
% Utilization	81.1%	91.4%	89.1%	81.1%	85.7%

Key Observation: Each quarter the Company operated with excess capacity. Said another way, the Company paid for capacity (people, plant, equipment) that it never used (and the customer was not willing to pay for).

And last, let's understand pricing...

	Quarter 1	Quarter 2	Quarter 3	Quarter 4	Annual Total
Sales	\$ 7,644,000	\$ 8,360,000	\$ 8,128,000	\$ 7,056,000	\$ 31,188,000
Materials and	(2,984,000)	(2,975,000)	(2,897,000)	(2,407,000)	(11,263,000)
Value-Added					
Revenue	4,660,000	5,385,000	5,231,000	4,649,000	19,925,000
Hours Applied Each					
Quarter	71,000	80,000	78,000	71,000	300,000
Earned Rate per					
Hour	\$ 65.63	\$ 67.31	\$ 67.06	\$ 65.48	\$ 66.42

Key Observation: The Company's earned rate per hour was well above what they thought they were quoting, and surprisingly consistent given the high variety of work they were performing.

So what did they do?

- Immediately began analyzing quoting differently
 - ***Earned rate per hour*** along with margin %
 - High material content jobs were a focus
- Focus was on filling the shop
 - ***Capacity was actively monitored*** in each location and compared with backlog / active demand
 - Targeted areas that were perpetually underutilized
- Reduced certain cost structure (excess warehouse space)
- Targeted expanding relationships with existing customers

The results were pretty impressive...

	Quarter 1	Quarter 2	Quarter 3	Quarter 4	Annual Total
Sales	\$ 8,505,200	\$ 9,943,343	\$ 9,552,661	\$ 9,229,134	\$ 37,230,338
Materials and	(3,154,737)	(3,776,276)	(3,808,129)	(4,066,854)	(14,805,996)
Value-Added	5,350,463	6,167,067	5,744,532	5,162,280	22,424,342
% of Revenue	62.9%	62.0%	60.1%	55.9%	60.2%
All Other Costs	4,836,299	5,121,615	4,872,906	4,392,707	19,223,527
Net Income	\$ 514,164	\$ 1,045,452	\$ 871,626	\$ 769,573	\$ 3,200,815
Hours Applied Each Quarter	83,072	96,446	89,878	84,842	354,238
Earned Rate per Hour	\$ 64.41	\$ 63.94	\$ 63.91	\$ 60.85	\$ 63.30

Lessons Learned

- *90% + of profitability came with the last 10% of revenue*
- **Simplifying** financial information made it much more *meaningful and manageable to ALL users*
- How did they do it?
 - Understood their **cost structure, capacity and pricing**
- This took a team effort – **finance, sales and operations** working together to take advantage of opportunity

Example Company Profitability Model

Current-Year Facts

# of Hours	84,367
Total Capacity	140,612
Revenue / Hour	\$145
Material / Hour	\$68
Subcontract Exp / Hour	\$0
Labor / Hour	\$24
Value-Add / Hour	\$76.97

Future-State Scenario

Sales Assumptions:

Add'l Hours /Year	0
Pricing approach	Value-Add
VA Rate on Add'l Hours	\$76.97
Annual or One-Time?	Annual

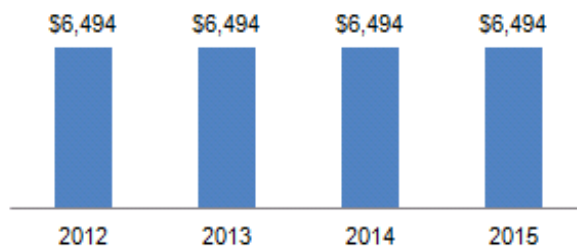
Variable Cost Assumptions:

Add'l Labor costs/Hour	\$0
Add'l Subcontract costs/Hour	\$0
Other add'l costs/Hour	\$0

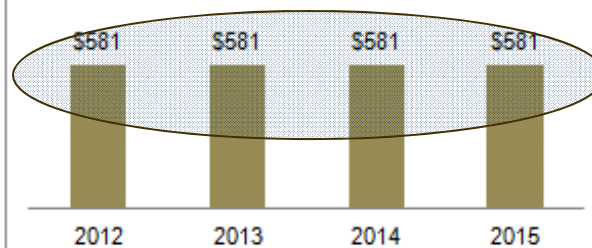
Infrastructure Cost Assumptions:

Add'l Salaries & Wages (,000)	\$0
Capital Investment (,000)	\$0
Depreciation Life (Years)	0
Add'l Hours of capacity	0
Incurred in which year?	2013

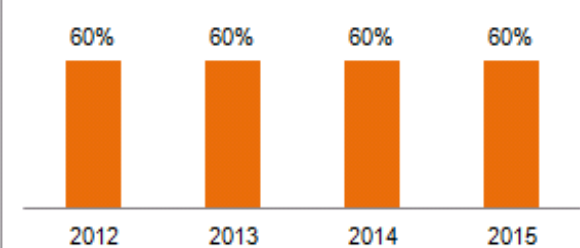
VA Revenue



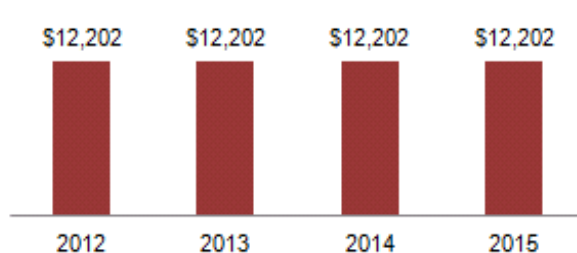
Net Income



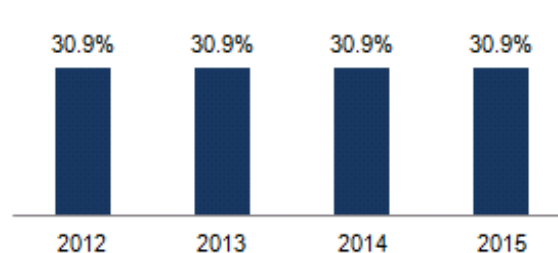
Utilization



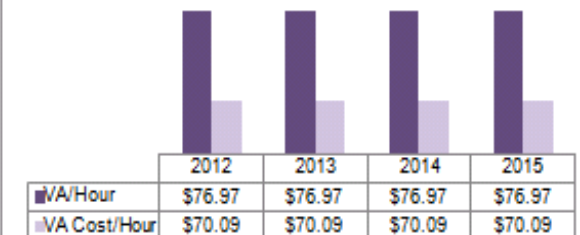
Revenue



Gross Margin %



VA Rate & Cost / Hour



Same Company – at Full Capacity

Current-Year Facts

# of Hours	84,367
Total Capacity	140,612
Revenue / Hour	\$145
Material / Hour	\$68
Subcontract Exp / Hour	\$0
Labor / Hour	\$24
Value-Add / Hour	\$76.97

Future-State Scenario

Sales Assumptions:

Add'l Hours /Year	10,000
Pricing approach	Value-Add
VA Rate on Add'l Hours	\$70.00
Annual or One-Time?	Annual

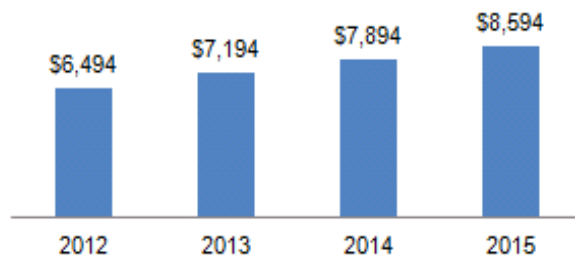
Variable Cost Assumptions:

Add'l Labor costs/Hour	\$20
Add'l Subcontract costs/Hour	\$0
Other add'l costs/Hour	\$0

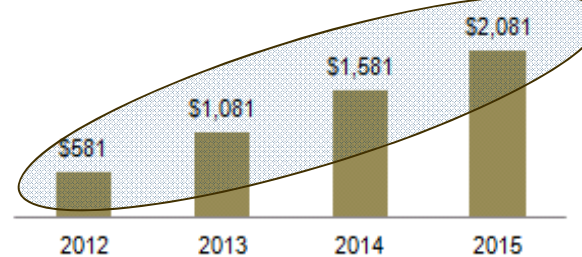
Infrastructure Cost Assumptions:

Add'l Salaries & Wages (,000)	\$0
Capital Investment (,000)	\$0
Depreciation Life (Years)	0
Add'l Hours of capacity	0
Incurred in which year?	2013

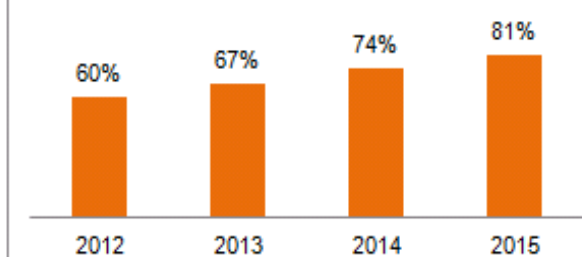
VA Revenue



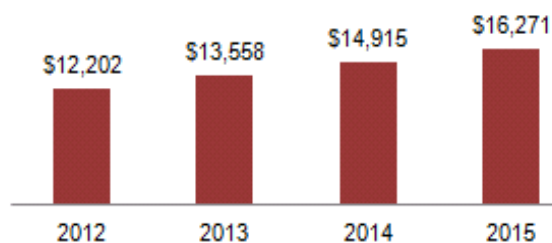
Net Income



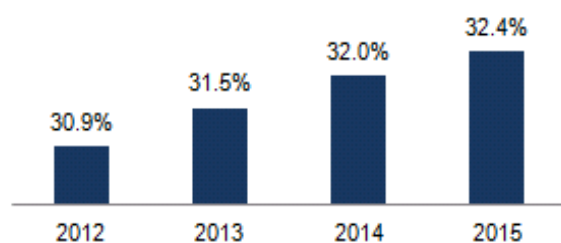
Utilization



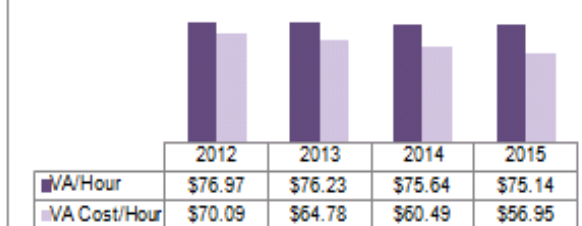
Revenue



Gross Margin %



VA Rate & Cost / Hour



Final Thoughts...

- Your business is much more complex than a lemonade stand, but your profitability model is not
- The three keys to improving profitability
 - Understand your **cost structure**
 - Understand your **capacity**
 - Understand your **pricing**
- Improving profitability is a team sport – ***sales, operations and finance*** work together to win!



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