

New Rules of Business Finance
Securing Capital in Challenging Times
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Executive Summary-1

- We are in a Cyclical and Severe Capital Crunch especially for Middle Market

And we can't control its duration

- We can make our Companies more *profitable*,
less risky, and
more attractive



to Capital Providers

Executive Summary-2

- Any company can improve its **Gross Margin**

And its Operating Margin

- Then we communicate the changes to

Capital Providers

- Our Follow up leads to *Results!*



Agenda

→ **The State of Finance for the Middle Market**

Reducing Risk, Improving Cash Flow

Planning and Execution

Communicating to the Capital Provider



Follow up and *Results!*

Middle Market is Hobbled by “Imperfect Information”

A company’s ability to obtain capital is highly variable because of:

- Lenders’ Changing Risk Tolerance
- Competition
- Lack of Information on Pricing
- “Externalities”

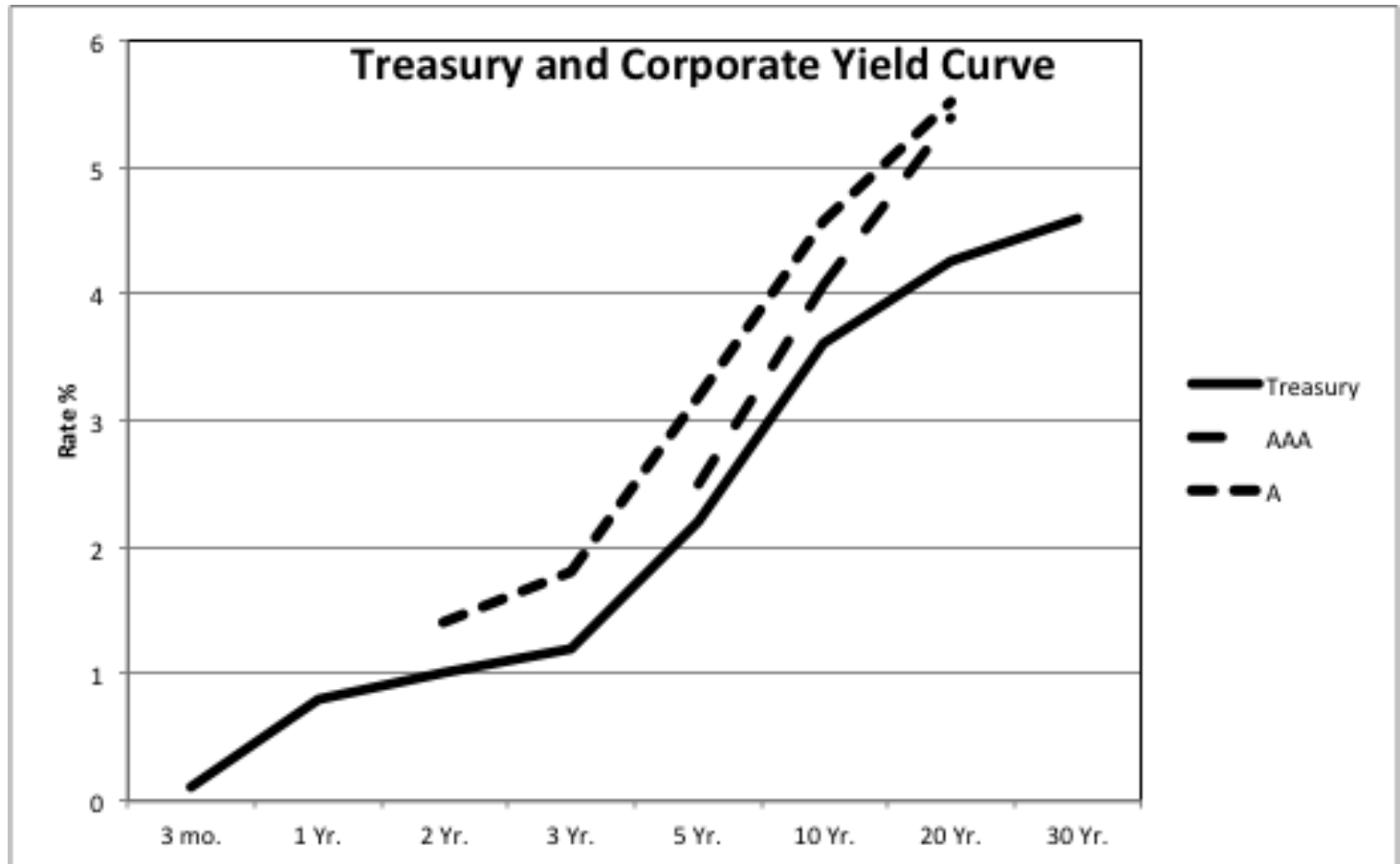


Half of Private Equity’s Challenge is Funding Source

Larger Capital Markets Have Good Information

Yield Curve Shows Risk vs. Return

Rate



Source: Bloomberg April 10, 2011

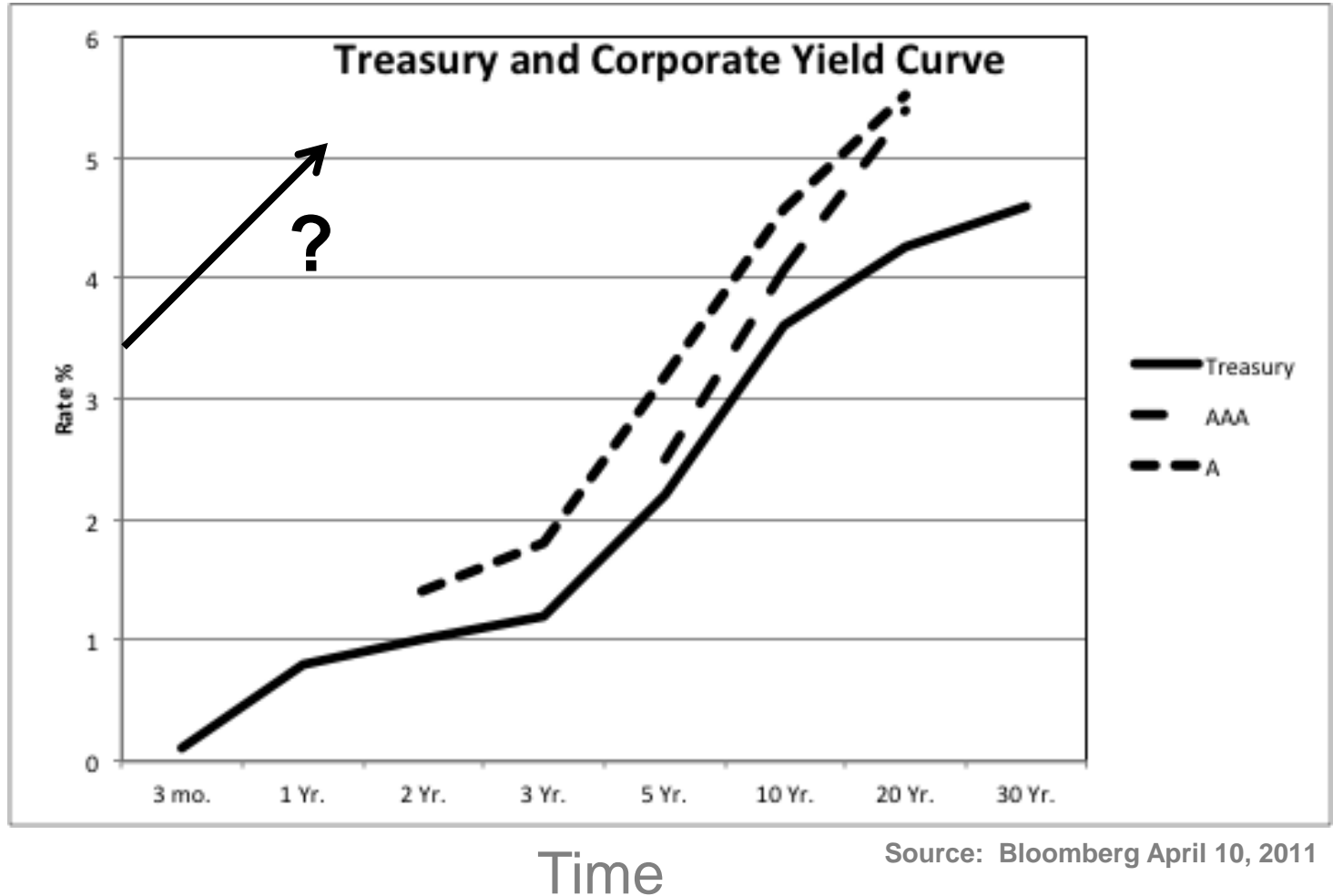
Time



Where is the Middle Market?

Prime is 3.5%

Rate



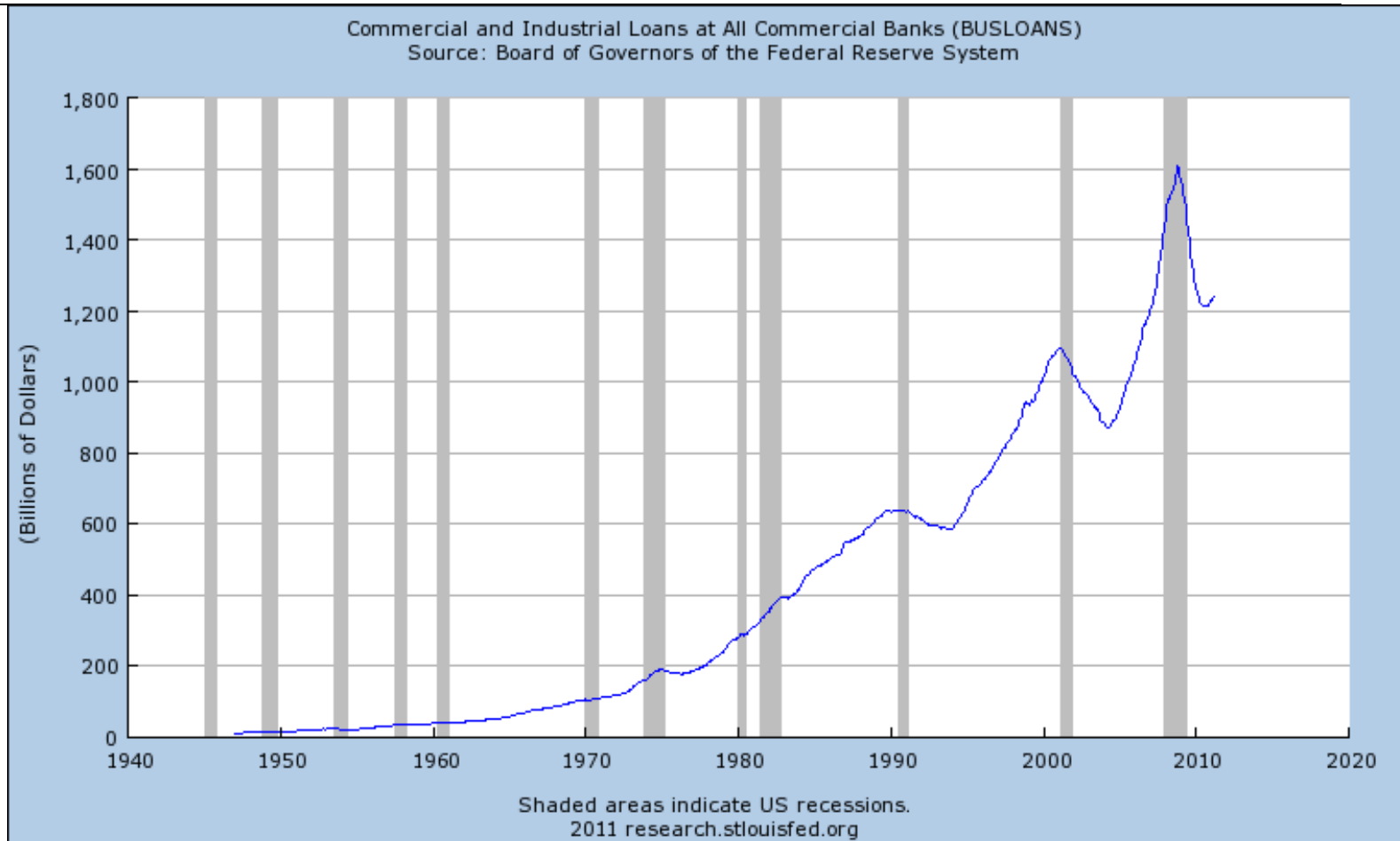
Middle Market has no benchmark for Pricing

In our communities:

- Lenders' Risk Tolerance Highly Variable, from bank to bank and over time
- Competition is mixed
Geography
"Relationship Banking"
- **"Externalities"**
Another periodic capital crunch:
The banks over-lend
The FDIC calls them on it
Capital standards applied
Some Borrowers lose.

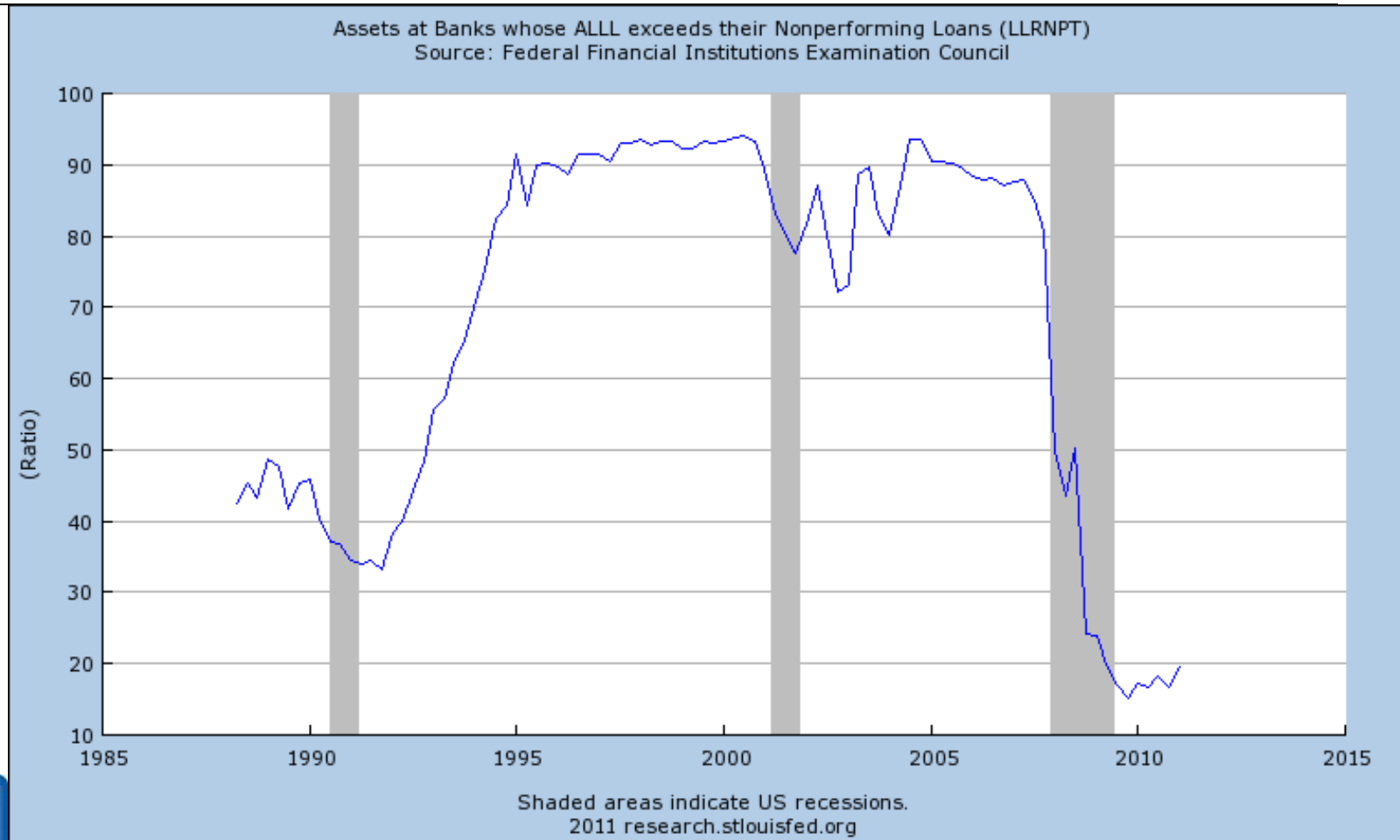


Business Loans Outstanding



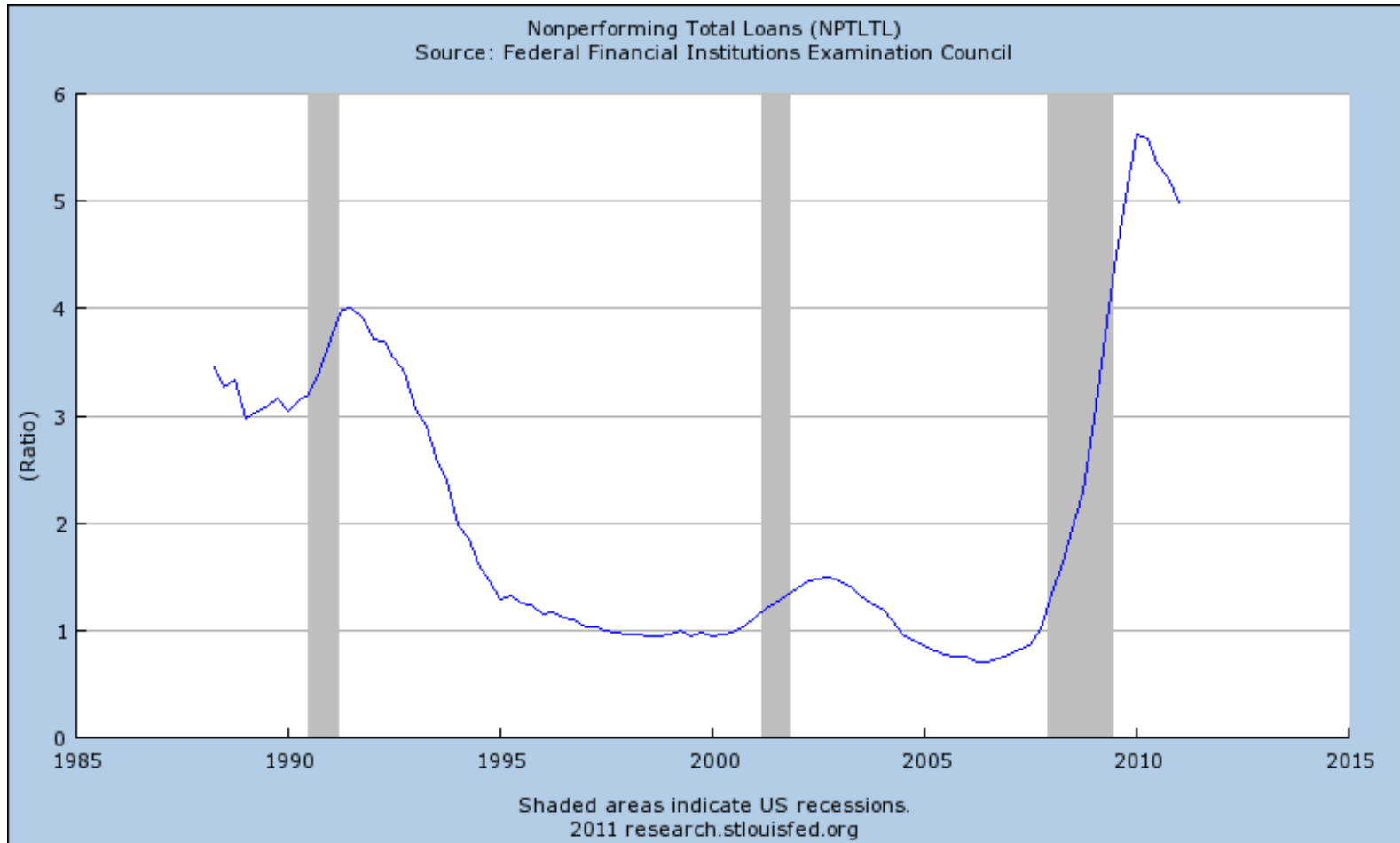
Source: St. Louis Fed

Reserve Adequacy



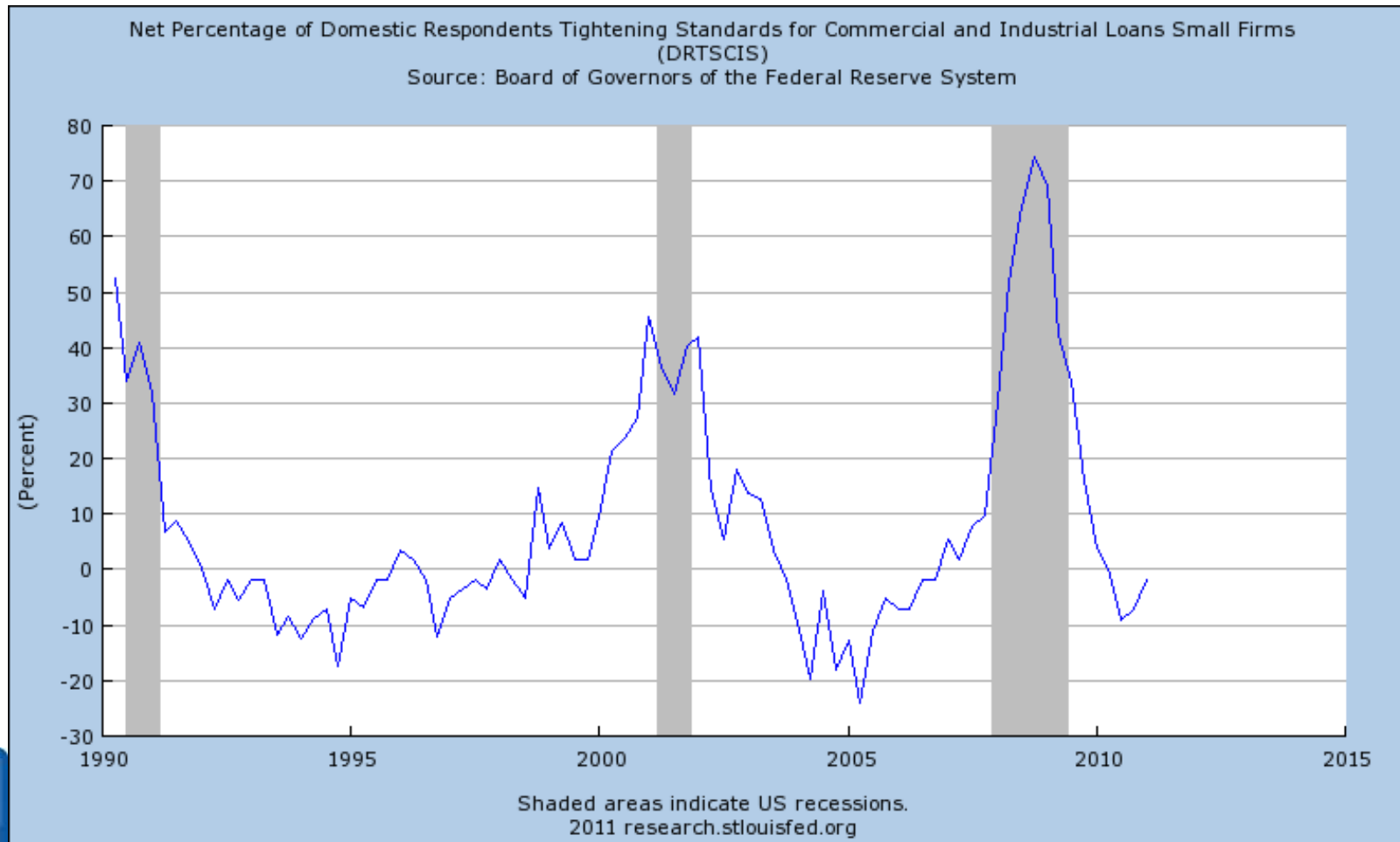
Source: St. Louis Fed

Non-Performing Loans



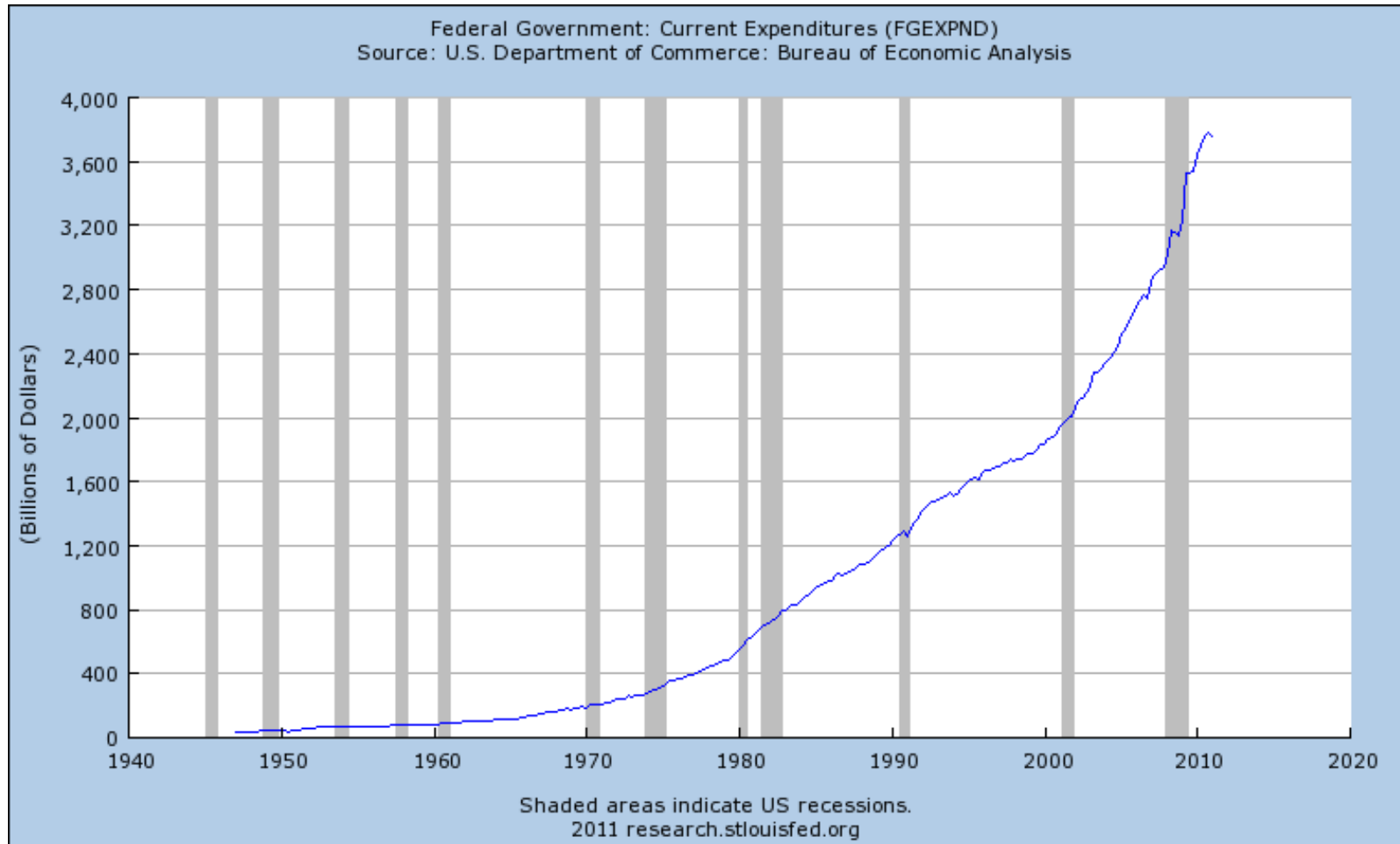
Source: St. Louis Fed

Loan Officer Survey-Tightening Standards-Small Firms



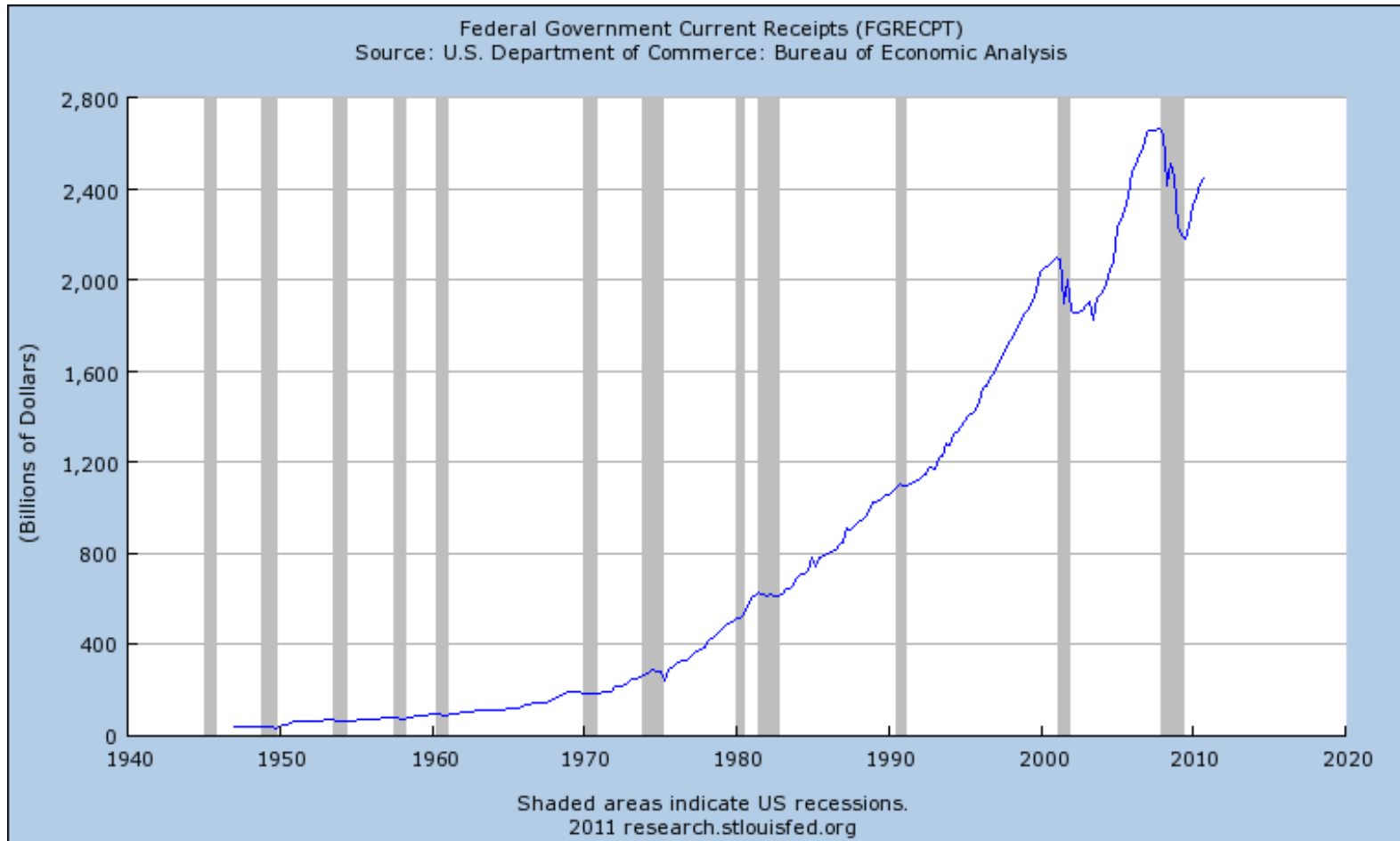
Source: St. Louis Fed

Bonus Round! Federal Spending



Source: St. Louis Fed

Bonus Round! Federal Receipts



Source: St. Louis Fed

Is There a place for relationship Banking?

Mergers

Cyclical Capital Crunches

Changing Personnel

—The key ones? Those you have never met!

New Normal in economic conditions

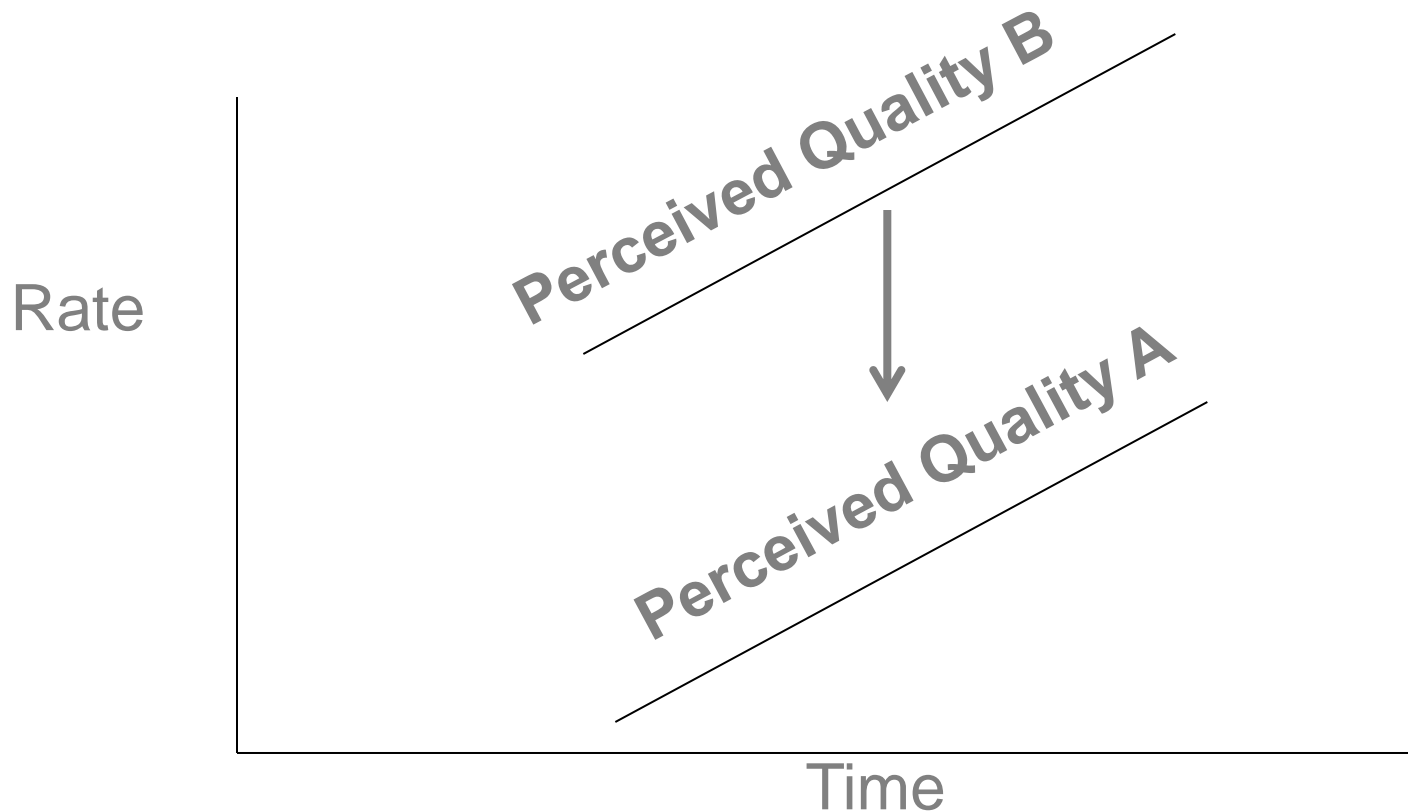
—Drops in demand

—Scary politics



Look for Nationwide Loan Brokers

We Assume Market Forces Still Respond to Reduced Risk



Our Job is To  Cash Flow and  Risk

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We Use the Personal Training Metaphor

For a challenging process



- *An Expert*
- *Who is Objective*
- *And Who Motivates*



Discover what you *Should* improve
Then, turn “*Shoulds*” into “*Musts*”

You Need Two Courses of Action

Profitability Analytics-*Gross Margin*

—We Use proprietary

“Core Products/Core Customer” methodology

Company Optimization-*Operating Margin*

--Using Variety of marketing, Operations,
Organizational improvement techniques



We Frequently Find Two or more 'Companies' under one Roof

Core Business

Stable Client Base

Proven Demand

Established Firm
Advantages

Non-Core Business

Unstable Base

Unproven Demand

Unclear go-to-
Market

Why?

- CEO Enthusiasm or
- Legacy business
- Incomplete merger integration



We use “Core Product/Core Customer” as First Hypothesis

We Show breakdown of Total Profit



“Core Products” born in Printing Co.



Didde-Glaser Web Press, ca. 1980

Family's Printing Co Needed Rescue

Envelopes

Forms

Agencies

Profit

Profit

Media

Loss

Profit

Trade

Loss

(None)



**Core Product/Core Customer the basis of
Company's Performance Improvement Strategy**

“Core Product/Core Customer” are Found for Most Companies

**Key
Buyers**

**Encourage to buy
Better /Take other
actions**

**Core Products/
Core Customers**

**Occasional
Buyers**

Disregard/Exit

**Encourage to buy
Better /Take other
actions**



**Occasional
Products**

**Key
Products**

Performance Improvement for an Engine Distributor

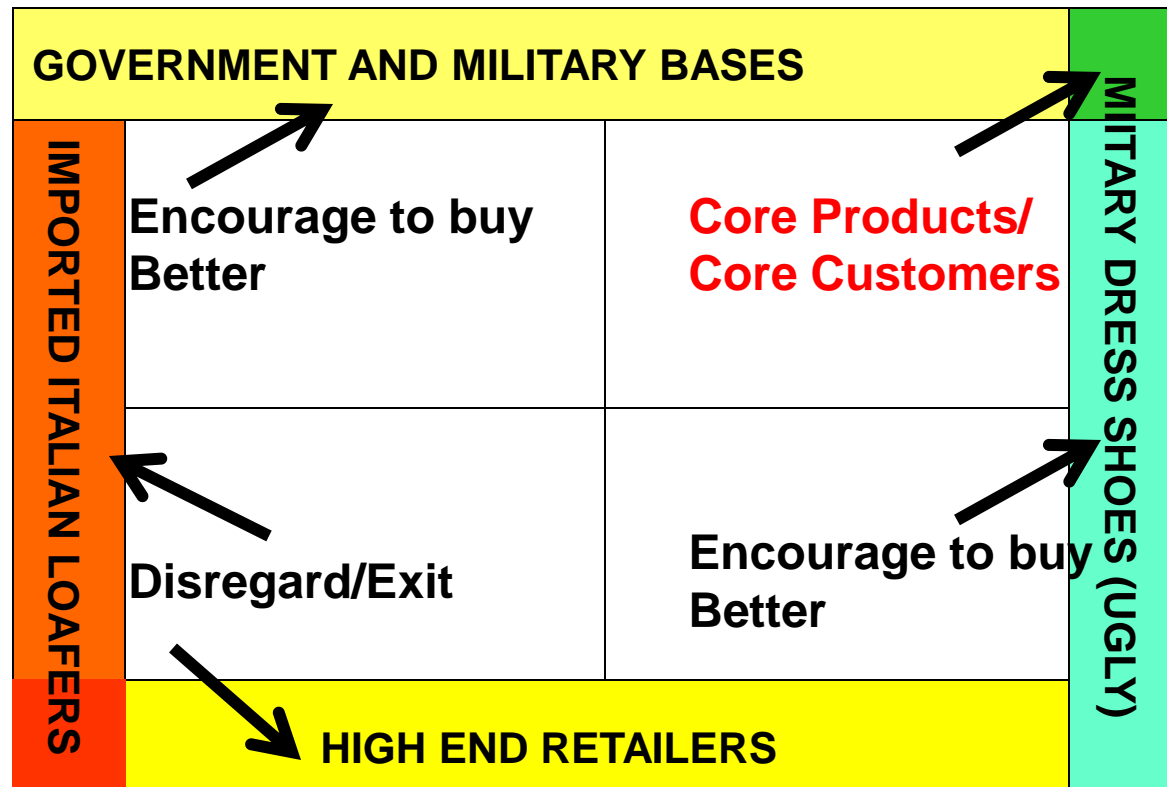
In This Case, 20 Customers x 6 Categories Contributed 60%

CUSTOMERS IN HOUSTON		REPAIR PARTS AND KITS
Encourage to buy Better	Core Products/ Core Customers	
Disregard/Exit	Encourage to buy Better	



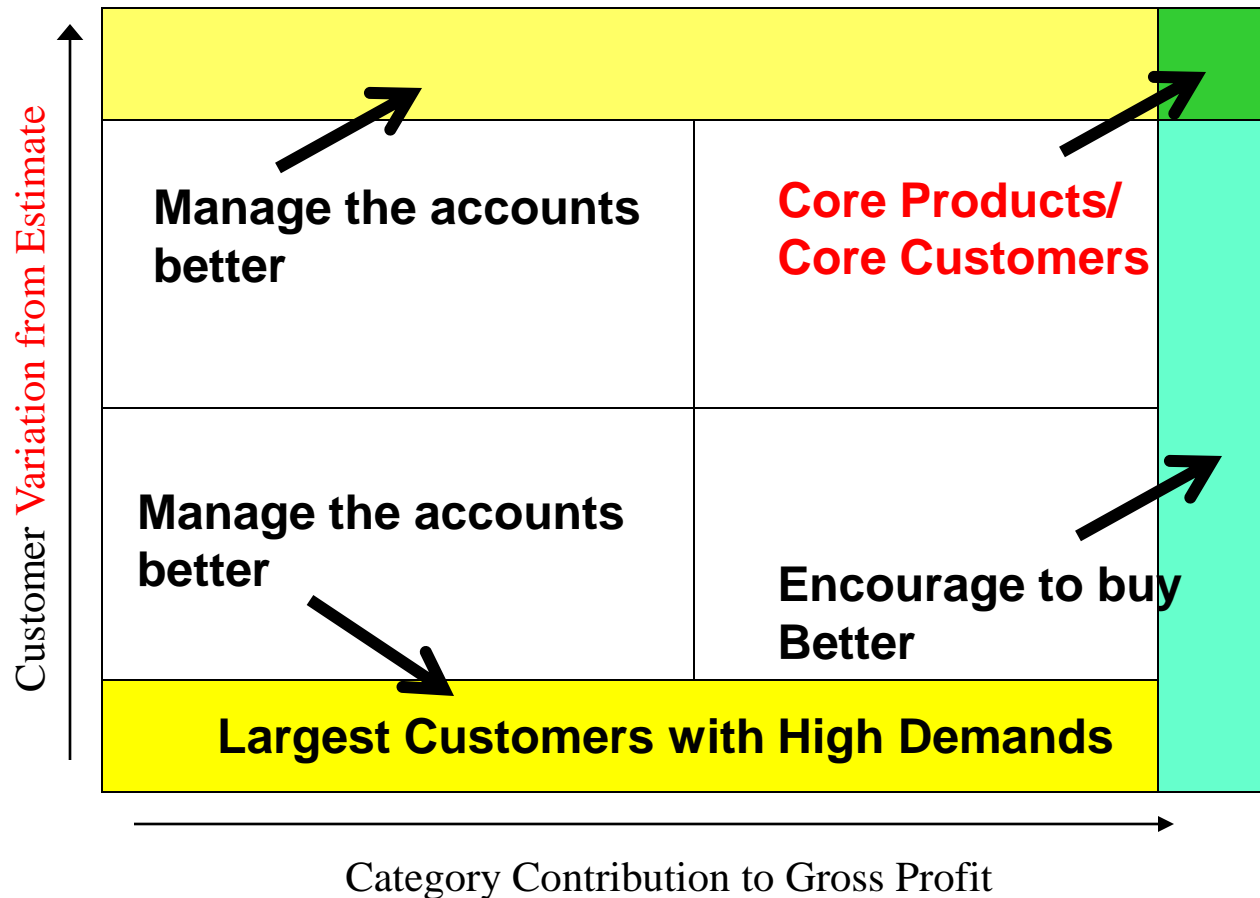
Turnaround Situation—Shoe Manufacturer

Reducing losses Increases total \$ Contribution

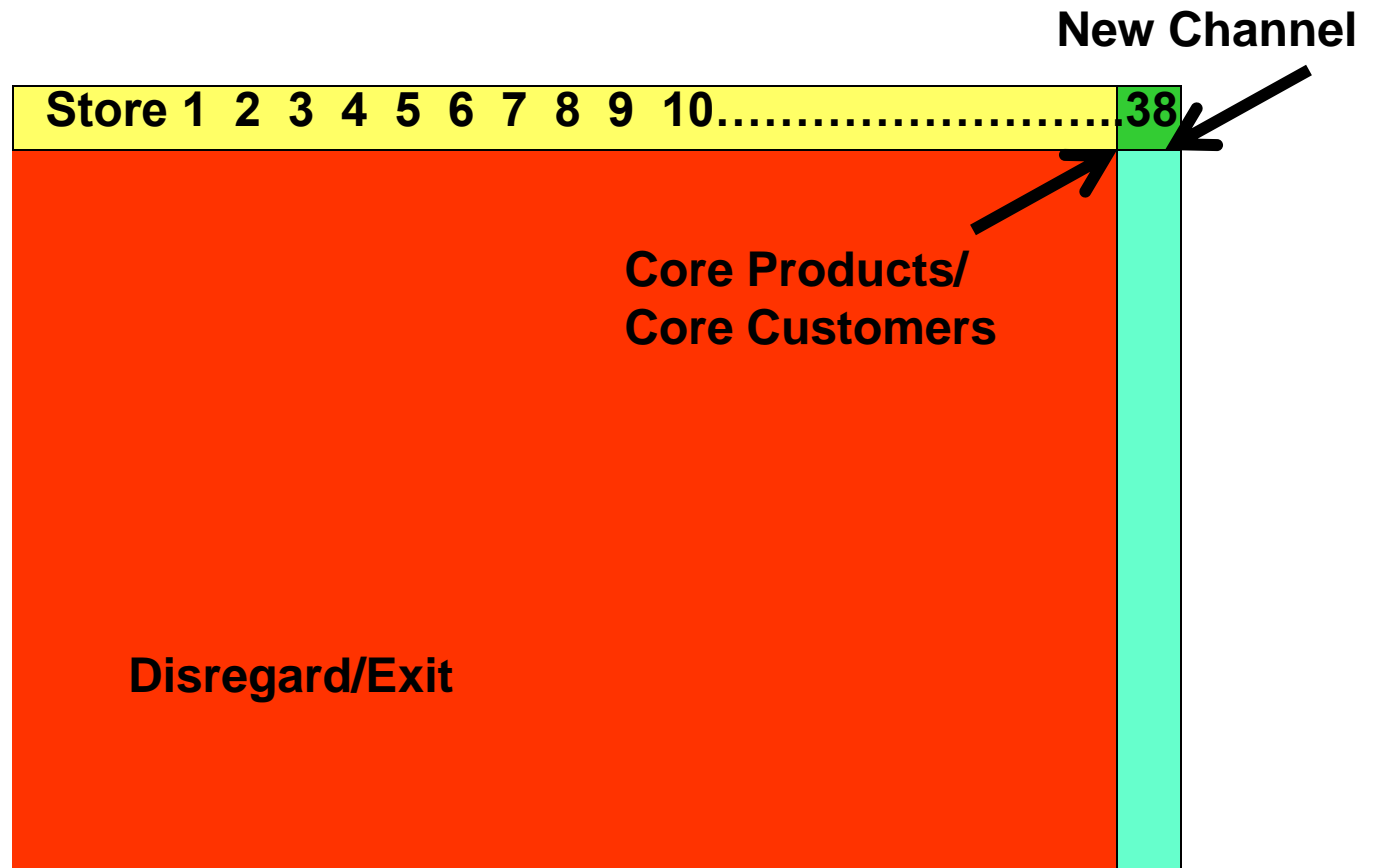


Performance Improvement for Specialty Graphic Arts

Changed to "Sum of Variation from Estimate"



Turnaround Situation Specialty Retailer



Change it up: Restaurant Chain

Changed Definition of Customer to "Time of Day"

6 7 8 9 10	Encourage to buy Better	Core Products/ Core Customers	Breakfast
11 12 1 2 3 4 5 6 7	Disregard/Exit	Encourage to buy Better	



Name 3-5 key Customers, and the Products they buy

Customers



Products



Now Name 3-5 Next Customers, and the Products *they* buy

Customers

Products



For these Different Customers, Consider:

How do You Treat the Customers Differently?

What is the History?

- Different Sales Channel, Salesperson, Pricing, Support, Geography, systems?
- New business, legacy business?

What are Differences in Products?

- Have the products succeeded in the past, or never?
- Technology, demographic, competitive changes?



What *Must* you change?

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Planning and Execution

Communicating to the Capital Provider



Follow up and *Results!*

Three Activities Affect Results

Marketing

Operations

Organization

***Financial
Results***



The Engine Company's Core Product Data Drove Marketing

They asked: What is different between cohorts?

Found Differences in Client

Industry

Geography

Buyer Level

Sales Process

And in Product

Purchase Frequency

Price point

Preferences



Behavioral Analytics result in Better Results, More Desirable M&A Target

Organizational Puzzle

	Family Business	High Tech Business
Governance	Informal	Formal
Communication	Indirect	Direct
Processes	Undeveloped	Highly developed
Values	Loyalty	Performance
Exit strategy	Unplanned	Highly planned
Strategy	Reactive	Proactive
Leadership team	Responsive	Empowered

EXAMPLE

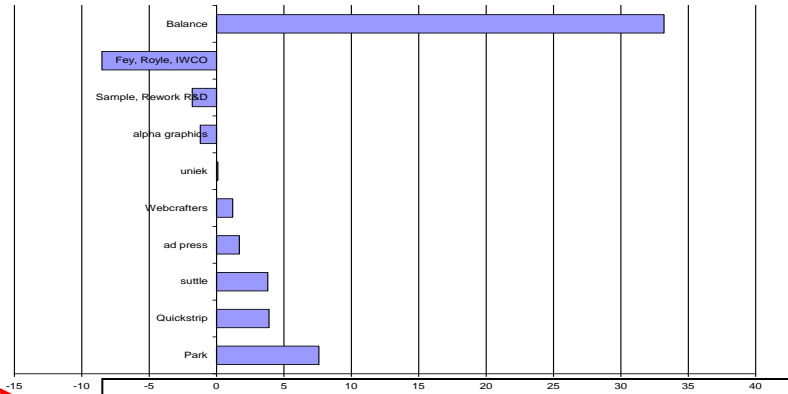
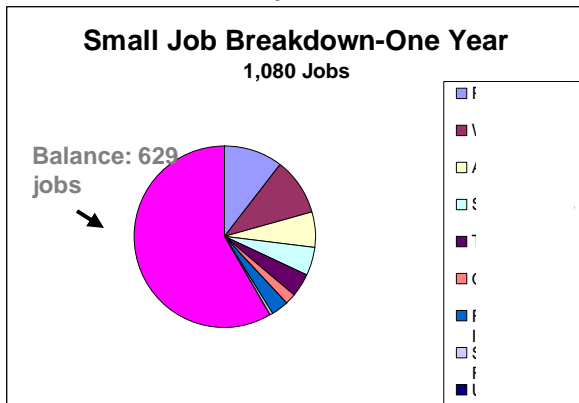


One Client had no Small client strategy

Operations Puzzle

One Third of Past Year's 3,000 Jobs Are Under \$500...

...And Small job relationships are profitable

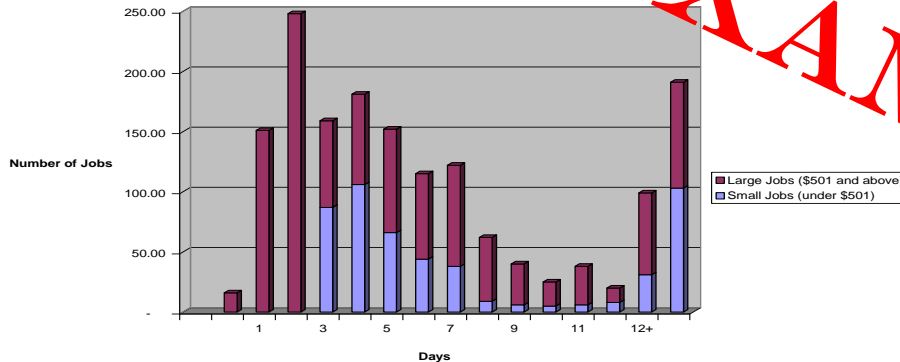


Large Customers Require Faster Service Times

Stock-in to Delivery Service Times
1/09-7/09

Small jobs in aggregate have no labor variance

EXAMPLE



We Use Process maps to Create Data from Staff Opinion

EXAMPLE

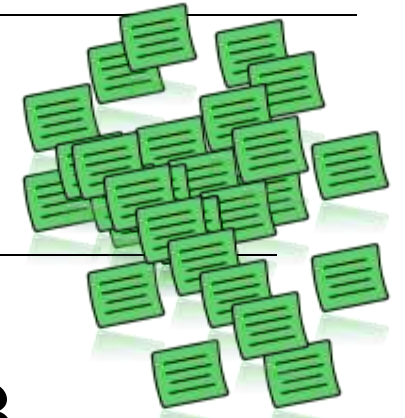
1



2



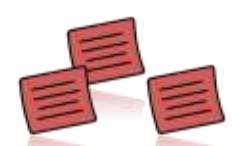
3



4



5



6



7

8

9



We asked Staff Where Key Resources were needed

Brainstorm the Steps you Think You Should Take—and Where

Customers

Products



Should = Must

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Financial Projections Highlight Company Actions & their Effects

This is the main means of Communication to the Markets

Will Show Improved Gross Margin
--From Core Exercise

Will Show Improved Operating Margin
--From Optimization Exercise



There is NO Substitute for a detailed Projection

You need to Express all findings in Financial Projections

Major Assumptions: Sales and Margins

April Projections based on detailed management reports

Wholesale projected at 30% of 2008 volume for Madison and New Berlin (In addition to wholesale units already scheduled to ship in April). Wholesale pricing is at 75% of inventory values.

Retail @ 50% 2008 sales for Madison and New Berlin at 10% margin

Assume E-bay and Open House sales at 55 units @ retail

Seasonality assumed to follow history



For Initiatives, Show Detailed Understanding of Implementation

Assume \$3.5k/ Revenue/Truck/Yr at
Weighted GM of 56%

For Profit Target of \$240k/quarter, Co.
will need Sales run rate of \$1.7 Million

....485 Trucks by xxxx, 2011



Source: parts and service calcs.xls

Financials – P&L, Balance Sheet, Cash flow, Covenants

	<u>Apr-09</u>	<u>May-09</u>	<u>Jun-09</u>	<u>Jul-09</u>	<u>Aug-09</u>	<u>Sep-09</u>	<u>Oct-09</u>
Total Sales	2,288,293	1,575,097	1,030,296	532,515	307,185	231,769	182,000
Total Margin	(57,412)	128,862	(1,524)	(36,127)	45,605	1,830	32,339
Total Margin %	2.5%	8.2%	-0.1%	-6.8%	14.8%	0.8%	17.8%
Total Operating Expenses	196,820	267,058	164,804	164,089	133,697	129,305	121,814
Operating Profit	(254,232)	(138,195)	(166,329)	(200,216)	(88,091)	(127,475)	(89,575)
Total Other Income/Expense	43,449	45,490	42,436	40,620	38,771	3,833	40,784
Net Income/Loss	\$ (297,681)	\$ (183,685)	\$ (208,765)	\$ (240,836)	\$ (126,862)	\$ (165,441)	\$ (230,359)

EXAMPLE

Balance Sheet	<u>Mar-09</u>	<u>Apr-09</u>	<u>May-09</u>	<u>Jun-09</u>	<u>Jul-09</u>	<u>Aug-09</u>	<u>Sep-09</u>	<u>Oct-09</u>
Cash	19,845	359,871	397,263	87,797	(82,730)	(147,646)	(309,119)	(441,813)
Accounts Receivable	983,298	1,195,777	1,073,770	940,085	761,308	657,954	639,529	631,322
Inventory	7,259,341	5,099,442	4,379,262	3,794,996	3,318,056	3,148,177	3,009,938	2,951,978
Other Assets	1,487,610	1,469,755	1,451,900	1,435,799	1,419,698	1,403,597	971,330	955,229
Total Assets	\$ 9,750,094	\$ 8,124,845	\$ 7,302,194	\$ 6,258,677	\$ 5,416,332	\$ 5,062,082	\$ 4,311,679	\$ 4,096,717
Accts Payable	1,385,008	1,325,722	1,417,230	1,230,803	1,128,637	1,127,637	1,131,637	1,138,637
Floor plan - GE	3,916,181	2,617,821	2,157,881	1,764,630	1,358,384	1,234,150	1,129,875	1,106,885
Floor plan - JB	3,750,000	3,750,000	3,489,760	3,298,746	3,228,051	3,187,407	3,148,443	1,113,473
Other Secured Debt - JB	2,019,133	2,017,168	1,993,348	1,969,622	1,945,775	1,922,515	1,482,076	1,460,718
Other Secured Debt	1,243,236	1,240,446	1,237,639	1,234,816	1,231,975	1,229,117	1,226,242	1,223,349
Other Liabilities	454,939	489,772	506,105	468,595	472,880	442,488	434,096	425,705
Total Liabilities	12,768,497	11,440,929	10,801,963	9,967,211	9,365,702	9,138,314	8,553,369	8,468,767
Equity	(3,018,403)	(3,316,084)	(3,499,769)	(3,708,534)	(3,949,370)	(4,076,232)	(4,241,691)	(4,372,050)
Total Liab & Equity	\$ 9,750,094	\$ 8,124,845	\$ 7,302,194	\$ 6,258,677	\$ 5,416,332	\$ 5,062,082	\$ 4,311,679	\$ 4,096,717



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Follow up and *Results!* ←

Two Important Follow-ups

Internally with Team

Monthly Meeting

Track What assumptions are working

What needs to be changed?

This can be great work experience &

Great Life Experience

Externally with Lenders

Monthly Meeting

Track What assumptions are working

What needs to be changed?

Show what you did last Month to get This month's numbers

Create a Great Environment for Transaction



Goals





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