

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

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- 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

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- 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

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→ **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”

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

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

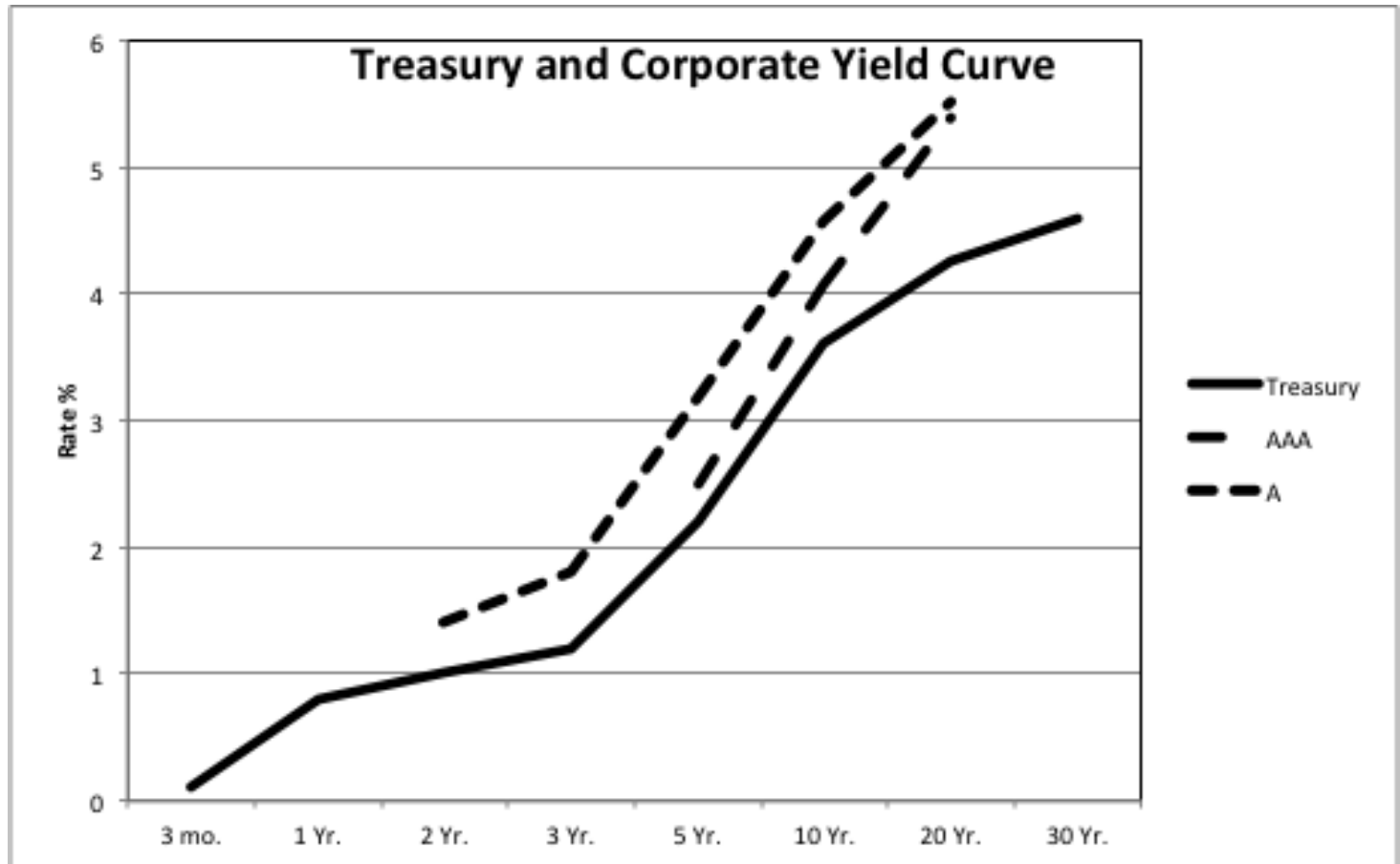


Half of Private Equity’s Challenge is Funding Source

# Larger Capital Markets Have Good Information

Yield Curve Shows Risk vs. Return

Rate



Source: Bloomberg April 10, 2011

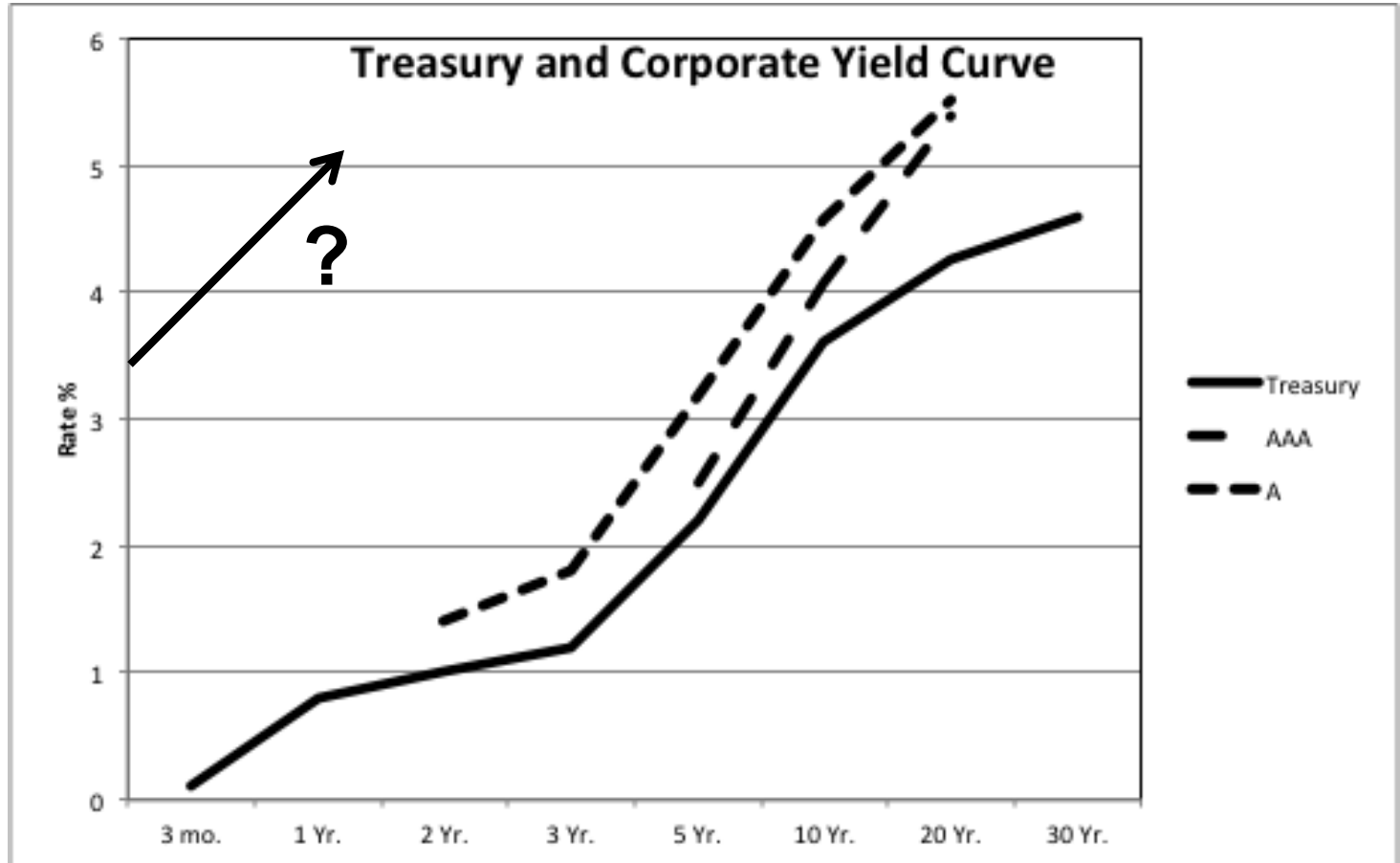
Time



# Where is the Middle Market?

Prime is 3.5%

Rate



Time

Source: Bloomberg April 10, 2011



# Middle Market has no benchmark for Pricing

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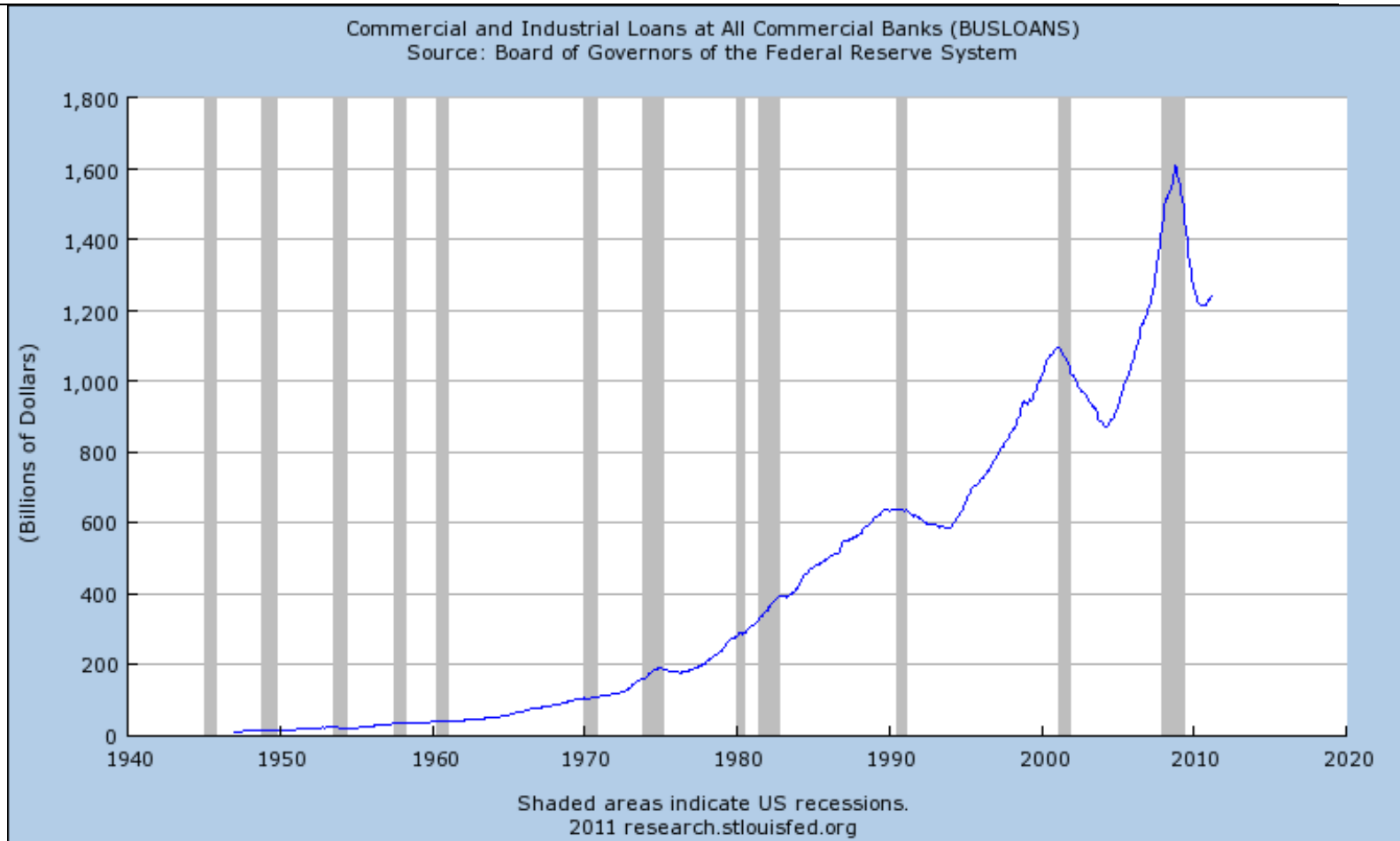
In our communities:

- 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.



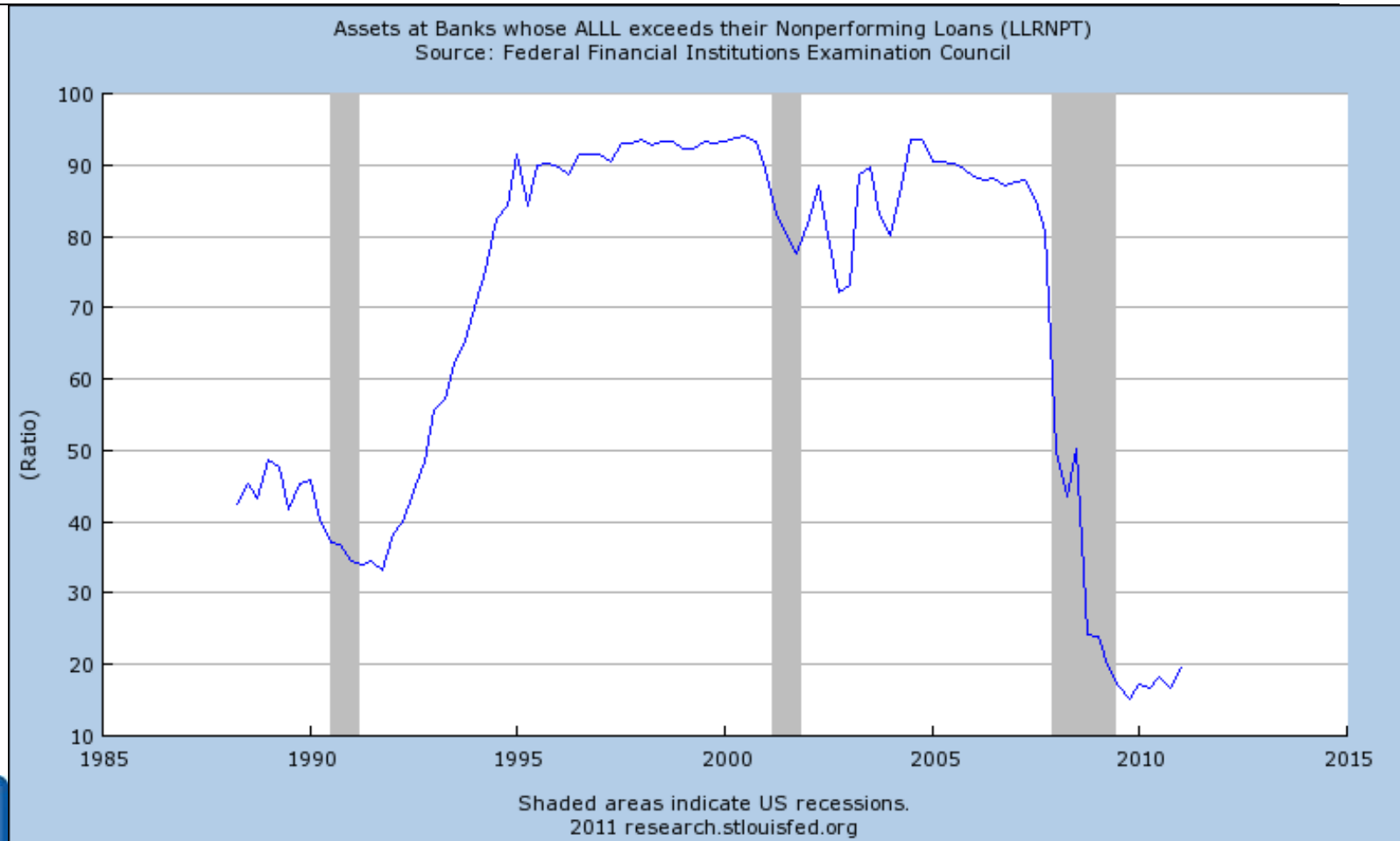


# Business Loans Outstanding



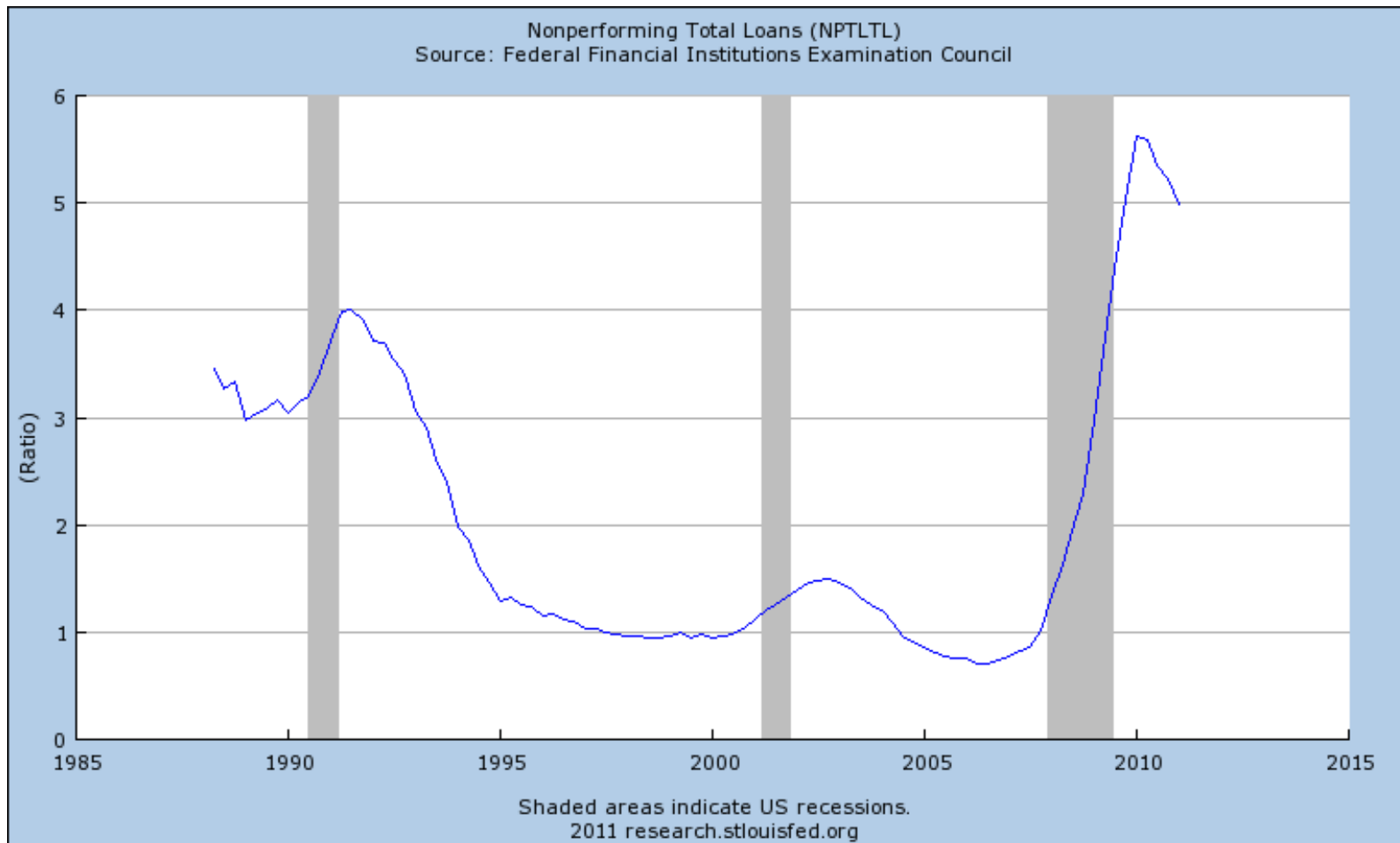
Source: St. Louis Fed

# Reserve Adequacy



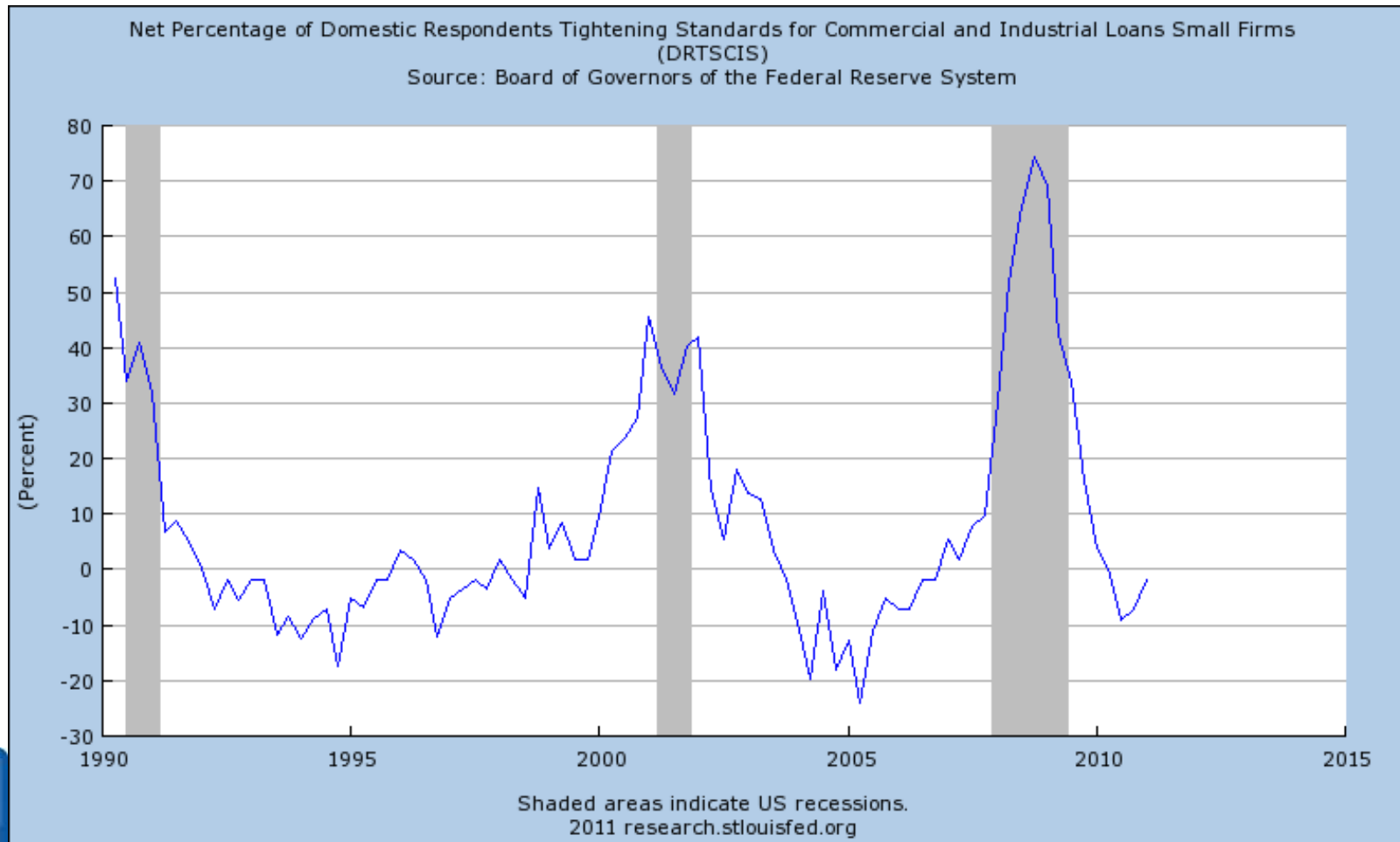
Source: St. Louis Fed

# Non-Performing Loans



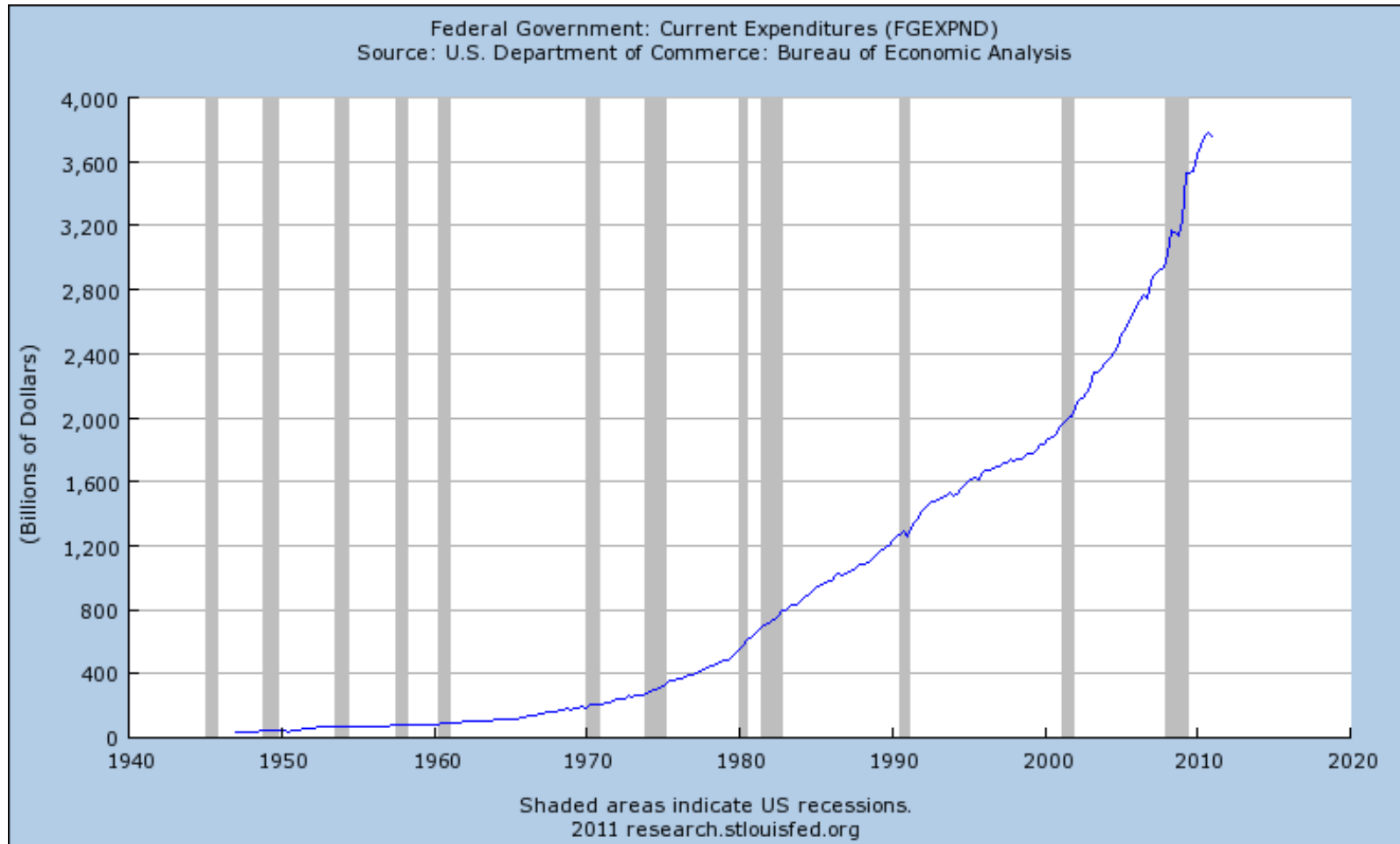
Source: St. Louis Fed

# Loan Officer Survey-Tightening Standards-Small Firms



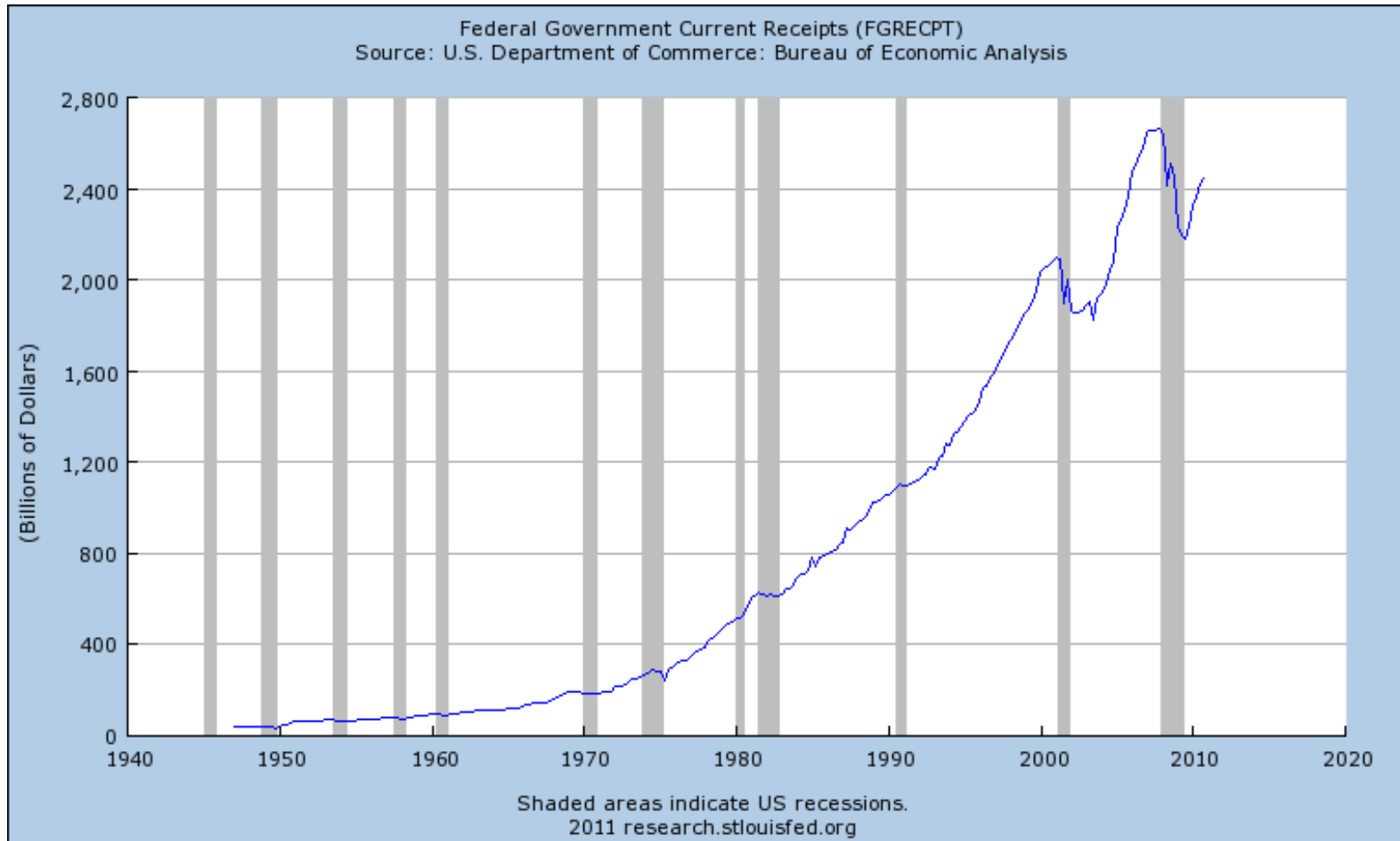
Source: St. Louis Fed

# Bonus Round! Federal Spending



Source: St. Louis Fed

# Bonus Round! Federal Receipts



Source: St. Louis Fed

# Is There a place for relationship Banking?

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**Mergers**

**Cyclical Capital Crunches**

**Changing Personnel**

—The key ones? Those you have never met!

**New Normal in economic conditions**

—Drops in demand

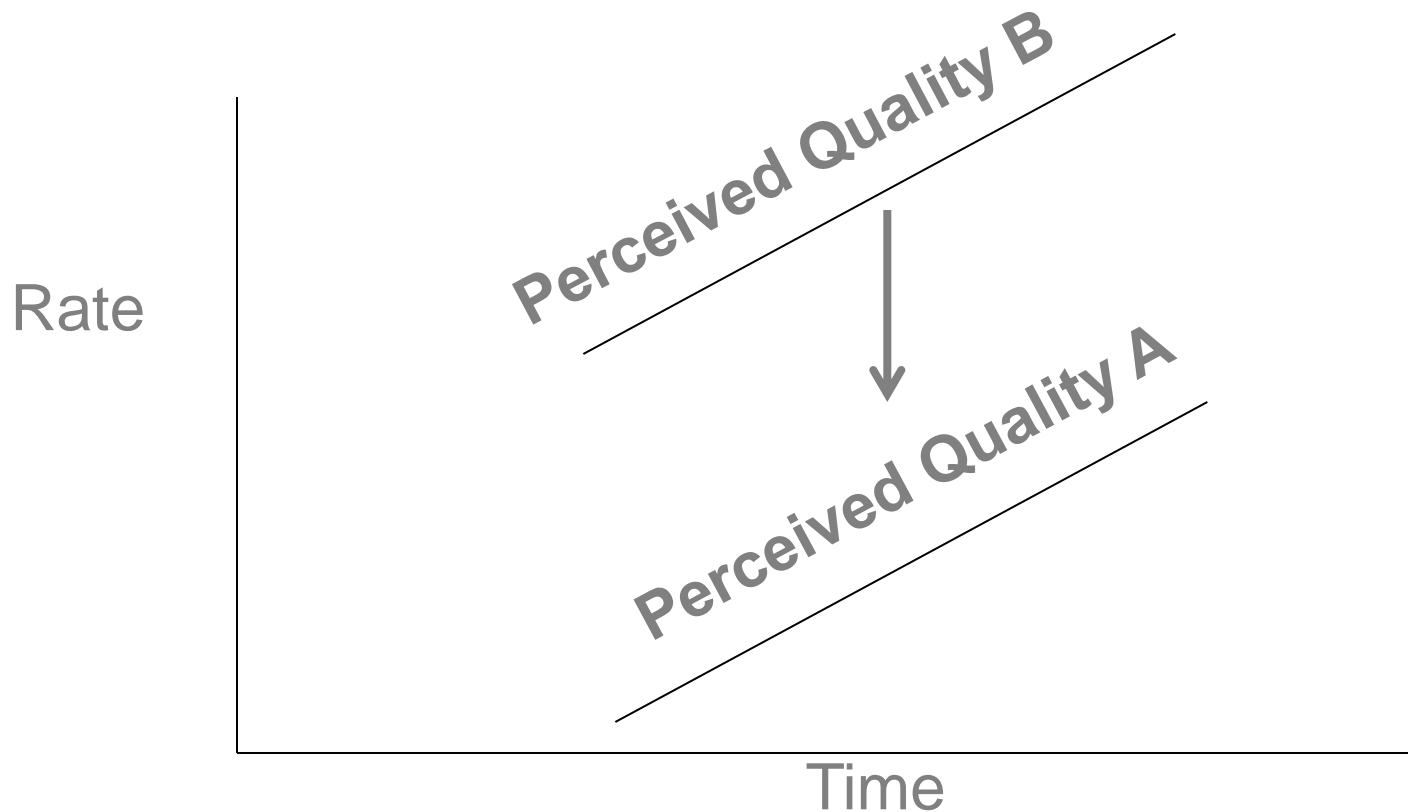
—Scary politics



**Look for Nationwide Loan Brokers**

# We Assume Market Forces Still Respond to Reduced Risk

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Our Job is To  Cash Flow and  Risk



# Agenda

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-Exercises in Core Business

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**Follow up and *Results!***

# We Use the Personal Training Metaphor

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*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

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## 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

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## 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.

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**Didde-Glaser Web Press, ca. 1980**

# Family's Printing Co Needed Rescue

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**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

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**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

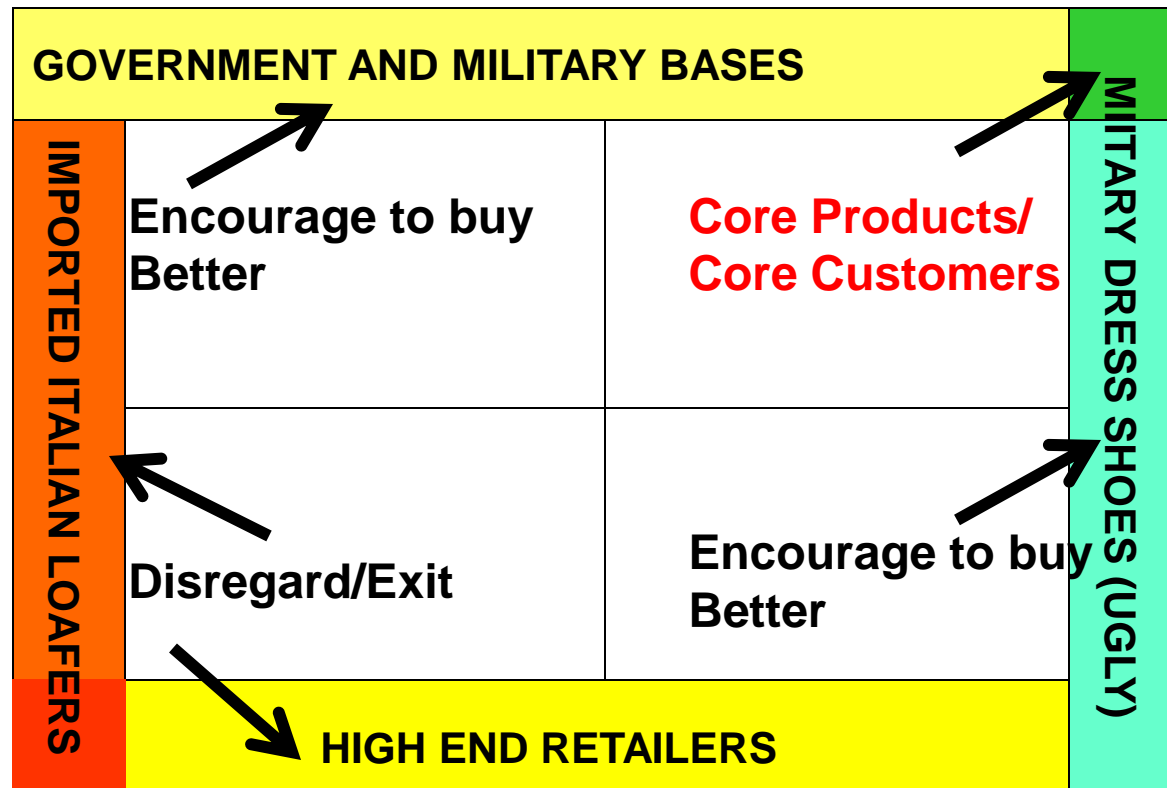
*In This Case, 20 Customers x 6 Categories Contributed 60%*

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



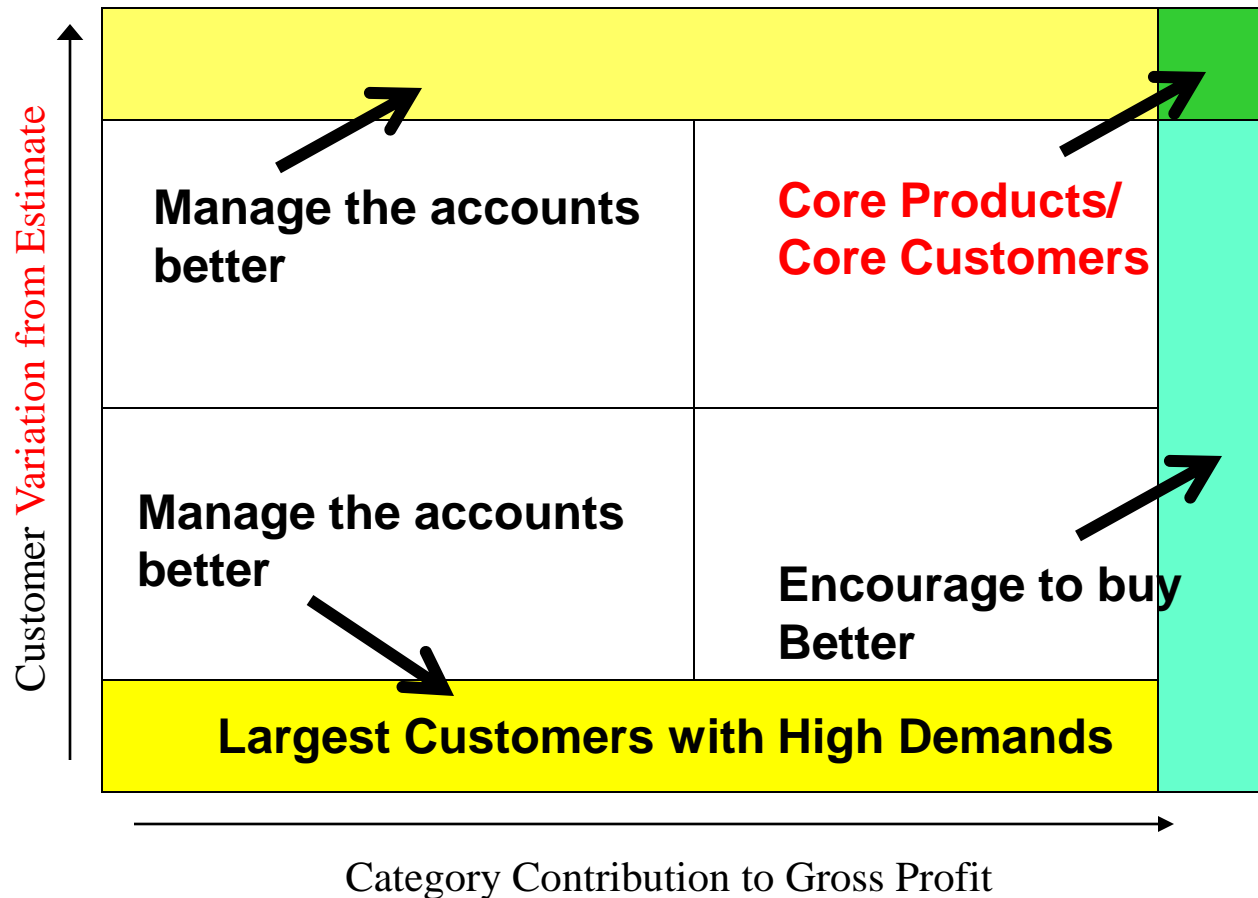
# Turnaround Situation—Shoe Manufacturer

*Reducing losses Increases total \$ Contribution*



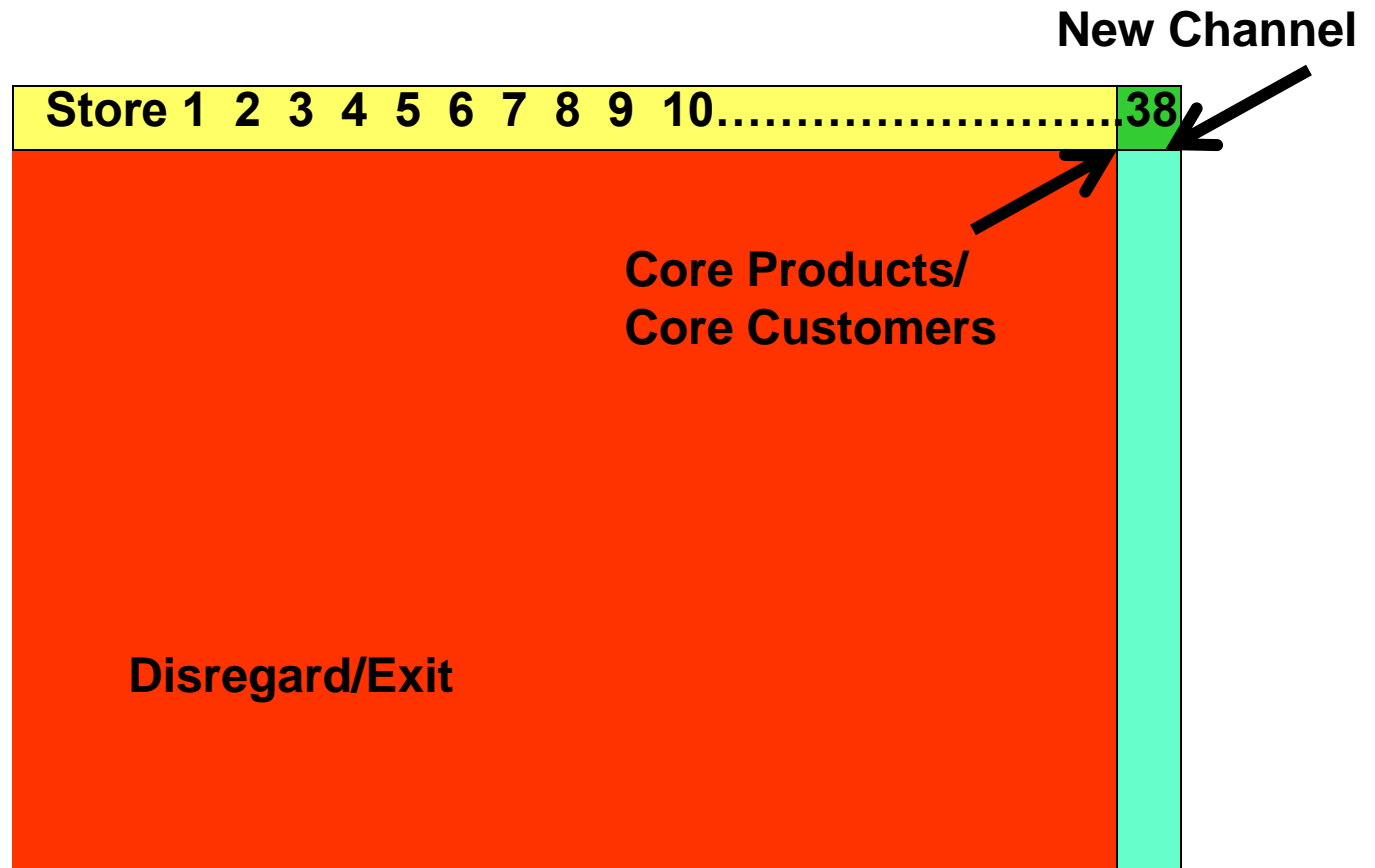
# Performance Improvement for Specialty Graphic Arts

*Changed to "Sum of Variation from Estimate"*



# Turnaround Situation Specialty Retailer

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# Change it up: Restaurant Chain

*Changed Definition of Customer to "Time of Day"*

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



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

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Customers




Products



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

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Customers


Products



# For these Different Customers, Consider:

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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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# Three Activities Affect Results

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**Marketing**

**Operations**

**Organization**

***Financial  
Results***



# **The Engine Company's Core Product Data Drove Marketing**

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**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

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## Organizational Puzzle

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

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**EXAMPLE**

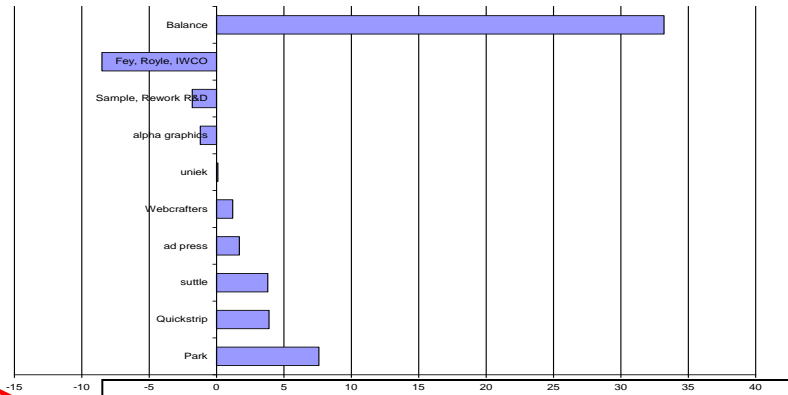
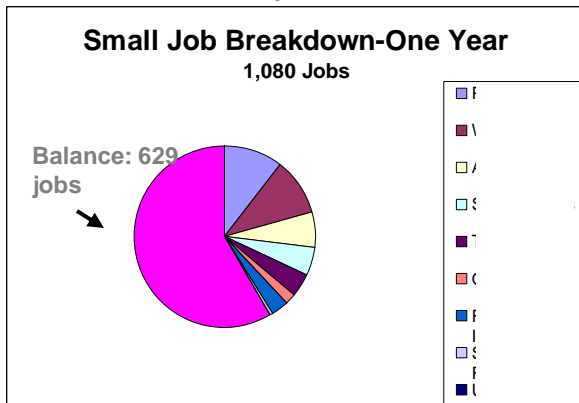


# One Client had no Small client strategy

## Operations Puzzle

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

**...And Small job relationships are profitable**

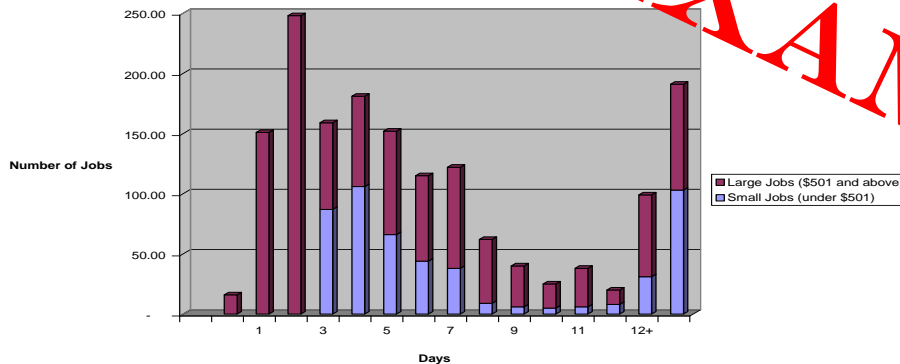


**Large Customers Require Faster Service Times**

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

Small jobs in aggregate have no labor variance

**EXAMPLE**



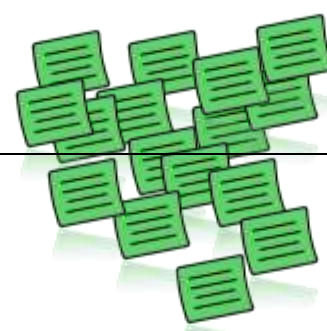
# We Use Process maps to Create Data from Staff Opinion

**EXAMPLE**

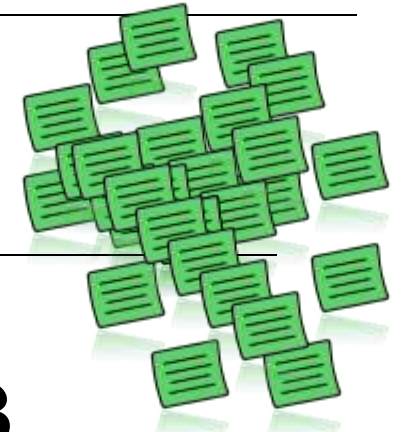
1



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

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Customers


Products



Should = Must

# Agenda

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**Follow up and *Results!***



# **Financial Projections Highlight Company Actions & their Effects**

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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

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## 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)	\$ (130,359)

**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

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## *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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