VERNOCONSULTING

How Wholesalers Make Money and Manage Profit

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Topics We Will Cover

Understanding the P&L Basics

The Breakeven Concept

- How to use Breakeven Concept to Make Decisions
- Calculating Breakeven on Price Discounts or Price Increases

The Importance of Managing Gross Profit Margin

Cost Per Stop

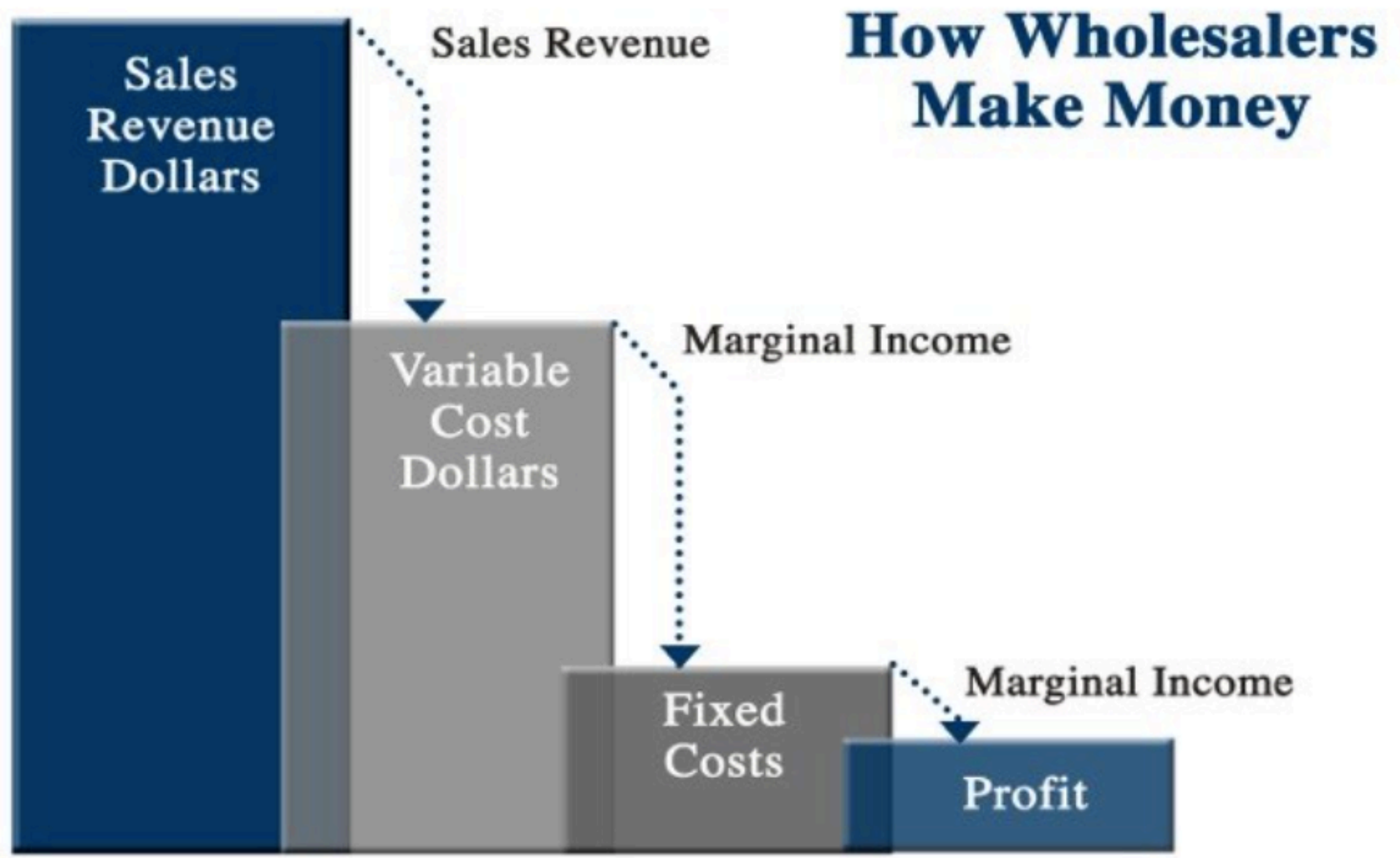
- Gross Profit Per Stop: the Most Important Key Operating Indicator
- How to Impact Profitability Per Stop

Understanding P&L Basics

P&L Basics: Derek Jeter Distributing Company

Sales Revenue	$100,000,000
- Cost of Goods Sold	$75,000,000
Gross Profit	$25,000,000
- Operating Expense	$20,000,000
Operating Profit	$5,000,000

How Revenue Flows to Profit



The Breakeven Concept

- How to use the Breakeven Concept to Make Decisions
- Calculating Breakeven on Price Discounts or Price Increases

COMPANY BREAKEVEN TERMS DEFINED

- **Company Breakeven** is the amount of sales in dollars or units, required to cover all the wholesalers costs.
  - The **Breakeven** is where the wholesaler does not show an operating loss or profit.

- **Margin of Safety** is the portion of sales that can be lost before the wholesaler starts showing a negative profit.
  - The **MOS** can be expressed in sales dollars, cases or percentage.

THE BIG VARIABLE COST DEBATE

- **Which costs are fixed and which are variable?**

  - Variable costs are costs that move up or down as sales dollars or units move up or down.

  - If you sell **1 less case** of beer, which costs will go down?
    - Cost of Good Sold (the $ you pay the brewery for the beer including freight)
    - Sales or delivery commissions if you pay a % of sales or cents per case
    - Other costs that will decrease?

- **The simplest way to calculate breakeven is to use your Gross Profit % as your Marginal Income % and assume all your operating expenses are fixed.**

The Company Breakeven Formula

Company Breakeven $

1	$25,000,000 Gross Profit $	/	$100,000,000 Sales Revenue $	=	25% Gross Profit %
2	$20,000,000 Operating Expenses $	/	25% Gross Profit %	=	$80,000,000 Company Breakeven $

Margin of Safety

$100,000,000 Sales Revenue $	—	$80,000,000 Company Breakeven $	=	$20,000,000 Margin of Safety $

The Breakeven and the Margin of Safety can easily be expressed in terms of CEs by dividing the Breakeven $ or Margin of Safety $ by the Average Sales Dollars per CE.

QUESTION?

- With a Company Breakeven Point of $80,0000, if you sell $80,000,001, how much profit did you make?

  A. $5,000,000
  B. $2,000,000
  C. $1
  D. 25 cents

How to Use Breakeven to Help Make Decisions

- **Assumptions to be used on exercises found on slides 12 & 13:**

  - Payroll costs for a position include auto, health insurance, retirement, and payroll taxes
    - On premise sales rep all-in costs = $70,000
    - Craft sales rep all-in costs = $75,000
  - The average cost of a delivery including the sales rep and driver and associated costs = $100
  - Average gross profit per case = $5.00
  - Craft gross profit per case = $7.50

How Many More Cases Do You Need to Sell to Cover the Incremental Costs?

Use Assumptions on Slide #11

1) You want to add another another craft only sales rep with an annual all-in cost of $75,000.	2) An account wants you to increase their delivery frequency from 1x/week to 2x/week.
Show your work here:	Show your work here:

$$\frac{\$75{,}000}{\$7.50 \text{ GP / Craft CE}} = \textbf{10,000 Additional CE of Craft / Year}$$

$$\frac{\$100 \text{ Cost / Delivery}}{\$5.00 \text{ GP / CE}} = \textbf{20 Additional CE / Delivery}$$

20 CE x 52 Weeks =

1,040 Additional CE/ Year

How Many More Cases Do You Need to Sell to Cover the Incremental Costs?

Use Assumptions on Slide #11

3) Your on premise manager wants to take 100 accounts off tel-sell and add another sales route.	4) Your out of code beer costs have increased from $35,000 annually to $100,000 annually.
Show your work here: $\frac{\$70{,}000}{\$5.00 \text{ GP / CE}} =$ **14,000 Additional CE / Year**	Show your work here: \$100,000 - \$35,000 = \$65,000 of incremental OOC $\frac{\$65{,}000 \text{ OOC}}{\$5.00 \text{ GP / CE}} =$ **13,000 CE / Year to Cover Incremental OOC** $\frac{\$100{,}000 \text{ OOC}}{\$5.00 \text{ GP / CE}} =$ **20,000 CE / Year to Cover 100% of OOC**

Price Discount / Increase Breakeven Definition and Formula

- **Price Discount Breakeven** – Amount of incremental volume the wholesaler would need to sell at the discounted margin in order to make the same amount of gross profit made at the current margin.

- **Price Increase Breakeven** – Amount of volume the wholesaler can lose and still make the same amount of gross profit made at the current margin.

$$\frac{\text{Current Margin per Case}}{\text{New Margin per Case}} = \text{Breakeven}$$

PRICE DISCOUNT BREAKEVEN

- Price Discount Scenario:
  - Current sales = 25,000 CE
  - Supplier recommends a more aggressive discount of \$2.00 per case
  - Wholesaler's share of the deeper discount (assume 50/50 split) = \$1.00 per case
  - Current Margin = \$6.00 per case
  - New Discounted Margin = \$5.00 per case

1) What is the Price Discount Breakeven?	2) How many incremental cases do you need to sell to breakeven?
Show your work here: $\frac{\$6}{\$5}$ = **1.2 or 120%**	Show your work here: 1.2 x 25,000 CE = 30,000 CE 30,000 CE – 25,000 CE = **5,000 Incremental CE**

You would need to increase sales by __20__% or __5,000__ CE to replace the lost gross profit resulting from the price discount.

PRICE INCREASE BREAKEVEN

- Price Increase Scenario:
  - Current Sales = 25,000 CE
  - Supplier recommends a $2.00 per case PTR increase
  - Wholesaler's share of the Margin Increase = $1.00 per case
  - Current Margin = $5.00 per case
  - New Increased Margin = $6.00 per case

1) What is the Price Increase Breakeven?	2) How many less cases can the wholesaler sell and still breakeven?
Show your work here: $\frac{\$5}{\$6}$ = **.83 or 83%**	Show your work here: .83 x 25,000 CE = 20,750 CE 25,000 CE – 20,750 CE = **4,250 Less CE**

You could lose __17__% or _4,250_ CE of your volume and still make the same gross profit as before the price increase.

The Importance of Managing Gross Profit Margin

CALCULATING GROSS PROFIT MARGIN

$$\frac{\text{Gross Profit \$}}{\text{Sales \$}} = \text{Gross Profit Margin \%}$$

1) What is Derek Jeter Dist. Co.'s Gross Profit Margin %?

Show your work here:

$$\frac{\$25{,}000{,}000}{\$100{,}000{,}000} = \mathbf{25\%}$$

2) If the Gross Profit Margin decreases from 25% to 24.5%, how much would the Gross Profit decrease?

Show your work here:

$$25\% \times \$100{,}000{,}000 = \$25{,}000{,}000$$

$$24.5\% \times \$100{,}000{,}000 = \underline{\$24{,}500{,}000}$$

Difference = $500,000

-or-

$$\begin{array}{r} .5\% \\ \underline{\times\ \$100{,}000{,}000} \\ \mathbf{\$500{,}000} \end{array}$$

IMPACT GROSS MARGIN HAS ON PROFITS

- If the Gross Profit Margin decreases from 25% to 24.5%, the Gross Profit would decrease **$500,000**.
- Can Derek Jeter Distributing Company cut enough costs to make up for the .5% decrease in gross margin?

$500,000 in cost reduction is equivalent to:
• 10 employees @ 50,000 each, or
• 25,000 cases of out-of-code, or
• 3 sales and 3 delivery routes, or
• 2+ executives, or
• A combination of portions of the above

Key Takeaway

It is very difficult to cut enough expenses to make up for a meaningful loss in Gross Profit Margin

Cost per Stop

- Gross Profit per Stop: The Most Important Key Operating Indicator
- How to Impact Profitability Per Stop

DIRECT COST PER STOP

- Definition of direct costs:
  - **Delivery**
    - Cost of the truck = lease payment, maintenance, fuel, taxes, licensing and insurance
    - Cost of the driver = annual pay, payroll taxes, and fringe benefits
  - **Sales**
    - Cost of the sales rep = annual pay, payroll taxes, and fringe benefits
    - Cost of sales rep vehicle = car allowance or total of lease payment, maintenance, fuel, taxes, licensing, and insurance

Direct Cost Per Stop Example

Avg. Driver Comp	$50,000
Driver Benefits @20%	$10,000
Total Driver Cost	**$60,000**
Avg. Sales Rep Comp	$55,000
Sales Rep Benefits @20%	$11,000
Total Sales Rep Cost	**$66,000**
Avg. Annual Cost for 1 Truck	$20,000
Avg. Annual Cost for 1 Sales Car	$5,000
Total Vehicle Cost	**$25,000**

Total Direct Sales and Delivery Cost per Route
$151,000 / Year
$604 / day

Direct Cost Per Stop Example

Total Direct Sales and Delivery Cost per Route
$151,000 / Year
$604 / day

Delivery Stops / Day	Direct Sales and Delivery Cost per Stop	Cases Required to Cover Direct Costs at $5 GP / Case
12	$50	10 cases
15	$40	8 cases
20	$30	6 cases

NOT INCLUDED IN DIRECT COST PER STOP EXAMPLE

- The direct cost breakeven in the previous example **ONLY** covers the direct costs.

- It DOES NOT cover any of the following costs:
  - Owner's costs
  - Warehouse and warehouse labor
  - Marketing and brand management costs
  - Sales management and supervision
  - Out-of-code
  - Administration Costs (admin, accounting, IT)
  - Financial costs (interest, depreciation, amortization, taxes)

Four Strategies to Drive Account Level Profitability

1) Make Loser Accounts Into Winner Accounts

2) Reduce Loss on Loser Accounts (Eliminate Loser Accounts or Improve costs or sales in Loser Accounts)

3) Make Winner Accounts Into Bigger Winners

4) Find More Winner Accounts

USING SALES TO IMPROVE GP/STOP

- Sell additional cases of current brands
- Sell higher-end products with higher GP per case
- Sell new brands or SKUs
- Improve pricing
  - Control bridge buying
  - Make sure discounts are passed on to consumers
- More displays / in-store promotions
- Replace slow moving SKUs with higher potential products
- Reduce Stock outs

MANAGING COSTS TO IMPROVE GP/STOP

- Reduce total number of deliveries
  - Reduce off days deliveries
  - Decrease delivery stop frequency
  - Produce perfect orders
  - Combine draft and package delivery
  - Implement delivery minimum

- Increase driver efficiency so they can make more deliveries / day
  - Make routes more geographically efficient
  - Load by stop
  - Use more bulk delivery to reduce unnecessary helpers on routes

Other Ways to Improve Costs / Stop

- Decrease the sales costs
  - Have a less expensive person take the order
  - Use tel-sell to take orders
  - Reduce sales frequency
- Reduce driver and/or merchandiser overtime
- Eliminate wasteful merchandising stops

GP / Stop Key Operating Indicators

- Average GP $ per Stop versus GP $ per Stop Goal
- # of Stops Below the GP $ per Stop Target
- # of Accounts that Average Below the GP $ per Stop Target
- Average Margin per Case versus Margin per Case Goal
- Average Cost per Stop versus Cost per Stop Goal
- Average Cases per Stop versus Cases per Stop Goal
- # of Off Day Deliveries and Hot Shot Deliveries

Wrap Up

- Copy of this presentation and other helpful tools:

  www.verno-consulting.com/seminars/nextgen-2017/

- Relevant issues of *Verno's Beer Brief*
  - How Wholesalers Make Money
  - Preparing Next Generation Owners
  - Using Breakeven Analysis
  - Service Policy Strategy
  - Delivery Route Cost Reduction
  - Warehouse Efficiency Killers
  - Managing Craft ROI
  - Sales Best Practices
  - Being Scalable

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