

DRIVING VALUE CREATION

USING BREAK-EVEN ECONOMICS

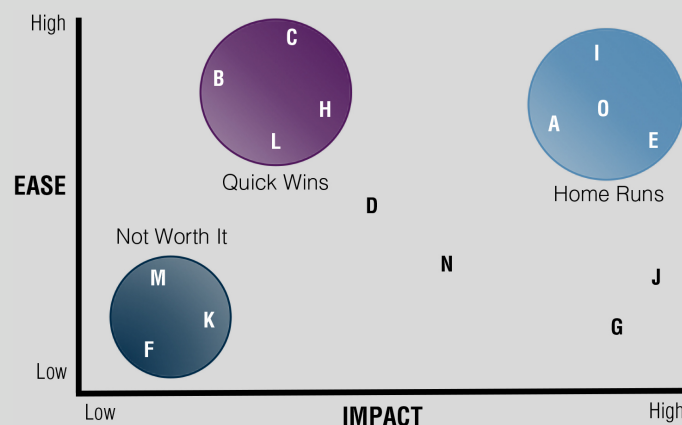


Break-even (BE) analysis is a straightforward approach for driving business operations improvement focus. It provides a simple, easily understood methodology for developing and tracking cost reduction initiatives and validating value creation.

USING VARIABLE AND FIXED COSTS AS A FOUNDATION

There are only two basic levers to pull for rapidly increasing EBITDA: variable costs and fixed costs. The first step in creating an effective BE model is dependent on the finance and operations teams accurately allocating expenses into the proper variable or fixed cost buckets. Although this allocation process can be challenging and time consuming initially, it is worth the

effort as it creates a solid foundation for identifying initiatives, determining financial outcomes and establishing priorities based on an ease versus impact analysis. Once armed with a clear delineation of costs, the BE analysis becomes a powerful tool for driving change and quickly assessing EBITDA impact for every action taken.



- Notes:**
- 1) Ease versus Impact evaluation for proposed projects A through O.
 - 2) Quick wins will improve morale and inspire confidence.
 - 3) Home runs will have the most profound effect on performance with the least amount of effort.

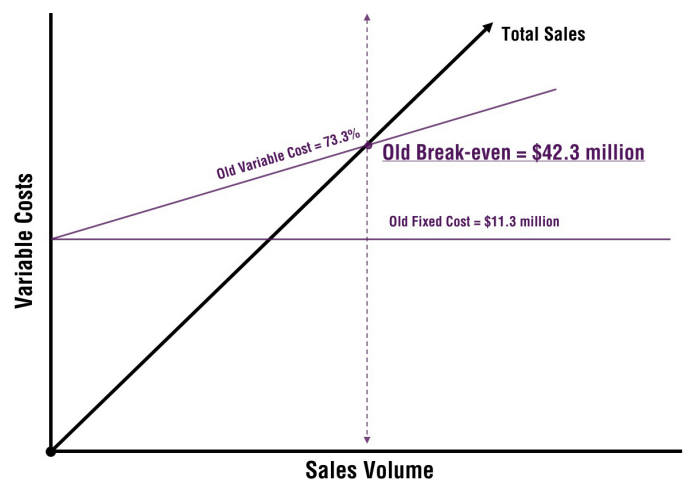


PUTTING BE METHODOLOGY INTO ACTION

The following case study illustrates how the BE methodology effectively created lasting and sustainable value in the target business transformation. The process began with refining the allocations for variable and fixed costs. This upfront work guaranteed the accuracy and ultimately the effectiveness of the BE model.

After completing the allocation process, the cost compilation indicated that the company's variable and fixed costs in the beginning of the process were approximately 73.3 percent and \$11.3 million, respectively. Using these two values, the company calculated an annual EBITDA BE revenue of \$42.3 million (\$11.3 million in annual fixed costs divided by the 26.7 percent variable margin). This calculated BE value was then used as a tool for tracking variable and fixed cost reductions and validating the expected EBITDA improvements. Any reduction in the variable or fixed costs would result in a lower EBITDA BE that could be easily assessed using the model.

The next step was to develop a list of potential initiatives that would reduce variable and fixed costs. This was done by

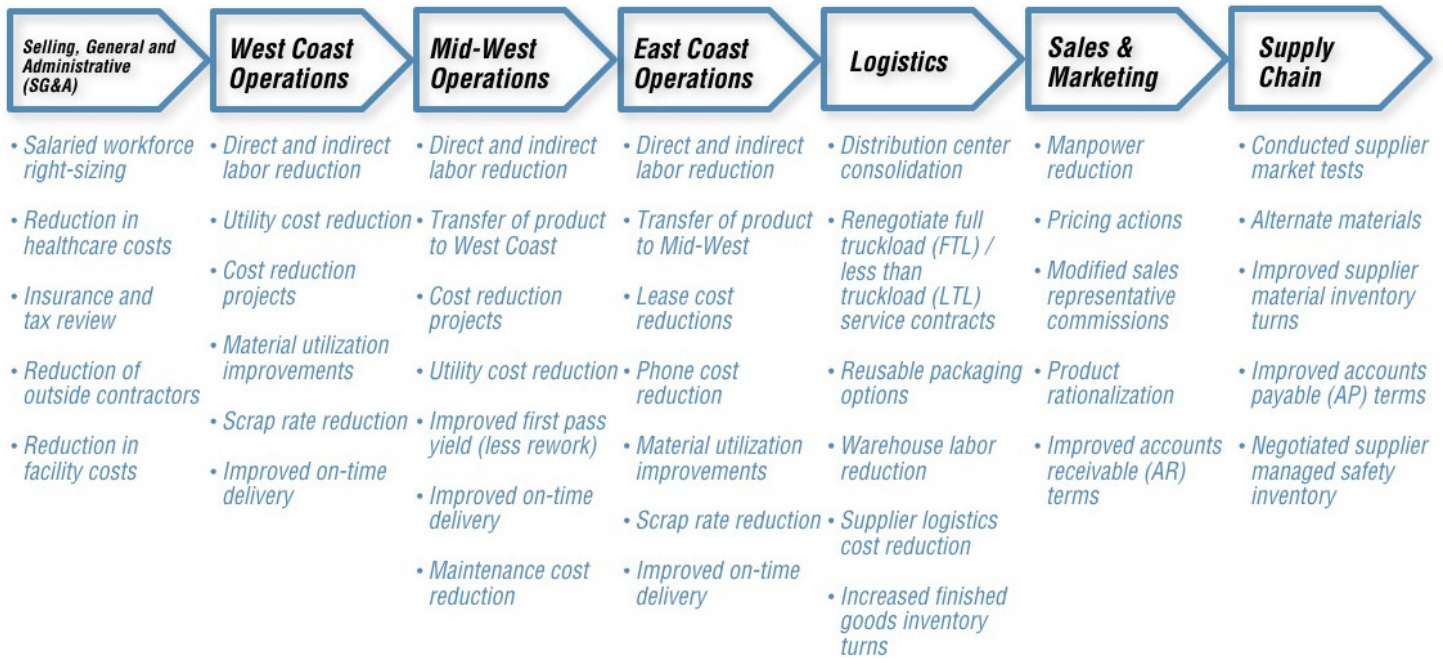


breaking the cost reduction initiatives into business system groups. The following categories were used in this example.



Teams were created and a brainstorming process was conducted to identify initiatives. These proposed cost reductions were further screened and prioritized by the teams in order to

create a list of actions with established goals and timing. The following list is an example of the type of initiatives that were created in the process.

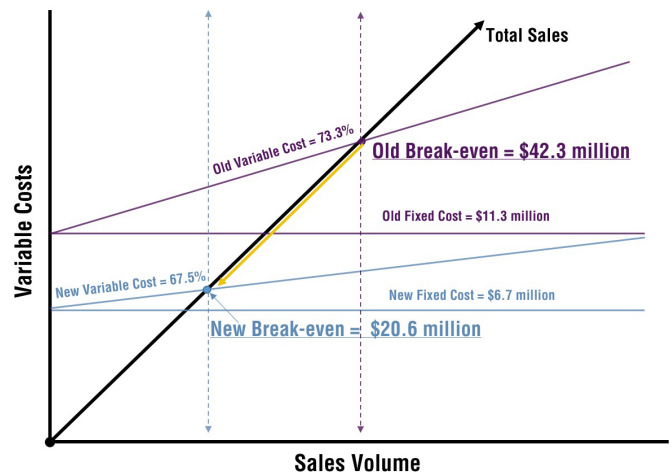


The next step was to prioritize identified actions utilizing an ease versus impact selection process to ensure resources were focused on creating quick wins and home runs in the transformation process.

Each of the above actions had a variable or fixed cost allocation associated with the initiative that was tracked as a Gantt chart line item with an expected variable or fixed cost percentage reduction (dollar amount), an assigned responsible party and a specific date of completion. Weekly meetings were held with all team leads and senior management to ensure all line item actions were on schedule, to identify and eliminate any roadblocks in the process, and to assign additional resources if required.

In this example, the cumulative results revealed a decrease in variable costs from 73.3 percent to 67.5 percent (increased variable margin from 26.7 percent to 32.5 percent) and a fixed cost reduction from \$11.3 million to \$6.7 million. The resulting annual EBITDA BE revenue was reduced from \$42.3 million to

\$20.6 million (reduced BE by 51.3 percent). Using the annual forecasted revenue for the year of \$95 million, the identified improvements increased the EBITDA projection from \$14.1 million to over \$24 million, or a 71.4 percent increase.



MEASURING TANGIBLE IMPROVEMENTS IN FINANCIAL RESULTS

The simplicity of the break-even model enabled connection of specific actions to tangible financial results with relative ease. It narrowed the whole business improvement focus down to only two lines in the above chart: fixed cost and variable cost. This improved the communication of goals and the associated clarity of purpose, and in turn accelerated execution speed.

Actions were specific and execution-focused with clear financial impacts. Aggressive EBITDA BE optimization could now become the engine for future sales growth by quickly providing a more competitive business model and increased leverage for the sales and marketing team. Strengthen the cost foundation of the business and increased sales will follow.

Being armed with accurate annual EBITDA BE revenue, fixed costs and variable margin values enables investors to easily estimate current and expected EBITDAs without having to wait for month end financials. See the table below to walk through the process for calculating weekly EBITDA contribution using the case study BE data.

Quick Real-time EBITDA Estimates Using Break-even Analysis			
Annual Fixed Costs	\$6,700,000		
Aggregate Variable Margin	32.50%		
EBITDA Break-even (BE) Revenue	\$20,600,000	= \$6,700,000 ÷ 32.5%	
Weekly BE Revenue	\$412,000	= \$20,600,000 ÷ 50 weeks	
Week 1 Actual Revenue	\$1,950,000		
Week 2 Actual Revenue	\$1,825,000		
Week 3 Forecasted Revenue	\$1,965,000		
Week 4 Forecasted Revenue	\$2,230,000		
Sum of Week 1 & 2 Revenues	\$7,970,000		
Sum of 4 Week BE Actual & Forecasted Revenue	\$1,648,000	= 4 x \$412,000	
Revenue in Excess of BE	\$6,322,000	= \$3,775,000 - \$824,000	
Week 1 through 4 EBITDA Contribution	\$2,054,650	= \$6,322,000 x 32.5%	

Note: Using revenue only, quickly estimate expected EBITDA with a relatively high level of certainty.

In order to secure the ongoing accuracy of the above estimate, it is important to track and control variable and fixed costs to avoid model deviations. Also, depending on sales cyclicity, product mix can have an impact on the estimation process as well. Product category sales variations coupled with associated impacts on aggregate fixed costs and variable margins must be known. The aggregate values can be modified as required in order to preserve EBITDA estimate accuracy.

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