Tidewater Group, Inc.

Distributors—How is your company doing?

We are often asked how an owner can determine if their company is doing as well as it should. This is a difficult question, because there is no one answer. Distributors to food service, grocery, specialty, seafood or produce to name a few generate different returns. However, the "bottom line" is that here are many factors than can be used as benchmarks and firms usually consider one or more. The following criteria are important indicators of success for food distributors.

1. **Sales:** Average growth in the food industry is measured by population growth plus inflation (US population growth is about 1.5%, Inflation in 2004 was 3.0%, total about 4.5%). Superior growth for a distributor is considered to be 10% and generally there is little premium paid for growth that is higher than 15% because it is considered not to be sustainable. However, consistent growth of 8% to 10% is considered to be excellent and a premium is paid.

2. **Gross Profits:** Gross margins should be calculated after deducting the cost of inventory, and freight-in, from net sales. All other costs should be below the gross profit line. A distributor should target a gross profit percentage in the 18% to 22% range. Note this will vary by segment of the market served. If substantial sales are "bid business" the gross margin will be in the lower end of the range or in the 12%-15% area. If most sales are direct, gross margins should be at the higher end of the range. If your margin is below the above range, gradually adjust pricing, reduce costs, and discontinue low margin items to improve profitability.

3. **Operating Expenses:** Sales, general and administrative expenses, excluding interest, and owner compensation over that of a manager. These expenses should be in the range of 13% to 18% of sales. Distributors with sales of $25 million o more should spend no more than 12% to 14% of sales on expenses. Expense control is crucial to achieving a sustainable operating profit that will fund future growth.

4. **Debt:** Bank debt needs to be managed as best as possible. Asset management as discussed below will be helpful. Receivables need to be collected as quickly as possible. Payables can sometimes be stretched if communication with suppliers is good. Inventory needs to turn quickly and slow moving items must justify their slot or be discontinued. Good asset management will reduce bank debt.

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5. **Asset Management:**

    - **Inventory:** Inventory should turnover 9-12 times per year---25 to 50 times for a produce or seafood distributor. Obviously the faster the inventory turns the less working capital is required.

    - **Accounts Receivable:** Days sales outstanding (DSO=A/R÷Sales X 365) Should be between 25 and 40days. Accounts payable should be paid in the same time frame that A/R are collected. If this presents a problem with suppliers, you need to collect receivables faster---or change suppliers.

6. **Operating Profit / EBITDA:** Strive to achieve a 6 % or higher operating profit margin. A company with a 4% martin is good but not great. If the owner's compensation and perks are more than a manager then---the extra compensation is added back into profits before calculating the margin.

7. **SKU's:** Less is better than more. A company should consider dropping the bottom selling 5% of SKU's when new products are added. More SKU's mean more carrying costs so each SKU should produce sales and profits at a level that enables the company to achieve its objectives.

The Tidewater Group specializes in the food industry. We are knowledgeable about mergers and acquisitions, financial structure, strategic planning, and other issues important to owners in the food industry. If we can be of service, please give us a call.

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