Plainview Technology Corporation

On February 13, 2012, recent Wharton grad Laura Hansen began her job as a research analyst at IDS in Minneapolis, Minnesota. IDS was the largest financial services firm between Chicago and the West Coast, providing brokerage services and managing over $100 billion in assets in its mutual funds and investment advisory division. Hansen turned down a number of Wall Street positions to return home to Minnesota.

As Hansen settled into her new office on the 53rd floor of the IDS Tower (the largest skyscraper between Chicago and Seattle), she was immediately greeted by her new boss, Lars Martens. Martens had an emergency that he needed Hansen to deal with ASAP. Plainview Technology Corp. had scheduled a 3:30 pm conference call to discuss its fiscal year 2011 earnings release and answer questions from its analysts. The IDS analyst assigned to Plainview, Clint Brass, had been fired yesterday for providing stock tips in exchange for getting his daughter accepted to the Breck School. Brass destroyed all of his files when he was tipped off that he would be fired. Thus, Martens needed Hansen to get up to speed on Plainview prior to the 3:30 pm call without the file of historical information on Plainview.

Martens did have a few pieces of information to give Hansen. First, he had a recent newspaper article that profiled the company (see Exhibit 1). Next, KPMG faxed over Plainview's fiscal 2011 financial statements late yesterday, for which they gave a clean audit opinion (see Exhibit 2). One of the interns typed them in a spreadsheet and produced a common-size analysis (see Exhibit 3), a time-series ratio analysis (see Exhibit 4), and a cross-sectional ratio comparison of Plainview to three of its competitors (see Exhibit 5). The intern also produced some graphs of this information (see Figures 1 and 2) and included a definition of all of the ratios (see Appendix). Finally, the intern had pulled the list of the company officers and their areas of expertise from the Board of Directors biographies (see Exhibit 6). This would help Hansen decide to whom to direct questions during the call.

Martens told Hansen that this was the first time that Plainview was hosting a conference call. Last year, the company was only followed by analysts in the Minneapolis area, and the company's officers drove up for the day to meet with the analysts when their numbers came out. But, due to their recent strong stock performance, Plainview had been picked up by at least three Wall Street analysts, and institutional investors have been flocking to the stock. As a result, Plainview decided to host a conference call. As the IDS analyst, Hansen would have the opportunity to ask questions, and would probably get to ask one of the first questions due to the long relationship that IDS has had with Plainview.

Professor Brian Bushee prepared this case as the basis for class discussion rather than to illustrate either effective or ineffective handling of an administrative situation.

As Martens started to leave, he said, "Laura, it is extremely important that you ask insightful, knowledgeable questions during the call. The Wall Street guys are starting to encroach on our turf, and we need to show our clients that we have the horsepower to provide better research on our local firms than they can provide. We need you to really shine during this call." With that, Hansen found the coffee room, poured herself a big cup of Folgers, and got to work.

Exhibit 1: Recent Newspaper Article on Plainview Technology

Plainview Technology: A Southern Minnesota Success Story
By Chris Johnson, Minneapolis Star and Tribune, November 21, 2011, p. C1

How do you lose your biggest customer and still have a record year? Follow the lead of this Plainview, Minnesota company that manufactures iris scanning equipment for biometric identification. In the third quarter of 2009, defense contractor GreyOps Inc. decided to move its subcontracting work to Puerto Rico, where labor is cheaper. For Plainview Technology, that meant saying farewell to over half its business. But instead of sinking, the company managed to double the number of customers to 50 in 18 months. It also found new customers in the health care, financial institutions, and nuclear power industries. By year end 2009, sales and profits had risen 45% and 44%, respectively. In 2010 revenues increased 66% to $70 million and profits more than doubled to $3 million. Another record year is on the horizon when Plainview announces earnings in February. Says Plainview CEO Jeffrey Smesmo: “The worst happened, but we surfaced a much stronger company.”

<u>Humble Beginnings</u>

Plainview Technology Corporation was founded in 2004 by Jeffrey Smesmo, Gene Scharfenkamp, and David Visker. The three founders were former employees of TLT Systems, one of Plainview’s major competitors. “We saw a niche that TLT was just not going after,” says Smesmo. The three decided to escape the Twin Cities and its high cost of living for their home turf of Plainview. “All of our families were excited to be coming home. Plus, opening up shop in Plainview would help the community recover from the tough times that the local farmers have had recently,” Smesmo explains.

Using their network of contacts from their TLT days, the founders were able to ramp up the business quickly. The company turned its first profit in 2006, just two years after breaking ground in Plainview. To fuel its rapid growth, the company raised venture capital funds in 2007 from a Minneapolis-based venture capital firm, Nelson Johnson. “We needed a ready source of cash, as well as the expertise to go public, which was our dream from the start,” says Smesmo. The VC firm helped Plainview float its initial public offering on the NASDAQ in January 2009. The company chose the ticker symbol, PATC, in honor of Smesmo’s mother, Patsy. “From farm field to the NASDAQ in just five years is a testament to the strength of Plainview’s business model,” says David Poncin, an equity analyst for Piper, Jaffrey, and Hopwood who is bullish on the company’s stock.

<u>Exploiting a niche</u>

Plainview designs, develops, and manufactures iris scanning equipment for biometric identification. In 2008, the company had 15 customers, primarily in the defense contractor industry. Defense contractors use iris scanning to provide high-security access to its employees. Plainview must invest heavily in R&D to develop new technologies for the rapidly-evolving security requirements of its customers. “We work very closely with our customers to make sure we are up-to-date with their needs,” Smesmo says.

Exhibit 1 (continued): Recent Newspaper Article on Plainview Technology

During the 2000's, new 6G technology was rapidly replacing the old 5G technology. In 2008, 46% of Plainview sales were 6G, versus 14% in 2007. "We have had to turn the shop upside down in order to meet the demands for the new technology," says Smesmo. "But, it ensures our competitive niche." The trend to 6G technology has further spurred the use of iris scanners over the retina scanners. "Iris scanners are now the wave of the future," says Poncin.

But, Plainview faces heavy competition. Its main domestic competitors are TLT Systems, IRIS Inc., and Orezano Corporation, which are larger than Plainview and, consequently, able to handle larger manufacturing contracts. "TLT rapidly moved to try to steal our business once we started up. But, we have fended them off so far," says Smesmo. "For smaller contracts, we have a clear competitive advantage in terms of quality, service, price, and reliability." A bigger challenge is offshore manufacturers, who are increasing their presence in the industry due to significantly lower labor rates. "Plainview cannot compete on high-volume, low-cost 'commodity' iris scanners," says Poncin.

<u>Crisis</u>

In the third quarter of 2009, Plainview's largest customer, GreyOps, moved its contract manufacturing business to an offshore supplier to take advantage of lower labor costs. GreyOps accounted for roughly half of Plainview's revenue at this time. In addition, another major customer, MaxiTank, was experiencing serious financial troubles. "We were certainly on the brink," remembers Smesmo. In response to this bad news, management had to find new sources of revenues and profits. "We had been making some inroads into expanding our customer base beyond defense contractors," recalls Smesmo. "But, we really had to roll up our sleeves and beat the bushes in '09 to find new market segments. Hospitals, banks, and power plants were all looking to upgrade their security systems. Fortunately, our small size and high quality and service allowed us to attract new customers quickly with custom products."

After stopping the bleeding, management needed a game plan for the future. "We can never compete on labor costs with offshore manufacturers. But, we have incredibly skilled workers. The solution was to automate," says Smesmo. Plainview floated a new stock issue and greatly increased its borrowing to fund the automation of its plants. The company also opened new plants in Visalia, California and Gaffney, South Carolina. "We poured every cent into our physical plant. We expanded to be closer to our East and West Coast customers. It was a big risk, but it has paid off handsomely", says Smesmo. "Plainview's ability to attract new customers is legendary in the industry. Their high-quality, custom-product focus has been a message that has sold well with their customer base," says Poncin

Exhibit 1 (continued): Recent Newspaper Article on Plainview Technology

A rosy future

Driven by double-digit growth in sales and profits from their new market segments, Plainview's stock price has increased by 600% to $22/share since the start of 2010. Financial analysts following the stock, including Poncin, have consistently issued "strong buy" recommendations. In addition, the company has attracted significant interest from Wall Street analysts and investors. "We have transitioned from a local stock to a national player. I see us becoming a global force within the next five years," says Smesmo.

Earlier this month, the Plainview Rotary Club announced that Jeffrey Smesmo was its "Man of the Year." Not only is Plainview Technology now Southern Minnesota's largest employer, outpacing even Hormel and the Mayo Clinic, many residents have substantial personal investments in the company's stock. "The whole community has rallied around us," says Smesmo. Management sees even greener pastures in Plainview's future. "The management team has been foregoing cash raises in favor of stock options. We want to invest the cash in the business. We are making a big bet on the company in tying up our wealth with the company's stock price."

Poncin recommends keeping "your eye on Planview (pun intended). You could be looking at the company that joins 3M and Honeywell in the universe of Minnesota tech superstars."

Exhibit 2: Plainview Financial Statements, 2008 – 2011

Plainview Corporation
Balance Sheet ($000's)

Assets	12/31/2008	12/31/2009	12/31/2010	12/31/2011
Cash & Equivalents	1,915	295	288	1,045
Accounts Receivable	9,310	4,704	12,013	12,625
Inventories	8,963	7,481	20,660	28,532
Prepaid Expenses	334	275	203	280
Current Assets	20,522	12,755	33,164	42,482
Land	85	85	295	295
Building & Improvements	2,260	3,878	4,546	5,093
Construction in Progress	140	2	21	442
Machinery and Equipment	7,064	19,548	31,009	49,226
Accumulated Depreciation	(2,474)	(4,708)	(9,245)	(16,436)
Net Property, Plant, & Equip	7,075	18,805	26,626	38,620
Other Assets	709	380	94	103
Total Assets	28,306	31,940	59,884	81,205
Liabilities & Stockholders' Equity:				
Curr. Portion of L.T. Debt	592	1,066	2,207	753
Accounts Payable	7,287	3,360	8,445	8,531
Accrued Wages	429	529	1,237	1,468
Accrued Taxes	523	21	836	182
Other Current Liabilities	243	355	820	797
Current Liabilities	9,074	5,331	13,545	11,731
Long Term Debt	11,641	6,742	23,451	29,210
Deferred Tax and Other	800	721	641	587
Total Long Term Liabilities	12,441	7,463	24,092	29,797
Common Stock	59	84	95	107
Paid In Capital	6,007	16,866	16,929	29,275
Retained Earnings	725	2,196	5,223	10,295
Stockholders' Equity	6,791	19,146	22,247	39,677
Total Liabs. & Stkhldrs.' Eq.	28,306	31,940	59,884	81,205

Exhibit 2 (continued): Plainview Financial Statements, 2008 – 2011

Plainview Corporation
Income Statement ($000's)

For the year ended:	12/31/2008	12/31/2009	12/31/2010	12/31/2011
Sales	29,255	42,420	70,229	102,026
Cost of Sales	(24,943)	(36,726)	(59,330)	(85,404)
Gross Profit	4,312	5,694	10,899	16,622
Selling, Gen.. & Admin.	(1,955)	(2,298)	(3,824)	(5,469)
Operating Income	2,357	3,396	7,075	11,153
Interest Expenses	(764)	(1,086)	(1,953)	(2,665)
Other/Net	(305)	54	(77)	(40)
Pre-tax Income	1,288	2,364	5,045	8,448
Taxes	(406)	(894)	(2,018)	(3,378)
Extraordinary item	140			
Net Income	1,022	1,470	3,027	5,070
Earnings Per Share	0.17	0.19	0.35	0.51

Exhibit 2 (continued): Plainview Financial Statements, 2008 – 2011

Plainview Corporation
Statement of Cash Flows

	12/31/2008	12/31/2009	12/31/2010	12/31/2011
Cash Flows from Operating Activities:				
Net Income	1,020	1,470	3,027	5,070
Depreciation	1,145	2,372	4,537	7,191
Allowance for Doubtful Accts.	270	12	48	48
Changes in:				
A/R	(7,441)	4,594	(7,357)	(660)
Inventories	(5,294)	1,481	(13,179)	(7,872)
Prepaid, other	(64)	(1)	179	14
Accounts Payable	6,173	(3,927)	5,084	86
Accrued Wages	227	99	708	232
Other Current Liabs.	200	110	464	(23)
Accrued Taxes	401	(494)	994	865
Extraordinary item	(140)	-	-	-
Cash Flow from Operations	(3,503)	5,716	(5,495)	4,951
Cash Flows from Investing Activities:				
Capital Expenditures	(3,704)	(14,044)	(12,490)	(19,387)
Sale of Equipment	266	327	150	85
Cash Flows from Investments	(3,438)	(13,717)	(12,340)	(19,302)
Cash Flows from Financing Activities:				
Proceeds from borrowing	8,107	8,088	21,113	29,659
Payments on borrowing	(1,417)	(11,792)	(3,349)	(25,986)
Common Stock issued	1,909	10,084	64	11,436
Cash Flows from Financing	8,599	6,380	17,828	15,109
Net Change In Cash	1,658	(1,621)	(7)	757
Cash Interest Paid	782	1,086	1,968	2,636
Cash Taxes Paid	-	1,404	1,024	2,422

Exhibit 3: Common Size Analysis of Plainview

Balance Sheet				
Assets	12/31/2008	12/31/2009	12/31/2010	12/31/2011
Cash & Equivalents	0.07	0.01	0.00	0.01
Accounts Receivable	0.33	0.15	0.20	0.16
Inventories	0.32	0.23	0.35	0.35
Prepaid Expenses	0.01	0.01	0.00	0.00
Current Assets	0.73	0.40	0.55	0.52
Land	0.00	0.00	0.00	0.00
Building & Improvements	0.08	0.12	0.08	0.06
Construction in Progress	0.00	0.00	0.00	0.00
Machinery and Equipment	0.25	0.61	0.52	0.61
Accumulated Depreciation	(0.09)	(0.15)	(0.15)	(0.20)
Net Propery, Plant, & Equip	0.25	0.59	0.44	0.48
Other Assets	0.03	0.01	0.00	0.00
Total Assets	1.00	1.00	1.00	1.00
Liabilities & Stockholders' Equity:				
Curr. Portion of L.T. Debt	0.02	0.03	0.04	0.01
Accounts Payable	0.26	0.11	0.14	0.11
Accrued Wages	0.02	0.02	0.02	0.02
Accrued Taxes	0.02	0.00	0.01	0.01
Other Current Liabilities	0.01	0.01	0.01	0.01
Current Liabilities	0.32	0.17	0.23	0.15
Long Term Debt	0.15	0.21	0.39	0.36
Deferred Tax and Other	0.03	0.02	0.01	0.01
Total Long Term Liabilities	0.44	0.23	0.40	0.37
Common Stock	0.00	0.00	0.00	0.00
Paid In Capital	0.21	0.53	0.28	0.36
Retained Earnings	0.03	0.07	0.09	0.13
Stockholders' Equity	0.24	0.60	0.37	0.49
Total Liabs. & Stkhldrs.' Eq.	1.00	1.00	1.00	1.00

Income Statement				
For the year ended:	12/31/2008	12/31/2009	12/31/2010	12/31/2011
Sales	1.00	1.00	1.00	1.00
Cost of Sales	(0.85)	(0.87)	(0.84)	(0.84)
Gross Profit	0.15	0.13	0.16	0.16
Selling, Gen.. & Admin.	(0.07)	(0.05)	(0.05)	(0.05)
Operating Income	0.08	0.08	0.10	0.11
Interest Expenses	(0.03)	(0.03)	(0.03)	(0.03)
Other/Net	(0.01)	0.00	(0.00)	(0.00)
Pre-tax Income	0.04	0.06	0.07	0.08
Taxes	(0.01)	(0.02)	(0.03)	(0.03)
Extraordinary item	0.00	-	-	-
Net Income	0.03	0.03	0.04	0.05

Exhibit 4: Time-Series Ratio Analysis of Plainview

Time-Series Ratio Analysis	Plainview 12/31/2008	Plainview 12/31/2009	Plainview 12/31/2010	Plainview 12/31/2011
DuPont Analysis				
Return on Equity (NI/Avg SE)	12.99%	11.34%	14.63%	16.38%
Return on Assets (EBI/Avg TA)	4.90%	7.26%	9.40%	9.68%
Financial Leverage (Avg TA/Avg SE)		2.32	2.22	2.28
Correction factor (NI/EBI)		0.67	0.70	0.74
Return on Assets				
Return on Sales (EBI/Sales)	4.74%	5.16%	6.15%	6.69%
Asset turnover (Sales/Avg TA)		1.41	1.53	1.45
Profitability Ratios				
Gross margin	14.74%	13.42%	15.52%	16.29%
SG&A as % of Sales	6.68%	5.42%	5.45%	5.36%
Operating Margin	8.06%	8.01%	10.07%	10.93%
Asset Turnover				
Accounts Receivables Turnover		6.05	8.40	8.28
Days Receivables (DR)		60.29	43.44	44.07
Inventory Turnover		4.47	4.22	3.47
Days Inventory (DI)		81.71	86.56	105.12
Accounts Payable Turnover		6.62	12.28	10.99
Days Payable (DP)		55.13	29.71	33.21
Net trade cycle (DR + DI - DP)		86.87	100.29	115.98
Fixed asset turnover		3.28	3.09	3.13
Liquidity Ratios				
Current ratio	1.24	2.39	2.45	3.45
Quick ratio	0.68	0.94	0.91	1.11
Other Information and Ratios				
Sales growth		45.0%	65.6%	45.3%
Earnings before after-tax interest (EBI)	1,526	2,187	4,316	6,829
Federal statutory tax rate	34%	34%	34%	34%
Effective tax rate	32%	38%	40%	40%
Purchases		35,244	72,509	93,276
Depreciation / Avg Gross PP&E		25.4%	28.8%	36.4%

Note: 2008 ratios exclude the extraordinary item

Exhibit 5: Cross-Sectional Ratio Analysis of Plainview and Competitors

	Plainview	IRIS	TLT Systems	Orezano	Plainview	IRIS	TLT Systems	Orezano	Plainview	IRIS	TLT Systems	Orezano
	12/31/2009	12/31/2009	6/30/2010	8/31/2009	12/31/2010	12/29/2010	6/30/2011	8/31/2010	12/31/2011	12/31/2011	6/30/2012	8/31/2011
DuPont Analysis												
Return on Equity	11.34%	7.57%	1.33%	43.49%	14.63%	6.64%	1.91%	31.49%	16.38%	5.27%	2.02%	22.19%
Return on Assets	7.26%	5.55%	3.22%	9.08%	9.40%	4.45%	3.09%	10.98%	9.68%	3.76%	2.41%	9.51%
Financial Leverage	2.32	1.95	0.59	6.84	2.22	2.13	0.88	4.10	2.28	2.00	1.20	3.33
Return on Assets												
Return on Sales	5.16%	3.46%	1.71%	3.79%	6.15%	2.97%	1.62%	4.02%	6.69%	2.27%	1.34%	4.02%
Asset turnover	1.41	1.60	1.88	2.40	1.53	1.50	1.91	2.73	1.45	1.66	1.80	2.36
Asset Turnover												
A/R Turnover	6.05	6.11	7.98	7.90	8.40	5.50	8.70	10.24	8.28	6.60	8.39	8.56
Days Receivables	60.29	59.72	45.72	46.21	43.44	66.34	41.97	35.64	44.07	55.28	43.49	42.64
Inventory Turnover	4.47	7.59	4.17	5.31	4.22	7.06	4.45	7.16	3.47	6.96	4.20	5.70
Days Inventory	81.71	48.12	87.46	68.71	86.56	51.71	82.10	50.95	105.12	52.47	86.92	64.06
A/P Turnover	6.62	9.88	11.30	6.94	12.28	8.16	12.93	8.84	10.99	8.62	9.14	7.01
Days Payable	55.13	36.96	32.31	52.60	29.71	44.73	28.22	41.27	33.21	42.33	39.94	52.05
Net trade cycle	86.87	70.88	100.86	62.32	100.29	73.32	95.86	45.32	115.98	65.42	90.48	54.65
Fixed asset turnover	3.28	3.47	8.62	10.74	3.09	3.29	7.47	11.32	3.13	3.49	7.16	10.93
Liquidity Ratios												
Current ratio	2.39	2.46	3.34	1.50	2.45	2.05	2.98	1.72	3.45	2.00	2.32	1.49
Quick ratio	0.94	1.60	1.24	0.76	0.91	1.20	1.14	0.92	1.11	1.00	0.86	0.68

Exhibit 6: Plainview Board of Directors

Jeffrey J. Smesmo (43) is Chairman, Chief Executive Officer, and a Director. He is responsible for sales and marketing, finance, and general management of the Company. He was previously employed by TLT Systems, Inc., where he held the position of Treasurer and Chief Financial Officer. He holds a B.S. degree in Accounting from St. Cloud State University and is a Certified Public Accountant.

Gene E. Scharfenkamp (42) is President, Chief Operating Officer, and a Director. He is responsible for manufacturing, engineering, and programs operations. He was previously employed by TLT as a plant manager and a manufacturing manager. Prior to that, he was employed by Honeywell. He holds a B.S. degree in Industrial Engineering from Mankato Polytechnic Institute.

David L. Visker (45) is an Executive Vice President and a Director. He is responsible for material management and procurement. He was previously employed by TLT as Vice President of Purchasing. Prior to that, he was employed by General Mills as manager of subcontracts. He holds a B.S. degree in Operations Management from the University of Minnesota at Morris

Yuji A. Fujiya (57) is a Director and member of the Audit Committee. He has served as President of Fujiya Trading Company in Tokyo, Japan since 2006.

Lois Nielson (49) is a Director and member of the Audit Committee. She is partner of Nielson Technology Partners, a venture capital firm. Prior to that, she was a securities analyst with First Bank Corporation.

James R. Kaltz (46) is a Director and member of the Audit Committee. He is President of State Bank and Trust of Albert Lea, Minnesota (Plainview's bank) and Chief Executive Officer of StateBanc Corporation, the bank's holding company.

Brian E. Schade (65) is a Director and a member of the Compensation Committee. He has been a manufacturing consultant since 2001. Prior to that, he was employed by TLT as Division Vice President, and served as General Manager of IBM's Rochester Electronics Division.

E. William Campe (32) is a Director and a member of the Compensation Committee. He is Vice President and Principal of Nelson Johnson Investment Group, Inc., a venture capital firm in Bloomington, Minnesota (which provided pre-IPO funding to Plainview and is currently Plainview' largest shareholder).

Robert L. Vogel (59) is a Director and a member of the Compensation Committee. He is the mayor of Plainview, Minnesota and the President of Vogel Motor Company, an automobile dealership.

Figure 1: Cross-sectional Ratio Analysis of Plainview and Competitors – DuPont Analysis

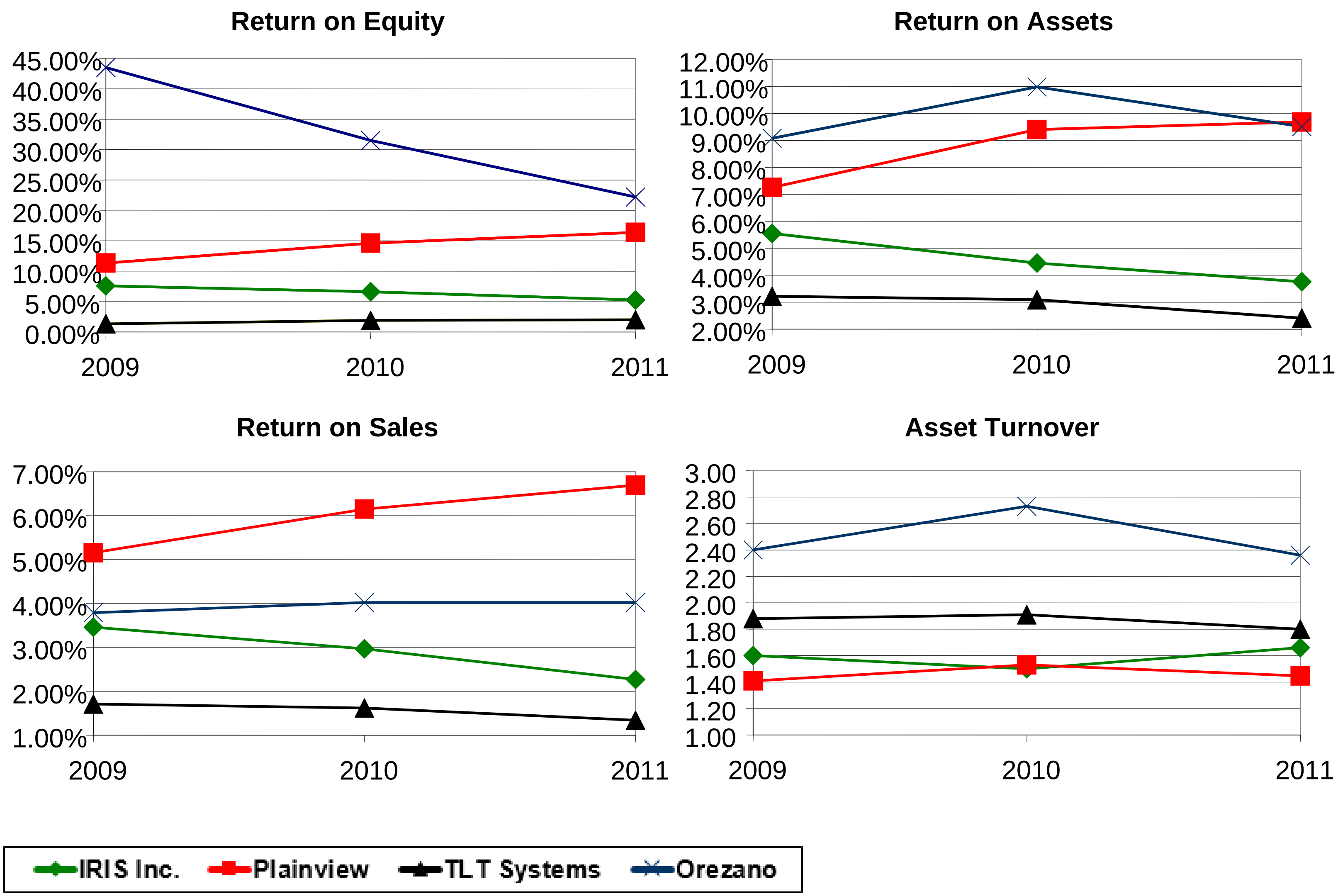
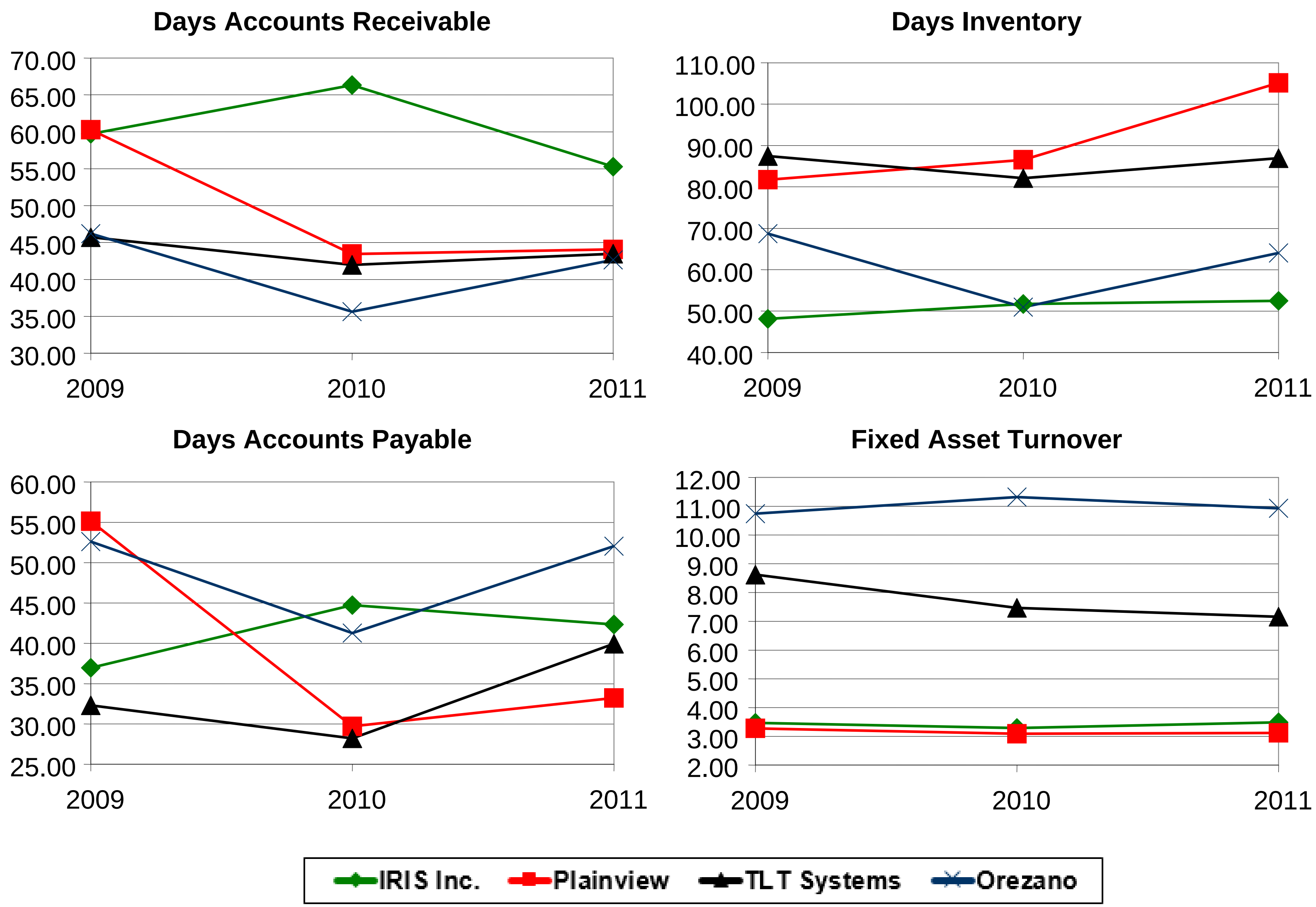


Figure 2: Cross-sectional Ratio Analysis of Plainview and Competitors – Asset Turnover Analysis



Appendix: Ratio Definitions

DuPont Analysis: ROE = ROA * Financial Leverage * Correction Factor

Return on Equity (ROE) = Net income/Average Stockholders' Equity

Return on Assets (ROA) = (Net income + (1-.34)*Interest Expense) /Average Total Assets

Financial Leverage = Average Total Assets/Average Stockholders' Equity

Correction Factor = Net income/ (Net income + (1-.34)*Interest Expense)

ROA = ROS * Asset Turnover

Return on Sales (ROS) = (Net income + (1-.34)*Interest Expense)/ Sales

Asset Turnover = Sales /Average Total Assets

Gross Margin = (Sales – Cost of Goods Sold) / Sales

SG&A as a % of Sales = SG &A Expense / Sales

Operating Margin = Operating Income / Sales

Accounts Receivable Turnover = Sales/Average Accounts Receivable
Days Receivable = 365/Accounts Receivable Turnover

Inventory Turnover = COGS/Average Inventory
Days Inventory = 365/Inventory Turnover

Accounts Payable Turnover = Purchases/Average Accounts Payable
Days Payable = 365/Accounts Payable Turnover

(Purchases = Ending Inventory + COGS – Beginning Inventory)

Net Trade Cycle = A/R Days + Inventory Days - A/P Days

Fixed Asset Turnover = Sales/Average Net Property, Plant and Equipment