

PolyPanel. Financing Growth

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Introduction

At the beginning of 2008, PolyPanel, a successful, growing company, asked for a line of credit with a maximum of €500,000 to finance inventories and credit to customers. PolyPanel was founded in 2003 and after rapid growth was able to make a profit in its third year of operations. The prospects of the company were good for the coming years. The company submitted its financial statements to the bank (see **Exhibits 1 and 2**). One of the bank's credit analysts visited the company and interviewed the founder and general manager, Mr. Lichtstein. The following comments are a summary of his opinions.

The Business

PolyPanel is a retail distributor of panels for the construction or modification of houses and industrial warehouses. The panels can be used as ceilings or walls; they are easy to install, light and resistant, but expensive. There are a variety of materials for every use. PolyPanel sells mainly sandwich panels,¹ but it also has panels of polycarbonate, metacrilate, plastic, etc. For each material there are several choices of color, thickness, etc. PolyPanel also sells the accessories to finish the installation. In total, PolyPanel has around 200 references (different products).

The typical client is a small contractor that works in new buildings or reforms of old ones. There are also final clients that do their own repairs at home. At present, PolyPanel has around 2,000 clients registered. Around 55% of sales are concentrated in the six months around summer.

¹ Two metal sheets with polyurethane inside that work very well as isolation material.

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PolyPanel is located in a growing industrial area in the vicinity of Munich. Asked about competition, Mr. Lichtstein answers:

"The only big competitor is my former company, but they have worse service and slightly higher prices. In the area there are around 20 distributors of other construction materials that sell panels, but with much less variety of products and services; for example, they have around 10 panels as opposed to the 200 we have. We have more references, better service to the customer and faster delivery at a very reasonable price. In theory, a winning formula, but nevertheless I assume that every competitor may steal some potential customers from us.

As in any distribution company, purchasing and management of the inventory is crucial. PolyPanel typically buys a big truckload (1,000 m² of panel) three times a week and the supplier issues a 60-day bill. The main supplier represents 80% of purchases and is one of the world leaders.

PolyPanel cuts the big panels to the measurements required by the customer (a typical order is for around 20 m² – 40 m²). The cutting process is crucial: up to five points of margin could be lost if the process is not done with careful planning in order to avoid waste. Another crucial point is to have plenty of products (references) available for quick delivery (two to three days) to the customer. At present, PolyPanel has around 20,000 m² of panel, or roughly €400,000, in stock."

Management and Personnel

Mr. Lichtstein (41), manager and founder of the company, is in charge of purchases and finance. He had worked for 10 years with his main competitor (four of them as a general manager) before starting his own company in 2003 at the age of 36. Educational background: civil engineer.

There is one sales director plus one sales person that visit potential customers regularly. One person is in charge of the warehouse, aided by three employees, and, finally, there is one truck driver. In total, one general manager, two managers and five employees. The employees have a 20% stake in the company; the other 80% is in the hands of Mr. Lichtstein and his father.

Profit & Loss and Financial Situation

According to Mr. Lichtstein,

"the first three years of operations, from 2003 to 2005, were really tough: we had to invest a lot in inventory and reform the facilities, plus hire new people and train them, plus define the product catalog, selling process, etc.... really hectic! And, on top of that, you don't have enough customers to make a profit. But I am really satisfied: we achieved terrific growth, tripling sales in only three years; we already have a team of committed people, good customer satisfaction and product reliability.

In 2007, we had sales of almost €3 million and a reasonable profit of €50,000. I see a lot of sales growth potential. For example, in Lombardy (Italy) a medium-size distributor of panels sells around €5 million. In Bavaria we have more industrial activity, economic growth and fewer distributors of panels. I don't see any reason why we couldn't reach €5 million or €7 million in sales in a few years. My target is 25% sales growth annually during the next three years. If we maintain our COGS at around 70%, with that level of sales I am convinced we will make a good profit.



Our main investment is the inventory (we typically have around 60 days of sales) and receivables from customers (60-day bill for most of the customers, although there are a few that are billed at 90 days). We pay the supplier at 60 days; if we pay cash they offer a 2% discount for early payment, but so far I haven't used it. Our investment in fixed assets is as small as possible. We have a rented warehouse of 900 m² plus another 200 m² for administrative offices. Most of the machinery is also rented.

By far, the main problem during these first years has been the lack of financing. I started with only the €60,000 that I could gather from my father and my small savings. I knew that we would have losses during the first years and we didn't have the money to cover them. But if you wait until you get all the money you need, you never start the business. I thought: go for it, and we will see how to survive.

I have been trying to get money from anywhere. After two years, in 2005 we increased capital. At present we have invested €300,000 of our own money, which I got from mortgaging my house. The second year I borrowed from friends.² I have negotiated with many banks and savings banks to get credit lines. At present, I have seven of around €50,000 each. Now I want to replace these seven lines with only one of half a million euros, and with only one saving bank that understands our business. With this move we will have tackled the permanent cash stress."

Perspective of the Bank

The director of the local branch of the savings bank knew Mr. Lichtstein since the very beginning of PolyPanel. He had granted a line of credit of €50,000 in 2004. Now, in 2007, the savings bank was looking for growth opportunities and expansion, especially to support local and promising new companies. PolyPanel could be one of them. After four years (2002-2005) of slow growth (around 0%), the economic environment in Germany was clearly improving: economic growth reached almost 4% during the years 2006-2007 and the perspective for the coming years, especially within the industry, was optimistic.

As part of the credit analysis, the savings bank had contacted the main supplier of PolyPanel, who provided a good opinion about Mr. Lichtstein.

"We have had commercial relations with Mr. Lichtstein during the last four years. He is our main distributor in Bavaria. We knew that he would face the typical problems of a new company, but we bet on him. He is prudent, a hard worker, keeps control of the costs and financing, and has sound judgment about his business."

² In the balance sheet: "other liabilities."

Exhibit 1

PolyPanel. Profit & Loss Account

P&L (Thousands of Euros)	2004	2005	2006	2007	Forecast		
					2008	2009	2010
Sales	977	1,500	2,200	2,936	3,650		
COGS	684	1,035	1,540	2,052			
Transportation & commercial exp.	69	108	145	208			
Gross margin	224	357	515	676			
Salaries	166	203	253	336	-	-	-
Overhead	120	153	181	221	-	-	-
Opex (operational expenses)	286	356	434	557			
EBITDA	-62	1	81	119			
Depreciation	20	33	31	31	30	30	30
EBIT	-83	-32	50	88			
Financial results	-8	-15	-22	-30			
Profit before taxes	-91	-47	28	58			
Taxes (25%)	23	12	-7	-15			
Net income	-68	-35	21	44			

Pro memoriam:

Purchases	775	1,052	1,656	2,179
Salary of Mr. Lichstein	60	90	90	100
New investments in FA	1	117	9	8

P&L Ratios		Media	Assumptions		
			2008	2009	2010
Growth of sales	170%		24%	25%	25%
COGS / Sales			70%	70%	70%
Transportation / Sales			7%	7%	7%
Gross margin / Sales					
Growth of salaries	46%		-	-	-
Growth of overhead	20%		-	-	-
Growth of opex	34%		-	-	-
Opex / Sales			19%	19%	19%
EBITDA / Sales					
ROS (Net income / Sales)					
RONA (EBIT / Net assets)					
ROE (Net income / Equity)					
Interest rate, average			6%	6%	6%

Guidelines

1. Calculate the P&L ratios and then do your analysis.
2. For the forecast, use the assumptions **in bold and green.**

Source: Own elaboration.



Exhibit 2

PolyPanel. Balance Sheets

Balance (thousand €)	2004	2005	2006	2007	SAF	Forecast		
					2004-07	2008	2009	2010
Cash	1	8	6	6		0	0	0
Receivables	188	305	473	649				
Other	42	56	38	18		0	0	0
Inventory	192	209	325	452				
Current assets	423	578	842	1.125				
Non current assets	60	144	123	100		100	100	100
TOTAL ASSETS	483	722	965	1.225				
Payables to suppliers	131	210	390	400				
Promissory notes with supplier				162				
Other liabilities	151	74	35	22		0	0	0
Bank lines of credit	100	122	202	310		Leave it empty. See line 68.		
Current liabilities	382	406	627	894				
Long term debt	100	200	200	150		120	90	60
Capital	150	300	300	300				
Reserves	-81	-149	-184	-163				
Net income of the year	-68	-35	21	44				
Equity	1	116	137	181				
LIABILITIES + EQUITY	483	722	964	1.225				
					Credit needed	0	0	0

Short Balance Sheet	2004	2005	2006	2007	SAF	Forecast		
					2004-2007	2008	2009	2010
NFO	140	286	411	535				
NCA, not current asset, net	60	144	123	100				
NA, net assets	200	430	534	635				
D, Bank debt	200	322	402	460				
E, Equity	1	116	137	181				
Liabilities + Equity	201	438	539	641				
Cash surplus (+) or credit (-)	1	8	6	6				

NFO vs. WC								
NFO	140	286	411	535				
WC	41	172	215	231				
Cash (+) or credit (-) net	-99	-114	-196	-304				

Balance ratios								
Days of collection						80	80	80
Days of inventory						80	80	80
Days of payment						90	90	90
NFO / Sales								

Source: Own elaboration.