



# The Silver Lining to Industry Transformation

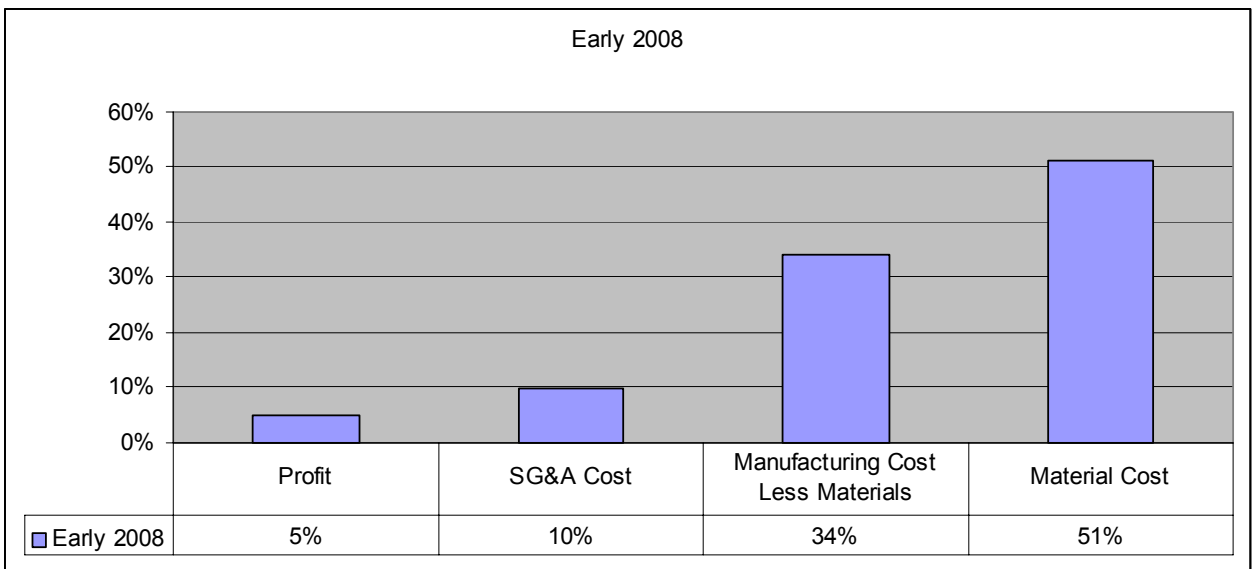
Jeoff Burris, Principal, & Adam Thor Director True Cost Modeling  
Advanced Purchasing Dynamics, Inc.  
July 2009

In order to respond to the dramatic storm in our manufacturing economy many companies have taken extraordinary actions to stay solvent. Automotive suppliers especially took rapid and drastic steps to try and maintain at least break-even cash flow while production has fallen to historic, Post WWII levels.

Is there an upside for these companies from this economic storm? The answer is an unqualified yes. Astute companies who have reduced variable and structural costs and changed their business processes to support these lower cost structures will emerge from the current environment with a leaner cost structure and higher profitability.

Advanced purchasing Dynamics' True Cost Modeling process is based upon utilizing actual cost information from suppliers' shop floors. The process can be used in a myriad of useful ways. We utilized our data to model the bottom line impacts of the ongoing business conditions on a stampings supplier. We assumed that the supplier had pre-recession sales of \$100 mil produced on a size mix of stamping presses operating at 80% of capacity.

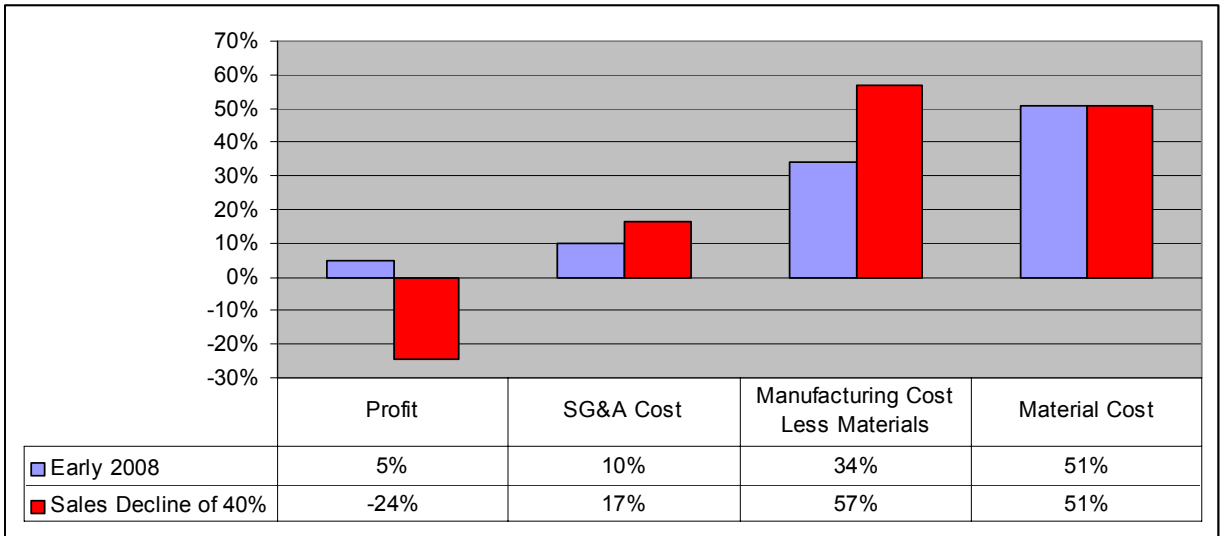
In the first half of 2008 before the fall of automotive volumes the supplier's financial profile looked as follows:



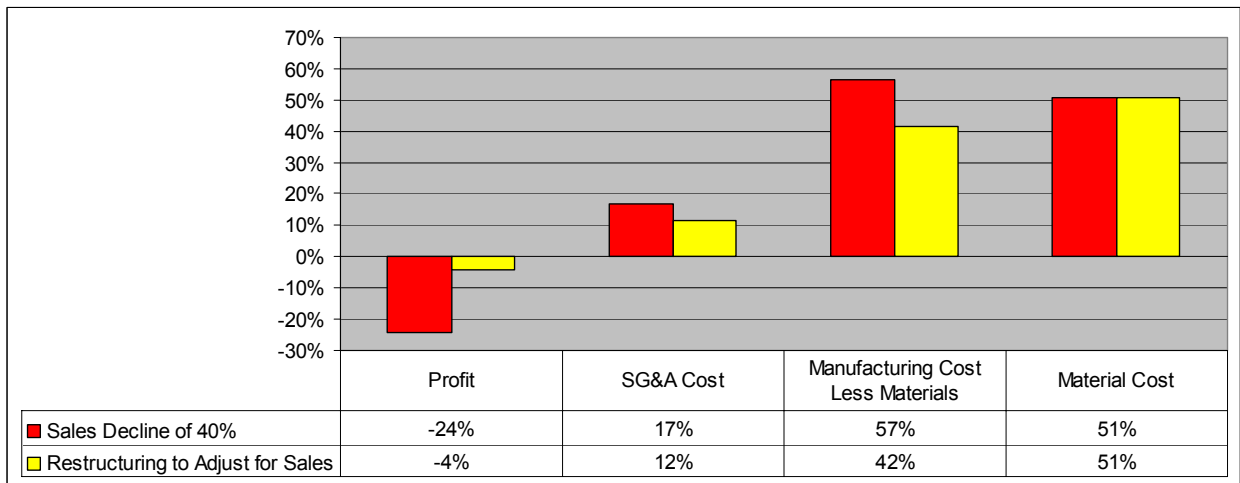
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If a result of the economic storm is that the supplier's sales fall 40% and the supplier does nothing to adjust for the sales shortfall but decrease its purchases of raw materials, financial profiles would change to the following:



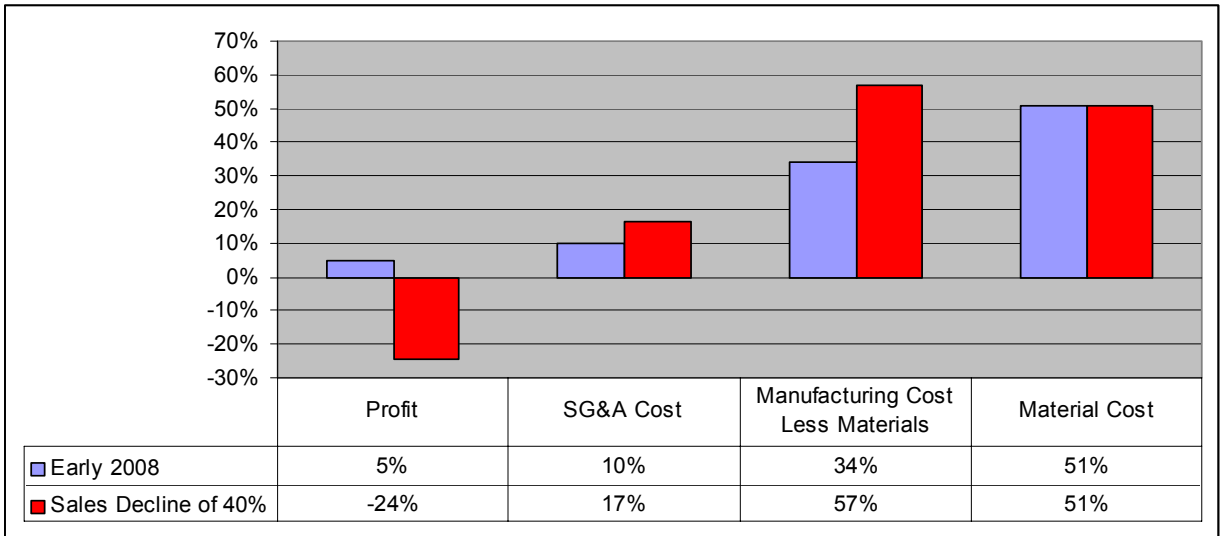
However, based upon discussion we have had with many CEOs, most suppliers responded to the sales shortfall by reducing costs to at least a breakeven cash flow level. In our model we did this by reducing SG&A by 30% and non-material variable costs by 35%. As a result of this restructuring the supplier's financial profile changes to the following:



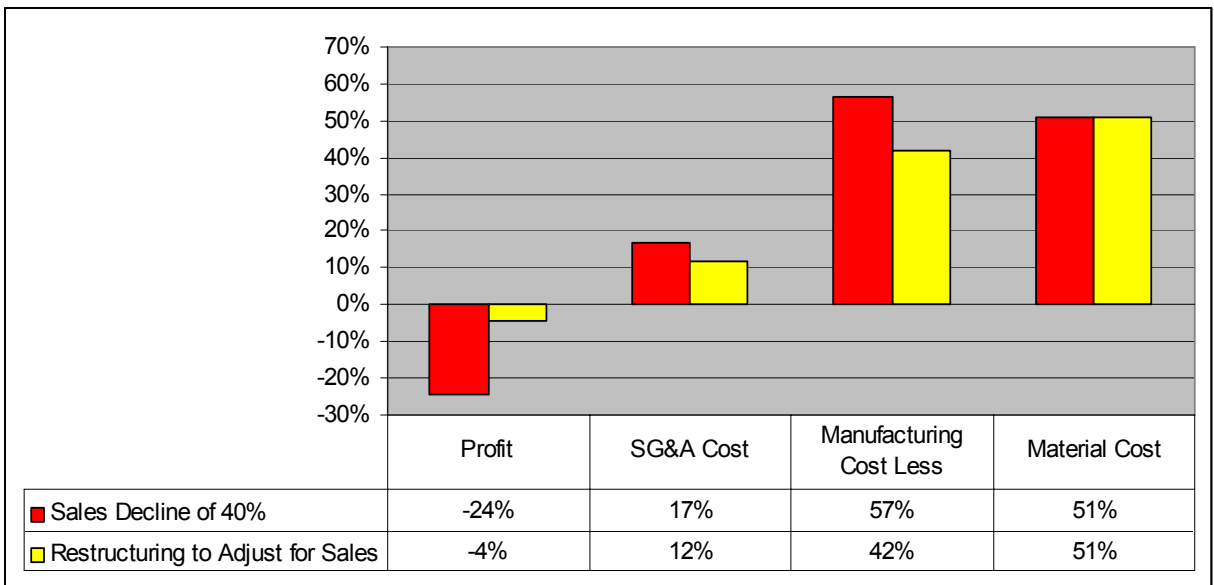
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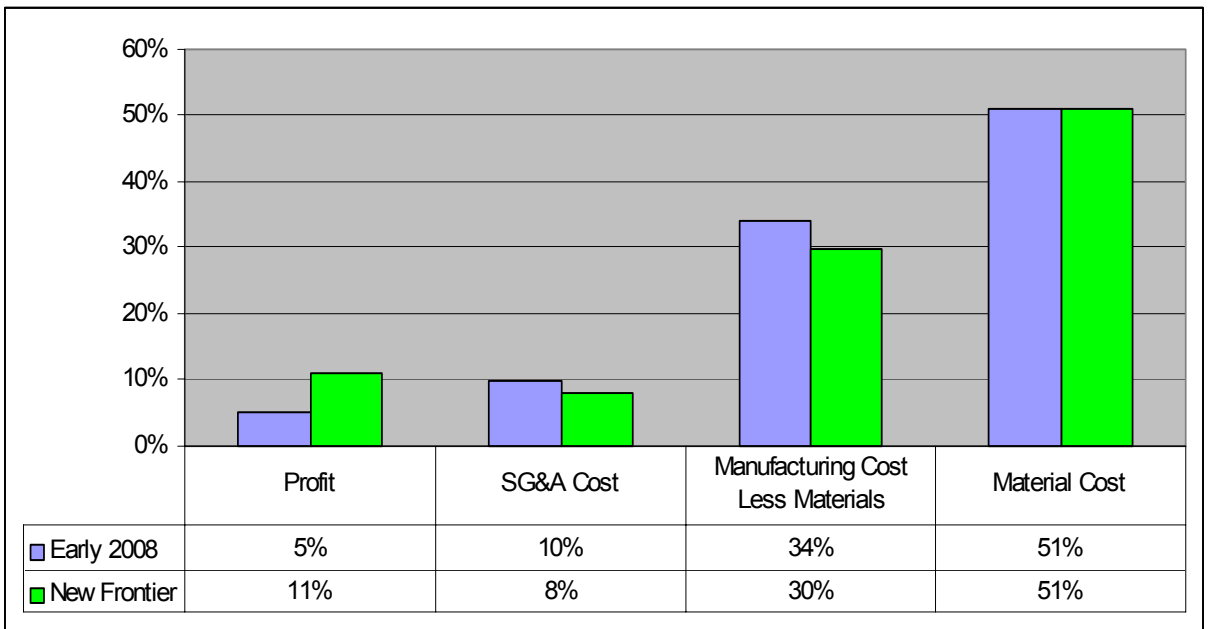
During the industry restructuring, many of the automotive manufacturers are rapidly reducing their supply bases moving business to more financially sound suppliers who are cost and quality leaders.

We assumed that our modeled supplier wins business awards worth \$30 mil of sales when industry volumes come back. They also bought used equipment at the currently distressed industry prices of 20% of book value.

We anticipated that when industry volumes return they would increase their cost structure from the pre-restructuring levels as follows:

- SG&A to historical dollar levels – not %.
- Direct, Indirect and Salaried Labor by 20% .
- Indirect variable 15%.
- Fixed cost 5%.

This would result in the New Frontier financial profile:





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We utilized only some of the anecdotal information from CEOs as the basis for the cost adjustments we made to our model. We were conservative by not incorporating some of the actions companies are taking to reduce their fixed and financing costs including:

- Renegotiating equipment and building leases.
- Consolidating manufacturing locations.
- Renegotiating service contracts such as information technology.
- Reducing their finance costs through financial restructuring.

Purchasing organizations can help suppliers through this process by:

- Encouraging suppliers to not only reduce costs but to also streamline their processes and practices so that the lower cost structures will be sustainable.
- Providing suppliers assistance in identifying restructuring opportunities.
- Providing rapid response to suppliers requests for information or assistance.
- Communicating clear and concise expectations and information about any new or take over business awards.

With an ongoing, collaborative focus on cost management throughout the supply chain suppliers and customers can both benefit from the structural cost improvements.

**Advanced Purchasing Dynamics, Inc. has supported many companies through difficult restructuring and aided them in improving their supply chain cost structures.**

**To find out how Advanced Purchasing Dynamics can help your firm, please contact us at [www.apurchasingd.com](http://www.apurchasingd.com).**