

The Ball Park Financial Terrain of U.S. Manufacturers and Distributors

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Agenda

- Review Income Statement and Balance Sheet
- Review Comparable Profits Method (CPM)
- Review Profit Level Indicators (PLI) of CPM
- What does the Ball Park look like?

Different Views of Transfer Pricing Analysis

- Formulary Apportionment Method
- Ball Park – Broad Overview
- APA Regulatory Analysis

Transfer Pricing 101

- Income Statement
- Balance Sheet
- PLIs

Income Statement

Sales

- Cost of Goods Sold (COGS)

Gross Profit

- Selling, General and Administrative Expenses (SG&A)

Operating Income Before Depreciation

- Depreciation, Depletion & Amortization

Operating Profit

- Interest Expense

- Non-Operating Income/Expense

- Special Items

Pretax Income

Balance Sheet

Assets

Cash & Equivalents
Account Receivables
Inventories
Prepaid Expenses
Total Current Assets
Property Plant & Equip (PPE)
Investments at Equity
Other Investments
Intangibles
Deferred Charges
Other Assets
Total Assets

Liabilities and Stockholder's Equity

Long Term Debt Due In One Year
Notes Payable
Accounts Payable
Taxes Payable
Accrued Expenses
Other Current Liabilities
Total Current Liabilities
Long Term Debt
Deferred Taxes
Investment Tax Credit
Minority Interest
Other Liabilities
Total Liabilities
Equity
Total Liabilities And Stockholder's Equity

Profit Level Indicators (PLI)

- Operating Profit Margin
- Gross Profit Margin
- Berry Ratio
- Return on Capital Employed (ROCE)
- Cost Plus

Operating Profit Margin

Income Statement

Sales

- Cost of Goods Sold (COGS)

Gross Profit

- Selling, General and Administrative Expenses (SG&A)

Operating Income Before Depreciation

- Depreciation, Depletion & Amortization

Operating Profit

$$\text{Operating Profit Margin} = \frac{\text{Operating Profit}}{\text{Sales}}$$

Gross Profit Margin

Income Statement

Sales

- Cost of Goods Sold (COGS)

Gross Profit

- Selling, General and Administrative Expenses (SG&A)

Operating Income Before Depreciation

- Depreciation, Depletion & Amortization

Operating Profit

$$\text{Gross Profit Margin} = \frac{\text{Gross Profit}}{\text{Sales}}$$

Berry Ratio

Income Statement

Sales

- Cost of Goods Sold (COGS)

Gross Profit

- Selling, General and Administrative Expenses (SG&A)

Operating Income Before Depreciation

- Depreciation, Depletion & Amortization

Operating Profit

$$\text{Berry Ratio} = \frac{\text{Gross Profit}}{\text{SG\&A} + \text{Dep.}}$$

Return on Capital Employed (ROCE)

Income Statement

Sales
- Cost of Goods Sold (COGS)
Gross Profit
- SG&A + Depreciation
Operating Profit

Assets

Cash & Equivalents
Account Receivables
Inventories
Prepaid Expenses
Total Current Assets
Property Plant & Equip (PP&E)
Investments at Equity
Other Investments
Intangibles
Deferred Charges
Other Assets
Total Assets

$$\text{ROCE} = \frac{\text{Operating Profit}}{\text{PP\&E} + \text{Prepaid Expenses} + \text{Current Asset-Other Assets} + \text{Receivables} + \text{Inventories}}$$

Cost Plus

Income Statement

Sales

- Cost of Goods Sold (COGS)

Gross Profit

- SG&A + Depreciation

Operating Profit

$$\text{Cost Plus} = \frac{\text{Operating Profit}}{\text{Cost of Goods Sold} + \text{SG\&A} + \text{Depreciation}}$$

Hierarchy of Profitability Distributors By Operating Margins

- Trading Companies (Low Operating Margins)
- Plain Vanilla Distributors
- Distributors involved with Intangibles (High Margins)

Hierarchy of Profitability Manufacturers

- Maquiladoras
- Contract Manufacturers
- Low Intangible Manufacturers
- Licensed Manufacturers
- High Intangible Manufacturers

Caveats on this Presentation

- Not a Safe Harbor
- Just Shows the Lay of the Land
- Does Not Include Research Companies

Screening Criteria

- Companies in Compustat 1999 Active File
- Manufacturers: SIC 3000 to 3990 (Durable Goods Only)
- Distributors: SIC 5000 to 5199
- All Companies or Over \$100 Million
- Distributors: SG&A < 5% of Sales
- Contract Manufacturers

Reported Results

- Every 5% of Population
- 5 or 10 Year Averages of Profit Level Indicators
- Interquartile Ranges

Distributor	Berry Ratio			Operating Margin			Cost Plus			ROCE	
	Lower Bou	Median	Upper Bou	Lower Bou	Median	Upper Bou	Lower Bou	Median	Upper Bou	Lower Bou	Median
5 Years											
All Compa	1.078	1.196	1.371	0.50%	2.70%	5.20%					
Sales Over	1.156	1.242	1.422	2.00%	3.60%	5.60%					
SG&A/Sal	1.258	1.408	1.835	0.50%	1.70%	2.20%					
SG&A/Sal	1.286	1.422	1.835	0.50%	1.90%	2.20%					
10 Years											
All Compa	1.091	1.197	1.357	0.70%	2.80%	5.10%					
Sales Over	1.155	1.238	1.412	2.00%	3.50%	5.40%					
SG&A/Sal	1.264	1.473	1.768	0.70%	1.70%	4.50%					
SG&A/Sal	1.295	1.484	1.768	1.10%	1.90%	4.50%					
Manufacturing											
5 Years											
All Companies				-3.60%	5.30%	10.40%	-2.00%	6.00%	11.80%	-2.30%	9.80%
Sales Over \$100 Mill				4.90%	8.50%	12.50%	5.40%	9.50%	14.50%	8.60%	14.00%
10 Years											
All Companies				-1.70%	4.90%	9.10%	-0.30%	5.60%	10.40%	0.10%	8.90%
Sales Over \$100 Mill				4.60%	7.50%	11.30%	5.20%	8.30%	13.10%	7.90%	12.20%
Contract M* Active Only											
5 Years											
All Companies				4.20%	6.50%	8.80%	4.90%	7.00%	9.80%	7.50%	11.70%
Sales Over \$100 Mill				5.30%	7.00%	9.40%	5.60%	7.80%	10.40%	9.50%	12.80%
10 Years											
All Companies				4.10%	6.20%	7.90%	4.00%	6.80%	8.70%	7.90%	11.00%
Sales Over \$100 Mill				5.20%	6.80%	8.30%	5.70%	7.40%	9.10%	10.20%	11.70%
Contract M* Active and Inactive											
5 Years											
All Companies				4.20%	6.70%	9.60%	4.40%	7.60%	10.80%	8.20%	11.70%
Sales Over \$100 Mill				5.00%	7.30%	9.90%	5.30%	7.90%	11.10%	9.50%	12.80%
10 Years											
All Companies				3.80%	6.20%	8.10%	4.00%	6.80%	8.90%	8.50%	11.00%
Sales Over \$100 Mill				5.20%	6.90%	8.50%	5.60%	7.40%	9.40%	9.80%	11.70%

APA & §482 Analysis

- APA Analysis is a Highly Refined Analysis of Comparable Companies that are Screened based on
 - Function (Distributors, Manufacturers, Service Providers)
 - Standard Industry Classification (SIC)
 - Size
 - Comparability

APA & §482 Analysis

- APA Analysis involves Asset Intensity Adjustments when Appropriate
- Comparable Companies are Scrutinized in Great Detail to Obtain Appropriate Benchmarks for the Tested Party

APA & §482 Analysis

- APA Analysis may lead to Profit Levels for the Tested Party that in Relationship to the Tables Provided are on the Low End, Middle, or Upper End of PLIs in the tables of this session.
- The Outcome is Dependent on the Characteristics of the Tested Party, the Comparability of the Benchmark Companies and the Adjustments Required to True Up the Comparable Analysis.

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