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Improving profitability of upholstery manufacturing through higher material utilization and reduced COGS

Yael Barak, Product Marketing, Plataine

Today's economic conditions make it increasingly difficult to remain profitable. Sales are up from last year, but are still down from 2008, while economists debate daily on what the future holds. In such an environment, it is hard for anyone to make sound business decisions on future investments or costs control.

In their Furniture Insights newsletter, published on July 2010, Smith Leonard Accountants & Consultants reported that new orders for the first five months of 2010 increased by up to 10% compared with the same period in 2009. However, last year at the same time, new orders were off 21% compared with 2008.

According to Ken Smith, Managing Partner at Smith Leonard, "the key today is to hang on", he said. "Once the economy gets turned and consumers begin to move back to more normal times, those left standing should do well." (Furniture Today magazine, July 2010)

Smith Leonard's July 2010 newsletter further states that, the US residential furniture industry's volume has declined by 31.4% since 2005, leaving residential furniture companies with an **average operating profit of only 3.23%** of sales in 2009. According to Smith, these are especially challenging numbers when an operating profit of less than 2% is not sufficient to pay interest and principal as well as fund capital expenditures and provide return on investment.

The Operating Profit of a company is calculated from the Net Sales minus all Operating Expenses, including Cost of Goods Sold (COGS), Selling and General Administrative Expenses as well as Depreciation and Amortization expenses.

Following the recession of 2009, most companies have already reduced their levels of fixed costs as much as they could. In fact, one of the greatest challenges seen by many of our customers today is finding the right level of reduction in fixed costs, with the risk that excessive cuts will hinder future growth, should business conditions improve in the future.

In today's environment, fixed costs have mostly reached a stable level, yet sales (and revenues) are still down and profitability is low, if existent at all.

Consider a typical upholstery manufacturing operation. COGS comprises approximately 40%-70% of all operating expenses whereas the cost of fabric comprises 12%-20% of COGS.

Considering these figures, any improvement in fabric utilization can have a significant and immediate impact on COGS, leading to overall improved profitability.

Chart 1 (below) includes sample Income Statements of three furniture manufacturers (Figures in million $US)

	Company A	Company B	Company C
Sales Revenues	670	1180	232
Operating Expenses:			
Cost of Goods Sold (COGS)	274	777	101
Depreciation, Depletion and Amortization	28	25	6
Selling, General & Admin Expenses	356	334	119
Operating Profit	12	44	6
Operating Profit out of Sales	1.79%	3.73%	2.59%
COGS out of Total Expenses	41.64%	68.4%	44.69%

Through an integrated approach to manufacturing optimization and proprietary algorithms, Plataine's software tools have **a proven track record of improving fabric utilization by as much as 10-15% in upholstery manufacturing**. Similar results are also shown in plywood and foam cutting, with additional productivity benefits stemming from process automation.

Chart 2 illustrates this impact whereby a 10-15% reduction in fabric costs can lead to a 1-3% reduction in COGS, or a 0.5% to 1.2% reduction in total expenses.

Chart 2 – Impact of reduction in fabric costs on total expenses

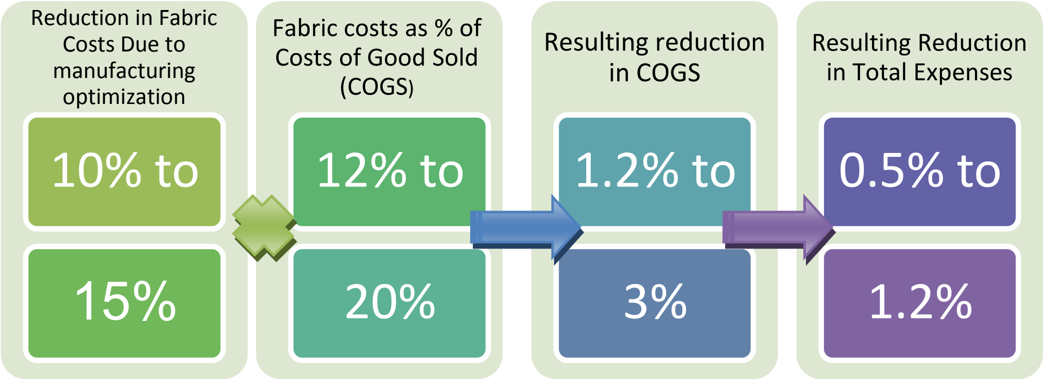
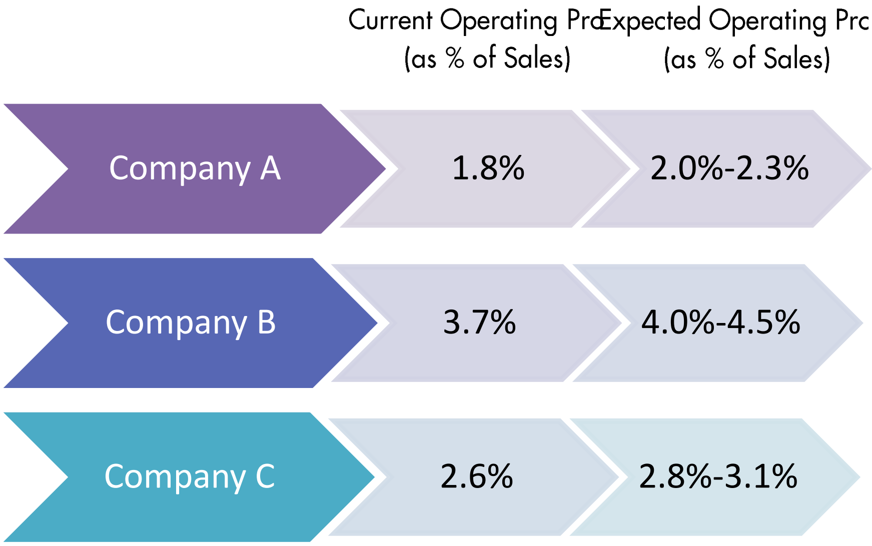


Chart 3 (below) demonstrates the potential impact of such cost savings on **profitability** for each of the abovementioned companies.

Chart 3 – Impact of reduction in expenses on overall profitability



Company A, for example, will see its level of profitability rise over the 2% threshold required to sustain long-term growth. Similarly, companies B and C will see a significant increase in profitability, keeping them further clear of dangerous waters and allowing more flexibility for future investments.

Given the examples and discussion above, any increase in fabric utilization goes far beyond the upholstery manufacturing floor and can be at the heart of the corporate's strive to increase profitability. For more information about Plataine solutions visit: www.plataine.com.

About the Author

Yael Barak leads Plataine's Product Marketing activities. Prior to joining Plataine, Yael has experience both in marketing at ClickSoftware and as a mechanical engineer in a medical device company, Impliant. Yael holds a mechanical engineer degree from Tel Aviv University and an MBA from the Interdisciplinary Center (IDC).