Parck
Instruments, LLC

To: Finance Team
From: Steve Winslow, Manager New Business Acquisition
Re: Welcome to Parck

Dear Finance Team:

Jan Johanson, VP of Business Development for Essex, asked me to provide information and guidance
related to the finance function at Parck. I have attached a number of documents that will help you begin to understand Parck's financial situation. Those documents are as follows:

1. Overview of Parck Statements – A review of financial terms and their specific usage at Parck Instruments, LLC.

2. Income Statement – Three years prior income statements for Parck.

3. Balance Sheet – Three years prior balance sheets for Parck.

I suggest you be prepared to help the rest of your team as it relates to the following items:

1. Remind them of the basic financial statements and any important terminology from the

2. What important trends do you notice in the Income Statement?

3. What important trends do you notice in the Balance Sheet?

I hope this information is helpful.

Sincerely,
Steve Winslow

Overview of Parck Financials
Income Statement

- **Revenue:**
  - Parck is primarily engaged in the selling of Table Top Blood Analyzers (TTBA)
  - Parck bills its customers and recognizes revenue at the point of shipment

- **COGS:**
  - Cost of Goods Sold includes the cost of all direct materials and direct labor used to manufacture the TTBA.
  - Direct Material costs include any inbound freight and any taxes incurred.
  - Direct Labor include direct operator costs incurred in the manufacture of products sold. Direct Labor per product is calculated by adding the total direct labor costs incurred for an accounting period divided by the total number of goods produced during that period. Total Direct Labor is driven by the number of operators (by operation), the number of shifts per accounting period and the direct labor wage rates in force at the time.
  - Side Note: Parck uses the average weighted inventory cost methodology for inventory valuation – and therefore cost of goods sold calculations.

- **Gross Profit:**
  - Gross Profit (also known as Gross Margin, or GM) is calculated by subtracting total cost of goods sold (COGS) from revenue.

- **Scrap:**
  - Scrap is calculated as the cost of materials that become defective at some point in the manufacturing process. Scrap materials are considered to have no residual value and are generally disposed of. Scrap costs generally rise and fall with volume and are therefore considered a variable cost.

- **Warranty Costs:**
  - Customers generally return products that fail to perform to expectations specifications.
  - Warranty costs are the costs associated with servicing defective / unreliable products that were returned to Parck by its customers.

- **Variable Overhead**
  - Variable overhead generally includes things such as energy, lighting, heat, steam, general shop floor maintenance, etc that are associated with the manufacturing of products. These costs generally move somewhat with volume and are considered variable costs.

- **Retrofit Costs:**
  - Each month, Parck takes all of its unsold finished product and upgrades it to its latest version / generation of product for sale in the following month. Parck accounts for this costs at a standard of $150 per unit which has generally been the average upgrade cost.

- **Other Variable Costs:**
  - Other variable costs may be incurred that would be accounted for as “Other”.

- **Contribution Margin:**
  - Contribution Margin is the difference between total revenues and total variable costs.

- **Readiness to Serve:**
  - RTS, or Readiness to Serve Costs are also generally referred to as "SG&A" and include a wide range of base costs. The majority of these costs are staff-related costs and include Engineering, HR, Finance, Marketing, as well as other related expenses.

- **Advertising Expense:**
  - This is the cost of advertising, (both consumer and channel).

- **Research and Development:**
  - R&D costs include testing costs, research studies, special engineering projects, IP investments, etc.

- **Depreciation:**
  - Depreciation is incurred on plant and equipment. Parck generally uses a straight-line method for depreciation and most of its P&E are depreciated over a 7 year period with no residual value.

- **Inventory Carrying Cost:**
  - Inventory Carrying Cost line on the P&L is an allocation of inventory-related operating costs including related insurance costs, warehouse costs, Quality Assurance, obsolescence, shrinkage, etc. The cost allocation calculates carrying cost as 12% per annum of the value of inventory (including Raw, WIP and Finished Goods). Note: Other inventory carrying costs (i.e. finance costs) are captured below the OM line in interest expense.

- **Other Base Costs:**
  - This line captures any other base costs not accounted for in the lines described above.

- **Operating Margin:**
  - OM is the difference between CM and Base Costs and is a key management metric.

- **Interest:**
  - Interest Expense is the cost of carrying debt and includes any debt used to finance inventory or other parts of the operation.

- **Taxes:**
  - Corporate Taxes are accounted for here and are based on a corporate tax rate of 35% of Taxable Income.

- **Net Income:**
  - Net Income is the total income after all interest and taxes.

Overview of Parck Financials
Balance Sheet

- **Current Assets**
  - Current assets are all assets that can be converted to cash with one year, including cash itself.
  - Cash is the monetary value of all physical currency and banknotes held by Parck. Parck Instruments holds a business preferred checking account at Fifth Bank of Wisconsin.
  - Accounts receivable is all money owed to Parck Instruments from its customers. Parck instruments payment terms vary by customer. Clinics, laboratories, and hospitals have 30, 60, and 90 days payment terms respectively. For example, if Parck sells a TTBA to a clinic in the month of January, it will receive payment from that clinic in the month of February.
  - Inventory is the value of all raw materials and finished goods owned by Parck. Any work-in-progress is classified as raw materials. Finished goods remain as inventory until they are delivered to customers.
  - Deferred tax assets are a form of carry over losses. When Parck incurs losses in a financial quarter, it can use these losses to offset a future tax burden. Deferred tax assets are a non-cash asset, but may be used in lieu of cash to pay the IRS

- **Non-Current Assets**
  - Non-current assets are all assets that cannot be converted to cash with in one year
  - Plant, property, and equipment (net) is the value of all physical assets, such as land, buildings, vehicles, and machinery. PP&E is recorded on the balance sheet net of accumulated depreciation.

- **Current Liabilities**
  - Current liabilities are all debts or obligations owed within one year.
  - Accounts payable is all debts owed to equipment suppliers. Parck negotiates payment terms with suppliers individually. These payment terms tend to vary from 30 days to 90 days by supplier. For example, if Parck orders a printer from Avery-Schwartz in January and that printer is delivery in February, Parck must pay Avery-Schwartz by April.
  - Deferred tax liabilities are taxes Parck owes to the IRS but has not yet paid. Parck makes quarterly tax payments to the IRS. Parck's deferred tax liability occurs when there is difference between taxes owed on TTBA sales and taxes paid to the IRS.
  - Short term notes payable is value of any principal payments on loans owed due in less than one year. This does not include interest payments.

- **Non-Current Liabilities**
  - Long term notes payable is value of any principal payments on loans owed due in over one year. This does not include interest payments. Currently, Parck has a $7.5MM working capital loan from Fifth Bank of Wisconsin. The principal payment from this loan is due in a balloon payment in three years (Next Year + 1).

- **Owner's Equity**
  - Equity is the value what Parck owns (assets) minus what Parck owes (liabilities). Equity belongs to the owners Parck.

Overview of Parck Financials
Cash Flow Statement

- **Beginning Cash**
    - Cash balance at the beginning of the month / quarter

- **Impact of Operating Activities**
    - The cash flow statement divides cash into three category, operating activities, investing activities, and financing activities. Operating activities is cash brought in through regular business activities as well as changes in working capital.
    - Net Income is the total income after all interest and taxes.
    - Depreciation is incurred on plant and equipment. Parck generally uses a straight-line method for depreciation and most of its P&E are depreciated over a 7 year period with no residual value.
    - Dec / (Inc) in accounts receivable is the net change in AR on the balance sheet from period to period
    - Dec / (Inc) in Inventory is the net change in inventory on the balance sheet from period to period
    - Dec / (Inc) in Tax Assets is the net change in tax assets on the balance sheet from period to period
    - Dec / (Inc) in Accounts Payable is the net change in AP on the balance sheet from period to period

- **Impact of Investing Activities**
    - Net additions to PP&E includes all new purchases of plant, property, and equipment. Such as capital equipment purchases.

- **Impact of Financing Activities**
    - Inc / (Dec) in Notes Payable is any change in principal owed to lenders. This includes both payment of principal or additional loan payments

- **Ending Cash**
    - Cash balance at the end of the month / quarter

Income Statement

Annual, In Thousands [$K]	PY-2	PY-1	PY
Revenue			
TTBA Sales	$56.31	$54.46	$51.79
Other Sales	-	-	-
Total Revenue	$56.31	$54.46	$51.79
COGS			
Direct Material	$25.49	$27.65	$27.11
Direct Labor	$9.46	$9.86	$9.90
Total COGS	$34.95	$37.51	$37.01
Gross Profit	$21.36	$16.95	$14.79
	38%	*31%*	*29%*
Other Variable Costs			
Scrap	$0.03	$0.03	$0.03
Warranty	$0.14	$0.24	$0.33
Variable Overhead	$1.17	$1.20	$1.21
Retrofit Costs	-	-	-
Other Variable Costs	-	-	-
Total Other Variable Costs	$1.34	$1.47	$1.57
Total Variable Costs (incl. COGS)	$36.29	$38.98	$38.58
Total Contribution Margin	$20.02	$15.48	$13.22
	36%	*28%*	*26%*
Base Costs			
Ready to Serve	$4.95	$4.81	$4.65
Advertising Expense	$1.73	$1.75	$1.93
Research & Development	$4.48	$3.58	$2.79
Depreciation	$3.21	$3.93	$3.93
Inventory Carrying Cost	$0.06	$0.06	$0.07
Other Base Cost	-	-	-
Total Base Costs	$14.45	$14.13	$13.37
Total Operating Costs	$50.73	$53.11	$51.95
Total Operating Profit	$5.58	$1.35	($0.16)
OM %	*10%*	*2%*	*0%*
Interest	$0.75	$0.75	$0.75
Taxes	$1.69	$0.21	($0.32)
Net Income	$3.14	$0.39	($0.59)
	6%	*1%*	*-1%*

Balance Sheet

Annual, In Thousands [$K]	PY-2	PY-1	PY
Current Assets			
Cash	$6.12	$3.11	$5.07
Accounts Receivable	$5.43	$6.37	$7.08
Inventory	$0.56	$0.59	$0.65
Deferred Tax Asset	-	$0.08	$0.39
Other Current Assets	-	-	-
Total Current Assets	$12.11	$10.15	$13.20
Non-Current Assets			
Property, Plant & Equipment (net)	$19.29	$20.36	$16.43
Other Non-Current Assets	-	-	-
Total Non-Current Assets	$19.29	$20.36	$16.43
Total Assets	$31.40	$30.51	$29.62
Current Liabilities			
Accounts Payable	$7.26	$5.98	$5.68
Deferred Tax Liability	-	-	-
Short-term Notes Payable	-	-	-
Other Current Liabilities	-	-	-
Total Current Liabilities	$7.26	$5.98	$5.68
Non-Current Liabilities			
Long-term Notes Payable	$7.50	$7.50	$7.50
Other Non-Current Liabilities	-	-	-
Total Non-Current Liab.	$7.50	$7.50	$7.50
Total Liabilities	$14.76	$13.48	$13.18
Owners Equity			
Common Stock	$5.00	$5.00	$5.00
Retained Earnings	$11.64	$12.03	$11.44
Total Owners Equity	$16.64	$17.03	$16.44

Statement of Cash Flow

Annual, In Thousands [$K]	PY-1	PY
Beginning Cash	$6.12	$3.11
Impact of Operating Activities		
Net Income	$0.39	($0.59)
Depreciation	$3.93	$3.93
Dec/(Inc) in Accts Rec	($0.94)	($0.71)
Dec/(Inc) in Inventory	($0.03)	($0.06)
Dec/(Inc) in Tax Assets	($0.08)	($0.32)
Inc/(Dec) in Accts Payable	($1.28)	($0.30)
Cash from Operations	$1.99	$1.95
Impact of Investing Activities		
Net Additions to P&E	($5.00)	-
Impact of Financing Activities		
Inc/(Dec) in Notes Payable	-	-
Net change in cash +/(-)	($3.01)	$1.95
Ending Cash	$3.11	$5.07

Parck
Instruments, LLC

To: Finance Team
From: Steve Winslow, Manager New Business Acquisition
Re: Overview of Cash Flow Management

Dear Finance Team:

You are responsible for managing Parck Instrument's cash flow needs, using our Parck_Books software. Parck business has many cash flow needs. To manage cash flow, you must deftly navigate Parck's income statement, balance sheet, and statement of cash flow. You must ensure that Parck always has ample cash available to fund its business.

Revenue / Accounts Receivable

Each quarter Parck receives ~$12MM in cash from customers for prior TTBA sales. Customers pay Parck within 30 to 90 days of TTBA delivery. A hospital that purchases a TTBA in January send Parck instruments a check in April. Parck does not have the ability to negotiate customer payment terms.

Operating Expenses

Parck currently spends ~$12MM in cash per quarter on operating expenses. This includes purchase of materials, scrap costs, and most base costs. This does not include depreciation, which is a non-cash expense. Parck's finance team only manages certain operating expense. Essex automatically manages labor, warranty, RTS, advertising expenses, and R&D expenses on behalf of Parck.

Interest

Parck has a $7.5MM working capital loan with Fifth Bank of Wisconsin. The loan has a 10% annualized interest rate, which must be paid in monthly installments of $62.5K.

Taxes

Parck pays a 35% annual corporate tax rate. Parck's tax needs are complicated and can be discussed in more detail with our tax accounting team. After the end of each quarter. Parck's tax team will add an estimated tax bill for the quarter into Parck Book and you the finance team will be responsible for cutting the check to the IRS.

Accounts Payable

Each quarter Parck spends about $7MM in cash on raw materials. The sourcing team places these orders and negotiates payment terms with the vendors. Each vendor offers different payment terms to Parck, but these terms vary from 30 to 90 days.

Plant & Equipment

Parck's shop operations team may on occasion purchase new capital equipment for the Parck factory. Parck finance team is responsible for paying the capital equipment vendors. Shop ops may negotiate payment terms.

Loans (See Next Page)

The finance team must ensure that Parck's business is adequately capitalized. Currently, Parck has a $7.5MM working capital loan from the Fifth Bank of Wisconsin. The principal from the loan is due in full in two years time. This upcoming year, Parck is solely responsible for interest payments on the loan.

If Parck needs additional capital, Parck can take out a new loan either from Fargo Community Bank or Bank of America. The two loans are not identical. Parck's management team must pick whichever loan best meets the needs of its business.

If Parck cash accounts drop below zero, Essex corporation will provide Parck with emergency liquidity. We do not recommend relying on this. Essex management views this as a failure on behalf of the Parck management teams and it will not bode well for their future at Parck.

Managing Accounts Payable

The Essex finance team will use the Parck_Books software to manage accounts payable. In the Parck_Books software is the Invoice_Management worksheet. On the left side of that worksheet is the pending invoices table. This table show which invoices Parck is responsible for and when those payments are due. To pay an invoice, the Parck finance team must type the value they want to pay into the Schedule Payment column. At the end of the month, the software will write checks to all vendors for the amounts written in the Schedule Payment column.

I hope this information is helpful.

Sincerely,
Steve Winslow