

## **1-800 I SEE YOU**

It was December 12, 1994 and Brad Card wanted some financing for Christmas. As Chief Executive Officer of CHEAP VISION, a small startup company which supplies prescription contact lenses to consumers over the phone within a guaranteed 48-hour period, he was pleased that the company was doing well. Sales had been steadily increasing during the first few months of operations. Last July, Brad decided to incorporate in order to expand operations and have better access to capital. He named the new company 1-800 I SEE YOU, and planned to continue selling contacts over the phone, only this time on a national scale.

### **Prescription Contact Distributors**

Prescription contact lens sales had been growing in the United States at about 10% per year, and were expected to continue at that rate until the year 2000. As a result, industry analysts projected the contact lens sales to total approximately \$2.25 billion in 1995.

Historically, ophthalmologists and optometrists (eye care practitioners) supplied the patient with their initial pair of contacts, and subsequently provided new contacts when needed. However, a number of alternative sellers of contacts had emerged over the past few years. Direct marketers, such as 1-800 I SEE YOU, were companies that sold contact lenses directly to the patient, circumventing the eye care practitioner. It was estimated that by 1996 direct marketers would account for approximately 5% of contact lens sales in the U.S., and that this trend would continue at an exponential rate due to the increased popularity of disposable contact lenses.

### **Operations**

1-800 I SEE YOU's operations included teleservices, order entry, customer service and distribution and fulfillment. The teleservice agent received orders by a 1 800 number (1-800 I SEE YOU), mail, fax, and email. The agent then processed the order directly into the inventory system, which automatically matched the order, updated inventory, and notified the agent when the delivery should take place. Operating hours were 6:00 a.m. to 8:00 p.m. (MST) and 8:00 a.m. to 3:30 p.m. (MST) on Saturdays. During non-business hours the company used a machine recording to inform customers of the company's hours of operations.

The laws in most states required that contact lenses be sold only with a valid prescription. As such, it was company policy to attempt to obtain a valid prescription from the patient, either by mail or fax. If the company was unable to obtain a valid prescription, the company shipped the contact lenses to the customer based on the information that the customer provided.

## **Suppliers**

Obtaining supplies of contact lenses had been difficult for the company. Historically, substantially all of the major manufacturers of contact lenses refused to sell lenses directly to direct marketers. As such, most of the supplies were purchased from large optical retail chains with excess inventory, such as Cole National Corporation, LensCrafters, and National Vision Association. Usually, these suppliers allowed for a 60-day deferral of payment.

It came to the company's attention that at least one manufacturer had begun tracing its products in an effort to deter retail chain stores from selling excess inventory to direct marketers. A direct result would be that the company would be forced to carry a higher amount of inventory.

## **Government Regulation**

The company has obtained licenses to sell prescription contacts in only California and Texas, although there had been some sales in other states. However, the company received notice from New Mexico that selling prescription contacts in that state was in violation of its state laws, and 1-800 could face fines and penalties. Although this was not a serious concern, as 1-800 I SEE YOU expanded it could pose barriers for future growth.

In a move that should help the company, 28 State General Attorneys filed actions against three major soft contact lens manufacturers and several optometrists and their trade associations. This suit directly related to manufacturers and certain eye care practitioners' refusal to sell lenses to direct marketers, citing the refusal as a conspiracy with eye care practitioners to eliminate alternative channels of trade from the contact lens market. As well, the Federal Trade Commission (FTC) had recently begun inquiries into whether eye care practitioners should be required to release contact lens prescriptions to their patients.

## **Brad's Problem**

Although the company was profitable on a small scale, and was projected to be profitable in the future, the working capital needed for the company was large. Part of this problem stemmed from the large amounts of inventory the company was forced to carry. Usually, there needed to be more than four times the expected sales for any given month. However, because the company purchased inventory in bulk from large optical retail chains, inventory levels could be sporadic.

The company also needed to stock up on many unusual and rare prescriptions of contacts that usually sat for some time. This increased the amount of capital needed for operations. Brad figured they should carry even up to 10 times the sales for a given month until a base of inventory was established.

### **Pro Forma Financial Statements**

Brad's made the following forecasts for 1995 through to 1997 (see Exhibit 1).

- The cost of goods sold was projected to be 63% of sales.
- Selling, general, and administrative expenses were split up into three categories: personnel, advertising, and administrative (office expenses). Personnel costs included wages and salaries of employees, including employment taxes and other expenses, at a total cost of \$2000 per month per employee. In the first year, Brad also planned on taking out only \$2000 per month for himself, although that he expected to increase that in 1996 and 1997. He also needed to hire a system administrator for a management information system in June, which would probably cost \$4000 a month with perhaps some future considerations.
- All equipment would be depreciated straight line over a five year period with no residual value.
- Office costs included office rent, utilities, and anything else not attributable directly to sales.
- The business income tax rate was approximately 38.5% combined state and federal.
- There needed to be a cash level maintained for working capital of \$2000 or 5% of sales, whichever was greater.

### **Preparation Questions**

1. Generate pro-forma balance sheet, income statement, and cash flow statement monthly for 1995, and annually for 1996 and 1997.
2. Based on your projections from question one, how much financing does Brad need, how or from whom should he raise it, and when should he raise it-should he get it all up front or spread it out? If you recommend equity, how much of the company should Brad give up for the equity raised?

## Exhibit 1

	1995												1996	1997
	Feb	Mar	Apr	May	Jun	Jul	Aug	Sept	Oct	Nov	Dec	Year Total		
<b>Income Statement Items</b>														
<b>Sales</b>	2,500	3,900	6,084	9,491	14,806	23,097	36,032	56,210	87,687	136,792	213,396	589,996	3,628,000	21,115,000
<b>Personnel</b>	6,000	6,000	6,000	6,000	10,000	12,000	16,000	30,000	44,000	72,000	98,000	306,000	1,006,000	5,420,000
<b>Employed</b>	3	3	3	3	4	5	7	14	21	35	48	48		
<b>Advertising Costs</b>	250	500	250	500	500	250	250	250	750	750	750	5,000	400,000	1,500,000
<b>Depreciation</b>	333	333	333	333	667	667	667	667	667	667	667	6,000	26,000	143,000
<b>Office Costs</b>	2,000	2,000	2,000	2,000	3,000	3,000	3,000	4,500	4,500	4,500	4,500	35,000	135,000	725,000
<b>Balance Sheet Items</b>														
<b>Contact Purchases</b>	20,000	10,000	15,000	18,000	25,000	35,000	50,000	60,000	110,000	90,000	110,000	543,000	2,500,000	18,300,000
<b>Office and Computer Equipment Purchases</b>	20,000	0	0	0	20,000	0	0	0	0	0	0	40,000	160,000	400,000