

Executive Summary

Breakaway Bicycle Company designs and builds custom bicycle frames to the exact specifications of the finest road and mountain bike racing professionals in the world. Breakaway has earned this right because its founder and master builder, Mike Giro, hand crafts road and mountain frames that satisfy the one common specification of all competitive cyclists — it helps them to win races.

Since 1990, Breakaway has designed and built bike frames for racing professionals and those biking enthusiasts who take their riding seriously and want to own the best equipment. As more and more of the population gain an interest in competitive cycling, the demand for custom built bicycles has also increased. Many individuals, particularly those interested in mountain biking, have found that there is a tremendous interest in competitive mountain biking which include grueling cross-country races and gravity-defying events such as the “in your face” downhill racing. Based on marketing projections, this interest increased following the 1996 Summer Olympics in Atlanta where mountain bike racing made its debut as an Olympic medal event.

To meet the expected demand for custom built bike frames that can handle this type of riding, as well as road racing, Breakaway is seeking the financing necessary to add new workstations and hire additional designer-builders. The cost to purchase and install the additional workstations is \$60,000. The additional salary expense is projected to increase labor expenses by \$6,250 per month. If this investment is made, though, marketing projections and written commitments from several mountain bike racing teams in the U. S. and Europe reflect a 25 percent increase in bike frame sales. This increase translates into sales revenue of \$1,390,800 for 2000 and \$1,619,600 for 2001.

Introduction

Breakaway Bicycle Company was started by Mike Giro in 1990 and began building high quality hand-crafted bicycle frames. Because these bike frames were popular with serious bicycle enthusiasts, Breakaway moved from a workshop behind Mr. Giro's house to a larger shop located on LeTour Street in Boulder, Colorado in 1993. The company now employs 10 people, including Mr. Giro, who design, build, and test each new bicycle frame. The great majority of customers that Breakaway builds bikes for are serious cyclists who require their road bikes and mountain bikes to be light, stiff, responsive, and race worthy.

Breakaway Bicycle Company is a closely held Colorado corporation created in 1990. For federal income tax purposes, Breakaway is classified as a subchapter S corporation. There are three shareholder directors, each of whom is an officer working for the company.

Industry Analysis

According to a study done by the Department of Transportation, approximately 25 million bicycles are purchased every year. The vast majority of these bicycles (96 percent) are built on an assembly line and sell for an average price of \$200.00. The remaining 4 percent of the market are high-end custom built bicycles that cost an average of \$1,500. Accordingly, the custom built bicycle market generates revenues of \$1.5 billion on sales of one million frames. Because the Summer Olympic Games are scheduled for 2000, projected sales are expected to be significantly higher. An industry study assembled in 1997 reflected that the sale of all types of bicycles and accessories increased 30 percent following the 1996 Summer Olympics.

A survey taken by The Bike Tour, a monthly bicycling periodical, shows that the type of individual that purchases a custom built bicycle typically is a serious bicycling enthusiast. This person rides over three thousand miles a year and is interested in using the equipment that is best suited to handle this much riding. Accordingly, this individual may spend several thousand dollars a year to purchase equipment that will improve the performance and enjoyment of a bike

ride. It is these bicycle enthusiasts that are the target market in which Breakaway Bicycle Company is hoping to increase its market share.

Customers

A large number of individuals who purchase custom built bike frames live in the Western, Southwestern and Pacific Northwestern sections of the U.S. They are between the ages of 24 and 45, have some college education and have a median income of \$40,000. In the past, the target market was predominately male, but the efforts made by bike companies, like Breakaway, to market high end bikes to women in recent years has had a significant impact. Sales figures for 1997 show that 25 percent of all custom made frames were sold to women, an 80 percent jump over 1992 sales figures.

There are currently two general categories of bicycle riders -- mountain bike riders and road bike riders. The popularity of mountain bikes is so great that most, if not all, custom built frame companies have added at least one, if not several, mountain bike frames to their sales catalogue. In fact, in almost all cases, mountain bike sales have far outpaced road bike sales every year for the last five years. Based on an industry survey of all bike makers included in the Bike Tour article, the sale of mountain bikes is expected to increase by 20 percent every year for the next five years. This projection is based on the fact that serious road bike enthusiasts are finally being converted to mountain bikes and the second-ever Olympic mountain biking event in 2000 should generate even more interest in mountain bike racing.

Competition

Currently, there are five large custom bike frame companies in the U.S. that split up a large share (75 percent) of this market. Breakaway is not currently among this group of five. However, if the company can expand production to meet current demand, projected sales indicate that Breakaway will also experience an increase in mountain bike sales within the next three years. This increase in sales is attributable to the increasing popularity of mountain bike racing in the U.S. and Europe and the name recognition that Breakaway is building for the quality of their road and mountain bikes.

Strengths, Weaknesses, Opportunities and Threats Analysis

Strengths. The strengths that Breakaway brings to the marketplace are considerable. Breakaway has built a very good reputation with professional road and mountain bike racers in the United States. With the work Mr. Brown is doing in Europe, Breakaway is continuing to take market share even from those frame builders who have been around since the 1920s. But the greatest strength that Breakaway possesses is the innovative approach it has taken to designing and building frames. Being a smaller company, Breakaway has greater flexibility than its larger competitors to try different materials, geometries and welding methods since it does not have to consult with 20 engineers to see whose idea is best. This means that the latest breakthrough in design will be implemented and tested before it is even off the drawing board at other companies.

Weaknesses. Because of its relative small size, Breakaway is not a common name among non-professional cyclists. If Breakaway had the resources to produce more custom designed bikes, it would be possible to increase sales revenues in the lucrative market that is made up of non-professional riders who, nevertheless, are serious about their cycling and want the best equipment in the market. Currently, five of the larger custom design framebuilders in the U.S. and Europe are dominating this market that research has shown generates total sales of \$800

million worldwide.

Breakaway also has a substantial amount of work to do in order to obtain a large portion of the European market. Breakaway is currently competing with frame builders who have been designing and building frames for professionals since the 1920's and whose names are now almost synonymous with cycling. Furthermore, with European cyclists, national loyalty often is a factor in choosing a framebuilder.

Opportunities. If Breakaway can obtain the necessary resources, the opportunities are almost limitless. Under the marketing efforts of Mr. Brown, Breakaway has made steady inroads in establishing a presence in the European road racing circuit. Furthermore, several professional riders have test ridden Breakaway frames and have found them to be far more technically innovative than many European custom built frames. Clearly, the market for Breakaway frames would increase if the company had the manpower, machinery, and facility space to custom build a greater number of frames. Based on the Bike Tour survey, the demand for custom road frames can be expected to increase by 20 percent in the year following the Olympics, and then experience 2 percent to 3 percent annual growth for the next four years. Accordingly, Breakaway anticipates experiencing at least a 15 percent increase in road bike sales in 2000 and then 3 percent every year after that for the next four years.

The mountain biking rage also has a firm grasp on the European market. While there was initial resistance to mountain bikes from some of the cycling traditionalists in Europe, this is quickly crumbling as the new generation of bike racers find mountain biking to be an excellent form of off-season training as well as just plain fun. Because Breakaway has been active in sponsoring and organizing mountain biking competitions, the company has developed name recognition in the U.S. and Europe. This name recognition has resulted in a large share of the custom mountain bike frame market in Europe and a health market share in the U.S. If Breakaway can obtain the necessary financing to expand its operations, it anticipates a steady 15 percent growth rate based on current sales figures and market conditions.

Threats. During the early nineties, a great number of bicycle frame builders who had not foreseen the tremendous popularity of mountain bikes experienced financial difficulties when the demand for assembly line-produced road bikes fell. As a result of these difficulties, many companies either merged with other bike companies or simply went out of business. For companies like Breakaway, whose revenues were not as dependent on purchases by recreational users, the effect was not as great. However, this industry downturn did have a negative impact on most companies' plans for future expansion and development. Until recently, in fact, Breakaway was one of the few American bike companies to aggressively pursue a share of the European market road and mountain bike market. Now, a number of the high-end bike companies have retooled their facilities to take advantage of the sustained demand for mountain bikes and have been aggressively pursuing market share in the U.S. and abroad.

While Breakaway has a significant presence in European mountain biking, this is changing as other international competitors move into this market. European bike companies have recently begun entering the mountain bike market. While they still have considerable ground to cover to match the quality of American frame builders like Breakaway bikes, name recognition with Europe's serious cyclists is opening the market to them. Accordingly, to maintain a significant presence in the high end market of American and European mountain biking, Breakaway is going to have to step up production of its custom bikes to meet the demand of its potential customers. If it does not, there is an increasing number of competitors in Europe and America willing to fill this demand.

Marketing Strategy

Breakaway currently sells all of its bicycles through catalogue sales and mail order sales. While

this is an effective way of reaching cycling enthusiasts, Mr. Giro has been working on developing a home page on the Internet that will describe the company, its philosophy, and the specifications of its various bike frames. An electronic order form will also be developed that will allow the customer to order the bicycle after designating the customer's measurements, color preference, and other specifications. Mr. Giro is working with a computer consultant from Computing Development Strategies to add graphics that include color pictures of the various frames and samples of the available colors. The cost of this development has been estimated to be \$5,000. However, based on discussions with various bicycle component distributors, the Internet is a particularly effective means of advertising to Breakaway's target market. In fact, based on a recent survey in a popular computer magazine, the typical Internet user is very similar to the target market Breakaway is hoping to reach. Consequently, Breakaway is projecting that Internet advertising will generate an additional 5 percent in sales and revenues.

Breakaway has advertised, and will continue to advertise, in various bicycling magazines in the U.S. The average monthly cost of this type of advertising is \$3,125 per month. Breakaway has received very favorable ratings from these magazines for its innovative frame designs and quality of workmanship. These reviews will be included in the magazine ads.

Breakaway will continue sponsoring mountain bike racing events in the U.S. and in Europe. Based on previous experience, this is an excellent way to generate exposure for Breakaway and it fortifies Breakaway's reputation as a mountain bike frame builder. In 2000, Breakaway anticipates sponsoring three races at a cost of \$25,000 per race. In 2001, Breakaway has tentatively committed to sponsoring five races at \$40,000 per race.

Human Resources

Mike Giro Managing Director of Operations

Steve Brown Director of Marketing and Sales

Jane Giro Chief Financial Officer and Treasurer

Mike Giro has 20 years of experience designing and building high performance bicycle frames and components. Mr. Giro became involved with designing frames as a teenager when he assisted a local frame builder in designing the bike frames for the U.S. Junior National Bicycle Team. As a member of this team, Mr. Giro was able to address the technical aspects of design with the practical insight developed from personally experiencing the shortcomings of various bike frames.

Over the next 10 years, Mr. Giro worked for various frame builders and experimented with different metal alloys and carbon composite designs to find a feather-light frame that would meet the heavy demands of a professional racer. As a result of his success in this research, he became an integral member of the production team that changed the face of cycling by designing a large part of the aerodynamic frames and components that provided the decisive advantage in several racing victories, not the least of which was the 1989 Tour De France.

In 1990, Mr. Giro started his own custom frame building company. Almost immediately, he obtained contracts to build racing bicycles for two of the top professional teams in the United States. As a result of this exposure and a number of very favorable articles in industry periodicals, the demand for Breakaway bike frames continued to increase. To meet this demand, Mr. Giro hired six designers-framebuilders and moved to a larger facility near downtown Boulder in 1992. Since 1992, Mr. Giro has gained recognition for the custom made mountain bicycle frames he has designed for two professional downhill racing teams. Currently, Mr. Giro is paid a salary of \$100,000.

Steve Brown has been involved in bicycling almost as long as Mike Giro, but from a different

perspective. Steve Brown was a professional racer on the European circuit for 12 years prior to coming to work for Breakaway. As the member of several European teams, Mr. Brown developed relationships with several Director Sportifs (Racing Team Managers), which he has utilized to gain access to those individuals who make the decisions regarding team frame builders. To date, Mr. Brown has been instrumental in obtaining contracts to build bicycle frames for four racing teams in Europe.

Currently, Mr. Brown has made great inroads in the European mountain bike racing sport by providing frames to a number of mountain bike teams. He has also had success in gaining corporate sponsorship for mountain bike racing events in France and Germany. Currently, Mr. Brown is paid a salary of \$60,000 plus bonuses.

The financial management experience that Jane Giro brings to Breakaway has been a key component in its continued financial stability. Ms. Giro, a certified public accountant, developed substantial experience during her nine years at a public accounting firm that specialized in consulting with small and midsize corporations. Using this experience, she was able to plan many of Breakaway's expenditures for plant and equipment as well as marketing and advertising so that they coincided with Breakaway's period of cash flow surpluses. By prudently managing Breakaway, the company was able to avert the financial disaster that many bicycle companies experienced in the early 1990's when demand for bikes temporarily contracted. Currently, Ms. Giro has been closely monitoring the market expansion in Europe and reviewing the contracts and initial start-up costs related to this expansion. Ms. Giro is paid a salary of \$45,000.

Labor costs. Breakaway has 10 employees, which include the officers and owners of the company. The seven designer-builders that Breakaway has hired are each paid a salary of \$35,000 per year. If Breakaway obtains the necessary financing, then three additional designer-builders will be hired at an individual annual salary of \$25,000. Based on previous years, Breakaway has generally given 7 percent or greater salary increases to non-owner employees every year. The corporation will continue giving a like percentage for the next three years.

Operations

Capital equipment purchases and maintenance costs. The machinery used to design and build Breakaway bicycles is sufficient for its current production level. However, if demand increases to its projected level, then three additional workstations will be needed for three new designer-builders. The cost for the machinery and computer equipment for each workstation is \$20,000. If Breakaway obtains the necessary financing (\$100,000), this equipment will be ordered and placed into service within two months.

Additional facility space. The new equipment that will be purchased will obviously require additional floor space. To meet this requirement, Breakaway management considered:

- leasing additional space in a unit adjacent to the present workshop
- moving the whole workshop to a larger facility
- moving the administrative offices out of the current workshop and leasing office space for the management and administrative staff two rental units away from the present workshop

Leasing the unit that is adjacent to the present workshop is a favorable option because it will be relatively easy to shuttle designer-builders and materials between workstations in both units since they are right next to each other. However, the adjacent unit is 1,500 square feet and Breakaway has calculated the required additional floor space to be only 600 square feet. This means that Breakaway will be paying \$2 per square foot for 900 square feet that it does not need. Moving all the graphite inventory from the storage facility to this adjacent workshop was

considered as a cost saving way to utilize the additional space. However, this would only save Breakaway \$200 per month.

The second alternative was quickly dismissed because the indirect costs of the move far outweighed the benefit of having all the workstations in one building. It was estimated that the move would take approximately one month and hinder the building of 80 bicycles. The related lost revenue would be approximately \$128,000. Furthermore, this did not take into account the cost of printing new ads, brochures, and mailings that would have to be distributed to reflect the change of address.

Accordingly, the best option open to Breakaway was to move the administrative offices down the block. This was considered the best alternative because it would not disrupt the builder-designers workflow, the square foot price of the new office space was actually cheaper than the present workshop, and the new workstations could be easily accommodated in the space currently occupied by the administrative offices. The new office space is approximately 800 square feet. The terms of the new lease are \$1,200 per month for 36 months.

Inventory costs. The fact that Breakaway custom builds bike frames to each individual's specifications means that there is no inventory of frames in stock. The company does maintain the necessary inventory of graphite composite building material necessary to build and ship one week's worth of orders (approximately 18 bikes). The cost of 200 pounds of the graphite material is \$8,000. The cost of maintaining this perpetual inventory is \$200 a month for space at a nearby storage facility.

Inventory and Construction Costs and Capital Expenditures

Unit price. Breakaway currently builds road and mountain bike frames. The price of a road frame is \$1,800 and the price of a mountain frame is \$1,600. The prices of these bikes are not expected to increase during the three-year period included in the financial projections.

Unit cost. The following breakdown lists the material and labor expenses incurred in building a bike frame:

1. Computer Design and drawing (5 hours of labor) = \$50
2. Creating and pouring the cast iron mold for the frame (2.5 hours of labor and \$25 for materials) = \$50
3. Pouring the graphite composite material (2.5 hours of labor and \$100 for materials) = \$125
4. Shaping and finishing the frame (6 hours of labor and \$15 for materials) = \$75
5. Painting and buffing the frame (5 hours of labor and \$10 for material) = \$85
6. Packing and shipping the frame to the customer = \$80

Accordingly, the total cost to produce one bike frame and ship it to the customer is \$465.