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FOREWORD BY **VERNE HARNISH**, CEO, GAZELLES, INC.;
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**SIMPLE
NUMBERS,
STRAIGHT TALK,
BIG PROFITS!**
4 KEYS TO UNLOCK YOUR
BUSINESS POTENTIAL

GREG CRABTREE

WITH BEVERLY BLAIR HARZOG



“Most people miss opportunity because it wears overalls and looks like work”

– Thomas Edison



Simple Numbers... Straight Talk... Big Profits

4 Keys to Unlock Your Business Potential

- Your data is lying! - Why how you deal with Owner's compensation is distorting your data
- Profit matters more than you think – How to set the right profit targets for your business
- Labor Productivity drives you profit engine – How do measure it and improve it
- 4 Forces of cash flow – Get the priorities right to set your business on a solid foundation



Next Level – Covered in Book

- How to maximize labor productivity by communication performance expectations
- Reporting – Rhythm, Data & Priorities Simplified
- Three Sources of Capital – Which is Right for You?
- Economic Value - what is your business really worth to you?



Two Challenges For You

- You get
 - a salary for what you do and
 - a return on what you own
- Why Your Net Income is lying!
- Be a More Demanding Employee
 - What does **your** industry say **you're** worth?
- Be a More Demanding Shareholder



Three examples

	Company 1	Company 2	Company 3
Revenue	\$1,000,000	\$1,000,000	\$1,000,000
Salaries	\$400,000	\$500,000	\$600,000
Operating Costs	\$350,000	\$350,000	\$350,000
Total Expenses	\$750,000	\$850,000	\$950,000
Pre-tax Net income	\$250,000	\$150,000	\$50,000
as % of Revenue	25.0%	15.0%	5.0%



Three examples - Continued

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Pre-tax Net income	\$250,000	\$150,000	\$50,000
as % of Revenue	25.0%	15.0%	5.0%
Owner salaries included above	\$-	\$100,000	\$200,000
Dividends taken out	\$250,000	\$-	\$100,000
Market based wage	\$100,000	\$100,000	\$100,000
Revised actual net income	\$-	\$150,000	\$(50,000)
Business Net potential	\$150,000	\$150,000	\$150,000
Cash available to grow	\$-	\$150,000	\$(50,000)



Multi-Shareholder Companies

- No Two Individuals are worth *Exactly* the same amount of money

CEO has to be the defined leader:
“Here’ s the way forward, follow me”



Gregism

“Fair does not Mean Equal!”



Got Investors?

- Plan when management will be able to take a market based wage, and when investors will begin to see a cash return
- Forecasting Cash-Flows and creating a level of expectation



Communication is Key

What is Profit?

- **EBITDA** - Earnings before: Interest, Taxes, Depreciation and Amortization – the most abused term in finance
- **Pre-tax profits** – easier to define and more traceable to true cash flow
- **Gross profit** – Revenue less direct costs (the true economic engine) – my definition excludes labor
- **Contribution margin** – my definition is gross profit minus direct labor – can also be used to track net benefit from a single activity
- **Labor Efficiency Ratio (LER)** – measure of how effective your labor is



Exhibit 2.1 - Gross Profit Examples

	Construction Company	Services Company
Revenue	<u>\$20,000,000</u>	<u>\$3,750,000</u>
Cost of Goods Sold:		
Materials	5,000,000	-
Subcontractors	<u>12,150,000</u>	<u>900,000</u>
Total Cost of Goods Sold	<u>17,150,000</u>	<u>900,000</u>
Gross Profit	2,850,000	2,850,000
Direct Labor	<u>1,000,000</u>	<u>1,000,000</u>
	Direct LER 2.85	2.85
Contribution Margin	<u>1,850,000</u>	<u>1,850,000</u>
Operating expenses:		
Facilities	150,000	150,000
Marketing	75,000	75,000
Salaries (management and admin)	750,000	750,000
Payroll taxes and benefits	100,000	100,000
Other operating expenses	<u>150,000</u>	<u>150,000</u>
Total operating expenses	<u>1,225,000</u>	<u>1,225,000</u>
	Management LER 2.46	2.46
Net operating Income	<u>625,000</u>	<u>625,000</u>
	Overall LER 1.63	1.63
Other expenses:		
Depreciation	75,000	75,000
Interest Expense	<u>25,000</u>	<u>25,000</u>
Total other expenses	<u>100,000</u>	<u>100,000</u>
Pre-tax Net Income	<u>\$525,000</u>	<u>\$525,000</u>
	as a % of Revenue 2.63%	14.00%
	as a % of Gross Profit 18.42%	18.42%

Exhibit 2.1 - Gross Profit Examples

		Construction Company	Services Company	
Business engine	Revenue	<u>\$20,000,000</u>	<u>\$3,750,000</u>	
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	as a % of Gross Profit	18.42%	18.42%	

Does your engine fit the frame it is trying to move?

Breaking Even Isn't Good Enough Why 10% is the New Breakeven

Profitability Percentages (Pre-Tax):

5% - You're on Life Support

10% - When you're a *good* business

15% - When you're a *great* business

- Anything over 15%, take it while you can!

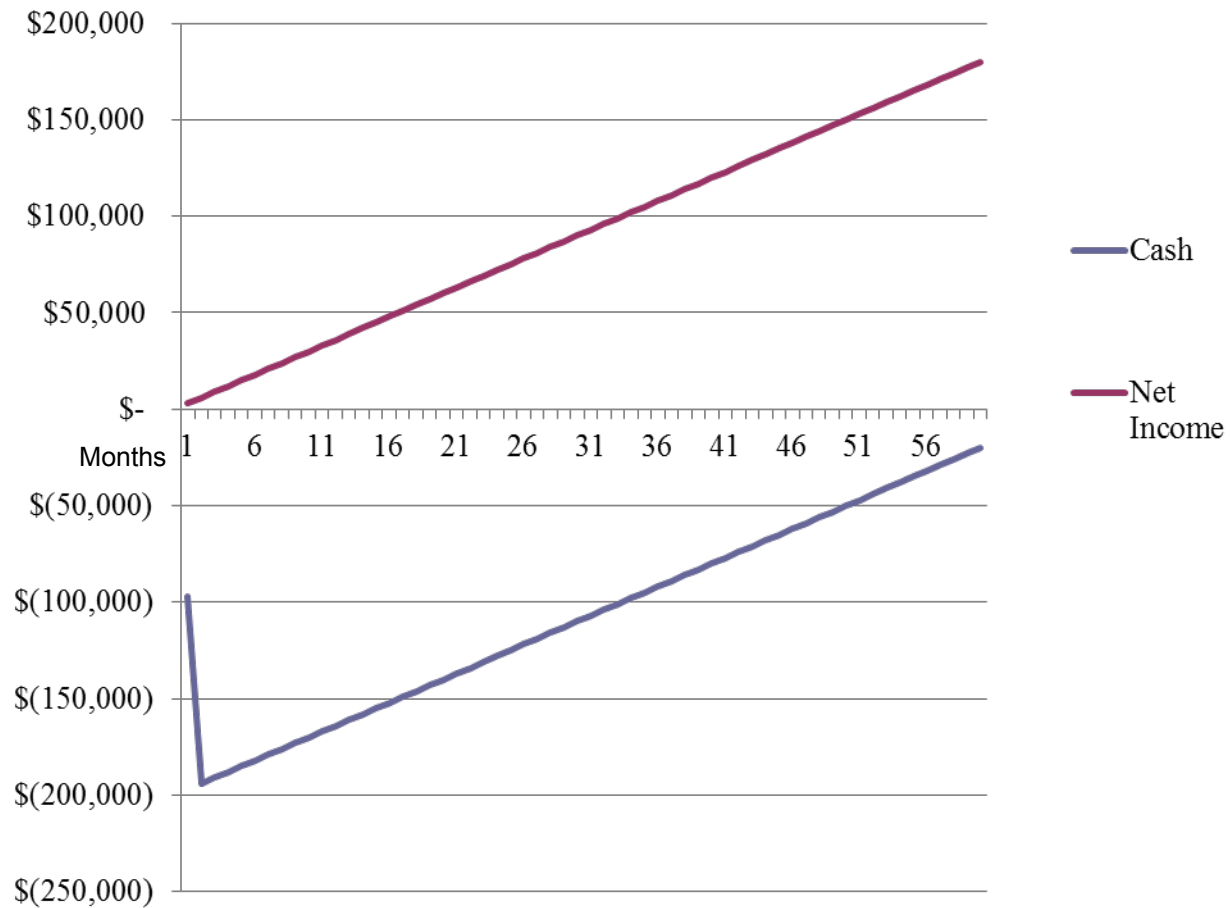


Cash Flow versus Profit

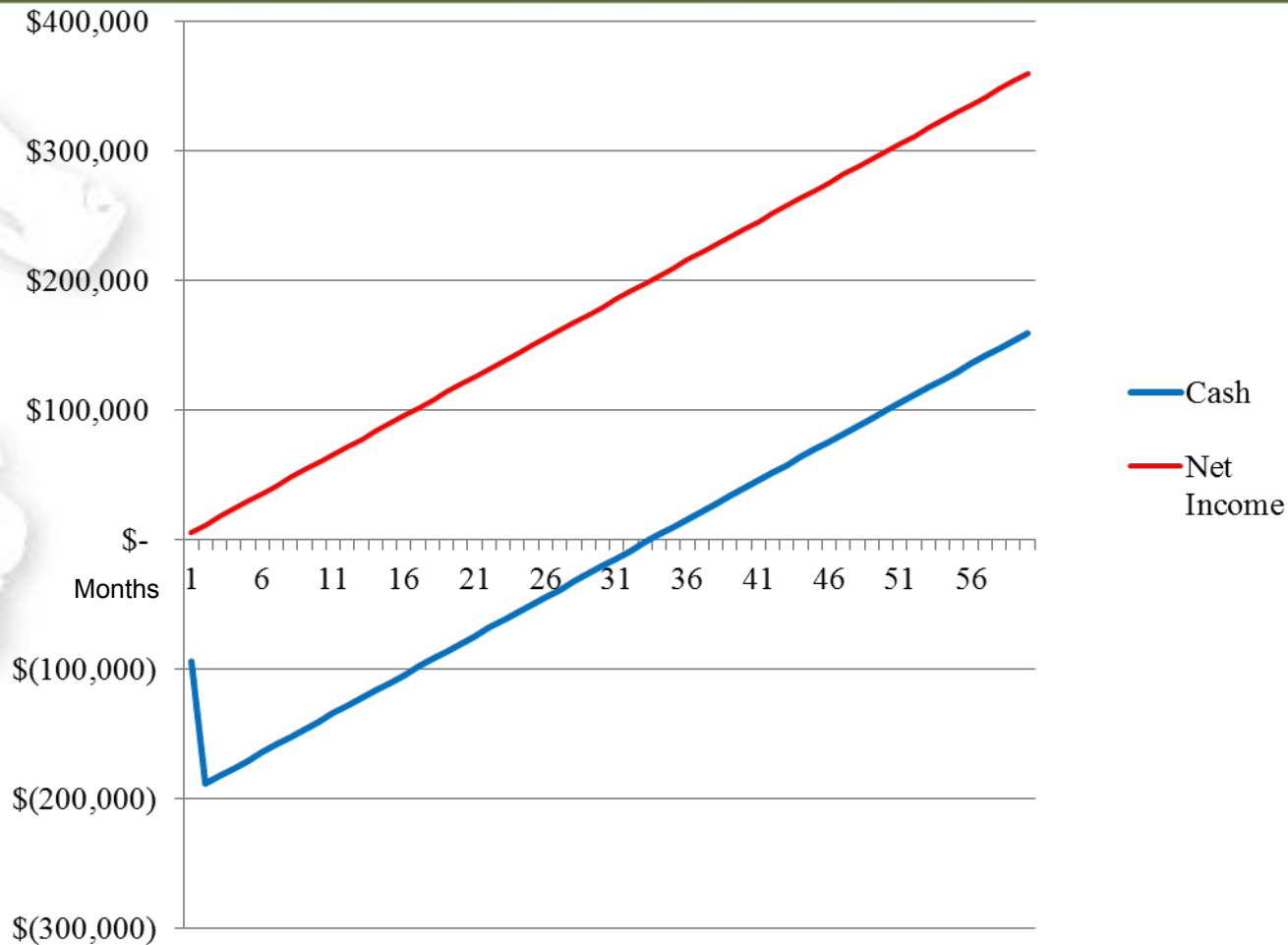
- Examples at 5%/10% & 15%
- Revenue at \$100,000 per month
- Tax Rate 40%
- Assume service based business that bills at the end of the month and gets paid in an average of 45 days



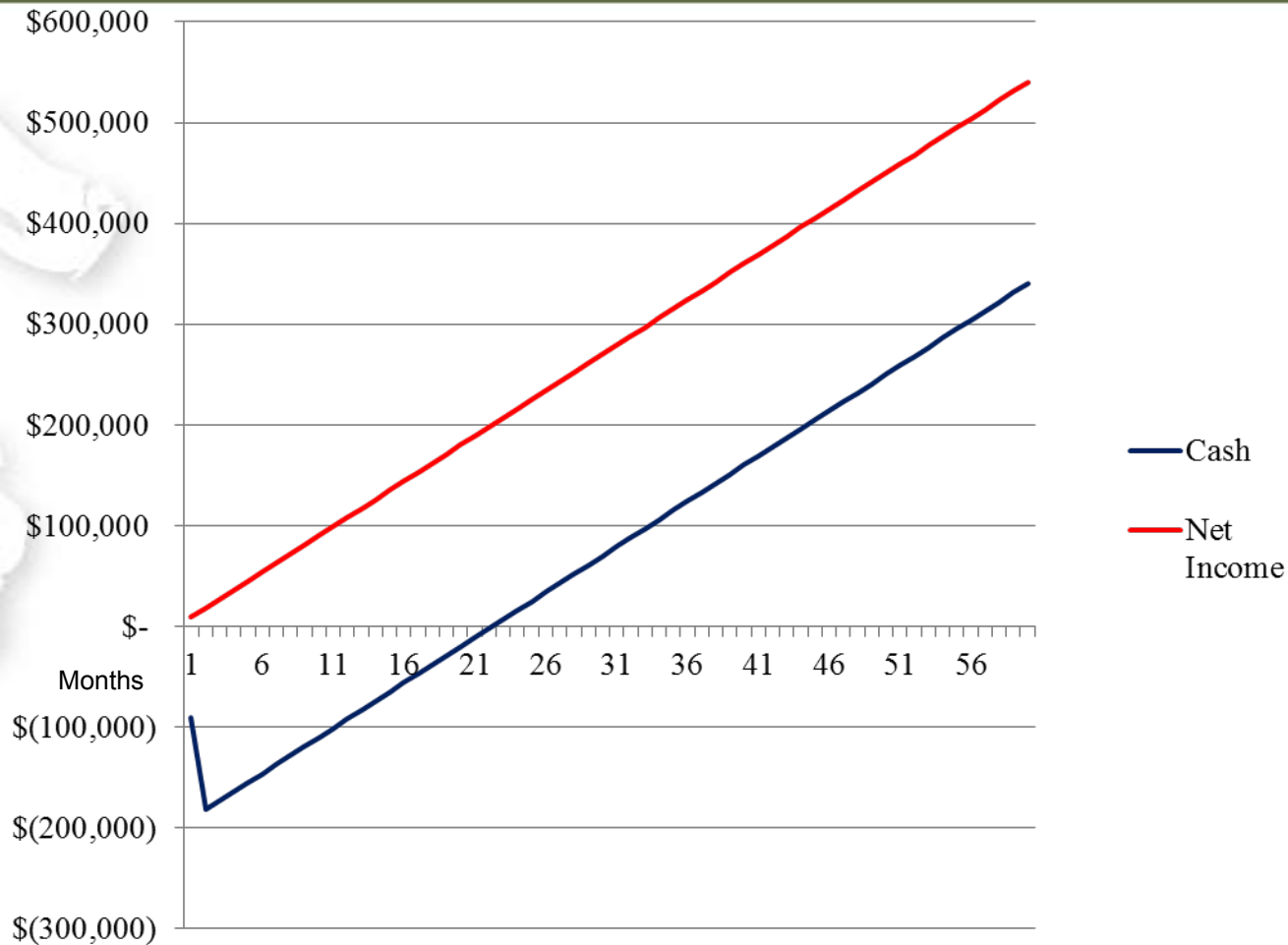
Cash Flow versus Profit 5%



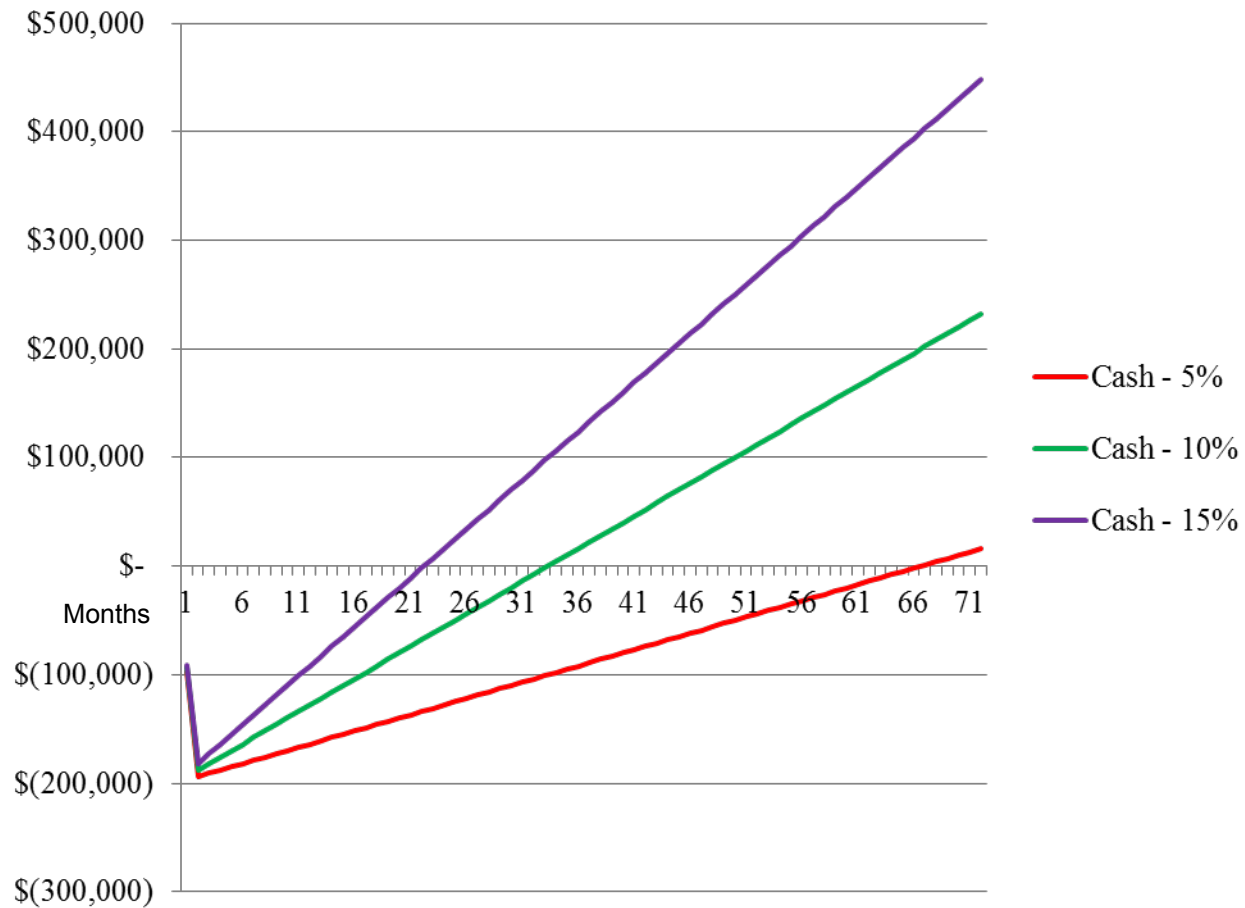
Cash Flow versus Profit 10%



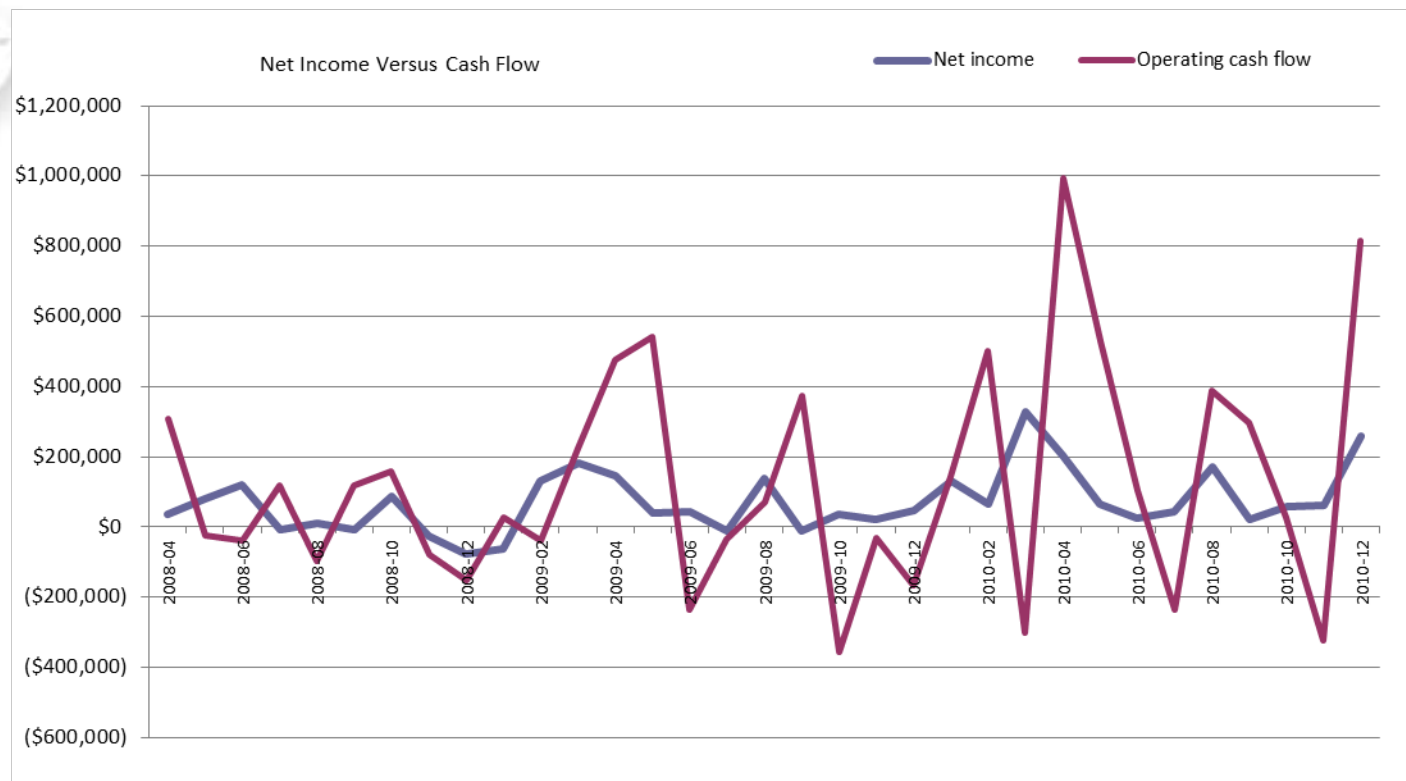
Cash Flow versus Profit 15%



Cash Flow versus Profit Recap



Ups and Downs of Operating Cash Flow



Labor Productivity

- Labor Productivity is the Key to Profitability
- Until you fix profitability, trying to fix cash flow is like re-arranging the deck chairs on the Titanic



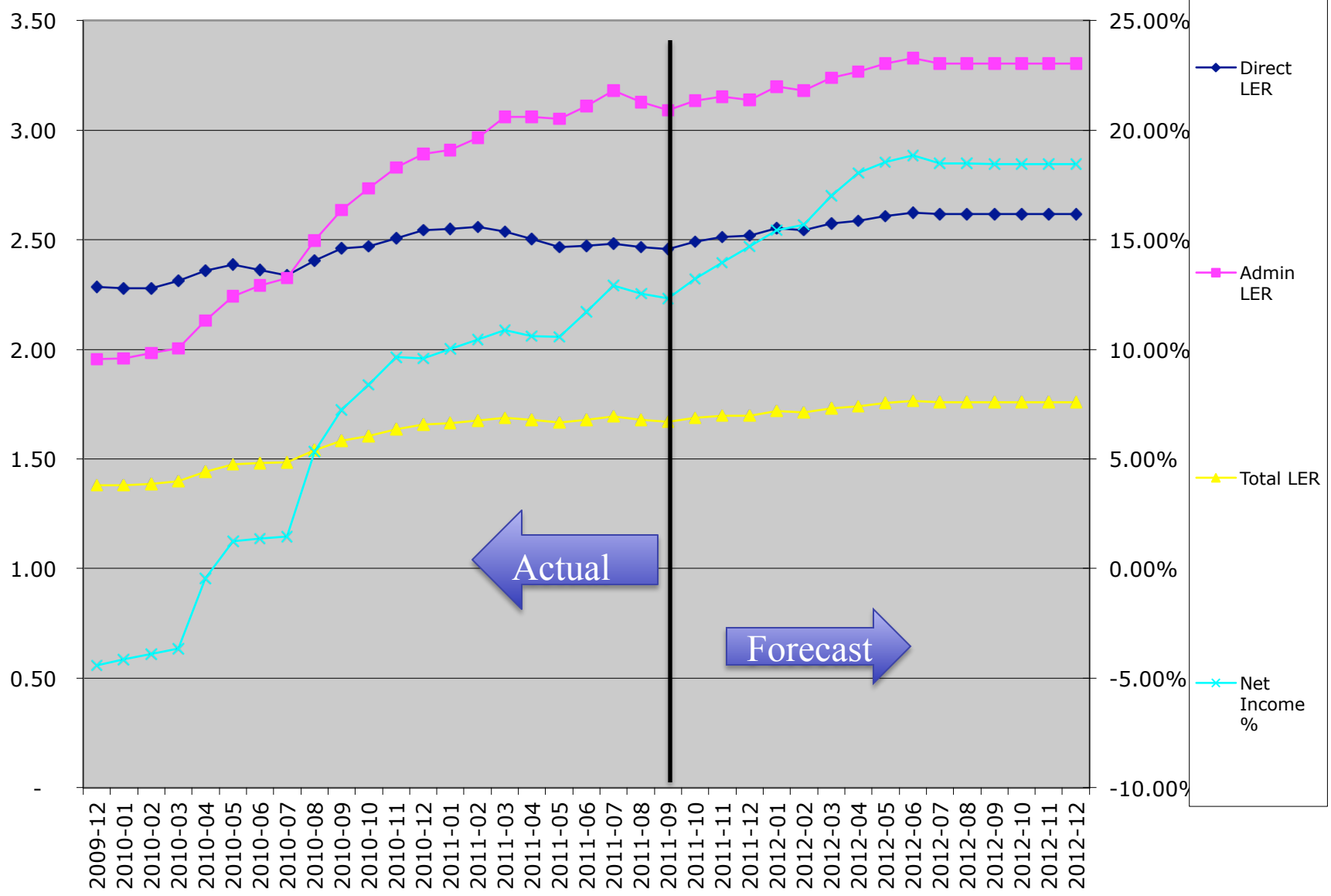
Getting to 15% Pre-Tax Profit

- Know your current capacity
- Being Profitable and Maintaining Market Share can be better than growth
- Remember, 10% is the new breakeven
- Use the “baffle” concept to grow to 15% in profit before you add more labor



	Original	Step #1 10%	Step #2 15%	Step #3 back to 10%	Step #4 Back to 15%
Revenue	450,000.00	492,195.19	534,383.35	534,383.35	587,821.68
Direct Costs excluding labor	<u>130,000.00</u>	<u>142,195.19</u>	<u>154,383.35</u>	<u>154,383.35</u>	<u>169,821.68</u>
Gross Profit	320,000.00 71.1%	350,000.00 71.1%	380,000.00 71.1%	380,000.00 71.1%	418,000.00 71.1%
Direct Labor	<u>90,000.00</u>	<u>90,000.00</u>	<u>90,000.00</u>	<u>98,333.33</u>	<u>98,333.33</u>
Contribution Margin	230,000.00	260,000.00	290,000.00	281,666.67	319,666.67
Management/Admin Labor	75,000.00	75,000.00	75,000.00	83,333.33	83,333.33
Sales Labor	35,000.00	35,000.00	35,000.00	43,333.33	43,333.33
Other Operating Costs	<u>100,000.00</u>	<u>100,000.00</u>	<u>100,000.00</u>	<u>101,666.67</u>	<u>105,000.00</u>
Pre-tax Profit	<u>20,000.00</u>	<u>50,000.00</u>	<u>80,000.00</u>	<u>53,333.33</u>	<u>88,000.00</u>
Pre-tax Profit as % of Revenue	4.44%	10.16%	14.97%	9.98%	14.97%
CM as % of Revenue	51.11%	52.82%	54.27%	52.71%	54.38%
Other Operating Costs as % of Rev	22.22%	20.32%	18.71%	19.03%	17.86%
Labor Efficiency:					
Direct Labor (GP/DL)	\$3.56	\$3.89	\$4.22	\$3.86	\$4.25
Sales Labor (CM/SL)	\$6.57	\$7.43	\$8.29	\$6.50	\$7.38
Management Labor (CM/ML)	\$3.07	\$3.47	\$3.87	\$3.38	\$3.84

R12 Labor efficiency



4 Forces of Cash Flow

Prioritized In Order:

- Taxes
- Repay debt
- Build Working Capital (Core Capital Target)
- Dividends (Distributions)



Entrepreneur Wealth Cycle

1. Get the Business Healthy
 1. Owner at a market based wage
 2. No LOC debt, and 2 months cash on hand
2. Get the owner healthy
 1. Same personal goals as business
3. Grow profitably to market acceptance
4. Harvest profits or sell, it is your choice



Crabtree
Rowe & Berger

Return on Investment

Exhibit 7.1: Return on Investment Example

	20X1	20X2	20X3	20X4	20X5
Revenue	\$1,750,000	\$3,200,000	\$3,450,000	\$4,750,000	\$5,000,000
Net Income	\$200,000	\$500,000	\$415,000	\$750,000	\$620,000
% to Income	11.4%	15.6%	12.0%	15.8%	12.4%
Equity	\$245,000	\$650,000	\$ 850,000	\$1,500,000	\$1,300,000
Return on Investment	82%	77%	49%	50%	48%
Distribution		\$95,000	\$215,000	\$100,000	\$820,000



What is Your Business Worth?

- My concept of Economic Value
 - 3 years pre-tax net income
 - Equity at date of valuation
- How long are you willing to wait to be repaid without having to sell the business?



Exhibit 9.1: FMV Calculation - 10%

EBITDA History

	<u>20X1</u>	<u>20X2</u>	<u>20X3</u>	<u>20X4</u>	<u>20X5</u>
Revenue	\$1,050,000	\$1,920,000	\$2,070,000	\$2,850,000	\$3,000,000
Net operating income	105,000	192,000	207,000	285,000	300,000
<i>% to income</i>	10.0%	10.0%	10.0%	10.0%	10.0%
Tax Distributions (40% on previous year)		42,000	76,800	82,800	114,000
Profit distributions (amounts above core capital target)			17,000	107,700	85,200
Total Distributions	-	42,000	93,800	190,500	199,200
Equity at year end (assumes \$50k to start)	155,000	305,000	418,200	512,700	613,500
Core capital target	157,500	288,000	310,500	427,500	450,000
Retrun on Investment	68%	63%	49%	56%	49%



Exhibit 9.2: FMV Calculation - 10%

Valuation

Equity + last 3 years EBITDA

if 3 years are not available, take the average of the years available times 3

Value Calculation	20X1	20X2	20X3	20X4	20X5
Average NOI	105,000	148,500	use last 3 yrs	use last 3 yrs	use last 3 yrs
x3	315,000	445,500	504,000	684,000	792,000
Equity	155,000	305,000	418,200	512,700	613,500
FMV before discounts	470,000	750,500	922,200	1,196,700	1,405,500
Discount for lack of marketability					
Percentage	20%	20%	20%	20%	20%
Amount	94,000	150,100	184,440	239,340	281,100
FMV before lack of control discount	376,000	600,400	737,760	957,360	1,124,400
Discount for lack of control					
Percentage	20%	20%	20%	20%	20%
Amount	75,200	120,080	147,552	191,472	224,880
FMV after applying discounts	300,800	480,320	590,208	765,888	899,520

Multiple of EBITDA	4.69
Multiple of Revenue	0.47
Payback term at 100% sale	7%
Tax	40%
Periods	14.34
Payment (3 year after tax average)	158,400.00

