



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

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

- 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

	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%
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)



Sweat Equity

Q: The Market says I am worth \$100,000, but my business can only afford to pay me \$30,000, what does it mean?

A: 1.) Below Market Wage and
2.) No Return on Investment

How to Track of Sweat Equity



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”



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“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



Transitioning Out Of Your Business

- Business owner taking a part-time role
- Promoting a key employee does not hurt profitability
- Creating a baseline



The Bottom Line

- If you're not taking a market based wage, you are lying to yourself
- Be paid what the market says you should be paid in your current role



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Change what you say or change what you do, just pick one of the two...



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



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	
	<u>2.46</u>	<u>2.46</u>
Net operating Income	<u>625,000</u>	<u>625,000</u>
	Overall LER	
	<u>1.63</u>	<u>1.63</u>
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>	
	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>	
Business chassis	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	<u>2.46</u>	<u>2.46</u>
	Net operating Income	<u>625,000</u>	<u>625,000</u>	
		Overall LER	<u>1.63</u>	<u>1.63</u>
	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%	

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!

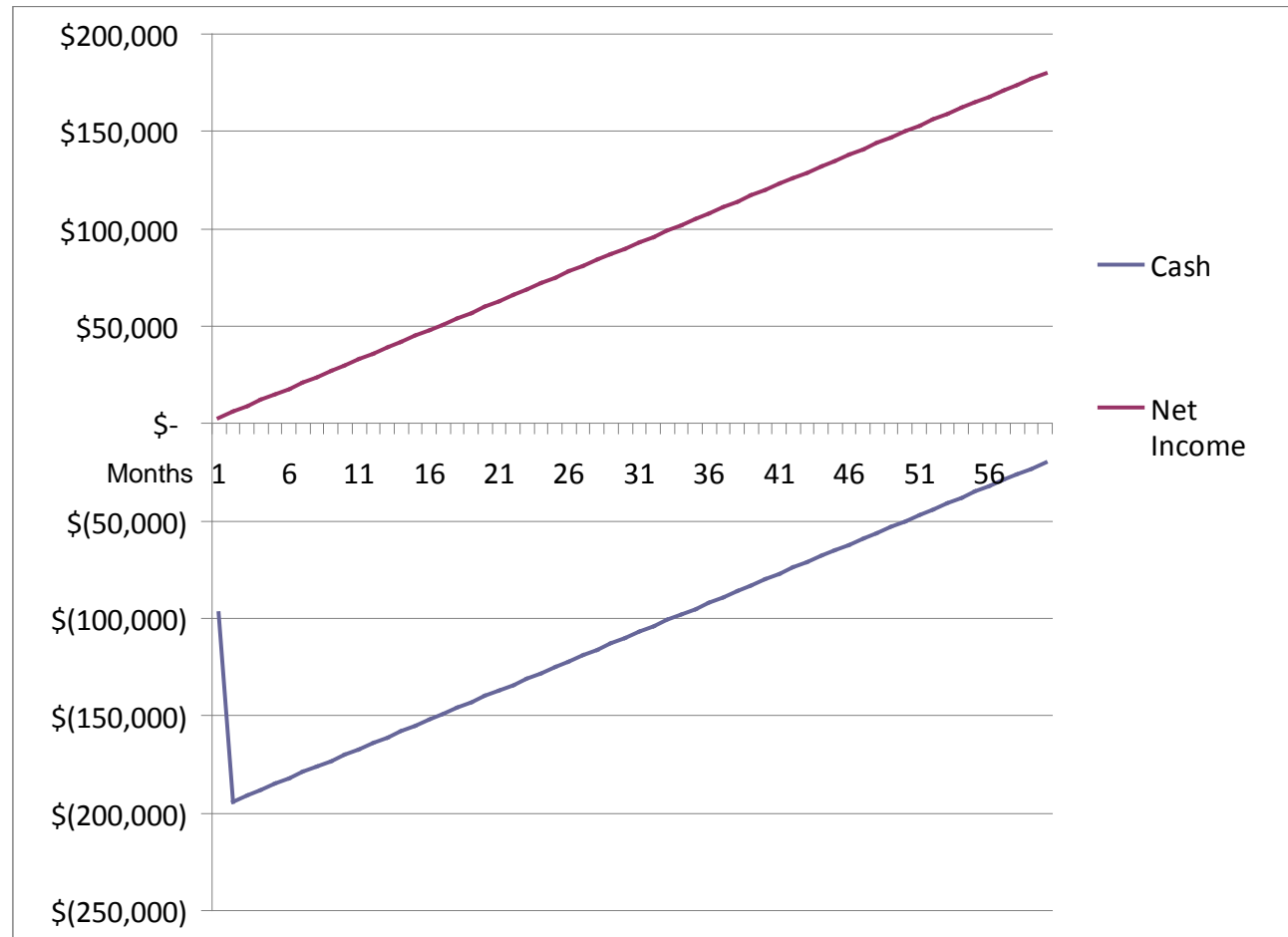


Cash Flow versus Profit

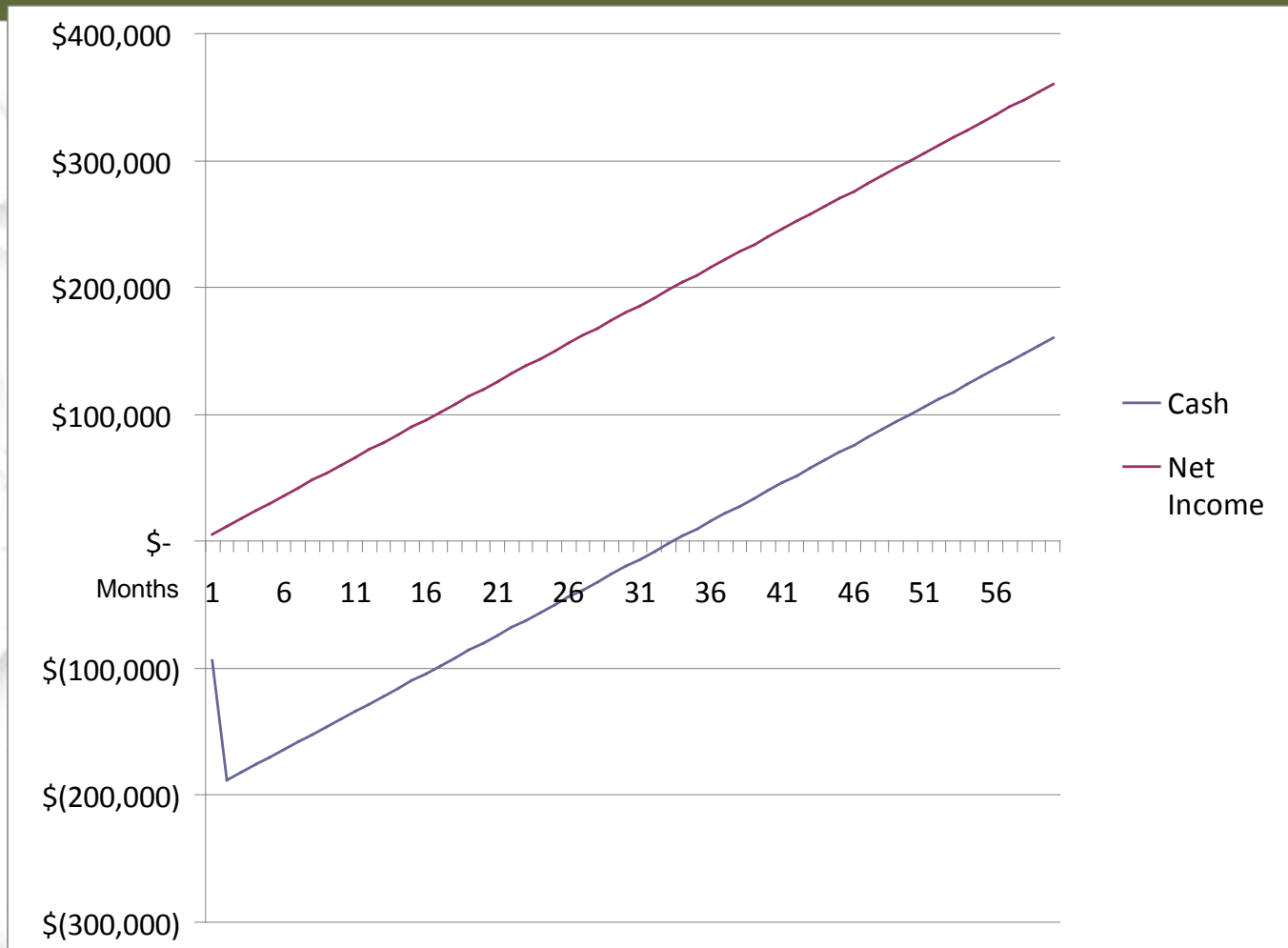
- Examples at 5%/10% & 15%
- Revenue at \$100,000 per month
- Tax Rate 40%
- Assume service based business that bills at the end of the month and gets paid in an average of 45 days



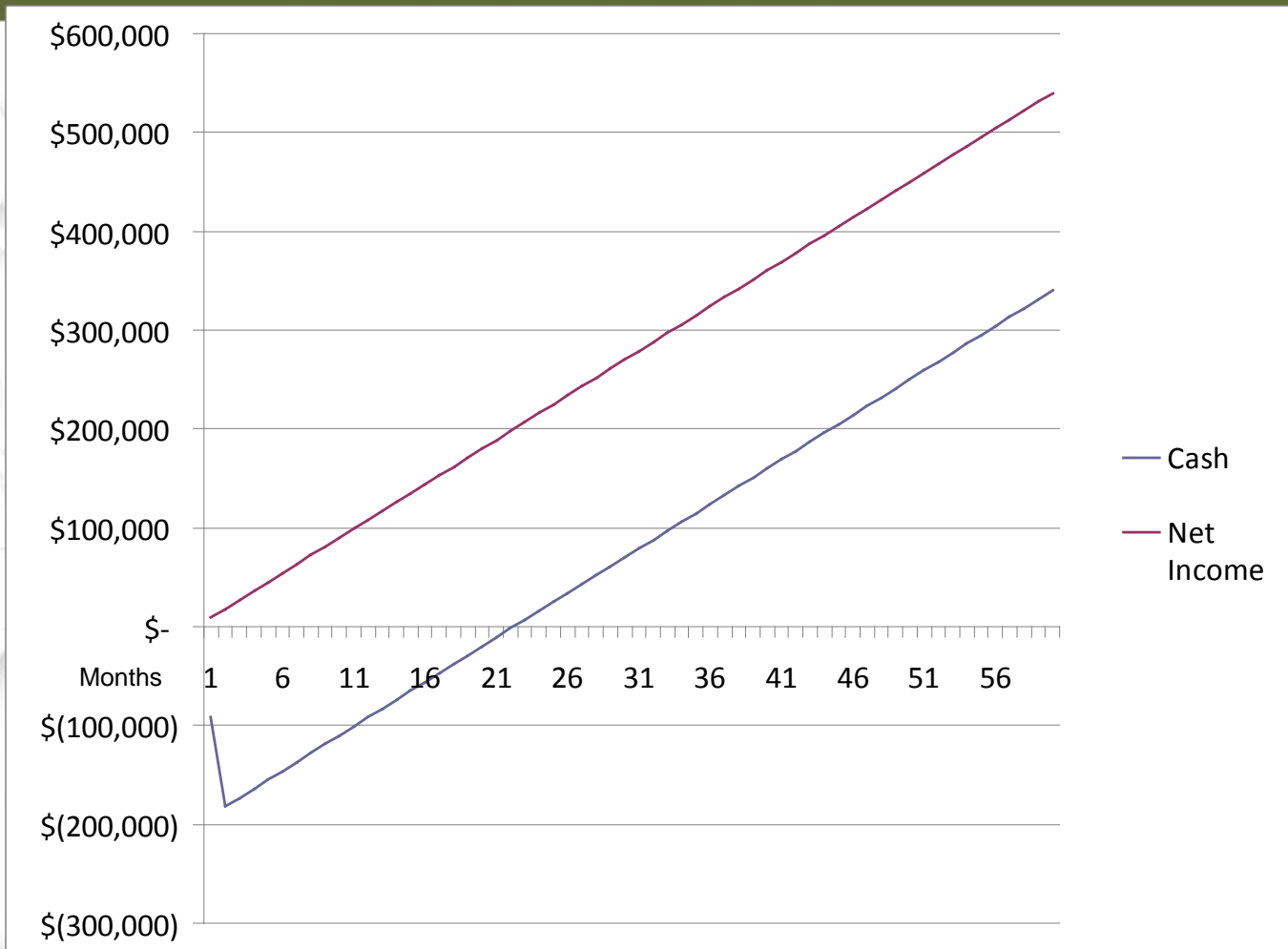
Cash Flow versus Profit 5%



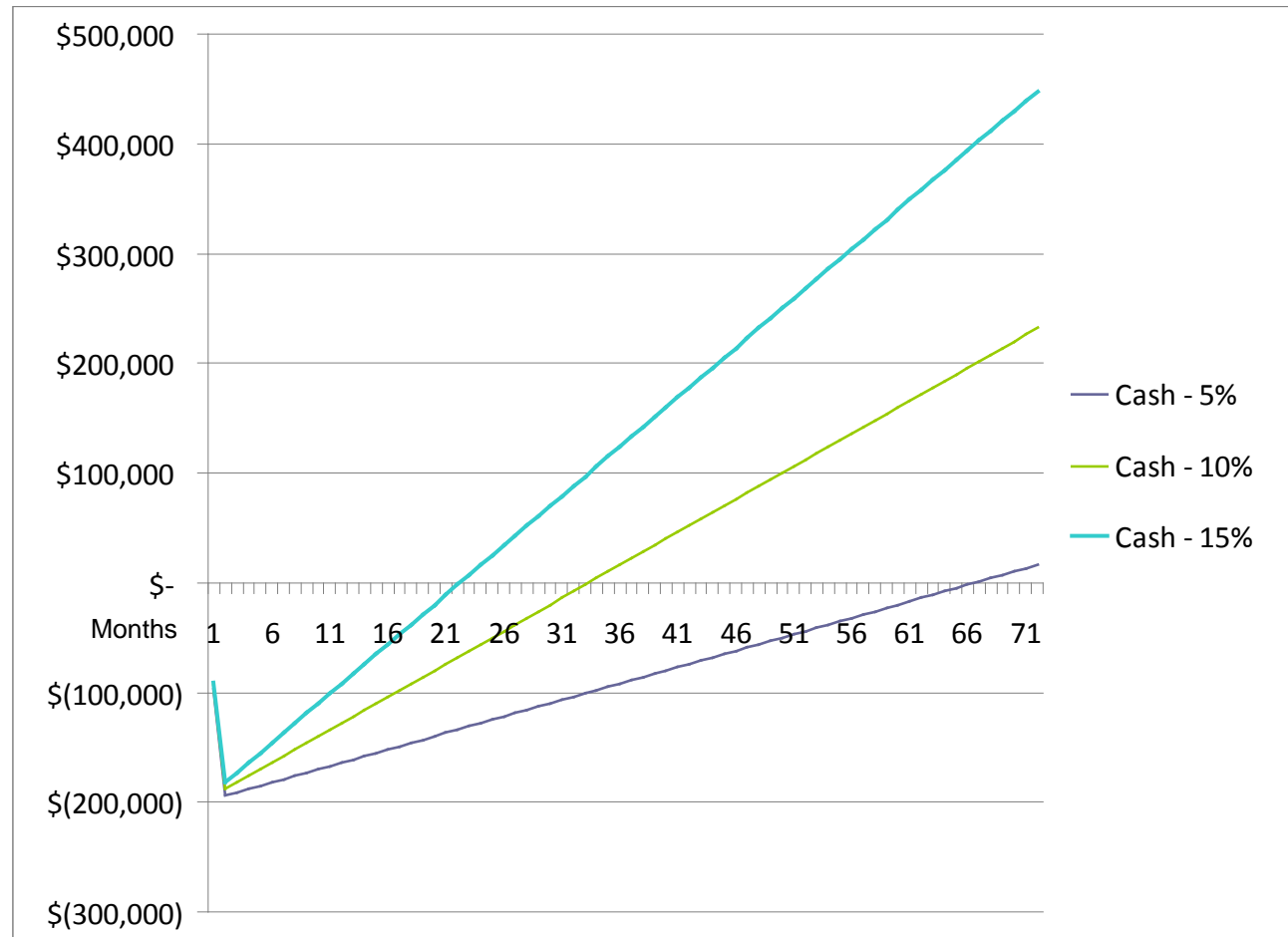
Cash Flow versus Profit 10%



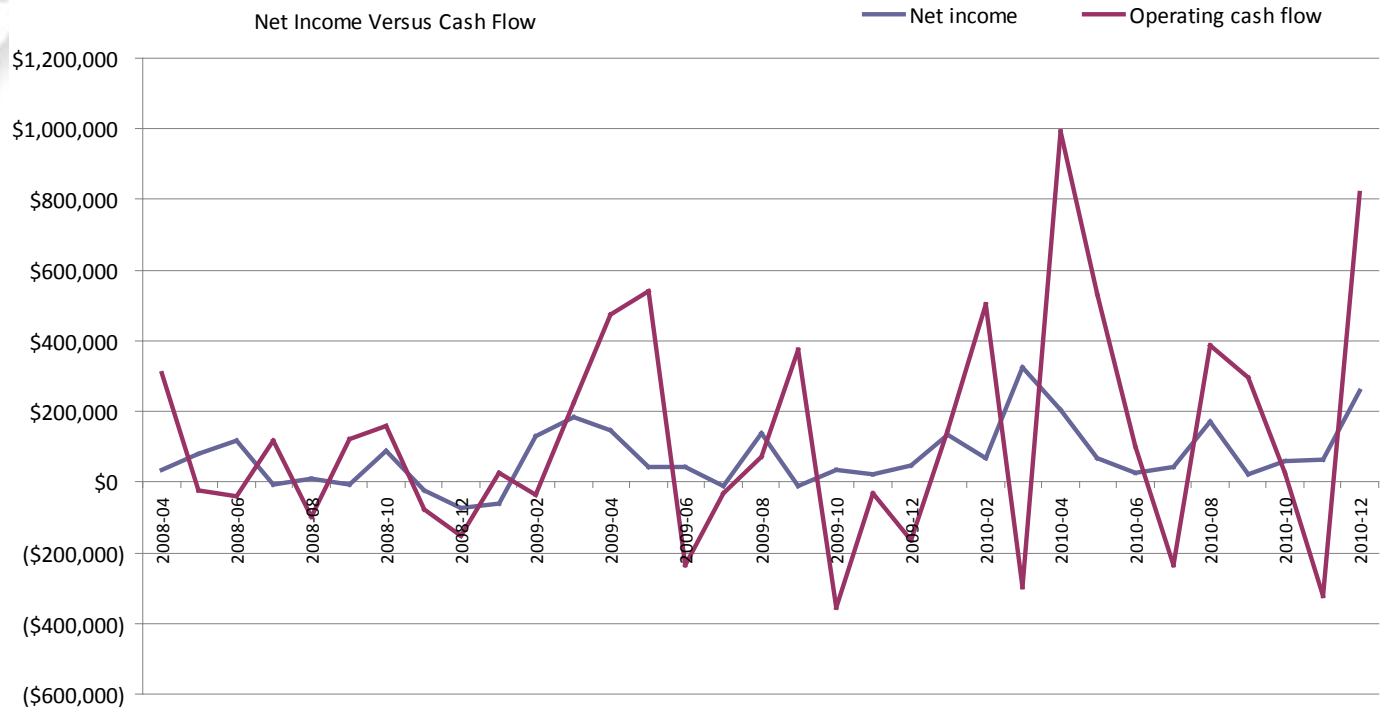
Cash Flow versus Profit 15%



Cash Flow versus Profit Recap



Ups and Downs of Operating Cash Flow



#1 Key Performance Indicator

- How Big of A Check Did You Write to the IRS (pay in taxes)?
- There are only two ways to not pay taxes...
 - You cheated, or
 - You made no profit
 - Both are bad!



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When all else fails....

you can always serve as the bad
example.



From Start-Up to \$5 Million

- Eight Functional Areas (from Gazelles.com):
 1. CEO
 2. Sales
 3. Marketing
 4. Operations
 5. Technology
 6. Finance
 7. Customer Service
 8. Human Resources

MythBuster

The vast majority of businesses that survive are profitable by the time they reach \$1 Million



The Black Hole For Businesses

- Between \$1 million and \$5 million of revenue is referred to as “The Black Hole”
- Conditions force the addition of staff and infrastructure before it can be justified
- Can your business make it through the journey? Do you have the proper provisions?



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“When the horse is dead, dismount”
- *unknown author*



Most Challenging Level of Profitability

- Between \$2 million and \$4 million in annual revenue
- Lesson from sociology



How Much Capital is Enough

- Calculate the estimated Capital Needed by month
- Find the deepest part of the hole
- Depending on your confidence in the forecast, you may want to double it!
- Learn to ration it as you make the journey
- Hire with care: Remember High Turnover means Lower Profitability



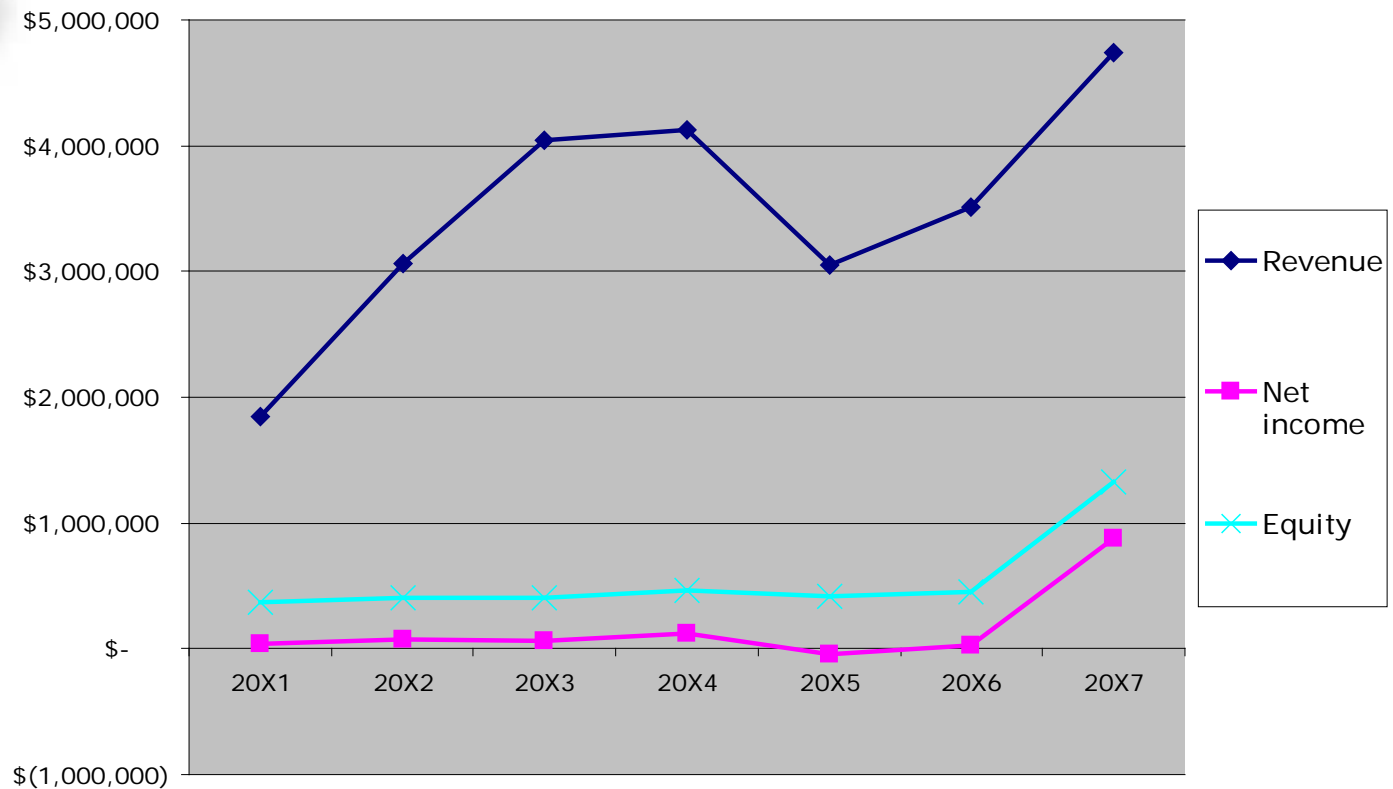
\$1 Million to \$5 Million: How to be Successful on the Journey

- Are you receiving:
 - 1.) Market Based Wage
 - 2.) Return on Investment
- If your living off profits and salary of the business: ***Do Not Attempt to Expand***
- Get profitable, get out of debt and get your market wage before you start the journey



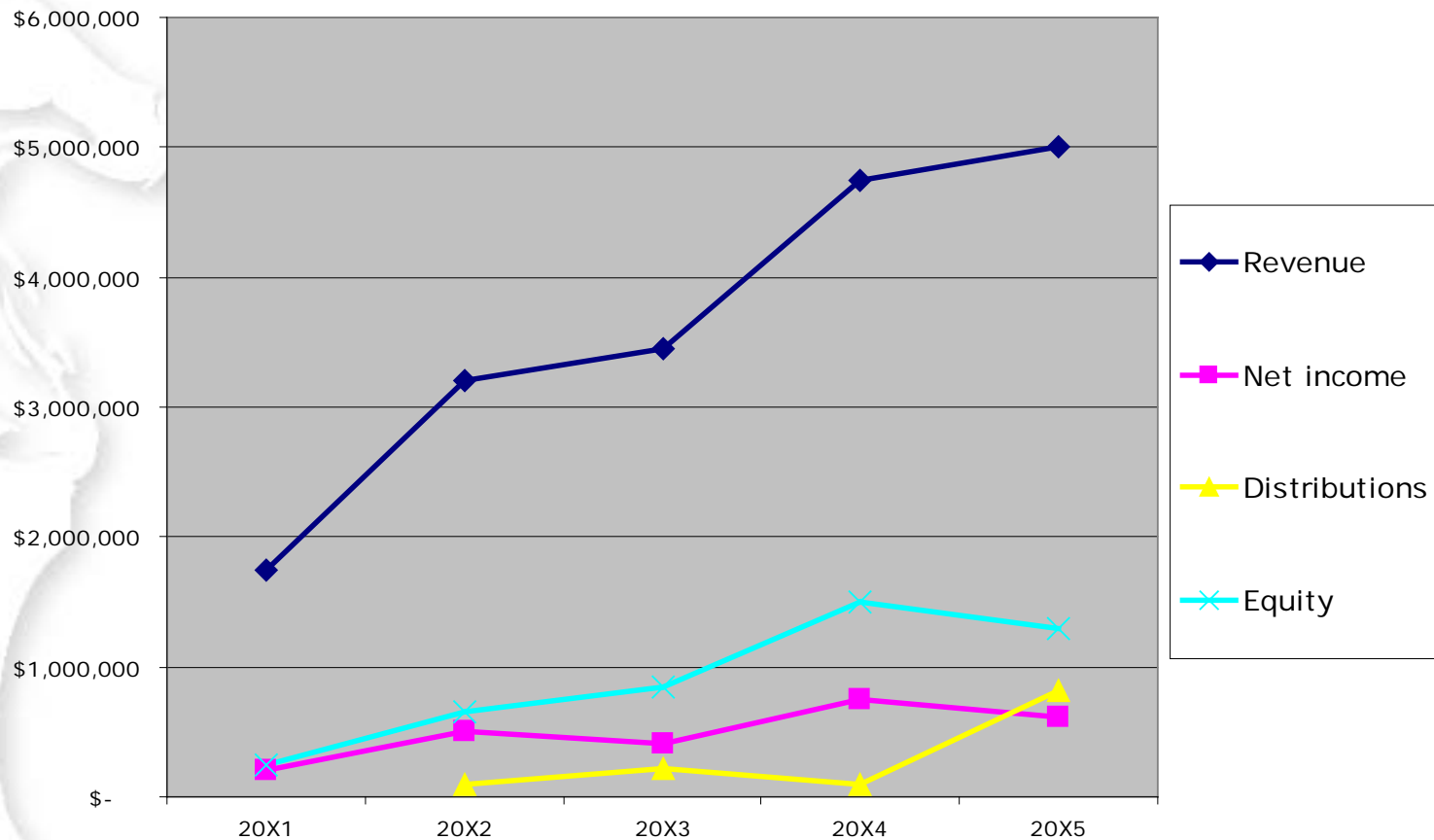
Surviving The Black Hole

Company A



Surviving the Black Hole

Company B



Labor Productivity is the Key to Profitability

- Salary Cap concept
- NFL (Football) Team Example
- Real life examples of change after introduction to the Salary Cap concept
- Million Dollar Makeover



Plugging in Your Salary Cap Number

Revenue		\$1,000,000
Salaries	????	
Non Salary Costs	????	
	<hr/>	
Total Expenses		????
		<hr/>
Pre tax Profit (10%)		<u>\$ 100,000</u>



Plugging in Your Salary Cap Number

Revenue		\$1,000,000
Salaries	????	
Non Salary Costs	????	
	<hr/>	
Total Expenses		\$ 900,000
		<hr/>
Pre tax Profit (10%)		\$ 100,000
		<hr/>



Plugging in Your Salary Cap Number

Revenue		\$1,000,000
Salaries	????	
Non Salary Costs	\$400,000	
Total Expenses		<u>\$ 900,000</u>
Pre tax Profit (10%)		<u>\$ 100,000</u>



Plugging in Your Salary Cap Number

Revenue		\$1,000,000
Salaries	\$500,000	
Non Salary Costs	<u>\$400,000</u>	
Total Expenses		<u>\$ 900,000</u>
Pre tax Profit (10%)		<u>\$ 100,000</u>



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
Revenue	450,000.00
Direct Costs excluding labor	<u>130,000.00</u>
Gross Profit	320,000.00 71.1%
Direct Labor	<u>90,000.00</u>
Contribution Margin	<u>230,000.00</u>
Management/Admin Labor	75,000.00
Sales Labor	35,000.00
Other Operating Costs	<u>100,000.00</u>
Pre-tax Profit	<u>20,000.00</u>
Pre-tax Profit as % of Revenue	4.44%
CM as % of Revenue	51.11%
Other Operating Costs as % of Rev	22.22%
Labor Efficiency:	
Direct Labor (GP/DL)	\$3.56
Sales Labor (CM/SL)	\$6.57
Management Labor (CM/ML)	\$3.07

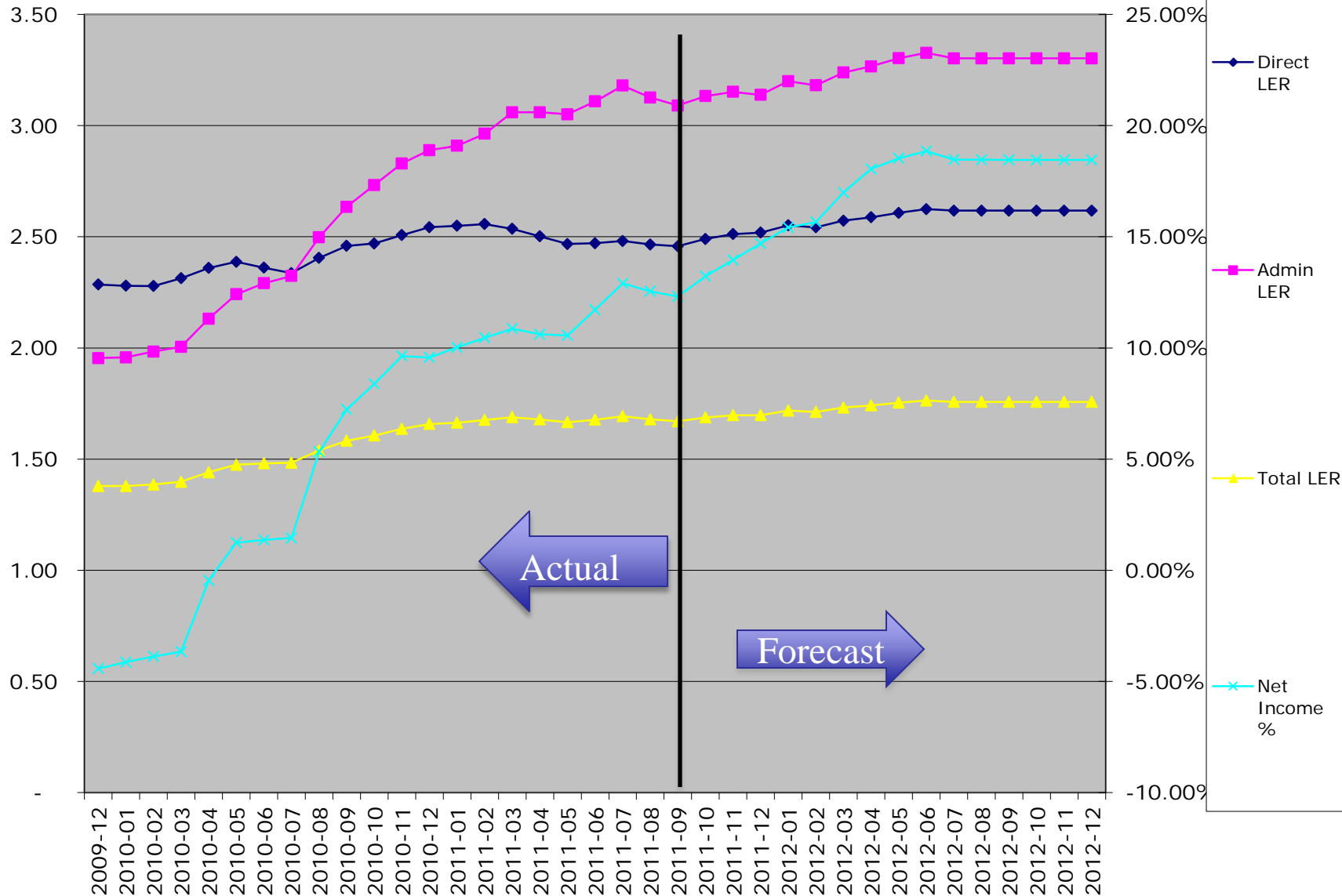
	Original	Step #1 10%
Revenue	450,000.00	492,195.19
Direct Costs excluding labor	<u>130,000.00</u>	<u>142,195.19</u>
Gross Profit	320,000.00	350,000.00
	71.1%	71.1%
Direct Labor	<u>90,000.00</u>	<u>90,000.00</u>
Contribution Margin	<u>230,000.00</u>	<u>260,000.00</u>
Management/Admin Labor	75,000.00	75,000.00
Sales Labor	35,000.00	35,000.00
Other Operating Costs	<u>100,000.00</u>	<u>100,000.00</u>
Pre-tax Profit	<u>20,000.00</u>	<u>50,000.00</u>
Pre-tax Profit as % of Revenue	4.44%	10.16%
CM as % of Revenue	51.11%	52.82%
Other Operating Costs as % of Rev	22.22%	20.32%
Labor Efficiency:		
Direct Labor (GP/DL)	\$3.56	\$3.89
Sales Labor (CM/SL)	\$6.57	\$7.43
Management Labor (CM/ML)	\$3.07	\$3.47

	Original	Step #1 10%	Step #2 15%
Revenue	450,000.00	492,195.19	534,383.35
Direct Costs excluding labor	<u>130,000.00</u>	<u>142,195.19</u>	<u>154,383.35</u>
Gross Profit	320,000.00 71.1%	350,000.00 71.1%	380,000.00 71.1%
Direct Labor	<u>90,000.00</u>	<u>90,000.00</u>	<u>90,000.00</u>
Contribution Margin	<u>230,000.00</u>	<u>260,000.00</u>	<u>290,000.00</u>
Management/Admin Labor	75,000.00	75,000.00	75,000.00
Sales Labor	35,000.00	35,000.00	35,000.00
Other Operating Costs	<u>100,000.00</u>	<u>100,000.00</u>	<u>100,000.00</u>
Pre-tax Profit	<u>20,000.00</u>	<u>50,000.00</u>	<u>80,000.00</u>
Pre-tax Profit as % of Revenue	4.44%	10.16%	14.97%
CM as % of Revenue	51.11%	52.82%	54.27%
Other Operating Costs as % of Rev	22.22%	20.32%	18.71%
Labor Efficiency:			
Direct Labor (GP/DL)	\$3.56	\$3.89	\$4.22
Sales Labor (CM/SL)	\$6.57	\$7.43	\$8.29
Management Labor (CM/ML)	\$3.07	\$3.47	\$3.87

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

	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



Price Increase Chart

		Your present Gross Profit								
		20%	25%	30%	35%	40%	45%	50%	55%	60%
Increase your price by:	To produce the same profit, you can decrease sales volume (units) by:									
2%		9.1%	7.4%	6.3%	5.4%	4.8%	4.3%	3.8%	3.5%	3.2%
4%		16.7%	13.8%	11.8%	10.3%	9.1%	8.2%	7.4%	6.8%	6.3%
6%		23.1%	19.4%	16.7%	14.6%	13.0%	11.8%	10.7%	9.8%	9.1%
8%		28.6%	24.2%	21.1%	18.6%	16.7%	15.1%	13.8%	12.7%	11.8%
10%		33.3%	28.6%	25.0%	22.2%	20.0%	18.2%	16.7%	15.4%	14.3%
12%		37.5%	32.4%	28.6%	25.5%	23.1%	21.1%	19.4%	17.9%	16.7%
14%		41.2%	35.9%	31.8%	28.6%	25.9%	23.7%	21.9%	20.3%	18.9%
16%		44.4%	39.0%	34.8%	31.4%	28.6%	26.2%	24.2%	22.5%	21.1%
18%		47.4%	41.9%	37.5%	34.0%	31.0%	28.6%	26.5%	24.7%	23.1%
20%		50.0%	44.4%	40.0%	36.4%	33.3%	30.8%	28.6%	26.7%	25.0%
25%		55.6%	50.0%	45.5%	41.7%	38.5%	35.7%	33.3%	31.3%	29.4%
30%		60.0%	54.5%	50.0%	46.2%	42.9%	40.0%	37.5%	35.3%	33.3%

Price Decrease Chart

		Your present Gross Profit								
		20%	25%	30%	35%	40%	45%	50%	55%	60%
Reduce your price by:	To produce the same profit, you must increase sales volume (units) by:									
2%		11.1%	8.7%	7.1%	6.1%	5.3%	4.7%	4.2%	3.8%	3.4%
4%		25.0%	19.0%	15.4%	12.9%	11.1%	9.8%	8.7%	7.8%	7.1%
6%		42.9%	31.6%	25.0%	20.7%	17.6%	15.4%	13.6%	12.2%	11.1%
8%		66.7%	47.1%	36.4%	29.6%	25.0%	21.6%	19.0%	17.0%	15.4%
10%		100.0%	66.7%	50.0%	40.0%	33.3%	28.6%	25.0%	22.2%	20.0%
12%		150.0%	92.3%	66.7%	52.2%	42.9%	36.4%	31.6%	27.9%	25.0%
14%		233.3%	127.3%	87.5%	66.7%	53.8%	45.2%	38.9%	34.1%	30.4%
16%		400.0%	177.8%	114.3%	84.2%	66.7%	55.2%	47.1%	41.0%	36.4%
18%		900.0%	257.1%	150.0%	105.9%	81.8%	66.7%	56.3%	48.6%	42.9%
20%			400.0%	200.0%	133.3%	100.0%	80.0%	66.7%	57.1%	50.0%
25%				500.0%	250.0%	166.7%	125.0%	100.0%	83.3%	71.4%
30%					600.0%	300.0%	200.0%	150.0%	120.0%	100.0%

Where Did the Cash Go?

Beginning Cash	\$100,000	
Net income	<u>\$125,000</u>	
Cash available:		\$225,000
?????????	??????	
?????????	??????	
?????????	??????	
?????????	??????	
	<hr/>	
Total cash adjustments		<hr/> \$200,000
Cash at end of year		<hr/> \$25,000



Where Did the Cash Go?

Beginning Cash	\$100,000	
Net income	<u>\$125,000</u>	
Cash available:		\$225,000
Taxes paid (40% of Net Income)	\$50,000	
??????????	??????	
??????????	??????	
??????????	??????	
	<hr/>	
Total cash adjustments		<hr/> \$200,000
Cash at end of year		<hr/> \$ 25,000



Where Did the Cash Go?

Beginning Cash	\$100,000	
Net income	<u>\$125,000</u>	
Cash available:		\$225,000
Taxes paid	\$50,000	
Principle Payments	\$50,000	
??????????	??????	
??????????	??????	
	<hr/>	
Total cash adjustments		<hr/> \$200,000
Cash at end of year		<hr/> \$25,000



Where Did the Cash Go?

Beginning Cash	\$100,000	
Net income	<u>\$125,000</u>	
Cash available:		\$225,000
Taxes paid	\$50,000	
Principle Payments	\$50,000	
Vehicle Purchase	\$50,000	
??????????	<u>??????</u>	
Total cash adjustments		<u>\$200,000</u>
Cash at end of year		<u>\$ 25,000</u>



Where Did the Cash Go?

Beginning Cash	\$100,000	
Net income	<u>\$125,000</u>	
Cash available:		\$225,000
Taxes paid	\$50,000	
Principle Payments	\$50,000	
Vehicle Purchase	\$50,000	
Distribution – Down Payment on Condo	<u>\$50,000</u>	
Total cash adjustments		<u>\$200,000</u>
Cash at end of year		<u>\$ 25,000</u>



Gregism

“too late to shut the gate when the
cow’s done left the barn”



Cash Flow Revealed – How It Should Be

Beginning Cash	\$100,000	
Net income	\$125,000	
Cash available:		\$225,000
Taxes paid	\$50,000	
Principal payments	\$50,000	
	<hr/>	
Total cash adjustments		\$100,000
		<hr/>
Cash available to meet Core Capital Target		\$125,000
Core Capital Target (2 x \$50,000)		(\$100,000)
Cash available for discretionary spend		\$ 25,000
		<hr/>



4 Forces of Cash Flow

Prioritized In Order:

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



#1 Force of Cash Flow

Taxes

- Before you spend, put aside \$\$ for Taxes, avoid the tax day “surprise”
- Cash versus Accrual
- Timing is Key



#2 Force of Cash Flow

Debt

- Line of Credit:
 - Should be reduced to \$0 for 30 consecutive days in a 12 month period
 - No “Evergreen” Loans
- Long-Term Debt:
 - Repayment of Debt only with after tax profits



#3 Force of Cash Flow

Working Capital a.k.a Core Capital

- Core Capital Defined
 - 2 months operating expenses in cash
 - After
 - All line of credit is paid off
 - Trade payables are current
 - Estimated taxes are current or set aside



#4 Force of Cash Flow

Distributions of Profits

- Safely Removing Cash when it will not hurt the stability or growth of the business
- Know the difference between
 - “tax” distributions
 - “profit” distributions



Managing your Salary Cap

- Every business has a culture and it is an important part of the foundation of the business
- Managing the “salary economy” is one of the most important elements to maintain culture
- Avoid the “King with no clothes” scenario



The Salary Economy

- The market ultimately determines wages for output
- Did the person you hired have
 - 15 years of experience or ...
 - 1 year of experience 15 times?
- Hiring someone at \$40,000 when they are used to making \$80,000



Using Salary Survey's

- Use Salary Surveys to help determine salaries for employees
- Use local market information at Chamber of Commerce
- Ask peers in the same industry



Just Say No to COLA's

- No to Cost of Living Adjustments

Q: Does Cost of living drive wages, or do wages drive cost of living?

A: Available wages drives the Cost of Living. Wages are like fuel, people will spend what is available to them.



Communicating Employee Level Business Strategy

Five Critical Areas of Employee Evaluations

- Internal Customer (How good of a teammate are you?)
- External Customer
- Productivity
- Profitability
- Core Skill sets



Communicating Employee Level Business Strategy

Five Critical Areas of Employee Evaluations

- Internal Customer (How good of a teammate are you?)
 - Working as a team is key to any company being profitable long-term
 - Avoid thinking “that’s not my job”
 - Everybody appreciates help



Communicating Employee Level Business Strategy

Five Critical Areas of Employee Evaluations

- External Customer

- Without customers, we do not eat!
- Everybody will interface with the customer at some point, are you prepared?
- Know how to turn customer challenges into opportunities without just giving money or account credit



Communicating Employee Level Business Strategy

Five Critical Areas of Employee Evaluations

- Productivity
 - How Productive are you?
 - Do you find a way to get things done everyday that need to be done?
 - Do you require a deadline to be productive?
 - Is working more your only method of being more productive?



Communicating Employee Level Business Strategy

Five Critical Areas of Employee Evaluations

- Profitability

- For what you produce, are you being paid what the market says that productivity is worth?
- Production or Admin, can I hire the same talent in the market for substantially less pay?
- Profitability encompasses productive days and down days



Communicating Employee Level Business Strategy

Five Critical Areas of Employee Evaluations

- Core Competencies
 - Identify the 3 to 5 core competencies required for each role
 - Avoid the specialization trap
 - Only have specialist when you can fully utilize their skills or only pay when they work
 - Try to add one or two key skill sets to keep specialists connected to the rest of the work team
 - The most profitable employees usually are the ones who can do multiple roles or tasks



Identify the top 3 to 5 skill sets

At our firm:

1. Prepare/Forecast Personal Tax Return
2. Prepare/Forecast Business Tax Return
3. Install, train and maintain accounting systems
4. Prepare reviewed financial statements
5. Create an integrated cash flow forecast model with balance sheet, P&L and cash flow

What are the 3-5 skill sets in your industry for each role in your business?



Open Book Management

- Is it right for you?

Total transparency in your organization can lead to fact based conversation, instead of rumor based conversation.



Productivity from Every Dollar Spent

- This includes *your* market based wage, as well as employees
- Be at 15% pretax profit before adding labor
- Flexible labor capacity examples



Caution with Incentive Plans

- Don't think you can substitute Incentive Plans for *Management and Leadership*
- Throwing Money at the Problem does not always change the outcome
- Picking numbers out of the air



Three Sources of Capital

- Source # 1: Use your Own Money
- Source # 2: Other People's Money
- Source # 3: Sweat Equity



Source # 1: Use your Own Money

- If you start your business with your money, you will work harder to defend it
- Without debt, it is easier and faster to get to 15% pre-tax profit
- It is possible, and it can be done!



Source # 2: Other People's Money

- Family, Friends, Fools, Venture and Angel Capital
- Family/Friends/Fools can have unrealistic expectations
- Angel Investors have become more structured, have experience in working deals both good and bad



Source # 3: Sweat Equity

- Most common and my personal favorite
- The difference between a market based wage and what you are receiving as a salary
- The goal is to pay yourself a market based wage and get to 15%, but not overnight



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



Reporting Rhythm

- Reports
 - What Report?
 - When to Look at Report?
 - Why to Look at Report?



Example of Reporting Rhythm

- Daily update that tells me who paid us that day and what the cash balance is
- Weekly email that shows projections of payables for the next two weeks
- High-level numbers in a “Rolling 12”



Exhibit 8.1: Two Week Cash Flow/Payable Projection

	ABC Bank	XYZ Bank	Total
QB Balance:	\$71,338.98	\$25,000.00	\$96,338.98
Total Line	\$100,000.00		
LOC Balance	(\$25,000.00)		

Available for draw \$75,000.00

Accounts Receivable:

Current	1-30	31-60	61-90	>90	Total
\$ 6595.30	\$77,780	\$10,645	\$19,063	\$65,853	\$114,084

Payables	5/25/2009	6/1/2009
Bills	\$6,912.52	\$738.59
Credit Card Payables	\$1,013.25	\$525.00
Loan Payment (1st)		\$2,500.00
Rent (1st)	\$9,935.00	
Tax Deposit		\$8,930.94
Payroll (Net)	\$26,002.24	
401(k)		\$1,548.65
	\$43,863.01	\$14,243.18



Two-Week Cash Flow Cycles

1. General bills
2. Payroll
3. Payroll taxes
4. Rent
5. Payments for fixed-term notes



Daily Polls and Weekly Reports

- Once you get beyond an average of 20-plus customers, daily polls aren't always practical (especially in seasonal business)

Weekly Reports

- Cost and Cash Flow Management
- Sales and Production
- Weekly labor efficiency



Weekly Production and Labor Efficiency

- “Gross Profit Per Labor Dollar”
- If you manage your numbers on at least a weekly basis, you’ ll start to establish a gut feeling about profitability



Exhibit 8.2: Labor Productivity

Period	GP%	Billings	GP\$	Labor	Labor Efficiency		
					Week	MTD	YTD
January	49.50%	\$145,000	\$71,775	\$35,000		\$ 2.05	\$2.05
February	51.20%	\$154,000	\$78,848	\$37,000		\$ 2.13	\$2.09
March	47.60%	\$180,000	\$85,680	\$40,000		\$ 2.14	\$2.11
April	50.10%	\$190,000	\$95,190	\$42,000		\$ 2.27	\$2.15
May							
Week 1	50.00%	\$40,000	\$20,000	\$10,000	\$2.00	\$2.00	\$2.14
Week 2	50.00%	\$38,000	\$19,000	\$9,500	\$2.00	\$2.00	\$2.14
Week 3	50.00%	\$35,000	\$17,500	\$11,000	\$1.59	\$1.85	\$2.10
Week 4	50.00%					\$1.85	\$2.10
Week 5	50.00%					\$1.85	\$ 2.10
May Total		\$113,000	\$56,500	\$30,500		\$1.85	\$2.10



Monthly Numbers and the Rolling 12

- Every month ends a 12-month accounting period, and I compare those months and the 12-month period side by side

What is my overall revenue? What's my gross profit? What's my salary cap?



Exhibit 8.3: Rolling 12 P&L Sample

	<u>20X1-12</u>	<u>20X2-01</u>	<u>20X2-02</u>	<u>20X2-03</u>	<u>20X2-04</u>	<u>20X2-05</u>	<u>20X2-06</u>
Revenue	815,000.00	950,000.00	970,000.00	1,008,000.00	998,000.00	1,085,000.00	1,120,000.00
Cost of Goods Sold	289,000.00	315,000.00	320,000.00	320,000.00	315,000.00	322,000.00	320,000.00
Gross Profit	526,000.00	635,000.00	650,000.00	688,000.00	683,000.00	763,000.00	800,000.00
<i>as % to Revenue</i>	65%	67%	67%	68%	68%	70%	71%
Operating Expenses:							
Facilities	74,000.00	79,000.00	78,000.00	80,000.00	87,000.00	90,000.00	89,000.00
Marketing	48,000.00	52,000.00	53,000.00	53,000.00	50,000.00	49,000.00	48,000.00
Labor - All	369,000.00	384,000.00	391,000.00	394,000.00	405,000.00	408,000.00	418,000.00
Payroll taxes & benefits	31,000.00	32,000.00	33,000.00	42,000.00	43,000.00	45,000.00	46,000.00
Other operating expenses	72,000.00	81,000.00	87,000.00	100,000.00	101,000.00	97,000.00	93,000.00
Total Operating Expenses	594,000.00	628,000.00	642,000.00	669,000.00	686,000.00	689,000.00	694,000.00
Net Operating Income	(68,000.00)	7,000.00	8,000.00	19,000.00	(3,000.00)	74,000.00	106,000.00
<i>as % to Revenue</i>	-8.34%	0.74%	0.82%	1.88%	-0.30%	6.82%	9.46%
Profit target @ 10%	81,500.00	95,000.00	97,000.00	100,800.00	99,800.00	108,500.00	112,000.00
Above (below) target	(149,500.00)	(88,000.00)	(89,000.00)	(81,800.00)	(102,800.00)	(34,500.00)	(6,000.00)
Salary Cap	219,500.00	296,000.00	302,000.00	312,200.00	302,200.00	373,500.00	412,000.00
Labor efficiency (GP/Labor\$)	1.43	1.65	1.66	1.75	1.69	1.87	1.91
Labor efficiency target @ 10%	2.40	2.15	2.15	2.20	2.26	2.04	1.94
Additional GP needed to hit 15%							62,000.00
Productivity increase required							8%

Quick Tips about Quickbooks

- 7-8 Key Groupings
- Use the expand feature to “drill down” on important numbers
- Unfortunately, no “Rolling 12”



Cash Basis vs. Accrual Basis

- Understanding of accrual-basis accounting methods is encouraged
- Understand how the Profit and Loss and Balance Sheet relate
- Know where your cash went, get to 15% pre-tax profit!



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
Return 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
<i>Average NOI</i>	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

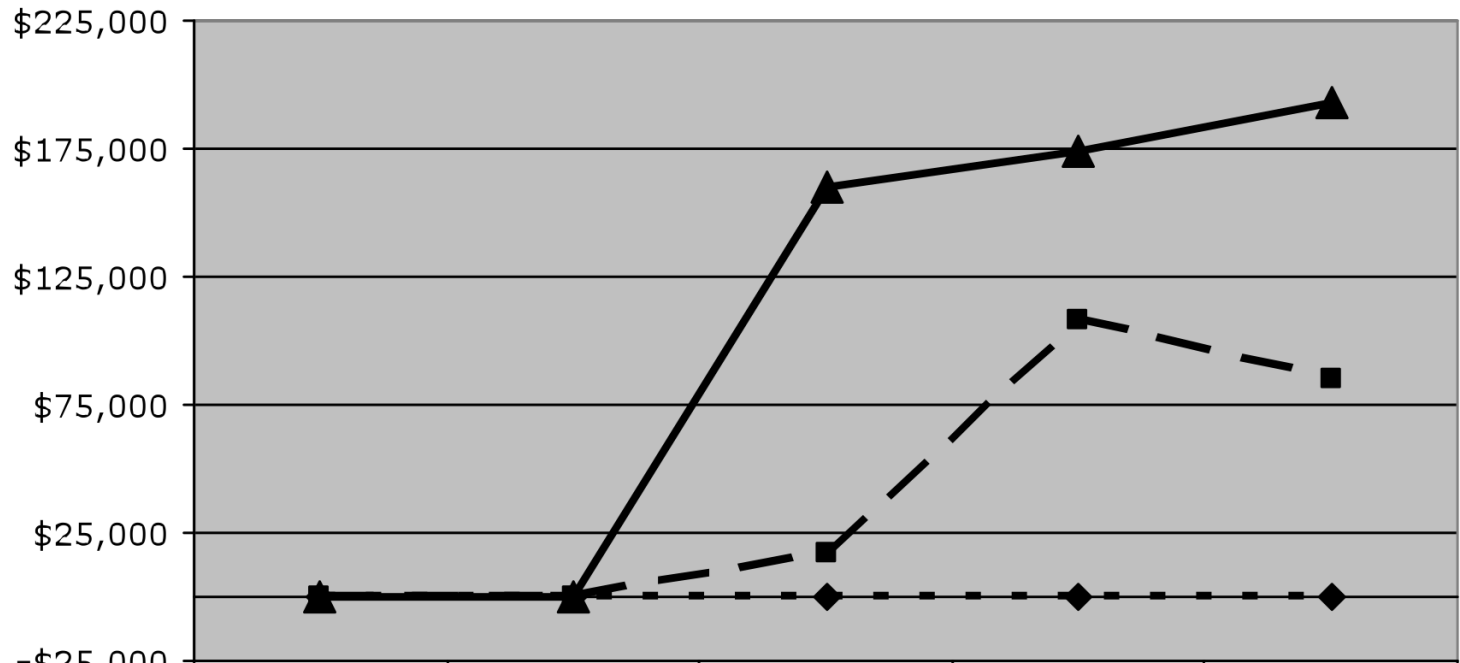
Multiple of EBITDA	4.69
Multiple of Revenue	0.47
Payback term at 100% sale	7%
Tax	40%
Periods	14.34
Payment (3 year after tax average)	158,400.00

Look at the numbers

- Same sales path over 5 years
- Following the rules of tax distributions only
- Value differences at 5%, 10% & 15%

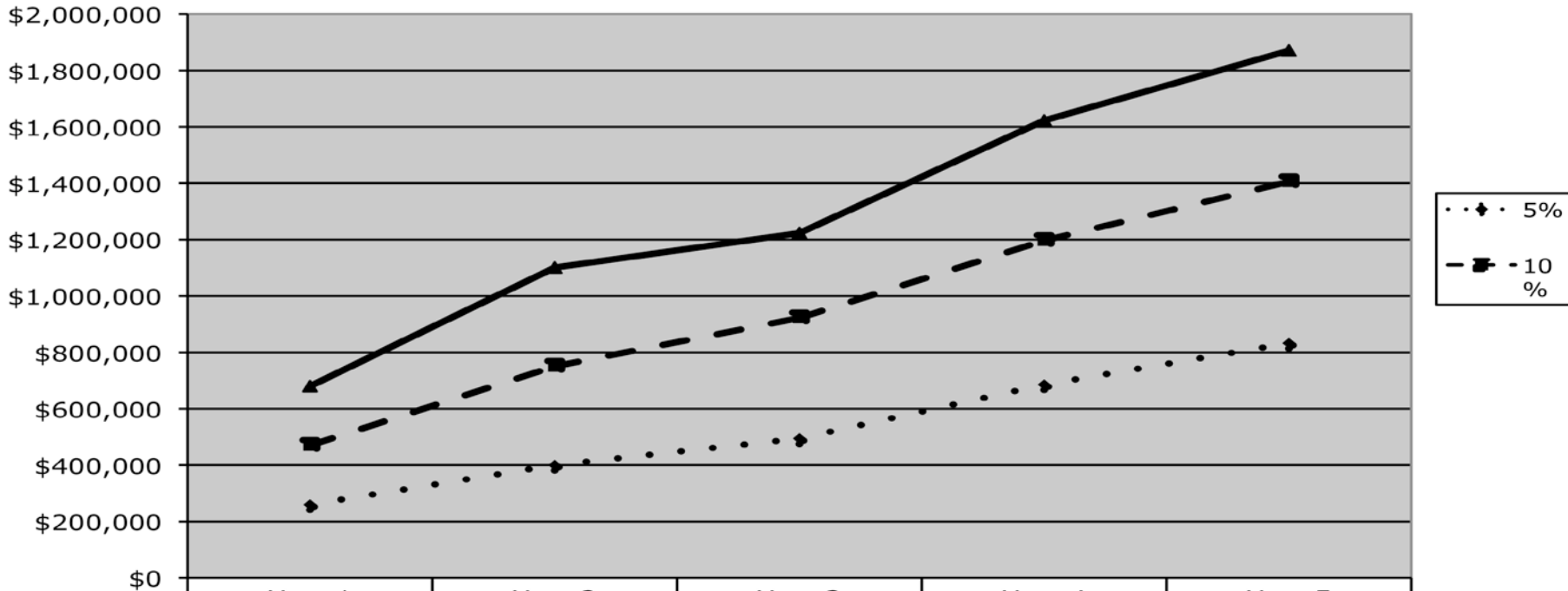


Exhibit 9.6: Profit Distribution



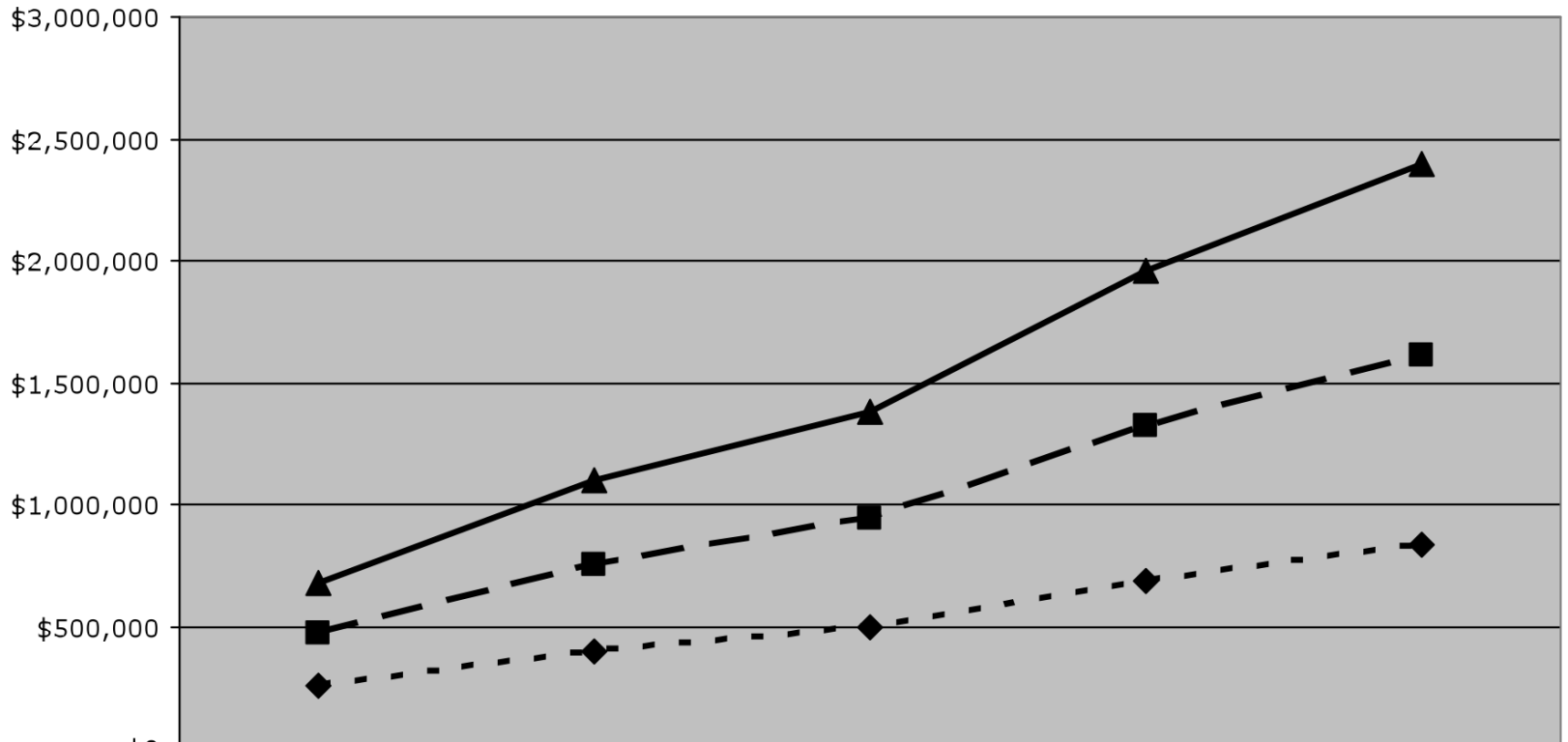
	Year 1	Year 2	Year 3	Year 4	Year 5
- ◆ - "5%"	0	0	0	0	0
- ■ - "10%"	0	0	17000	107700	85200
- ▲ - "15%"	0	0	160500	174050	192800

Exhibit 9.8: Company Value



	Year 1	Year 2	Year 3	Year 4	Year 5
• ♦ • 5%	\$260,000	\$400,250	\$494,600	\$685,700	\$832,700
-■- 10%	\$470,000	\$750,500	\$922,200	\$1,196,700	\$1,405,500
-▲- 15%	\$680,000	\$1,100,750	\$1,223,300	\$1,622,550	\$1,870,750

Exhibit 9.9: Value + Distribution



	Year 1	Year 2	Year 3	Year 4	Year 5
- ◆ - 5%	260000	400250	494600	685700	832700
- ■ - 10%	470000	750500	939200	1321400	1615400
- ▲ - 15%	680000	1100750	1383800	1957100	2398100

Examples applying this concept

- 50/50 Shareholder buyout
- Sweat Equity Bonus for Employee
- 10% Ownership stake for Key employee played out over 5 years



Exhibit 9.4: 5 Year 50% Example - 10%

You can buy Half of the company from cash flows in 5 Years

Value of company \$1,405,500.00
(Use undiscounted value since it is 50%
ownership)

Purchase Value of 50% \$702,750.00

Term in Years 5

Interest Rate 7%

Annual Payment \$171,394.19

Sum of annual Payments \$856,970.93

-8.2%% variance
\$(12,994.19) Excess/(Shortfall)

Cash Flows
available

Pre-Tax Income (3 yr avg)	18.78%	\$264,000.00
Tax Cost	40%	<u>\$105,600.00</u>

any excess allows for slight funding of growth

any shortfall has to be covered by capital, debt or
growth

Net Available for
Loan Payment \$158,400.00

(Note: This assumes business is fully capitalized and does not need more Working Capital)

Exhibit 7.2 - Sweat Equity Bonus Example

Bonus	\$50,000.00	
Assumes base pay was \$75,000		
SS & Medicare	(2,696.60)	5.39%
Federal & State W/H (Est)	<u>(17,303.40)</u>	34.61%
Net check	<u><u>\$30,000.00</u></u>	

	Total	Per share	After 40% Discount
Annual Revenues	\$1,000,000.00		
Average pre-tax profit	\$150,000.00		
Equity (core capital of \$150,000 plus receivables of \$150,000)	\$300,000.00		
Business Value	\$750,000.00	\$750,000.00	\$450,000.00
Current shares Outstanding	750,000	\$1.00	\$0.60
Shares urchased for \$30,000 net	<u>50,000</u>		
Total Shares	<u><u>800,000</u></u>		

Annual Profit Allocation/ROI	Annual Profit	% ownership	Investment	ROI	Tax Distribution	Profit Distribution
Original Shareholders	\$140,625.00	93.75%	\$300,000.00	46.88%	\$56,250.00	\$84,375.00
Patrick	\$9,375.00	6.25%	\$30,000.00	31.25%	\$3,750.00	\$5,625.00

FMV Calculation - 15% Shareholder Example

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	157,500	288,000	310,500	427,500	450,000
% to income	15.0%	15.0%	15.0%	15.0%	15.0%
Equity at year end (assumes \$50k to start)	207,500	432,500	467,300	596,550	682,750

Valuation

Value Calculation

Average NOI

	157,500	222,750	use last 3 yrs	use last 3 yrs	use last 3 yrs
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x3	472,500	668,250	756,000	1,026,000	1,188,000
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Equity	207,500	432,500	467,300	596,550	682,750
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FMV before discounts	680,000	1,100,750	1,223,300	1,622,550	1,870,750
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FMV after applying discounts	435,200	704,480	782,912	1,038,432	1,197,280
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Multiple of EBITDA	4.16
Multiple of Revenue	0.62
Payback term at 100% sale	7%
Tax	40%
Periods	11.84
Payment (3 year after tax average)	237,600.00

Shareholder sale example	10%	10%	10%	10%	10%
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# shares outstanding	1,000,000	1,000,000	1,000,000	1,000,000	1,000,000
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shares sold	100,000	100,000	100,000	100,000	100,000
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price per share internal	\$0.4352	\$0.7045	\$0.7829	\$1.0384	\$1.1973
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price per share external	\$0.6800	\$1.1008	\$1.2233	\$1.6226	\$1.8708
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Shareholder purchase	43,520				
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Internal sale value by year (after discounts)	\$43,520	\$70,448	\$78,291	\$103,843	\$119,728
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External value by year (before discounts)	\$68,000	\$110,075	\$122,330	\$162,255	\$187,075
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