



by
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FOREWORD BY **VERNE HARNISH**, CEO, BAZELLES, INC.,
AUTHOR, *MASTERING THE ROCKEFELLER HABITS*

**SIMPLE
NUMBERS,
STRAIGHT TALK,
BIG** 4 KEYS TO UNLOCK YOUR
BUSINESS POTENTIAL
PROFITS!

GREG CRABTREE

WITH BEVERLY BLAIR HARZOG

Seeing Beyond Numbers



“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 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>	
	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>	
<hr/>				
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!

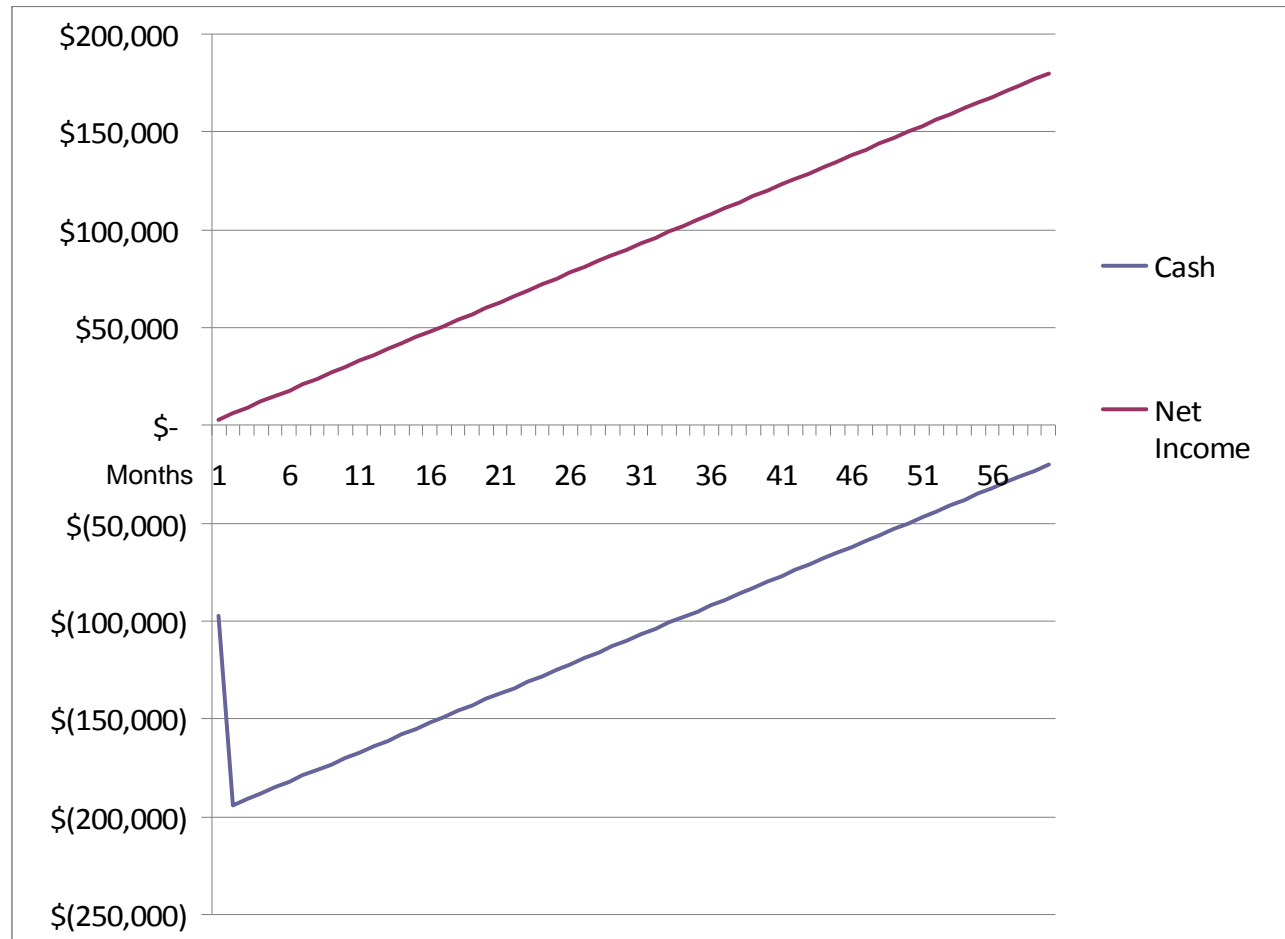


Cash Flow versus Profit

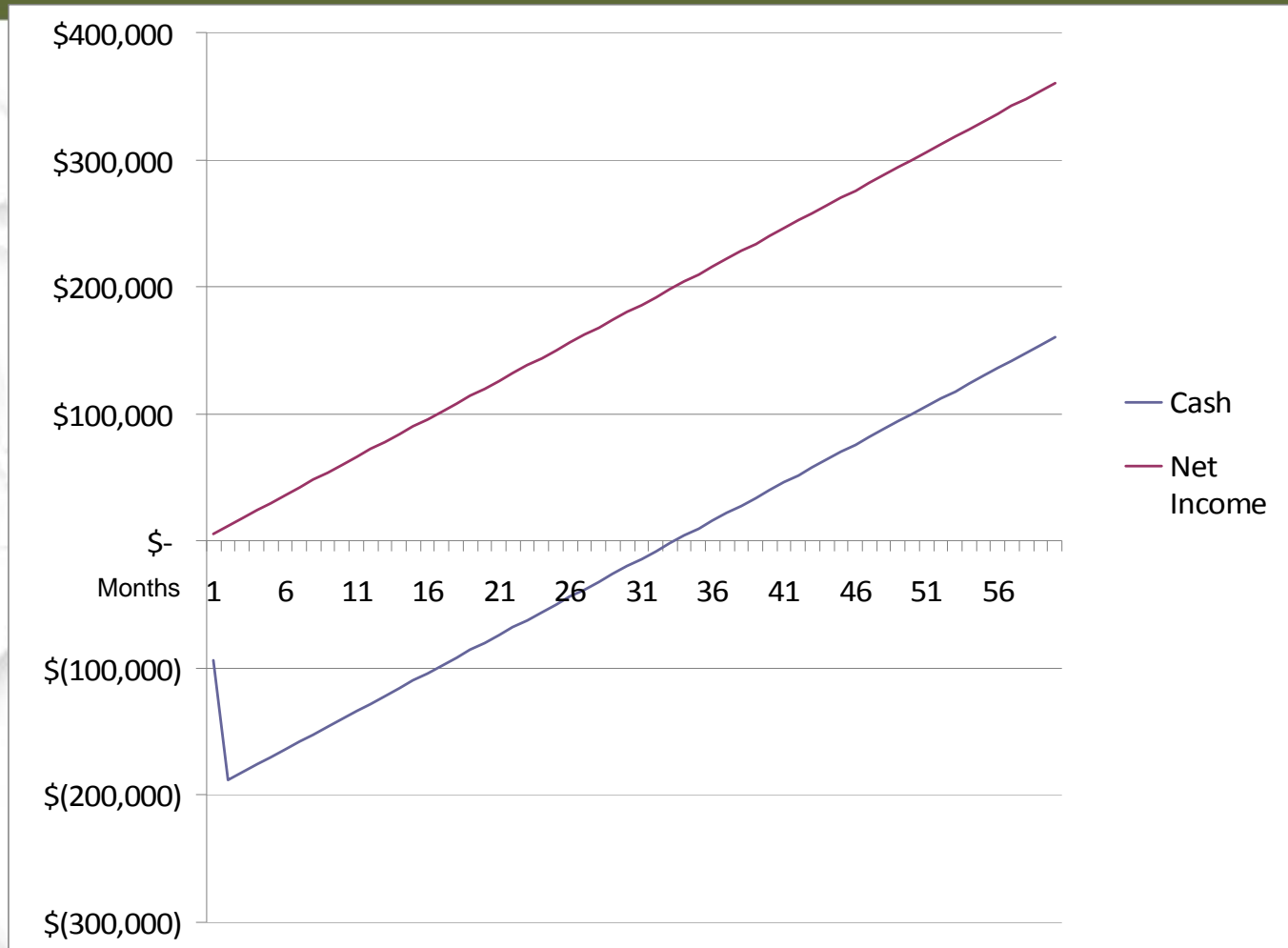
- Examples at 5%/10% & 15%
- Revenue at \$100,000 per month
- Tax Rate 40%
- Assume service based business that bills at the end of the month and gets paid in an average of 45 days



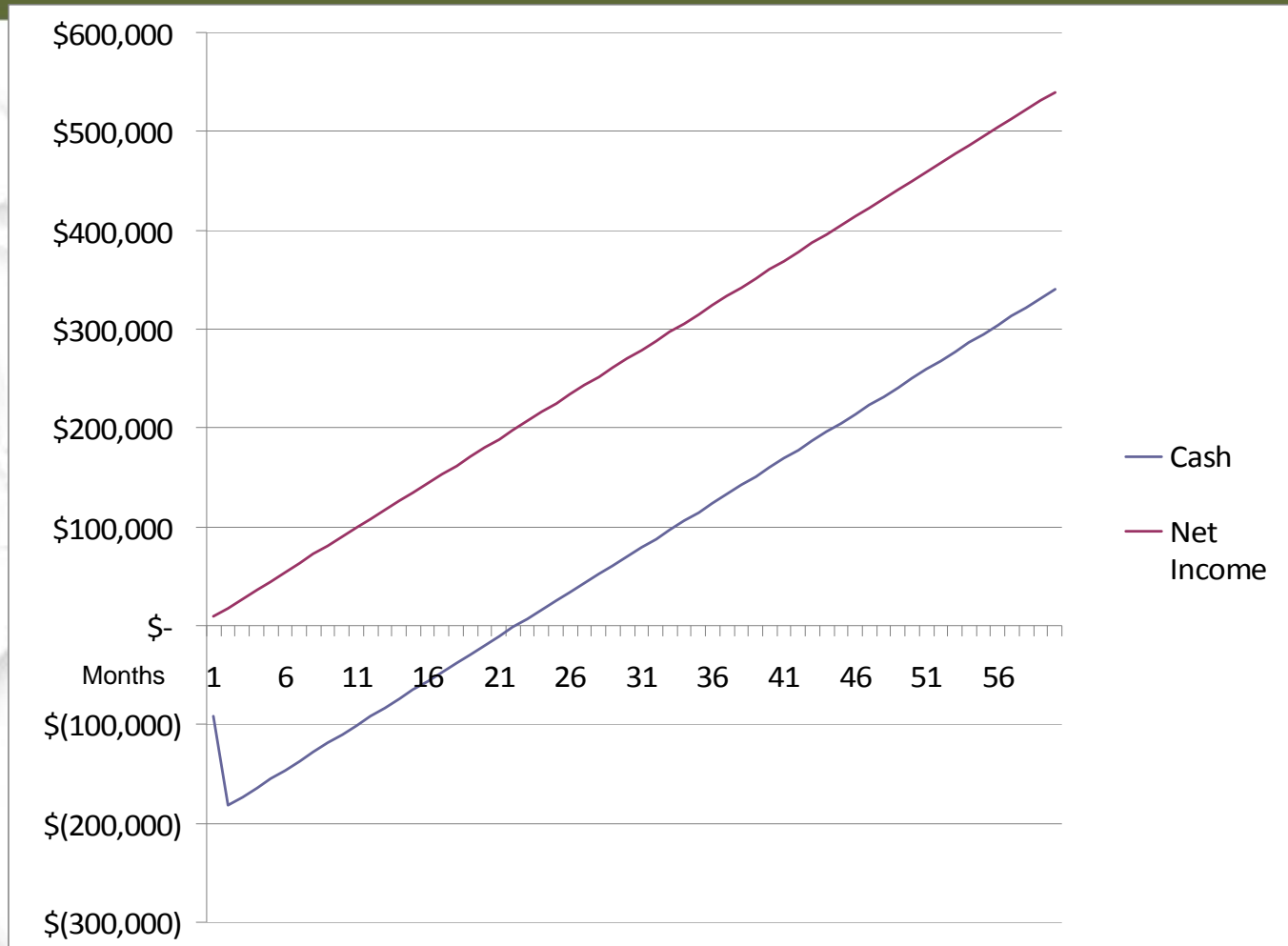
Cash Flow versus Profit 5%



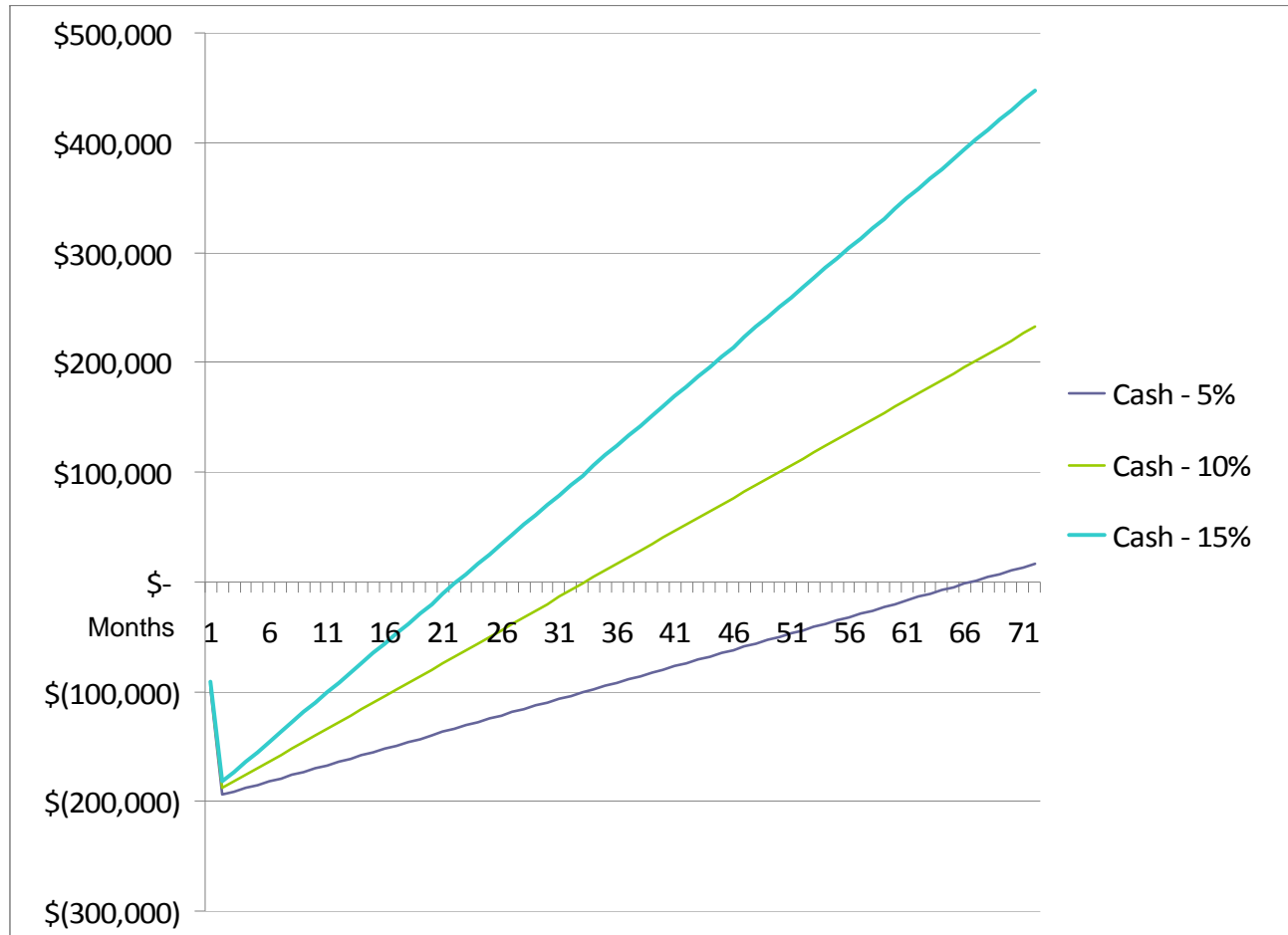
Cash Flow versus Profit 10%



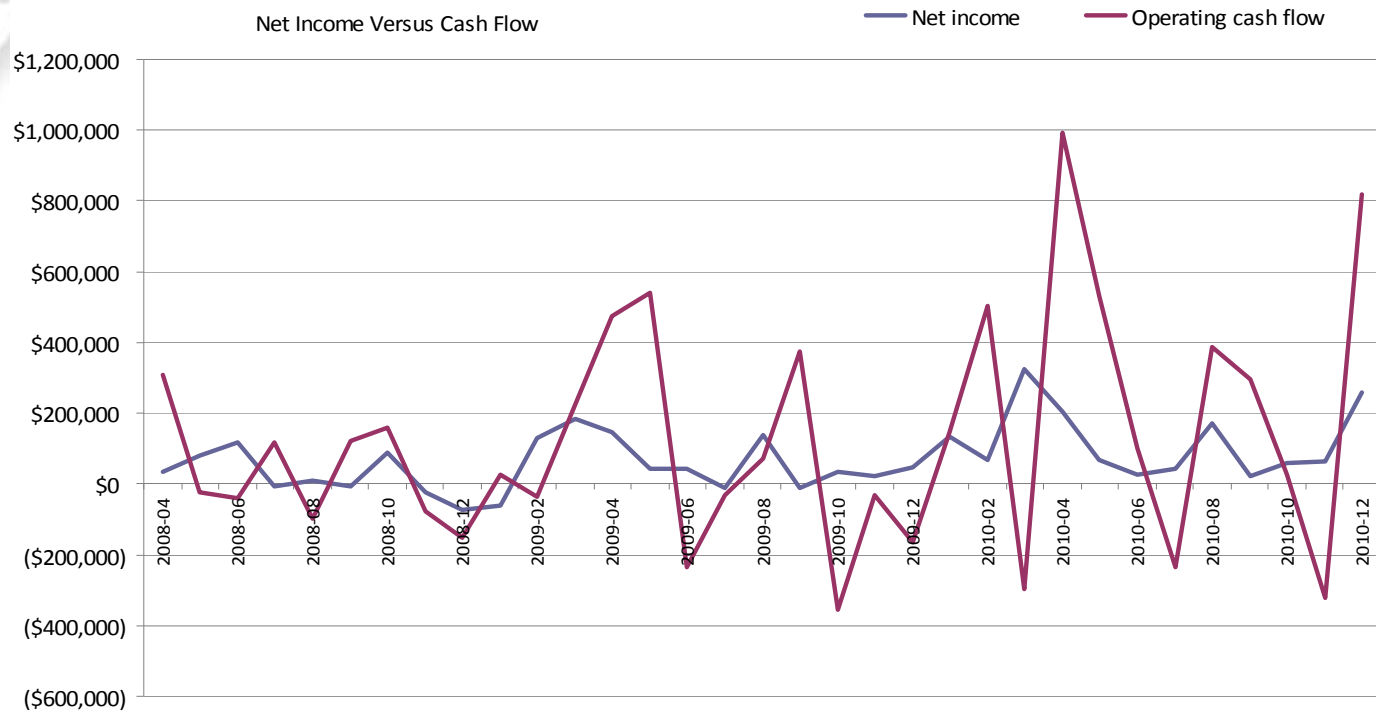
Cash Flow versus Profit 15%



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



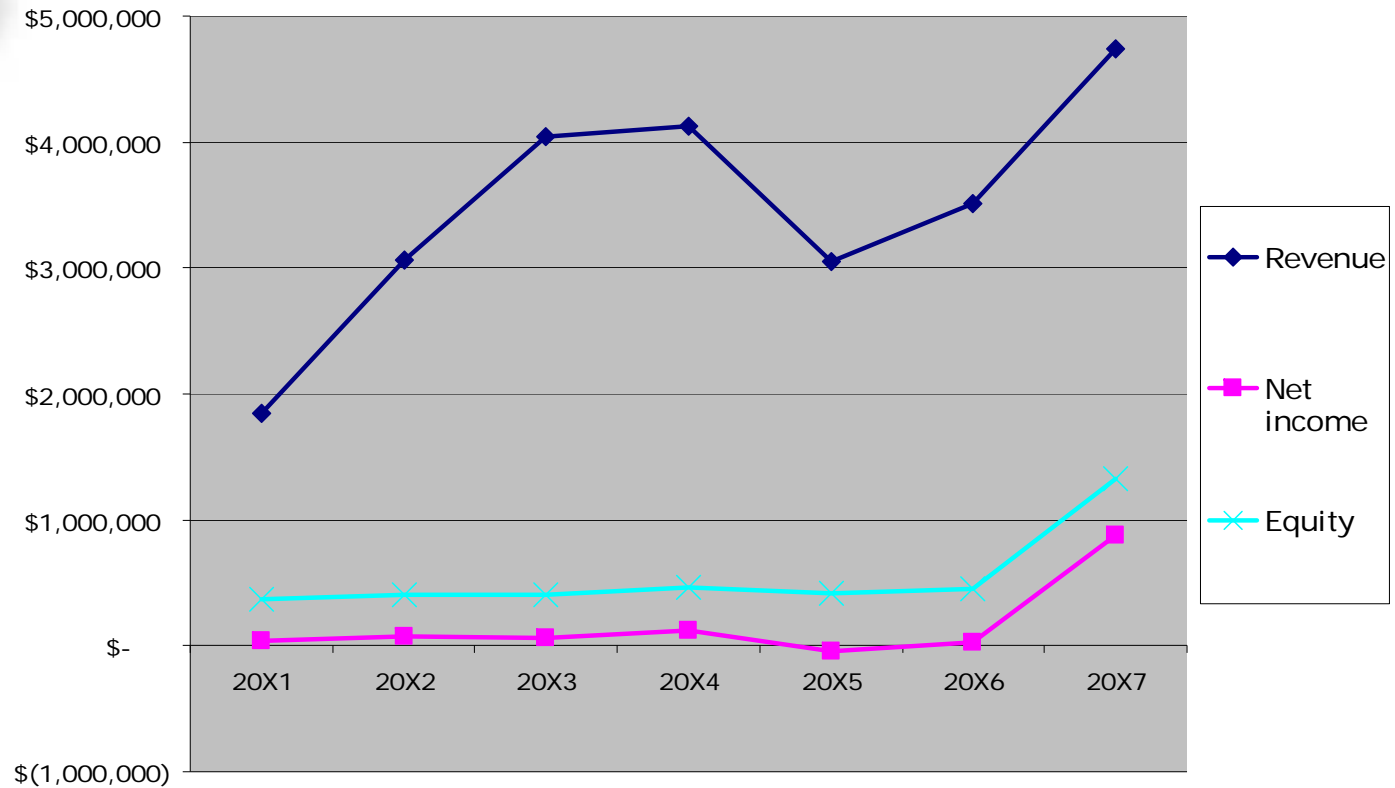
\$1 Million to \$5 Million: How to be Successful on the Journey

- 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



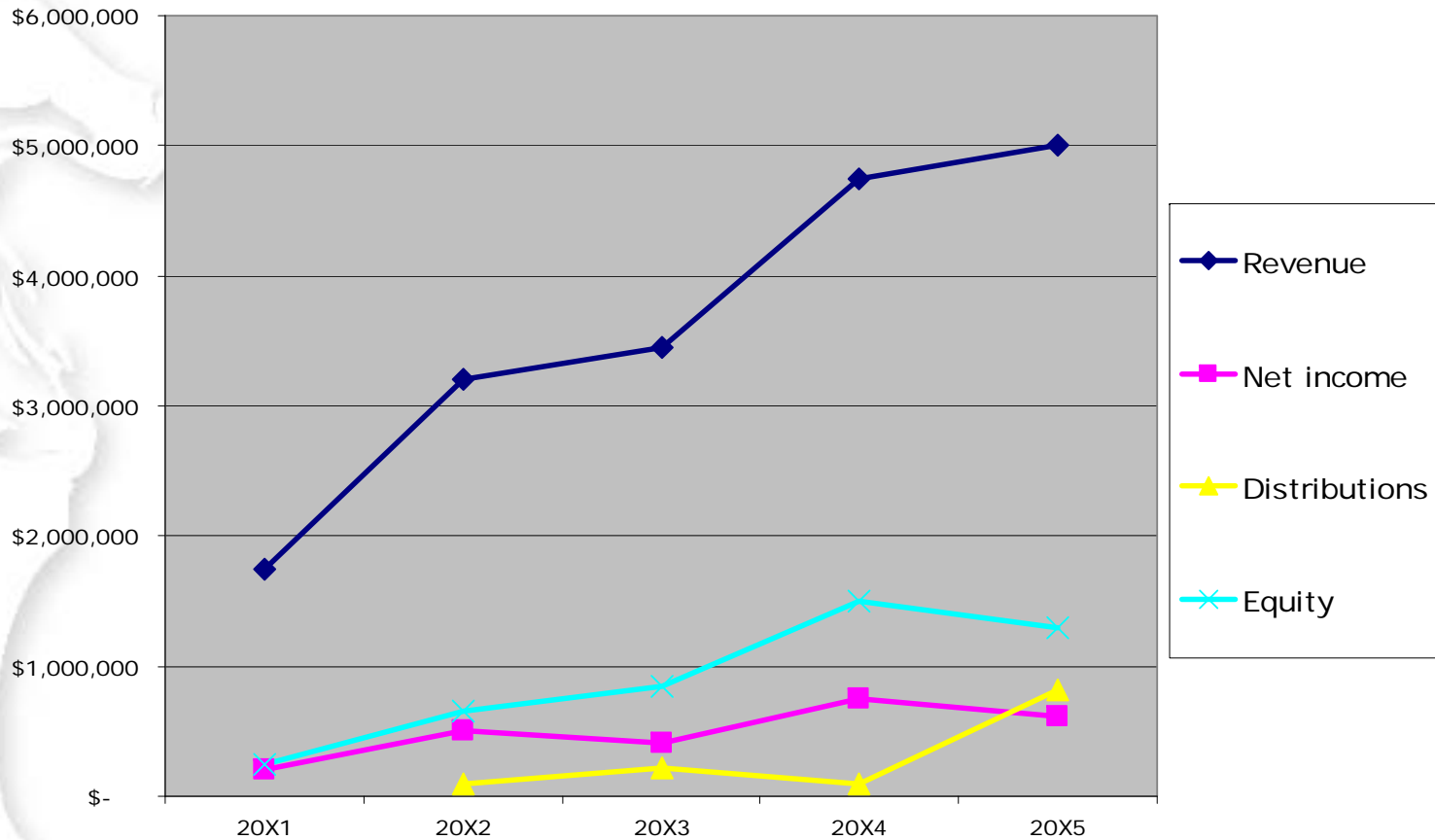
Surviving The Black Hole

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%)		\$ 100,000
		<hr/>



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 \$ 900,000

Pre tax Profit (10%) \$ 100,000



Plugging in Your Salary Cap Number

Revenue \$1,000,000

Salaries \$500,000

Non Salary Costs \$400,000

Total Expenses \$ 900,000

Pre tax Profit (10%) \$ 100,000



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

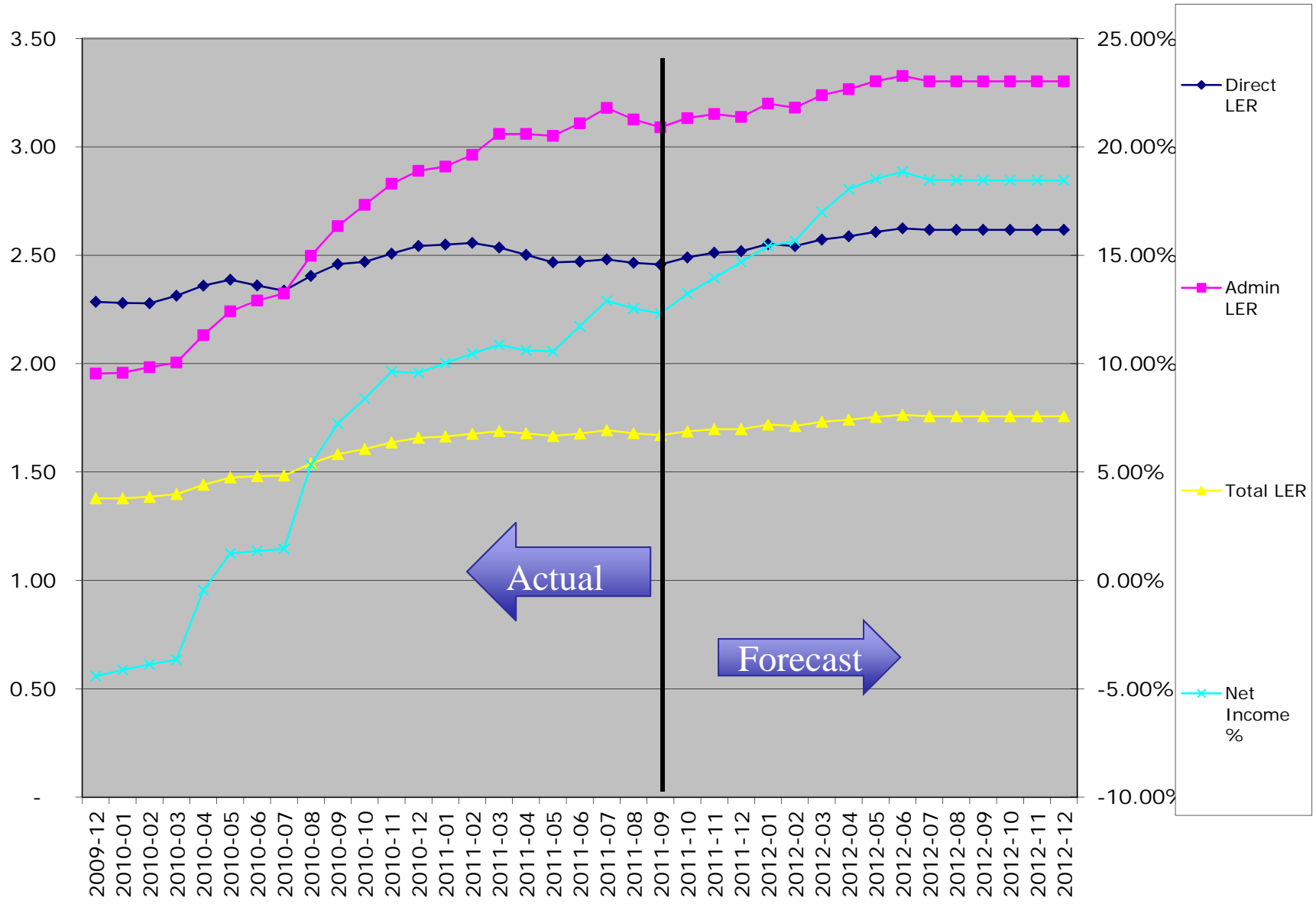
	Original	Step #1 10%
Revenue	450,000.00	492,195.19
Direct Costs excluding labor	<u>130,000.00</u>	<u>142,195.19</u>
Gross Profit	320,000.00	350,000.00
	71.1%	71.1%
Direct Labor	<u>90,000.00</u>	<u>90,000.00</u>
Contribution Margin	<u>230,000.00</u>	<u>260,000.00</u>
Management/Admin Labor	75,000.00	75,000.00
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>



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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

