

EO Arizona Chapter

by
Greg Crabtree

Greg.crabtree@crbcpa.net

256-704-0620

Download presentation at
www.seeingbeyondnumbers.com/EOAZ



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

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

- **Assessment Against Core Principles**
 - 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



Action!

- Putting Data Into Action
 - Data Cube concepts
 - Advanced Labor Efficiency
 - Retail Examples
- What reports should I look at?
 - Daily
 - Weekly
 - Monthly



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%

Best??

Better??

Good??

Think again!



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)

Starving

Best

Near death



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!”



Profit Terms – Watch your language!

Weak

- **EBITDA** - Earnings before: Interest, Taxes, Depreciation and Amortization – the most abused term in finance

Best

- **Pre-tax profits** – easier to define and more traceable to true cash flow

Weak

- **Revenue** – This is the vanity number

Better

- **Gross profit** – Revenue less direct costs (the true economic engine) – my definition excludes labor

Best

- **Contribution margin** – my definition is gross profit minus direct labor



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 Net income as % to Revenue):

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!



#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!



Gregism

When all else fails....

you can always serve as the bad
example.

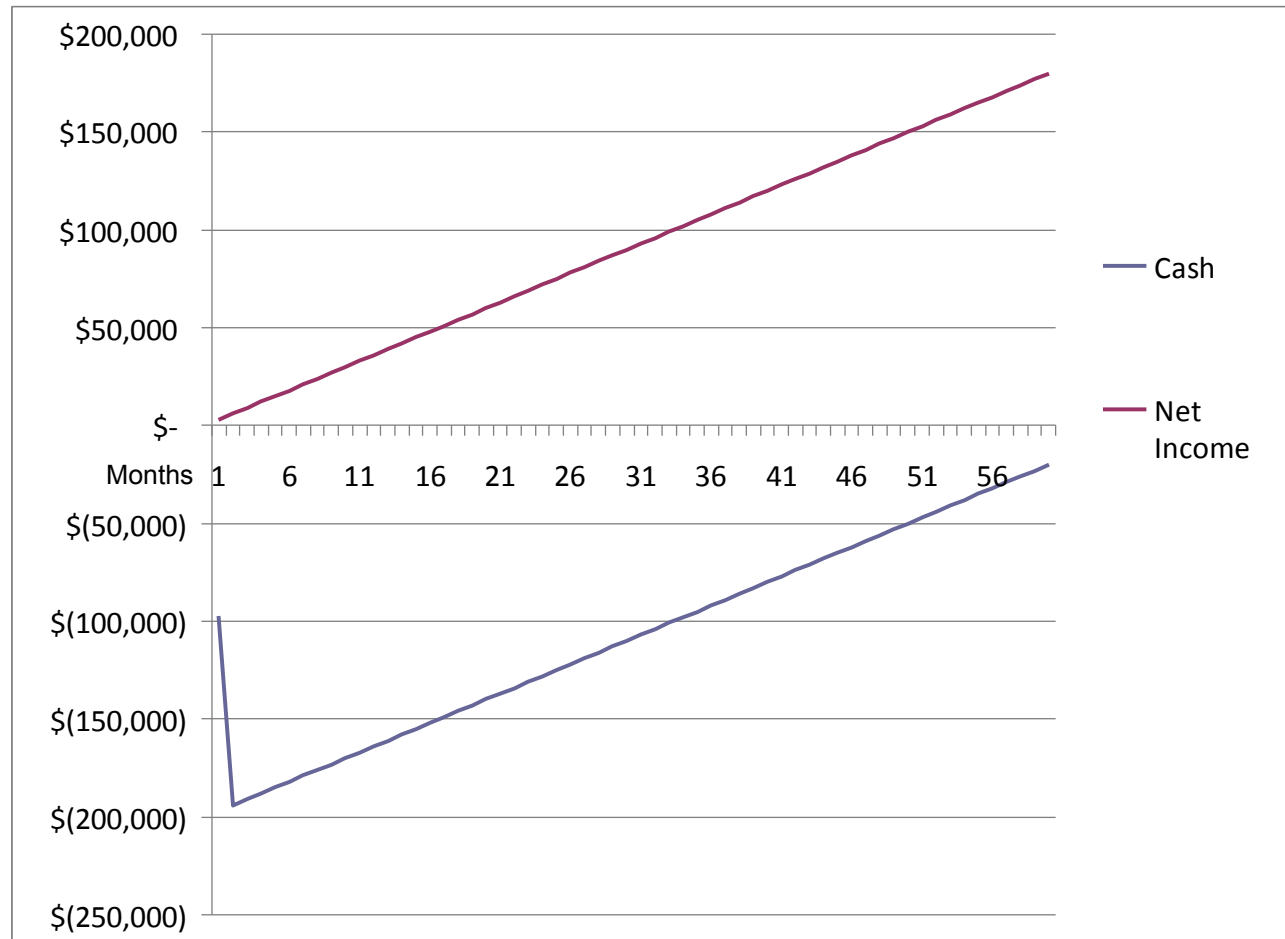


Cash Flow versus Profit

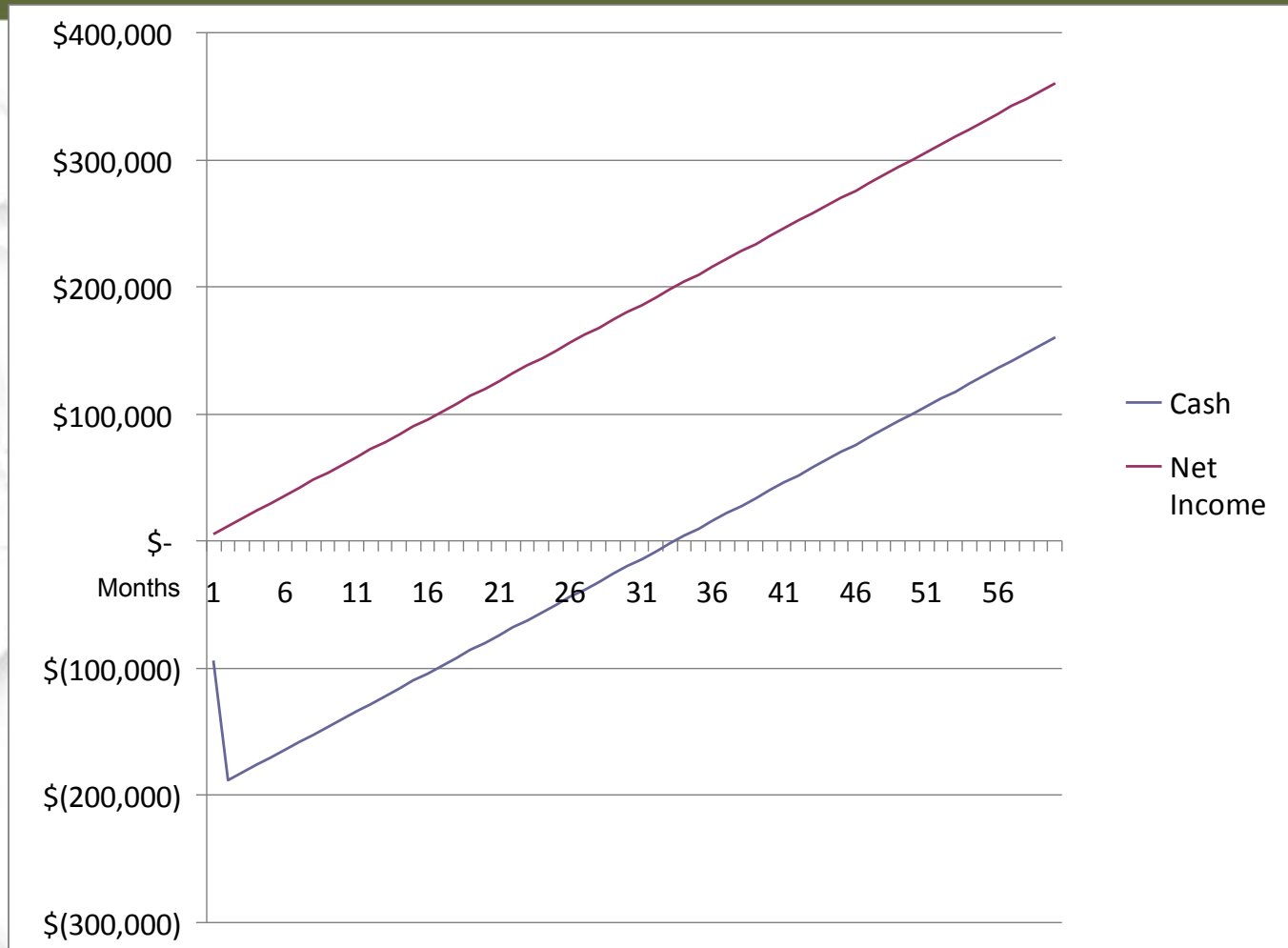
- Examples at 5%/10% & 15%
- Revenue at \$100,000 per month
- Tax Rate 40%
- Assume service based business that bills at the end of the month and gets paid in an average of 45 days



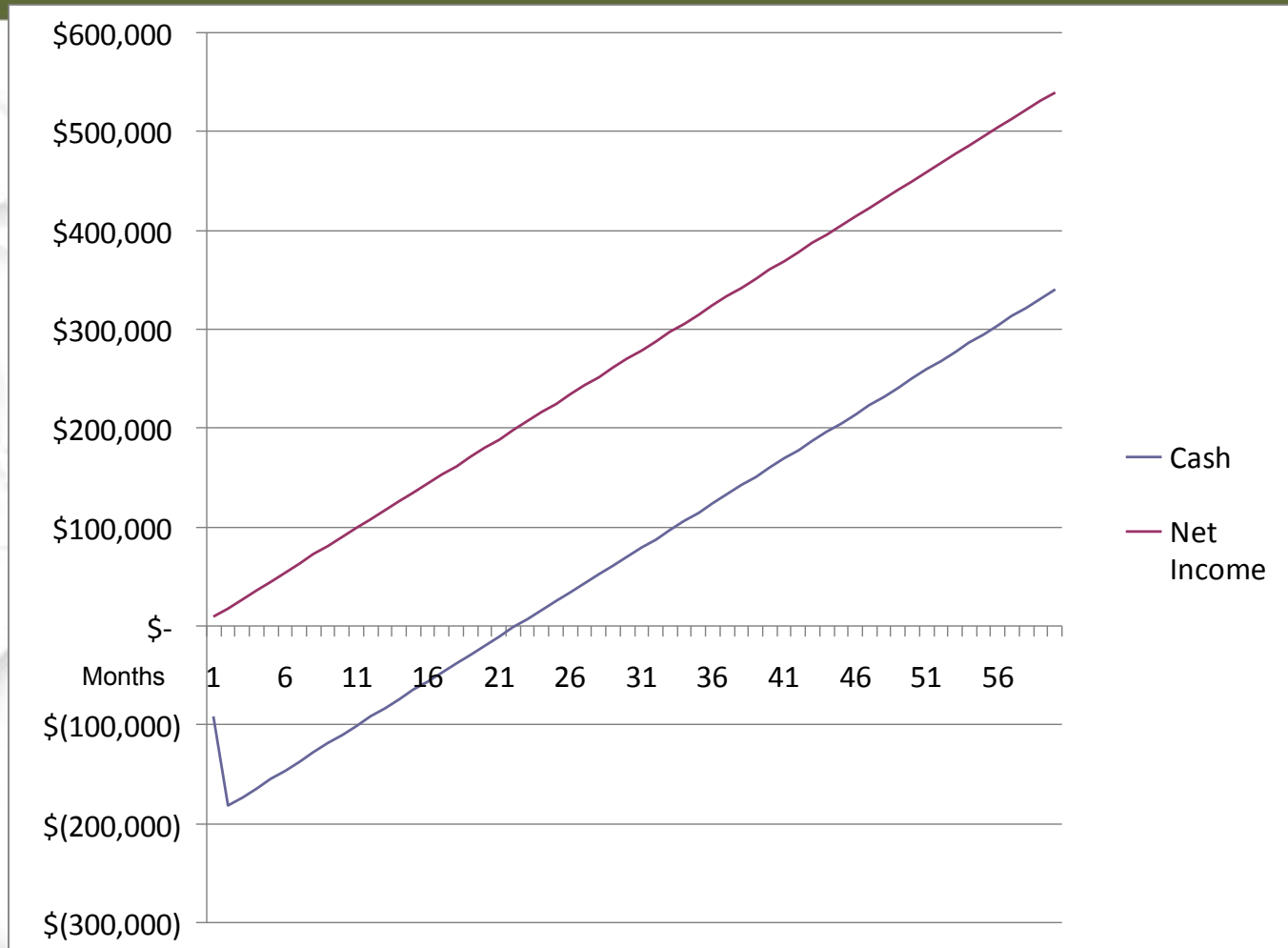
Cash Flow versus Profit 5%



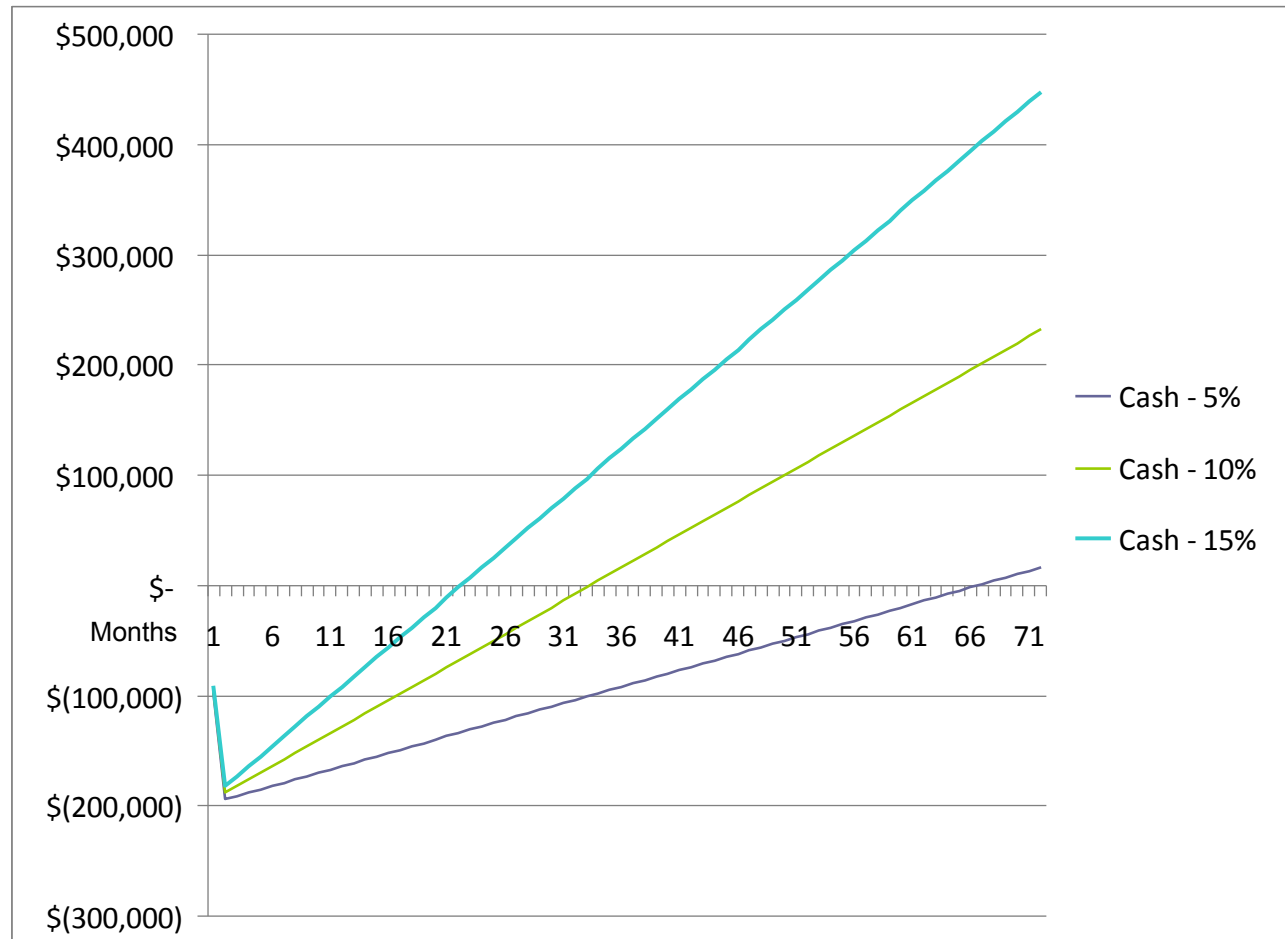
Cash Flow versus Profit 10%



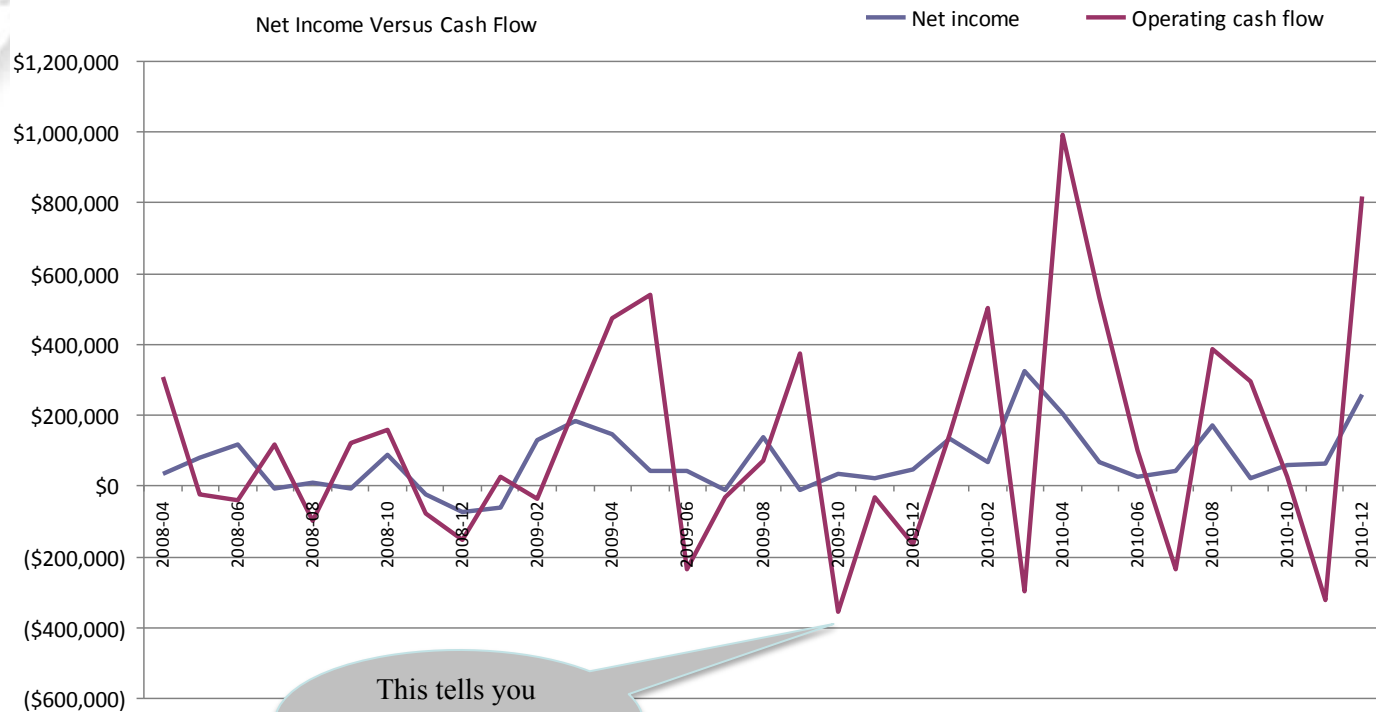
Cash Flow versus Profit 15%



Cash Flow versus Profit Recap



Ups and Downs of Operating Cash Flow



This tells you what your core capital need is



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?



\$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 Unless You Have Outside Cash to Invest***
- Get profitable, get out of debt and get your market wage before you start the journey



Labor Productivity is the Key to Profitability

Salary Cap Concept Using
NFL (Football) Team Example



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



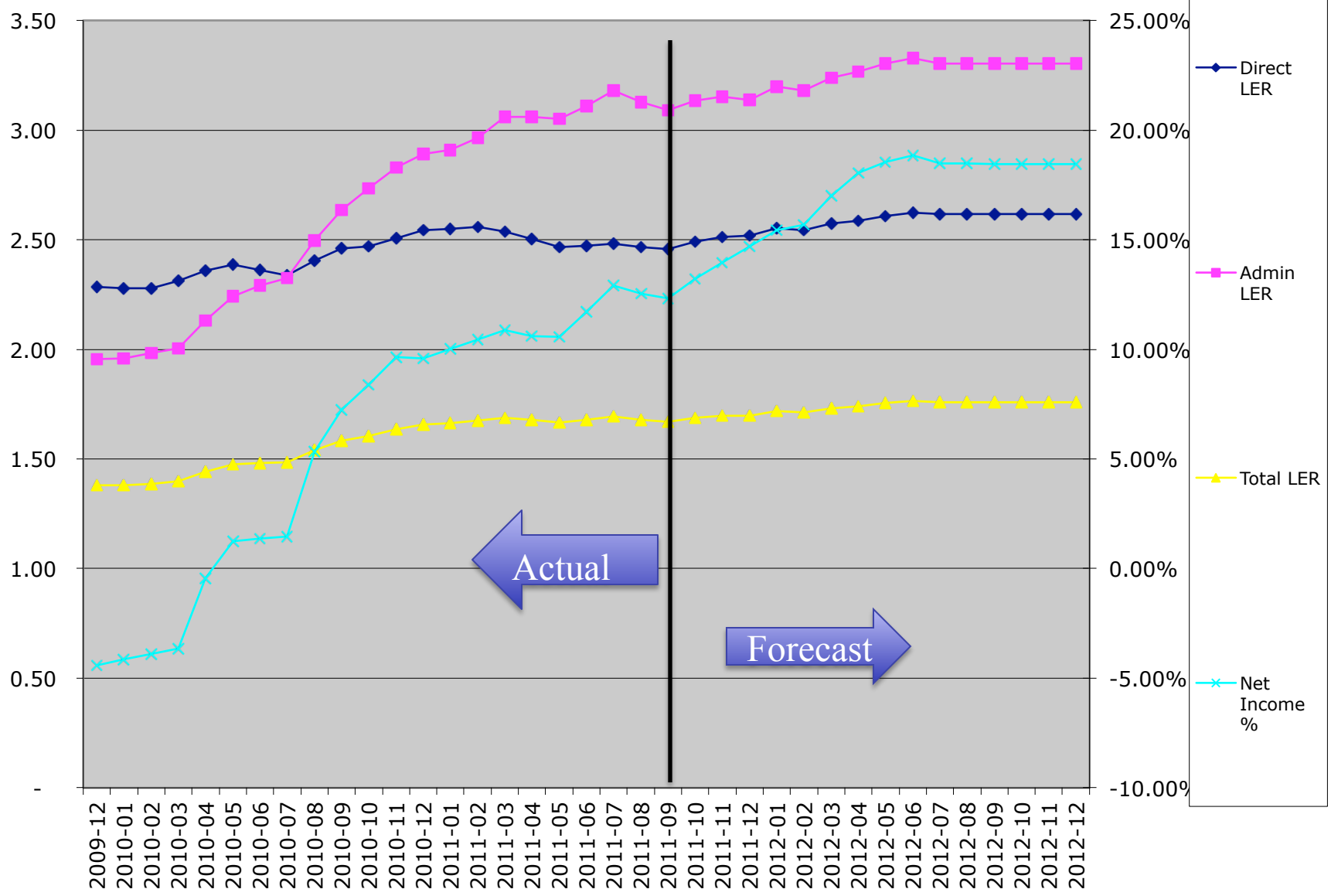
Getting to 15% Pre-Tax Profit

- 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	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



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>



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 = 2 months operating expenses with no LOC debt)
- Dividends (Distributions)



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?



Reporting Rhythm

- Daily – email cash balance and who paid if customer volume is small
 - Note – cash balance is from accounting system, not the bank. If you rely on the bank to tell you, you do not have a real time accounting system



Reporting Rhythm

- Weekly -
 - email that shows projections of payables for the next two weeks (cut and paste, do not attach)
 - Weekly sales/GP/LER to monthly target



Reporting Rhythm

- Monthly -
 - Top level P&L, by month, by Rolling 12
 - Balance Sheet by month
 - Cash Flow
 - Reforecast at top level



Reporting Rhythm

- Quarterly -
 - Same as Monthly
 - Pareto Analyses Sales/GP/LER
 - By Customer
 - By Location
 - By Employee
 - Review Operating Expense trends



Reporting Rhythm

- Critical Numbers
 - P&L
 - Pre-tax net income
 - GP\$
 - LER (Direct/Admin/Marketing)
 - Balance Sheet
 - Core Capital
 - Days sales in AR
 - Return on Equity (Rolling 12)
 - Debt to Equity



Reporting Rhythm

- Fraud Control
 - Real time data is best control mechanism
 - View data across time series to spot trends
 - Avoid “adjusting entries” when possible
 - Use QB assisted payroll or outside payroll services to avoid payroll tax failures
 - Take ownership of understanding the data

