

# Brightstar Webinar

*“Clear Up the Distortions!”*

*Slides at:*

*[www.simplenumbers.me/brightstar](http://www.simplenumbers.me/brightstar)*

Greg Crabtree

[Greg.crabtree@crbcpa.net](mailto:Greg.crabtree@crbcpa.net)

256-704-0620



FOREWORD BY **VERNE HARNISH**, CEO, GAZELLES, 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

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

## *Clear Up the Distortions!*

- **Your data is lying! - The way you deal with the following items is making your financial data worthless**
  - **Owner compensation** – Stop playing games to save taxes or ego with owner compensation
  - **Not all revenue is real** – Learn how to filter out “pass through” activity that is distorting your operating profits
  - **Owner occupied real estate** – It may or may not have been a good deal to own your own real estate, but do not distort the operating profit measurement of your business to justify your real estate decision
  - **Tax Depreciation** – If you are recording “tax” depreciation instead of “book” depreciation, you are distorting your view of profitability. Also, make sure you are not falling for the tax trap of spending a dollar to save 40 cents in tax.



# Why Owner Salaries Matter

- 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
- Be a More Demanding Shareholder
- Can distort profits from start up to over \$60 million in revenue



# 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

- If you are doing a job worth \$100,000 and you could only pay yourself \$30,000, that is the definition of “sweat equity”.
- How long are you going to accept below market wage?
- Methods to track 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”



# 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 Margin** – 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

<b>Business engine</b>	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>
	<b>Gross Margin</b>	2,850,000	2,850,000
	Direct Labor	<u>1,000,000</u>	<u>1,000,000</u>
	Direct LER (GM/DL)	2.85	2.85
	<b>Contribution Margin</b>	<u>1,850,000</u>	<u>1,850,000</u>

<b>Business chassis</b>	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>
	<b>Management LER (CM/ML)</b>	<u>2.46</u>	<u>2.46</u>
	<b>Net operating Income</b>	<u>625,000</u>	<u>625,000</u>
	<b>Overall LER</b>	<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>	
<b>Pre-tax Net Income</b>	<u>\$525,000</u>	<u>\$525,000</u>	
	as a % of Revenue	2.63%	14.00%
	as a % of Gross Margin	18.42%	18.42%

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

# Owner Occupied Real Estate Rules

- If you are thinking of owning your own building, here are the two promises you need to keep....
  - If I become a bad landlord, I will protect my business and move.
  - If I become a bad tenant, I will protect my building and kick my sorry business out and get a better tenant.



# Owner Occupied Real Estate Rules

- Charge market rates
- Treat yourself like you would an unrelated party
- Avoid increasing your facilities cost unnecessarily
- Don't fall for the "tax benefit" argument



# Depreciation Matters

- Do not use “tax” depreciation for your accounting records
- Avoid making large purchases at year end to “get rid of profits”. *Why do you want to spend a dollar to save 40 cents in tax?*
- Do not mix Section 179 expensing with debt

