

Brightstar Webinar #4

*Principles of Building Wealth
through Business
Part 2 – Debt, Core Capital &
Return on Investment*

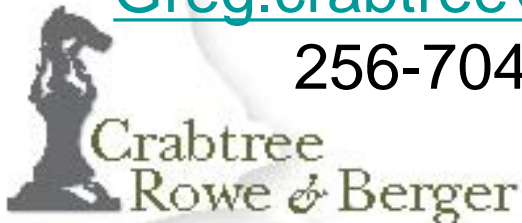
Slides at:

www.simplenumbers.me/brightstar

Greg Crabtree

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

Webinar Overview

- Where Did the Cash Go?
- Debt
 - Best practices on how to finance the acquisition and growth of your business
 - Lines of Credit & Factoring for Receivables
 - Term Debt
 - SBA Loans
- Core Capital Target
 - How to know when your business is healthy
- Return on Investment
 - Distributions and dividends



Where Did the Cash Go?

| | | |
|------------------------|------------------|------------------|
| Beginning Cash | \$100,000 | |
| Net income | <u>\$125,000</u> | |
| Cash available: | | \$225,000 |
| ????????? | ?????? | |
| ????????? | ?????? | |
| ????????? | ?????? | |
| ????????? | ?????? | |
| | <hr/> | |
| 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 (40% of Net Income) | \$50,000 | |
| ?????????? | ?????? | |
| ?????????? | ?????? | |
| ?????????? | ?????? | |
| | <hr/> | |
| Total cash adjustments | | <hr/> \$200,000 |
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| Vehicle Purchase | \$50,000 | |
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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> |



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/> |

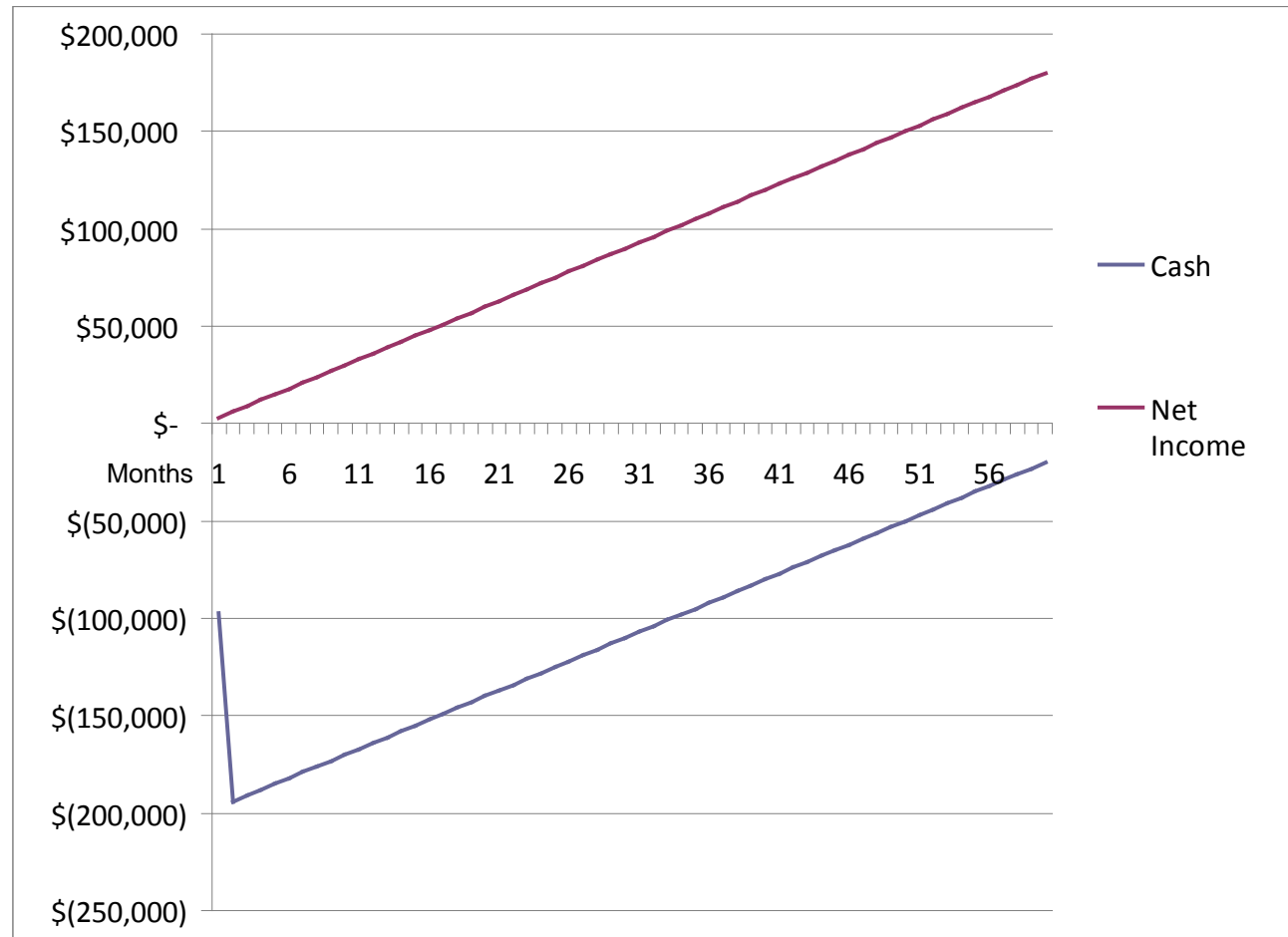


Cash Flow versus Profit

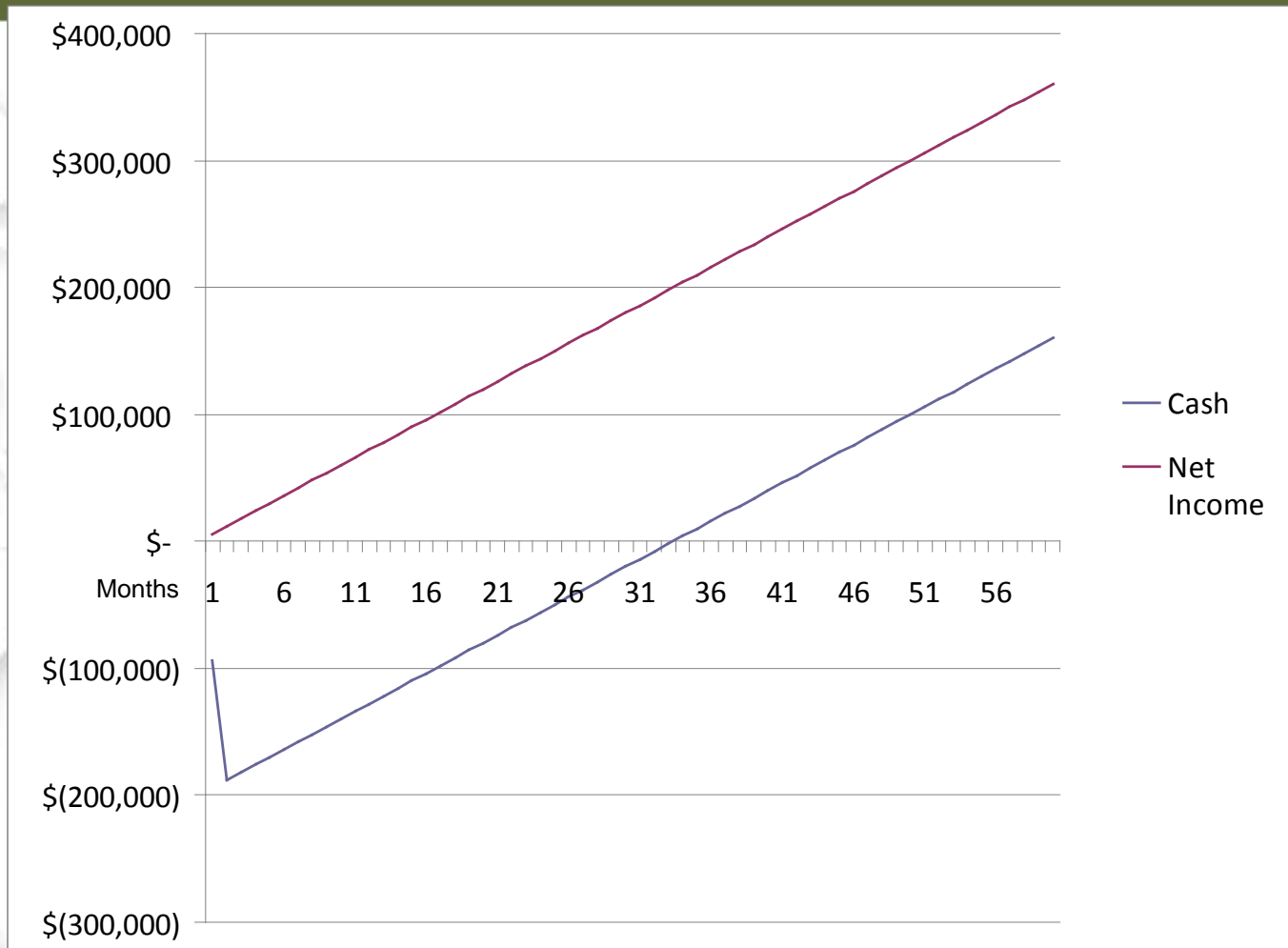
- Examples at 5%/10% & 15%
- Revenue at \$100,000 per month
- Tax Rate 40%
- Assume service based business that bills at the end of the month and gets paid in an average of 45 days
- For retail business, inventory is equivalent to A/R



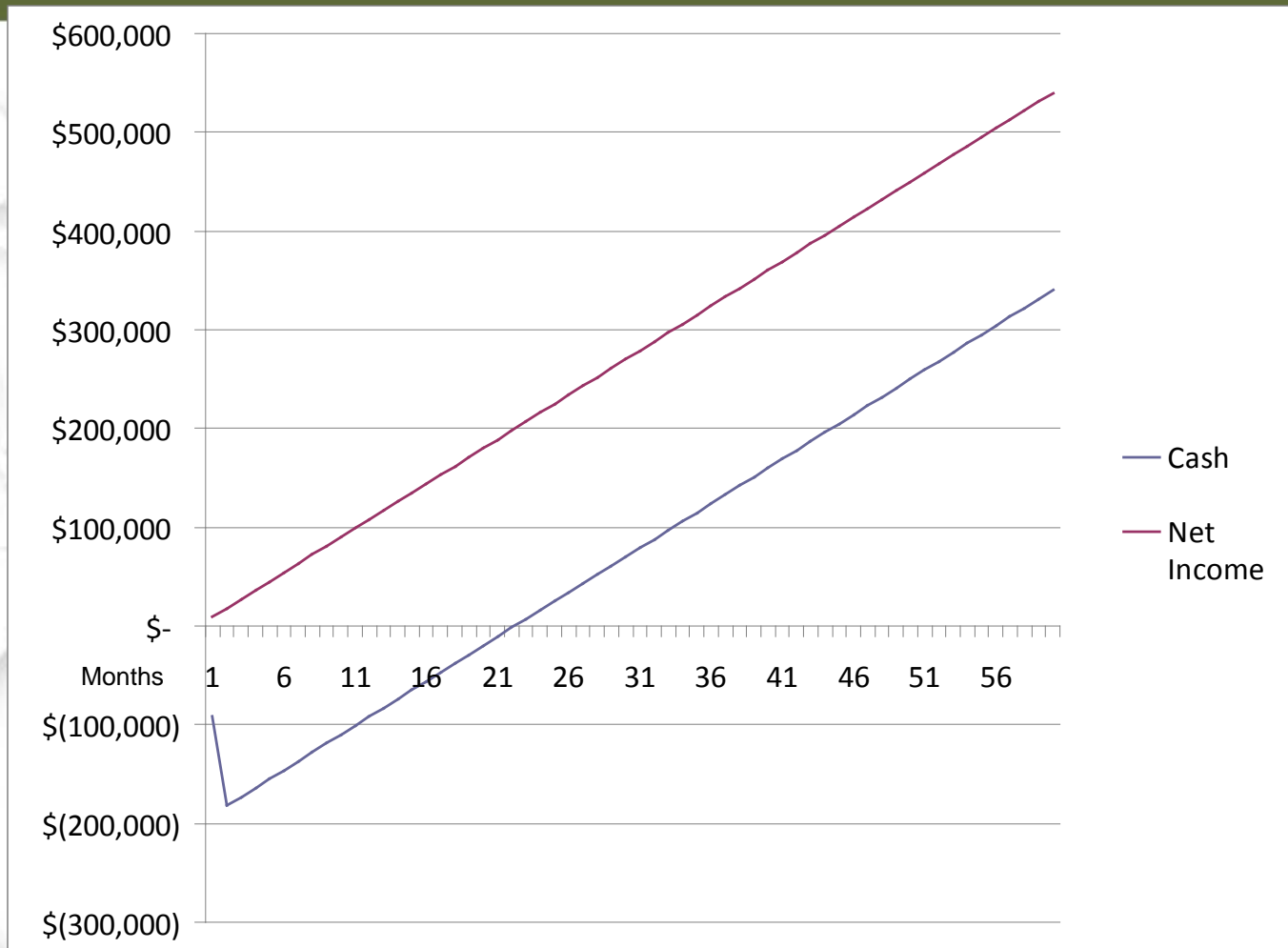
Cash Flow versus Profit 5%



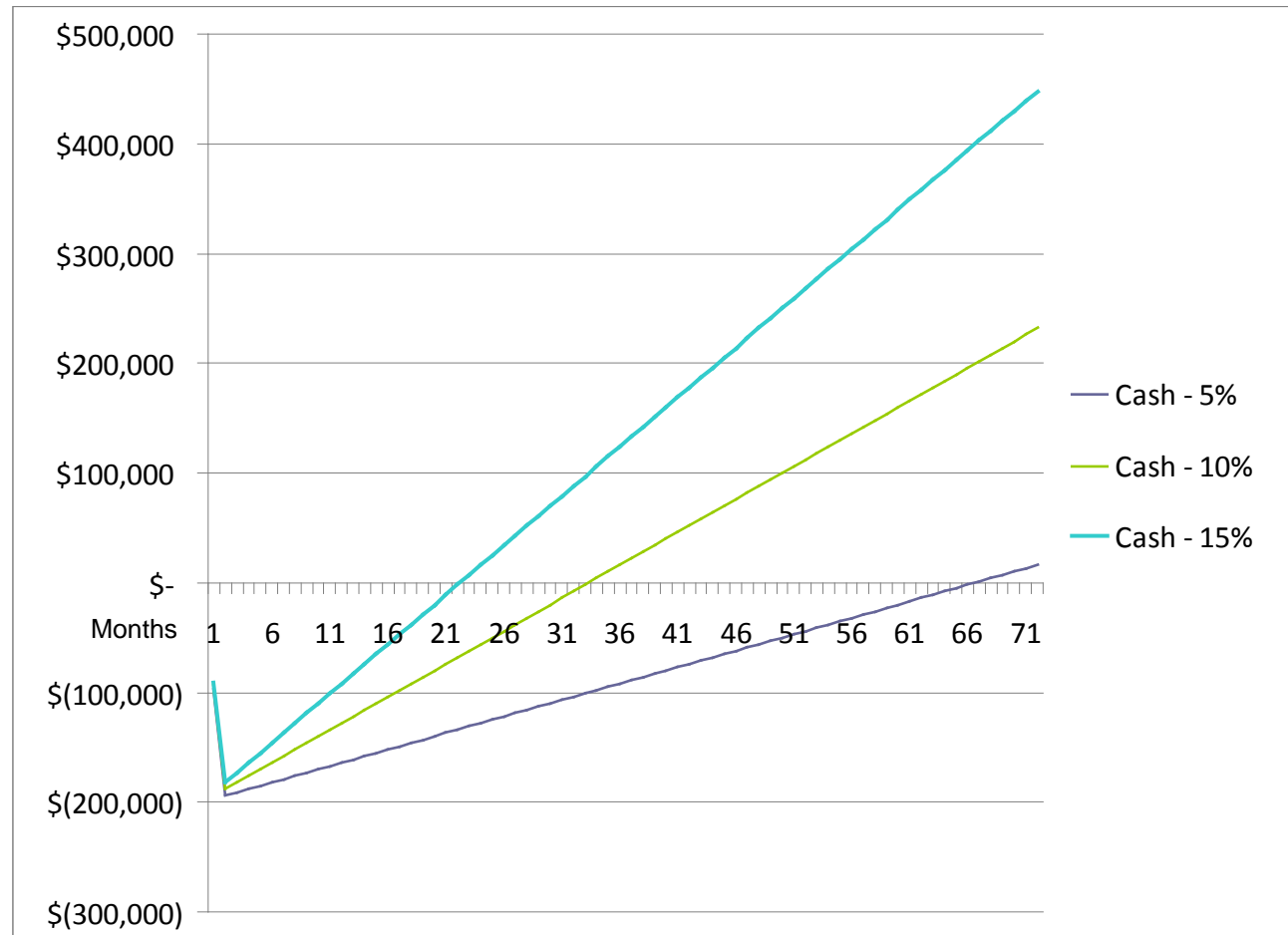
Cash Flow versus Profit 10%



Cash Flow versus Profit 15%



Cash Flow versus Profit Recap



4 Forces of Cash Flow

Prioritized In Order:

- Taxes
- Repay debt
- Build Cash to Reach Core Capital Target
- Dividends (Distributions)

#1 Force of Cash Flow

Taxes

- Before you spend, put aside \$\$ for Taxes, avoid the tax day “surprise”
 - Pay to IRS at last possible moment to avoid penalties
 - Set taxes aside quarterly in tax savings account
- Cash versus Accrual



#2 Force of Cash Flow

Debt

- Line of Credit:
 - A true LOC should be reduced to \$0 for 30 consecutive days in a 12 month period
 - No “Evergreen” Loans
- Factoring
 - More expensive than a line of credit
 - Generally used as a bridge to get qualified for a traditional line



#2 Force of Cash Flow

- Term Debt:
 - Repaying Debt requires after tax profits!
 - Use term debt to fund purchase of assets where payment happens over useful life of asset
 - SBA loans to purchase businesses are often structured as term debt
 - Watch out for invasive covenants and guarantees (Especially on SBA loans)



#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
 - Operating expenses include direct labor



BrightStar, Inc.**Sample Company - Core Capital Target**

| | 2012-11 | | |
|---------------------------------|------------|-----------------------------------|-----------------|
| Revenue | 207,145.00 | Annualized Revenue | \$ 2,485,740.00 |
| Non-Labor Cost of Goods Sold | | | |
| Gross Margin | 207,145.00 | | |
| <i>as % to Sales</i> | 100.00% | | |
| | | Core Capital Target | |
| Direct Labor | 91,424.00 | Direct Labor | \$ 91,424.00 |
| Direct Payroll taxes & benefits | 14,245.00 | Direct Payroll Taxes and Benefits | 14,245.00 |
| | | Operating Expenses | 74,856.00 |
| Contribution Margin (CM) | 101,476.00 | | |
| <i>as % to Sales</i> | 48.99% | One Month Core Capital | \$ 180,525.00 |
| <i>LER</i> | 2.27 | | |
| Operating Expenses: | | 2 Months | \$ 361,050.00 |
| Facilities | 4,278.00 | As a % of Annualized Revenue | 14.52% |
| Royalty | 13,271.00 | | |
| Marketing | 2,072.00 | | |
| Labor - Admin | 29,260.00 | | |
| Payroll taxes & benefits | 5,746.00 | | |
| Other operating expenses | 20,229.00 | | |
| | | | |
| Total Operating Expenses | 74,856.00 | | |
| <i>as % to Sales</i> | 36.14% | | |
| <i>Admin LER to CM</i> | 3.47 | | |
| Net Operating Income | 26,620.00 | | |
| <i>as % to Sales</i> | 12.85% | | |

#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
 - Reinforces the need to set owner salary at market rate and live off your salary and use profit distributions to build your wealth



Wealth Building Premise

| | |
|---------------------------------------|--------------|
| Revenue | \$ 2,000,000 |
| Net Income | \$ 200,000 |
| as % to Revenue | 10% |
| Equity needed to be fully capitalized | \$ 400,000 |
| Return on Equity | 50% |
| Tax Rate | 45% |
| Net after tax output | \$ 220,000 |

