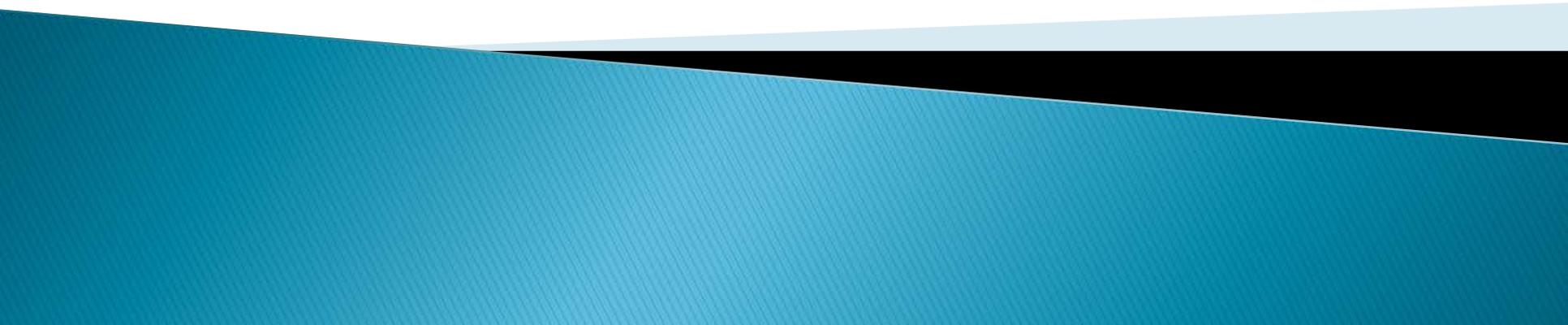


Your Financial Toolbox
Driving Profitability and Cash Flow

Dennis Kwak



Outline

- ▶ Overall Business Objective
 - ▶ Financial Statements:
 - The P&L
 - The Balance Sheet
 - Supporting Exhibits – Inventory
 - Why financial statements should be generated and reviewed
 - ▶ Cash Flow – Daily/Weekly Management
- 



Overall Business Objective

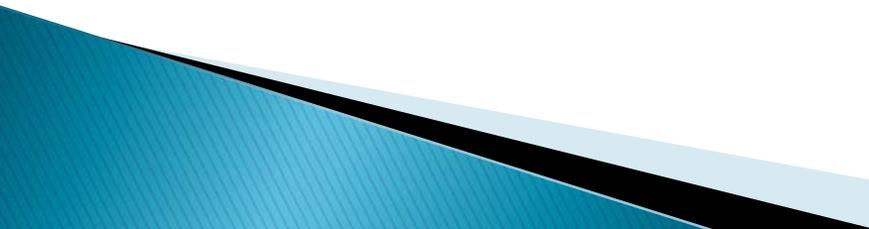
- ▶ Why are we in business?
 - Making Money
 - Earning a Profit
 - “Creating Customer Value”
 - Sustained, Growing Profitability and Positive Cash Flow
 - ▶ Basically, as you already know, you make money by “efficiently delighting an adequate number of paying customers”.
- 

The P&L

- ▶ P&L is short for “Profit & Loss”. It is also called the “Income Statement” or sometimes the “Summary of Operations”.
- ▶ The P&L addresses a Business’s Financial PERFORMANCE over a PERIOD of Time, typically Months and Years.
- ▶ The Monthly P&L Review should compare **Current Month – Last Month**; **Year to Date – Prior Year to Date**; **Last Full Year – Current Year**



Drivers of P&L Improvement

- ▶ Profitably Increased by **Sales Revenue Volume**
 - ▶ Improved **Margin Rate** – What you sell something for versus what it cost you.
 - ▶ **Operating Expense Control/Reduction:**
 - **Personnel** – Salaries, Wages, Commissions, Payroll Taxes, Employee Benefits
 - **Occupancy** – Rent, Utilities, Insurance, Depreciation (non-Cash)
 - **Marketing** – Advertising & Promotion “Programs”
 - **Other** – Bank & Credit Card Fees, Professional Fees (Attorneys, CPAs, Consultants), Travel & Entertainment, Supplies
- 



P&L Review

- ▶ **Generic Structure** – Sales thru Profit (Income Before Tax or After Tax, as appropriate)
 - ▶ **EBITDA**– Earnings Before Interest, Tax, Depreciation, & Amortization
- 

P&L Change

		Baseline	Breakeven	10% Profit	Change Formula
Sales	"Top Line"	1,000	920	1,193	
Cost of Goods Sold		430	396	513	
Gross Profit		570	524	680	-
%	"Margin Rate"	57.0%	57.0%	57.0%	
<u>Operating Expense</u>					
Marketing	Fix	60	60	60	
Personnel - Variable Selling	Var	110	101	131	
Management/Other	Fix	55	55	55	55
Total		165	156	186	
Occupancy - Rent	Fix	100	100	100	100
Utilities	Fix	20	20	20	20
Repairs	Fix	10	10	10	10
Insurance	Fix	10	10	10	10
Depreciation	Fix	40	40	40	40
Total	Fix	180	180	180	180
Other - Variable Credit Card Fees	Var	25	23	30	
All Other	Fix	75	75	75	75
Total		100	98	105	75
Total Operating Expense		505	494	531	
Operating Income		65	30	149	
Interest/Other	Fix	30	30	30	
Income Before Tax	"Bottom Line"	35	0	119	-
Profit %		3.5%	0.0%	10.0%	

Change Formula - Puruing the Profit

Now alter the P&L in the following manner:

- * 12% Sales Growth.
- * 1.5 points lower Margin Rate.
- * 7% Marketing of Total Sales
- * 1 additional point Variable Selling Expense
- * 3% Variable Credit Card Fees
- * \$10 additional Interest

And...additional Marketing and Interest

P&L Change

		Baseline	Breakeven	10% Profit	Change Formula
Sales	"Top Line"	1,000	920	1,193	1,336
Cost of Goods Sold		430	396	513	595
Gross Profit		570	524	680	742
%	"Margin Rate"	57.0%	57.0%	57.0%	55.5%
<u>Operating Expense</u>					
Marketing	Fix	60	60	60	94
Personnel - Variable Selling	Var	110	101	131	160
Management/Other	Fix	55	55	55	55
Total		165	156	186	215
Occupancy - Rent	Fix	100	100	100	100
Utilities	Fix	20	20	20	20
Repairs	Fix	10	10	10	10
Insurance	Fix	10	10	10	10
Depreciation	Fix	40	40	40	40
Total	Fix	180	180	180	180
Other - Variable Credit Card Fees	Var	25	23	30	40
All Other	Fix	75	75	75	75
Total		100	98	105	115
Total Operating Expense		505	494	531	604
Operating Income		65	30	149	138
Interest/Other	Fix	30	30	30	40
Income Before Tax	"Bottom Line"	35	0	119	98
Profit %		3.5%	0.0%	10.0%	7.3%

Change Formula - Puruing the Profit

Now alter the P&L in the following manner:

- * 12% Sales Growth.
- * 1.5 points lower Margin Rate.
- * 7% Marketing
- * 1 additional point Variable Selling Expense
- * 3% Variable Credit Card Fees
- * \$10 additional Interest

OUCH!

And...additional Marketing and Interest



The Balance Sheet

- ▶ The name comes from “being in balance”:
 - Assets = Liabilities + Equity
 - “Stuff we have” = “What we owe” + “The part that’s ours”
- ▶ It addresses a business’s financial position at a point in time
- ▶ The Monthly Balance Review should compare the **Current Month to the Prior Month**, **Prior Year End and Prior Year (12 Months ago)** – Four columns highlight changes.

Balance Sheet Review

- Balance Sheet Changes and Impact on Cash Flow – “All Assets aren’t equally desirable”.
- **GMROI** – **Gross Margin Return on Investment** – “For every \$ of Inventory Investment, how many \$s of Annual Gross Profit do I enjoy?”
- Using GMROI – Driven by Margin Rate and Inventory Turns – to drive Inventory Performance.

The Balance Sheet

	May-16 Current Month	Apr-16 Prior Month	Dec-15 Prior Year End	May-15 Prior Year	
ASSETS					"Stuff We Have"
Cash	50	100	500	1,000	
Receivables	800	800	700	600	Owed by Customers who Buy on Terms, typically 30 days, sometimes more or less.
Inventory	1,600	1,500	1,200	800	Product Held for Sale. Can be both Raw Materials and Finished Product.
Net Fixed Assets	950	900	800	700	Long Term - Buildouts, Equipment, Vehicles. Depreciated over time.
Total Assets	3,400	3,300	3,200	3,100	
LIABILITIES					"What We Owe"
Accounts Payable	1,800	1,500	1,000	500	Owed to Suppliers from Buying on Terms, typically 30 days, sometimes more or less.
Customer Deposits	450	500	550	600	Customer has given Money, but Received Nothing. Source of Cash - "Interest Free Money".
Notes Payable	1,000	1,000	1,000	500	Debt - Bank Loans, etc., typically Longer Term. Can be Lines of Credit or Term Loans.
Total Liabilities	3,250	3,000	2,550	1,600	
EQUITY	150	300	650	1,500	"The Part That's Ours" - Impacted by Profit/Loss and Owner Capital Infusion/Draws.
LIABILITIES & EQUITY	3,400	3,300	3,200	3,100	Equals Assets - In Balance

Recommended 4 Column Format

Exercise

What do you see happening here, specifically by line and overall?

What questions would you have about the Balance Sheet?



Inventory, Turns, GMROI

	<u>Baseline</u>	<u>Worse</u>	<u>Better</u>	<u>Mixed</u>	<u>Mixed</u>
Inventory	1,000	1,000	1,000	1,000	1,000
Turns	3.0	2.5	3.5	2.5	3.5
Number of Days	120	144	103	144	103
Margin Rate	55.0%	50.0%	60.0%	60.0%	50.0%
Annual Cost of Goods Sold	3,000				
Annual Sales	6,667				
Annual Gross Margin	3,667				
GMROI	3.67				

Turns = Annual Cost of Goods Sold / Inventory

Number of Days = 360 / Turns

GMROI = Annual Margin / Inventory = Gross Margin Return on Investment

GMROI = For every Dollar of Inventory Investment, how many Dollars of Annual Gross Margin do we enjoy?

Inventory, Turns, GMROI

	<u>Baseline</u>	<u>Worse</u>	<u>Better</u>	<u>Mixed</u>	<u>Mixed</u>
Inventory	1,000	1,000	1,000	1,000	1,000
Turns	3.0	2.5	3.5	2.5	3.5
Number of Days	120	144	103	144	103
Margin Rate	55.0%	50.0%	60.0%	60.0%	50.0%
Annual Cost of Goods Sold	3,000	2,500			
Annual Sales	6,667	5,000			
Annual Gross Margin	3,667	2,500			
GMROI	3.67	2.50			

Turns = Annual Cost of Goods Sold / Inventory

Number of Days = 360 / Turns

GMROI = Annual Margin / Inventory = Gross Margin Return on Investment

GMROI = For every Dollar of Inventory Investment, how many Dollars of Annual Gross Margin do we enjoy?

Inventory, Turns, GMROI

	<u>Baseline</u>	<u>Worse</u>	<u>Better</u>	<u>Mixed</u>	<u>Mixed</u>
Inventory	1,000	1,000	1,000	1,000	1,000
Turns	3.0	2.5	3.5	2.5	3.5
Number of Days	120	144	103	144	103
Margin Rate	55.0%	50.0%	60.0%	60.0%	50.0%
Annual Cost of Goods Sold	3,000	2,500	3,500		
Annual Sales	6,667	5,000	8,750		
Annual Gross Margin	3,667	2,500	5,250		
GMROI	3.67	2.50	5.25		

Turns = Annual Cost of Goods Sold / Inventory

Number of Days = 360 / Turns

GMROI = Annual Margin / Inventory = Gross Margin Return on Investment

GMROI = For every Dollar of Inventory Investment, how many Dollars of Annual Gross Margin do we enjoy?

Inventory, Turns, GMROI

	<u>Baseline</u>	<u>Worse</u>	<u>Better</u>	<u>Mixed</u>	<u>Mixed</u>
Inventory	1,000	1,000	1,000	1,000	1,000
Turns	3.0	2.5	3.5	2.5	3.5
Number of Days	120	144	103	144	103
Margin Rate	55.0%	50.0%	60.0%	60.0%	50.0%
Annual Cost of Goods Sold	3,000	2,500	3,500	2,500	
Annual Sales	6,667	5,000	8,750	6,250	
Annual Gross Margin	3,667	2,500	5,250	3,750	
GMROI	3.67	2.50	5.25	3.75	

Turns = Annual Cost of Goods Sold / Inventory

Number of Days = 360 / Turns

GMROI = Annual Margin / Inventory = Gross Margin Return on Investment

GMROI = For every Dollar of Inventory Investment, how many Dollars of Annual Gross Margin do we enjoy?

Inventory, Turns, GMROI

	<u>Baseline</u>	<u>Worse</u>	<u>Better</u>	<u>Mixed</u>	<u>Mixed</u>
Inventory	1,000	1,000	1,000	1,000	1,000
Turns	3.0	2.5	3.5	2.5	3.5
Number of Days	120	144	103	144	103
Margin Rate	55.0%	50.0%	60.0%	60.0%	50.0%
Annual Cost of Goods Sold	3,000	2,500	3,500	2,500	3,500
Annual Sales	6,667	5,000	8,750	6,250	7,000
Annual Gross Margin	3,667	2,500	5,250	3,750	3,500
GMROI	3.67	2.50	5.25	3.75	3.50

Turns = Annual Cost of Goods Sold / Inventory

Number of Days = 360 / Turns

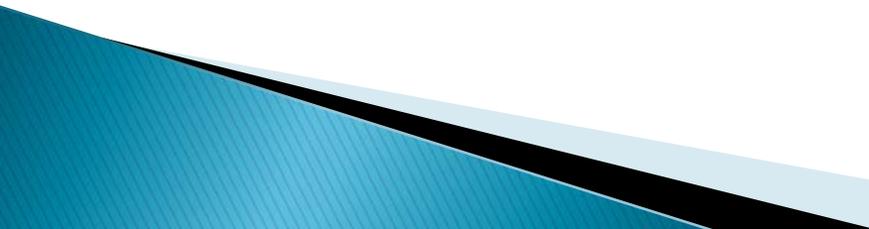
GMROI = Annual Margin / Inventory = Gross Margin Return on Investment

GMROI = For every Dollar of Inventory Investment, how many Dollars of Annual Gross Margin do we enjoy?

Cash Flow

- ▶ Cash Flow is NOT Accounting Profit or Loss
- ▶ It is Cash Received versus Cash Disbursed
- ▶ Understanding of Cash Flow is critical because “Cash is what pays the bills”
- ▶ Cash Flow is driven by:
 - P&L – **Profit or Loss**
 - Balance Sheet

Cash Flow Drivers

- ▶ Profit or Loss (adjusted for Depreciation – non Cash)
 - ▶ Plus or Minus changes in key Balance Sheet items:
 - Receivables – Collecting or swelling
 - Inventory – Turning or not
 - Fixed Assets – Long Term Investment
 - Payables – Disbursement Practices
 - Debt – Borrowing or Paying it back
- 

Cash Management

- ▶ Exercise – Discussion:
 - Weekly Cash Flow – Should not wait for a month
 - Tracking – Inflows versus categorized Outflows:
 - **Hard Costs** – Personnel (Payroll & related), Occupancy (Rent, Utilities, Insurance), Debt, Taxes (Property, GET) – These items follow cycles.
 - **To Suppliers** – If/as you have the Cash available – Prioritized.
 - Forecasting – Inflows minus Hard Costs equals Available for Suppliers.

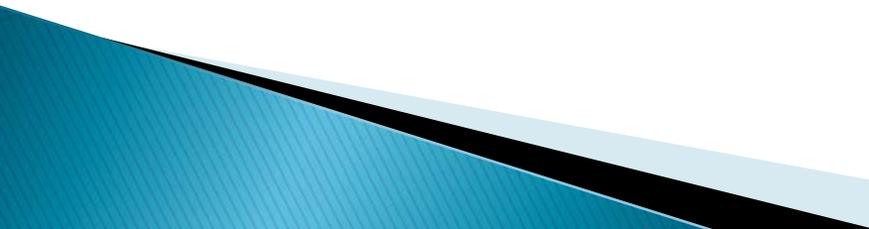
Cash Flow Tracking and Forecast - Actual & Forecast

Whole Dollars	Actual	Actual	Actual	Actual	Actual	Actual	Forecast	Forecast	Forecast	Forecast	Forecast
Week End Date:	Week Ended										
	12/31/12	01/07/13	01/14/13	01/21/13	01/28/13	02/04/13	02/11/13	02/18/13	02/25/13	03/04/13	03/11/13
Cash Balance - Beginning	50,000	48,000	58,000	48,000	49,000	52,000	52,000	52,000	52,000	50,000	50,000
Cash In:											
Receipts from Sales	460,000	460,000	460,000	485,000	485,000	485,000	465,000	465,000	465,000	465,000	465,000
Loan Proceeds											
Equity Infusion											
Total Cash In	460,000	460,000	460,000	485,000	485,000	485,000	465,000	465,000	465,000	465,000	465,000
Cash Out - Hard Costs:											
Payroll/Tax/Benefits		275,000		284,000		295,000		285,000		285,000	
Rent & Utilities	135,000	135,000	10,000	10,000	135,000	135,000	10,000	10,000	135,000	135,000	10,000
Lease Payments	2,000		5,000		2,000		5,000		2,000		5,000
Loan Payments	5,000		20,000		5,000		20,000		5,000		20,000
General Excise Tax				80,000					80,000		
Total Cash Out - Hard Costs	142,000	410,000	35,000	374,000	142,000	430,000	35,000	295,000	222,000	420,000	35,000
Cash Available for Suppliers	368,000	98,000	483,000	159,000	392,000	107,000	482,000	222,000	295,000	95,000	480,000
Cash Out - To Supplier - Prioritized:	320,000	40,000	435,000	110,000	340,000	55,000	430,000	170,000	245,000	45,000	430,000
Cash Balance - Ending	48,000	58,000	48,000	49,000	52,000	52,000	52,000	52,000	50,000	50,000	50,000

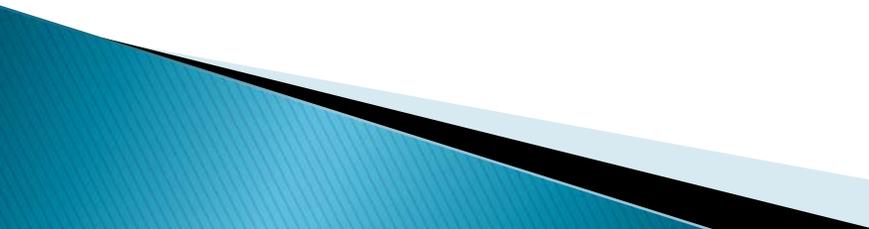
Exercise

Complete the Forecast, maintaining approx. \$50,000 in Ending Cash Weekly.

Summary

- ▶ “Making Money”, Earning a Profit and Generating Cash, is critical to the future of your Business and all of the “Stakeholders (Owners, Employees, Customers, Suppliers)” related to it.
 - ▶ The P&L tells you “how you are performing”.
 - ▶ The Balance Sheet tells you “where you stand”.
- 

Summary (Continued)

- ▶ Together they tell you about the health of your Business and where you need to focus to improve Financial Performance.
 - ▶ Cash Flow is critically important – Cash is the “life blood” of the Business.
 - ▶ Cash Flow is driven by BOTH P&L Performance AND Balance Sheet changes.
- 

Tips

- ▶ Create a Robust Pricing Strategy
- ▶ Trimming Business Costs (Start with 5% across all line items)
- ▶ Shorten Payment Terms to your customer
- ▶ Lengthen Payment Terms to your vendor
- ▶ Review unpaid accounts
- ▶ Set up debt collection process
- ▶ Offer discounts for pre-payment
- ▶ Pay outstanding bills on due date
- ▶ Plan and forecast cash flow!
- ▶ Pay short term expenses with CC (But need to pay balance at the end of the month)
- ▶ Collecting **Receivables**, Optimizing **Inventory**, Actively Managing **Payables**