Dear Profit Master,

Congratulations for taking the next step in improving the profitability and efficiency of your company!

Profit Guard will provide you with comparative statistical and graphical measurements of your company’s financial and operational performance on a monthly basis. All with very little effort on your part. The following pages have been put together as a tutorial to walk you through each of the sections.

Thank you.

Sincerely,

Steve LeFever
Founder & Chairman
The Profit Mastery Road Map

- The Road Map is a visual diagnostic tool designed to help identify key causal factors of financial underperformance.
- If your company has symptoms of Low (or declining) Cash, Low (or declining) Gross Margin, and/or Low (or declining) Net Profit, then begin the analysis process in one of those three shaded boxes.
- Move upwards out of the shaded box, against the direction of the arrow, toward an unshaded box.
- As you travel against the arrow, say to yourself, “...is caused by...” or “...can be caused by....”
- For instance, moving from “Low Gross Margin” to “No Cash Discounts,” you would say, “Low or Declining Gross Margin is/can be caused by not taking Cash Discounts.”
- Then, ask yourself if that’s an issue relevant to your company. What can be done to reduce or eliminate that causal factor?
- Perform a similar brainstorming exercise for each potential cause of your particular symptom(s). Develop specific goals and action plans to treat every causal factor you identify.
- Treating the identified potential causes of the symptom will lead to improved financial performance.
Your Guide to Profit Guard

"The Scorecard"

This Scorecard is the "report card" for the financial performance of your business. It’s designed to tell you how you’ve been performing for the last month, how you stack up against your peers in the industry and, more importantly, how to make improvements that will drive improved cash flow and increased profits.

The Scorecard consists of 14 ratios most commonly used to measure financial performance in an operating company. The names are in the first column from the left, how to compute them is in the next column (the “formula”) and the reporting periods are in the next three columns. Profit Guard has pulled this information from your QuickBooks and is providing your current month, last month, and two months ago calculations.

A critically important part of the process is your Goals, which are located in the second column from the right. These can be derived from your own company expectations, from Risk Management Association (RMA)* data, financial performance studies from your own industry, or other resources. Your goals provide the benchmarks to measure yourself against and see where improvements can be made. Clearly, the far right column contains your actual numbers used in the calculation.

### Industry Standard Ratios: Platinum reports only.

<table>
<thead>
<tr>
<th>Ratio Name</th>
<th>Formula</th>
<th>Reporting Periods</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current Assets to Current Liabilities</td>
<td>A</td>
<td>Last month, 2 months ago</td>
</tr>
<tr>
<td>Quick</td>
<td>B</td>
<td>Last month, 2 months ago</td>
</tr>
<tr>
<td>Net Working Capital to Total Liabilities</td>
<td>C</td>
<td>Last month, 2 months ago</td>
</tr>
<tr>
<td>Gross Margin</td>
<td>D</td>
<td>Last month, 2 months ago</td>
</tr>
<tr>
<td>Net Margin</td>
<td>E</td>
<td>Last month, 2 months ago</td>
</tr>
<tr>
<td>Sales</td>
<td>F</td>
<td>Last month, 2 months ago</td>
</tr>
<tr>
<td>Total Assets</td>
<td>G</td>
<td>Last month, 2 months ago</td>
</tr>
<tr>
<td>Net Profit Before Tax</td>
<td>H</td>
<td>Last month, 2 months ago</td>
</tr>
<tr>
<td>Total Assets Turnover</td>
<td>I</td>
<td>Last month, 2 months ago</td>
</tr>
<tr>
<td>Inventory Turnover</td>
<td>J</td>
<td>Last month, 2 months ago</td>
</tr>
<tr>
<td>Accounts Receivable Turnover</td>
<td>K</td>
<td>Last month, 2 months ago</td>
</tr>
<tr>
<td>Accounts Payable Turnover</td>
<td>L</td>
<td>Last month, 2 months ago</td>
</tr>
<tr>
<td>Average Payment Period</td>
<td>M</td>
<td>Last month, 2 months ago</td>
</tr>
</tbody>
</table>

*Note: NA designates the metric is not of value in the company
© 2003 Business Resources, Inc.®

### Profit Guard Calculations

**Hello Telephone Co.**

<table>
<thead>
<tr>
<th>Ratio Name</th>
<th>Value</th>
<th>Benchmark</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current Assets to Current Liabilities</td>
<td>A</td>
<td>1.3</td>
</tr>
<tr>
<td>Quick</td>
<td>B</td>
<td>1.3</td>
</tr>
<tr>
<td>Net Working Capital to Total Liabilities</td>
<td>C</td>
<td>2.0</td>
</tr>
<tr>
<td>Gross Margin</td>
<td>D</td>
<td>20.5%</td>
</tr>
<tr>
<td>Net Margin</td>
<td>E</td>
<td>11.0%</td>
</tr>
<tr>
<td>Sales</td>
<td>F</td>
<td>50.0%</td>
</tr>
<tr>
<td>Total Assets</td>
<td>G</td>
<td>100.0%</td>
</tr>
<tr>
<td>Net Profit Before Tax</td>
<td>H</td>
<td>100.0%</td>
</tr>
<tr>
<td>Total Assets Turnover</td>
<td>I</td>
<td>1.5</td>
</tr>
<tr>
<td>Inventory Turnover</td>
<td>J</td>
<td>5.0</td>
</tr>
<tr>
<td>Accounts Receivable Turnover</td>
<td>K</td>
<td>2.5</td>
</tr>
<tr>
<td>Accounts Payable Turnover</td>
<td>L</td>
<td>2.0</td>
</tr>
<tr>
<td>Average Payment Period</td>
<td>M</td>
<td>15.0</td>
</tr>
</tbody>
</table>
It is important to understand the trends that come to light as a result of laying out your ratios in this manner. For instance, carefully review your Gross Margin for the last three periods. Is it increasing or decreasing? What are the underlying causes one way or the other?

One of the most valuable and unique features of the scorecard is that we have quantified in “$$ and cents” the variances between your most recent numbers and your Goals – and we have used these variances to populate the “Road Map.”

Thus, we have delivered to you extremely powerful decision-relevant financial intelligence – identifying in visual format: (1) where are the opportunities for improvement against the “standard”, (2) quantifying in “$$ and cents” the financial impact of achieving your goal, and (3) identifying whether the improvement will have a primary impact on Cash (C) or Profits (P).

In other words, the Scorecard and Road Map together provide a unique visual system to “find the leaks and plug ‘em” – and they show you the financial impacts in cash or profits.

*Go to rmahq.org for more information.
Profit Mastery Assessment

The Profit Mastery Assessment (PMA) is a summary assessment report that serves as your basis to take action on. The information for your PMA comes from both your Scorecard and your Roadmap and provides you with a monthly quantification of potential cash and profit opportunities within your business. How you manage the finances of your business can and will make a significant difference!

The first column contains the issues every business owner deals with: Accounts Receivable (AR), Inventory, Payables and Gross Margin. The next column tells you how much cash you may be able to gain, the next column lets you know how much cash may be required, and the final column provides you with potential profit opportunity.

More importantly, the Sensitivity Analysis gets these numbers down to the value of money in your pocket on a day-to-day basis. This 1-Day Sensitivity is the true "gut check" of your management decisions. It shows you how much additional cash you will have in your bank account with every day you can improve these metrics. This number helps you and your team understand that incremental improvements in your financial performance can have a significant impact.
Inventory Turn-Days, Accounts Receivable Turn-Days, and your Average Payable Payment are all cash conversion metrics that either deposit money in the bank or suck money out of your business. Carefully monitor your Profit Guard report each month, paying special attention to your gross margin metric. You will find that it can be amazing what a minor 1% improvement in your gross margin can mean to the profitability of your company. With your Profit Guard report, you know where to look in your business to make improvements in these metrics. We strongly urge you to review your Profit Guard report with your CPA or financial advisor for specific strategies to improve your performance.
KPI Trend Charts

This chart shows the trend of three important metrics. The total Revenue/Sales is keyed to the right-hand side axis. Operating Cash Flow and Net Profit are keyed to the left-hand side axis.

Net Profit

is the amount of value added or lost in a business during a specific operating period of time. The accounting numbers used to generate this chart include non-cash values – this information must be considered along with cash when measuring the performance of a business.

Operating Cash Flow (OCF)

Shows cash flow from operating activities. It reflects inflows and outflows of cash related to operating the enterprise, and is a measurement of the internal generation of cash. If this is consistently larger than profit, the company will continue to build cash reserves or internal investment capacity. Since it adjusts for liabilities, receivables, and depreciation, operating cash flow is a more accurate measure of how much cash a company has generated (or used) than traditional measures of profitability such as net income or EBIT or EBITA. For example, a company with high-cost fixed assets on its books (factories, test equipment, or machinery, etc.) would likely have decreased net income due to depreciation. Since depreciation is a non-cash expense, Operating Cash Flow would provide a more accurate picture of the company's current cash holdings than the artificially low net profit. Operating Cash Flow is represented by columns in the chart.

Revenue or Sales

is the measurement of all billings for the value of products or services provided to customers for a reported time period. Sales can be expected to result in collections of cash as defined in related agreements.
Quick Ratio
This ratio, also called "acid test" or "liquidity" ratio, measures only cash, marketable securities (cash equivalents) and accounts receivable because they are considered to be the most liquid forms of current assets. It is the measurement of a company’s ability to generate cash in the short run to run the business and pay its bills. A Quick Ratio less than 1.0 implies dependency on inventory and other current assets to liquidate short-term debt.

Current Ratio
This ratio, also called the “solvency” ratio, is a comparison of current assets to current liabilities, commonly used as a measure of short-run solvency, i.e., the immediate ability of a business to pay its current debts as they come due. Potential creditors use this ratio to measure a company's overall ability to repay short-term debts.

Debt to Worth Ratio
Also known as the “leverage” or “risk” ratio, is represented by the purple line on the chart. This ratio measures the relative level of reliance on the use of outside funding (debt) to pay for Assets versus how much the owners/shareholders are providing. The smaller the net worth and the larger the liabilities, the less security for creditors. A business may expect trouble when this relationship exceeds 3:1.
**Gross Margin**
This chart reveals how much a company earns in relation to the direct costs that it incurs for producing its products and/or services. In other words, this chart is a visual translation of the accounting formula (gross profit divided by gross sales) for comparing gross margin. This is normally expressed as a percentage as shown on the left scale of this chart.

Gross margin is a good indication of how profitable a company is at the most fundamental level.

Gross margin is often confused with markup which is gross profit divided by cost of goods sold (COGS).

**Net Margin**
The ratio of net profits to revenues for a company or business segment - typically expressed as a percentage – that shows how much of each dollar of revenue generated is translated into profits. Net margins can generally be calculated as:

\[
Net \ Margin = \frac{Net \ Profit}{Sales}
\]

Where Net Profit = Sales – COGS – Operating Expenses – Interest and Taxes
Sales to Total Assets
A ratio that measures a company's earnings before taxes against its total net assets. The ratio is considered an indicator of how efficiently a company is using its assets to generate revenues. The lower the number, the lower the efficiency.
Return on Investment
A performance measure used to evaluate the efficiency of an investment or to compare the efficiency of a number of different investments. To calculate ROI, the benefit (return) of an investment is divided by the cost of the investment; the result is expressed as a percentage or a ratio. In this case, the investment is the shareholders’ equity in the business (net worth) and the benefit is the net profit before tax.

Return on Assets (ROA)
The return on assets (ROA) percentage shows how efficiently a company’s assets are being used to generate profit. The ROA is calculated by dividing a company’s annualized earnings by its total assets (net income/total assets). This number reveals what a company is doing with what it has – how many dollars the company derives in profit from each dollar invested in Assets.

ROA is a useful number for comparing competing companies in the same industry. The number will vary widely across different industries. Return on assets gives an indication of the capital intensity of the company, which will depend on the industry; companies that require large initial investments will generally have lower return on assets.
How many times a company turns over its receivables, inventory, and Payables typically has the most impact on a company’s cash flow. A company can have very good net profits, but still run out of Cash if it does not manage these three metrics well.

**Accounts Receivable Turnover**
An accounting measure used to quantify a firm's effectiveness in extending credit as well as collecting debts. The receivables turnover ratio is an activity ratio, measuring how efficiently a firm uses its assets. A turn of 12 would mean the receivables are collected on average every 30 days.

**Accounts Payable Turnover**
This tells you how many times you turnover your payables account per year. Accounts payable turnover ratio is calculated by taking annualized materials COGS (supplier purchases) and dividing it by the average accounts payable outstanding during the period. This is a short-term liquidity measure used to quantify the rate at which a company pays off its suppliers.

**Inventory Turnover**
A ratio showing how many times a company's inventory is sold and replaced over a one-year period. Since inventory represents the goods you sell, the more times you turn them over in a year usually the better. Too many turns has the risk that if your sales are faster than you are replenishing your inventory, you will not be able to fulfill orders. An inventory turn of 12 is the same as having one month of inventory on hand for sale.
How fast a company collects its receivables, pays its bills, or “turns over” its inventory typically has the most impact on a company’s cash flow. A company can have very good net profits, but still run out of Cash if it does not manage these three metrics well.

**Average Days to Collect Receivables**
Shows the average number of days it takes for the company to collect what is owed from customers (receivables). The fewer the days, the faster cash is collected. Computed by dividing 365 (days in a year) by Accounts Receivable Turn.

**Average Days of Payables**
Reflects the number of days a company takes to pay its bills. Longer periods (over 30 days) are generally less desirable. Computed by dividing 365 by Accounts Payable Turn.

**Average Days of Inventory**
Shows the average number of days that materials, work in progress (inventory held for production purposes), and finished goods are held by the organization before sale. Shorter duration reflects higher conversion rate to cash. Computed by dividing 365 by Inventory Turn.
**Cash Conversion Cycle (CCC)**

This is a measure of Receivables, Payables, and Inventory reflected within the same time period. The CCC Measures how long a firm will be deprived of cash if it increases its investment in resources in order to support customer sales. It is thus a measure of liquidity risk. However, shortening the CCC creates its own risks: while a firm could even achieve a negative CCC by collecting from customers before paying suppliers, a policy of strict collections and lax payments is not always sustainable.
The Break-Even analysis taught in the Profit Mastery class can help you with your company planning to understand the effects of fixed or variable cost changes.

1) Top Chart:

**Sales Required to Support Fixed Cost Changes**

This chart tells you the impact on Sales that will result from an addition (or reduction) of fixed cost to generate the same Net Profit. In this sample company case, every $1 of Fixed Cost increase requires an increase of $1.54 in sales to result in the same Net Profit. The inverse is true as well: for every $1 decrease in Fixed Costs, $1.54 less in Sales is needed to yield the same Net Profit. The chart graphs this equation:

$1 \text{ Fixed Cost (FC)} \times 1.54 = \text{Sales}$
Other practical examples of the power of this information about your company would include hiring a new employee at a cost $100,000 in Salary and Fringes - the company would have to increase its sales by $154,000 to support that new employee.

The same would be true for the purchase of office equipment such as computers: a $5,000 cash purchase of a computer would require $7,700 of additional sales. Likewise, on the negative side, you could determine fixed cost reduction requirements if your sales forecast were to be reduced. For example, if your forecast sales reduction were to be $200,000 you would need to reduce your operational expenses by $129,870 in order to maintain your same Net Profit.

2) Bottom Chart: **Net Profit impact with Variable Cost % Change**

This chart illustrates the impact on Net Profit as a result of Variable Cost increases and decreases. As you recall from the Profit Mastery University class, variable costs are directly related to sales. They are primarily affected by the Costs of Goods Sold (COGS) or the total cost to deliver your product or service to a customer. In this sample company, every 1% VC decrease will result in $12,921 annual Net Profit increase. Correspondingly, every 1% VC increase will result in $12,921 annual Net Profit decrease.

This is very useful in planning future profit improvements for your company. As demonstrated with this sample company, if you wanted an additional $150,000 in profits you would need to reduce your variable cost by 11.6%. Conversely, if you knew you were going to have a variable cost increase due to a supplier raising prices, this chart would help you understand the impact on your profits. So, if a supplier cost increase has an overall 5% increase in your variable cost, this sample company would realize a $64,605 decrease in their profits.

1. The math is performed from your company Income Statement using the following equation: Sales - Variable Costs (VC) - Fixed Costs (FC) = 0
The Financial Gap that is taught in the Profit Mastery University class is a very powerful planning tool for a company. You simply use the chart at the bottom of this page to estimate your company’s financial needs for growth. This calculation uses information from both your Balance Sheet and Income Statement.

1) Top Table: **Current**

This table shows a company’s current status. The Current Sales and the Current Net Profit growth percentage shown at the top of the “Current” table are calculated from your Income Statement for the past 12 months. The rest of the table is from your Balance Sheet, averaged over the last 3 months. The % of sales is calculated by Profit Guard for use to determine the Financial Gap required for the growth of your business.

2) Middle Table: **Growth**

This Table is presented to demonstrate the results if you were to plan growth of 100% - double your current sales. This is simply a refresher of what was taught in the class.
The arrows on both sides show you how the math is done by adding down on the left side then subtracting up on the right side. The table is not suggesting you plan on growing 100%, but is simply an illustration. This sample company would have a Financial Gap of $535,295 if they were to grow 100% and maintain all internal operating efficiencies at the same rate as today. This means that this company would need $535,295 to fund their growth through either a loan or an investment to achieve this growth.

3) Bottom Chart: **Financial Gap Analysis**

The chart plots your company’s Financial Gap at various growth percentages. Since you subscribe to the Profit Guard Platinum, you also get the benefit of seeing how your Financial Gap compares to your industry. Profit Guard plots your data against the top 10%, the top 25%, as well as the average 50% of performing companies in your industry. The chart is quite easy to use. Simply select the growth rate you would like on the bottom of the chart and then look at your Financial Gap line. Then, follow it over to the Y-axis (Vertical) to find the relevant Financial Gap. In this sample company, if it was planning a 150% sales growth it would need about $900,000 to fund that growth - assuming the same efficiencies in its operations found on the current Balance Sheet.
Profit Guard has expanded the usefulness of the Financial Gap Analysis that was taught in the Profit Mastery University class. As discussed in the class, operational efficiencies are assumed to stay the same as those reflected on your current balance sheet. However, as growth gets more aggressive, this assumption may require adjustment, so Profit Guard adds the elements of varying efficiencies. These charts plot the variation in operational efficiencies at various growth levels. In this, case Profit Guard demonstrates how the variable changes in Receivables, Inventory, and Payables will affect your Financial Gap.

1) Top Chart: Receivables as Variable

This chart shows a family of curves that reflect your Financial Gap at different growth rates for your business when you vary Receivables, the average time that it takes to collect what is owed to you by your customers. Receivables are typically measured in days. The Average days is on the X-Axis and the Y-axis being the Financial Gap. On your report, the center of the horizontal X-Axis represents your company’s current
Receivable performance. The Average days are then varied in ±5 day increments. The lower your receivables the more money you will have to fund growth. With this sample company at a planned growth of 100%, a decrease in Receivables of 20 days from 43 days to 23 days would represent a lowering of the Financial Gap from $550,000 to $400,000, a $150,000 improvement. If the specific growth rate is demonstrated on the chart, you simply extrapolate between the lines as all the lines have the same slope.

2) Middle Chart: **Inventory as Variable**

This chart shows a family of curves with different growth rates when you vary the Inventory, the average time that it takes to consume your inventory or how long it would be before you run out of Inventory if you bought no more inventory. Inventory is typically measured in days, the Average days shown on the X-Axis and the Y-axis being the Financial Gap.

On your Profit Guard Report, the center of the horizontal X-Axis is your company’s current Inventory performance. The Average days are then varied in ±5 day increments. The lower your inventory, the more money you will have to fund growth. With this sample company, a 20 day decrease in Inventory to 59 days would represent a lowering of the Financial Gap from $550,000 to $450,000, a $100,000 improvement.

3) Bottom Chart: **Payables as a Variable**

This chart shows a family of curves with different growth rates when you vary the Payables, the average period of time you take to pay your suppliers for your COGS. The Average days is indicated on the X-Axis and the Y-axis being the Financial Gap. Payables are typically measured in days. The center of the horizontal X-Axis represents your company’s current Average Days. The Average days are then varied in ±5 day increments. The higher or longer you take to pay your suppliers, the more money you will have to fund growth. With this sample company an increase in Payable Days of 20 days from 31 days to 51 days would represent a lowering of the Financial Gap from $550,000 to $450,000, a $100,000 improvement.