

Profit Mastery: Creating Value and Building Wealth  
Facilitator's Guide Update/Page Replacement Instructions

Copy the pages double sided on three hole paper or three hole punch them after copying

**Remove:**

I-5  
I-9 (Intro. chapter)  
1:2d  
2:2b and 3  
2:7  
2:15 through 2:25

**Replace with:**

I-5 (Intro. Chapter)  
I-9 (Intro. Chapter)  
1:2d  
2:2b and 3  
2:7  
2:15 through 2:25

Note the change in order of pages 2:18 and 2:19. They are now to be completed at the conclusion of Section 2, Chapter 3. This improves the flow of Chapter 2. **IMPORTANT! Keep the green Road Map, page 2:22 Don't discard it with the other pages.**

3:13 through 19  
3R:11  
4:2c through 4:4

3:13 through 19  
3R:11  
4:2c through 4:4

**IMPORTANT! Keep the 11x17" Cash Flow worksheet between 4:4a and 4:4. Don't discard it with the other pages.**

4:9  
4:17  
5:3 through 5:17

4:9  
4:17  
5:3 through 5:17

This provides you with the Financial Gap Illustrated info. on the \$600,000 case study itself.

When you have finished, you will have an updated Facilitators Guide that will conform to the new third edition Participants Guide.



## Video Sections, Chapters & Time Allocations

(Does not include any pre and post Video Activities)

| Meeting # | Video # | Section # | Video Chapter # | Topic                                      | Chapter Length (minutes) | Total Video Time  |
|-----------|---------|-----------|-----------------|--|--------------------------|-------------------|
|           | 1       | 1         | 1               | Introduction to Profit Mastery             | 22                       |                   |
|           |         |           | 2               | Quiz Review                                | 33                       | <b>55 minutes</b> |
|           | 2       | 2         | 1               | Introduction to Case Study                 | 22                       |                   |
|           |         |           | 2               | Introduction to Financial Statements       | 27                       |                   |
|           |         |           | 2b              | Your Ratio Scorecard                       | 17                       |                   |
|           |         |           | 2c              | Comparing to Your Industry                 | 11                       | <b>1 hour</b>     |
|           |         |           | 3               | The Completed Scorecard                    | 18                       | <b>35 minutes</b> |
|           | 3       |           | 4               | The Road Map                               | 34                       |                   |
|           |         |           | 5               | The Road Map & Low Cash                    | 20                       |                   |
|           |         |           | 6               | The Road Map & Low Cash continued          | 15                       | <b>1 hour</b>     |
|           |         |           | 7               | Profit Mastery Assessment                  | 17                       | <b>26 minutes</b> |
|           | 4       | 3         | 1               | Starting Break-Even                        | 36                       |                   |
|           |         |           | 2               | Working Through Olympic Case Study         | 27                       | <b>1 hour,</b>    |
|           |         |           | 3               | Break-Even by Unit & Pricing Discussion    | 21                       | <b>24 minutes</b> |
|           | 5       | 4         | 1               | Starting the Cash Budget - Profit Plan     | 23                       |                   |
|           |         |           | 2a              | Building the Cash Flow                     | 19                       |                   |
|           |         |           | 2b              | Continuing the Cash Flow                   | 2                        |                   |
|           |         |           | 2c              | Finish Cash Flow - Lending Section         | 4                        |                   |
|           |         |           | 2d              | Graphing the Cash Flow                     | 8                        | <b>1 hour,</b>    |
|           |         |           | 3               | Cash Flow Wrap Up                          | 53                       | <b>49 minutes</b> |
|           | 6       | 5         | 1               | Intro. to Growth's Impact on Balance Sheet | 19                       |                   |
|           |         |           | 2a              | Evergreen at \$900k                        | 16                       |                   |
|           |         |           | 2b              | Ratios at 600k vs. 900k                    | 6                        | <b>1 hour,</b>    |
|           |         |           | 3               | Financial Gap wrap-up                      | 44                       | <b>25 minutes</b> |
|           | 7       | 7         | 1               | Steve's Thoughts on Banking & Transition   |                          | <b>28 minutes</b> |

## THE ROLE OF A FACILITATOR

Leading, coordinating, making progress easier. These are all parts of a normal day's work for a good facilitator. As facilitator, your presence is vital in helping participants get the most out of this material.

### Facilitator:

1. a person or thing that facilitates.
2. a person responsible for leading or coordinating the work of a group, as one who leads a group discussion.
3. someone who makes progress easier.

### Facilitate:

To make easy or easier.

### Before the Program

You most likely will be the person within your organization responsible for filling seats in the workshop. It's a great program but only if you get people to enroll. We've included some marketing tips for your use in promoting the program.

### Key Tips:

- Start early. Send out "save the date" notices as soon as the date is determined.
- Use testimonials from former attendees.
- Be enthusiastic. It's finance, remember!
- Don't market to the people who really need it. Your best prospects are those who are already successful. Let them talk it up to the stragglers in the next go-round.
- Be persistent. People don't like to leave their businesses. Expect excuses.
- Be organized. We've included checklists and packing lists in our Profit Mastery® Administration Guide.

### Pre-Workshop

Once you've got people signed up, be sure to get prepared.

- Send emails, and be available to answer any questions.
- Feel free to choose some of the pre and post activities as "pre-work" for your participants.
- Review the material, especially the case studies, time your activities, and read the FAQ's carefully.

### At the Workshop

This DVD is based on a workshop that has been presented to hundreds of thousands of people over the last 25 years. Over two and half decades, we've had an opportunity to develop and hone the presentation to be as clear as possible. Even so, we still sometimes come across participants who need extra help and guidance to understand one particular point.

## HOW TO USE THIS GUIDE

This page is Page I:6 in the Participant's Guide

### Key to symbols

We've included some symbols throughout this guide to give you a quick visual clue about the specific material. Here's a guide to what the different symbols mean:

#### DVD Notes

This area contains notes on each of the DVD chapters. You'll want your participants to open their workbooks to the appropriate DVD note area at the start of each chapter. We've also included some space so that they can also record their own notes from each section here as well.

#### Activity

Here's where you'll be working on some pre- and post-DVD activities to help your participants either prepare for an upcoming chapter or review a just completed one.

#### Case Study

When you see this symbol, you'll be at a place in the program where you will need to complete a Case Study Activity with your participants. You'll see this symbol on your Case Study material as well.

#### Summary

This symbol indicates where key points from each section will be summarized.

#### Facilitator Script

This symbol indicates script that you can use to either introduce concepts or materials before a DVD Chapter, or review key points after completing a chapter.

#### Play DVD



## HOW TO MARKET THE PROGRAM

Resources, checklists & marketing materials designed to help you get the word out can be found in our administrative guide. Contact your BRS account manager for more resources.

## INTRODUCTION TO PROFIT MASTERY®: CREATING A FOUNDATION FOR CHANGE

### *Theme*

As the owner of an independent business, you're challenged every day to play multiple roles in a limited time. You put on and take off a series of management hats — and sometimes you wear them simultaneously. But the one hat you can never shed is that of financial manager and planner. Discover a whole new way at looking at the numbers side of the business. Learn why you need to start working on the business, versus in the business, so that you can make better decisions, choose better actions, and experience better results.

### *Learning Objectives*

- Define your vision of success.
- Identify and understand the key drivers of success (or failure) in business.
- Learn the 7 steps to Fiscal Fitness.
- Identify key areas that need management action.
- Think about working *on* versus *in* your business.
- Begin to learn the language of finance.
- Start looking at your business in a new way.

## LEADER'S OUTLINE

|                |           |   |  |              |
|----------------|-----------|---|--|--------------|
|                | <b>1.</b> | Warm Up Activities                        |  |              |
| _____          |           | Warm Up Activity #1                       |  | <b>1: 3</b>  |
|                |           | <b>What's Your Definition of Success?</b> |  |              |
| _____          |           | Warm Up Activity #2                       |  | <b>1: 3</b>  |
|                |           | <b>Three Program Goals</b>                |  |              |
| <u>22 min.</u> | <b>2.</b> | DVD: Section 1 Chapter 1                  |  | <b>1: 4</b>  |
|                |           | <i>Introduction to Profit Mastery</i>     |  |              |
|                | <b>3.</b> | End of DVD Activities                     |  |              |
| _____          |           | Activity #1                               |  | <b>1: 8</b>  |
|                |           | <b>What are your Seven Steps?</b>         |  |              |
| _____          |           | Activity #2                               |  | <b>1: 9</b>  |
|                |           | <b>The Quiz</b>                           |  |              |
| <u>33 min.</u> | <b>4.</b> | DVD: Section 1 Chapter 2                  |  | <b>1: 10</b> |
|                |           | <i>Quiz Review</i>                        |  |              |
|                | <b>5.</b> | End of DVD Activities                     |  |              |
| _____          |           | Activity #1                               |  | <b>1: 14</b> |
|                |           | <b>Errors of Omission Checklist</b>       |  |              |
| _____          |           | Activity #2                               |  | <b>1: 15</b> |
|                |           | <b>Biz FIT Assessment</b>                 |  |              |
| _____          |           | Activity #3                               |  | <b>1: 16</b> |
|                |           | <b>Get Into Action!</b>                   |  |              |
| _____          | <b>6.</b> | Summary                                   |  | <b>1: 17</b> |
| _____          | <b>7.</b> | Preview of Next Unit/Closing              |  | <b>1: 17</b> |
| <u>55 min.</u> |           | DVD Time                                  |  |              |
| _____          |           | Total Time For DVD And Other Activities   |  |              |

## CHAPTER ONE SCRIPT (CONT'D)

### Why Don't People Look At the Numbers?

When do we do the things that we're less good at? Later, when there's time. And if you're good enough at the other things and you plan carefully, you can make sure that later never comes. We're going to work today to make you a little more comfortable wearing this finance hat. And when you think about it, don't all of the other hats here have a financial element to them? Our goal is to help connect all the things we do in a day to the numbers or the results that they create. Because if you want to create a certain financial outcome, you need to know how what you do impacts the numbers.

We've got some "warm-up" activities to help you get started on your role as a financial manager. We find it very useful to find out how participants define success, whether it is their business, professional life, or personal life, and then have them define their specific goals for the program. It also helps me identify why you came to this program and what you want out of your life and your business. While this course can help you with the process and concepts, only you know the "why," or the motivation, behind embarking on this process and what you specifically want to get out of this program.



## WARM UP ACTIVITIES



### Purpose:

To gain understanding of why we want to improve our business: what's the ultimate goal?

### Materials:

- Pens/Pencils
- Flip Chart & paper
- Markers
- Masking tape



### Purpose:

To help participants identify three specific goals they want to achieve from the program.

To help you, as the leader, learn what your participant's goals are for the program

### Materials:

- Tent cards
- Markers

### Warm Up Activity #1:

What's Your Definition of Success?

#### Procedure:

1. Divide the participants up into groups of 4-6.
2. Ask them to appoint a leader based on criteria of your choice.
3. Give them 10 minutes to discuss Question #1 and come up with a list for their group, and ask them to write their answers on flip chart paper.
4. When time is up, ask each group to share their definitions.
5. Ask them to post their definitions around the room.

### Warm Up Activity #2:

Identify three goals for what you want out of this program.

#### Procedure:

1. Ask the participants to turn to page 1:3 of their guides.
2. Ask the participants to read the instructions for the activity.
3. Allow them 5-7 minutes to complete the exercise.
4. Ask them to stand once they are finished.
5. Once they are done, ask them to turn their tent cards so that their names are on the outside facing the front of the room and keep their goals on the side facing them during the program.

## INTRODUCING SECTION TWO

### Preparations and Activities

Make sure you have your Cascade Office Systems Case Study out and available:

Income Statement

Balance Sheet

Ratio Worksheet “Scorecard”

Road Map

Make sure you have your calculator and pencils handy.

Facilitator Script:

**We’re going to move on to the next wealth builder for a business in Section 2: Getting Your Arms Around the Numbers. Here’s where we’re really going to start working and getting dirt under our fingernails.**

**Here are our objectives for this Section:**

- 1. Evaluate Financial Performance**
- 2. Utilize Financial Information to Identify Strengths, Weaknesses and Opportunities**
- 3. Create a Scorecard Using Ratios and Industry Benchmarks**
- 4. Create a Profit Mastery Assessment**



## WARM UP ACTIVITY



### Purpose:

To help participants understand the importance of timely and accurate financial statements

### Materials:

- Pens/Pencils
- Participant guide - page 2: 3

### Facilitator Tip:

Be careful not to put participants on the spot with this exercise. You can ask them to record answers but don't make them share their answers in front of the group.

### Warm Up Activity:

What's the Current State of Your Financial Statements?

### Procedure:

1. Ask the participants to turn to page 2 : 3 of their guide
2. Introduce the exercise with the following script

**By the end of the day, we hope we've inspired you to no longer dread seeing your financial statements, but to actually look forward to working with them. The quality of the analysis you'll be learning over the next several hours, is only equal to the quality of the financial data you'll be reviewing. And speaking of financial data, what's the "state of your statements"? Take a few minutes to answer the questions in the warm-up activity.**

3. Allow the participants a few minutes to read and complete the assignment themselves.
4. Finish up with the following script

**We recommend setting aside a regular time at least once a month to review your financial statements. You should be able to get accurate financial statements at the following intervals:**

|                   |  |
|-------------------|--|
| <b>Month end:</b> | <b>By 15th of following month</b>                |
| <b>Quarterly:</b> | <b>By 15th of month following quarter end</b>    |
| <b>Annual:</b>    | <b>By end-of-month following fiscal year-end</b> |

**If you're not there yet, don't despair! However, I strongly recommend you make this a top priority going forward on your action sheets.**

## WARM UP ACTIVITY

### Warm Up Activity:

What's the Current State of Your Financial Statements?



How often do you get financials (income statement and balance sheet)

- Once a month       Once a Quarter       Once a year

How much time do you spend looking at them?

- None  
 As little as possible  
 1 hour  
 2-4 hours per month  
 One day a month

On a scale from 1 to 10, with 1 being not at all satisfied and 10 being totally satisfied, how happy are you with the quality of your financial statements?

Not at all satisfied

Totally Satisfied

1      2      3      4      5      6      7      8      9      10

## DVD PRESENTATION BEGINS



### Section 2, Chapter 1: Intro to Case Study

22 minutes

#### Facilitator Tip:

Have participants take turns reading paragraphs aloud in the Cascade Case Study.

Steve will end this Chapter by asking the participants to place Cascade Income Statement and Balance Sheet side by side and ask them to note the first three things that they see.

Also, Steve refers to the Financial Operating Cycle Graphic several times in this section. Be sure that they have their workbook turned to page 2: 5 where there is a copy of the graphic.

Make sure participants take the Cascade Office System case study (pages 2:8 and 2:9) out of their workbooks. Review the pages in the case study and review the introduction to the case study. Also, have your participants take out the last page of the blue Section 2 resource pages, "Profit Mastery Answers" and turn it over on the front of their desk! (Don't let them cheat and look at the answers - make them do the work!)

**Cascade Office Systems originally opened when John Thomas began manufacturing custom wood office furniture for a select clientele. (He had just taken early retirement from a major manufacturer, where he had been a successful sales rep for over 20 years.)**

**The new business was a gradual success on the strength of Mr. Thomas's reputation and his ability to deliver quality furniture at a reasonable price.**

**Mr. Thomas semi-retired from the business during this year, turning it over to his daughter and son-in-law, Laura and Rob. Both of them perceived a growing market opportunity revolving around the production of custom office furniture for computers. While not forsaking the existing business, they implemented an impressive development campaign two years ago, including an expansion of the existing building. Last year, they began their marketing effort with an aggressive promotion based on price and quality.**

**It's now the end of the current fiscal year and they have come to you for financial assistance. They are flushed with excitement, telling you things will be great if they can just get the funds they need to get "over the hump." They brush off any talk of problems as "only temporary."**

**Script: As we begin this chapter, Steve is going to talk about an important cycle in business: the Financial Operating Cycle.**

Ask the participants to open their guides to page 2: 5 and follow along with the DVD.

Start the DVD

## CASE STUDY: Cascade Office Systems

Cascade Office Systems originally opened when John Thomas began manufacturing custom wood office furniture for a select clientele. (He had just taken early retirement from a major manufacturer, where he had been a successful sales rep for over 20 years.)

The new business was a gradual success on the strength of Mr. Thomas's reputation and his ability to deliver quality furniture at a reasonable price.

Mr. Thomas semi-retired from the business this year, turning it over to his daughter and son-in-law, Laura and Rob. Both of them perceived a growing market opportunity revolving around the production of custom office furniture for computers. While not forsaking the existing business, they implemented an impressive development campaign two years ago, including an expansion of the existing building. Last year, they began their marketing effort with an aggressive promotion based on price and quality.

It's now the end of the current fiscal year, and they have come to you for financial assistance. They are flushed with excitement, telling you things will be great if they can just get the funds they need to get "over the hump." They brush off any talk of problems as "only temporary."

What observations can you offer?

### *Action Steps:*

1. Gather accurate financial information.
2. Package the information so you can see the relationships.
3. Calculate financial ratios.
4. Record your industry composites (if available).
5. Compare your results.
6. Analyze the possible causes of problems.
7. Take action — formulate a plan, implement it, and monitor the results.

# NOTES ON THE VIDEO PRESENTATION

Section 2, Chapter 1: Introduction to Case Study

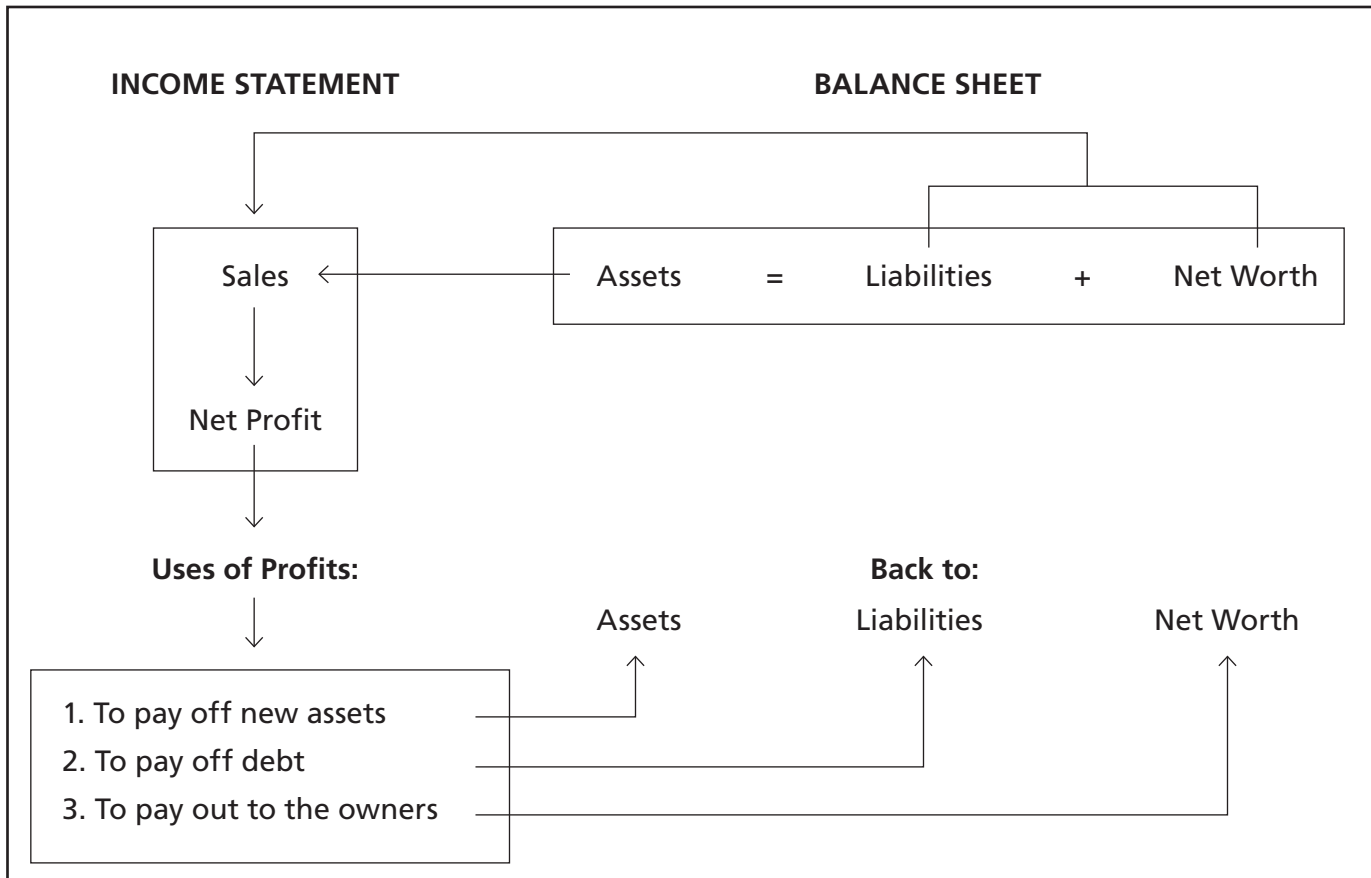
## Seven Steps - Where are we?

1. Plan Properly
- 2. Monitor Financial Position**
3. Understand Price-Volume-Costs
4. Manage Cash Flow
5. Manage Growth
6. Properly Finance Business
7. Plan for Transition



Assets = \_\_\_\_\_ + \_\_\_\_\_

## THE FINANCIAL OPERATING CYCLE



## NOTES ON THE VIDEO PRESENTATION

Section 2, Chapter 1: Introduction to Case Study



Where do the funds for Net Worth come from?

1. \_\_\_\_\_

2. \_\_\_\_\_

Where do liabilities come from?

1. \_\_\_\_\_

What Statement are they measured on?

Why do you have Assets?

Why do we make sales?

What three things can you do with Net Profits After Tax?

1. \_\_\_\_\_

2. \_\_\_\_\_

3. \_\_\_\_\_



## NOTES ON THE VIDEO PRESENTATION

Section 2, Chapter 1: Introduction to Case Study

### Learning Objectives

Evaluate Financial Performance

Utilize Financial Information

Create Scorecard

Create Profit Mastery Assessment



### Cascade Office Systems

Established Business

Transferred from father to  
daughter & son-in-law

New product line

Expansion of building

Promotion of “price and quality”

Need money to “get over the hump”

### Action Steps - What is the process?

Gather accurate financial information

Package information to show relationships

Calculate financial ratios

Record industry composites

Compare your results

Analyze possible causes of problems

Take action

Take Action > Formulate a Plan > Implement It > Monitor the Results

## END OF DVD ACTIVITY



### Purpose:

Have participants practice financial statement review

### Materials:

- Cascade Case Study Financial Statements

### Case Study Assignment

Review Cascade's Financials

#### Procedure:

1. Take a look at the financial statements.
2. Write down your first three impressions.
3. What do you like? Put a "✓" by those numbers.
4. What don't you like? Put a "?" by those numbers.
5. What do you have questions about? Again, put a "?" by those numbers
6. If doing this as a group exercise, compare your impressions with your table partners.

## END OF DVD ACTIVITIES

### Activity #1

What ratios do I need in my business?



Procedure:

1. Look at the Cascade Ratio page Scorecard on page 2:12.
2. Make a check mark by those you think are most important in measuring the performance of your business.
3. List any additional ratios that you would want to add for your own business.
4. List possible sources for industry comparative financial information.

## DVD PRESENTATION BEGINS



### Section 2, Chapter 2c Comparing to Your Industry

11 minutes

#### Facilitator Tip:

Make sure participants  
have the Industry  
Comparison page handy.

Ask the participants to open their guides to page 2 :16 and follow along with the DVD.

Start the DVD.

The information is also enlarged for easier viewing on page 17.

**SPECIAL NOTE:** At the end of Chapter 2c, go directly to page 20a. Skip pages 2:18 and 2:19 in the Participant's Guide and do those at the end of Chapter 3.

# CASE STUDY: CASCADE OFFICE SYSTEMS

## Industry Comparison Data Page

| Current Data    |                  |                   |                       |            | Ratio #                            |
|-----------------|------------------|-------------------|-----------------------|------------|------------------------------------|
| 0-1<br>MM<br>55 | 1-10<br>MM<br>62 | 10-50<br>MM<br>26 | 50-<br>100<br>MM<br>2 | ALL<br>145 | ASSET SIZE<br>NUMBER OF STATEMENTS |
| %               | %                | %                 | %                     | %          | ASSETS                             |
| 100.0           | 100.0            | 100.0             |                       | 100.0      | Total                              |
|                 |                  |                   |                       |            | LIABILITIES                        |
|                 |                  |                   |                       |            | Net Worth                          |
| 100.0           | 100.0            | 100.0             |                       | 100.0      | Total Liabilities & Net Worth      |
|                 |                  |                   |                       |            | INCOME DATA                        |
| 100.0           | 100.0            | 100.0             |                       | 100.0      | Net Sales                          |
| 30.1            | 22.2             | 23.0              |                       | 25.8       | Gross Profit 4                     |
| 2.9             | 3.2              | 4.0               |                       | 3.3        | Profit Before Taxes 5              |
|                 |                  |                   |                       |            | RATIOS                             |
| 2.2             | 2.8              | 3.6               |                       | 2.9        |                                    |
| 1.6             | 1.8              | 2.5               |                       | 1.8        | Current 1                          |
| 1.0             | 1.4              | 2.0               |                       | 1.3        |                                    |
| 1.3             | 1.4              | 1.7               |                       | 1.4        |                                    |
| 0.7             | 0.8              | 1.2               |                       | 0.8        | Quick 2                            |
| 0.4             | 0.5              | 0.7               |                       | 0.5        |                                    |
| 17              | 32               | 38                |                       | 28         |                                    |
| 41              | 43               | 50                |                       | 43         | Sales / Receivables 12 and 11      |
| 59              | 54               | 54                |                       | 55         |                                    |
| 41              | 49               | 70                |                       | 50         |                                    |
| 64              | 74               | 89                |                       | 74         | Cost of Sales / Inventory 10 and 9 |
| 101             | 107              | 122               |                       | 114        |                                    |
|                 |                  |                   |                       |            |                                    |
| 1.0             | 0.5              | 0.6               |                       | 0.6        |                                    |
| 1.8             | 1.2              | 0.8               |                       | 1.2        | Debt / Worth 3                     |
| 4.7             | 2.3              | 1.7               |                       | 2.9        |                                    |
| 40.5            | 29.6             | 29.1              |                       | 31.9       | % Profit Before Taxes / Tangibles  |
| (48)            | (61)             | 11.8              |                       | (137)      | Net Worth 8                        |
| 0.9             | 4.7              | 5.0               |                       | 4.2        |                                    |
| 16.1            | 14.6             | 18.4              |                       | 14.6       | % Profit Before Taxes /            |
| 8.5             | 6.9              | 4.6               |                       | 6.6        | Total Assets 7                     |
| -1.5            | 1.1              | 1.0               |                       | 0.9        |                                    |
|                 |                  |                   |                       |            |                                    |
| 3.1             | 2.9              | 2.0               |                       | 2.8        |                                    |
| 2.4             | 2.4              | 1.6               |                       | 2.1        | Sales / Total Assets 6             |
| 1.9             | 1.7              | 1.5               |                       | 1.7        |                                    |

## NOTES ON THE VIDEO PRESENTATION

Section 2, Chapter 2c: Comparing to Your Industry



*Simulated Data Page*

CASCADE OFFICE SYSTEMS  
 MANUFACTURERS - WOOD FURNITURE - EXCEPT UPHOLSTERY  
 SIC #2511

### Current Data

| 0-1<br>MM<br>55 | 1-10<br>MM<br>62 | 10-50<br>MM<br>26 | 50-100<br>MM<br>2 | All<br>145 | Asset Size<br>Number of Statements                               | Ratio # |
|-----------------|------------------|-------------------|-------------------|------------|--|---------|
|                 | 100.0            |                   |                   |            | <b>ASSETS</b><br>Total   |         |
|                 | 100.0            |                   |                   |            | <b>LIABILITIES</b><br>Net Worth<br>Total Liabilities & Net Worth |         |
|                 | 100.0            |                   |                   |            | <b>INCOME DATA</b><br>Net Sales                                  |         |
|                 | 22.2             |                   |                   |            | Gross Profit   | 4       |
|                 | 3.2              |                   |                   |            | Profit Before Taxes  | 5       |
|                 | 2.8              |                   |                   |            | <b>RATIOS</b>  |         |
|                 | 1.8              |                   |                   |            | Current  | 1       |
|                 | 1.4              |                   |                   |            |  |         |



## END OF DVD ACTIVITY



### Purpose:

- Practice using industry comparatives to benchmark company performance

### Materials:

- Pens / Pencils
- Cascade Ratio Analysis Spreadsheet/Scorecard
- Industry Cascade Composite Page

### Facilitator Tip:

Be sure to have your Ratio Answer Sheet available in case of questions.

### Case Study Assignment

Complete the ratio scorecard.

### Procedure:

1. Using the Industry Composite page on 2:16, find the correct comparative number and insert into the appropriate benchmark under the “Industry Composite” page of Cascade Office System Ratio Analysis Spreadsheet “Scorecard”

### Facilitator Script:

#### How to Find Numbers on Industry Composite Page:

1. Find the area labeled “Current Data”
2. Go to second column, labeled “1-10mm”
3. Find the number in the middle of the group corresponding to the ratio you are seeking
4. Take the middle number in that grouping.

## END OF DVD ACTIVITY

### Case Study Assignment

Complete the ratio scorecard.

Procedure:

1. Using the Industry Composite page on 2:16, find the correct comparative number and insert into the appropriate benchmark under the “Industry Composite” page of Cascade Office System Ratio Analysis Spreadsheet “Scorecard.”



## DVD PRESENTATION BEGINS



Section 2, Chapter 3  
The Completed  
Scorecard

18 minutes

Ask the participants to open their guides to page 2 : 21 and follow along with the DVD.

*Participants should have completed the Ratio Score Card before viewing this chapter.*

Start the DVD.

Steve speak:

**The Brothers** – Similar companies in your industry.

**Out of Round** – the amount your performance differs from your industry comparison.

**Garlic Toast** – When you're in really deep trouble. As in "You're Toast!"

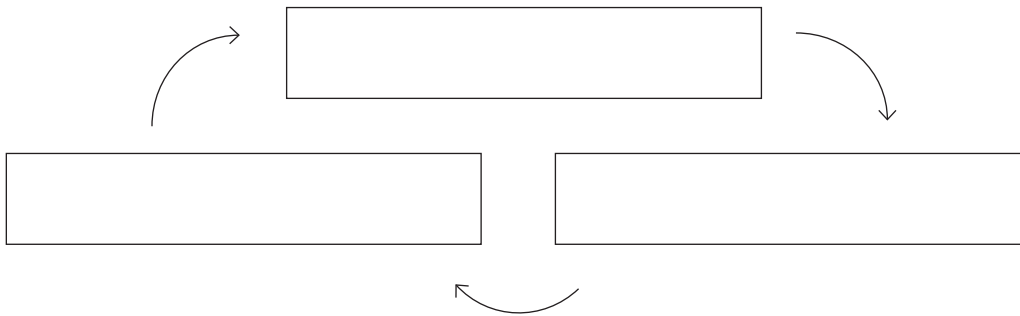
**Beat the Bogey** – To do better than minimum standards.

**Deep Kimchee** - Big trouble (see garlic toast)

## NOTES ON THE VIDEO PRESENTATION

Section 2, Chapter 3: The Completed Scorecard

### Working Capital Cycle



Steve speak:

**The Brothers** – Similar companies in your industry.

**Out of Round** – the amount your performance differs from your industry comparison.

**Garlic Toast** – When you're in really deep trouble. As in "You're Toast!"

**Beat the Bogey** – To do better than minimum standards.

**Deep Kimchee** - Big trouble (see garlic toast)

## KEY AREAS TO REVIEW AT THE CONCLUSION OF CHAPTER THREE



1. To be meaningful, the financial statements must be accurate. If not, then you've got GIGO: Garbage In, Garbage Out. Some companies keep two sets of books: one for the IRS and one for management. Use the management books for your analysis – they're likely to show the most honest portrayal of the company's performance.
2. The ratios listed in the case study are the minimum number that one would want to use for this particular company and the industry it's in. Many of these ratios will be appropriate for other types of companies also. However, if you're not sure which ratios are the best to use for your own company, who should you go see? Your accountant. They should know your business and industry.
3. There is more than one way to compute many of the ratios. For instance, it may be more meaningful to use balance sheet averages for some of the ratios rather than the number that's outstanding as of the focal date. The case study uses the most simple method of computing the ratios. Again, if you're not sure which way is the best method to use for your own company, see your accountant.
4. Get in the habit of using the sentence (below) that was used in the tape to better understand what the ratio is saying to you in words. We find that most people conceptualize words better than they do numbers.
5. "For every \$1 of (the bottom part of the ratio), there is \$X of (the top part of the ratio). So, for instance, a Current Ratio of .99 (Current Assets to Current Liabilities) says: for every \$1 of Current Liabilities, there is \$ .99 of Current Assets. So, for every dollar that is payable within the coming 12 months, the company should be able to come up with 99 cents to pay for it.

## KEY AREAS TO REVIEW AT THE CONCLUSION OF CHAPTER THREE

6. Many of you have seasonal businesses. You might find at any one time that your numbers might be high or low due to this factor. For example, Accounts Receivable might be very high for retailers at the end of December. For that reason, you might want to use an average number for your calculation to avoid skewing of the data.
7. One ratio that Steve does not talk about, but we look at very closely in our industry benchmark studies, is called ODP, which stands for Owners Discretionary Profit. It measures Net Profit Before Tax, Plus Owners Salary, Divided by Sales. It's really the ultimate measure of performance, and we suggest you add this one to your scorecard.
8. Where can you find comparative industry financial benchmarks? Risk Management Association, or RMA. Virtually any commercial bank should be pleased to provide its customers with their RMA numbers, and show them how to read and interpret the information.
9. Other sources of comparative financial data include: trade associations, franchise organizations, Dun & Bradstreet, and libraries (particularly of business colleges).

If one's company is unique enough that it's not meaningful to use available industry numbers to compare its performance, or perhaps there are no industry comparatives, then to whom do you compare yourself? Yourself! See what your own trends are doing over time. And then, who says there's any law that prevents you from just making up some industry numbers? Or, in other words, create your own goals of performance, and treat them like industry standards.



## DVD PRESENTATION BEGINS



Section 2, Chapter 4  
The Road Map

34 minutes

### Facilitator Tip:

Be sure participants have their Road Map handy for the next three chapters.

Ask the participants to open their guides to page 2 : 23 and follow along with the DVD.

Start the DVD.

## NOTES ON THE VIDEO PRESENTATION

Section 2, Chapter 4: The Road Map

### Introduction to the Road Map

How to use the Road Map

What are three key symptoms?

1. Low or declining \_\_\_\_\_.

2. Low or declining \_\_\_\_\_.

3. Low or declining \_\_\_\_\_.

Walk through road map

Goal: Identify leaks and plug them

Link in with ratios

Where do you start?



## NOTES ON THE VIDEO PRESENTATION

Section 2, Chapter 4: The Road Map



Gross margin and the road map

Cascade Road Map Analysis

### What's their low gross margin costing?

|  |       |
|--|-------|
| Peers margin                                 | 22.2% |
| Their margin                                 | 18.5% |
| Difference                                   | 4%    |
| Sales: \$2,000,000 x .04 = <b>\$80,000</b> = |       |
| Margin \$s left on table                     |       |

Finding the \$80,000

### No Cash Discounts

|   |                        |
|---|------------------------|
| Cost of Goods Sold last year<br>(Materials + Direct Labor)  | \$1,760,000            |
| Assume Direct Labor Costs   | - \$760,000            |
| Total Materials Cost of Goods   | <u>\$1,000,000</u>     |
| If suppliers offered a 2% discount on purchases, and Cascade<br>took advantage half the time, costs would drop: | .01                    |
|   | \$1,000,000            |
|   | x .01                  |
| Additional Gross Profit   | <u><b>\$10,000</b></u> |

### Low Productivity

|  |                 |
|--|-----------------|
| Direct Labor Costs                             | \$760,000       |
| % Productivity Improvement                     | <u>x .04</u>    |
| Reduced Labor Costs and Increased Gross Profit | <b>\$30,000</b> |

## NOTES ON THE VIDEO PRESENTATION

Section 2, Chapter 4: The Road Map



### Shrinkage

Assumption in this particular case study is that there is no employee theft.

### Poor Buying

|                                      |                 |
|--------------------------------------|-----------------|
| Goal: Better Buying                  |                 |
| Assumed Materials Cost of Goods Sold | \$1,000,000     |
| Cost Reduction                       | <u>x .02</u>    |
| Additional Gross Profit              | <b>\$20,000</b> |

### Poor Pricing

|                                      |                 |
|--------------------------------------|-----------------|
| Goal: Increase Overall Pricing by 1% |                 |
| Total Sales Last Year                | \$2,160,000     |
| Price Increase                       | <u>.01</u>      |
| Additional Gross Profit              | <b>\$22,000</b> |

### Summary

|                  |                                       |
|------------------|---------------------------------------|
| Cash Discounts   | \$10,000                              |
| Low Productivity | \$30,000                              |
| Poor Buying      | \$20,000                              |
| Poor Pricing     | <u>\$22,000</u>                       |
|                  | <b>\$82,000</b> (rounded to \$80,000) |

## END OF DVD ACTIVITY



### Purpose:

- Help get participants thinking creatively about other ways to track productivity.

### Materials:

- Pens / Pencils

### Activity #1

How Many Ways Can You Measure Productivity?

#### Procedure:

#### 1. Facilitator Script:

**Think about as many ways as you can to measure or track employee productivity. How do you do measure it, can you do it, should you do it? Your manual lists some examples.**

|                          |   |   |
|--------------------------|---|---|
| Benchmark                | = | What Number divided by What Number  |
| <hr/>                    |   |   |
| Revenue per client       | = | Total Revenue / # Clients Served  |
| Revenue per job          | = | Total Revenue / # Jobs  |
| Average Daily Revenue    | = | Total Revenue / # of Days Worked  |
| Average Revenue Per Hour | = | Total Revenue / # Hours Worked  |
| Individual Productivity  | = | Take any of the above ratios and calculate for individuals producing the services |

#### 2. What other ways can you think to track productivity?

Ask the participants to come up with additional methods to track productivity. Suggestion: If you have people working in groups, make it a contest to see which group can come up with the most ways in 10 minutes.

Your ideas:

|           |   |                                    |
|-----------|---|------------------------------------|
| Benchmark | = | What Number divided by What Number |
| <hr/>     |   |                                    |

**Question 3: Total Sales Needed to Earn \$50,000 Profit.**



$$\begin{array}{rcl} FC & = & \$ 151,820 \\ + \text{Profit goal} & + & \$ 50,000 \\ \hline \text{Total FC} & = & \$ 201,820 \end{array} \qquad \begin{array}{rcl} FC & = & \$ 201,820 \\ CM & = & \frac{\quad}{.16} \\ BE & = & \$ 1,261,375 \end{array}$$

Name four ways to put more profit in the profit cup:

Sales:

1.

2.

Costs

3.

4.

What if you could do all four things?

## NOTES ON THE VIDEO PRESENTATION

### Section 3, Chapter 2: Working Through Olympic Questions



1. The most important number in Break-Even is: \_\_\_\_\_

2. Think of Profit as \_\_\_\_\_

3. Calculate Break-Even in your own business.

#### Break-Even by Unit

Examples of units:

#### What is Olympic's Break-Even in Units?

|                |                 |
|----------------|-----------------|
| Sales Price    | \$5.00/sq. yard |
| Variable Costs | \$4.20/sq. yard |
| Fixed Costs    | \$151,820       |

$$\begin{aligned} \text{Break-Even Units} &= \frac{\text{Fixed Costs}}{\text{Unit Selling Price} - \text{Unit Variable Cost}} \\ &= \text{units needed to "Break-Even"} \end{aligned}$$

**Turn to page 3 : 15a.**

## END OF DVD ACTIVITY



### Purpose:

Practice computing Break-Even on a per unit basis

### Materials:

- Pens/Pencils
- Calculators

### Facilitator Tip:

Using answers (right) as a guide, go through Question 1 with your participants.

### Case Study Assignment #2

Practice Break-Even on a Per Unit Basis

Procedure:

1. Have participants answer the case study questions on 3:15.

*(Answers below)*

#### Question 1

|                |             |                    |   |                                     |
|----------------|-------------|--------------------|---|-------------------------------------|
| <b>Step 4:</b> | Fixed Costs | $\frac{151,820}{}$ | = | $\frac{151,820}{}$                  |
|                | CM per unit | $(5.00 - 4.20)$    | = | .80                                 |
|                | = BE        | =                  |   | <b>189,775 square yards (units)</b> |

#### Question 2

|                |             |                   |  |                                    |
|----------------|-------------|-------------------|--|------------------------------------|
| <b>Step 4:</b> | Fixed Costs | $\frac{20,000}{}$ |  |                                    |
|                | CM per unit | .80               |  |                                    |
|                | = BE        | =                 |  | <b>25,000 square yards (units)</b> |

#### Question 3

|                |             |                    |   |                                     |
|----------------|-------------|--------------------|---|-------------------------------------|
| <b>Step 4:</b> | Fixed Costs | $\frac{151,820}{}$ | = | $\frac{151,820}{}$                  |
|                | CM per unit | $(5.10 - 4.20)$    | = | .90                                 |
|                | = BE        | =                  |   | <b>168,689 square yards (units)</b> |

## END OF DVD ACTIVITY

### Case Study Assignment #2

Practice Break-Even on a Per Unit Basis

Olympic has a homogeneous unit — sq. yards — that can be used to measure all product sold. What Bob needs to know now is how many sq. yards he needs to sell.

*Here is the cost breakdown per yard:*

|                            |                 |
|----------------------------|-----------------|
| • Sales Price (per yard)   | \$5.00/sq. yard |
| • Variable Cost (per yard) | \$4.20/sq. yard |
| • Fixed Cost               | \$151,820       |

1. How many sq. yards must be sold to break-even?
  
  
  
  
  
  
  
  
  
  
2. How many sq. yards must be sold by a new salesperson (who will get an annual salary of \$20,000) to cover his cost?
  
  
  
  
  
  
  
  
  
  
3. How many sq. yards must be sold if the selling price is raised to \$5.10 - assuming there is no new salesperson and no change in variable cost?



***Setting your price is like setting a screw. A little resistance is a good sign.***

Harry Beckworth  
Selling the Invisible

## DVD PRESENTATION BEGINS



Section 3, Chapter 3:  
Unit Break-Even &  
Wrap-up

18 minutes

Ask the participants to open their guides to page 3 :16 and follow along with the DVD.

Start the DVD

**NOTES ON THE VIDEO PRESENTATION**  
Section 3, Chapter 3: Unit Break-Even & Wrap-up



**Unit Break-Even**

$$\begin{aligned} \text{Break-Even Units} &= \frac{\text{Fixed Costs}}{\text{Unit Selling Price} - \text{Unit Variable Cost}} \\ &= \text{units needed to "break-even"} \end{aligned}$$

**Question #1: What is Olympic's Break-Even in Units?**

|                |                 |
|----------------|-----------------|
| Sales Price    | \$5.00/sq. yard |
| Variable Costs | \$4.20/sq. yard |
| Fixed Costs    | \$151,820       |

Contribution amount for each unit:

## NOTES ON THE VIDEO PRESENTATION

### Section 3, Chapter 3: Unit Break-Even & Wrap-up

#### Break-Even by Unit Questions

Determining what's fixed vs. variable



#### Question #1:

How many sq. yards must be sold to break-even?

$$\text{Unit BE} = \frac{\text{Fixed Costs}}{\text{CM}} = \frac{\$151,820}{.8} = 189,775 \text{ sq. yards}$$

[CM per sq. yard = (5.00 - 4.20) = .80/sq. yard]

#### Question #2:

How many sq. yards does a new salesperson need to sell?

$$\frac{\$20,000 \text{ Fixed Cost}}{\$.80/\text{unit CM}} = 25,000 \text{ sq. yards}$$

#### Question #3:

How many sq. yards must be sold if the selling price is raised to \$5.10?

$$\frac{\text{Fixed Costs}}{\text{CM / unit}} = \frac{\$151,820}{(\$5.10 - \$4.20)} = \frac{\$151,820}{.90}$$
$$\text{BE} = 168,689 \text{ sq. yards (units)}$$

#### Question #4:

What happens if price per sq. yard is lowered by 10 cents (2% price drop)?

$$\frac{\text{Fixed Costs}}{\text{CM / unit}} = \frac{\$151,820}{(\$4.90 - \$4.20)} = \frac{\$151,820}{.70}$$
$$\text{BE} = 216,885 \text{ sq. yards (units)}$$

**NOTES ON THE VIDEO PRESENTATION**  
 Section 3, Chapter 3: Unit Break-Even & Wrap-up

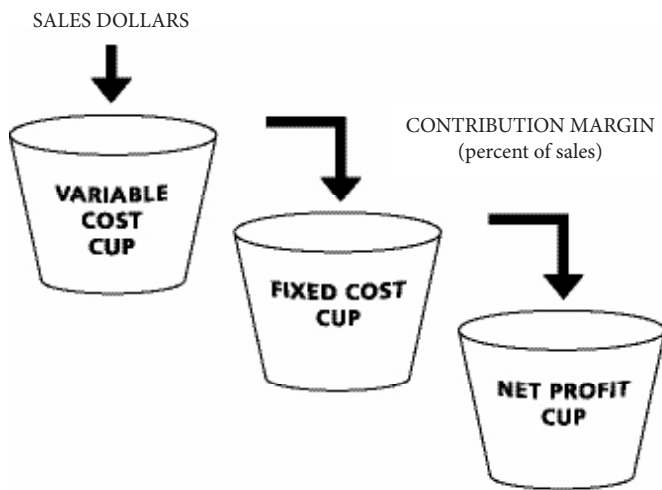
**Conclusion**

| Question 3  | Question 4   |
|---|--|
| $189,775 \text{ sq. yds @ } \$5.00/\text{sq. yd}$<br>$-168,688 \text{ sq. yds @ } \$5.10/\text{sq. yd}$<br><hr/> $21,087 \text{ fewer sq. yards}$<br><hr/> $\frac{21,087}{189,775} = 11\% \text{ decrease}$ | $216,885 \text{ sq. yds @ } \$4.90/\text{sq. yd}$<br>$-189,775 \text{ sq. yds @ } \$5.00/\text{sq. yd}$<br><hr/> $27,110 \text{ more sq. yards}$<br><hr/> $\frac{27,110}{189,775} = 14\% \text{ increase}$ |
| If price $\uparrow$ 2%<br>Then volume <b>can</b> decrease $\downarrow$ 11%  | If price $\downarrow$ 2%<br>Then volume <b>must</b> increase $\uparrow$ 14%  |



**Key Points**

- Know your costs
- Know your contribution margin percentage
- Treat profit like a fixed cost



- 1.
- 2.
- 3.
- 4.

Net profits occur if there is anything left after the "fixed cost" cup is filled.

***"Hold 'er Newt, she's headed for the rhubarb!"***

Steve LeFever  
 Translation: your company is out of control and headed for trouble!

**You need data, tools, and a process - like Profit Mastery!**

## END OF DVD ACTIVITY



### Purpose:

Have participants practice applying pricing decisions.

### Materials:

- Pens/Pencils
- Calculators

### Activity #1

Play Around with Pricing Changes in the Most Recent Year

#### Procedure:

1. Have participants calculate what would happen to the Break-Even if price was decreased by 5% and 10%. (*Answers below*)
2. What does that represent as a percentage increase in sales volume in both cases?
3. What would be needed to achieve those increases in sales volumes in both cases, and how might those changes affect the company's costs and subsequent Break-Even?

#### 1a) If Price decreases by 5% (to \$4.75)

$$\frac{\text{Fixed Costs}}{[\text{Selling Price} - \text{VC}/\text{Unit}]} = \frac{\$151,820}{[\$4.75 - 4.20]} = \frac{\$151,820}{.55 \text{ CM/yd.}} = 276,036 \text{ yards}$$

|  |                           |           |  |  |  |
|--|---------------------------|-----------|--|--|--|
|  | New BE                    | 276,036   |  |  |  |
|  | (less) Old BE             | - 189,775 |  |  |  |
|  | additional sales required | 86,261    |  |  |  |

$$86,261 / 189,775 = 45\% \text{ increase in volume}$$

**2a) If price decreases by 5 %, then total volume of sales must increase by 45 %**

#### 1b) If Price decreases by 10% (to \$4.50)

$$\frac{\text{Fixed Costs}}{[\text{Selling Price} - \text{VC}/\text{Unit}]} = \frac{\$151,820}{[\$4.50 - 4.20]} = \frac{\$151,820}{.30 \text{ CM/yd.}} = 506,066 \text{ yards}$$

|  |                           |           |  |  |  |
|--|---------------------------|-----------|--|--|--|
|  | New BE                    | 506,066   |  |  |  |
|  | (less) Old BE             | - 189,775 |  |  |  |
|  | additional sales required | 316,291   |  |  |  |

$$316,291 / 189,775 = 167\% \text{ increase in volume}$$

**2b) If price decreases by 10 %, then total volume of sales must increase by 167 %**

## END OF DVD ACTIVITY

### Activity #1

Play Around with Pricing Changes in the Most Recent Year



#### Procedure:

1. Calculate what would happen to the Break-Even if price was decreased by 5% and 10%.
2. What does that represent as a percentage increase in sales volume in both cases?
3. What would be needed to achieve those increases in sales volumes in both cases, and how might those changes affect the company's costs and subsequent Break-Even?



## **LOSE A LITTLE ON EACH SALE . . . MAKE IT UP IN VOLUME**

We've talked about the concept of Break-Even Analysis as a tool for managing and controlling costs, and it is. However, it's also an excellent tool for looking at both marketing and pricing decisions, thus making Break-Even a most useful tool.

Why, then, don't more business owners use it? Mostly, we believe, because the concept itself doesn't sound too exciting. First of all, you're not in business to Break-Even, right? Second, bankers never ask for it because it's not a part of the standard credit analysis package. And third, it's just like any tool — it's useless until you know how to apply it.

It's always good to know how pricing decisions affect your volume; but many business owners never take the time to figure it out. Before we look at an example, let's take just a second to review the two kinds of costs — fixed and variable. These are categorized by how they behave in a business — not where they're located on an income statement.

As you know, fixed costs do not vary over a “reasonable” range of sales — examples are salaries, rents, and utilities. However, variable costs are directly proportional to sales — examples are cost of goods sold and commissions. You have to decide how each cost category behaves in your business. Use this guide: sales cause variable costs; if sales don’t cause it, it’s fixed. With that basic review in mind, let’s look at an example:

|  |  |             |
|--|--|-------------|
| Total Annual Fixed Cost:   |  | $\$270,000$ |
| Selling Price per Unit:  |  | $\$300$     |
| Variable Cost per Unit:  |  | $\$210$     |
| Question:  | How many units must be sold to break-even? |             |
| Answer:  | Sale of one unit                           | $\$300$     |
|  | (less) Variable cost of unit               | $- 210$     |
|  | (equals) Contribution margin per unit      | $\$90$      |
| $\frac{\text{Fixed Cost}}{90.00} = \frac{270,000}{90} = 3,000 \text{ units}$ |  |             |

This says that for each unit sold, \$90 is left to contribute to covering fixed costs. Naturally, if fixed costs are \$270,000, then 3,000 units must be sold to break-even.

However, the really useful information is tied to an analysis of what happens when prices are changed. Suppose, for example, that we raised the price 5% with no corresponding increase in cost (5% increase = \$15.00).

|   |  |             |
|---|--|-------------|
| Annual Fixed Costs =  |  | $\$270,000$ |
| Selling Price/Unit  |  | $\$315$     |
| (less) Variable Cost/Unit                                       |  | $-210$      |
| (equals) Contribution Margin/Unit                               |  | $\$105$     |
| $\text{Break-Even} = \frac{270,000}{105} = 2,571 \text{ units}$ |  |             |

## KEY ISSUES TO DISCUSS PRIOR TO BEGINNING THE DVD

3. Break-Even gave us a picture of what the business might look like at some point in the future; in other words going from point A – where we are now – to point B some place down the road. But what it doesn't show is what the business might look like in between points A & B. What will your sales and related expenses look like on a month-by-month or quarter-by-quarter basis? What's going to happen to our cash flow during those times? How do our seasonal/cyclical patterns affect sales, costs, and cash flow?

That's what we're going to answer now in the next several chapters. We're going to help a company build a two-part picture, or projection, of its future. Take out the cash flow analysis, which is after page 4:9.

1. The first part is going to take the form of a profit plan. In other words, we're going to build a rough P&L projection of the company's future. This is a relatively short-term look at the future – just one year out. The projection will take place on the first eleven lines of this form. And, one other important thing – we're going to use the Accrual Method of accounting to build the projection. (Note: may be a good place to briefly discuss basic differences between accrual and cash accounting.) See 4R: 2-3.

2. The second part of the picture, from line 12 to the bottom of the page, is a Cash Budget. What this will do is take the assumptions from the profit plan and show the owner that if those assumptions about sales and related expenses are accurate, what might the company's checkbook look like as a result. And that will provide us a lot of information to talk about at our next class. And by the way, in the Cash Budget, we'll be using the Cash Method of accounting.

*So, before we start the DVD, let's talk a few minutes about cash flow.*



### Facilitator Tip:

Review the components of the Olympic Cash Flow Worksheet with participants.

Vocabulary Review:  
Give participants five minutes to read through vocabulary terms on their own (page 4:1)

## WARM UP ACTIVITY



### Purpose:

To help participants get ready for the section and start to understand the differences between profits and cash flow.

### Materials:

- Pens/Pencils
- Goals for Section

### Warm Up Activity:

Getting Ready for Cash Flow

### Procedure:

Have participants read introduction to the section, including learning objectives.

Break them into groups and ask them to discuss the following questions:

1. Do more sales necessarily result in more cash and profits?
2. Are profits and cash the same thing?
3. Why, as my sales go up, does my cash sometimes go down?
4. What types of businesses or industries do you think are most susceptible to cash flow challenges?

## WARM UP ACTIVITY

### Warm Up Activity:

What do you know about Cash Flow vs. Profits?

Review the introduction to this section, including the learning objectives at the beginning of this section.

Answer the following questions:

1. Do more sales necessarily result in more cash and profits?
2. Are profits and cash the same thing?
3. Why, as my sales go up, does my cash sometimes go down?
4. What types of businesses or industries do you think are most susceptible to cash flow challenges?



## DVD PRESENTATION BEGINS



### Section 4, Chapter 1: Starting the Cash Budget - Profit Plan

23 minutes

Ask your participants to review pages 4, 5, 6, 7, 8, and 9.

During the video, Steve will be moving back and forth to get data for the cash budget.

In the back of the resource materials have your participants remove and turn over the Cash Budget graph, and the 30-, 45-, and 60-day Cash Flow sheets. Do not let them look at this material during this portion of the video. Make them do their own work!

Read through case study on page 4.5 aloud.

Start the DVD.

## NOTES ON THE VIDEO PRESENTATION

Section 4, Chapter 1: Starting the Cash Budget - Profit Plan



### Seven Steps - Where are we?

1. Plan Properly
2. Monitor Financial Position
3. Understand Price-Volume-Costs
4. **Manage Cash Flow**
5. Manage Growth
6. Properly Finance Business
7. Plan for Transition

### Learning Objectives

- Identify the advantages of planning ahead
- Understand why profits don't always equal cash
- Understand seasonal impacts
- Learn how to use cash budgeting as a management tool

### Case Study

Olympic Flooring Background:

- Significant sales growth: 25% in latest year
- Cash and profits declining
- Renegotiation \$165,000 short term note
- Working out payment plan for payables

## CASE STUDY: Olympic Flooring

Bob Nelson has just completed his Fiscal Year, and he has taken some of your financial management advice. He now believes in planning — so he's come to you for assistance in completing a profit plan and cash budget for the next twelve months.



Bob has made a couple of important steps toward getting financial control of his business:

1. He's re-negotiating his \$165,000 short-term note, converting it to a 4 1/2 year loan.
2. He's contacted his suppliers and has their support — for the time being — in return for his commitment to pay for new shipments in 60 days and pay off his past due accounts payable.

### *Income Statement as of December:*

He projects a sales increase for the coming year of approximately 33% -- or a gross sales figure of \$1,430,000. Based on analysis of his past performance, you figure his income statement for this projected level of sales will look like this:

|                            |         |                 |
|----------------------------|---------|-----------------|
| SALES                      |         | \$1,430,000     |
| Cost of Goods Sold         |         | (1,072,600)     |
| GROSS PROFIT               |         | 357,400         |
| GENERAL EXPENSES           |         |                 |
| General Operating Expenses | 307,200 |                 |
| DEPRECIATION               | 7,200   |                 |
| TOTAL OPERATING EXPENSES   | 314,400 | (314,400)       |
| NET PROFIT BEFORE TAXES    |         | 43,000          |
| TAX                        |         | (6,700)         |
| NET PROFIT AFTER TAX       |         | <b>\$36,300</b> |

## NOTES ON THE VIDEO PRESENTATION

Section 4, Chapter 1: Starting the Cash Budget - Profit Plan

### Monthly Forecast Worksheet



|              |             | <i>Line 1</i>    | <i>Line 2</i>    | <i>Line 3</i>  |
|--------------|-------------|------------------|------------------|----------------|
|              | % Total     | Sales            | COGS             | Gross Profit   |
| January      | 5           | 71,500           | 53,600           | 17,900         |
| February     | 6           | 85,800           | 64,300           | 21,500         |
| March        | 9           | 128,700          | 96,600           | 32,100         |
| April        | 12          | 171,600          | 128,700          | 42,900         |
| May          | 13          | 185,900          | 139,400          | 46,500         |
| June         | 12          | 171,600          | 128,700          | 42,900         |
| July         | 9           | 128,700          | 96,600           | 32,100         |
| August       | 9           | 128,700          | 96,600           | 32,100         |
| September    | 7           | 100,100          | 75,100           | 25,000         |
| October      | 7           | 100,100          | 75,100           | 25,000         |
| November     | 6           | 85,800           | 64,300           | 21,500         |
| December     | 5           | 71,500           | 53,600           | 17,900         |
| <b>Total</b> | <b>100%</b> | <b>1,430,000</b> | <b>1,072,600</b> | <b>357,400</b> |

Note: *General Operating Expenses* and *Depreciation* will be spread evenly throughout the year.

|                                    |   |                |   |                        |
|------------------------------------|---|----------------|---|------------------------|
| MONTHLY General Operating Expenses | = | \$307,200 / 12 | = | \$25,600 <i>Line 4</i> |
| + MONTHLY Depreciation             | = | 7,200 / 12     | = | \$600 <i>Line 5</i>    |
| <hr/>                              |   |                |   | <hr/>                  |
| <i>Total Operating Expenses</i>    | = |                | = | <i>\$26,200 Line 6</i> |

## END OF DVD ACTIVITY



### Purpose:

Get participants working on the case study and practice building a profit plan.

### Materials:

- Pens/Pencils
- Calculators
- Profit Plan from Case Study

### Case Study Assignment #1

Filling Out Profit Plan

#### Procedure:

1. Working with their pairs, have participants complete the Profit Plan through June (through Line 9).

## NOTES ON THE VIDEO PRESENTATION

*Section 4, Chapter 2c: Finish Cash Flow - Lending Section*

### How to Graph:

Take out Cash Budget Graph

Line 1: Total Sales

Line 9: Profits Before Tax

Line 25: Cash Position



Fill out the graph in your own case study materials.

## END OF DVD ACTIVITY



### Purpose:

Give the participants a visual picture of the differences between Total Sales, Net Profit and Ending Cash.

### Materials:

- Pens/Pencils
- Calculators
- Completed Profit Plan & Cash Flow Graph

### Case Study Assignment #4

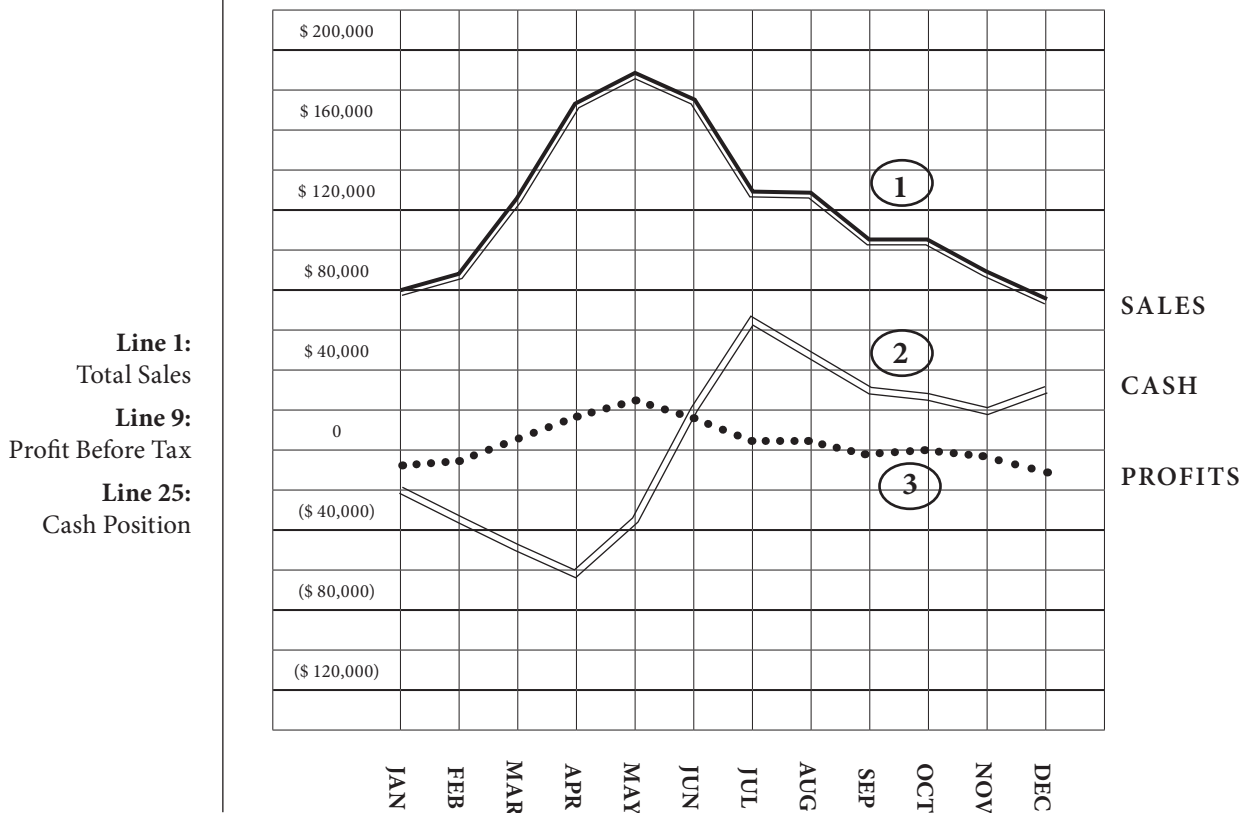
Graph the Cash Flow

#### Procedure:

From your completed Profit Plan and Cash Flow Worksheets:

1. Have participants take out Cash Budget Graph.
2. Take line one, total sales, place a dot at each month on the graph, then connect the dots.
3. Take line nine, net profits, place a dot at each month on the graph, then connect the dots.
4. Take line twenty-five, ending cash position, place a dot at each month on the graph, then connect the dots.
5. Use different colors or linestyles to graph each line.

#### CASH BUDGET GRAPH:



**Line 1:**  
Total Sales

**Line 9:**  
Profit Before Tax

**Line 25:**  
Cash Position

SALES

CASH

PROFITS

## WARM UP ACTIVITY

### Warm Up Activity #1:

Thinking About and Planning for Growth

Thinking about your own business, what kind of assets and liabilities can vary with your sales?

What kind of assets or liabilities vary only with significant increases in sales?

What is the impact on a service company of sales growth?

1. Discussion: List different business models. Which ones are most impacted on the balance sheet by sales growth:

- Restaurants
- Hair Salons
- Manufacturers
- Training Companies

2. Now read the Introduction to the Evergreen Case Study on page 5:6.



*Not one of the good-to-great companies focused obsessively on growth.*

Jim Collins

“Good to Great”

## DVD PRESENTATION BEGINS



### Section 5, Chapter 1: Intro Growth's Impact on Balance Sheet

19 minutes

#### Facilitator Tip:

Participants can find the  
Evergreen Case Study on  
page 5:6.

Review Evergreen Distributing at \$600,000 on page 5:6. Demonstrate how to add going down the left-hand side of the balance sheet, and subtract going up the right-hand side of the balance sheet.

Important to note: subtracting going up is counter-intuitive and confusing: be sure they understand the process before starting the video.

Also, explain how to calculate a new net worth. In the case study, you take 3% of the projected sales added to the old net worth of \$286,000. The totals are \$313,000 of new net worth at \$900,000 in sales and \$334,000 of new net worth at \$1.6 million in sales.

Reviewing these two processes before you start the video will help your participants follow along efficiently.

Ask the participants to open their guides to page 5: 4 and follow along with the DVD.

Start the DVD.

## NOTES ON THE VIDEO PRESENTATION

Section 5, Chapter 1: Intro to Growth's Impact on Balance Sheet

### Seven Steps - Where are we?

1. Plan Properly
2. Monitor Financial Position
3. Understand Price - Volume - Costs
4. Manage Cash Flow
5. **Manage Growth**
6. Properly Finance Business
7. Plan for Transition



**Financial Gap** is the difference between the money you \_\_\_\_\_  
and the money you \_\_\_\_\_

### Learning Objectives

- Understand why growth costs money
- Forecast what you'll need to grow
- Learn how better management will help
- Answer what you need to borrow and when you will pay it back

Growth is recorded on the income statement,

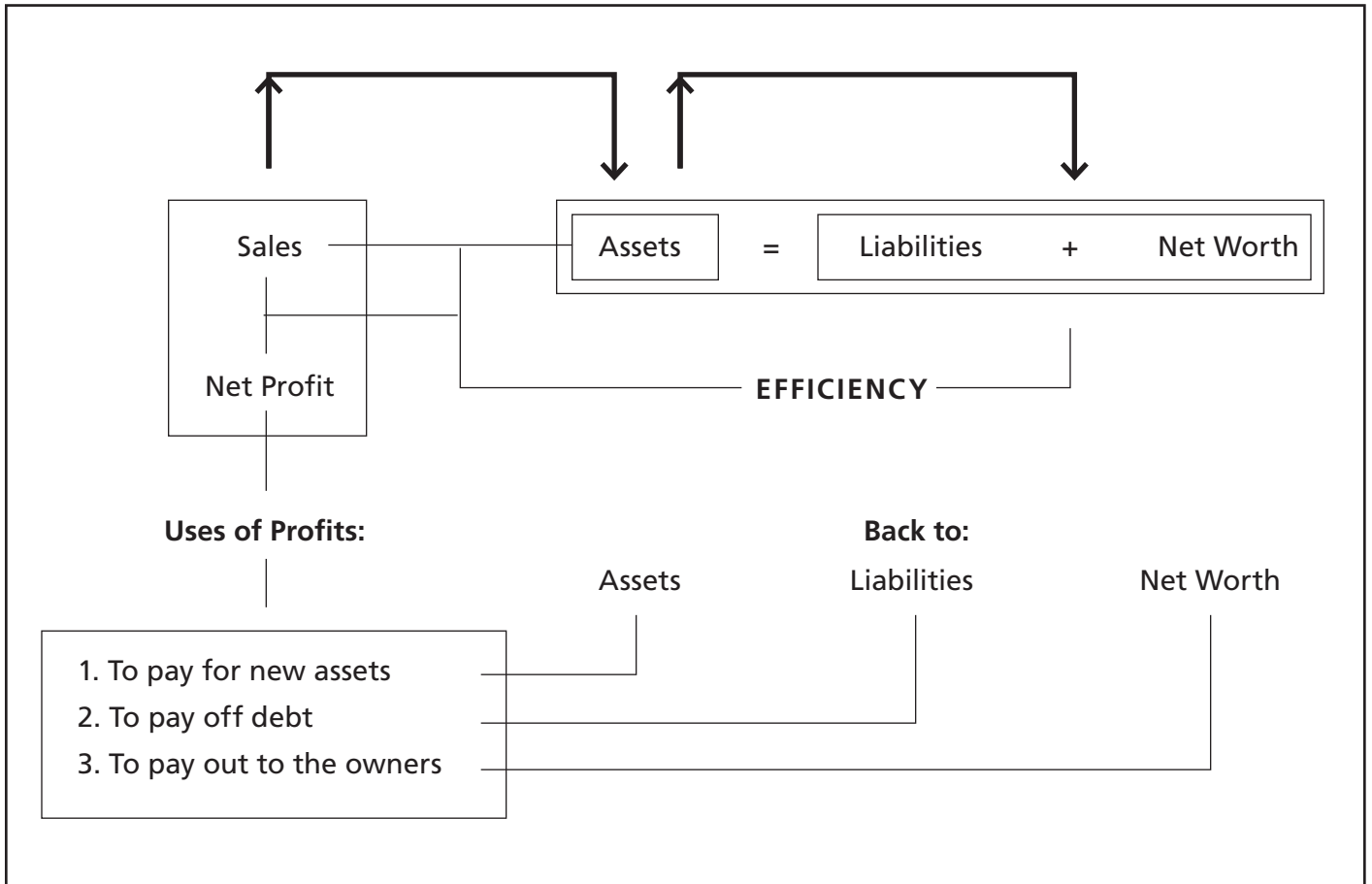
but *paid for* on the \_\_\_\_\_

## NOTES ON THE VIDEO PRESENTATION

Section 5, Chapter 1: Intro to Growth's Impact on Balance Sheet



### Financial Operating Cycle



When business owners talk about growth, what are they typically talking about?

#### Sources of Money to Grow

1. \_\_\_\_\_
2. \_\_\_\_\_
3. \_\_\_\_\_
4. \_\_\_\_\_

## NOTES ON THE VIDEO PRESENTATION

Section 5, Chapter 1: Intro to Growth's Impact on Balance Sheet



### Evergreen Distributing - Sales at \$600,000

Evergreen Distributing is a small, local supplier of Olympic Flooring. Recently, however, their sales have begun to increase rapidly. In the year just completed, sales reached \$600,000, and now they have a real opportunity — and a decision to make:

If they continue on their present course, they expect sales to rise to \$900,000.

If they “go for it” they figure they can reach \$1,600,000 in sales next year.

In either case, they expect profits to remain the same as they were this year:

**Net Profit After Tax: 3% of Sales**

For the year just completed—sales of \$600,000—the balance sheet looked like this:

| Assets                      |                | % of Sales* | Liabilities                              |                | % of Sales*     |
|-----------------------------|----------------|-------------|--|----------------|-----------------|
| Cash                        | \$24,000       | 4%          | Notes Payable                            |                | Financial Gap = |
| Accounts Receivable         | 108,000        | 18%         | Accounts Payable                         | \$90,000       | -               |
| Inventory                   | 156,000        | 26%         | Accruals                                 | 42,000         | -               |
| <b>Total Current Assets</b> | <b>288,000</b> |             | <b>Total Current Liabilities</b>         | <b>132,000</b> | =               |
| Equipment                   | 150,000        | 25%         | Long-Term Liabilities                    | 140,000        | -               |
| Land/Building (fixed)       | 120,000        |             | <b>Total Liabilities</b>                 | <b>272,000</b> | =               |
| <b>Total Fixed Assets</b>   | <b>270,000</b> |             | Net Worth                                | 286,000        | -               |
| <b>Total Assets</b>         | <b>558,000</b> |             | <b>Total Liabilities &amp; Net Worth</b> | <b>558,000</b> |                 |

**Subtract Going Up**

\*Assets and liabilities that vary with sales are indicated by an entry in the percent-of-sales column. Variable assets (as a percent of sales) are:  $4\% + 18\% + 26\% + 25\% = 73\%$ . This, in turn, is equal to  $Total\ Variable\ Assets / Total\ Sales = 438,000 / 600,000 = .73$

#### Key Tip:

Each variable balance sheet category is calculated as a percent of sales.

#### Next Up:

Work through Evergreen at \$900,000 balance sheet on your own.

## END OF CHAPTER ONE

Why do some balance sheet numbers have no percentage signs beside them?

Because they are non-variable; meaning they do not vary with sales.

Financial Gap Analysis creates a strategic link between the Income Statement, where growth is measured in terms of Sales, and the Balance Sheet, where we oftentimes pay for growth. Steve identified the balance sheet link in terms of a Percentage of Sales relationship; in other words, at a given point in time, what do certain assets and/or liabilities on our balance sheet represent as a percent of the company's sales? Steve was really identifying two things:

1. Which of the company's Assets or Liabilities were Variable (eg: if sales rise or fall, those assets or liabilities will rise or fall)? And:
2. What was the relationship between those Variable Assets and Variable Liabilities as a Percentage of Sales?

For instance, at Evergreen's real year-end, its Cash represented 4% of the Evergreen's sales for the year ( $\$24\text{K Cash} \div \$600\text{K Sales} = .04$ ). What this said in words was: "Last year, for every \$1 in Sales, there was \$.04 in Cash." Or another way of saying it is: "Last year, for every \$1 in Sales, they needed \$.04 in Cash to help produce \$1 in Sales." Percentage relationships were then developed between the rest of Evergreen's variable Assets and Liabilities. These relationships are actually a reflection of the efficiency with which the company had managed its balance sheet to produce its sales for the past year. And, we assumed that the efficiencies that we had identified from the past would remain consistent into the future — thus allowing us to project what the balance sheet might look like at given levels of future sales.

You may have noticed that not every Asset or Liability had a percentage number next to it. That's because not all Assets or Liabilities vary with sales. For instance, Land & Buildings on the Asset side, and Long-Term Debt on the Liability side weren't variable, so there was no percentage of sales relationship to identify for those items.



*"Hold 'er Newt, she's headed for the rhubarb!"*

Steve LeFever  
Translation: your company is out of control and headed for trouble!



## END OF VIDEO ACTIVITY

### Case Study Assignment #1 - Evergreen at \$900,000

Work through Evergreen at \$900,000 option on your own or with a facilitator. First, calculate a new net worth which is 3% of projected sales of \$900,000 added to the old net worth of \$286,000 and put in the \*new net worth line.

Fill in numbers, project the balance sheet, and do the ratios.



Why do some balance sheet number have no % beside them?

1. What do ratios imply?
2. What do trends imply?
3. What does it say to the bank?
4. Where do you think the bank would like them to be?
- 5.

| Evergreen Distributing Balance Sheet |                  | % of Sales* |  |                  | % of Sales*          |
|--------------------------------------|------------------|-------------|--|------------------|----------------------|
| Cash                                 | \$36,000         | 4%          | Notes Payable                                | <b>\$126,000</b> | <b>Financial Gap</b> |
| Accounts Receivable                  | 162,000          | 18%         | Accounts Payable                             | 135,000          | 15%                  |
| Inventory                            | 234,000          | 26%         | Accruals                                     | 63,000           | 7%                   |
| <b>Total Current Assets</b>          | <b>\$432,000</b> |             | <b>Total Current Liabilities</b>             | <b>\$324,000</b> |                      |
| Equipment                            | 225,000          | 25%         | Long-Term Liabilities                        | 140,000          |                      |
| Land/Building                        | 120,000          |             | Total Liabilities                            | 464,000          |                      |
| Total Fixed Assets                   | 345,000          |             | *New Net Worth<br>(old Net Worth* = 286,000) | 313,000          |                      |
| <b>Total Assets</b>                  | <b>\$777,000</b> |             | <b>Total Liabilities &amp; Net Worth</b>     | <b>\$777,000</b> |                      |

|                                     | Derivation  | Definition   |      |
|-------------------------------------|---|--|------|
| Current Ratio                       | $\frac{\text{Current Assets}}{\text{Current Liabilities}}$            | Measures solvency:<br><i>the company's ability to pay its bills.</i>   | 1.33 |
| Quick Ratio<br>(or acid test ratio) | $\frac{\text{Cash} + \text{Accts. Rec.}}{\text{Current Liabilities}}$ | Measures liquidity:<br><i>the company's ability to generate cash; to pay bills without relying on the sale of inventories.</i> | .61  |
| Debt-to-Net Worth                   | $\frac{\text{Total Liabilities}}{\text{Net Worth}}$                   | Measures the company's ability yo withstand adversity:<br><i>shows the riskiness of the company</i>                            | 1.48 |

## END OF VIDEO ACTIVITY

### Case Study Assignment #1 - Evergreen at \$900,000

Work through Evergreen at \$900,000 option on your own or with a facilitator. First, calculate a new net worth which is 3% of projected sales of \$900,000 added to the old net worth of \$286,000 and put in the \*new net worth line. Fill in numbers, project the balance sheet, and do the ratios.



1. Why do some balance sheet number have no % beside them?
2. What do ratios imply?
3. What do trends imply?
4. What does it say to the bank?
5. Where do you think the bank would like them to be?

| Evergreen Distributing Balance Sheet |         | % of Sales* |  | % of Sales*          |
|--------------------------------------|---------|-------------|--|----------------------|
| Cash                                 |         | 4%          | Notes Payable                                | <b>Financial Gap</b> |
| Accounts Receivable                  |         | 18%         | Accounts Payable                             | 15%                  |
| Inventory                            |         | 26%         | Accruals                                     | 7%                   |
| <b>Total Current Assets</b>          |         |             | <b>Total Current Liabilities</b>             |                      |
| Equipment                            |         | 25%         | Long-Term Liabilities                        | 140,000              |
| Land/Building                        | 120,000 |             | Total Liabilities                            |                      |
| Total Fixed Assets                   |         |             | *New Net Worth<br>(old Net Worth* = 286,000) |                      |
| <b>Total Assets</b>                  |         |             | <b>Total Liabilities &amp; Net Worth</b>     |                      |

|                                     | Derivation  | Definition   |
|-------------------------------------|---|--|
| Current Ratio                       | $\frac{\text{Current Assets}}{\text{Current Liabilities}}$            | Measures solvency:<br><i>the company's ability to pay its bills.</i>   |
| Quick Ratio<br>(or acid test ratio) | $\frac{\text{Cash} + \text{Accts. Rec.}}{\text{Current Liabilities}}$ | Measures liquidity:<br><i>the company's ability to generate cash; to pay bills without relying on the sale of inventories.</i> |
| Debt-to-Net Worth                   | $\frac{\text{Total Liabilities}}{\text{Net Worth}}$                   | Measures the company's ability to withstand adversity:<br><i>shows the riskiness of the company</i>                            |

## DVD PRESENTATION BEGINS



Section 5, Chapter 2:  
Evergreen at \$900,000

16 minutes

Ask the participants to open their guides to page 5: 8 and follow along with the DVD.

Start the DVD

## NOTES ON THE VIDEO PRESENTATION

Section 5, Chapter 2: Evergreen at \$900,000



We want to find the impact of growth on cash and capital so we don't get any Gaps!

### Evergreen at \$900,000

| Evergreen Distributing Balance Sheet |                  | % of Sales* |  | % of Sales*      |                      |
|--------------------------------------|------------------|-------------|--|------------------|----------------------|
| Cash                                 | \$36,000         | 4%          | Notes Payable                            | <b>\$126,000</b> | <b>Financial Gap</b> |
| Accounts Receivable                  | 162,000          | 18%         | Accounts Payable                         | 135,000          | 15%                  |
| Inventory                            | 234,000          | 26%         | Accruals                                 | 63,000           | 7%                   |
| <b>Total Current Assets</b>          | <b>\$432,000</b> |             | <b>Total Current Liabilities</b>         | <b>\$324,000</b> |                      |
| Equipment                            | 225,000          | 25%         | Long-Term Liabilities                    | 140,000          |                      |
| Land/Building                        | 120,000          |             | Total Liabilities                        | 464,000          |                      |
| Total Fixed Assets                   | 345,000          |             | Net Worth<br>(old Net Worth* = 286,000)  | 313,000          |                      |
| <b>Total Assets</b>                  | <b>\$777,000</b> |             | <b>Total Liabilities &amp; Net Worth</b> | <b>\$777,000</b> |                      |

## BALANCE SHEET RATIO REVIEW

Reference Guide

|   | Derivation  | Definition   |
|---|---|--|
| <b>SOLVENCY</b><br>Current Ratio                        | $\frac{\text{Current Assets}}{\text{Current Liabilities}}$            | Measures solvency:<br><i>the company's ability to pay its bills.</i>   |
| <b>LIQUIDITY</b><br>Quick Ratio<br>(or acid test ratio) | $\frac{\text{Cash} + \text{Accts. Rec.}}{\text{Current Liabilities}}$ | Measures liquidity:<br><i>the company's ability to generate cash; to pay bills without relying on the sale of inventories.</i> |
| <b>LEVERAGE</b><br>Debt-to-Net Worth                    | $\frac{\text{Total Liabilities}}{\text{Net Worth}}$                   | Measures the company's ability to withstand adversity:<br><i>shows the riskiness of the company</i>                            |

## END OF DVD ACTIVITY



### Case Study Assignment #1, cont.:

Evergreen Ratio Analysis

Procedure:

Calculate the following Balance Sheet Ratios for Evergreen Distributing at \$600k and \$900k.

### Balance Sheet Ratios

|                      | At \$600,000 | At \$900,000 |
|----------------------|--------------|--------------|
| <b>CURRENT</b>       | 2.18         | 1.33         |
| <b>QUICK</b>         | 1.00         | .061         |
| <b>DEBT-TO-WORTH</b> | .095         | 1.48         |

|                      |                     | At \$600,000     | At \$900,000     |
|----------------------|---------------------|------------------|------------------|
| <b>CURRENT</b>       | Current Assets      | 288,000          | 432,000          |
|                      | Current Liabilities | 132,000          | 324,000          |
| <b>QUICK</b>         | Cash + Accts. Rec.  | 24,000 + 108,000 | 36,000 + 162,000 |
|                      | Current Liabilities | 132,000          | 324,000          |
| <b>DEBT-TO-WORTH</b> | Total Liabilities   | 272,000          | 464,000          |
|                      | Net Worth           | 286,000          | 313,000          |

## END OF DVD ACTIVITY

### Case Study Assignment #1, cont.:

Evergreen Ratio Analysis

Procedure:

Calculate the following Balance Sheet Ratios for Evergreen Distributing at \$600k and \$900k.



### Balance Sheet Ratios

|                      | At \$600,000 | At \$900,000 |
|----------------------|--------------|--------------|
| <b>CURRENT</b>       |              |              |
| <b>QUICK</b>         |              |              |
| <b>DEBT-TO-WORTH</b> |              |              |

|                      |  |
|----------------------|--|
| <b>CURRENT</b>       | $\frac{\text{Current Assets}}{\text{Current Liabilities}}$     |
| <b>QUICK</b>         | $\frac{\text{Cash + Accts. Rec.}}{\text{Current Liabilities}}$ |
| <b>DEBT-TO-WORTH</b> | $\frac{\text{Total Liabilities}}{\text{Net Worth}}$            |

## DVD PRESENTATION BEGINS



Section 5, Chapter 2a:  
Evergreen at \$600,000  
vs. \$900,000

6 minutes

Ask the participants to open their guides to page 5:10 and follow along with the DVD.

Start the DVD.

## NOTES ON THE VIDEO PRESENTATION

Section 5, Chapter 2a: Evergreen at \$600k vs. \$900k

### Balance Sheet Ratios

|                      |  | At<br>\$600,000 | At<br>\$900,000 |
|----------------------|--|-----------------|-----------------|
| <b>CURRENT</b>       | $\frac{\text{Current Assets}}{\text{Current Liabilities}}$     | 2.18            | 1.33            |
|                      |  |                 |                 |
| <b>QUICK</b>         | $\frac{\text{Cash + Accts. Rec.}}{\text{Current Liabilities}}$ | 1.00            | 0.61            |
|                      |  |                 |                 |
| <b>DEBT-TO-WORTH</b> | $\frac{\text{Total Liabilities}}{\text{Net Worth}}$            | 0.95            | 1.48            |
|                      |  |                 |                 |



*You never know. So don't assume that you should. Plan for several possible futures.*

Harry Beckworth  
"Selling the Invisible"

Is Evergreen a bad company at \$600,000? At \$900,000?

What kind of growth is bad?

What makes it efficient and managed vs. out of control?

Now on to Evergreen at \$1,600,000.

## END OF DVD ACTIVITY

### Case Study Assignment #2:

Calculate Evergreen's Balance Sheet and ratios at **\$1.6 M.**

\* Net Profit at 3% of Sales



First, calculate a new net worth which is 3% of projected sales of \$1.6 M added to the old net worth of \$286,000 and put in the \*new net worth line.

Fill in numbers, project the balance sheet, and do the ratios.

Procedure:

Have participants calculate the ratios on page 5: 11.

| Evergreen Distributing Balance Sheet |                  | % of Sales* |  |                    | % of Sales*          |
|--------------------------------------|------------------|-------------|--|--------------------|----------------------|
| Cash                                 | \$64,000         | 4%          | Notes Payable                                | \$462,000          | <b>Financial Gap</b> |
| Accounts Receivable                  | 288,000          | 18%         | Accounts Payable                             | 240,000            | 15%                  |
| Inventory                            | 416,000          | 26%         | Accruals                                     | 112,000            | 7%                   |
| <b>Total Current Assets</b>          | <b>\$768,000</b> |             | <b>Total Current Liabilities</b>             | <b>\$814,000</b>   |                      |
| Equipment                            | 400,000          | 25%         | Long-Term Liabilities                        | 140,000            |                      |
| Land/Building                        | 120,000          |             | Total Liabilities                            | 954,000            |                      |
| Total Fixed Assets                   | 520,000          |             | *New Net Worth<br>(old Net Worth* = 286,000) | 334,000            |                      |
| <b>Total Assets</b>                  |                  |             | <b>Total Liabilities &amp; Net Worth</b>     | <b>\$1,288,000</b> |                      |

### Balance Sheet Ratios

#### Purpose:

Determine the impact of increased sales on Evergreen's ratios.

#### Materials:

Evergreen Distributing Case Study from Resource Area

|                      | At \$600,000 | At \$900,000 | At \$1,600,000 |
|----------------------|--------------|--------------|----------------|
| <b>CURRENT</b>       | 2.18         | 1.33         | .94            |
| <b>QUICK</b>         | 1.0          | .61          | .43            |
| <b>DEBT-TO-WORTH</b> | .95          | 1.48         | 2.86           |

## END OF DVD ACTIVITY

### Case Study Assignment #2:

Calculate Evergreen's Balance Sheet and ratios at **\$1.6 M.**

\* Net Profit at 3% of Sales

First, calculate a new net worth which is 3% of projected sales of \$1.6 M added to the old net worth of \$286,000 and put in the \*new net worth line. Fill in numbers, project the balance sheet, and do the ratios.



Procedure:

Complete the Balance Sheet and calculate the ratios below.

| Evergreen Distributing Balance Sheet |           | % of Sales* |  |           | % of Sales*          |
|--------------------------------------|-----------|-------------|--|-----------|----------------------|
| Cash                                 | \$        | 4%          | Notes Payable                                | \$        | <b>Financial Gap</b> |
| Accounts Receivable                  |           | 18%         | Accounts Payable                             |           |                      |
| Inventory                            |           | 26%         | Accruals                                     |           | 7%                   |
| <b>Total Current Assets</b>          | <b>\$</b> |             | <b>Total Current Liabilities</b>             | <b>\$</b> |                      |
| Equipment                            |           | 25%         | Long-Term Liabilities                        | 140,000   |                      |
| Land/Building                        | 120,000   |             | Total Liabilities                            |           |                      |
| Total Fixed Assets                   |           |             | *New Net Worth<br>(old Net Worth* = 286,000) |           |                      |
| <b>Total Assets</b>                  | <b>\$</b> |             | <b>Total Liabilities &amp; Net Worth</b>     | <b>\$</b> |                      |

### Balance Sheet Ratios

|                      | At \$600,000 | At \$900,000 | At \$1,600,000 |                      | Formulas  |
|----------------------|--------------|--------------|----------------|----------------------|---|
| <b>CURRENT</b>       |              |              |                | <b>CURRENT</b>       | $\frac{\text{Current Assets}}{\text{Current Liabilities}}$            |
| <b>QUICK</b>         |              |              |                | <b>QUICK</b>         | $\frac{\text{Cash} + \text{Accts. Rec.}}{\text{Current Liabilities}}$ |
| <b>DEBT-TO-WORTH</b> |              |              |                | <b>DEBT-TO-WORTH</b> | $\frac{\text{Total Liabilities}}{\text{Net Worth}}$                   |

## DVD PRESENTATION BEGINS



Section 5, Chapter 3:  
Gap Wrap-Up

44 minutes

Ask the participants to open their guides to page 5: 12 and follow along with the DVD.

Start the DVD

## NOTES ON THE VIDEO PRESENTATION

Section 5, Chapter 3: Financial Gap Wrap-Up

**Step 1:** Find the new net worth

**Step 2:** Follow the “Road Map”



### Evergreen \$1.6 M:

| Evergreen Distributing Balance Sheet |                    | % of Sales* |  | % of Sales*        |                      |
|--------------------------------------|--------------------|-------------|--|--------------------|----------------------|
| Cash                                 | \$64,000           | 4%          | Notes Payable                            | \$462,000          | <b>Financial Gap</b> |
| Accounts Receivable                  | 288,000            | 18%         | Accounts Payable                         | 240,000            | 15%                  |
| Inventory                            | 416,000            | 26%         | Accruals                                 | 112,000            | 7%                   |
| <b>Total Current Assets</b>          | <b>\$768,000</b>   |             | <b>Total Current Liabilities</b>         | <b>\$814,000</b>   |                      |
| Equipment                            | 400,000            | 25%         | Long-Term Liabilities                    | 140,000            |                      |
| Land/Building                        | 120,000            |             | Total Liabilities                        | 954,000            |                      |
| Total Fixed Assets                   | 520,000            |             | Net Worth<br>(old Net Worth* = 286,000)  | 334,000            |                      |
| <b>Total Assets</b>                  | <b>\$1,288,000</b> |             | <b>Total Liabilities &amp; Net Worth</b> | <b>\$1,288,000</b> |                      |

### Balance Sheet Ratios:

|                      | At \$600,000 | At \$900,000 | At \$1,600,000 |
|----------------------|--------------|--------------|----------------|
| <b>CURRENT</b>       | 2.18         | 1.33         | 0.94           |
| <b>QUICK</b>         | 1.00         | 0.61         | 0.43           |
| <b>DEBT-TO-WORTH</b> | 0.95         | 1.48         | 2.86           |

## NOTES ON THE VIDEO PRESENTATION

Section 5, Chapter 3: Financial Gap Wrap-Up



What do we see?

Ability to: pay bills, generate cash, manage risk has deteriorated.

He's traded off growth on the income statement for debt on the balance sheet.

Is he too risky?

Is this too much growth in one year?

Management strategies that make a difference and lessen risk:

Experience

Vision

Plan

If you don't like what you see, what can you do?

### Management Efficiencies Checklist

- \_\_\_\_\_ Manage Current Assets (inventory & receivables)
- \_\_\_\_\_ Restructure Debt
- \_\_\_\_\_ Make More Profit
- \_\_\_\_\_ Sell Existing Unproductive Assets
- \_\_\_\_\_ Curtail Expansion
- \_\_\_\_\_ Lease Fixed Assets
- \_\_\_\_\_ Sale / Leaseback of Existing Fixed Assets
- \_\_\_\_\_ Accept More Risk
- \_\_\_\_\_ Don't Grow
- \_\_\_\_\_ Get New Equity

**NOTES ON THE VIDEO PRESENTATION**  
 Section 5, Chapter 3: Financial Gap Wrap-Up



**Evergreen at \$900,000**

You can't grow if you can't pay for it!

**Manage Inventory Turnover**

Here's the math:

Cost of Goods Sold is 70% of sales:

$$\$900,000 \times 70\% = \$630,000$$

$$\begin{aligned} \text{INVENTORY TURNOVER} &= \frac{\text{Cost of Goods Sold}}{\text{Inventory}} \\ &= \frac{\$630}{\$234} \\ &= 2.7 \text{ turns per year} \end{aligned}$$

$$\begin{aligned} \text{INVENTORY TURN-DAYS} &= \frac{360 \text{ days}}{\text{Inventory Turnover}} \\ &= \frac{360}{2.7} \\ &= 133 \text{ days} \end{aligned}$$

$$4 \text{ TURNS} = 90 \text{ days}$$

$$\begin{aligned} \text{TARGET INVENTORY} &= \frac{\text{Cost of Goods Sold}}{\text{Inventory Turnover}} \\ &= \frac{\$630,000}{4} \end{aligned}$$

|                           |           |
|---------------------------|-----------|
| Inventory at 2.7 turns:   | \$234,000 |
| - Inventory at 4.0 turns: | \$157,500 |
| Inventory Savings:        | \$76,500  |

**NOTES ON THE VIDEO PRESENTATION**  
 Section 5, Chapter 3: Financial Gap Wrap-Up



**Manage Accounts Receivable**

Here's the math:

$$\begin{aligned} \text{RECEIVABLE TURNOVER} &= \frac{\text{Credit Sales}}{\text{A/R}} \\ &= \frac{\$900,000}{\$162,000} \\ &= 5.6 \text{ turns} \end{aligned}$$

$$\text{AVERAGE COLLECTION PERIOD} = \frac{360 \text{ days}}{\text{A/R Turnover}}$$

$$\begin{aligned} (\text{ACCOUNTS RECEIVABLE TURN DAYS}) &= \frac{360}{5.6} \\ &= 64 \text{ days} \end{aligned}$$

A/R collection reduced to 45 days

$$\begin{aligned} \text{ACCOUNTS RECEIVABLE TURNOVER} &= \frac{360 \text{ days}}{\text{Average Collection Period}} \\ &= \frac{360}{45} \\ &= 8 \text{ turns} \end{aligned}$$

$$\begin{aligned} \text{TARGET ACCOUNTS RECEIVABLE} &= \frac{\text{Credit Sales}}{\text{Target A/R Turnover}} \\ &= \frac{\$900,000}{8} \end{aligned}$$

|                            |                    |
|----------------------------|--------------------|
| <i>A/R at 5.6 turns:</i>   | <i>\$162,000</i>   |
| <i>- A/R at 8.0 turns:</i> | <i>- \$112,500</i> |
| <i>A/R Savings:</i>        | <i>\$49,500</i>    |

## NOTES ON THE VIDEO PRESENTATION

Section 5, Chapter 3: Financial Gap Wrap-Up

### Refinancing Debt

Take 80% of the \$75,000 that was used to buy new equipment and move it into long-term debt. (\$60,000 moved to long-term debt.)



### Evergreen "Managed" at \$900k

Here's what the ratios looked like when he applies better management:

| Evergreen Distributing Balance Sheet |                  | % of Sales* |  |                  | % of Sales*          |
|--------------------------------------|------------------|-------------|--|------------------|----------------------|
| Cash                                 | \$36,000         | 4%          | Notes Payable                            | 0                | <b>Financial Gap</b> |
| Accounts Receivable                  | 112,000          | 12%         | Accounts Payable                         | 75,000           | 15%                  |
| Inventory                            | 157,000          | 17%         | Accruals                                 | 63,000           | 7%                   |
| <b>Total Current Assets</b>          | <b>\$306,000</b> |             | <b>Total Current Liabilities</b>         | <b>\$138,000</b> |                      |
| Equipment                            | 225,000          | 25%         | Long-Term Liabilities                    | 200,000          |                      |
| Land/Building                        | 120,000          |             | Total Liabilities                        | 338,000          |                      |
| Total Fixed Assets                   | 345,000          |             | Net Worth<br>(old Net Worth* = 286,000)  | 313,000          |                      |
| <b>Total Assets</b>                  | <b>\$651,000</b> |             | <b>Total Liabilities &amp; Net Worth</b> | <b>\$651,000</b> |                      |

### Balance Sheet Ratios:

|                      | At \$600,000 | At \$900,000 | At \$900,000<br>"Managed" |
|----------------------|--------------|--------------|---------------------------|
| <b>CURRENT</b>       | 2.18         | 1.33         | 2.22                      |
| <b>QUICK</b>         | 1.00         | 0.61         | 1.08                      |
| <b>DEBT-TO-WORTH</b> | 0.95         | 1.48         | 1.08                      |

### Summary:

*With a managed Balance Sheet, he:*

Borrows less  
Shrinks down the gap between borrower and lender.

*It's a great tool!*

## SECTION SUMMARY

### *Closing*



The “moral” of Financial Gap Analysis is two-fold:

1. Understand the potential cost of growth, and the related consequences of growth, before the costs and consequences happen. Give yourself **time** to **plan** for your future.
2. Get the company’s financial “house” in order as efficiently as you can right **now**, so that as the business grows, its naturally decreasing efficiencies will have less of a negative financial impact.

### *The Sponge Technique*

The “**Sponge Technique**” provides owners and managers with a tool with which to ask “what if” questions. What if we managed certain areas of the business differently (more efficiently) in the future? Could that change in management behavior help reduce the amount of new capital we might need to help pay for future growth? What can we manage better, how will we achieve the desired efficiency, what will it do for us, does this make sense (can we do it, is it reasonable)?

*Get Control, Keep Control, Be Efficient!*

## PREVIEW OF NEXT SECTION

Our next, and final section, deals with how to successfully finance your company and think ahead to transitioning your business.

If you apply all the tools you've been given in the previous sections, we guarantee you'll be miles ahead of your competition for financing funds.

