Behind the Numbers
Optimizing Financial Performance

GETTING THE MOST OUT OF YOUR INCOME STATEMENT
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Let’s talk about numbers ...

0% margin sales
Cost structure
Variable cost %
0% margin units
Fixed Costs
Contribution margin
Impact of price increase
Variable costs
Impact of price decrease
• Balance Sheet –

  • **Assets**: What we own (real estate, equipment)
  • **Liabilities**: What we owe (debts).
  • **Equity**: What’s left.
  • \( A = L + OE \)
  • Reflects the aggregation of all managements decisions and how cash is affected.
  • Each category is **either** a source of cash or a use of cash.
Balance Sheet

Assets: Increase assets = Use of cash
Decrease Assets = Source of cash

Liabilities: Increase = Source of Cash
Decrease = Use of Cash

Equity: Increase = Source of Cash
Decrease = Use of Cash
Income Statement

- Portrays Revenue and Income from customers
- Less production costs
- Less overhead and operating expenses to produce?
- Net Income
- It is not a cash flow statement!!!
- Is profitability a source or use of cash??
- Does profit = cash?????
Income Statement

Revenues
- Expenses
Net income

$400
256

$144

Statement of Retained Earnings

Retained earnings, June 1
+ Net income
- Dividends
Retained earnings, June 30

0
144
0

$144

Balance Sheet

Total assets
Liabilities
Contributed capital
Retained earnings
Total liabilities and equity

$444
200
100
144
$444
Normal Income Statement

Sales

- Cost of Goods Sold

Gross Margin

- Fixed Expenses

Profit
Normal Income Statement

Sales
- Cost of Goods Sold
  Gross Margin
- Fixed Expenses
  Net Profit

Managed Income Statement

Sales
- Variable Costs (VC)
  Contribution Margin
- Fixed Costs (FC)
  0% Margin
John’s Hat Company
($10.00 selling price; $75,000 fixed costs)

Hat cost $4.00
Commission .50
Variable Costs (=CoGS) $4.50

VC as % of Sale Price 45%
(Var. Cost divided by Selling Price)

What’s left to cover Fixed Costs?
John’s Hat Company

Selling price $10.00
- Variable Cost % 45%

**Contribution Margin**

55% = $5.50

“What’s left” to pay Fixed Costs
Cost Structure of John’s Hat Company

Variable Cost %  45%
Fixed costs       $75,000

0% margin sales (no profit, no loss) = FC/CM

With above cost structure,
0% margin = FC/CM% = $75,000/0.55 = $136,364
If sales increase by $1.00 to $136,365, how much does the company make in profit?

$1.00 – $0.45 = $0.55

If sales increase by $2.00?

2 X $0.55 = $1.10

If sales increase by $100?

100 X $0.55 = $55.00
If fixed costs increase by $23,000 to hire a new employee, how much in additional sales needed to breakeven?

\[ \frac{23,000}{.55} = \$41,818 \]

If the company plans to earn a $40,000 profit, how much in additional sales needed to breakeven?

\[ \frac{40,000}{.55} = \$72,727 \]

*Note: Every $1.00 more in FC means $1/CM = \$1/.55 = \$1.82 in new sales needed to reach 0% margin.*
Steps to Computing Breakeven Sales

1. Classify costs on income statement as FC or VC, total.
2. Compute VC as % of sales (VC/Sales).
3. Determine CM \((1 - VC\%) = CM\%\).
4. Divide FC by CM\%.
Larry's Landscaping & Garden Supply
Profit & Loss
October 2011 through September 2012

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<thead>
<tr>
<th>Oct '11 - Sep 12</th>
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<tbody>
<tr>
<td><strong>Ordinary Income/Expense</strong></td>
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<tr>
<td><strong>Income</strong></td>
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<tr>
<td>Landscaping Services</td>
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<td>Markup Income</td>
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<td>Retail Sales</td>
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<tr>
<td>Service</td>
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<td><strong>Total Income</strong></td>
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<td><strong>Cost of Goods Sold</strong></td>
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<td><strong>Total COGS</strong></td>
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<td><strong>Gross Profit</strong></td>
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<td><strong>Expense</strong></td>
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<td>Payroll Expenses</td>
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<td>Automobile</td>
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<td>Bank Service Charges</td>
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<td>Professional Fees</td>
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<td>Rent</td>
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<tr>
<td>Tools and Misc. Equipment</td>
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<td>Uncategorized Expenses</td>
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<td>Utilities</td>
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<tr>
<td><strong>Total Expense</strong></td>
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<td><strong>Net Ordinary Income</strong></td>
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<td><strong>Other Income/Expense</strong></td>
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<tr>
<td><strong>Other Income</strong></td>
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<td>Misc Income</td>
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<td>Interest Income</td>
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<td><strong>Total Other Income</strong></td>
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<tr>
<td><strong>Net Other Income</strong></td>
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<tr>
<td><strong>Net Income</strong></td>
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</tbody>
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Computing 0% Margin by Units

\[ \$10 - 4.50 = \$5.50 \]

0% margin units = \( \frac{\text{FC}}{\text{CM per unit}} \)
= \( \frac{\$75,000}{\$5.50} \)
= 13,636 units
Impact of Price Increase

5% increase in selling price = $0.50
Then $10.50 - $4.50 = $6.00

New BE = FC/CM
= $75,000/$6.00
= 12,500 units, down 1,136 units (8%)

Increase selling price 5%, MAY sell 8% less and still reach 0% margin.
Impact of Price Decrease

5% decrease in selling price = $.50
   Then $9.50 - $4.50 = $5.00

New 0% margin = FC/(CM per unit)
   = $75,000/$5.00
   = 15,000 units, up 1,364 units (10%)

Decrease selling price 5%, **MUST** sell 10% more to reach 0% margin.
Impact of Price Changes Summary

Increase selling price 5%, *MAY* sell 8% less and still breakeven.

Decrease selling price 5%, *MUST* sell 10% more to breakeven.
1. The choice is yours: you can manage your income statement or it will manage you.
2. You have complete control over every aspect of your business.
3. Proper planning will help you avoid crisis.
4. Attend a Profit Mastery class to take it to the next level.
Successful business owners

- Understand “Cash Is King”
- Work on business as well as in business
- Come with the end in mind
- Have a plan
- Must structure financing to buy back business
- Benchmark their business
- Do a strategic plan (SWOT)

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