Profit Mastery

Metrics Matters: Identifying and Implementing the Key Drivers of Unit Profitability (for Franchisees)
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Chairman  
Profit Mastery

Rod Bristol  
EVP  
Profit Mastery

Lisa Hafetz  
Profit Mastery
OBJECTIVES FOR TODAY’S SESSION:

● Discover the three key processes that drive unit profitability in every franchise network.

● Learn a specific new financial tool that enables franchisees to make better business decisions, customized specifically for QSR, B2B, and SERVICE industry franchises.
“In the entire franchise industry, Home Instead Senior Care ranks highest in franchisee satisfaction, and is the company many franchisors wish to emulate. Home Instead’s endless dedication to their franchisees and unit-level performance has put them in a very elite group of companies. It’s no coincidence that Home Instead uses the Profit Mastery program, and I’m confident it has played a significant role in their continued success.”

“Although there are numerous factors that drive franchisee satisfaction, franchisee financial success is at the core. As part of their commitment to franchisee success, Home Instead adopted and implemented the Profit Mastery system to drive unit level financial performance.”

Eric Stites, CEO and Managing Director, Franchise Business Review
What Drives Unit Profitability?

Financial Performance is a three-legged stool

- Education – Establishing the Foundation
- Benchmarking – Creating the Yardstick
- Performance Groups – Providing the Accountability and Discipline
Driving Financial Performance

Measure...
Monitor Financial Position

What Gets Measured, Gets Managed, and

What Gets Managed, Gets Done!
Seven Steps to Business Success

1. Plan properly before start up
2. Monitor financial position
3. Understand the relationship between price, volume, and costs
4. Manage cash flow
5. Manage growth
6. Borrow properly
7. Plan for transition
What Drives Unit Profitability?

Financial Performance is a three-legged stool

- Education – Establishing the Foundation
- Benchmarking – Creating the Yardstick
- Performance Groups – Providing the Accountability and Discipline
Section 2: The Financial Operating Cycle

Net Profits

Income Statement
- Sales
- Net Profit

Cash Flow

Balance Sheet
- Assets = Liabilities + Net Worth

Efficiency

Uses of Profits:
- To pay for New Assets
- To pay off Debt
- To pay out to Owners
## Cascade Office Systems
### Ratio Analysis Spreadsheet

<table>
<thead>
<tr>
<th></th>
<th>Year 1</th>
<th>Year 2</th>
<th>Year 3</th>
<th>Industry Composite</th>
<th>Calculations, Trends, or Observations</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>BALANCE SHEET RATIOS:</strong> Stability (or “Staying Power”)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
| 1. Current | Current Assets | 1.7 | 1.1 | 0.99 | 1.8 | 726,100  
Current Liabilities | | | | | | 734,400  
| 2. Quick | Cash + Accts. Rec. | 0.8 | 0.5 | 0.38 | 0.8 | 282,300  
Current Liabilities | | | | | | 734,400  
| 3. Debt-to-Worth | Total Liabilities | 1.5 | 1.4 | 2.68 | 1.2 | 823,700  
Net Worth | | | | | | 307,300  |
| **INCOME STATEMENT RATIOS:** Profitability (or “Earning Power”) | | | | | |
| 4. Gross Margin | Gross Profit | 21% | 20% | 18.5% | 22.2% | 400,000  
Sales | | | | | | 2,160,000  
| 5. Net Margin | Net Profit Before Tax | 3.5% | 3.0% | 0.29% | 3.2% | 6,300  
Sales | | | | | | 2,160,000  |
| **ASSET MANAGEMENT RATIOS:** Overall Efficiency Ratios | | | | | |
| 6. Sales-to-Assets | Sales | 2.3 | 2.3 | 1.9 | 2.4 | 2,160,000  
Total Assets | | | | | | 1,131,000  
| 7. Return on Assets | Net Profit Before Tax | 8.2% | 6.9% | 0.56% | 6.9% | 6,300  
Total Assets | | | | | | 1,131,000  
| 8. Return on Investment | Net Profit Before Tax | 20.9% | 16.5% | 2.0% | 15.8% | 6,300  
Net Worth | | | | | | 307,300  |
| **ASSET MANAGEMENT RATIOS:** Working Capital Cycle Ratios | | | | | |
| 9. Inventory Turnover | Cost of Goods Sold | 5.6 | 8.1 | 4.2 | 4.9 | 1,760,000  
Inventory | | | | | | 419,000  
| 10. Inventory Turn-Days | Inventory Turnover | 64 | 44 | 86 | 74 | 360  
| 11. Accounts Receivable Turnover | Accounts Receivable | 8.9 | 10 | 8 | 8.5 | 2,160,000  
Sales | | | | | | 270,000  
| 12. Accounts Receivable Turn-Days | Accts. Rec. Turnover | 40 | 36 | 45 | 43 | 360  
| 13. Accounts Payable Turnover | Cost of Goods Sold | 12 | 10.4 | 5.7 | 9.8 | 1,760,000  
Accounts Payable | | | | | | 310,100  
| 14. Average Payment Period | Accts. Pay. Turnover | 30 | 34 | 63 | 37 | 360  
| | | | | | | 5.7  |
The Road Map
Cause-and-effect relationships leading to financial distress.

HIGH CURRENT LIABILITIES
$126K (C)

HIGH BORROWING
$10K (P)

HIGH INTEREST

LOW CASH

$10K (P)

LOW PRODUCTIVITY
$38K (P)

POOR INVENTORY CONTROL

LOW GROSS MARGIN
$80K (P)

LOW REPAID EARNINGS

LOW NET PROFITS

LOW SALES

HIGH HIDDEN COSTS

POOR EXPENSE CONTROL

LOW SALES
$10K (P)

SHRINKAGE
$22K (P)

BOOKKEEPING ERRORS

POOR BUYING
$16K (C)

NOT ENOUGH INVENTORY

NOT ENOUGH CUSTOMER CREDIT

TOO MUCH INVENTORY

HIGH A/R

PROFIT MASTERY

Learn how to use the Road Map:
www.hbs-seattle.com/roadmap.html
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## Profit Mastery Assessment (PMA)
### Cascade Office Systems

<table>
<thead>
<tr>
<th>Issue</th>
<th>Cash</th>
<th>Profit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accts. Rec.</td>
<td>$16,000</td>
<td></td>
</tr>
<tr>
<td>Inventory</td>
<td>$60,000</td>
<td></td>
</tr>
<tr>
<td><strong>Hidden Costs</strong></td>
<td></td>
<td><strong>$19,000</strong></td>
</tr>
<tr>
<td>Gross Margin</td>
<td></td>
<td><strong>$80,000</strong></td>
</tr>
<tr>
<td>—Discounts</td>
<td></td>
<td>($10,000)</td>
</tr>
<tr>
<td>—Productivity</td>
<td></td>
<td>($38,000)</td>
</tr>
<tr>
<td>—Buying</td>
<td></td>
<td>($10,000)</td>
</tr>
<tr>
<td>—Pricing</td>
<td></td>
<td>($22,000)</td>
</tr>
<tr>
<td>Refinance</td>
<td><strong>$126,000</strong></td>
<td></td>
</tr>
<tr>
<td><strong>TOTALS</strong></td>
<td><strong>$202,000</strong></td>
<td><strong>$99,000</strong></td>
</tr>
</tbody>
</table>
Section 3: Break-Even

Test: How does a Business make a Profit?

Answer these two questions:

1) Needed Sales:

2) If FC ↑ $1.00, what sales required ________

VC = 70%
FC = $144,000
TP = $60,000
The Cup Theory
The Concept of Contribution Margin

Sales

Variable Cost Cup

Contribution Margin

Fixed Cost Cup

Net Profit Cup
# Section 4: Manage Cash Flow

## PROFIT PLAN / CASH BUDGET FOR OLYMPIC FLOORING

### A/R Collection Period: 60 days

<table>
<thead>
<tr>
<th>JAN</th>
<th>FEB</th>
<th>MAR</th>
<th>APR</th>
<th>MAY</th>
<th>JUN</th>
<th>JUL</th>
<th>AUG</th>
<th>SEP</th>
<th>OCT</th>
<th>NOV</th>
<th>DEC</th>
<th>TOTALS</th>
</tr>
</thead>
<tbody>
<tr>
<td>71,500</td>
<td>85,800</td>
<td>128,700</td>
<td>171,600</td>
<td>185,900</td>
<td>171,600</td>
<td>128,700</td>
<td>128,700</td>
<td>103,100</td>
<td>106,100</td>
<td>85,800</td>
<td>71,500</td>
<td>1,430,000</td>
</tr>
<tr>
<td>53,600</td>
<td>64,300</td>
<td>96,600</td>
<td>128,700</td>
<td>139,400</td>
<td>128,700</td>
<td>96,600</td>
<td>96,600</td>
<td>75,100</td>
<td>75,100</td>
<td>64,300</td>
<td>53,600</td>
<td>1,072,600</td>
</tr>
<tr>
<td>17,900</td>
<td>21,500</td>
<td>32,100</td>
<td>42,900</td>
<td>46,500</td>
<td>42,900</td>
<td>32,100</td>
<td>32,100</td>
<td>25,000</td>
<td>25,000</td>
<td>21,500</td>
<td>17,900</td>
<td>357,400</td>
</tr>
<tr>
<td>25,600</td>
<td>25,600</td>
<td>25,600</td>
<td>25,600</td>
<td>25,600</td>
<td>25,600</td>
<td>25,600</td>
<td>25,600</td>
<td>25,600</td>
<td>25,600</td>
<td>25,600</td>
<td>25,600</td>
<td>307,200</td>
</tr>
<tr>
<td>600</td>
<td>600</td>
<td>600</td>
<td>600</td>
<td>600</td>
<td>600</td>
<td>600</td>
<td>600</td>
<td>600</td>
<td>600</td>
<td>600</td>
<td>600</td>
<td>7,200</td>
</tr>
<tr>
<td>26,200</td>
<td>26,200</td>
<td>26,200</td>
<td>26,200</td>
<td>26,200</td>
<td>26,200</td>
<td>26,200</td>
<td>26,200</td>
<td>26,200</td>
<td>26,200</td>
<td>26,200</td>
<td>26,200</td>
<td>314,400</td>
</tr>
<tr>
<td>(8,300)</td>
<td>(4,700)</td>
<td>5,900</td>
<td>16,700</td>
<td>20,300</td>
<td>16,700</td>
<td>5,900</td>
<td>5,900</td>
<td>(1,200)</td>
<td>(1,200)</td>
<td>(4,700)</td>
<td>(8,300)</td>
<td>43,000</td>
</tr>
<tr>
<td>6,700</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>6,700</td>
</tr>
<tr>
<td>(8,300)</td>
<td>(4,700)</td>
<td>5,900</td>
<td>16,700</td>
<td>20,300</td>
<td>16,700</td>
<td>5,900</td>
<td>5,900</td>
<td>(1,200)</td>
<td>(1,200)</td>
<td>(4,700)</td>
<td>(8,300)</td>
<td>43,000</td>
</tr>
<tr>
<td>36,300</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>36,300</td>
</tr>
</tbody>
</table>

### Purchases made during the last two months of Prior Year:
- **November**: 67,460
- **December**: 57,300

| Purchases | 89,600 | 121,700 | 132,300 | 121,700 | 89,600 | 89,600 | 68,100 | 68,100 | 57,300 | 47,600 | 62,000 | 82,000 | 1,029,600 |

### CASH INFLOWS:
- **Collections**: Accts. Receiv.: 53,900
- **Other Income (Expense)**: 64,800

### CASH OUTFLOW:
- **Accounts Payable**: 47,500
- **Past Due: Accounts Payable**: 4,000
- **General Expenses**: 25,600
- **Capital Purchases**: 15,000

### CASH POSITION
| (19,500) | (35,600) | (50,300) | (63,800) | (38,100) | 19,200 | 67,900 | 52,300 | 30,300 | 39,300 | (8,500) | 27,400 |

### MONTHLY Short-Term Loan
| 20,000 | 40,000 | 55,000 | 65,000 | 40,000 | (15,000) | (65,000) | (50,000) | (30,000) | (25,000) | (15,000) | (20,000) |

### ENDING CASH (lines 25 + 26 + 27)
- **200,000**

### TOTAL Short-Term Loan
| 20,000 | 60,000 | 105,000 | 180,000 | 220,000 | 205,000 | 140,000 | 90,000 | 60,000 | 35,000 | 20,000 | 0 |

### TOTAL Long-Term Loan
| 165,000 | 162,000 | 159,000 | 156,000 | 153,000 | 150,000 | 147,000 | 144,000 | 141,000 | 138,000 | 135,000 | 132,000 | 129,000 |
Section 5: Manage Growth ... Financial Gap
The Financial Operating Cycle

**Net Profits**

Income Statement

- Sales
- Net Profit

**Cash Flow**

Balance Sheet

Assets = Liabilities + Net Worth

**Efficiency**

Uses of Profits:

- To pay for New Assets
- To pay off Debt
- To pay out to Owners
## Case Study

### Evergreen Distributing

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

<table>
<thead>
<tr>
<th>PERCENT OF SALES*</th>
<th>PERCENT OF SALES*</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash ......... $24,000</td>
<td>Note Payable .............. $ 0</td>
</tr>
<tr>
<td>Accounts Receivable .... 108,000</td>
<td>Accounts Payable .......... 90,000</td>
</tr>
<tr>
<td>Inventory .............. 156,000</td>
<td>Accruals .................. 42,000</td>
</tr>
<tr>
<td>Total Current Assets .... <strong>$ 288,000</strong></td>
<td>Financial Gap</td>
</tr>
<tr>
<td>Equipment .................. 150,000</td>
<td>Long-Term Liabilities ..... <strong>140,000</strong></td>
</tr>
<tr>
<td>Land/Building ............ 120,000</td>
<td>Total Liabilities .......... 272,000</td>
</tr>
<tr>
<td>Total Fixed Assets .... 270,000</td>
<td>Net Worth .................. <strong>286,000</strong></td>
</tr>
<tr>
<td>Total Assets .............. <strong>$ 558,000</strong></td>
<td>Total Liabilities and Net Worth ........ <strong>$ 558,000</strong></td>
</tr>
</tbody>
</table>
Evergreen Distributing
Balance Sheet

**TO DO:** Calculate the balance sheet that Evergreen will have if they achieve their projections of $900,000 in sales, then evaluate the financial health of the company using your balance sheet ratios.

<table>
<thead>
<tr>
<th>PERCENT OF SALES*</th>
<th>PERCENT OF SALES*</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Projected Sales</strong></td>
<td>$900,000</td>
</tr>
<tr>
<td><strong>Projected NPAT</strong></td>
<td>$27,000</td>
</tr>
</tbody>
</table>

<p>| | | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>$36,000</td>
<td>4%</td>
</tr>
<tr>
<td>Accts. Receivable</td>
<td>$162,000</td>
<td>18%</td>
</tr>
<tr>
<td>Inventory</td>
<td>$234,000</td>
<td>26%</td>
</tr>
<tr>
<td>Total Current Assets</td>
<td>$432,000</td>
<td></td>
</tr>
<tr>
<td>Equipment</td>
<td>$225,000</td>
<td>25%</td>
</tr>
<tr>
<td>Land/Building</td>
<td>$120,000</td>
<td></td>
</tr>
<tr>
<td>Total Fixed Assets</td>
<td>$345,000</td>
<td></td>
</tr>
<tr>
<td><strong>Total Assets</strong></td>
<td>$777,000</td>
<td></td>
</tr>
<tr>
<td><strong>Note Payable</strong></td>
<td>$126,000</td>
<td></td>
</tr>
<tr>
<td><strong>Accounts Payable</strong></td>
<td>$135,000</td>
<td>15%</td>
</tr>
<tr>
<td><strong>Accruals</strong></td>
<td>$63,000</td>
<td>7%</td>
</tr>
<tr>
<td><strong>Total Current Liabilities</strong></td>
<td>$324,000</td>
<td></td>
</tr>
<tr>
<td><strong>Long-Term Liabilities</strong></td>
<td>140,000</td>
<td></td>
</tr>
<tr>
<td><strong>Total Liabilities</strong></td>
<td>$464,000</td>
<td></td>
</tr>
<tr>
<td><strong>Net Worth</strong></td>
<td>$313,000</td>
<td></td>
</tr>
<tr>
<td><strong>Total Liabilities and Net Worth</strong></td>
<td>$777,000</td>
<td>($old Net Worth* = 286,000)</td>
</tr>
</tbody>
</table>
Evergreen Distributing
"Managed" Balance Sheet

If Evergreen was able to implement the efficiency improvements listed above -- and achieved its target sales level of $900,000, with a net profit after tax of $27,000 -- it's balance sheet would look like this:

<table>
<thead>
<tr>
<th>PERCENT OF SALES</th>
<th>PERCENT OF SALES</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>$36,000</td>
</tr>
<tr>
<td>Accounts Receivable</td>
<td>112,500</td>
</tr>
<tr>
<td>Inventory</td>
<td>157,000</td>
</tr>
<tr>
<td>Note Payable</td>
<td>$0</td>
</tr>
<tr>
<td>Equipment</td>
<td>225,000</td>
</tr>
<tr>
<td>Land/Building</td>
<td>120,000</td>
</tr>
<tr>
<td>Total Fixed Assets</td>
<td>345,000</td>
</tr>
<tr>
<td>Total Current Assets</td>
<td><strong>$306,000</strong></td>
</tr>
<tr>
<td>Total Current Liabilities</td>
<td><strong>$138,000</strong></td>
</tr>
<tr>
<td>Long-Term Liabilities</td>
<td>200,000</td>
</tr>
<tr>
<td>Net Worth</td>
<td>313,000</td>
</tr>
<tr>
<td>Total Liabilities</td>
<td>338,000</td>
</tr>
<tr>
<td>Total Liabilities and Net Worth</td>
<td><strong>$651,000</strong></td>
</tr>
</tbody>
</table>
What Drives Unit Profitability?

Financial Performance is a three-legged stool

- Education – Establishing the Foundation
- Benchmarking – Creating the Yardstick
- Performance Groups – Providing the Accountability and Discipline
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Color Centers, Inc.

Benchmarking Study

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# Color Centers, Inc.
## Common-Sized Profit and Loss
### Percentage of Total Sales

<table>
<thead>
<tr>
<th></th>
<th>All Centers</th>
<th>Top 25%</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2004</td>
<td>2005</td>
</tr>
<tr>
<td><strong>SALES</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cost of Goods Sold</td>
<td>66.5</td>
<td>70.3</td>
</tr>
<tr>
<td><strong>GROSS PROFIT</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>STAFF COSTS</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Production and Delivery Wages and Bonuses</td>
<td>14.4</td>
<td>11.0</td>
</tr>
<tr>
<td>Sales and Administrative Wages and Bonuses</td>
<td>5.5</td>
<td>7.8</td>
</tr>
<tr>
<td>Payroll Taxes, Workers’ Compensation and Benefits</td>
<td>1.5</td>
<td>1.9</td>
</tr>
<tr>
<td>Staff Costs Excluding Owner Compensation</td>
<td>21.3</td>
<td>21.1</td>
</tr>
<tr>
<td>Owner Draws, Compensation and Benefits</td>
<td>0.6</td>
<td>9.8</td>
</tr>
<tr>
<td><strong>TOTAL INCLUDING OWNERS</strong></td>
<td>31.1</td>
<td>30.3</td>
</tr>
<tr>
<td><strong>OPERATING EXPENSES</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Royalties</td>
<td>5.9</td>
<td>5.1</td>
</tr>
<tr>
<td>Rent</td>
<td>5.4</td>
<td>5.0</td>
</tr>
<tr>
<td>Equipment Operating Leases and Rents</td>
<td>6.9</td>
<td>6.9</td>
</tr>
<tr>
<td>Equipment Depreciation</td>
<td>2.7</td>
<td>2.7</td>
</tr>
<tr>
<td>Accounting and Legal</td>
<td>3.6</td>
<td>8.5</td>
</tr>
<tr>
<td>Advertising</td>
<td>4.4</td>
<td>4.4</td>
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<tr>
<td>Bad Debts</td>
<td>0.4</td>
<td>0.1</td>
</tr>
<tr>
<td>Bank Charges</td>
<td>0.6</td>
<td>0.5</td>
</tr>
<tr>
<td>Computer Expenses</td>
<td>3.3</td>
<td>0.3</td>
</tr>
<tr>
<td>Electricity/Gas</td>
<td>4.9</td>
<td>4.9</td>
</tr>
<tr>
<td>Insurance</td>
<td>4.4</td>
<td>4.4</td>
</tr>
<tr>
<td>Automobile Expense</td>
<td>1.6</td>
<td>1.5</td>
</tr>
<tr>
<td>Office Supplies</td>
<td>2.1</td>
<td>1.1</td>
</tr>
<tr>
<td>Freight and Postage</td>
<td>3.2</td>
<td>0.2</td>
</tr>
<tr>
<td>Taxes and Licenses</td>
<td>0.3</td>
<td>0.3</td>
</tr>
<tr>
<td>Repairs, Maintenance and Cleaning</td>
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<td>Seminars, Conference and Training</td>
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<td>Telephone</td>
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<td>General and Other Administrative Expenses</td>
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<tr>
<td><strong>TOTAL OPERATING EXPENSES</strong></td>
<td>29.5</td>
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<tr>
<td><strong>OPERATING PROFIT</strong></td>
<td>5.8</td>
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<td><strong>OTHER INCOME AND EXPENSE</strong></td>
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<tr>
<td><strong>PROFIT BEFORE TAX</strong></td>
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Actual categories determined in design phase of project.
## Financial Operating Ratios

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<tr>
<th>PROFITABILITY</th>
<th>(Number of Responses)</th>
<th>All Centers 2004 (200)</th>
<th>2005 (200)</th>
<th>Top 25% 2004 (50)</th>
<th>2005 (50)</th>
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<tr>
<td>Cost Of Goods Sold</td>
<td>Cost of Goods Sold</td>
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<td>28.6%</td>
<td>27.5%</td>
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<tr>
<td>Gross Margin</td>
<td>Gross Profit</td>
<td>71.5%</td>
<td>71.4%</td>
<td>72.5%</td>
<td>72.9%</td>
</tr>
<tr>
<td>Staff Costs Excluding Owners</td>
<td>Non-Owner Salaries, PR Taxes, Benefits</td>
<td>21.1%</td>
<td>21.4%</td>
<td>20.8%</td>
<td>21.0%</td>
</tr>
<tr>
<td>Operating Expenses</td>
<td>Operating Expenses</td>
<td>29.6%</td>
<td>28.8%</td>
<td>25.8%</td>
<td>25.8%</td>
</tr>
<tr>
<td>Net Profit Margin*</td>
<td>Net Income Before Tax</td>
<td>3.7%</td>
<td>8.2%</td>
<td>6.3%</td>
<td>9.2%</td>
</tr>
<tr>
<td>Owner's Discretionary Profit Margin</td>
<td>Net Income Before Tax Plus Owner Salary</td>
<td>16.2%</td>
<td>19.2%</td>
<td>22.4%</td>
<td>24.6%</td>
</tr>
<tr>
<td>Owner's Discretionary Profit Dollars</td>
<td>Net Income Before Tax Plus Owner Salary</td>
<td><strong>$98,000</strong></td>
<td><strong>$120,000</strong></td>
<td><strong>$240,000</strong></td>
<td><strong>$285,000</strong></td>
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# Color Centers, Inc.
## Median Financial Operating Ratios

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<th>All Centers</th>
<th>Top 25%</th>
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<tr>
<td></td>
<td>2004</td>
<td>2005</td>
<td>(200)</td>
<td>(200)</td>
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<tr>
<td></td>
<td>(50)</td>
<td>(50)</td>
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<tr>
<td><strong>PROFITABILITY</strong></td>
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<td></td>
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<tr>
<td>Cost Of Goods Sold*</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sales</td>
<td>28.5%</td>
<td>28.6%</td>
<td>27.5%</td>
<td>27.0%</td>
</tr>
<tr>
<td>Gross Margin</td>
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<td></td>
<td></td>
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<tr>
<td>Non-Owner Salaries, PR Taxes, Benefits</td>
<td>21.1%</td>
<td>21.4%</td>
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<td>21.0%</td>
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<tr>
<td>Gross Profit</td>
<td></td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Sales</td>
<td>71.5%</td>
<td>71.4%</td>
<td>72.5%</td>
<td>72.9%</td>
</tr>
<tr>
<td>Operating Expenses</td>
<td></td>
<td></td>
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<tr>
<td>Operating Expenses</td>
<td>29.6%</td>
<td>28.8%</td>
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<td>25.8%</td>
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<tr>
<td>Net Profit Margin*</td>
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<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net Income Before Tax</td>
<td>3.7%</td>
<td>8.2%</td>
<td>6.3%</td>
<td>9.2%</td>
</tr>
<tr>
<td>Owner’s Discretionary Profit Margin</td>
<td>16.2%</td>
<td>19.2%</td>
<td>22.4%</td>
<td>24.6%</td>
</tr>
<tr>
<td>Owner’s Discretionary Profit Dollars</td>
<td>$98,000</td>
<td>$120,000</td>
<td>$240,000</td>
<td>$285,000</td>
</tr>
<tr>
<td><strong>PRODUCTIVITY</strong></td>
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<tr>
<td>Sales Per Employee</td>
<td></td>
<td></td>
<td></td>
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</tr>
<tr>
<td>Including Owners</td>
<td>$112,004</td>
<td>$115,349</td>
<td>$134,149</td>
<td>$133,094</td>
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<tr>
<td>Rent Per Square Foot*</td>
<td>$11</td>
<td>$13</td>
<td>$12</td>
<td>$16</td>
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<tr>
<td><strong>FINANCIAL POSITION</strong></td>
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<tr>
<td>Sales-To-Assets</td>
<td></td>
<td></td>
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<tr>
<td>Return On Assets*</td>
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<td></td>
<td></td>
<td></td>
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<tr>
<td>Owner’s Discretionary Profit</td>
<td>35.0%</td>
<td>37.0%</td>
<td>47.0%</td>
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<tr>
<td>Debt-To-Worth</td>
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<tr>
<td>Net Worth + Shareholder Loans</td>
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<td>68.0%</td>
<td>97.0%</td>
<td>98.0%</td>
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<tr>
<td>CASH FLOW</td>
<td></td>
<td></td>
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<td></td>
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<tr>
<td>Current</td>
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<tr>
<td>Current Assets</td>
<td>1.28</td>
<td>1.15</td>
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<td>1.40</td>
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<td>Current Liabilities</td>
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<td>.92</td>
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<td>1.12</td>
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<tr>
<td>Inventory Turnover*</td>
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<tr>
<td>Cost of Goods Sold</td>
<td>25.44</td>
<td>33.25</td>
<td>34.98</td>
<td>34.68</td>
</tr>
<tr>
<td>Inventory Turnover*</td>
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<tr>
<td>Accounts Payable Turnover*</td>
<td>14 days</td>
<td>11 days</td>
<td>10 days</td>
<td>10 days</td>
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<tr>
<td>Average Accounts Receivable Days</td>
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<td>41 days</td>
<td>47 days</td>
<td>46 days</td>
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<tr>
<td>Accounts Payable Turnover*</td>
<td>7.4</td>
<td>7.3</td>
<td>8.5</td>
<td>8.1</td>
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<tr>
<td>Average Accounts Payable Days</td>
<td>49 days</td>
<td>50 days</td>
<td>43 days</td>
<td>45 days</td>
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</table>

*Selection of additional ratios for Full Scope Study determined in the design phase. Not included in Limited Scope Study.*
Executive Summary

This executive summary describes the operating results for Color Centers, Inc. franchisees for these critical areas:

- profitability -- gross profits, net profits, and expense control
- productivity -- staff efficiency
- financial position -- asset management and controlling debt
- cash flow -- managing the working capital cycle

Profitability

The chart below shows what happens to each sales dollar of the “average” center versus that of the average “top 25%” center. This chart is based on figures from the “average” common-sized profit and loss from Appendix A-3, which will not be exactly the same as the median ratios shown on Appendix A-2. To learn more about median ratios and the averages shown in the common-size profit and loss, refer to the overview of the three basic statements in Section I.

Average for All Centers

![Pie chart for average for all centers]

Average For Top 25% Centers

![Pie chart for average for top 25% centers]

Source: Common-Sized Profit and Loss, Appendix A-3.

Top performers have 24% in net profit before tax plus owner compensation, compared to 18% for all centers. This 6% difference represents more than 40% more in profit dollars to the top performers (profit to owners was derived by adding net profit after tax to owner compensation). Their profit advantage comes primarily from managing cost of goods sold and operating expenses (overhead).

Cost of Good Sold Management

Cost of goods sold is a combination of ink, chemicals, supplies, shipping, delivery and outsourcing costs. Here is a breakdown of the items that make up average costs of goods sold on the common-sized profit and loss.
Compiled by:
Profit Mastery
200 First Avenue West, Suite 301
Seattle, Washington 98119  USA
Phone – 206.284.5102
Fax - 206.282.4092
Email : info@profitmastery.net
www.profitmastery.net

Your company’s Consulting Report, used in conjunction with the Group Benchmarking Study, is designed to be an extremely powerful tool to improve the cash flow and profitability of your business. This report card identifies how your operation stacks up against the top performers in your network and outlines action plans that specifically address the areas of profitability, productivity, working capital, financial position, and working capital.

Color Centers, Inc.

Company Consulting Report
“CCR”
## Color Centers, Inc.
### Financial Benchmarks

#### Seagate

**Center No:** 99999

<table>
<thead>
<tr>
<th></th>
<th>All Companies</th>
<th>Top 25%</th>
<th>$600k to $1mm</th>
<th>Your Results 12/31/2005</th>
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<td><strong>Profitability</strong></td>
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<tr>
<td>Cost of Goods Sold</td>
<td>29.6%</td>
<td>27.0%</td>
<td>29.7%</td>
<td>28.0%</td>
</tr>
<tr>
<td>Gross Profit</td>
<td>71.4%</td>
<td>72.9%</td>
<td>70.2%</td>
<td>72.0%</td>
</tr>
<tr>
<td>Staff Cost</td>
<td>21.4%</td>
<td>21.5%</td>
<td>21.3%</td>
<td>25.0%</td>
</tr>
<tr>
<td>Operating Expenses</td>
<td>28.9%</td>
<td>25.8%</td>
<td>28.3%</td>
<td>32.8%</td>
</tr>
<tr>
<td>Net Profit</td>
<td>4.3%</td>
<td>9.3%</td>
<td>6.2%</td>
<td>3.1%</td>
</tr>
<tr>
<td>Owner's Discretionary Profit Percent</td>
<td>15.2%</td>
<td>24.6%</td>
<td>21.6%</td>
<td>13.1%</td>
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<tr>
<td>Owner's Discretionary Profit Dollars</td>
<td>$120,000</td>
<td>$285,000</td>
<td>$147,000</td>
<td>$98,500</td>
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#### Productivity

<p>| | | | | |</p>
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<tr>
<th></th>
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<tbody>
<tr>
<td>Sales Per Employee</td>
<td>$115,349</td>
<td>$133,094</td>
<td>$124,612</td>
<td>$75,000</td>
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<tr>
<td>Staff Cost Per Employee</td>
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<td>$36,373</td>
<td>$36,290</td>
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<td>Sales Per Square Foot</td>
<td>$600</td>
<td>$800</td>
<td>$500</td>
<td>$500</td>
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<tr>
<td>Rent Per Square Foot</td>
<td>$13</td>
<td>$16</td>
<td>$12</td>
<td>$13</td>
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<td>Median Sales</td>
<td>$625,000</td>
<td>$1,200,000</td>
<td>$735,000</td>
<td>$750,000</td>
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#### Financial Position

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<tbody>
<tr>
<td>Sales to Assets</td>
<td>2.22</td>
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<td>Return on Assets</td>
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<td>50.0%</td>
<td>34.0%</td>
<td>34.4%</td>
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<tr>
<td>Return on Investment</td>
<td>65.0%</td>
<td>98.0%</td>
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<td>Debt to Worth</td>
<td>2.59</td>
<td>1.29</td>
<td>1.60</td>
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#### Cash Flow

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<td>1.40</td>
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<td>Quick Ratio</td>
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<td>0.92</td>
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<td>Inventory Turnover</td>
<td>33.2</td>
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<tr>
<td>Inventory Turn Days</td>
<td>11</td>
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<td>12</td>
<td>10</td>
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<tr>
<td>Average Accounts Receivable Collection Days</td>
<td>41</td>
<td>45</td>
<td>50</td>
<td>66</td>
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<tr>
<td>Average Accounts Payable Repayment Days</td>
<td>50</td>
<td>45</td>
<td>54</td>
<td>49</td>
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</table>
You and your staff implemented our first comprehensive Operating Ratio Study. Through this we established financial benchmarks which our franchise owners are using to measure and improve their performance… The proof of the pudding is in the eating and I am pleased to report that our franchisees’ discretionary income increased by 30%.

Gerry Bergler, Executive Vice President

Allegra Print and Imaging
Bus. Sol. Roundtable on Benchmarking

Business Solution Roundtables
Tuesday, February 13
8:00 AM – 9:45 AM

Rod Bristol, along with Jeff Beavis, Founder and CEO of FirstLight Home Care will be leading a Roundtable entitled: Benchmark Your Network to Improve Financial Performance
What Drives Unit Profitability?

Financial Performance is a three-legged stool

- Education – Establishing the Foundation
- Benchmarking – Creating the Yardstick
- Performance Groups – Providing the Accountability and Discipline
Guide to Profit Mastery
Performance Groups
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<th>#2</th>
<th>#3</th>
<th>#4</th>
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<th>#6</th>
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<td>Q1</td>
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<tr>
<td></td>
<td>2011 EOY</td>
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<td>679,594</td>
<td>1,894,562</td>
<td>2,117,814</td>
<td>790,509</td>
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<td>2</td>
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<td>83.3%</td>
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<td>84.1%</td>
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<td>89.0%</td>
<td>75.5%</td>
<td>100.0%</td>
<td>76.3%</td>
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<tr>
<td></td>
<td>Dispensing Revenue + Total Revenue</td>
<td>83.6%</td>
<td>83.6%</td>
<td>73.8%</td>
<td>84.6%</td>
<td>75.8%</td>
<td>89.5%</td>
<td>73.9%</td>
<td>100.0%</td>
<td>76.8%</td>
<td>100.0%</td>
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<tr>
<td>3</td>
<td>Exam Revenue %</td>
<td>16.7%</td>
<td>16.7%</td>
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<td>15.9%</td>
<td>25.1%</td>
<td>11.0%</td>
<td>24.5%</td>
<td>0.0%</td>
<td>23.7%</td>
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<td>Exam Revenue + Total Revenue</td>
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<td>16.4%</td>
<td>26.2%</td>
<td>15.4%</td>
<td>24.2%</td>
<td>10.5%</td>
<td>26.1%</td>
<td>0.0%</td>
<td>23.2%</td>
<td>0.0%</td>
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<tr>
<td>4</td>
<td>Revenue $ per Unit Sold</td>
<td>234</td>
<td>264</td>
<td>272</td>
<td>248</td>
<td>60</td>
<td>186</td>
<td>220</td>
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<td>Spec Revenue + Units Sold Excl. Contacts</td>
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<tr>
<td>5</td>
<td>Materials Cost of Goods %</td>
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<td>32.6%</td>
<td>42.1%</td>
<td>19.4%</td>
<td>36.4%</td>
<td>30.5%</td>
<td>32.6%</td>
<td>31.8%</td>
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<td></td>
<td>Materials COGS + (Total Revenue - Exam Revenue)</td>
<td>32.2%</td>
<td>36.8%</td>
<td>39.2%</td>
<td>32.2%</td>
<td>64.5%</td>
<td>27.5%</td>
<td>34.0%</td>
<td>31.7%</td>
<td>29.3%</td>
<td>21.7%</td>
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<td>6</td>
<td>Lab Labor Cost of Goods %</td>
<td>3.0%</td>
<td>1.3%</td>
<td>4.2%</td>
<td>2.3%</td>
<td>3.3%</td>
<td>0.0%</td>
<td>3.8%</td>
<td>2.3%</td>
<td>3.0%</td>
<td>4.0%</td>
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<td></td>
<td>Lab Labor Costs + Total Revenue</td>
<td>3.0%</td>
<td>1.3%</td>
<td>4.2%</td>
<td>2.2%</td>
<td>3.3%</td>
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<td>3.0%</td>
<td>2.1%</td>
<td>2.4%</td>
<td>3.5%</td>
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<tr>
<td>7</td>
<td>Gross Margin</td>
<td>72.5%</td>
<td>78.4%</td>
<td>71.5%</td>
<td>72.6%</td>
<td>68.5%</td>
<td>82.7%</td>
<td>72.5%</td>
<td>69.5%</td>
<td>75.1%</td>
<td>68.2%</td>
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<td></td>
<td>Gross Profit + Total Revenue</td>
<td>72.8%</td>
<td>89.2%</td>
<td>71.1%</td>
<td>72.8%</td>
<td>58.7%</td>
<td>75.4%</td>
<td>74.9%</td>
<td>68.3%</td>
<td>77.5%</td>
<td>78.3%</td>
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<td>8</td>
<td>Dispensing Gross Margin</td>
<td>67.4%</td>
<td>74.1%</td>
<td>62.1%</td>
<td>67.4%</td>
<td>57.9%</td>
<td>80.6%</td>
<td>53.6%</td>
<td>66.5%</td>
<td>67.4%</td>
<td>66.2%</td>
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<tr>
<td></td>
<td>(Dispensing Revenue - COGS)/Dispensing Revenue</td>
<td>67.8%</td>
<td>83.2%</td>
<td>60.8%</td>
<td>67.8%</td>
<td>45.5%</td>
<td>72.5%</td>
<td>66.0%</td>
<td>68.3%</td>
<td>70.7%</td>
<td>78.3%</td>
</tr>
</tbody>
</table>
FINANCIALS (page 1 of 2)

PERFORMANCE REVIEWS / GOAL SETTING
- I know my Owners Discretionary Profit goal for the next three years
- I know my key performance ratios. I keep track of them over time and benchmark myself against my industry performance group peers on at least a six-month basis
- I keep a monthly watch on my gross and net margins
- I feel comfortable talking to my banker, financial staff, and advisors about the financial state of my business

FINANCIAL STATEMENTS
- I have an excellent bookkeeper
- I receive accurate financial statements on at least a monthly basis by the 15th of the following month
- My year-end statements are finalized by the end of the first quarter after my fiscal year ends

COST
- I know my company’s cost structure: $_____ in total costs are fixed costs, _____% of total costs are variable cost and my contribution margin percentage is _____%
- I know my company’s Break-Even sales amount on a monthly and yearly basis
- I understand and use Break-Even as a decision-making tool in my company
- I can complete the following sentence: For every dollar of fixed costs that I add, I need to add an additional $_____ in sales in order to make the same profit

MANAGING GROWTH
- My company is primarily profit rather than growth driven
- I have a balance sheet prepared on at least a quarterly basis
- I know the four general sources of funds available to acquire new assets, and I know which is best for my growth situation
- I understand how managing my inventory and accounts receivable more efficiently can reduce my need for outside funding
Performance Groups – Do They Work?

You assisted us in the development of Profit Mastery Performance Groups designed to deliver continuity to the measurement and management process. Through our ongoing involvement with Profit Mastery, we have learned that Performance Group members consistently outperform non-members in growth, profitability, and efficiency.

Gigi Harding, CEO / Kwik-Kopy Canada
The Home Instead Story...

IFA Financial Boot Camp in 2003

“This is the missing piece!”

National and Regional Training

Their first ever Benchmark Study

The Pilot Performance Group

The Results...
Testimonial

Roger Baumgart, President Home Instead Senior Care

“(Profit Mastery) has become (the) standard for assessing and refining individual franchise performance.”

November 9, 2006

Steve LeFever
Chairman
Business Resource Services
200 First Avenue West, Suite 301
Seattle, WA 98115

Dear Steve,

On behalf of everyone at Home Instead Senior Care, thank you for the very positive impact your Profit Mastery® performance initiative—known to us as PerforMax—has had on the company over the past 2 1/2 years. You and your firm, Business Resource Services, have helped focus the attention of Home Instead Senior Care’s franchise owners on those critical tasks and issues that will help them build their businesses.

At our 2004 Leadership Conference and our 2004 International Convention, you introduced PerforMax to Home Instead Senior Care’s franchise owners, after which you and your staff implemented the company’s first-annual comprehensive Operating Ratio Study. Through this exercise, Home Instead Senior Care established financial benchmarks that owners are now using on a daily basis to measure and improve their performances.

In addition, you recently conducted four PerforMax seminars, during which you trained Home Instead Senior Care franchisees in the use of financial information to manage their businesses. Subsequently, you guided the company in its formation of “Performance Groups” designed to help owners continuously apply these important PerforMax components.

In short, PerforMax has become Home Instead Senior Care’s standard for assessing and refining individual franchise performance. Consequently, we’re pleased to be working with you now to license the PerforMax component—so we can bring them in house to ensure continuity and full implementation throughout the Home Instead Senior Care network.

Steve, thanks for the support and guidance Home Instead Senior Care has received from you and your staff. The knowledge you’ve imparted to our franchise owners and to our Home Office staff members has been invaluable—information that has strengthened the entire company.

Sincerely,

Roger H. Baumgart
President
Steve LeFever, along with Steve White, of PuroClean Care will be leading a Roundtable entitled: Performance Groups – Implementing a Process that Produces Results
Let’s Dig Deeper…

**B2B** – Lisa Hafetz

**QSR** – Rod Bristol

**Service** – Steve LeFever
Seven Steps to Business Success

1. Plan properly before start up
2. Monitor financial position
3. Understand the relationship between price, volume, and costs
4. Manage cash flow
5. Manage growth
6. Borrow properly
7. Plan for transition
Break-Even Analysis
The Key to Break-Even Analysis

Know Your Cost Structure!

So you can effectively react to changes in your business

- Pricing
- Volume
- Costs
What Types of Questions Can Break-Even Answer?

1. If I cut or add a fixed cost how will it impact the volume of sales I need to Break-Even?

1. If I lower prices how will it impact Break-Even?

2. If I raise prices how will it impact Break-Even?
Break-Even
(as explained by your college professor)
Understanding Contribution Margin

Accountant’s P&L

Sales - COGS = Gross Profit
- OE
Net Profit
Break-Even 4 Step Process

1. Classify expenses as **variable** or **fixed**
2. Determine **Variable Cost Percentage**
3. Determine **Contribution Margin Percentage**
4. Calculate **Break-Even** in dollars
How Do Fixed Costs Behave?

Step 1

COSTS vs. SALES
How Do Fixed Costs Behave?

Sample Fixed Costs:
- Officer Salary
- Office Supplies
- Insurance
- Utilities
- Rent
How Do Variable Costs Behave?

Step 1

COSTS

SALES
How Do Variable Costs Behave?

Step 1

Sample Variable Costs
- Materials – COGS
- Freight
- Commissions
- Production Labor
- Bad Debts
- CC Fees
- Royalties
$ Revenue

Variable Costs:
$ Materials – COGS
$ Freight
$ Commissions
$ Production Labor
$ Bad Debts
$ CC Fees
$ Royalties

= $ Total Variable Costs

Fixed Costs:
$ Management Salaries & Office Payroll
$ Rent
$ Depreciation
$ Telephone
$ Insurance, etc.

= $ Total Fixed Costs
Understanding Contribution Margin

Accountant’s P&L

Sales
- COGS
= Gross Profit
- OE
Net Profit

Contribution Margin

Managed or Break-Even P&L

Sales
- VC
What’s Left
- FC
Net Profit

With Net Profit at 0, you are at Break-Even
STEP 2

Determine **Variable Cost Percentage**

\[
\text{Variable Cost Percentage} = \frac{\text{Variable Costs}}{\text{Sales}} \times 100
\]
STEP 3

Determine **Contribution Margin**

Sales %* - Variable Cost % = **Contribution Margin %**

* Sales % will always be 100%
STEP 4

Calculate Break-Even in dollars

Break-Even = \frac{Fixed Costs}{Contribution Margin \%}

Note: Turn the CM % into a decimal prior to making this calculation
Break-Even 4 Step Process

1. Classify expenses as **variable** or **fixed**

2. Determine **Variable Cost Percentage**

3. Determine **Contribution Margin Percentage**

4. Calculate **Break-Even** in dollars
Steve’s Pen Company
Steve’s Pen Company

Here’s the math:

Break-Even = \frac{\text{Fixed Costs}}{\text{C.M. } \%} = \frac{800,000}{.4} = 2,000,000

If fixed costs increase by $1.00, what do we need in increased sales to cover that cost?

\text{Fixed Costs increase} = 1.00 = 2.50
\frac{\text{C.M. } \%}{.4}
An example

If we hire a sales manager and pay her $60,000 (salary + benefits), what do we need in increased sales to cover her salary?

\[
\text{Fixed Costs increase} = \frac{\$60,000}{.4} = \$150,000
\]
The Cup Theory
The Concept of Contribution Margin

Sales → Variable Cost Cup → Contribution Margin → Fixed Cost Cup → Net Profit Cup
The Cup Theory

The Concept of Contribution Margin

- Variable Cost Cup: $1,200,000
- Fixed Cost Cup: $800,000
- Contribution Margin: $800,000
- Net Profit Cup: $0

- Total Revenue: $2,000,000
- Contribution Margin Percentage: 60%
- Contribution Margin: $800,000

The Cup Theory illustrates the concept of contribution margin, which is the difference between revenue and variable costs. This margin contributes to covering fixed costs and generating profit.
The Cup Theory

The Concept of Contribution Margin

Variable Cost Cup: $1.00

- 60% Contribution Margin
- $0.60 Variable Cost

Fixed Cost Cup: $0

Net Profit Cup: $0.40

Contribution Margin: $0.40
The Cup Theory

The Concept of Contribution Margin

Sales

Variable Cost Cup

Fixed Cost Cup

Contribution Margin

Net Profit Cup
The Cup Theory

The Concept of Contribution Margin

- Sales
- Variable Cost Cup
- Contribution Margin
- Fixed Cost Cup
- Net Profit Cup

Contribution Margin
Target a Profit

You want to have a profit of $200,000 at the end of the fiscal year. What do you need in increased sales to insure this level of profit?

Fixed Costs = $800,000 (FC)
Targeted Profits = $200,000 (TP)
Total FC + TP = $1,000,000

\[
\text{Total FC + TP} = \$1,000,000 = \$2,500,000
\]

Contribution Margin % = .4
The Cup Theory

The Concept of Contribution Margin

Variable Cost Cup

$2,500,000

60%

$1,500,000

Fixed Cost Cup

$800,000

$1,000,000

Contribution Margin

Net Profit Cup

$200,000
Four Ways to Increase Profits

- **Sales**
- **Variable Cost Cup**
- **Fixed Cost Cup**
- **Net Profit Cup**

**Contribution Margin**
Four Ways to Increase Profits

1. Increase Price

Sales ($) -> Variable Cost Cup -> Contribution Margin

Variable Cost Cup -> Contribution Margin -> Fixed Cost Cup

Fixed Cost Cup -> Contribution Margin -> Net Profit Cup

Net Profit Cup
Four Ways to Increase Profits

1. Increase Price
2. Increase Sales (in units)
Four Ways to Increase Profits

1. Increase Price
2. Increase Sales (in units)
3. Lower Variable Costs (shrink the cup)
Four Ways to Increase Profits

1. Increase Price
2. Increase Sales (in units)
3. Lower Variable Costs (shrink the cup)
4. Lower Fixed Costs (shrink the cup)
1. Increase Sales (In $)
2. Increase Sales (in units)
3. Lower Variable Costs (shrink the cup)
4. Lower Fixed Costs (shrink the cup)
Four Ways to Increase Profits

1. Increase Sales (In $)
2. Increase Sales (in units)
3. Lower Variable Costs (shrink the cup)
4. Lower Fixed Costs (shrink the cup)

What’s the strategic management value of this picture?
Break-Even – Making Pricing Decisions

- What’s the most common pricing decision business owners make?

- THERE IS NO MAGIC BULLET

- But you need to know the consequences of the pricing decisions you do make.
Raise Prices 10%
Reduce Prices by 10%
10% Price Changes - A Summary

With a 10% price increase you can sell **20% fewer** units and still make the same profit.

With a 10% price decrease you **must** sell **33% more** units in order to make the same profit.
The Cup Theory

The Concept of Contribution Margin

Sales

Variable Cost Cup

Contribution Margin

Fixed Cost Cup

Net Profit Cup
Know Your Costs!
Profit Mastery

Metrics Matters: Identifying and Implementing the Key Drivers of Unit Profitability (for Franchisees)
Cascade Home Care (Practice Example)

Chris Martin wants to calculate his break-even sales volume from three years ago but it turns out he needs your help. Use the information to calculate his break-even from 2015.

Variable Cost: ............ $279,000  \( VC = \text{Caregiver (COGS)} + \text{Royalties} \)

Fixed Cost: ................. $135,000

In 2015, his sales were:

Sales: ......................... $450,000
What are Fixed Costs in a Service Business?

Sample Fixed Costs
- Officer Salary
- Office Supplies
- Insurance
- Utilities
- Rent

Step 1
What are Variable Costs?

Sample Variable Costs:
- Materials – COGS
- Freight
- Commissions
- Production Labor
- Bad Debts
- CC Fees
- Royalties
Cascade Home Care (Practice Example)

What were break-even sales for Cascade Home Care?

\[
\text{VC\%} = \frac{\$279,000}{\$450,000} = .62 \quad 100\% - 62\% = 38\% = .38
\]

\[
\$135,000
\]

\[
.38
\]
Break-even = $355,263

\[
\frac{1.00}{0.38} = 2.63
\]
Cascade Home Care Case Study

Now Chris is wondering, what are the trends in his cost structure. He now recognizes the importance and impact of cost control – so he has requested your continued assistance in putting together his cost structure for 2016 and 2017 – in addition to 2015.
## Cascade Home Care Case Study

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<tr>
<td>Variable Costs:</td>
<td>$416,000</td>
<td>$569,000</td>
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<td>Fixed Costs:</td>
<td>$224,500</td>
<td>$302,000</td>
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<tr>
<td>Sales:</td>
<td>$650,000</td>
<td>$875,000</td>
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</table>
Cascade Home Care Case Study

2016 Break-even

\[
\text{VC} \% = \frac{\$416,000}{\$650,000} = 64\%
\]

\[
\text{CM} = 100\% - 64\% = 36\%
\]

\[
\text{Break-even} = \frac{\$224,500}{.36} = \$623,611
\]

\[
\$1.00 / .36 = \$2.78
\]
Cascade Home Care Case Study

2017 Break-even

\[
\text{VC \%} = \frac{\$569,000}{\$875,000} = 65%
\]

\[
\text{CM} = 100\% - 65\% = 35\%
\]

\[
\text{Break-even} = \frac{\$302,000}{.35} = \$862,857
\]
## Cascade Home Care Case Study

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<th>2015</th>
<th>2016</th>
<th>2017</th>
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<tr>
<td>VC %</td>
<td>62%</td>
<td>64%</td>
<td>65%</td>
</tr>
<tr>
<td>CM %</td>
<td>38%</td>
<td>36%</td>
<td>35%</td>
</tr>
<tr>
<td>FC ($)</td>
<td>$135,000</td>
<td>$224,500</td>
<td>$302,000</td>
</tr>
</tbody>
</table>
Cascade Home Care Case Study

Note: Questions 2, 3, 4 relate to 2017 data

2. What **additional** annual sales are needed if the rent increases by $1,500 per month?

\[
\begin{align*}
$1,500 \times 12 &= $18,000/\text{year} \\
\rightarrow \text{FC} &= $18,000
\end{align*}
\]

\[
$18,000 / .35 = $51,428
\]
3. Chris is evaluating hiring a marketing representative, and he wonders how much he should plan to pay. You recommend a salary of $40,000. Now please calculate for Chris what additional sales will be needed to cover this new employee’s cost.

Salary: $40,000

\[ \text{FC} \uparrow \; \$40,000 \times 0.35 = \$114,286 \]
b) Burden rate (2017)

$11,500  Payroll Tax (Admin)
$3,500   Other Admin

$15,000  Burden total

$15,000  Burden cost
$107,500 Gross payroll  = 14%
Cascade Home Care Case Study

FC = $40,000 Salary
   + $5,600 14% Burden
   $45,600 FC Increase

$45,600 * .35 = $130,286
c) Use 20% burden rate (cell phone, car-related expenses)

\[ FC = \$40,000 + (20\%) \times (\$8,000) = \$48,000 \]

\[ \frac{\$48,000 \text{ FC}}{0.35} = \$137,143 \]
Cascade Home Care Case Study

3a. $40,000 \div .35 = \$114,286$

3b. w/14% perks: $45,600 \div .35 = \$130,286$

3c. w/20% perks: $48,500 \div .35 = 137,143$
4. Chris shares with you that his goal is to generate an Owner’s Discretionary Profit (ODP) of $220,000. What sales will be required to accomplish this – assuming no rent increase and no new marketing representative? (Remember, he is already taking a salary of $61,000 – which is included in fixed costs. Also, assume there will be no price increase).
Cascade Home Care Case Study

Current Sales: $875,000

\[ FC = \$302,000 \text{ (including } \$61,000 \text{ salary)} \]

Current Salary = \$61,000

Target ODP = \$220,000

\[ \text{Target ODP} = \$220,000 - \text{Current Salary} = \$61,000 \]

Additional ODP = \$159,000
Cascade Home Care Case Study

Management Focus: We need enough "35 cents" to cover the $302,000 FC – AND an additional $159,000 ODP

Calculation: $302,000 FC
$159,000 Add. ODP
$461,000 "bogey"

$461,000 = $1,317,143 .35
Cascade Home Care Case Study

$1,317,143 \text{ Total Sales}
- \quad $875,000
\quad \underline{$442,143 \text{ New Sales}}

\frac{\$442,142}{\$875,000} = 50.5\% \text{ sales increase}
Chris needs a 50.5% sales increase to generate an ODP of $220,000 with a .35 contribution margin.
Cascade Home Care Case Study

5. Let’s assume that Chris is able to implement some of our recommendations from his Profit Mastery assessment – and he is able to **increase** his contribution margin back to his 2015 levels. In this event, what would his required sales level be to produce an ODP of $220,000?

2015 CM = .38  From #4 on previous page:

- $302,000 FC
- $159,000 Additional ODP
- $461,000 "Bogey"
Cascade Home Care Case Study

$461,000 \times .38 = $1,213,158 \text{ total sales}

\text{Percentage Increase}

\frac{$1,213,158 - $875,000}{$875,000} = \frac{$338,158}{$875,000}$
$338,158
$875,000 = 38.6% sales increase

Chris only needs a 38.6% sales increase to generate an ODP of $220,000 with a .38 contribution margin
Now, let’s assume that, in fact, Cascade **will** incur the following cost increases. (1) hire a marketing manager at a total fixed cost of $48,000 and (2) rent **will** increase $1,500 per month. At his 2017 contribution margin, what sales will be required to produce an ODP of $220,000?

\[
\begin{align*}
\text{FC} &= \$302,000 \\
\text{Salary / perks} &= \$48,000 \\
\text{Rent} &= \$18,000 \\
\text{Add’l ODP} &= \$159,000 \\
\end{align*}
\]

\[
\frac{\$527,000}{.35} = \$1,505,714
\]
Cascade Home Care Case Study

$1,505,714 - $875,000 = $630,714

$630,714 / $875,000 = 72.1% \text{ Sales ↑}

7. The sales figure you calculated in #6 above represents a 72.1% increase over his 2017 sales of $875,000. Please evaluate the various options you would recommend to achieve his ODP $ goals.
8. Unit Pricing. Below is the data you have. How many hours do you have to sell break-even?

Rate = $21/hr  
FC = $600,000/yr ($50,000/mo)  
Labor Rate - $12/hr  
Burden – 15%  
Royalty – 5%  

National Avg. $15 - $27  
Labor at 55%  
VC = Caregiver (COGS) + Royalties
Cascade Home Care Case Study

$21 \times 0.05 = \$1.05 \text{ Royalty}
Cascade Home Care Case Study

$21 \times 0.05 = $1.05 \text{ Royalty}

$12 \times $1.15 = $13.80 \text{ Burden}
Cascade Home Care Case Study

$21 \times 0.05 = $1.05 \text{ Royalty}

$12 \times 1.15 = $13.80 \text{ Burden}

VC = $13.80 + $1.05 = $14.85
Cascade Home Care Case Study

$21 \times 0.05 = 1.05 \text{ Royalty}

$12 \times 1.15 = 13.80 \text{ Burden}

VC = 13.80 + 1.05 = 14.85

CM = 21 - 14.85 = 6.15
Cascade Home Care Case Study

$21 \times 0.05 = \$1.05 \text{ Royalty}

$12 \times \$1.15 = \$13.80 \text{ Burden}

\text{VC} = \$13.80 + \$1.05 = \$14.85

\text{CM} = \$21 - \$14.85 = \$6.15

600,000 \div \$6.15 = 97,560 \text{ hours}
Cascade Home Care Case Study

9. Same data as #8 except you raise the billing rate to $22/hour.

a. How many hours do you have to sell?
Cascade Home Care Case Study

\[ \% P \uparrow = \frac{1}{22} = 4.8\% \]
Cascade Home Care Case Study

\[
\% \ P \ \uparrow \ = \ \frac{1}{22} \ = \ 4.8\%
\]

\[
22/\text{hr x } .05 = 1.10 \ \text{Royalty}
\]
Cascade Home Care Case Study

% \( P \uparrow \) = \( \frac{1}{22} \times 100 \) = 4.8%

\( \frac{22}{hr} \times 0.05 = \$1.10 \) Royalty

\( \$12 \times 1.15 = 13.80 \) Burden
Cascade Home Care Case Study

\[ \% \text{ P} \uparrow = \frac{1}{22} = 4.8\% \]

\[ \frac{22}{\text{hr}} \times 0.05 = 1.10 \text{ Royalty} \]

\[ 12 \times 1.15 = 13.80 \text{ Burden} \]

\[ \text{VC} = 13.80 + 1.10 = 14.90 \]
Cascade Home Care Case Study

% P ↑ = $1/$22 = 4.8%

$22/hr x .05 = $1.10  Royalty

$12 x 1.15 = 13.80 Burden

VC = $13.80 + $1.10 = $14.90

$22-$14.90 = $7.10
Cascade Home Care Case Study

\[ \% P \uparrow = \frac{1}{22} = 4.8\% \]

$22/hr \times 0.05 = $1.10 \text{ Royalty}

$12 \times 1.15 = 13.80 \text{ Burden}

VC = $13.80 + $1.10 = $14.90

$22 - $14.90 = $7.10

600,000 \div $7.10 = 84,507 \text{ hours}
b. What percentage can your hours decrease and still break-even?
Cascade Home Care Case Study

% hours ↓ -- 97,560
- 84,507
13,043

13,043 / 97,560 = 13.4%
Moral: If this company raises price 4.8\% ($1.00/hr), then hours can decrease by 13.4\% (13,043 hours) before they make less.
Seven Steps to Business Success

1. Plan properly before start up
2. Monitor financial position
3. Understand the relationship between price, volume, and costs
4. Manage cash flow
5. Manage growth
6. Borrow properly
7. Plan for transition
CONCLUSIONS:

- **Unit Profitability is Driven By:**
  
  - Financial education that provides the foundation of financial understanding across an entire network.
  
  - Financial benchmarking that establishes a yardstick of measurement, giving a franchisee the opportunity to create the most profitable business possible.
  
  - Performance groups that establish a level of accountability and discipline that enables franchisees to do the hardest of all management processes, CHANGE.
OBJECTIVES FOR TODAY’S SESSION:

● Discover the three key processes that drive unit profitability in every franchise network.

● Learn a specific new financial tool that enables franchisees to make better business decisions, customized specifically for QSR, B2B, and SERVICE industry franchises.
Section 3: Break-Even

Test: How does a Business make a Profit?

Answer these two questions:

VC = 70%
FC = $144,000
TP = $60,000

1) Needed Sales:
2) If FC ↑ $1.00, what sales required ________
Seven Steps to Business Success

1. Plan properly before start up
2. Monitor financial position
3. Understand the relationship between price, volume, and costs

**Income Statement** Mgt.
How to make a profit!
Your definition of B-E...
Only time to be at B-E?
Learning Objectives

- Use Break-Even to:
- Look at an income statement in a new way (Look and Use)
- Understand how costs **behave** in a company (CPA vs Mgt. Intel.)
- Eval. how changes in Price, Volume, and Costs impact profitability (**Predictive**)  
  - Reaction time to changing costs?  
  - Time is _______...
Warm Up Activity

What do you think your monthly and annual Break-Even number is?
   Monthly $ _______  Annual $ __________

If your employee breaks something that costs $50, how much in sales do they need to do to cover those lost dollars?  $ ______________

If you going to hire a new employee for $40,000 a year in salary and benefits, how much in increased sales do you need to do to cover that cost?  $ ______________

If you are going to open a new location for $250,000, what kind of sales will you need to cover your inv. and make a return on your inv.?  $ ______________
What Types of Questions Can Break-Even Answer?

1. If I cut or add a fixed cost how will it impact the volume of sales I need to Break-Even?

2. If I Raise prices how will it impact Break-Even?

3. If I Lower prices how will it impact Break-Even?

4. Review the Key Terms
Break-Even 4 Step Process

1. Classify expenses as **Fixed** or **Variable**

2. Calculate **Variable Costs as a % of Sales**
   \[
   \frac{VC}{Sales} = \underline{VC}\% \\
   \]

3. Determine **Contribution Margin %**
   \[
   100\% - \underline{VC}\% = \underline{\%} \\
   \]

4. Divide **Fixed Costs** by
   \[
   \text{Cont. Margin}\% = \text{Break-Even} \\
   \]
Standard Income Statement

Accountant’s P&L

Sales
- **COGS**
= Gr. Profit
- **Op. Exp.**
Net Profit

Reclassify Costs

At B-E Profit = ____
Fixed Costs?

You gotta pay’em whether or not you sell anything!
How Do Fixed Costs Behave?

Sample Fixed Costs
- Officer Salary
- Office Supplies
- Insurance
- Utilities
- Rent (F&V)
How Do Variable Costs Behave?

**Proportional to Sales**

Sales Cause Variable Costs
How Do Variable Costs Behave?

Sample Variable Costs
- Materials – COGS
- Freight
- Commissions
- Production Labor
- Bad Debts
- CC Fees
- Royalties

Sales vs. Variable Costs Graph
Strategic Thinking…

If Sales are going UP?
Strategic Thinking...

If Sales are going DOWN?
Reconstruct the P&L

Accountant’s P&L

Sales
- COGS
= Gross Profit
- OE (- VOEs)
Net Profit

Contribution Margin

Managed or Break-Even P&L

Sales
- Var. Costs
What’s Left
- Fixed Costs
Net Profit

With Net Profit at 0, you are at Break-Even
$ Sales - VCs

Variable Costs:
$ Materials – COGS
$ Freight
$ Commissions
$ Production Labor
$ Bad Debts
$ CC Fees
$ Royalties

= Contribution Margin

- Fixed Costs:
$ Management Salaries & Office Payroll
$ Rent
$ Depreciation
$ Telephone
$ Insurance, etc.

= Net Profit
We need to build an Example…
Rod’s Pen Company

Pens cost  $0.50  Sell for $1.00
Commissions  $0.10
Variable Costs  $0.60

Variable Cost % = 60%
The Contribution Margin as a % = ______
If Fixed Costs = $800,000, how much sales are needed to Break-Even?
(How many $.40s? D/M?)
Rod’s Pen Company

Here’s the math:

Break-Even = \frac{\text{Fixed Costs}}{\text{C.M. %}} = \frac{\$800,000}{.40} = \$2,000,000

How much will I make?

\$2,000,001 = \underline{} \quad \$2,000,002 = \underline{}

How long do the \$.60 VCs keep going??
Cost structure of a business...

Variable Cost % = 60%
Fixed Costs = $800,000

Every business has a cost structure!

Every banker wants every business owner to know...

VC% = \frac{VC}{FCs}

If you don’t know your costs?

Succeed by _______________ ??
The Cup Theory
The Concept of Contribution Margin

Sales (start with $1)

Variable Cost Cup

Fixed Cost Cup

Contribution Margin

Net Profit Cup

Net Profit Cup

Net Profit Cup

Net Profit Cup

Net Profit Cup

Net Profit Cup

Net Profit Cup

Net Profit Cup

Net Profit Cup

Net Profit Cup

Net Profit Cup
The Cup Theory
The Concept of Contribution Margin

Variable Cost
$2,000,000
60%

Fixed Cost
$1,200,000

Contribution Margin
40% $800,000

Net Profit
$0

Cup

Fixed Cost Cup
$800,000

Cup

$2,000,000
Lessons from The Cup Theory

- What happens if you never fill the Fixed Cost Cup?
- What happens if you never fill the Variable Cost Cup? *You’re ________*

Lessons from the Airlines...

*Lose a little on each sale.....*
Rod’s Pen Company

What additional sales are needed if we want to make a $200,000 Profit? (If you don’t set a goal...)

$ ______________

Fixed Costs inc. = $200,000 =
C.M. % .40

$500,000

Not $2.2M
The Cup Theory
The Concept of Contribution Margin

Variable Cost Cup
$1,500,000
60%

Fixed Cost Cup
$800,000

Net Profit Cup
$200,000

Contribution Margin
40%

$1,000,000
Break-Even 4 Step Process

1. Classify expenses as **Fixed** or **Variable**

2. Calculate **Variable Costs as a % of Sales**
   
   \[
   \frac{VC}{Sales} = \underline{\text{VC%}}
   \]

3. Determine **Contribution Margin %**
   
   \[100\% - \text{VC\%} = \underline{%}\]

4. Divide **Fixed Costs** by **Contribution Margin %** = Break-Even
How do you treat Profit?

Treat Profit as a ________  __________

Not a cost of Operations but a

cost of __________

Return on ___________________
If fixed costs increase by $1.00, what do we need in increased sales to cover that cost?

**Fixed Costs increase** = $\ 1.00 = $2.50

C.M. % .4

*Operating Leverage...*
Carl’s Creative Sandwich Shop (Practice)

Carl Forssen has owned his Creative Sandwich Shop franchise for almost 9 years. He’s located in a major mid-west city and has been operating profitably for many years. Carl heard from his banker that break-even analysis is a powerful management tool that can be used to assess almost any business decision. He has come to you for help in better understanding how to apply the concept in his own franchise.

Carl wants to calculate his Break-even from 3 years ago and he needs your help. From his P&L, Sam has gone through each line item and identified what he believes to be his variable and fixed costs. In summary, here’s what he found from 2015:
Carl’s Creative Sandwich Shop (Practice)

Total Variable Costs: $310,000

Total Fixed Costs: $103,000

Net Sales: $500,000
What’s needed now is to help Carl compute his variable cost percentage and contribution margin percentage — and calculate what his break-even was in 2015.

<table>
<thead>
<tr>
<th>VC Sales</th>
<th>$310,000</th>
<th>VC% = 62%</th>
<th>100%</th>
</tr>
</thead>
<tbody>
<tr>
<td>$500,000</td>
<td>0.62</td>
<td>0.38</td>
<td></td>
</tr>
</tbody>
</table>

**Break-even = $271,000**
1. Figure out how much profit Carl made in 2015.

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Sales</td>
<td>$500,000</td>
</tr>
<tr>
<td>- Var. Costs</td>
<td>$310,000</td>
</tr>
<tr>
<td>= CM</td>
<td>$190,000</td>
</tr>
<tr>
<td>- Fix. Costs</td>
<td>$103,000</td>
</tr>
<tr>
<td>Profit</td>
<td>$87,000</td>
</tr>
</tbody>
</table>

$1.00 / .38 = $2.63
We’re now into Q1 2018 and Carl needs to figure out what has happened to his company over the last three years. He has had good sales growth, but he is concerned about the operational efficiency of the business.

From his P&L, Carl has again gone through each line item and identified what he believes to be his variable and fixed costs today. Here’s the latest #s:
Carl’s Creative Sandwich Shop (Case Study)

Total Variable Costs: $495,000

Total Fixed Costs: $157,500

Net Sales: $750,000
Carl’s Creative Sandwich Shop  (Case Study)

Now, three years later, let’s help Carl compute his variable cost percentage and contribution margin percentage — and then show him how to apply that information as a decision-making tool.

\[
\text{VC\%} = \frac{\$495,000}{\$750,000} = 66\% \\
\text{CM} = 100\% - 66\% = 34\%
\]

\[
\text{B-E} = \frac{\$157,500}{.34} = \text{Break-even} = \$463,200
\]
3. Figure out how much profit Carl made in 2017.

<table>
<thead>
<tr>
<th>Total Sales</th>
<th>$750,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>- Var. Costs</td>
<td>$495,000</td>
</tr>
<tr>
<td>= CM</td>
<td>$255,000</td>
</tr>
<tr>
<td>- Fix. Costs</td>
<td>$157,500</td>
</tr>
<tr>
<td>Profit</td>
<td>$97,500  13%</td>
</tr>
</tbody>
</table>

$1.00 / .34 = $2.94
Carl’s Creative Sandwich Shop (Case Study)

What has Happened to Carl’s Operation in the Last Three Years?
5. Higher food and labor costs are expected to increase overall variable costs by 2% next year. Assuming his mix of sales, other costs, and pricing remain consistent, what will be his break-even sales level?

Old VC%  .66  \[ \text{100\%} \]  \[ \frac{\text{157,500 FC}}{\text{.32 CM}} = \$492,200 \]

+ Add’l VC  .02  \[ \text{-68\%} \]

= New VC%  .68  \[ \text{32\% New CM\%} \]

Inc. Sales Needed:  \[ \$492,200 \text{ New B-E} \]
\[ \$463,200 \text{ Old B-E} \]
\[ + \$29,000 \text{ add’l sales} \]
Carl’s Creative Sandwich Shop (Case Study)

\[
\frac{29,000}{750,000} = +3.8\% \text{ increase}
\]

If variable costs increase 2%, sales must increase 3.8%
Carl’s Creative Sandwich Shop (Case Study)

6. Carl needs to bring his shop up-to-date to maintain an appealing look to customers. At the Carle time, he wants to install a new computer system to better track the details of his operation. Here are some of his estimated costs and related goals:

- $16,000 computer system cost
- $40,000 Remodeling cost
- $1,500 est. annual interest expense to finance the project over 5 years
- His goal is to recover costs in 5 years
- He has a goal to earn a 10% ROI

Assuming costs, prices, and sales mix remain consistent, how much additional annual sales will Carl need to achieve his goals?
Carl’s Creative Sandwich Shop  (Case Study)

$56,000 \div 5 \text{ years} \times 10\% \quad \rightarrow \quad $5,600/\text{yr. return on investment goal}

$18,300 = $53,800 \text{ add’l sales needed} \quad (\because \frac{18,300}{53,800} = 0.34)

\frac{$53,800}{$750,000} = +7.2\% \text{ sales increase}

\begin{align*}
\text{New Fixed Costs} & \\
$11,200 \quad \text{(annual)} & \\
$5,600 \quad \text{(ROI)} & \\
$1,500 \quad \text{(interest)} & \\
$18,300 & 
\end{align*}
7. The shop had 50,000 checks last year. How many checks were needed to Break-even?

\[
\begin{align*}
\frac{750,000}{50,000} &= \frac{15.00 \text{ sales/check}}{} \\
\frac{495,000}{50,000} &= \frac{9.90 \text{ VC/check}}{} \\
&= \frac{5.10 \text{ CM/check}}{}
\end{align*}
\]

\[
\begin{align*}
\frac{157,500}{5.10} &= 30,900 \text{ checks}
\end{align*}
\]
8. Carl’s going to increase his weekly marketing budget by $700.
   How many additional checks per week will he need to bring in to cover his cost?

   \[
   \frac{$700}{$5.10} = 137 \text{ checks/week}
   \]

   \[
   \frac{50,000}{52} = 960 \text{ current checks per week}
   \]

   \[
   \frac{137 \text{ checks}}{960} = +14.3\% \text{ check increase}
   \]
Carl is excited about the new opportunities to grow his business through Catering.

Here are the numbers:

Average Catering Sale = $100
Variable Costs 66% = $66

CM per sale $34
Carl’s Creative Sandwich Shop (Case Study)

Carl is going to start by using one of his senior staff being paid $15 an hour to sell catering 2 hours a day during the weekdays, five days per week for a total cost of $600 per month.

A. How many sales per week/day does the staff person need to make to pay for themselves?

\[
\begin{align*}
\text{Fixed Cost} &= 18 \text{ orders per month}/4.5 \text{ per week}/1 \text{ order per day} \\
\text{CM} &= 34 \\
\end{align*}
\]

B. How much in new Profits will Carl have if the person averages three sales per day In a 5 day week? ($300 per day x 20 days)

\[
\begin{align*}
\text{New revenue} &= 6,000 \\
\text{Variable Costs} &= 3,960 \\
\text{Additional Profit} &= 2,040 \\
\end{align*}
\]

WHY? Your Fixed Costs are already covered!
Carl’s Creative Sandwich Shop (Case Study)

10. Carl is considering raising his prices up to provide a $1.00 price increase, up 6.7% to $16. How many fewer checks can he sell and still make the same profit? Remember, he will need to pay his Royalties (7% plus 2% ad fund) on the sales increase, which will total $4,500 ($50,000 x 9% = $4,500)

\[
\begin{align*}
\$800,000 & = \text{$16.00 sales/check} \\
50,000 \text{ checks} \\
\$499,500 & = \text{$9.99 VC/check} \\
50,000 \text{ checks} \\
& \text{ $6.01 CM/check}
\end{align*}
\]

\[
\frac{\$157,500}{\$6.01} = \text{BE = 26,123 checks}
\]
Carl’s Creative Sandwich Shop (Case Study)

Old BE = 30,900 checks
New BE = 26,123 checks
4,777 fewer checks

\[ \frac{4,777}{50,000 \text{ total checks}} = 9.6\% \text{ Fewer Checks} \]

If price goes UP $1.00, Checks can go down 9.6% and make the same amount of Profit.
What happens if Carl reduces his price by $1.00 to $14 per check? Now his variable costs will go down $4,500 due to the reduced Royalties.

\[
\frac{700,000}{50,000} = \frac{14.00 \text{ sales/check}}{}
\]

\[
\frac{490,500}{50,000} = \frac{9.81 \text{ VC/check}}{4.19 \text{ CM/check}}
\]

\[
\frac{157,500}{4.19} = \text{BE} = 37,470 \text{ checks}
\]
Carl’s Creative Sandwich Shop  (Case Study)

New BE = 37,470 checks
Old BE = 30,900 checks
6,570 MORE checks

6,570
50,000 checks

13.1% More Checks

If price goes DOWN $1.00 Carl MUST sell 13.1% MORE checks to make the same Profit.
CONCLUSIONS:

- **Unit Profitability is Driven By:**
  - Financial education that provides the foundation of financial understanding across an entire network.
  - Financial benchmarking that establishes a yardstick of measurement, giving a franchisee the opportunity to create the most profitable business possible.
  - Performance groups that establish a level of accountability and discipline that enables franchisees to do the hardest of all management processes, CHANGE.
Thank You and Evaluations

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Metrics Matters: Identifying and Implementing the Key Drivers of Unit Profitability (for Franchisees)
OBJECTIVES FOR TODAY’S SESSION:

● Discover the three key processes that drive unit profitability in every franchise network.

● Learn a specific new financial tool that enables franchisees to make better business decisions, customized specifically for QSR, B2B, and SERVICE industry franchises.
Section 3: Break-Even

Test: How does a Business make a Profit?

Answer these two questions:

1) Needed Sales:

2) If FC ↑ $1.00, what sales required ________

VC = 70%
FC = $144,000
TP = $60,000
Seven Steps to Business Success

1. Plan properly before start up
2. Monitor financial position
3. Understand the relationship between price, volume, and costs

Income Statement Mgt.
How to make a profit!
Your definition of B-E...
Only time to be at B-E?
Learning Objectives

● Use Break-Even to:

● Look at an income statement in a new way (Look and Use)

● Understand how costs behave in a company
  (CPA vs Mgt. Intel.)

● Evaluate how changes in Price, Volume, and Costs impact profitability (Predictive)
  – Reaction time to changing costs?
  – Time is ________...
Warm Up Activity

What do you think *your* monthly and annual Break-Even number is?
   Monthly $ _______  Annual $ ___________

If your employee breaks something that costs $50, how much in sales do they need to do to cover those lost dollars? $ ________________

If you are going to hire a new employee for $40,000 a year in salary and benefits, how much in increased sales do you need to do to cover that cost? $ ________________

If you are going to open a new location for $250,000, what kind of sales will you need to cover your inv. and make a return on your inv.? $ ________________
What Types of Questions Can Break-Even Answer?

1. If I **cut** or **add** a fixed cost how will it impact the volume of sales I need to Break-Even?

2. If I **Raise** prices how will it impact Break-Even?

3. If I **Lower** prices how will it impact Break-Even?

4. Review the Key Terms
Break-Even 4 Step Process

1. Classify expenses as **Fixed** or **Variable**

2. Calculate **Variable Costs as a % of Sales**
   \[
   \text{VC} \quad \text{Sales} = \ \text{_______VC%}
   \]

3. Determine **Contribution Margin %**
   \[
   100\% - \text{VC}\% = \ \text{_______%}
   \]

4. Divide **Fixed Costs** by
   \[
   \text{Cont. Margin}\% = \text{Break-Even}
   \]
Sales
- COGS
= Gross Profit
- Operating Expenses
  Net Profit

At B-E Profit = ____
Fixed Costs?

You gotta pay’em whether or not you sell anything!
How Do Fixed Costs Behave?

Sample Fixed Costs
- Officer Salary
- Office Supplies
- Insurance
- Utilities
- Rent (F&V)

Diagram:
- Fixed Costs vs. SALES
  - Fixed Costs: Capacity/Profits/Examples
How Do Variable Costs Behave?

Proportional to Sales

Sales Cause Variable Costs
How Do Variable Costs Behave?

Sample Variable Costs
- Materials – COGS
- Freight
- Commissions
- Production Labor
- Bad Debts
- CC Fees
- Royalties
Reconstruct the P&L

Accountant’s P&L

Sales
- COGS
- OE (-VOEs)
= Gross Profit
Net Profit

Contribution Margin

Managed or Break-Even P&L

Sales
- Var. Costs
- Fixed Costs
What’s Left
Net Profit

With Net Profit at 0, you are at Break-Even
$ Sales - VCs

Variable Costs:  
$ Materials – COGS  
$ Freight  
$ Commissions  
$ Production Labor  
$ Bad Debts  
$ CC Fees  
$ Royalties

= Contribution Margin

- Fixed Costs:
$ Management Salaries & Office Payroll  
$ Rent  
$ Depreciation  
$ Telephone  
$ Insurance, etc.

= Net Profit
We need to build an Example…
Lisa’s Pen Company

Pens cost  \( .50 \)  Sell for $1.00

Commissions  \( + .10 \)

Variable Costs  \( .60 \)

Variable Cost % = 60%
Lisa’s Pen Company

The Contribution Margin as a % = ______

If Fixed Costs = $800,000, how much sales are needed to Break-Even?

(How many $.40s? D/M?)
Here’s the math:

Break-Even = \frac{Fixed \ Costs}{C.M. \ %} = \frac{800,000}{.40} = 2,000,000

How much will I make?

$2,000,001 = _______  \$2,000,002 = _______

How long do the $.60 VCs keep going??
Cost structure of a business...

Variable Cost % = 60%
Fixed Costs = $800,000

Every business has a cost structure!

Every banker wants every business owner to know... VC%
FCs
If you don’t know your costs?

Succeed by _______________ ??
The Cup Theory
The Concept of Contribution Margin

Sales (start with $1)

Variable Cost Cup → Contribution Margin

Fixed Cost Cup

Net Profit Cup
The Cup Theory
The Concept of Contribution Margin

Variable Cost Cup
$1,200,000

60%

Fixed Cost Cup
$800,000

Contribution Margin
40%

Net Profit Cup
$0

$2,000,000

$800,000
Lessons from The Cup Theory

▪ What happens if you never fill the Fixed Cost Cup?

▪ What happens if you never fill the Variable Cost Cup? You’re ______

Lessons from the Airlines...
Lose a little on each sale.....
Lisa’s Pen Company

What additional sales are needed if we want to make a $200,000 Profit? (If you don’t set a goal...)

$ ______________

Fixed Costs inc. = $200,000 =
C.M. % .40

$500,000

Not $2.2M
The Cup Theory
The Concept of Contribution Margin

$2,500,000

Variable Cost Cup

$1,500,000

Fixed Cost Cup

$800,000

Net Profit Cup

$200,000

Contribution Margin

40%

$1,000,000

60%
Break-Even 4 Step Process

1. Classify expenses as **Fixed** or **Variable**

2. Calculate **Variable Costs as a % of Sales**
   \[
   \frac{VC}{Sales} = \underline{VC\%}
   \]

3. Determine **Contribution Margin %**
   \[
   100\% - VC\% = \underline{\%}
   \]

4. Divide **Fixed Costs** by **Contribution Margin %** = Break-Even
How do you treat Profit?

Treat Profit as a __________  __________

Not a cost of Operations but a

cost of __________

Return on __________________
If Fixed Costs Go Up $1.00?

If fixed costs increase by $1.00, what do we need in increased sales to cover that cost?

Fixed Costs increase = $1.00 = $2.50

C.M. % = .4

Operating Leverage...
Sam’s SUPERSIGNS (Practice Example)

Sam Smith has had his SUPERSIGNS franchise for almost 9 years. He’s located in a major mid-west city and has been operating profitably for many years. Sam heard from his banker that break-even analysis is a powerful management tool that can be used to assess almost any business decision. He has come to you for help in better understanding how to apply the concept in his own franchise.

Sam wants to calculate his Break-even from 3 years ago and he needs your help. From his P&L, Sam has gone through each line item and identified what he believes to be his variable and fixed costs. In summary, here’s what he found from 2015:
Sam’s SUPERSIGNS (Practice Example)

Total Variable Costs: $390,000
Total Fixed Costs: $130,000
Net Sales: $600,000
What’s needed now is to help Sam compute his variable cost percentage and contribution margin percentage—and calculate what his break-even was in 2015.

<table>
<thead>
<tr>
<th>VC</th>
<th>$390,000</th>
<th>VC% = 65%</th>
<th>100%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales</td>
<td>$600,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>FC</td>
<td>$130,000</td>
<td></td>
<td>35%</td>
</tr>
<tr>
<td>CM%</td>
<td></td>
<td>.35</td>
<td></td>
</tr>
</tbody>
</table>

FC: Fixed Costs
CM%: Contribution Margin%
Sam’s SUPERSIGNs (Practice Example)

Break-even = $371,428

2. How much Profit did Sam make in 2015?

Sales $600,000
- VCs $390,000
= CM $210,000
- FCs $130,000
$80,000 (13.3%)

$1.00/.35 = $2.86
Sam’s SUPERSIGN (Case Study)

We’re now into Q1 2018 and Sam needs to figure out what has happened to his company over the last three years. He has had good sales growth, but he is concerned about the operational efficiency of the business.

From his P&L, Sam has again gone through each line item and identified what he believes to be his variable and fixed costs today. Here’s the latest #s:
Sam’s SUPERSIGN (Case Study)

Total Variable Costs: $560,000
Total Fixed Costs: $140,000
Net Sales: $800,000
Sam’s SUPERSIGN (Case Study)

Now, three years later, let’s help Sam compute his variable cost percentage and contribution margin percentage — and then show him how to apply that information as a decision-making tool.
1. What was Sam’s break-even sales level in 2017?

\[ VC\% = \frac{\$560,000}{\$800,000} = 70\% \]

\[ CM\% = 100\% - 70\% = 30\% \]

\[ B-E = \$140,000 \]
Sam’s SUPERSIGNS (Case Study)

Break-even = $466,666

2. Figure out how much profit Sam made in 2017.
   - Sales $800,000
   - VCs $560,000
   = CM $240,000
   - FCs $140,000
   $100,000 (12.5%)

3. $1.00/.30 = $3.33
4. Sam needs to bring his location up-to-date. At the same time, he wants to install a new POS system to better track the details of his operation. Here are some of his estimated costs and related goals:

• $16,000 POS system cost
• $40,000 Remodeling cost
• $1,500 est. annual interest expense to finance the project over 5 years
• His goal is to recover costs in 5 years
• He has a goal to earn a 10% ROI

Assuming costs, prices, and sales mix remain consistent, how much additional annual sales will Sam need to achieve his goals?
Sam’s SUPERSIGN (Case Study)

<table>
<thead>
<tr>
<th>Investment</th>
<th>Calculation</th>
<th>New Fixed Costs</th>
</tr>
</thead>
<tbody>
<tr>
<td>$56,000</td>
<td>$56,000 ÷ 5 years</td>
<td>$11,200 (annual)</td>
</tr>
<tr>
<td>X 10%</td>
<td>$5,600/yr. return on investment goal</td>
<td>$5,600 (ROI)</td>
</tr>
<tr>
<td>$18,300</td>
<td>$61,000 add’l sales needed</td>
<td>$1,500 (interest)</td>
</tr>
</tbody>
</table>

- $18,300 = $61,000 add’l sales needed
- $61,000 = 7.6% sales inc.
- $800,000
5. If Sam hires a new sales person at $45,000 annual salary, how much in new sales will the salesperson need to provide before they begin to pay for themselves?

\[
\frac{\$45,000}{.30} = \frac{\$150,000}{12} = \$12,500 \text{ sales per month}
\]
6. Sam is excited about the new local group marketing plan for his area. His monthly contribution will be $600. What additional annual sales will be needed to cover this additional fixed cost?

$600 \times 12 = \$7,200 \text{ inc. annual fixed cost}

\$7,200 \times 0.30 \text{ CM} = \$24,000 \text{ inc. annual sales; } \$2,000 \text{ month}
7a. Higher COGs are expected to increase overall variable costs by 2%. Assuming his mix of sales, other costs, and pricing remain consistent, what will be his break-even sales level?

Old VC% 70% 100% $140,000 FC = $500,000
+ Add’l VC 02% - 72%
= New VC% 72% 28% New CM%

.28 CM
Sam’s SUPERSIGN (Case Study)

Inc. Sales Needed:  $500,000 New B-E

-$466,666 Old B-E

+ $33,334 add’l sales

$33,334 = 7% increase

$466,666

If variable costs increase 2%, sales must increase 7%
7b. Sam says “Forget that!!” What would be the impact if Sam can reduce variable costs by 2%?

\[
\begin{align*}
\text{Old VC\%} &= 70\% \\
- 2\% &= 68\% \\
\hline
68\% &= 32\% \\
\hline
$140,000 &= \$437,500 \\
.32 &= .32
\end{align*}
\]
Sam’s SUPERSIGNS (Case Study)

Decrease in sales       $466,666  Old B-E
                          -  $437,500  New B-E
                            $  29,166

$29,166 / $466,666 = 6.2%

If variable costs decrease 2%, sales CAN decrease 6.2%.
8. The store had 2,285 orders last year. How many orders were needed to break even?

\[
\begin{align*}
800,000 & = 2,285 \text{ orders} \\
\frac{560,000}{2,285} & = \frac{245}{2,285} \text{ VC/order} \\
& \frac{105}{2,285} \text{ CM/order}
\end{align*}
\]
Sam’s SUPERSIGN (Case Study)

$140,000 Fixed Costs

$105

1,333 orders to BE
CONCLUSIONS:

- **Unit Profitability is Driven By:**
  - Financial education that provides the foundation of financial understanding across an entire network.
  - Financial benchmarking that establishes a yardstick of measurement, giving a franchisee the opportunity to create the most profitable business possible.
  - Performance groups that establish a level of accountability and discipline that enables franchisees to do the hardest of all management processes, CHANGE.