


MicroLenders Forum 2020
Profit and Loss Analysis

March 11, 2020

1



Welcome

- P&L Overview
- Bookkeeping Foundation for Quality P&L
- Trend Analysis
- Margin Analysis
- Exercises

2



What You Will Leave Knowing

- Basic P&L Structure
- Elements of a Quality P&L
- Bookkeeping Suggestions to Create Quality P&L
- Key P&L Indicators of Business Health
- Helping Owners with Management Decisions using P&L
- Applying Margin and Trend Analysis to three companies

3



Both Lenders and Coaches

Both community lenders and business coaches should be versed in financial analysis basics

- Provide better advice to clients when you understand P&L and Balance Sheets – even if client has neither
- Both these financial statements are required for underwriting larger loans

4



What Can Financials Tell Us?

- Is business profitable
- Best pricing strategy
- Which product or service lines are most profitable
- Is owner managing inventory
- Is the owner managing overhead
- Is the business growing and how well is it managing growth

5



How Money Works in a Business

Even if client does not have financials but you understand how:

- To analyze trends and margins
- Permanent working capital and operating cycle work
- Profits get used in fast growth
- A Balance Sheet works
- Seasonality and growth impact cash

You will be a better-informed lender or coach.

It is hard to give quality advice if you don't know these financial concepts.

6



What is a Profit & Loss Statement

- The Profit and Loss Statement measures revenues and expenses over a defined period of time (month, quarter, year)
- Measures profitability: Whether the business is making a profit on what it sells
- Insights from the P&L can help with reducing expenses, growing revenue, and increasing profit.
- All businesses need income and expense records to file a tax return

7



Profit and Loss Structure

Basic formula

$$\begin{array}{r} + \text{ Sales} \\ - \text{ Cost of Goods Sold} \\ = \text{ Gross Profit} \\ \\ - \text{ Overhead} \\ = \text{ Net Profit} \end{array}$$

8

Sales



Income = Sales = Revenue

The revenue earned from the sale of goods and services.

9

Cost of Goods Sold



- Expenses incurred that are directly associated with the production or service delivery for sales in that period.
- Direct material and labor that went into the goods/products sold that month/quarter/year.
- Also called Variable Expense, as it varies with sales volume

10



What is COGS?

- **Manufacturing:** Direct materials, direct labor, shipping
- **Retail:** Wholesale cost of inventory, shipping
- **Service:** Usually don't have COGS, but in some cases labor and other costs are directly associated with service delivery

11



Microbusinesses and COGS

- Many microbusinesses cannot track COGS
- Don't have inventory & sales tracking technology; time; know-how
- Might only calculate once per year with year-end inventory count (tax return)
- It might not matter with businesses that turn over inventory within 30 days (restaurant for example)

12



Gross Profit

- Gross Profit = Sales - COGS
- Demonstrates the ability to control direct production costs: Purchasing, labor and materials
- Also indicates viability of pricing
- One of the best measures to help product businesses become more profitable

13



Overhead

- Ongoing expenses of operating a business: rent, phone, marketing, website, insurance, etc.
- Also called Fixed Expense
- Doesn't vary much (or at all) with changes in sales volume

14



That Leaves Net Profit (or Loss)

Net profit pays for (sole proprietor)

- Owners Draw
- Future expansion, like new equipment
- Principal portion of loan payment
- Income Taxes
- Inventory purchases, especially if buying in bulk or in high-growth mode
- Personal expenses

15



What Should Not Be on P&L*

- Personal Income Taxes or Personal Expenses
- Sales Tax
- Owners Draw (sole proprietorship)
- Principal portion of debt service (only interest portion is an expense)
- Inventory purchases that will last more than 30 days
- Loan Capital
- Equity infusions

*refer to this slide for today's exercises

16



P&L Quality

- Can't do today's analyses on P&L full of errors
- Common expense errors: See previous slide
- We'll look at an error-ridden P&L and a clean one today

17



It All Starts with Bookkeeping

- Can't do analysis without bookkeeping system
- With bad numbers, or no numbers, company flying blind
- Can lead to:
 - Poor pricing and product selection
 - Taking on contracts, leases, equipment too expensive or doesn't increase profitability
 - Unfortunate financing decisions

18



Easy to Fix in QuickBooks

- Type of Account
- Merging Accounts
- Eliminating sub-accounts
- Adding class or customer: job functions
- Splitting transactions
- Changing accounts
- P&L issues in general

19



Hard to Fix in QuickBooks

- Sales Tax or Payroll errors
- Switching to QB payroll mid-year
- Sales information already deposited
- Balance Sheet Accounts
- High volume of errors
- Errors going back years
- Equity mistakes

Just Start Over

20



Bookkeeping Set up Suggestions*

- Build your own Chart of Accounts
- Eliminate all overlapping expense accounts
- Don't use expense accounts to create detail
- Use sub-accounts sparingly
- Use COGS if applicable and do-able
- Avoid "Miscellaneous" – becomes a black hole
- Keep P&L to one page

*refer to this slide for today's exercises

21



P&L Analysis

Analyzing historical performance

- Detects positive or negative trends in a company's past performance
- Helps business owner improve performance by identifying opportunities or issues
- Helps determine ability to pay new debt service

22



Key P&L Indicators

- Sales: Growing
- COGS: Stable / Falling
- Gross Profit: Rising
- Overhead: Stable / Falling
- Net Profit: Rising
- Net Profit enough to pay owner's draw, taxes, expansion plans and existing debt

23



Insight

- Successful integration of growth: employees, commercial rent, new large contracts, two locations
- One source for determining Global Cash capacity for new debt
- With proper bookkeeping and report design, can support strategic management decisions about pricing and product lines

24



Trend Analysis

- Compares a business' progress to itself over time
- Measures progress by looking at total sales, expenses and net profit in **dollars**
- Analysis comes through comparison of this month/year to last month/year
- To conduct trend analysis we create spreadsheets* placing annual P&L's side by side.

* or a report from bookkeeping reporting

25



Margin Analysis

- Convert the P&L numbers into **percentages** of total sales for more complete analysis*
- $\text{COGS/Sales} = \text{COGS margin}$
- $\text{Gross Profit/Sales} = \text{Gross Profit margin}$
- $\text{Overhead/Sales} = \text{Overhead margin}$
- $\text{Net Profit/Sales} = \text{Net Profit margin}$

*Also is helpful to compare margins over time in a spreadsheet

26



ABC Gift Card Company

Using the P&L accounting, bookkeeping and reporting rules we've reviewed so far...

- Please find the ways this P&L does not comply.
- What would you recommend to a business owner who came in with this P&L?

27



Retail Store with Two Locations

This P&L was created using QB "Classes" function, that can separate income and expense items by location, division, product line, etc.

- Review the margin analysis for Store 1 and Store 2.
- What feedback would you give to the business owner who brought in this P&L?

28

QRS Construction Company



This P&L is the sample company in my QB program

- Please complete the margin percentages
- Complete the Analysis section at the bottom.
- Using Key P&L Indicators and Insight, what feedback would you give the business owner with this P&L?

29

Suggestions



- Become an expert on bookkeeping software/app, accounting rules, financial reports
- Develop expertise on accurate set up, leading to clean reports tailored for that business
- Learn how the P&L, Balance Sheet, Working Capital, Operating Cycle work (*NDC Business Credit Analysis*)

30



Thank You!

Call Us!
415-922-4480

- Get on CAMEO's list for great info and opportunities:
CameoNetwork.org
- Contact Heidi Pickman with your program requests and ideas
- hpickman@cameonetwork.org

ABC Company
Profit & Loss
 January 2006 through December 2008

| | Jan '06 - Dec 08 |
|--------------------------------|------------------|
| Ordinary Income/Expense | |
| Income | |
| Reimbursed Expenses | 157.07 |
| Sales | 95,667.90 |
| Total Income | 95,824.97 |
| Cost of Goods Sold | |
| Cost of Goods Sold | 10,440.30 |
| Total COGS | 10,440.30 |
| Gross Profit | 85,384.67 |
| Expense | |
| Advertizong | 4,175.76 |
| Automobile Expense | 266.46 |
| BANK FEE | 201.99 |
| BUSINESS LIABILITY INS | 512.00 |
| Capital ioan payment-Owner C | 2,400.00 |
| Capital loan payment-Owner A | 4,178.00 |
| Capitol loan payment-Owner D | 500.00 |
| commission fees | 408.59 |
| EQUIPMENT REPAIR | 2,083.60 |
| Equipment Supply | 4,287.31 |
| FLOAT-PAID | -300.00 |
| GENERAL SUPPLY | 213.33 |
| Insurance | |
| Liability Insurance | 129.00 |
| Total Insurance | 129.00 |
| INTERNET BANK FEES | 1,911.39 |
| LOAN REPAYMENT | 10,348.12 |
| New Equipment | 7,645.45 |
| petty cash | 6,164.00 |
| Postage and Delivery | 6,370.97 |
| Printing and Reproduction | 46,839.72 |
| Professional Fees | |
| Accounting | 300.00 |
| Legal Fees | 1,283.75 |
| Total Professional Fees | 1,583.75 |
| REFUND | 16.50 |
| Rent | 5,910.82 |
| Repairs | |
| Building Repairs | 582.77 |
| Total Repairs | 582.77 |
| SALES TAX | 309.00 |
| STATIONARY | 748.64 |
| Storage | 1,275.00 |
| Supplies | |
| Office | 602.13 |
| Total Supplies | 602.13 |
| Taxes | |
| State | 800.00 |
| Total Taxes | 800.00 |
| Telephone | 5,496.82 |
| TEXT | 198.10 |
| Travel & Ent | |
| Meals | 209.39 |
| Total Travel & Ent | 209.39 |
| TRAVEL & ENT.- GAS | 1,011.60 |
| Travel & Ent. Lodging | 948.39 |
| Uncategorized Expenses | 0.00 |

1:06 PM
01/12/09
Accrual Basis

ABC Company
Profit & Loss
January 2006 through December 2008

| | <u>Jan '06 - Dec 08</u> |
|-----------------------------|--------------------------|
| Utilities | |
| Gas and Electric | 2,615.41 |
| Utilities - Other | 191.71 |
| Total Utilities | <u>2,807.12</u> |
| VOID | 0.00 |
| Website domain fees | 2,641.04 |
| Total Expense | <u>123,476.76</u> |
| Net Ordinary Income | -38,092.09 |
| Other Income/Expense | |
| Other Income | |
| loose decks sales at SFGS | 408.52 |
| Total Other Income | <u>408.52</u> |
| Net Other Income | <u>408.52</u> |
| Net Income | <u><u>-37,683.57</u></u> |

Retail Store with Two Locations

Can be created w. "Classes" in QB

| | Store 1 | | Store 2 | | TOTAL | |
|------------------------------------|-----------------|--------------------|------------------|--------------------|-----------------|--------------------|
| | Apr 2015 | % of Income | Apr 2015 | % of Income | Apr 2015 | % of Income |
| Sales | 13,000.00 | 100.0% | 14,440.00 | 100.0% | 27,440.00 | 100.0% |
| Total Income | 13,000.00 | 100.0% | 14,440.00 | 100.0% | 27,440.00 | 100.0% |
| Cost of Goods Sold | 6,800.00 | 52.31% | 8,590.00 | 59.49% | 15,390.00 | 56.09% |
| Total COGS | 6,800.00 | 52.31% | 8,590.00 | 59.49% | 15,390.00 | 56.09% |
| Gross Profit | 6,200.00 | 47.69% | 5,850.00 | 40.51% | 12,050.00 | 43.91% |
| Expense | | | | | | |
| Cleaning service | 25.00 | 0.19% | 75.00 | 0.52% | 100.00 | 0.36% |
| Dues & Subscriptions | 50.00 | 0.39% | 100.00 | 0.69% | 150.00 | 0.55% |
| Equipment & Fixtures | 0.00 | 0.0% | 550.00 | 3.81% | 550.00 | 2.0% |
| Insurance | 300.00 | 2.31% | 600.00 | 4.16% | 900.00 | 3.28% |
| Office & Store Supplies | 200.00 | 1.54% | 400.00 | 2.77% | 600.00 | 2.19% |
| Payroll Expenses | 1,200.00 | 9.23% | 4,400.00 | 30.47% | 5,600.00 | 20.41% |
| Rent | 750.00 | 5.77% | 1,650.00 | 11.43% | 2,400.00 | 8.75% |
| Telephone | 150.00 | 1.15% | 300.00 | 2.08% | 450.00 | 1.64% |
| Travel Expense | 200.00 | 1.54% | 400.00 | 2.77% | 600.00 | 2.19% |
| Total Expense | 2,875.00 | 22.12% | 8,475.00 | 58.69% | 11,350.00 | 41.36% |
| Net Income | 3,325.00 | 25.58% | -2,625.00 | -18.18% | 700.00 | 2.55% |

QRS Construction Company

| | Jan - Dec 2016 | | Jan - Dec 2017 | |
|-----------------------------|------------------|-------------|----------------|-------------|
| Income | | | | |
| Construction Income | 164,681 | | 447,537 | |
| Reimbursement Income | 835 | | 2,120 | |
| Total Income | 165,516 | 100% | 449,657 | 100% |
| Cost of Goods Sold | | | | |
| Cost of Goods Sold | 5,621 | | 15,328 | |
| Job Expenses | 64,097 | | 165,299 | |
| Total COGS | 69,718 | | 180,627 | |
| Gross Profit | 95,799 | | 269,030 | |
| Expense | | | | |
| Automobile | 6,741 | | 6,845 | |
| Bank Service Charges | 138 | | 125 | |
| Insurance | 8,844 | | 20,125 | |
| Interest Expense | 4,484 | | 1,996 | |
| Payroll Expense | 0 | | 120,347 | |
| Postage | 0 | | 104 | |
| Professional Fees | 250 | | 250 | |
| Repairs | 2,064 | | 1,525 | |
| Tools and Machinery | 1,458 | | 2,821 | |
| Utilities | 2,772 | | 2,269 | |
| Total Expense | 26,751 | | 156,407 | |
| Net Ordinary Income | 69,048 | | 112,623 | |
| Other Income | 208.64 | | 376 | |
| Net Income | 69,256.32 | | 112,999 | |

ANALYSIS

| | | | |
|--|--------|--|--------|
| Change in Sales = (YR2 - YR1) / YR1 | | | |
| Change in GP = (YR2 - YR1) / YR1 | | | |
| Change in Net Profit = (YR2 - YR1) / YR1 | | | |
| COGS as % of sales trend | | | |
| Profit trend | | | |
| Growth trend | | | |
| Ability to repay debt | | | |
| Owner's Draw | 45,000 | | 45,000 |
| Taxes | 15,000 | | 25,000 |
| Net Cash for DS: Net Profit - Taxes - Draw | 9,256 | | 42,999 |
| New Annual Debt Service | 18,000 | | 18,000 |
| DS Coverage = Net Cash / DS | | | |