ATL Behind the Scenes

TRAINING SESSIONS

PRESENTED BY

ATL BUSINESS DIVERSITY

Welcome

ATL Behind the Scenes TRAINING SESSIONS

Audience questions

What is your Industry?

- Professional Services
- Manufacturing
- Construction
- Transportation
- Financial Services & Insurance
- Information Technology
- Retail & Trade
- Government
- Health Care
- Real Estate
- Media & Entertainment
- Other

Understanding the Financial Health of Your Business

PRESENTER

Milton Jones, Founding Member

Peachtree Providence Partners

PEACHTREE PROVIDENCE
PARTNERS

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Goals

01

Increase Awareness

02

Underscore the Need to Know Your Numbers

03

Activate Your Knowledge

04

Provide Direction and Resources

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Contents

Why Should You Know Your Numbers?

A. **Accounting and Finance are the language of business.**

A picture can be worth a thousand words, but certain key numbers paint the true picture.

B. **Your numbers are a GPS for your business.**

With them *in mind you find and stay on the pathways of success.*

Without them*, you can easily get lost.*

C. **Your numbers are the keys to the kingdoms of credit and investor capital.**

Without them*, those doors are locked.*

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Finance vs Accounting – What is the Difference?

Scope and Focus

A. Accounting

- Your firm’s financial transactions are grouped and presented based on the **accounting equation.**
- Assets (what you **own**) = liabilities (what you **owe**) + Owners’ Equity (Retained Earnings and Capital)
- This gives insights into your firm’s condition or situation.
- Focuses on the past

Scope and Focus

B. Finance

- Cash is King! Your firm is evaluated on how well it generates, uses and retains cash on the basis of several key measurements, the most important of which is **Free Cash Flow.**
- Free Cash Flow (FCF) = Cash a company has to distribute to investors or reinvest after all expenses have been covered.
- Focuses on the present and future

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Finance vs Accounting – What is the Difference?

How You Measure Financial Performance

A. **Accounting**

- Records and presents transactions on the **Accrual Basis** – when they are agreed upon versus when they are completed.

How You Measure Financial Performance

B. **Finance**

- Measures economic returns calculated on a **Cash Basis** – when cash is **actually exchanged** rather than initially agreed upon.

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Finance vs Accounting – What is the Difference?

How You Assess Value

A. Accounting

- Often relies on a conservatism principle which tends to suggest recording lower projected values of assets (LOCOM) and higher estimates of liabilities when there is uncertainty.
- Helps avoid over extension.

- LOCOM = Lower of Cost or Market

How You Assess Value

B. Finance

- Relies on an analytical process – valuation to determine the worth of a company, project or asset. Typically, one calculates net present value by using a discount rate to convert future cash flows into present values.

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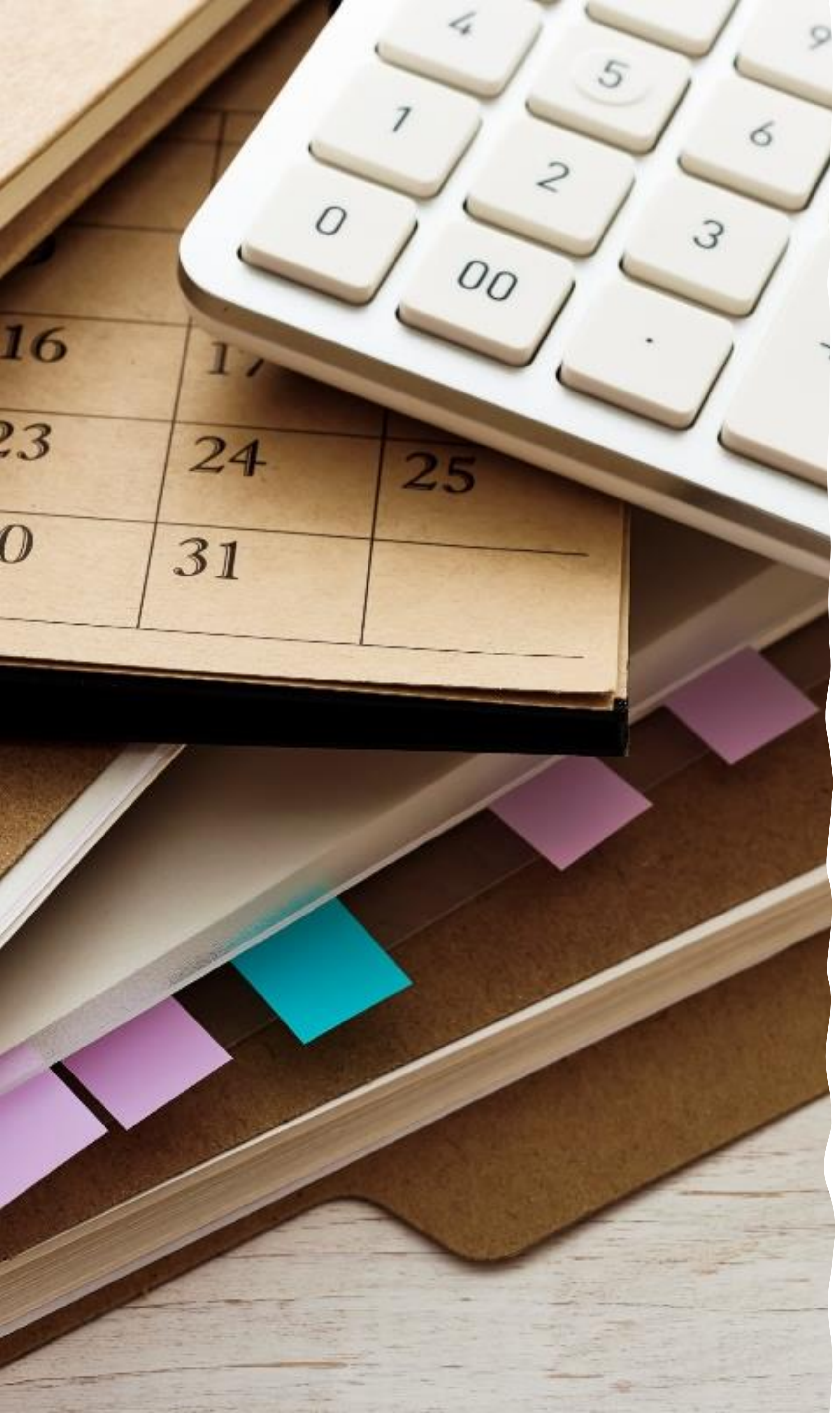

Finance vs Accounting - What is the Difference?

Conclusion

- Both are important and useful sets of tools to help you assess your company's performance and position.
- Both help you!

Know Your Numbers!

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Critical Financial Skills to Manage and Grow Your Business

Skill 1: Financial Statement Awareness and Analysis

- **What, When, Why, How**

A. **Balance Sheet** – financial document that communicates a company's worth or Net Book Value.

- Usually prepared monthly or quarterly.
- Internally, provides insight on what's working well or poorly.
- Externally, helps investors see assets a company has and obligations that exist. Helps auditors review compliance.

Critical Financial Skills to Manage and Grow Your Business

Skill 1: Financial Statement Awareness and Analysis

- **What, When, Why, How**

A. Balance Sheet (Continued)

- Accounting Equation
  - Assets = Liabilities + Owner's Equity
  - Types of Assets
    - Current assets (e.g., cash, A/R, marketable securities)
    - Fixed or long-term assets (e.g., buildings, property, plant and equipment FFE (furniture, fixtures, equipment), PP&E, etc.)
  - Types of Liabilities
    - Current Liabilities – typically due within 1 year
    - L/T or Non-Current liabilities – typically due beyond one year
    - Confirmed/Contracted obligation to provide goods or services in the future
  - Owner's Equity (**Assets – Liabilities = Owner's Equity**
    - Anything belonging to owners after liabilities are accounted for –
    - Retained Earnings/(loss), Paid-in Capital, etc.

    Assets – Liabilities = Owner's Equity
    - Retained earnings are the profits that your business has earned minus any stock dividends or other distributions.

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Critical Financial Skills to Manage and Grow Your Business

Skill 1: Financial Statement Awareness and Analysis

- **What, When, Why, How**

B. Income Statement

- Tells the financial story of a business's activities
- Usually presented monthly, quarterly and/or annually in comparison to the same period a year ago.
- What does it tell you?

  Is business making a profit or losing money

  How much it is paying to produce its product(s)

  Is it producing or consuming cash on a net basis

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Critical Financial Skills to Manage and Grow Your Business

Skill 1: Financial Statement Awareness and Analysis

- **What, When, Why, How**

Key Income Statement Categories

- Revenue
- Cost of Goods Sold
- Gross Profit
- General and Administrative Costs
- Depreciation
- Expenses
- Operating Income
- Income Taxes
- Net Income

Earnings Before Interest, Taxes, Depreciation and Amortization (EBITDA)

Critical Financial Skills to Manage and Grow Your Business

Skill 1: Financial Statement Awareness and Analysis

- **What, When, Why, How**

B. Income Statement (Continued)

- Vertical Income Statement Analysis
  - Typically shows all amounts as a percentage of a constant (Total Revenues or Total Expenses, etc.) and compare the **relative** size and impact of each category on the outcome.

- Horizontal Analysis
  - Typically compares changes in critical categories over time. This can help you see key trends and if they are moving in the right direction.

- Which One Should You Do? **Both Are Important!**

Critical Financial Skills to Manage and Grow Your Business

Skill 1: Financial Statement Awareness and Analysis

- **What, When, Why, How**

C. The Cash Flow Statement

- Tells the story of what happened to your business's cash during a specific duration of time typically known as an accounting period.
- By seeing how much cash impact different categories of activity generate you can make business decisions to change or sustain these activities and outcomes.
- Note:
  - **Cash flow =** NetFlow of cash **into or out of** a business.
  - **Profit** = amount of revenue left after all expenses have been paid.
  - A business can be **profitable** but have a **negative cash flow** and vice versa.

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Critical Financial Skills to Manage and Grow Your Business

Skill 1: Financial Statement Awareness and Analysis

- **What, When, Why, How**

C. The Cash Flow Statement (Continued)

- Key Categories of a Cashflow statement:
  - **Operating Activities** – cash flow generated from delivery of regular goods/services (including revenues and expenses)
  - **Investing Activities** – cash flow from buying or selling assets using free cash, **not debt**
    - Real estate, vehicles, patents sold, are examples.
  - **Financing Activities** – cash flow from debt and/or equity financing.

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Critical Financial Skills to Manage and Grow Your Business

Skill 1: Financial Statement Awareness and Analysis

- **What, When, Why, How**

C. The Cash Flow Statement (Continued)

- Two Ways to calculate the operational section of the Cash Flow Statement:

  - Direct Method – Add all cash **collections** from operating activities and then subtract all cash **disbursements** from operating activities.

  - Indirect Method – Start with net income and make adjustments to undo the impact of accruals like non-cash revenues and expenses. (Usually depreciation and amortization.)

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Critical Financial Skills to Manage and Grow Your Business

Skill 1: Financial Statement Awareness and Analysis

- **What, When, Why, How**

D. The Annual Report

- Whether you own a public company, private company or sole proprietorship, it is important to have your business activities compiled by an accountant into an annual report (audited or unaudited) or an annual compilation.

Why do an Annual Report?

-- It provides insights and answers to key questions such as:

- Amount and comparative changes in revenues and expenses as well as how they compart to each other.
- Amount of Profit or Loss
- Ability to pay debts as they come due
- What is required to sustain or expand the business
- Balance sheet condition: capital and cash

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Critical Financial Skills to Manage and Grow Your Business

Skill 1: Financial Statement Awareness and Analysis

- **What, When, Why, How**

D. The Annual Report

- While annual reports are critical, it is also very important to **review** your firm's results with your accountant **monthly** or **at least quarterly**.
- You should establish a banking relationship and review this information with your banker annually if not quarterly

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Critical Financial Skills to Manage and Grow Your Business

Skill 1: Financial Statement Awareness and Analysis

- **What, When, Why, How**

--CONCLUSIONS:

- Reviewing and understanding your Company's Balance Sheet, Income Statement, Cash Flow Statement and Annual Report can provide you with valuable insights about your business.

- If you want to know how you are doing and where you are going, you have to know your numbers and use them to tell your story.

Critical Financial Skills to Manage and Grow Your Business

Skill 2: Financial Fluency – Eight Terms and Definitions You Should Know

1. **Asset Allocation-** How you choose to spend money across different investment types: bonds, stocks, cash and Cash Equivalents**.**
2. **Capital Gain –** Increase in value of an asset or investment above the price you paid for it.
3. **Compound Interest –** Also referred to as interest on interest. When you save, invest or borrow, you earn or pay interest on the principal as well as on the interest earned or charged.
4. **Forecasting –** The process of using available data, knowledge and assumptions to develop a set of projected future incomes and expenses.

ATL Behind the Scenes TRAINING SESSIONS

Critical Financial Skills to Manage and Grow Your Business

Skill 2: Financial Fluency – Eight Terms and Definitions You Should Know

5. Liquidity – Describes how quickly assets can be liquidated into cash. (Cash is most liquid, real estate or land can take much longer and thus are less liquid.)

6. Net Worth – Difference between what you own (assets) and what you owe (liabilities).

7. Time Value of Money – The concept that currency received or in hand today is worth more than the same amount in the future. (This is due to inflation, not having the opportunity to invest today and the risk of not receiving the money in the future.)

8. Valuation – The process of determining the current worth of an asset, company or liability. You should know your company's investment or market value.

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Critical Financial Skills to Manage and Grow Your Business

Skill 3: ROI Calculation

A. **What is the ROI Calculation and why should you care? –** Return on investment (ROI) tells you how much Profit (or loss) has been generated from an investment that been made.

Anticipated ROI –

- uses forecasted revenues and expenses to determine if the investment or project is worthwhile.

Actual ROI –

- The true return after a project has concluded using all costs and revenues. It is typically compared to anticipated ROI.

B. **What is the ROI Formula**

ROI = (Net Profit/Amount of Investment) X 100

Example: Al invests $1,000 into ABC stock. He sells it one year later for $1,200. What is his ROI?

Al’s ROI = (200/1,000) X 100 = .2X100 = 20%

Critical Financial Skills to Manage and Grow Your Business

Skill 3: ROI Calculation

C. Calculating the ROI of a Project

Example 1

What if you could buy 1,000 chocolate bars for $2 each and sell them to a grocery store for $3 each. In addition, you need to pay $100 in transportation costs. Should you do the Project?

Calculation:

Expected Revenues = 1,000 X $3 = $3,000

Expenses = (1,000X$2) + $100 = <u>2,100</u>

Projected Profit $900

Projected ROI = 900/2100 X 100 = 42.9%

Critical Financial Skills to Manage and Grow Your Business

Skill 3: ROI Calculation

D. Calculating the ROI of a Project

Example 2

What if you already bought your chocolate bars for $2 each and paid the $100 to transport them as in example 1. What is your calculated return and course of action if the Grocery Store will only Pay $2.25 per bar

Actual Revenues = 1,000X$2.25	$2,250
Total Expenses = (1,000X$2.00) + $100	2,100
Net Profit	$ 150

ROI = ($150/2,100) X 100 = 7.1%

Recommended Course of Action:

Critical Financial Skills to Manage and Grow Your Business

Skill 3: ROI Calculation

D. Calculating the ROI of a Project

Example 3A

Base Assumption:

Revenue $600,000

Fixed Development Costs	$300,000
Variable Expenses	160,000
Total Expenses	460,000

Projected Profit ($600,000 – 460,000) = $140,000

Projected ROI = ($140,000/460,000) X 100 = 30.43%

Critical Financial Skills to Manage and Grow Your Business

Skill 3: ROI Calculation

D. Calculating the ROI of a Project

Example 3B

Revised Assumption

Client wants to reduce price by reducing project scope. Seeks a quantity based on price of $300,000. You want same ROI as base. What is the calculation?

Revenue $300,000

Fixed Development Costs	$150,000
Variable Expenses	80,000
Total Expenses	230,000

Projected Profit ($300,000 – 230,000) = $70,000

Projected ROI = ($70,000/230,000) X 100 = 30.43%

Critical Financial Skills to Manage and Grow Your Business

Skill 3: ROI Calculation

D. Calculating the ROI of a Project

Example 3C

What if Fixed Costs must be at $200,000?

Critical Financial Skills to Manage and Grow Your Business

Skill 4: Budgeting

Budgeting is one of the most important skills for a business owner to master. Key reasons for this include:

- Budgets can be a key tool for communicating expectations to stakeholders.
- To budget effectively, you have to dig into and gain insights about current performance and key trends internally as well as current and expected external conditions such as market and competitive factors, economic expectations, etc.
- Budgets help you determine where and how to allocate your time and resources.
- Budgets can serve as guidelines for compensation plans, individual performance goals and other motivational tools.
- Budgets can help inform you if your company is on track for expectations of yourself, stakeholders, bankers, etc.

Critical Financial Skills to Manage and Grow Your Business

Skill 5: Financial Performance Measurement

Overview

- Key Performance Indicators (KPI's) are metrics used to track, measure and analyze the financial health of your company.
- KPI's fall under a variety of categories such as:
  - Profitability
  - Liquidity
  - Solvency
  - Efficiency
  - Valuation

Critical Financial Skills to Manage and Grow Your Business

Skill 5: Financial Performance Measurement

Some KPI's should be measured and looked at Daily or Weekly (Like CNN news or Time Magazine) and these should be a dashboard. Examples include:

Daily, weekly, MTD Sales
MTD Sales vs Budget
Working Capital

Accounts Receivable Aging
Accounts Payable Aging
Quick Ratio

Critical Financial Skills to Manage and Grow Your Business

Skill 5: Financial Performance Measurement

Beyond daily and weekly, most KPI’s should be measured and analyzed on a monthly or quarterly basis (like Atlantic Monthly). Examples include:

- Gross Profit Margin
- Net Profit Margin
- Current Ratio
- Leverage Ratio
- Ration
- Inventory Turnover
- EBITDA
- Return on Equity
- Return on Assets
- Monthly/Quarterly Balance Sheet Review Debt to Equity
- Monthly/Quarterly Income Statement Review
- Actual Performance vs. Budget
- Average Customer Acquisition Cost

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Conclusions and Takeaways

Build SMART Goals for your business and track your progress toward those goals

Reviewing your Financial Statements on a recurring basis provides you with valuable Insights about your business.

Leverage Lessons Learned about your numbers to become more successful and attractive to bankers, investors and potential business partners.

If you want to know how you are doing and where you are going you have to know your numbers and use them to tell your story

Appendix

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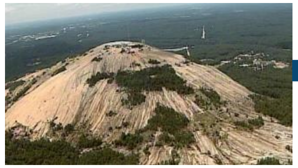
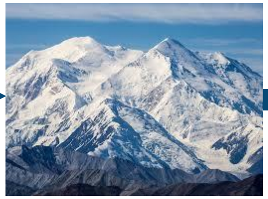
Build Your Business Maturity Bridge to Prosperity

Based on your business assessments each of you are at various stages of construction and or maintenance of the bridge to prosperity for your business

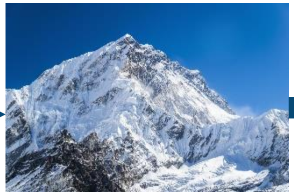
The typical bridge system connects four stages of business maturity to four mountain tops:



Stage 1: Concept or business idea



Stage 2: Value quest/strategy development



Stage 3: Financial credibility; M&A; strategy achievement and refinement

Stage 4: Capital adequacy; wealth creation; improved valuation

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Build Your Business Maturity Bridge to Prosperity (Cont'd)

Stage 1: Concept or Business Idea

All of you are past this stage in your bridge building, so let's review what you have likely experienced

1) You had a business concept that reflected a skill or passion you had that had profit potential
2) You took the leap and started your business
3) You put in personal money (cash and your personal debt) and perhaps reached out to friends and family for more to get started
4) You started generating revenue and moved from your kitchen table to office desk and tables
5) You achieved break-even, some amount of profit and paid down some debt
6) You hired an accountant to develop financial records, you filed tax returns and built rudimentary or better financial statement to guide your company
7) You hired an attorney to prepare an operating agreement to serve as your company's bylaws

ATL Behind the Scenes
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Build Your Business Maturity Bridge to Prosperity (Cont’d)

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Build Your Business Maturity Bridge to Prosperity (Cont'd)

<u>Stage 2: Value Quest/Strategy Development</u>

As you proceed(ed) from concept to value quest your business gets stronger

1) You know through experience what it takes to grow and sustain value
2) Your brand, image, financial credibility, team strength, and liquidity begin to sprout
3) You can realistically focus on current performance and project future growth
4) Your business has a financial identity, credible financial statements and a measurable value

Build Your Business Maturity Bridge to Prosperity (Cont'd)

Stage 2: Value Quest/Strategy Development (Cont'd)

As you build beyond value quest to strategy development and growth your business bridge expands further:

1) Your strategy is well-thought out and further refined. You also have a strategic plan for growth and prosperity
2) You have an actual or virtual staff in place to support strategy achievement and growth

3) You attract and establish a Board of Directors

Build Your Business Maturity Bridge to Prosperity (Cont'd)

Stage 2: Value Quest/Strategy Development (Cont'd)

As you build beyond value quest to strategy development and growth your business bridge expands further:

4) Your Company has a dedicated banker, accountant, and lawyer on your virtual team

5) You still have to personally guarantee debt, but more of the decision is based on the Company's balance sheet and cash flow than your personal net worth.

6) You may consider crowd-funding as a tool to raise capital

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Build Your Business Maturity Bridge to Prosperity (Cont'd)

Stage 3: Financial Creditability/M&A/Strategy Achievement and Refinement

1) Your product or services are recognized and respected in your target markets
2) You will likely expand to multiple shifts and locations
3) Your company is strong enough to raise capital in equity and or advanced debt markets
4) Your company is considering and capable of growth through acquisitions
5) Your strategy expands from local to regional, national or international
6) You upgrade the strength of your Board of Directors

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Build Your Business Maturity Bridge to Prosperity (Cont'd)

<u>Stage 4: Capital Adequacy, Wealth Creation, Improved Valuation to Buy, Merge or Sell</u>

1) You have established the stock in your company as a strong currency for acquisitions, mergers, and compensation
2) As you build increasing wealth, you have hired professional advisors to plan your estate and wealth transfer
3) You have identified successor(s) and position them to sustain the valuation of the company
4) Driving stock value through the four fundamentals liquidity, solvency, profitability, and operating efficiency is occupying almost all of the CEO and Board's time
5) The triggers to buy, sell or merge are increasingly critical to identify and monitor

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