



jd scott



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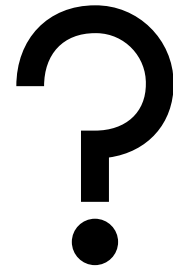
Chartered accountants

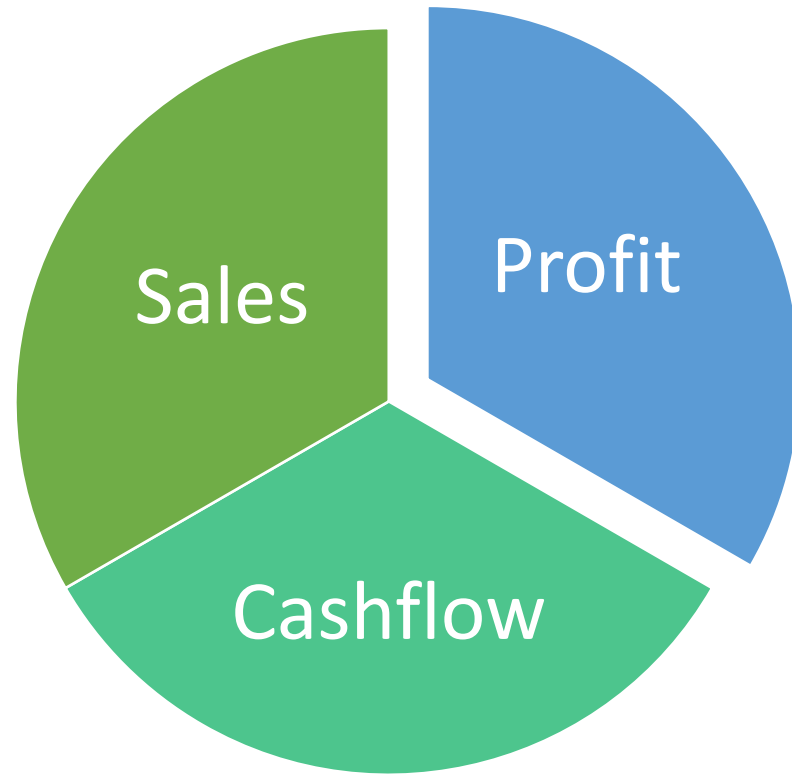
TEC PRESENTATION

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**Simple ways to use your numbers
to be more certain in your business
decisions.**

- Meet Tammy
- She runs a successful engineering consulting company called **CoSin Projects Pty Ltd.**
- The founder started the business 4 years ago and currently has 6 staff.
- Revenue is 
- But profit and cashflow is 





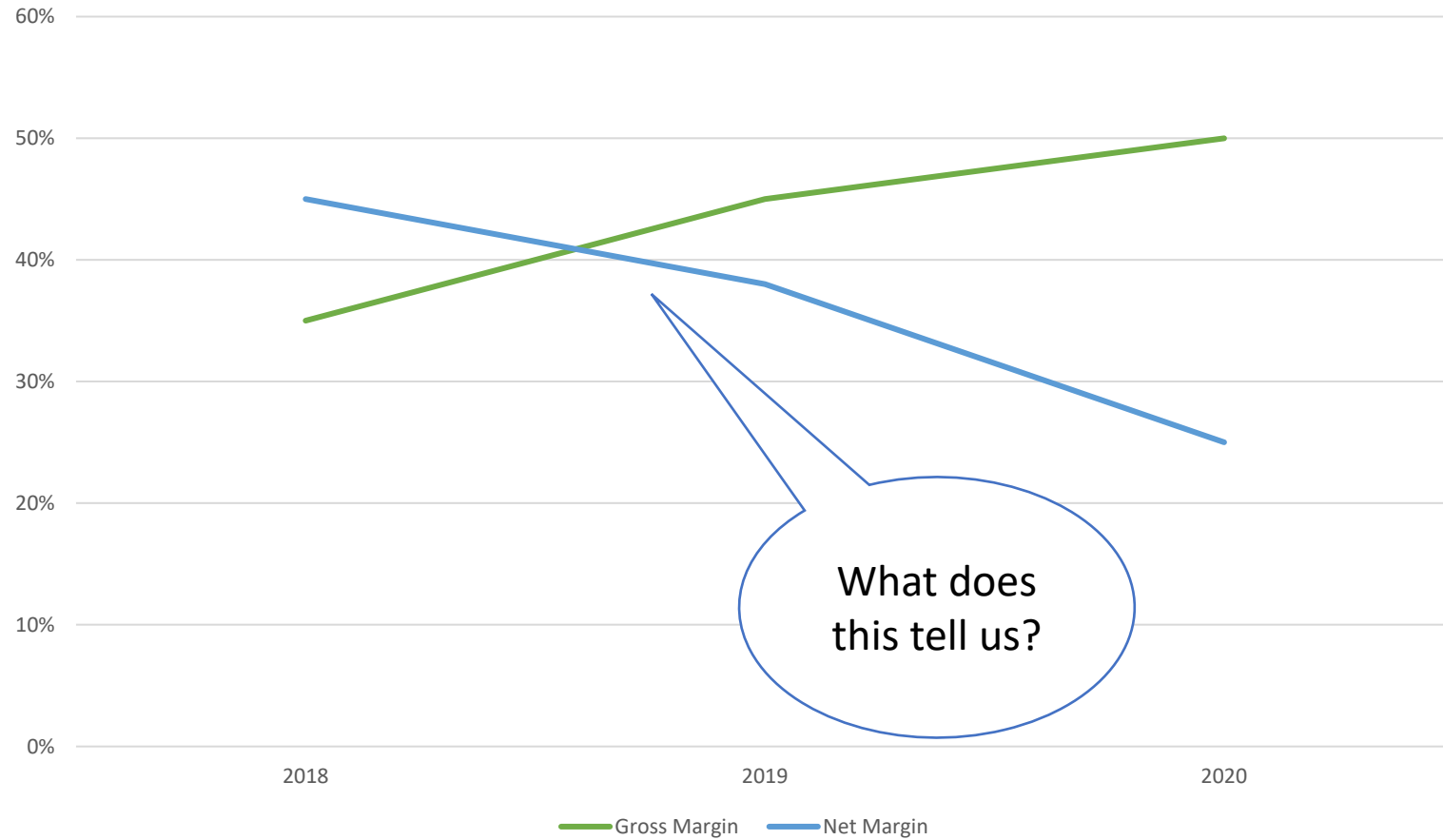
Profit ratios tell you how much profit your business is making for every \$ of revenue

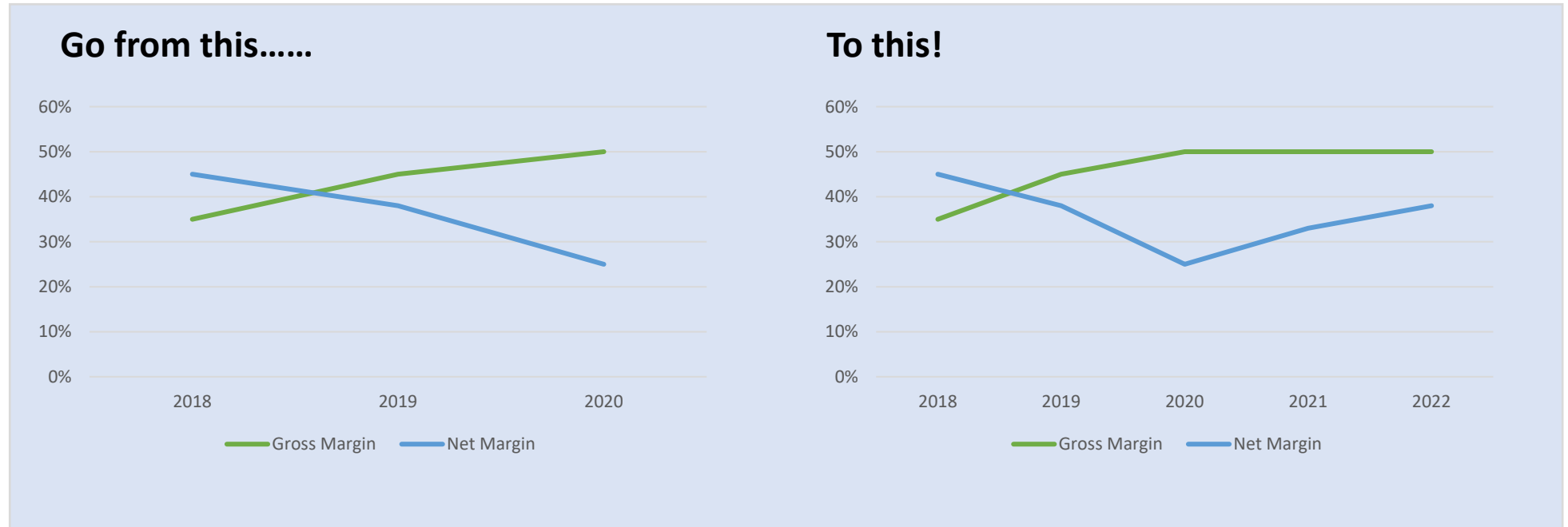
Gross profit ratio	$\frac{\text{Gross profit before tax}}{\text{Revenue}}$	How much am I making from delivering my goods or services?
Net profit ratio	$\frac{\text{Net profit before tax}}{\text{Revenue}}$	How profitable is your business?
Effective Tax ratio	$\frac{\text{Tax Paid}}{\text{Profit before tax}}$	How much tax am I paying?
Partner Time Index (for service based businesses)	$\frac{(\text{Net Profit} + \text{Partner} / \text{owner salary})}{\text{Client hours or billable hours}}$	How profitable is your business for every hour you spend on client work? Working on the business, not in the business

Gross profit ratio	$\frac{\$697,676}{\$1,394,490} = 50\%$	Gross margin. For every \$1 of income, Tammy produces 50c to pay other expenses and profit.
Net profit ratio	$\frac{\$347,175}{\$1,394,490} = 25\%$	For every \$ of revenue, Tammy generates 25c in profit
Effective Tax ratio	$\frac{\$121,511}{\$347,174} = 35\%$	Higher than tax rate of 27.5%. Why?
Partner Time Index	$\frac{(\$347,175 + \$190,000)}{990 \text{ hours}} = \542 per hour	For every client hour she works, Tammy makes \$542.



Profit ratios





What can she do?

- Are costs increasing? Why? Strategic decision or unintended consequence?
- Slow expenses growth
- What discretionary expenses are not needed / critical to the business?
- Longer term, salary reductions for support staff, rent reductions, change in processes, automation

So what
happened to
Tammy's
business over
the next two
years?



Cashflow ratios tell you how *liquid* you are
That is, how much cash you have

Cash is the life blood of your business

Cashflow ratios

Current ratio	$\frac{\text{Current Assets}}{\text{Current Liabilities}}$	Can I pay my bills? Must be higher than 1
Days debtors / Days creditors	$\frac{\text{Debtor or Creditor balance}}{\text{Annualised Revenue}} \times 365$	Measures how long on average it takes you to collect cash / pay bills. Can use average balance
Lock up – for businesses that use Work In Progress (e.g. consultants, lawyers, accountants etc)	$\frac{\text{Work in progress}}{\text{annualised revenue}} \times 365$	How much time it takes to turn your WIP into an invoice

What do Tammy's numbers tell us?

Current ratio	$\frac{650,000}{750,000} = 0.86$!
Days Debtors	$\frac{72,000}{1,394,490} \times 365 = 18.85 \text{ days}$	
Days WIP	$\frac{232,000}{1,394,490} \times 365 = 60.7 \text{ days}$	

On average from the time work on a project begins until the cash is in the bank it takes $(18.8 + 60.7) = 79.5$ days.

What do her numbers tell us?

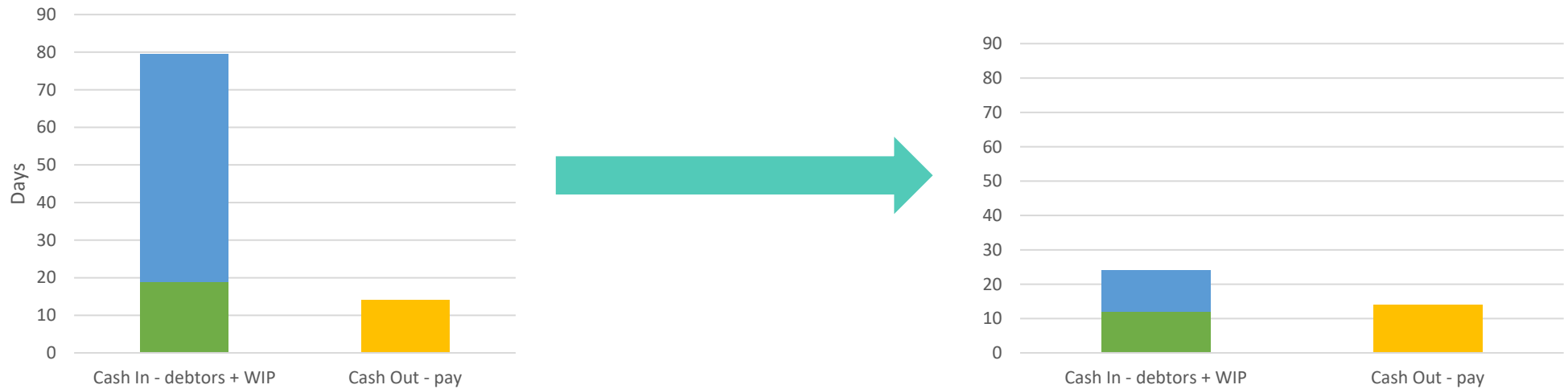
- Fortnightly payroll
- But it takes her 80 days to turn project work into cash.



What can she do?

- More regular billing (progress billing, upfront billing)
- Shorten invoice time (try 7 day terms)
- She might need an overdraft or other cash facility

After making the changes, Tammy reduced the gap from 66 days to 9 days



Side Note

Tammy's business is a people business. That is, what she sells involves using her staff to produce an output.

If her business involved goods (e.g. a retailer or importer), then days creditors is a better measure.

	✓	✗
Days Debtors	18.9	18.9
Days Creditors	22.5	14.2

Good –
collects cash
fast than it is
paid out

Not so good –
cash is paid
out faster
than it comes
in

Sales or customer ratios tell you a lot about acquiring customers.

Sales ratios

Customer Life Time Value	$\text{Customer value} \times \text{Average Customer Lifespan}$ $\text{Customer value} = \text{average purchase} \times \text{frequency}$	How much revenue a customer is likely to bring over its expected lifetime
Customer Acquisition Cost	$\frac{\text{Marketing spend}}{\# \text{ of new clients}}$ <p>Marketing spend = direct costs (e.g. advertising) + time (e.g. marketing team and your time as owner)</p>	How much is costs to acquire a customer

How much does it cost Tammy to acquire a new client?

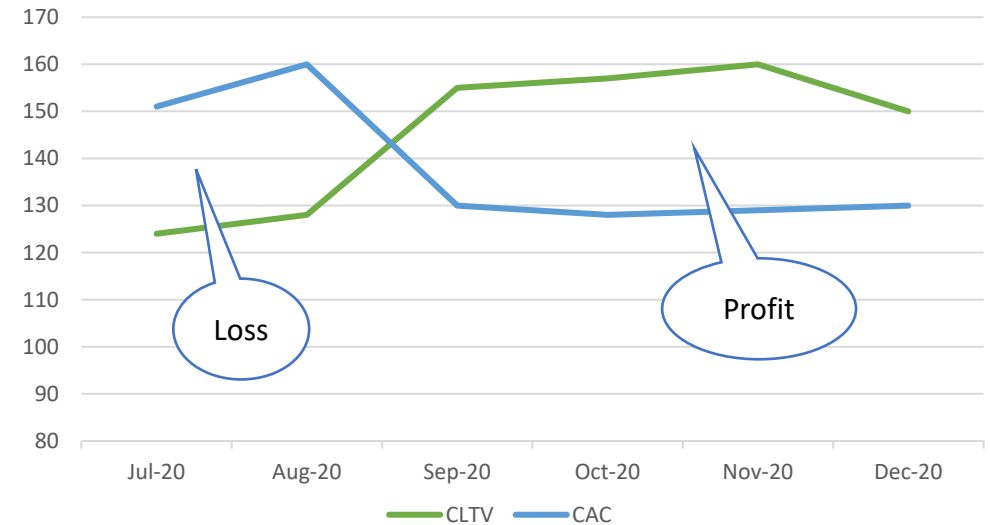
Customer Life Time Value	$\$20,000 \text{ per report} \times \text{twice a year} \times 3 \text{ years} = \$120,000$	Tammy is in a business where relationships are built on trust over the long term. Once she has a client, they tend to stick.
Customer Acquisition Cost	$\frac{\$55,000 \text{ per annum}}{2 \text{ new client per annum}} = \$27,500$	The lead time to acquire a new client is long. She has minimal direct costs, but lots of BD time

- If a new client was identified, is expected to only generate 1 report, it would be unprofitable.
- Accept?
- Depends
 - longer term relationship?
 - Other cross sell opportunities?
 - Can she lower cost of acquisition?
 - Is there a period of slack capacity? Better to utilize staff than not.

Lets look at another sort of business

This is a leading online fashion retailer

Customer Life Time Value	$\$62 \text{ average purchase} \times 3 \text{ times per year} = \186 CV $\$186 \times 8 \text{ months} = \124 Customer LTV	Shorter life cycle, customer turnover high. Needs efficient marketing / sales process
Customer Acquisition Cost	$\frac{\$12,533 \text{ per month}}{83 \text{ new client}} = \151 per client	Cost is higher than CLTV. Unprofitable!



Action time





How Tammy improved her business profit and cashflow

1. Spend a few minutes working out your current numbers. Is your data up to date?
2. Set benchmark / goals
3. Create a dashboard – its not hard
4. Review regularly (at least monthly). Hold a board meeting

Sample Dashboard

Tammy's aim is to improve net profit, reduce tax and improve her cashflow by reducing Work In Progress.

Ratio	Current	Target		Comment
Gross Profit ratio	50%	50%	●	Maintain at this level
Net Profit ratio	25%	30%	●	Increase to 30% without loss of revenue
Days Debtors	18.9	14	●	Chase late paying debtors (terms are 14 days)
WIP Days	60.7	20	●	Implement progress billing, up front deposits
Current ratio	0.87	1.1	●	Build a cash buffer over next 3 months
Tax ratio	35%	27.5%	●	Speak to accountant – business structure correct?

Here's your to do list – do these 10 things and you will become more profitable.

- Check your accounting data is up to date.
- Download the data into Excel – you need a P&L and balance sheet.
- Calculate profit ratios. Calculate it month by month for the past year and graph it. What's the trend? If its not up, why not?
- Tax ratio above 30%? Why? Ask your accountant
- Cashflow ratios – how do they look? Days debtors less than days creditors? Lock up close to pay cycle? If not, something must change and fast. Slow down payments and speed up cash collections.
- Sales ratios – how much revenue do you expect from each new client? What's it cost to acquire them?
- Now you know your history – work out where you want to go. Want to increase profits? Then either lower costs or increase sales. Want to improve cashflow? How fast are your clients paying?
- Create a dashboard. Set your benchmarks and monitor at your monthly board meeting.

Tammy's numbers

	July 2020	August 2020	September 2020	October 2020	November 2020	December 2020	FY 2020
Revenue	135,370	146,521	82,646	90,338	158,770	83,600	1,394,490
Cost of sales	48,132	66,781	61,731	47,943	72,146	51,674	696,814
Gross Profit	87,238	79,740	20,915	42,395	86,624	31,926	697,676
Expenses	26,243	27,077	30,325	30,927	25,184	35,495	350,501
Net profit	60,994	52,663	(9,410)	11,468	61,440	(3,569)	347,175
Tax							121,511
NPAT							225,664

Thank you



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