Duvall & Associates, Inc.

Taking Care of Business

PLAY WITH FIGURES FOR ANOTHER VIEW

“You are the one, you are my golden ratio.” Ace of Base

Too often, financial managers & owners simply take their financial statements – check out sales, some expenses and profits – and toss the reports in a drawer, content they have gleaned all possible knowledge from the numbers on the pages.

But you don’t have to be a numbers geek to find insight from financial nuggets which can be extracted from the base ore. Enter the world of ratios.

The most basic of ratios is the percentage of expenses to sales – and the most important of these ratios tends to be the gross profit (margin).

Sales minus cost of sales (COS) equal gross margin (GM). Gross margin divided by sales equal gross margin percentage (GM%).

Example A - $400,000 sales less $300,000 COS = $100,000 GM.
$100,000 GM divided by $400,000 sales = 25% GM%.

Many businesses fail for the very simple fact that managers price their products too low - often electing to price products at levels gauged against competitor rates - instead of rates required for sustainable profits.

Useful exercise – Identify and tally your monthly fixed costs (excluding of course your cost of sales). Dividing said costs by your GM% will determine your break-even point in sales.

Example B – You have a 25% GM% & $200,000 monthly fixed costs. The sales break-even point is ($200,000/25%) $800,000.

Calculation tidbits – Cost of sales should include materials, productive labor and allocable overhead. Monthly fixed costs should include provision for minimum necessary owner wages.

Engagement in this form of analysis will help clarify product pricing levels needed to financially survive and is essential in projecting future budgets.

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