



Prescription for Profits: Practical Tools to Assess the Financial Health of Your Pharmacy, Part I

Presented by:

Steve LeFever, President & Founder, Business Resources Services

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This program is approved by NCPA for 0.15 CEUs (1.5 contact hours) of continuing education credit. NCPA is approved by the Accreditation Council for Pharmacy Education as a provider of continuing pharmacy education.

Steve LeFever

Steve LeFever is a national leader in the development of practical financial programs and training for the independent business community. His dual role as a successful entrepreneur and as a commercial banker gives him a unique perspective on financial analysis, business management, and practical business decisions.

Steve is a successful entrepreneur in his own right – having founded several successful companies, including Business Resource Services. As an officer at Seattle First National Bank, Steve was a key figure in developing the most successful Business Advisory Services Group of any bank in the nation, tailoring financial services and training to the needs of small and mid-size companies.

In 1983, Steve founded his current firm, Business Resource Services (BRS) to further design, develop, and deliver practical financial training to the independent business community. Currently, BRS services are in high demand by commercial banks, a variety of industry trade groups, and major U.S. and international corporations, including Bank of America, Ace Hardware, Anheuser-Busch, Harley Davidson, the Int'l Franchise Assn. and Dale Carnegie. He's been a presenter at numerous JCK Shows, IJO conferences and his company currently facilitates dozens of jewelry performance groups.

As a leading educator, Steve travels over 200 days a year, presenting his unique approach to financial management to a wide variety of industries, including hardware, beverage, lumber and pharmaceutical. Steve has also taught business owners all over the world, including the U.S., Canada, Mexico, Europe, and Australia.

He currently holds faculty positions at the University of Wisconsin Graduate School of Banking and is a top-rated member of Anheuser-Busch's industry-leading management development program.

His unique teaching techniques focus on developing practical financial skills as decision-making tools, and the response to his programs nationwide has been overwhelming. In addition, his presentation style is an extremely effective combination of information, motivation, and humor.

Steve earned his Master's Degree in Business Administration at the University of Washington in Seattle and has served as a management consultant for over 20 years. He is a contributing writer to a variety of trade journals and is a frequent speaker for national associations. His particular consulting interests lie in managing capital and cash flow in start-up business and growth management.

Educational Objectives

Program Title: “Profit Mastery: Practical Tools to Assess the Financial Health of Your Pharmacy”

Name of Presenter: Steve LeFever

We go beyond the basics to explore strategic financial analysis. When you don't know where you are, it is difficult to chart a future course. Participants will work with a customized, pharmacy specific case study to learn how to solve the root cause of financial problems – instead of just treating the symptoms. We'll also show participants how to analyze company performance with financial ratios and how to use industry comparison analysis. A key component of the ratio analysis is the Financial Road Map. This valuable graphical tool will help pharmacy owners see how different parts of a company can drive financial performance. Participants will understand what financial statements really tell them about their pharmacy operation and learn to produce a Profit Mastery Assessment and develop action plan to improve profits and cash flow. Through a customized, pharmacy specific case study, participants will learn to:

1. Understand the critical need to consistently monitor financial position.
2. Create a practical process, using ratios, to assess financial performance: identifying strengths, weaknesses and areas of opportunity.
3. Identify the causes behind unsatisfactory performance.
4. Appreciate the dynamic relationships that exist between the balance sheet and income statement.
5. Understand the difference between profits and cash flow.
6. Use financial analysis as a tool to improve profits, increase cash flow.
7. Create goals and action plans to implement positive changes within the organization.
8. Enhance relationships and ability to communicate with bankers and other financing partners.

Profit Mastery

Practical Tools to Assess the Financial Health of Your Pharmacy

NCPA Convention
Las Vegas
October 10, 2006



by
Steve LeFever
Chairman

Business Resource Services
200 First Avenue West • Suite 301 • Seattle, WA 98119
Phone 206-284-5102 • Fax 206-282-4092 • brs@brs-seattle.com • www.brs-seattle.com

Profit Mastery: Keeping the Company in Shape

As a manufacturer, wholesaler, retailer, service, farmer or professional — you are (or will be) a business owner. Since you became involved in business, you have undoubtedly come to the realization that you have many roles — or “hats” — to wear if you are to be successful.

Independent Business

Of the more than 23,000,000 businesses operating in today's economy, over 98% would be defined as “small”; and yet, their cumulative effect is staggering. Consider the following statistics: small business accounts for . . .

- ♦ Over 50% of private employment
- ♦ Over 45% of total business output
- ♦ Over 40% of the GDP (Gross Domestic Product)

In addition, small business accounts for about two-thirds of the innovation and, currently, the growth rate in employment in small business is over eight times that of employment growth in other sectors.

Entrepreneurs

In ever-increasing numbers, people are going into business for themselves. Sometimes this is planned, sometimes not: some marry it, some inherit it, some get laid off. Others have a drive to build a better mousetrap; or to build net worth; or to pursue that special American Dream of a better life. Maybe it's just the chance to be a part of something that *you* built; succeeding on your own merits. Maybe it's a combination of all of these. In any case, the entrepreneurial spirit is alive and well.

Your Role

What is your role in your business? Most of the time, if there are two people involved in a business, one knows how to make it and one knows how to sell it. The financial management is often left to others — with the implicit understanding that if we can make it and sell it, then we're okay.

Financial Management

The Profit Mastery™ series, “*Managing and Financing Independent Business*” addresses your role as a money manager. Of course, most business owners have not been trained professionally in accounting or finance; but given the uncertain nature of business and economic cycles combined with an increasingly rapid rate of technological change, monitoring your financial condition and making sound financial decisions has never been more important. In short, financial management is too important to leave solely to accountants and bankers — after all, *it's your business* that will either prosper or suffer as a result of financial decisions.

Business Failures

Of all the new businesses that are formed each year, approximately 80% fail within the first ten years. Records show over 90% of business failures are attributable to faulty management — more precisely, poor financial management. Here are the primary financial killers:

- 1. Failure to plan properly before start up.**
- 2. Failure to monitor financial position.**
- 3. Failure to understand the relationship between price, volume, and costs.**
- 4. Failure to manage cash flow.**
- 5. Failure to manage growth.**
- 6. Failure to borrow properly.**
- 7. Failure to plan for transition.**

Fiscal Fitness: Control

Attempts to achieve physical fitness through crash diets, impulsive exercise, or superficial cosmetic and other quick-fix methods almost *never work*. The same is true in your business. Financial survival and health are the result of *continuous management and control* applied according to a plan. And the plan needs to be backed up by a sound knowledge of basic financial issues. That's how fiscal fitness is achieved and maintained.

The goal of this program is to provide access to all the necessary parts of the process. Your challenge is to gain control; to format the information and apply the process; to recognize symptoms and follow them back to causes — and to design corrective action steps. Financial management is not an all-or-nothing proposition. Whether this program is a first step or a review of techniques learned long ago, the journey through the process can be as rewarding as the result.

Financial Performance Statements and Ratio Analysis

DEFINITION..... Financial position refers to the economic condition of your business in comparison to its own past performance and to other companies of similar size.

REVIEW..... Section One reviewed the basic legal and tax issues affecting all businesses. The information in this section actually provides the means for a critical analysis of management roles and business organization in relation to both tax and non-tax issues.

IMPACT..... Determining your financial position is crucial to “fine tuning” your management decisions. It provides the level of detail a business owner needs to make sound choices.

RESULTS..... The information derived from financial position calculations lets you focus your attention on the *causes* of your business’ financial strengths and weaknesses. With this information you can take positive action to *keep* what is working and to *improve* what isn’t.

The Goal:

Determining your solvency, risk, and efficiency

The Tools:

Statement Spread Sheets
Financial Management Ratios
Cause and Effect “Road Map”

Key Terms

Assets	Everything that the business owns — including such items as cash, inventory, prepaid expenses, and vehicles.
Balance Sheet	A statement of financial position that shows the assets, liabilities and net worth of the business.
Current Assets	What the business owns that's expected to be turned into cash within one year — such as accounts receivable and inventory.
Liabilities	What the business owes to creditors — to the people who supply funds that must be repaid. <i>Debt</i> is another term for <i>liability</i> .
Current Liabilities	Obligations that are due to be repaid within one year.
Long-Term Debt	Obligations that are scheduled to be repaid in a period greater than one year.
Net Worth	What the business owes to the owners — the investment that the owners have in the company. Also called <i>owners' equity</i> .
Retained Earnings	The net profits (positive or negative) from the income statement that are left to accumulate in the business.
Leverage	The increased rate of return that is made on net worth by using debt to acquire assets.
Income Statement	The summary of the revenues, costs and expenses of a company that are recognized during an accounting period.
Gross Profit	Sales minus the Cost of Goods Sold, which is the cost of buying raw materials and producing finished goods.
Net Profit	The amount remaining after all expenses have been met. The difference between total sales and total costs and expenses.

The Steps You Take To Determine Your Course of Action

1. Gather Information

Obtain your financial statements for the last three years. Financial statements have a variety of uses besides just showing sales and profits, but getting information out of them requires your *active participation*.

2. Package the Information

Put the data in a spread sheet format; that is, place consecutive years in side-by-side columns.

3. Calculate Your Financial Ratios

These ratios are nothing more than the relationships between sets of two numbers, but they let us focus *on those relationships* rather than on the “raw” financial data. This packet contains the ratios that we believe are essential. In addition, you may want to add others that are specific to your type of industry.

4. Record Your Industry Composite Guidelines (if available)

Many trade associations and financial organizations produce financial data and ratio studies for particular industries. Robert Morris *Annual Statement Studies* is one of the most common sources (your local bank should have a copy available).

5. Compare Your Results

Look for *trends* in the financial statement spread sheets and in the ratio spread sheet. Also look for *changes* in trends. Compare your business (1) against prior years, (2) against the industry standards, and (3) against your future plans.

6. Analyze the Possible Causes of Problems

Ratio analysis can identify problems. The next step is to identify causes and then develop solutions. The financial cause-and-effect “Road Map” can help in finding possible causes of problems.

7. Take Action

Many times the *worst* decision is to *do nothing*. Usually inaction represents a “wait-and-hope” approach, indicating an inability to focus attention on the financial aspects of a business. *Formulate a plan, implement the plan, then monitor the results*. Taking action is, of course, the hard part. But if you follow the steps contained in this workbook, we *guarantee* that you will be better prepared to face and make those critical financial decisions.

Case Study

Lake's Pharmacy

Brad and René Lake's Pharmacy originally opened in 1990 in a small town just outside of a large metro area. (They had both worked for a family owned pharmacy for 10 years.)

The new business was a gradual success based on the strength of Brad and René's experience and their desire to provide a full service pharmacy.

Both of them enjoyed the great growth in their community as the metropolitan area expanded into their community. In 2003, they began to plan an expansion their location with a section of the new facility set aside for cognitive and disease state management services. In early 2004, they opened the enlarged store and increased the hours of operations from 55 hours per week in 2002 and 2003 to 58 hours per week in 2004. They also invested \$50,000 to help pay for the leasehold improvements. Brad and René have increased their participation in third-party prescriptions from 50% to 83% over the three years as a way to attract more business to their improved location.

It's now the end of fiscal 2004 and they have come to you for financial assistance. They are flushed with excitement, telling you things will be great if they can just get the funds they need to get "over the hump." They brush off any talk of problems as "only temporary."

What observations can you offer?

ACTION STEPS:

- Step 1. Gather accurate financial information.
- Step 2. Package the information so you can see relationships.
- Step 3. Calculate financial ratios.
- Step 4. Record your industry composites (if available).
- Step 5. Compare your results.
- Step 6. Analyze the possible causes of problems.
- Step 7. Take action — formulate a plan, implement it, and monitor the results.

Lake's Pharmacy

Balance Sheet Spreadsheet as of December 31

	2002	2003	2004	Trends
<i>Accounts Receivable/Third Party %</i>	41%	49%	69%	
<u>ASSETS</u>				
Cash	100,400	87,900	17,100	
Accounts Receivable	71,300	100,100	177,800	
Inventory	128,200	152,600	238,700	
Other — A/R officer				
Prepaid	10,100	10,000	25,000	
<i>Total Current Assets</i>	310,000	350,600	458,600	
Equipment & Fixtures	110,000	110,000	244,000	
Leasehold Improvements	15,000	15,000	119,000	
Vehicles	26,000	26,000	26,000	
Accumulated Depreciation	(97,300)	(105,800)	(133,300)	
<i>Fixed Assets (net)</i>	53,700	45,200	255,700	
Intangible Assets				
<i>Total Assets</i>	363,700	395,800	714,300	
<u>LIABILITIES & NET WORTH</u>				
Notes Payable — bank			183,500	
Current Portion — long-term debt	10,000	10,000	20,000	
Accounts Payable — trade	123,200	120,000	160,900	
Accruals	28,800	30,700	55,700	
Other				
<i>Total Current Liabilities</i>	162,000	160,700	420,100	
Long Term Debt				
Notes Payable – Shareholder	20,000	10,000	50,000	
Other				
<i>Total Long Term Liabilities</i>	20,000	10,000	50,000	
<i>Total Liabilities</i>	182,000	170,700	470,100	
Capital Stock	30,000	30,000	30,000	
Additional Paid-In Capital				
Retained Earnings	151,700	195,100	214,200	
<i>Net Worth</i>	181,700	225,100	244,200	
<i>Total Liabilities and Net Worth</i>	363,700	395,800	714,300	

Lake's Pharmacy
Income Statement Spreadsheet
for the 12 months ending December 31

	2002	2003	2004	Trends
Square Footage	1700sq'	1700sq'	3000sq'	
Sales				
Prescriptions	1,377,000	1,558,000	2,075,000	
Other Sales	323,000	342,000	425,000	
Total Sales	1,700,000	1,900,000	2,500,000	
Cost of Goods Sold	1,261,400	1,451,600	1,957,500	
Gross Profit	438,600	448,400	542,500	
Expenses				
Owner's Compensation	95,000	95,000	90,000	
Salaries and Wages	134,500	148,800	190,000	
Payroll Taxes & Benefits	26,600	28,900	32,800	
Rent	26,000	26,000	40,000	
Utilities	8,500	8,600	12,500	
Prescription Containers	5,000	5,700	7,500	
Telephone	5,500	5,800	8,300	
Delivery Expenses	5,100	5,600	8,000	
Repairs and Maintenance	1,600	1,700	3,500	
Auto Expenses	1,700	1,900	2,300	
Travel & Schools	2,800	4,800	3,900	
Computer Expenses	3,200	3,900	8,000	
Postage	3,300	4,000	6,100	
Bank Fees	2,500	3,100	4,100	
Advertising	12,200	13,500	23,000	
Professional Services	4,600	7,500	7,700	
Office Supplies & Expenses	8,700	9,400	11,200	
Insurance	8,500	8,900	17,000	
Bad debts	800	600	200	
Depreciation	8,500	8,500	27,500	
Other	3,750	1,100	1,400	
Total Expenses	368,350	393,300	505,000	
Operating Profit	70,250	55,100	37,500	
Interest	2,250	3,900	15,000	
Other Income				
Net Profit Before Taxes	68,000	51,200	22,500	
Tax	12,000	7,800	3,400	
Net Profit After Tax	56,000	43,400	19,100	
<i>FTE</i>	6	7	9	

Lake's Pharmacy

Ratio Analysis Spreadsheet

	2002	2003	2004	Industry Composite RMA*	Calculations, Trends, or Observations
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BALANCE SHEET RATIOS: Stability (or "Staying Power")

1.	Current	$\frac{\text{Current Assets}}{\text{Current Liabilities}}$	1.91	2.18		2.10*	
2.	Quick	$\frac{\text{Cash} + \text{Accts. Rec.}}{\text{Current Liabilities}}$	1.06	1.17		.80*	
3.	Debt-to-Worth	$\frac{\text{Total Liabilities}}{\text{Net Worth}}$	1.00	.76		2.00*	

INCOME STATEMENT RATIOS: Profitability (or "Earning Power")

4.	Gross Margin	$\frac{\text{Gross Profit}}{\text{Sales}}$	25.8%	23.6%		25.8%* <u>1</u>	
5.	Net Margin	$\frac{\text{Net Profit Before Tax}}{\text{Sales}}$	4.0%	2.7%		2.1%* <u>2</u>	

PRODUCTIVITY RATIOS:

6.	Sales per Employee	$\frac{\text{Sales}}{\text{Total Employees}}$	\$283M	\$271M		UNK	
7.	Sales per Square Foot	$\frac{\text{Sales}}{\text{Square Feet}}$	\$1,000	\$1,118		\$1,157 <u>3</u>	

ASSET MANAGEMENT RATIOS: Overall Efficiency Ratios

8.	Sales-to-Assets	$\frac{\text{Sales}}{\text{Total Assets}}$	4.67	4.80		4.80*	
9.	Return on Assets	$\frac{\text{Net Profit Before Tax}}{\text{Total Assets}}$	18.7%	12.9%		9.3%*	
10.	Return on Investment	$\frac{\text{Net Profit Before Tax}}{\text{Net Worth}}$	37.4%	22.8%		24.1%*	
11.	GMROI	$\frac{\text{Gross Profit \$'s}}{\text{Inventory}}$	3.42	2.94		UNK	

ASSET MANAGEMENT RATIOS: Working Capital Cycle Ratios

12.	Inventory Turnover	$\frac{\text{Cost of Goods Sold}}{\text{Inventory}}$	9.8	9.5		9.2*	
13.	Inventory Turn-Days	$\frac{365}{\text{Inventory Turnover}}$	37	38		40*	
14.	Accounts Receivable Turnover	$\frac{\text{Credit Sales}}{\text{Accounts Receivable}}$	9.8	9.3		15.9**	
15.	Accounts Receivable Turn-Days	$\frac{365}{\text{Accts. Rec. Turnover}}$	37	39		23**	
16.	Accounts Payable Turnover	$\frac{\text{Cost of Goods Sold}}{\text{Accounts Payable}}$	10.2	12.1		20.8*	
17.	Average Payment Period	$\frac{365}{\text{Accts. Pay. Turnover}}$	36	30		18*	

1. NCPA_GM = 22.8% for 3,000 square foot store. NCPA GM range low to high third party -- 27.6% to 22.4%.

2. NCPA NPBT = 3.4% for 3,000 square foot store. NCPA NPBT range low to high third party -- 2.4 to 3.4%

3. NCPA source.

** Industry third party payments generally range from twice a month for Medicaid to 30 days for others. 23 days is an estimate.

PROFIT MASTERY ASSESSMENT (PMA)
Summary Report
Lakes Pharmacy

	Cash	Profit (NPBT)
Inventory	\$	Hidden cost
		Interest
A/R	\$	Hidden cost
		Interest
Gross Margin		
Labor		\$
Buying		\$
Pricing		\$
Cash Discounts		\$
Refinance	\$	
Total	\$	\$

The Profit Mastery Assessment (PMA) process utilizes the “Roadmap” to develop an action plan that is measurable and creates accountability.

Ratio Supplement:

Service Businesses and Professional Practices

*The process of ratio analysis that we have gone through for Cascade Office Systems applies to **all** businesses. But service businesses and professional practices can use the modified set of ratios to monitor their financial position more accurately.*

Balance Sheet Ratios

Use the same ratios on page 14* but add:

Cash Ratio = Cash/Current Liabilities

Measures the ability of the company to pay its bills with out relying on collection of accounts receivable. Indicates how well the company could respond to a sudden crisis or opportunity.

** NOTE: For many service companies, the current and quick ratios will be nearly identical because inventory is the main component that differentiates the two.*

Income Statement Ratios

Use the ratios on page 14; change “Sales” to “Revenues” or “Fees” as appropriate.

Asset Management Ratios

Use the ratios on page 14 but add:

Fixed Asset Utilization Ratio = Total Revenues/Net Fixed Assets

Measures how productive the company's fixed assets (i.e. equipment) are in generating revenue. A low ratio may indicate ineffective use of fixed assets or excessive fixed assets.

Working Capital Cycle Ratios

Use the ratios on page 15, but delete “Inventory Turnover” and “Inventory Turn-Days” and add:

Accounts Receivable Aging Schedule

Accounts Receivable Turnover and Average Collection Period represent overall averages for an accounting period. A more detailed means of monitoring accounts receivable is to “age” them — that is, to list each account and identify its payment status. The following is a sample aging format:

Accounts Receivable Aging Schedule

<u>Account</u>	<u>0-30 days</u>	<u>30-60 days</u>	<u>60-90 days</u>	<u>Over 90 days</u>
Red	\$XXX			
White		\$XXX		
Black	\$XXX		\$XXX	
Blue		<u>\$XXX</u>		<u>\$XXX</u>
Total	<u>\$XXX</u>	<u>\$XXX</u>	<u>\$XXX</u>	<u>\$XXX</u>

Productivity Ratios

The following ratios (or modifications of them) are among those commonly used to measure efficiency in production of services:

$$\textit{Average Revenue Per Client} = \textit{Total Revenue} \div \textit{\# Clients Served}$$

$$\textit{Average Revenue Per Job} = \textit{Total Revenue} \div \textit{\# Of Jobs}$$

$$\textit{Average Daily Volume} = \textit{Total Clients} \div \textit{\# Of Days Worked}$$

$$\textit{Average Revenue Per Hour} = \textit{Total Revenue} \div \textit{\# Of Hours Worked}$$

Individual Productivity: *Take any of the above ratios and calculate for individuals producing the services.*

A Word on Selecting and Computing Ratios

As we said earlier, computing ratios is a relatively simple activity. The key for you is to determine *which* ratios are the appropriate ones to use in your company's analysis. Any time we compare two different numbers to one another, we come up with a new ratio. Therefore, you could potentially compute scores of ratios using the numbers found on your balance sheet and income statement.

But, do the ratios you come up with *make sense*? If so, are they meaningful to you? For instance, you could compare the dollars of Personnel Expense (from the Income Statement) to the dollars of Fixed Assets (from the Balance Sheet) and derive a ratio. What does it tell you? Probably nothing! But, if you compare Sales to Personnel Expense, the ratio may tell you how efficiently you're using your people resources to produce revenues. Now that's something you might be interested in knowing. The point is, you need to select a set of ratios which actually communicate to you about how your business is operating, and then stick with and use those ratios over time to be able to spot *trends, strengths and weaknesses, and areas of opportunity*.

If you're not sure which ratios may be the best to use in your business, talk with your accounting professional—they know ratios *and* your business. That's why you pay them good money—to be a source of information and guidance in your role as a financial manager.

You also need to know that there may be more than one way to compute a specific ratio. Depending on your particular business, one method may be more accurate and meaningful to use than another. For instance, we used balance sheet dollars as of the date of the financial statement to compute the Inventory, Accounts Receivable, and Accounts Payable turn ratios on Page 15. In your own business, that method is probably okay *if* you have very steady volumes of costs of goods purchases and generation of credit sales throughout the year. However, if you experience *cyclical* patterns during the year, the use of "as of" dollars may tend to skew your ratios, depending on when your cycles occur, compared to the date of the statement being used.

It may be more meaningful for you to use *average* dollars of Inventory, Accounts Receivable, and Accounts Payable — either on an annualized, quarterly, or semi-annual basis — in order to reduce the effect which your cycles may have on the ratios. These are but a few examples of how to use different methods to calculate ratios. Again, if you're not certain which method is best suited for your own business, consult with your accountant.

Mark-Up Versus Margin: Clarifying the Issue

There are many people who believe mark-up and margin are the same thing — and *sometimes* they are. But generally they're not. The issue is how to arrive at a target selling price when you know the cost. The important concern here is the amount of gross profit dollars contributed from sales to cover general overhead.

Here's a simple example to illustrate the point:

Item selling price:	\$ 1.50
Item cost:	\$ 1.00
Does this price-cost relationship represent 50% mark-up or 33% mark-up?	

Regardless of your answer, we can safely say that this example represents a **gross profit margin** of 33%. The standard income statement format gives us the following:

Gross Profit Margin = $\frac{\text{Gross Profit Dollars}}{\text{Total Sales}}$		
(GPM)		
<i>Since:</i>	Total Sales	\$1.50
	– <u>Cost of Goods Sold</u>	<u>1.00</u>
	Gross Profit	.50
Gross Profit Margin % = $\frac{.50}{1.50} = .33 = 33\frac{1}{3}\%$		

The real question is: what mark-up does this represent? Or, stated another way, how much do you have to mark up a product over cost to produce a 33¹/₃% gross profit margin? The answer here depends on how you define mark-up. Here are the two possible definitions:

Definition A (the common definition):

$$\text{Mark-Up} = \frac{\text{Selling Price} - \text{Cost}}{\text{Cost}}$$

$$= \frac{1.50 - 1.00}{1.00}$$

$$= 50\%$$

Definition B (as defined by retailers):

$$\text{Mark-Up} = \frac{\text{Selling Price} - \text{Cost}}{\text{Selling Price}}$$

$$= \frac{1.50 - 1.00}{1.50}$$

$$= 33\frac{1}{3}\%$$

It's important to note that *either* definition of mark-up leads to a 33¹/₃% gross profit margin. Using the more conventional definition, it requires a 50% mark-up to produce a 33¹/₃% gross profit margin, but retailers would say it requires a 33¹/₃% mark-up. In other words, mark-up and margin are the same thing when using the retail definition.

We believe that confusion — and errors! — arise when you hear someone say the mark-up and the margin are the same (Definition B), then conclude that you simply multiply the cost by the mark-up (Definition A) to get the margin.

Here's an example: you assume that you can get a 40% margin by using a 40% mark-up (Definition A), so you do the following with an item costing \$1.00:

WRONG!

$\$1.00 \times 40\% = \0.40 mark-up

Selling Price = \$1.40

But this does not yield a 40% margin:

Sales	\$1.40
- Cost	1.00
Gross Profit	\$0.40

Gross Profit Margin = $\frac{\text{Sales} - \text{Cost}}{\text{Sales}}$

$= \frac{1.40 - 1.00}{1.40}$

$= 28.6\%$

As you can see, marking up the cost 40% produces only a 28.6% gross profit margin. Such a mistake would produce a shortfall of 12% — or \$120,000, if sales were \$1,000,000.

The moral: understand how to set prices; it's the gross profit you need. Mark-up only represents a concept

Lake's Pharmacy

Ratio Analysis Spreadsheet

	2002	2003	2004	Industry Composite "A"	Calculations, Trends, or Observations
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BALANCE SHEET RATIOS: Stability (or "Staying Power")

1.	Current	$\frac{\text{Current Assets}}{\text{Current Liabilities}}$	1.91	2.18	1.09	2.10	<u>458,600</u> <u>420,100</u>
2.	Quick	$\frac{\text{Cash + Accts. Rec.}}{\text{Current Liabilities}}$	1.06	1.17	.46	.80	<u>194,000</u> <u>420,100</u>
3.	Debt-to-Worth	$\frac{\text{Total Liabilities}}{\text{Net Worth}}$	1.00	.76	1.93	2.00	<u>470,100</u> <u>244,200</u>

INCOME STATEMENT RATIOS: Profitability (or "Earning Power")

4.	Gross Margin	$\frac{\text{Gross Profit}}{\text{Sales}}$	25.8%	23.6%	21.7%	25.8%	<u>542,500</u> <u>2,500,000</u>
5.	Net Margin	$\frac{\text{Net Profit Before Tax}}{\text{Sales}}$	4.0%	2.7%	.90%	2.1%	<u>22,500</u> <u>2,500,000</u>

PRODUCTIVITY RATIOS:

6.	Sales per Employee	$\frac{\text{Sales}}{\text{Total Employees}}$	\$283M	\$271M	\$278M	UNK	<u>2,500,000</u> <u>9</u>
7.	Sales per Square Foot	$\frac{\text{Sales}}{\text{Square Feet}}$	\$1,000	\$1,118	\$833	\$1,157	<u>2,500,000</u> <u>3,000</u>

ASSET MANAGEMENT RATIOS: Overall Efficiency Ratios

8.	Sales-to-Assets	$\frac{\text{Sales}}{\text{Total Assets}}$	4.67	4.80	3.50	4.80	<u>2,500,000</u> <u>714,300</u>
9.	Return on Assets	$\frac{\text{Net Profit Before Tax}}{\text{Total Assets}}$	18.7%	12.9%	3.2%	9.3%	<u>22,500</u> <u>714,300</u>
10.	Return on Investment	$\frac{\text{Net Profit Before Tax}}{\text{Net Worth}}$	37.4%	22.8%	9.2%	24.1%	<u>22,500</u> <u>244,200</u>
11.	GMROI	$\frac{\text{Gross Profit \$'s}}{\text{Inventory}}$	3.42	2.94	2.27	UNK	<u>542,500</u> <u>238,700</u>

ASSET MANAGEMENT RATIOS: Working Capital Cycle Ratios

12.	Inventory Turnover	$\frac{\text{Cost of Goods Sold}}{\text{Inventory}}$	9.8	9.5	8.2	9.2	<u>1,957,500</u> <u>238,700</u>
13.	Inventory Turn-Days	$\frac{365}{\text{Inventory Turnover}}$	37	38	45	40	<u>365/ 8.2</u>
14.	Accounts Receivable Turnover	$\frac{\text{Credit Sales}}{\text{Accounts Receivable}}$	9.8	9.3	9.7	15.9	<u>2,500,000x.69</u> <u>177,800</u>
15.	Accounts Receivable Turn-Days	$\frac{365}{\text{Accts. Rec. Turnover}}$	37	39	38	23	<u>365/ 9.7</u>
16.	Accounts Payable Turnover	$\frac{\text{Cost of Goods Sold}}{\text{Accounts Payable}}$	10.2	12.1	12.2	20.8	<u>1,957,500</u> <u>160,900</u>
17.	Average Payment Period	$\frac{365}{\text{Accts. Pay. Turnover}}$	36	30	30	18	<u>365/12.2</u>

PROFIT MASTERY ASSESSMENT (pma)
Summary Report
lakes pharmacy

	Cash	Profit (NPBT)
Inventory	\$26,000	\$6,500 Hidden cost
		\$2,000 Interest
A/R	\$69,300	\$6,900 Hidden cost
		\$5,175 Interest
Gross Margin		
Labor		\$15,000
Buying		\$20,000
Pricing		\$55,000
Cash Discounts		\$10,000
Refinance	\$152,000	
Total	\$247,3000	\$120,575

The Profit Mastery Assessment (PMA) process utilizes the “Roadmap” to develop an action plan that is measurable and creates accountability.

Learning Assessment Questions

Program Title: Program Title: “Profit Mastery: Practical Tools to Assess the Financial Health of Your Pharmacy”

Name of Presenter: Steve LeFever

1. An income statement represents:
 - a. The results of an operation over a given period of time
 - b. A cumulative picture of your business operations over a period of time
 - c. A summary of what your business owns and owes
 - d. The operations of your business over one year

2. The Financial Cycle and Order of Business are:
 - a. Lse equiptemnr

8. Identify at least two possible causes of a shrinking gross profit margin.
9. Growth (increased sales) usually results in increased levels of cash. True or False?
10. In the BRS Financial Roadmap, what are the three key symptoms indicative of current or future problems?
 - a. Low or declining cash
 - b. Low or declining margin
 - c. Low or declining profits
 - d. Poor bookkeeping
 - e. Low productivity
 - f. Low fixed costs

Learning Assessment Answers

Program Title: Program Title: “Profit Mastery: Practical Tools to Assess the Financial Health of Your Pharmacy”

Name of Presenter: Steve LeFever

Answers:

1. A
2. Failure to plan properly before startup
Failure to monitor financial position
Failure to understand the relationship between cost, volume, and profit
Failure to manage cash flow
Failure to manage growth
Failure to borrow properly
Failure to plan for transition
3. A & B
4. A, B & E
5. Cash
Inventory
Accounts Receivable
6. Yes
7. C, D & E
8. Shrinkage
Poor bookkeeping
Poor pricing
Poor inventory control
Not taking discounts
Low productivity
Poor buying
Reduced reimbursements
9. False
10. Low or declining cash
Low or declining margin
Low or declining profits