
EBIT-Duh!TM Finance for the HR Professional

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for **GVFHRA**



Objectives:

- ◆ Assess current knowledge of financial terminology
- ◆ Use the correct definition of commonly used financial terms
- ◆ Recognize the context for each term
- ◆ Have fun



EBIT-DA

- A. Earnings Before Income Tax, Debt, Assets
- B. Earnings By Inventory Turnover and Depreciation
- C. Earnings By Interest, Turnover Days and Amortization
- D. Earnings Before Interest, Tax, Depreciation and Amortization



EBIT-DA

D. Earnings Before Interest, Tax,
Depreciation and Amortization



Definitions

- ◆ Depreciation: a portion of the cost of an asset that is subtracted each year until the asset's value reaches 0. This reflects normal wear and tear.
- ◆ Amortization: allocating the cost of long-lived assets to periods in which their benefits are derived.
 - Amortization of intangibles



Gross Income or Gross Profit

- A. Revenues minus cost of goods sold
- B. Total sales minus returns and discounts
- C. Revenues minus fixed costs
- D. Total sales minus cost of inventory



Gross Income or Gross Profit

A. Revenues minus cost of goods sold

Revenues	200,000
Cost of Goods	<u>-150,000</u>
Gross Profit	50,000



Gross Margin

- A. Gross operating profit divided by sales
- B. Gross sales divided by operations costs
- C. Gross revenues divided by operations costs
- D. “Gross” is a word my mother taught me not to use



Gross Margin

A. Gross operating profit divided by sales

50,000

200,000 25%



Return on Assets

- ◆ ROA tells you what earnings were generated from invested capital (assets).
- ◆ It is best to compare ROA against a company's previous ROA numbers or the ROA of a similar company.
- ◆ Net v. Gross

$$\text{ROA} = \frac{\text{Net Income}}{\text{Total Assets}}$$



ROA

- ◆ If ABC company has a net income of \$1 million and total assets of \$5 million, its ROA is 20%;
- ◆ If DEF company earns \$1 million and has total assets of \$10 million, it has an ROA of 10%.
- ◆ Based on this example, which company is better at converting investment to profit?



ROA

- ◆ Based on this example, the ABC company is better at converting its investment into profit. When you really think about it, management's most important job is to make wise choices in allocating its resources.
- ◆ Anybody can make a profit by throwing a ton of money at a problem, but very few managers excel at making large profits with little investment.



ROA: Where's HR's Contribution?

- ◆ Another common internal use for ROA involves evaluating the benefits of investing in a new system versus expanding a current system. The best choice will ideally increase productivity and income as well as reduce asset costs, resulting in an improved ROA ratio.



ROA: Where's HR's Contribution?

◆ A small manufacturing company with a current sales volume of \$50,000, average assets of \$30,000, and a net income of \$6,000 (giving it an ROA of $\$6,000 / \$30,000$ or 20 percent) must decide whether to improve its current inventory management system or install a new one.

- Expanding the current system would allow an increase in sales volume to \$65,000 and in net income to \$7,800, but would also increase average assets to \$39,000. ($7,800 / 39,000 = 20\%$)
 - » Even though sales would increase, the ROA of this option would be the same—20 percent.
- On the other hand, installing a new system would increase sales to \$70,000 and net profit to \$12,250. Because the new system would allow the company to manage its inventory more efficiently, the average assets would increase only to \$35,000. ($12,250 / 35,000 = 35\%$)
 - » As a result, the ROA for this option would increase to 35 percent, meaning that the company should choose to install the new system.



Return on Equity

The ROE is useful for comparing the profitability of a company to that of other firms in the same industry.

Return on equity (ROE) measures the rate of return on the ownership interest (shareholders' equity) of the common stock owners. It measures a firm's efficiency at generating profits from every unit of shareholders' equity. ROE shows how well a company uses investment funds to generate earnings growth.



Calculate the Return on Equity

Eat and Get Out

Total Assets (TA) 1,000,000
Net Income (NI) 200,000
Liabilities 500,000
Owner's Equity (OE) 500,000

Eat and Get Gas

Total Assets (TA) 1,000,000
Net Income (NI) 200,000
Liabilities 250,000
Owner's Equity (OE) 750,000



Return On Equity

Eat and Get Out

Financial Leverage measure =
$$\frac{\text{Total Assets}}{\text{Owners Equity}}$$

$$\frac{1,000,000}{500,000} = 2$$

ROE= Return On Assets x
Financial Leverage
 $20 \times 2 = 40\%$

Eat and Get Gas

$$\frac{1,000,000}{750,000} = 1.3$$

ROE=ROA x FL
 $20 \times 1.3 = 26\%$



ROA and ROE

- ◆ Who in your organization would rather receive an incentive based on ROA?
- ◆ If your incentives are based on ROE who can virtually guarantee themselves a bonus?
How?



Leverage

- A. Use of debt to increase fixed assets
- B. Use of debt to increase returns
- C. Use of debt to decrease cash investment
- D. Use of debt to decrease investment risk



Leverage

B. Use of debt to increase returns



Trailing 12 Months

- A. Tool showing sales in the last 12 months
- B. Tool showing profits in the last 12 months
- C. Tool showing average sales in the last 12 months
- D. Tool showing a rolling average of sales from every previous 12 months

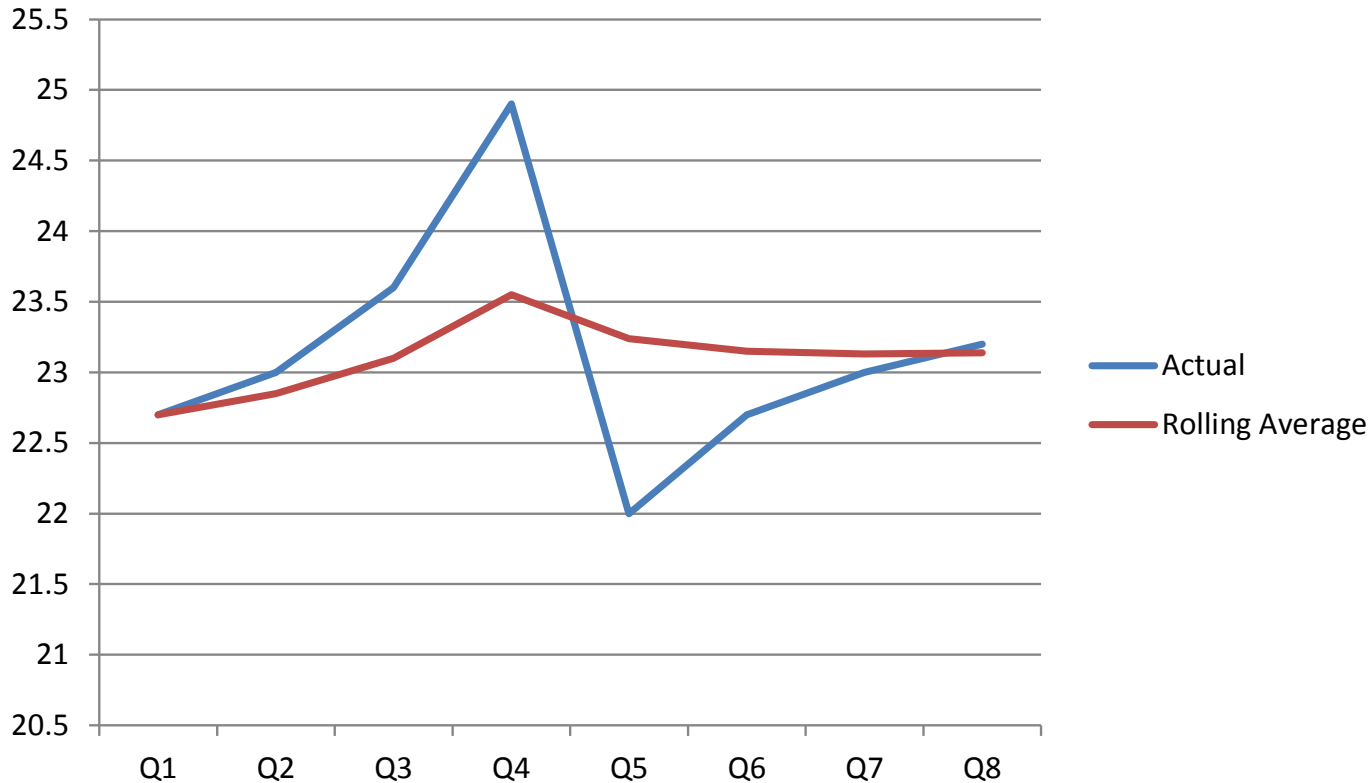


Trailing 12 Months

D. Tool showing a rolling average of sales from every previous 12 months



Trend: Trailing 12 Months



Balance Sheet & Extra Credit

- A. Statement of receipts over disbursement during a given period
- B. Statement of profit or loss comprised of net revenues less expenses
- C. Statement of inventory flow from purchase and sales
- D. Statement of financial position on a particular date



Balance Sheet

- A. Statement of receipts over disbursement during a given period--**Cash Flow Report**
- B. Statement of profit or loss comprised of net revenues less expenses -- **Income Statement**
- C. Statement of inventory flow from purchase and sales--**LIFO or FIFO**
- D. Statement of financial position on a particular date



Cash Flow Statement

Cash Flow Statement			
December 2010		Current Month	Year to Date
Scheduled Rent		\$5,465	\$32,860
Operating Revenue:			
Rent/Lease		\$3,335	\$18,757
Prepaid Rent		0	\$ 995
Other Income		\$81	\$ 131
Total operating revenue		\$3,406	\$29,701
Operating Expense			
Management Fee		\$450	\$2,250
Mailing		\$ 2	\$ 10
Maintenance		\$ 555	\$ 813
Plumbing		\$ 313	\$ 313
Electricity		\$ 75	\$ 384
Water/Sewer		\$ 116	\$ 425
Gas		\$ 22	\$ 83
Total Operating Expenses		\$1,534	\$ 4,281
Net Income		\$1,871	\$15,419
Beginning Cash Balance		\$1,448	
Increase (decrease) from Net Income from Operations		\$423	\$15,419
Increase (decrease) Owner Capital Accts.			
Owner Draw		(\$2,900)	(\$16,000)
Owner contribution of Capital		0	\$ 1,000
Increase (decrease) from Other Accounts			
Prepaid Rent Liability		0	0
Ending Cash Balance		\$ 419	\$ 419



Income Statement

Income Statement	2009	2010
Sales	\$1,500,000	\$2,000,000
Cost of Sales	<u>(\$350,000)</u>	<u>(\$375,000)</u>
Gross Income	\$1,150,000	\$1,625,000
Operating Expenses	<u>(\$235,000)</u>	<u>(\$260,000)</u>
Operating Income	\$915,000	\$1,365,000
Other Income (Expense)	\$40,000	\$60,000
Extraordinary Gain (Loss)	-	(\$15,000)
Interest Expense	<u>(\$50,000)</u>	<u>(\$50,000)</u>
Net Profit Before Taxes (Pretax Income)	\$905,000	\$1,360,000
Taxes	<u>(\$300,000)</u>	<u>(\$475,000)</u>
Net Income	\$605,000	\$885,000

Balance Sheet-Madeline's Markets

As of June 2009

Assets

Current

Cash/investments	\$900,000
Receivables	580,000
Inventories	\$3,900,000
Prepaid expenses	60,000

Total Current Assets 5,444,000

Property, plant & equip 3,800,000

Total Assets 9,240,000

Liabilities

Current

Accounts Payable	\$2,420,000
Short-term credit	200,000
Misc. Payables	137,000

Total Current Liabilities 2,757,000

Long Term Debt 200,000

Owner's Equity 6,283,000

Total Assets &
owner's equity

\$9,240,000



Who To Blame

- ◆ **The trial balance (summa summarium) is the end of Frater Luca Bartolomes Pacioli's accounting cycle. Debit amounts from the old ledger are listed on the left side of the balance sheet and credits on the right. If the two totals equal, the old ledger is considered balanced. If not, says Pacioli, "that would indicate a mistake in your Ledger, which mistake you will have to look for diligently with the industry and intelligence God gave you."**



At End of January	2008	2007	2006	2005	2004
Cash & Equivalents	445	600	793	506	1,103
Short Term Investments	12	14	14	1,659	1,749
Net Accounts Receivable	1,259	3,223	2,396	1,499	1,097
Total Inventory	11,731	12,822	11,401	10,076	9,076
Other Current Assets	<u>1,227</u>	<u>1,341</u>	<u>665</u>	<u>533</u>	<u>303</u>
Total Current Assets	14,674	18,000	15,269	14,273	13,328
Net Property, Plant, & Equipment	27,476	26,605	24,901	22,726	20,063
Net Goodwill	1,109	6,314	3,286	1,394	833
Net Intangibles	100	778	398	0	0
Note Receivable - Long Term	342	343	348	369	84
Other Long Term Assets	<u>623</u>	<u>223</u>	<u>203</u>	<u>258</u>	<u>129</u>
Total Long Term Assets	<u>29,650</u>	<u>34,263</u>	<u>29,136</u>	<u>24,747</u>	<u>21,109</u>
Total Assets	<u>44,324</u>	<u>52,263</u>	<u>44,405</u>	<u>39,020</u>	<u>34,437</u>
Accounts Payable	5,732	7,356	6,032	5,766	5,159
Accrued Expenses	3,393	3,706	3,116	2,971	2,430
Short Term Notes Payable	1,747	0	900	0	0
Current Portion LTD	300	18	513	11	509
Other Current liabilities	<u>1,534</u>	<u>1,851</u>	<u>2,145</u>	<u>1,707</u>	<u>1,456</u>
Total Current Liabilities	12,706	12,931	12,706	10,455	9,554
Long Term Debt	11,383	11,643	2,672	2,148	856
Deferred Income Tax	688	1,416	946	1,388	967
Other Liabilities	<u>1,833</u>	<u>1,243</u>	<u>1,172</u>	<u>871</u>	<u>653</u>
Total Long-Term Debt	<u>13,904</u>	<u>14,302</u>	<u>4,790</u>	<u>4,407</u>	<u>2,476</u>
Total Liabilities	<u>26,610</u>	<u>27,233</u>	<u>17,496</u>	<u>14,862</u>	<u>12,030</u>
Common Stock	85	121	120	119	119
Additional Paid-In Capital	5,800	7,930	7,149	6,650	6,184
Retained Earnings	11,388	33,052	28,943	23,962	19,680
Treasury Stock - Common	-314	-16,383	-9,712	-6,692	-3,590
Other Equity	<u>755</u>	<u>310</u>	<u>409</u>	<u>119</u>	<u>14</u>
Total Stockholders' Equity	<u>17,714</u>	<u>25,030</u>	<u>26,909</u>	<u>24,158</u>	<u>22,407</u>
Total Liabilities & SE	<u>44,324</u>	<u>52,263</u>	<u>44,405</u>	<u>39,020</u>	<u>34,437</u>
Total Common Shares Outstanding	1,690	1,970	2,124	2,185	2,257



Home Depot

Comparative Income Statements

For 12 months ended January	2008	2007	2006	2005	2004
Revenue	77,349	77,022	77,019	73,094	64,816
Cost of Goods Sold	51,352	52,476	51,081	48,664	44,236

HR Asset or Liability?

- ◆ On the balance sheet HR is....
- ◆ What are some ways HR can have a positive impact on the bottom line?



HR Asset or Liability?

- ◆ What are some ways HR can have a positive impact on the bottom line?
 - Increase productivity
 - » Organizational development efforts
 - » Leadership development
 - » HRIS
 - Decrease costs
 - » Process improvement decreasing cycle times
 - » Lawsuits, grievances, lost time
 - » Healthcare



Information List:

- ◆ *EBIT-Duh!*TM *Finance for the HR Professional*, Clare Novak
- ◆ <http://www.business-leadership-qualities.com/ebitseminar>
- ◆ <http://www.answers.com>
- ◆ <http://www.investopedia.com>
- ◆ Your own CFO or VP of Finance or internal finance person
- ◆ *Naked Finance* David Meckin
- ◆ *Basic Financial Management* Martin, Petty, Keown, Scott
- ◆ *The Portable MBA in Finance and Accounting* John Leslie Livingstone
- ◆ *Thinking Finance* Joel G. Siegel and Shim, Jae K.

