

INVENTORY COSTING, CASH FLOW AND KEY PERFORMANCE INDICATORS.

Are you looking at the right numbers?

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What we are going to discuss:

- Inventory Costing
- Cash Flow
- Key Performance Indicators

Inventory Costing - what goes into a keg?



Inventory Costing - The goal is to match the expense of an item being sold to the revenue generated by the sale of that item.

Four Accepted Methods of Inventory Costing:

- Specific Identification
- FIFO (First In, First Out)
- LIFO (Last In, First Out)
- **Weighted Average**

What costs should we consider putting into inventory versus expensing?

Direct Costs:

The costs associated directly with the manufacture of beer. These include:

- Ingredients - Grain, hops, yeast, etc.
- Labor - Brewery staff
- Propane (direct fire brewhouse)
- Other?

Indirect Costs:

Costs that allow for the production of beer but are not specifically related to the production.

These include:

- Utilities (Electricity, water, etc.)
- Lease of production facility and storage space
- Depreciation of equipment
- Other?

K.I.S.S

The only financial information worth having is information that is meaningful to you in the operation of your brewery.



So what costs should be going into inventory?

What costs does North Jetty Brewing put into keg inventory?

- Grain
- Hops
- Adjuncts

Why not:

- Yeast?
- Wages?
- Other?

IF YOUR COST OF KEGS SOLD
CONTAINS TOO MANY COST
CATEGORIES, THE NUMBERS
BECOME MUDDY AND
HARDER TO ANALYZE



An Example:

Two different ways to look at the same numbers

In this example cost of kegs sold includes:

- Grain, Hops, Adjuncts
- Brewers' wages allocation
- Yeast
- Propane

Jan - March, 2019

Keg Sales	\$ 50,000
Cost of Kegs Sold	<u>(25,000)</u>
Gross Profit - Keg Sales	\$ 25,000

Jan - March, 2020

Keg Sales	\$ 50,000
Cost of Kegs Sold	<u>(27,000)</u>
Gross Profit - Keg Sales	\$ 23,000

In this example cost of kegs sold includes:

- Grain
- Hops
- Adjuncts

Jan - March, 2019

Keg Sales	\$ 50,000
Cost of Kegs Sold	(15,500)
Brewer Wages	(8,300)
Yeast	(800)
Propane	<u>(400)</u>
Cost of Kegs Sold	<u>(25,000)</u>
Gross Profit - Keg Sales	\$ 25,000

Jan - March, 2020

Keg Sales	\$ 50,000
Cost of Kegs Sold	(15,650)
Brewer Wages	(9,500)
Yeast	(950)
Propane	<u>(900)</u>
Cost of Kegs Sold	<u>(27,000)</u>
Gross Profit - Keg Sales	\$ 23,000

BUT I REALLY WANT MY BREWER
WAGES IN KEG INVENTORY!!



Keeping your cost of sales numbers clean and clear improves the value of the information that they provide.



Any Questions? Comments?
Cash Flow - Cash is King



Cash Flow Overview: Cash Cycle

- Purchase of raw materials
- Manufacture of product (beer)
- Sales of product (beer)
- Receive payment for product sold

Start the cycle over...

The Two Main Financial Statements

- The Balance Sheet - Gives us a snapshot of the Assets, Liabilities, and Equity of the business at a specific point in time.
- The Statement of Operations - Gives us the results of operations over a particular period of time. It shows realized revenue less realized expenses.

The hard truth that we need to understand.....

The Statement of Operations
by itself tells us almost
NOTHING
about cash flow.



The two statements work together to give us an accurate picture of cash flow

In order to clearly see our cash flow, we have to look at **Three Statements**:

- Balance sheet at the **beginning** of the period
- Income Statement/Statement of Operations **during** the period
- Balance sheet at the **end** of the period

Let's look an example from a given month to see how we can use our three statements to get a clear(er) picture of cash flow for the period...

An Example:

The Month of April

Income Statement: 4/1 - 4/30

Revenue	\$ 50,000
Cost of Good Sold	<u>(15,000)</u>
Gross Profit	35,000
Other Expenses	<u>(25,000)</u>
Net Income	<u>\$ 10,000</u>

Selected Balance Sheet at 3/31

Accounts Receivable	\$ 50,000
Inventory	10,000
Accounts Payable	15,000
Notes Payable	100,000

Selected Balance Sheet at 4/30

Accounts Receivable	\$ 55,000
Inventory	9,000
Accounts Payable	13,000
Notes Payable	97,000

Let's look at the net cash flow from April:

Net Income	\$ 10,000
Increase in AR	(5,000)
Decrease in Inventory	1,000
Decrease in AP	(2,000)
Decrease in Notes Payable	<u>(3,000)</u>
Net Cash Flow for April	<u>\$ 1,000</u>

The Result

\$10,000 in net income translates to only \$1,000 net cash flow.

The Takeaway...

- Net income relates to, but does not give a clear picture, of cash flow
 - Add: decrease in assets, increase in payables
 - Subtract: increase in assets, decrease in payables
 - Add back: depreciation, amortization, other non-cash expense
- Owner Draws (LLC/Partnership/S-Corp) - balance sheet - decrease cash
- Debt service payments - balance sheet - decrease cash

Cash management items to consider...

- Cash management - two weeks, one month, one quarter
- Plan cash for growth - hidden costs beyond just the equipment
- Cash Lag
- Cash Crunch
- Have a line of credit available for emergencies - pay employees first!

Cash Crunch:

A personal story about the need for strong cash management and understanding cash flow



How do we identify
issues...hopefully before they
happen?

Key Performance Indicators



What is a Key Performance Indicator?

A measurable value that demonstrates how effectively a company is achieving key business objectives.

Actionable numbers and ratios that show overall performance of a business, and that help to identify areas that are performing well and areas that need attention.

Key Performance Indicators to consider...

- Cash Flow Forecast
- Gross Profit Margin as a Percentage of Sales
- Revenue Growth Rate
- Receivables Turnover
- Inventory Turnover
- Payables Turnover

Cash Flow Forecast

Cash in bank plus expected cash collections over next four weeks, less expected cash expenditures over next four weeks.

Related to: Quick Ratio, Acid Test, Defensive Ratio (dividing assets that are cash or easily converted to cash by current liabilities).

Also be sure to pull in amounts that have not been accrued.

Cash Flow Forecast - Example

Cash on Hand	\$ 15,000
AR	30,000
Taproom	<u>\$ 25,000</u>
Cash In	\$ 70,000
AP	\$ 25,000
Payroll	12,000
Debt/supplies/etc	<u>\$ 15,000</u>
Cash Out	\$ 52,000

= 1.35

Cash on Hand	\$ 10,000
AR	25,000
Taproom	<u>\$ 25,000</u>
Cash In	\$ 60,000
AP	\$ 32,000
Payroll	12,000
Debt/supplies/etc	<u>\$ 18,000</u>
Cash Out	\$ 62,000

= 0.97

Gross Profit Margin as a Percentage of Sales

Gross Profit (Sales less CGS), divided by Sales

Keg Sales	\$ 25,978
CGS - Keg	<u>7,793</u>
Gross Profit	\$ 18,185
GPM % Sales	0.70 or 70%

Keg Sales	\$ 32,593
CGS - Keg	<u>11,408</u>
Gross Profit	\$ 21,185
GPM % Sales	0.65 or 65%

May or may not be a bad thing...

Revenue Growth Rate

Sales this period, less sales last period, divided by sales last period.

Sales 2019	\$ 325,000
Sales 2020	<u>348,000</u>
Increase	\$ 23,000
% Increase	7.1% RGR

Receivables Turnover

Receivables Turnover Ratio is Net Credit Sales divided by Average Receivables

Net Credit Sales 20XX	\$ 200,000
Average Accounts Receivable 20XX	10,000
Receivables Turnover Ratio (200K / 10K)	20 Accts Receivable Turns Per Year
$12 / 20 = 0.6 \times 30$ days (avg month)	18 Avg days from Sale to Collections

IF average days to collect is higher than your terms that may be a red flag!

Inventory Turnover

Inventory Turnover is Cost of Goods Sold divided by Average Inventory

Cost of Goods Sold 20XX	\$ 67,000
Average Inventory 20XX	6,600
Inventory Turnover Ratio (67K / 6,600)	10 Inventory Turns Per Year
$12 / 10 = 1.2 \times 30$ days (avg month)	36 Avg days to Turn Inventory

Fewer Inventory Turns = Old product or production out-pacing sales

Accounts Payable Turnover

First find total purchases during the year:

Cost of Goods Sold from Suppliers 20XX	\$ 62,000
AP to those Suppliers - End of Year	5,700
Less: AP to those Suppliers - Beginning of Year	<u>(4,200)</u>
Total Purchases During the Year	\$ 63,500

THEN...

Accounts Payable Turnover Continued...

Accounts Payable Turnover is Total Purchases divided by Avg. Accts. Payable

Total Purchases from Supplies 20XX	\$ 63,500
Average Accounts Payable 20XX	4,950
Accounts Payable Turnover Ratio (63,500 / 4,950)	12.8 Payables Turns Per Year
$12 / 12.8 = 0.93 \times 30$ days (avg month)	28 Avg days to Turn Payables

Make sure taking advantage of terms offered by suppliers without slow paying

Other KPI's to Consider...

- Sales Payroll to Sales Revenue
- Brewery Wages to Cost of Sales
- Sales Mix and Change Over Time
- Case Equivalents sold to Distributors / Barrels Sold to Distributors

Come up with your own Key Performance Indicators based on what makes sense to you!

Final Thoughts...

- Require that staff takes vacations and time off
- Open the mail yourself every day - sign all checks yourself as owner
- Reconcile the bank account **OR** understand and review it each month
- Require at least monthly P&L, BS, AR Aging, AP Aging, Inventory Sheets

Owner oversight and understanding of the finances of a business are crucial to the success of that business...and to your ability to sleep at night!



Thanks!

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