

## Break-Even Calculator

When business owners look at their monthly profit-and-loss statements, they may only be seeing the tip of the iceberg. It's what looms underneath—that may cause enough damage to sink the ship — six or nine months down the road.

Spotting trouble ahead of time takes more than a quick review of sales, net income and cash positions. More in-depth analysis is the key to navigating around potential obstacles. Owners need to ask their controllers to dig into the numbers to better monitor business trends.

A company's income statement can be misleading. Many smaller companies list their expenses either alphabetically or from largest to smallest expense. Without having a better view of fixed versus variable costs and how they are changing monthly, many business owners tend to believe they can sell their way out of financial trouble.

Recalculating and monitoring the Break-Even Point (classifying expenses as either Fixed \$ or Variable % of Sales) provides another management tool that can help business owners know the true contribution of each sale. All labor (even the labor on the plant floor) should be considered a fixed expense for a proper short-term analysis, because payroll dollars continue regardless if sales revenues go up or down.

The Break-Even Point is defined by dividing fixed expenses by "Contribution" (100% minus the variable expenses *percentage*). For example, if a company has fixed expenses of \$100,000 per month and variable expenses are 80%, then 100% minus 80% = 20% (the amount that "contributes" to paying for the fixed costs).

$$\text{Break Even} = \frac{\text{Fixed Expenses}}{\text{Contribution}} = \frac{\$100,000}{20\%} = \$500,000/\text{mo.}$$

In order to cover the fixed costs, this company needs to divide the \$100,000 by 20%, which is \$500,000 in monthly sales, the Break-Even Point. By looking at the contribution margin percentages, a business owner can ask, "Is it possible to turn around the business with more sales or do I have to lower fixed costs?" Too often we find businesses with low contribution margins where the owner is trying to turn things around with more sales, when cost reductions are needed (and quickly!) to save the ship from sinking. In tough times, a sure recipe for disaster is hoping for the "big order from X" to come!

For questions or help, contact Pat Brennan at [pat@plc.com](mailto:pat@plc.com) or call 952-829-5700.

