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AMERICA'S SBDC TENNESSEE

BREAK-EVEN ANALYSIS

PROFITS V.S. LOSS; BREAKING EVEN

1. Income Statement

The primary components of a typical income statement start with the following:

- Total Revenues or Sales- This equals the total amount of funds derived from a product or service sold.
- Cost of Goods Sold- This includes all direct costs incurred to produce your product or service sold. Direct costs will fluctuate up or down as production changes. Labor and raw materials are examples of direct costs.
- Gross Profit- The gross profit is total total sales or revenues minus direct costs. It is called gross profit because additional expenses must be subtracted to calculate an operating profit.
- Operating Expenses- Operating expenses are incurred from selling and general administrative costs; these include indirect costs that were indirectly required to produce your product or service. They will not change as production changes. Clerical work and rent are examples of indirect costs.
- Operating Profit- This equals total revenues or sales minus cost of goods sold and other expenses.

2. Break-Even Analysis

Break-even analysis is a method used to determine how many units of a product or service must be sold to cover the fixed and variable costs of production and where profitability begins. This helps companies determine how many units need to be sold to cover all of their costs and expenses. The equation to find revenue is total fixed costs plus total variable costs. Fixed costs are expenses that have to be paid by a company independent of any specific business activities, while variable costs refer to a cost of doing business that changes in proportion to how much a company produces or sells.

3. Calculating Break-Even Output

The second financial document that you will want to work on in your financial projections is your statement of cash flows. The statement of cash flows takes your net profit or net loss from your profit and loss report, but it also applies any cash that you had to begin with and any other additional expenses. The statement of cash flows is extremely important because it helps you determine if you have enough cash available to float month by month.

4. Balance Sheet

Break-even output is calculated by fixed costs divided by selling price per unit minus variable costs per unit (fixed costs/selling price per unit – variable costs per unit).