

NAPEO First Friday Series – April 1, 2022

“Financial Risk Management”

Analyzing PEO Client Financial Fitness

Presented By



Agenda

- 1. Rising from COVID**
- 2. What is Financial Risk Management**
- 3. Financial Risk Management Client Analysis**
- 4. Getting Back to Growth**
- 5. PEO's Role in Helping Clients Become Successful**

COVID Impact

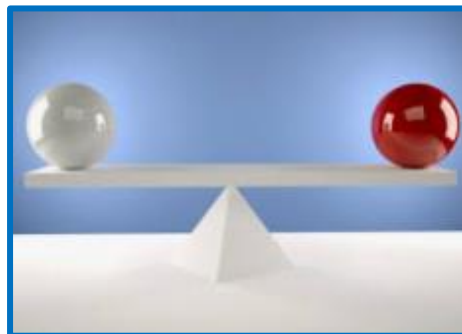
- **Lost Client Business Causes**
 - Major loss in demand for products / services
 - Loss of income - Simply ran out of cash
 - Couldn't make payroll or pay other major expenses
 - PPP was simply not enough to sustain business
 - Lack of available resources
 - Logistics / Supply Chain
 - Could not adapt business



Why PEO Clients **Grew** or **Were Stable** During COVID

Survival of the fittest...

- Financially Sustainable for the long haul (flush with cash)
- Able to deliver products and services
- Workforce worked outdoors
- Remote employees kept/increased business productivity
- T & E expenses almost eliminated
- Adapted business (food delivery, outdoor seating)
- Ability to lower costs and sustain services
- Capitalized on new opportunities (Staffing Co. for Nursing)
- PPP / Employee Retention Tax Credit helped to survive



Industries / Vertical Markets Affected – Where People Gathered...

- Hospitality: Lodging, resorts, tourism, spas, Airbnb, etc.
- Travel: Air, train/subway, bus, limo, etc.
- Entertainment: Theaters, live shows, concerts, athletic events
- Restaurant: Inability to evolve for takeout, lack of staff, no more seating inside
- Brick and Mortar Retail: Malls, shops, chains
- Franchises: Industry dependent

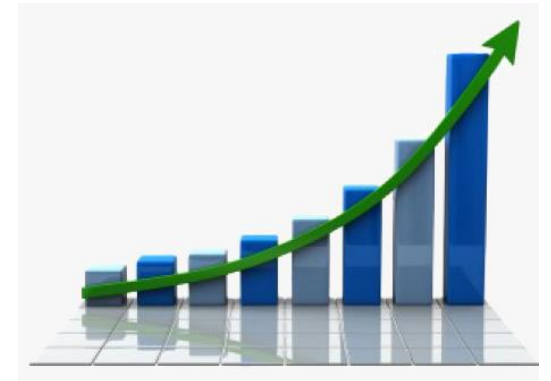
What was your client portfolio mix? Did you have significant loss of clients?

Did your client acquisition strategy change?



PEO Client Status

- Many older clients returned from being dormant with the PEO
- PEOs jettisoned many of their “higher risk” client base
- New client acquisition is full stream ahead
- Supply chain still problematic and can slow client growth
- Labor Shortage
- PEOs are thriving in the overall growth of the economy



Have PEOs Increased Their Client **Financial** Due Diligence

With COVID behind, have PEOs adapted any new processes to financially review and understand client's financial health

Not Really



Current PEO Financial Due Diligence

30 PEOs Polled

	New	Existing Clients
• Review of client’s financials	1	0
• Have the right to review financials (but don’t)	1	1
• Require Personal Guarantees	3	0
• Require cash deposit	3	2
• Require they have a credit line in place	3	3
• Access credit score only	4	0
• Validate bank accounts/FEIN	5	0
• Lower payroll risk by requiring wire <ul style="list-style-type: none"> • Some PEOs require wires only • Some move back to wires from ACH if chronic bounce problems • Almost all ACH bounces occur without warning • Recurring bounces can result in client termination 	10	10



Only clients with Payroll >\$30M

*** PEOs who use brokers many times rely on them for financial due diligence assistance – at some level**

What if you treated Financial Risk Management on par with WC / Benefits Risk Management?

Workers Comp Risk Management:

- **What:** Finding the most competitive rates for Workers' Compensation and benefits insurance to provide wage replacement and medical benefits to employees injured in the course of employment in exchange for relinquishment of the employee's right to sue.

Financial Risk Management:

- **What:** The ability to assess and understand PEO clients past, current and future financial fitness relative to the products and services provided within their markets to measure and mitigate financial risk.



Financial Risk Management – Why?

1. Avoid getting blindsided (bounces) for payroll
2. Terminating the client when you would rather not
3. Lack/loss of positive client relationship
4. Client Loss – Jump to another PEO (perhaps through a broker)
5. You float them and float them and.....at some point they just can't pay you back quickly (if at all) or results in termination
6. **Identify an opportunity to help your clients (financial assistance/review, access to capital)**

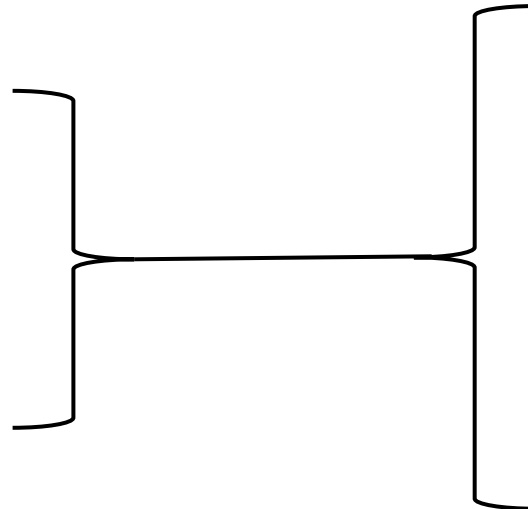
Financial Risk Management

Analyzing and Measuring the Financial Health of Clients

Client Financial Disclosure Required (it can be a positive)

Financial Data Collection and Analysis (i.e., via QuickBooks, etc.)

- P&L
- Balance sheets
- Bank statements
- Statement of cash flows

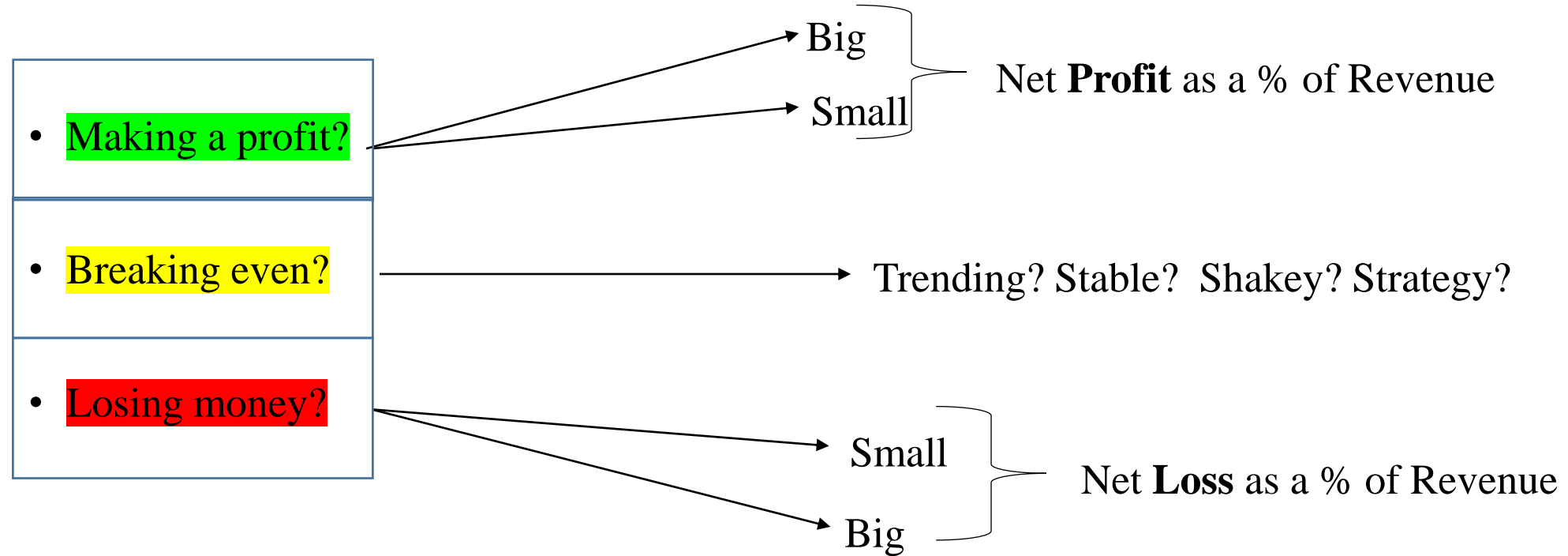


- Profitability
- Cashflow
- Debt
- Cash position
- Where is their money going
- Payroll % of revenues
- AR aging
- Fixed / Variable costs
- Assets / Liabilities

Broken down by current month, quarterly or annually

Financial Risk Management

P&L Analysis – an indicator of client financial health



Should be compared to pre-COVID and post.

Financial Risk Management

P&L Analysis - an indicator of client financial health fitness

If they are **Breaking Even** or **Losing Money**, what is their immediate, 3 or 6-month strategy to become profitable?

“Help me understand your strategy to turnaround / grow your company”

- New or existing contracts/clients in place (expected revenue gain)
 - Future or unsigned contracts should be taken into consideration (somewhat)
- Solid management team with knowledge/experience to become profitable
 - Been there, done that
 - Solid growth strategy and execution
- Obtaining capital to meet a growing demand can be difficult
- Overcoming major obstacles (i.e., debt)
- Does the strategy make sense? How real does it appear? Stay close to the progress

Financial Risk Management

Balance Sheet

A financial document that provides a financial snapshot in time that can change frequently

- **Debt Position** – is it a huge burden? Is it draining the company cash faster than revenues?

Loans, MCAs, Leases, LoCs,

- **Assets:** Ownership of things with monetary value.

Cash

Inventory

Property

Equipment

Investments

Prepaid expenses

AR from clients

- **Liabilities** are settled over time through the transfer of economic benefits

Loans

Accounts Payable

Mortgages

Bonds

Warranties

Accrued expenses

Financial Risk Management

Statement of Cashflow

A supporting financial document that provides Checks and balances against financial reports

- The statement of cash flows provides information about:
 - Cash receipts
 - Cash payments
- Net change in cash resulting from
 - Operating
 - Investing
 - Financing activities of a company.

FY Ended 31 Dec 2017		
All Figures in USD		
Cash Flow From Operations		
Net Earnings		2,000,000
<i>Additions to Cash</i>		
Depreciations		10,000
Decrease in Accounts Receivable		15,000
Increase in Accounts Payable		15,000
Increase in Taxes Payable		2,000
<i>Subtractions From Cash</i>		
Increase in Inventory		(30,000)
<u>Net Cash From Operations</u>		<u>2,012,000</u>
Cash Flow From Investing		
Equipment		(500,000)
Cash Flow From Financing		
Notes Payable		10,000
<u>Cash Flow for FY Ended 21 Dec 2017</u>		<u>1,522,000</u>

Financial Risk Management

Statement of Cashflow

Cash Flow From Operations

- If result is positive:
 - Is there enough cash to pay the bills (including payroll)
- If result is negative - Why:
 - Revenue declines
 - Price increases that cannot be passed on to customers
 - Bloated overhead, etc.
 - Management challenges

Cash Flow From Investing (Cap Ex)

- If Cap Ex spending is greater than Cash Flow From Operations, there may be a problem if it is an ongoing practice

Cash Flow From Financing

- If a note is payable this year, where will the cash come from to cover it (see Balance Sheet - Liabilities)

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Financial Risk Management

Bank Statements

A supporting financial document that provides a snapshot in time that changes frequently

Bank Statements show the cumulative balance of cash in the account, net of all the preceding transactions, as of the end of each day in a reporting period.

A summary table generally shows the time period, opening balance, deposits, withdrawals, and closing balance.
Where did the money go?

Why it's important

- Suspicious Activity (what cash is being used for)
- Track spending and their trends (robbing Peter to pay Paul?)
- Checks and balances against financial reports
i.e., “ if P&L shows \$200k in sales in a month, does the bank statement show a deposit of \$200k?”

Financial Risk Management

Ask about the ways they obtain and manage CASH:

- Do they monitor it closely (probably)
- Do they need to (or have) cashed in on any of their assets
- Do they stay on top of invoicing / collections (A/R)
- Do they ask for upfront money for services, large orders or long-term contracts (% of total)
- Do they delay payments to your vendors while waiting to get paid
- Have they cut costs adequately but can still deliver
- Have they gotten a business line of credit - is it tapped out?
- Do they lease equipment/space or have or own
- Are they getting paid faster (i.e., Venmo, wire, advance, etc.)

Financial Risk Management

Establish a Client Risk Profile



	Financial Risk Profile	Result
1	More than 3 years in Business	√
2	Contracts in place and generating revenue	√
3	Existing bank Line of Credit (not loan)	N
4	Executives with substantial prior experience	√
5	Payroll higher at present than last year	N
6	Growing (fast, somewhat, stable, no)	√
7	Capital needed in place (if needed)	N
8	Prior bankruptcy	N
10	Cash on hand = or > 3-weeks payroll	N
11	Payroll no more than 50% of sales (monthly)	√
12	Solid client base or only a few	Y
13	AR aging (15,30,45,60, 90 days)	Y
14	Debt greater that 15% of payroll (monthly)	N
15	Quality of Client's customers	√
16	Back Taxes Owed	N
17	Survived recession / COVID	Y
18	Products/services in high demand	√
19	Background checks clean	Y
20	Credit Check, FEIN/bank acct verification	√
21	Liens	N

SCORE the Client Based on Business Related Risk Factors

Significant Indicator of how well a company is capitalized

Making Payroll Is not always an indicator of Client Financial Health

- **Cashflow problems may still exist**

- Are **debt** payments increasing to outpace payroll soon?
- Do they make **payroll** by not paying other expenses?
- Do they ask for a few days of **float** while they collect AR?
- Running **breakeven** with no room to grow (money is very tight)
- **Cash** draining at a concerned pace
- Have been making payroll but barely



Challenges/Impediments to PEO Growth

- Vertical Market Recovery in the Client Base – Growing, shrunk, stable?
- **Resources**
 - Returning to work
 - Available?
- **Supply Chain**
 - Necessary for business?
 - Rising Costs
 - Expectations of receiving goods to hold/grow business
- **Demand for products / services**
 - Has the demand changed?
 - Ability to adapt product offerings?
 - Price competitive?



Tracking **Financial Fitness** (New Clients? Existing Clients?)

Client Financial Reviews - can easily be done informally and/or as part of underwriting

- P&L / Balance Sheets / Bank Statements / Statement of Cashflows
- Supply chain addressed?
- Shape of current and pipeline of business (existing and prospective)
- Is adequate company growth sustainable?
- Are they on target to meet / exceed financial strategy (or close to them)?
- Improving or improved business from capital influx



What can you do to make your clients succeed as a PEO Practice: Become a strong **Partner!**

Not Just Payroll and HR - Can you add value to help make your clients succeed / grow?

Broaden your offerings

- Check on clients often – can you help them in any areas?
- **Help them obtain resources**
 - Recruiting platforms for Clients (some PEOs provide this)
 - Provide cross client synergies (i.e., Staffing co. provides nursing staff for medical practices)
- **Recommend business and financial services**
 - CPAs / Accounting Services (you'd be surprised how many clients don't use them)
 - Cash Management Consultants
 - Business Consultants
- **Recommend sources of capital**
- **What can YOU do to help them survive and thrive?**



They will love the help!

Q & A

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