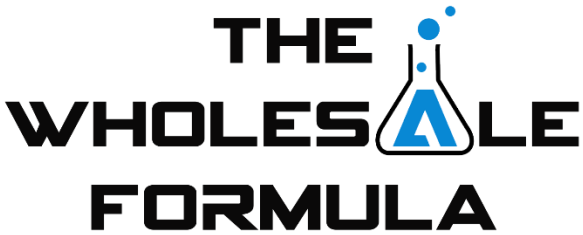

Module 2 – Profit Margin Expectations

Alright, welcome back. In this video, we are going to cover profit margins. Now that you know how to identify prospective products, it's time to learn how to estimate how much money you stand to make on those products. Let's begin.

You should note that you aren't going to know exactly how profitable a product is until you have

1. been approved to sell it,
2. received the price list from the brand owner
3. **AND** negotiated the best possible price.

However, we will show you how to estimate the potential profits for products by analyzing the Amazon listing.

We're going to take a close look at the type of margins you can expect with wholesale and how to calculate different profitability ratios before you know all costs and after you know all costs.

So, what is a profit margin and how do I calculate it?

Profit margin is a ratio of your profit divided by your sales and is expressed as a percentage. Your profit margin will tell you how much out of every dollar of sales you keep as earnings.

There are two types of Profit Margins, gross and net. Let's go over each one of these. I'll show you how to calculate them and how we use them in our business.

Gross Profit Margin is calculated by taking your gross income, which is your sales minus your cost of goods sold, and dividing it by your sales.

We find that gross profit margin is useful when looking at the profitability of products. It's a good tool to use to get a quick, general idea of how profitable an item is. You can use gross profit to measure your business's overall health, but we prefer to use net profit margin for that.

Net Profit Margin is calculated by taking your net income, which is your sales minus all of your costs, and then dividing that by your sales. Net Profit Margin is different than Gross Profit Margin because it takes into account all costs including fixed and variable. Fixed costs are costs that do not change with an increase or decrease in the number of products sold. Examples of fixed costs are rent, insurance, and

internet. Variable costs are costs that change with the level of output. These are costs such as materials, shipping, prep, and Amazon fees.

Net Profit Margin is useful because it allows us to look at how our business is performing over a period of time to see how our fixed costs and our variable costs are affecting our net income. We then look for opportunities to minimize those costs in any way we can without compromising our business. Over the course of time in a wholesale based business, you will be able to look at your net profit margins and get a really good barometer of how your business is doing and can make projections based on those figures.

Like I mentioned earlier, we typically look at our Net Profit Margin over the course of longer periods of time to look at

Another important profitability ratio is your ROI or return on investment. This allows you to see the "return" or profit compared to the cost of the investment.

The ROI calculation looks like this: Sales minus direct costs (which is your profit) divided by direct costs.

Direct costs are costs directly attributed to an individual product. For wholesale items, these would be:

Costs of goods, shipping costs (both to us and to Amazon), and processing costs.

The way that we use ROI is to make a purchasing decision on an individual item. So, we only look at direct costs associated with that product.

ROI helps us make faster and easier purchasing decisions, whereas profit margin is better used over a period of time such as monthly, quarterly, or annually to accurately evaluate the overall profitability of your business.

Ok, you might be thinking this looks complicated, but rest assured it's actually quite easy. Let's look at some examples.

Again, we do not know the exact costs of the product, but to get an estimation we have to start somewhere. This is important and it brings me to my next point. Through our experience it is best to assume keystone pricing which means that our cost is 50% of the Amazon selling price. That's how much we estimate to pay the brand owner for their product. Not only does this make our calculations easier, but it is usually a fairly accurate estimation. Now for an example.

Let's say we have a product that we sell for $25 on Amazon. So, first, let's calculate the Gross Profit Margin of this item. To do this, we are going to first total cost of goods.

We have the cost of the product from the brand owner, which is $12.50. Remember, that's 50% of the Amazon selling Price. Next, we add in our shipping and processing costs. This estimate covers all shipping in both directions plus all processing labor and materials such as bubble wrap, poly bags, boxes, tape, etc. Last, we add the Amazon fees, which in this case are $6.75. So, our total costs come to $20.50.

Using our formula, we subtract our costs, which were $21.25, from the Amazon sale price of $25. That leaves us with $3.75 gross profit. We will call this Amazon Net After Fees for simplicity sake.

Then, to calculate our profit margin, we simply divide our profit ($3.75) by the selling price ($25) and we see that we have a 15% profit margin.

I know that seems tedious, but really, it's pretty easy to do it quickly in your head.

So, my cost is $12.50, plus about $2 in shipping and processing. That's $14.50, plus Amazon fees, which for this item, will be about $6.75. That's $21.25. Ok, that's all my costs. I sell it for $25, so 25 - 21.25 is 3.75. Then, we use a calculator to find our estimated profit margin.

That only took about 20 seconds in real-time.

Now that you understand this calculation, you can apply it to any amount of your sales. For instance, if we sold $1000 of product with this margin, we would profit $150. So, if Jungle Scout estimates that we could sell 40 of these unicorns every month, which is $1000 worth, we know we would profit around $150.

Alright, now, using the same product, let's calculate the ROI real quick.

We already know our profit which was $3.75. Our investment is the direct costs which include the product ($12.50) plus the shipping and processing ($2) which is a total of $14.50.

So, using our formula, we simply take our profit $3.75 and divide it by the direct costs $14.50 and we get an estimated ROI of 26% for this product.

Now, I know what you're thinking, "that profit margin and ROI aren't that impressive." You're correct, and that may not be an attractive profit margin for a new seller, which brings me to another valuable point. We recommend that, in the beginning, you should only consider products with an Amazon selling price of at least $20. Twenty dollars should be the minimum price for items you are considering sourcing because, generally, the lower the price under $20, the lower the profit margin. This isn't always true, of course, but until you can find ways to lower your costs, we recommend you stick to sourcing items that are $20 or more.

In regards to Profit Margin, we expect a 15% minimum when evaluating products. We recommend that you do not initially consider products that have an estimated profit margin of less than 15%.

In terms of ROI, we recommend a 30% minimum when evaluating potential products. The return generated from our investment needs to be at least an estimated 30% for us considering moving forward with it.

These should be your target baselines for any wholesale product opportunity. However, we do suggest that you be flexible and make decisions that will help you make money! Remember, you won't know the real numbers until you get a pricelist from the brand owner.

Ok, almost done. The next thing I'm going to talk about will make all of this easier for you, and that's the FBA Calculator for Amazon. Amazon fees may be the hardest to pin down since they are based on multiple variables such as weight and dimension in addition to referral and closing fees. But luckily for us, this free FBA calculator browser extension we can use to estimate these costs and our profit margin.

Here's an example of what it can do. It saves us time by automatically entering the ASIN for you into Amazon's FBA calculator. As you can see it also enters the amazon selling price. The best part about this little widget is that it calculates the amazon fees, profit margin, and ROI after you enter your estimated cost. So, all you have to do is estimate the direct costs then enter them, and, boom, it calculates everything.

Notice that it also shows the estimated monthly sales. We've found these estimations to vary significantly from Jungle Scouts' estimations, so we don't recommend using these in any of your calculations. You'll also notice the estimated monthly profits. This should be disregarded for a couple of reasons as it's calculated using those same estimated sales.

But, all in all, this is a great little widget for quickly calculating ROI to see if it meets the 30% minimum.

The final thing I want to discuss is how and when to calculate your profit margins and ROI after you know your costs. Alright, so let's say we found a product such as this one and our estimations show that it meets our profit margin and ROI minimums.

Ok, now let's jump ahead and say we've contacted the brand owner and we get their approval to start selling this product. The brand owner then sends us a price sheet. It's at this point that we know our actual cost of the product. This would be where we would want to plug that now known product cost back into our profit margin and ROI calculations to get a more accurate calculation. Let's compare those pre-contact estimations with our new estimations. In this case, the product actually costs less than our estimations, so clearly that will have a positive impact on both our profit margin and ROI. And you can see that it did. What about the shipping and processing costs? Aren't those still unknown? Yes.

We're not going to know these until we've received the product, processed it and shipped it to Amazon's warehouse. Which brings me to my next point. After you've done taken these steps of placing your order, processing it, and shipping it to Amazon, you should again plug those numbers into your calculations to find your true profit margins and ROI. So, let's break that down real quick. Let's look at that same item and calculate its true profit margin and ROI.

Let's say we shipped 500 units of these to our prep center where they are prepped and then shipped to Amazon.

Breaking down those costs we see that we have the inbound shipping to the prep center. Depending on your volume, that shipment could be free. Much of our inbound shipping is free. But let's say that our order did not qualify for free shipping and the shipping was $0.30 / unit.

Ok, now let's look at our prep costs. Much like shipping, you can also get better pricing with higher

volume when it comes to your prep as well. Prep generally ranges anywhere from about $0.75 to $1.25 / unit. For this example, let's say our prep cost was $1.00 / unit.

Alright, now those items have to be shipped from the prep center to Amazon's warehouse.

You do this by creating a shipping plan in seller central. There is a video that outlines this process in our Amazon Tutorial Mini-Course. Shipping to Amazon with one of their partnered carriers provides us with discounted shipping. Let's say for this shipment, our cost is $75. We divide that by our 500 units and we see that it costs $0.15 to ship each unit. Now that we have everything broken down to a per unit cost, we can calculate the product's true profit margin and ROI.

So, we have the cost of the product which we now know is $15.50, the shipping and processing which is $1.45, and the FBA calculator tells us that our Amazon fees are $8.30. We add all those up and we see that our real total direct cost for this product is $25.25.

To get our profit margin, we subtract that from our selling price of $35.40 and we get $10.15. Then, we divide that by our selling price and voila, we see that our actual profit margin for this product is 28%.

To get our ROI, we take our profit of $10.15 and divide it by our direct costs of $16.95 and we see that this product yields a 60% ROI.

This is a pretty straightforward example, and after you practice a few times, you'll see that this is very simple.

Before we go, I want to talk about costs, specifically, ways to drive them down. For instance, the logistics involved in the previous example is just one of many ways to get your products from the brand owner, processed, and then to Amazon. Some items involve little to no prep and can be sent straight to Amazon using the shipment plan in seller central. Any time you can find a way to reduce or eliminate those costs, you increase your profit margins. There are plenty of ways to do this and you'll learn more about them as you continue through the course. Things such as increasing your order volume to get free shipping or utilizing pallet shipments instead of parcel when applicable. I just wanted to make you aware of this while we were on the subject.

I know this was a very detailed video with a ton of information. Don't worry if you feel like you didn't quite grasp all of it. It took us a long time to figure this stuff out. Just re-watch any parts you weren't clear on and most importantly, practice, practice, practice until you are comfortable doing the math. Understanding your numbers is a core component of building a thriving business that continues to make money year after year. Thanks for watching and I'll see you soon!