VINYL APPS

By Dale Salamacha

Dale is co-owner of Media1 Signs/Wrap This! (Longwood, FL).

Minding Your Money, Part 2

Dale delves deeper into managing finances.

Continuing July's discussion of finances, let's dig deeper and address specific financial aspects of your business. We received several questions from readers; we'll address those individually later. To answer questions, I've recruited our CFO, Sam Ahwal, to help. Sam has managed business finances for nearly 20 years; past clients include Budget Rent-A-Car, Enterprise Rent-A-Car and California Café. He first consulted for Media 1, then he became partner/CFO three years ago. He's made a huge impact on our functionality and profitability.

P&L 101

A profit-and-loss statement (P&L) and balance sheet are the two most important profitability indicators, yet they are the most misunderstood – especially by small businesses. The P&L indicates how well a company buys and sells its services in order to make a profit. The bottom line is: Revenue - Expenses = Profit. A careful P&L analysis reveals cash-flow available to reinvest in, or expand, the business.

A balance sheet involves three main parts: Assets, Equity and Liabilities. Assets are what the company owns; liabilities are what the company owes. What's left after subtracting liabilities is equity. The balance sheet is very crucial when you attempt to borrow money. It shows the lender your business' health, and whether you're a good financial risk.

Essentially, the balance sheet presents a snapshot of a company's financial well-being at a specific time, and a P&L shows the results of financial functions over time. These reports should be reviewed weekly, monthly, quarterly, semi-annually and at year's end.

We've got answers

Q. Should you buy or lease equipment?

A. I've always insisted on the best equipment and technology. Ultimately, buying equipment is preferable.

"Once you've bought something, it's hard to lose it," Ahwal said. "If you finance it, you can write off depreciation, but it also creates a liability for the company. You want more assets, not liabilities."

If you finance equipment, it belongs to the lender until you make that final payment. And, where technology is concerned, once you've made that last payment, you may already need to upgrade. If you aren't in a position to buy it outright, do a thorough cost/benefit analysis of that particular item. That's fancy CFO talk, but it means comparing the cost to how much business it will generate. Remember, that doesn't mean how much you *think* you can sell. It means how it will benefit production for jobs *already on your books*.

For example, we operate two, HP L25500 latex-ink printers. They generate roughly 25,000 sq. ft. of prints monthly. However, HP only rates them for 5,000 to 8,000 sq. ft. of monthly production. I went to Sam to discuss buying an HP LX850, which prints dual rolls up to 60 in. wide simultaneously, with greater speed than the L25500. Its listed capacity of 50,000 sq. ft. per month meets our needs, so I have to have one, right?

Sam reminded me it would require a $200,000 investment. Moreover, he said, when we start selling more than 35,000 sq. ft. per month, buying one will be financially justified. I've oversimplified it a bit, but you get the idea.

Q. Have you stopped offering products that weren't cost-effective?

A. Absolutely! All shops should frequently review their product offerings to make sure they're profitable. We made a significant change 10 years ago, when we moved our shop from a main highway with good exposure to a warehouse setting. We wanted to reduce walk-in customers who'd order windshield strips, magnetic signs and banners, which aren't our focus.

Here, a Wrap This! installer works on a boat wrap for Jeff Duncan, a competitive fisherman that the shop sponsors. Dale says a shop should play to its strengths and support its core, most profitable activities. For example, a shop that focuses on wraps shouldn't take on electric-sign installation unless it has the financial and logistical ability to readily accommodate it.

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Don't get me wrong, such jobs can be great moneymakers for shops set up to fabricate them. However, we specialize in large-scale fabrication, and we can't move our focus from our core business. Of course, once we've created a relationship with a client, we want them to consider us their one-stop sign company. We'll create any signs that meet their needs – as long as they support our profit margin.

For example, if you create vehicle wraps, don't take on channel-letter fabrication unless your shop can profitably support it. Always play to your strengths. You may choose to expand into different markets; just make sure your core work doesn't suffer as a result.

Q. How and when do you operate lines of credit, and how much do you pay back each month?

A. Most business owners I know insist on having open lines of credit. Many are adamant that successful businesses need access to credit lines. It can help to have access to additional monies outside of your revenue stream, but most companies misuse these funds.

Use credit lines *for two reasons only*: 1) Temporary emergencies (such as a building flood, when you must halt operations for two weeks, and you don't have the cash reserves to cover payroll and overhead), and 2) Future growth based on a proven track record. If you start selling 50,000 sq. ft. of digital graphics per month, but don't have the cash to buy a new printer, you need it to keep up with demand. Lines of credit are not for buying a new "sales vehicle" for your wife!

However, if you access a credit line, you should pay it back as quickly as possible. If you sit on borrowed money, you incur interest charges that further drain your profits.

Q. In the last column, you discussed 25-30% net profit as a target. What are target percentages for other types of expenses?

A. Whatever bookkeeping program your accountant uses includes an option to add a percentage column to the ledger. As discussed in the last article, percentages of profit and expenses should be the focus, not a sheer dollar figure.

Make sure your percentages stay consistent every week, month, quarter

and year. Of course, all businesses differ, but the percentages outlined should provide a good starting point. Working towards the goal of 25-30% profit, we strive for the following targets:

Payroll: 25-30% of gross revenue. This includes all payroll items, such as salaries, wages, commissions, etc. Not controlling this will sink your ship. When Sam first came here, our payroll consumed 52% of our gross revenue, and we were sinking fast. Paying lots of overtime created the problem. I'd never thought about it; I always believed you did what you had to do to meet deadlines. That mindset crippled our cashflow.

Sometimes, overtime comes with the territory; when you anticipate it, price your job accordingly. If you didn't calculate it, and I'd venture to say that rarely occurs, overtime is eating your lunch.

Costs aside, think how much overwork impacts your employees. If you push a guy to work 12 hours today, 14 hours tomorrow, etc., you will experience a huge loss of performance, which leads to a loss of productivity, and then profit. Not only will all this extra work skew your payroll, but it also drains your staff's motivation and production. When overtime is necessary, it should be allocated on a job-by-job basis, and sparingly.

Minimize overtime by cross-training your employees. Can your fabricator run the router table? Can your wrap installers be trained to design? Stretch your guys to do more than just "their job." They'll appreciate your confidence in them, and you'll reap the rewards with higher profits.

Cost of Goods Sold: 30-35%. This includes raw materials, subcontractors, freight, permits and anything else necessary to complete a specific project. The July column addressed working to decrease expenses, and making sure you get the best deal on necessary supplies and services.

Overhead: 10%. This includes rent, insurance, phone service, vehicle maintenance and expenses not directly related to production. Most of these expenses are relatively fixed, so, again, shop around.

Meeting these percentage goals results in 30% net profit. Please note these are estimated numbers, and every business has different needs.

Keep a keen eye on the financial aspects of your company, and give your customers more than they expect. Track P&L and balance-sheet data, and make adjustments immediately where needed. Once the money comes in, it's your job to make sure as much of it stays with you as possible. ■