

What do your Financials Tell You?

Last week, I discussed planning expenses to profits. I suggested that you make profits your first item of expense. I further indicated that, in order to survive, in a very difficult economy, you need to track your previous expenses to your profits and focus on establishing expense controls for the next quarter, 6 months, year, etc....

With fuel continuing to “spike”, it’s playing havoc on a trucking company’s bottom line. Therefore, making profits the first item of expense is critical to, not only survival, but the perpetuation of a business. It’s important to review your financials. What do your financials tell you and how quickly do you receive your financials after the end of each operating period? Each month, you should receive your financials within 5 – 7 days after the close of that month; if you’re not receiving them, promptly, you should make it mandatory that you start receiving them immediately.

Let’s review the importance of accurate financial information.

The Income Statement

This represents the profitability of a business over a period of time. Unlike the balance statement, the income statement wipes clean at the beginning of each new period;

- The formula – gross income minus total expenses equal net profit (loss).
- Gross income is composed of sales and other income derived from operations.
- Total expenses are composed of costs or goods sold, cost of sales, general and administrative cost and depreciation.

As the owner or CEO of a trucking business, your job is to keep expenses under control and gross income high enough to create the highest net profits possible. Operating income equals gross income minus total cost and expenses. Operating income is what you have earned;

- Net income equals operating income minus interest income and taxes.
- Net income is what you keep.

In a service business, great marketing and good people go a long way towards the success of any business. However, without a sound accounting program and a thorough understanding of your financial statements, you can undue or destroy all of your hard work. It’s important to understand all the financial aspects of your business. The above terms are just the beginning. You need to take the time to;

1. Review your financial statements.
2. Analyze them, and;
3. Understand your performance.

THE AHERN ADVISORY

in this issue

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Many trucking company owners that I speak with don't really understand how money works. When I ask them if they receive a cash flow statement, they're really not sure what I mean. **Cash flow statements depict sources and uses of cash over a given period of time.** It is of utmost importance to differentiate the concepts of cash flow and profitability. **Profitability is unimportant if assets are not collectible or liquid,** within a given time. **Positive cash flow, not profits, pays for lunch.**

I recognize that it's difficult to operate a trucking business; deal with all the issues on a day to day basis, and focus on financial performance; that's what accountants are for, right? Wrong! An Accountant, or Chief Financial Officer, plays a very important function in business. However;

- Don't leave it up to them to understand how to read a balance sheet and an income sheet.
- Don't leave it up to them to tell you when you're in trouble.

If they have to tell you you're in trouble, it's normally too late.

When you're operating a business, particularly when you're looking for capital, there are certain key financial ratios that banks and lenders look for;

1. **Current ratio (working capital)** – this measures short term solvency. **Working capital equals current assets divided by current liabilities;** this ratio should be at least 1:1. If your current liabilities are greater than your current assets, regardless of your profitability, you have (or will have) problems.
2. **Liquidity ratio or Quick ratio** – this is another measure of short term solvency. **Quick ratio equals cash, accounts receivable, marketable securities divided by current liabilities.** This ratio should be at least 1:1, or you're having cash flow problems.
3. **Debt to equity ratio** – this is a measure of long term solvency. **Debt to equity equals total liabilities divided by total shareholders' equity.** This ratio should be no less than 0.80% (80%).
4. **Operating profit margin** – this is a measure of profitability before interest and taxes. **Operating profit margins equal operating income divided by sales.** This ratio varies by industry from, as low as 5%, to as high as 40%.
5. **Inventory turnover** – this is a measure of inventory efficiency. **Inventory turnover equals total cost of goods sold divided by average inventory.** The higher the turnover ratio, the better (in most cases).
6. **Return on assets** – this is a measure of management productivity. An indicator of how well the firm's assets are being utilized. **Return on assets equals net income divided by assets.** The ratio varies by industry, but the higher the better.
7. **Return on investments** – this is a key measure of profitability relative to the firm's basic operation. **Return on investments equals operating income divided by assets.** Although ratios vary by industry, 0 – 10 is considered low; 10 – 20 medium and, in excess of 20 is high.
8. **Price to earnings ratio** – this a key measure of profitability, particularly from an investors perspective. **Price to earnings ratio equals price per share of common stock divided by earnings per share of common stock.** High growth industries tend to have higher priced earnings ratios because higher earnings are anticipated in the future.

As I stated in the beginning of this article, profits are a very nebulous figure. The real condition of a business is always cash flow. That is what keeps the company running. As you review your financials, (on a regular basis) you should understand all the above ratios. **The purpose of this exercise is to watch your trends.** Which way are your ratios and figures moving; up or down? **Only by doing this, will you truly understand your business?** **I know these terms are confusing and you may think; what does it have to do with trucking?** Cash flow and profits keep a business running. I've always said that, if you're a trucking company, whether you're utilizing independent contractors or company drivers;

- You need to treat each truck as a profit center.
- You need to be able to define what it costs to dispatch a truck on every single load, and;
- You should have a built in profit margin – most trucking companies don't, but they should.

The more financial information you have to operate your business, the better the opportunity you have to succeed. Without a good financial operating matrix, it's very difficult to operate your business. **If you don't know what your costs are and you don't have a plan, how do you expect to succeed?**

A friend of mine wrote a book that, unfortunately, was never published called Giant Steps into the 21st Century. I had the privilege to review the book before Robert Peterson passed away. He was in the process of publishing the book when he was diagnosed with cancer and he was given less than 30 months to live. **I still utilize many of his articles in my business practice. One of the things that Bob was able to instill in me was that; profit performance management requires** that owners of companies, as well as managers, become great coaches.

As a manager or owner of a trucking company, it's important to recognize that intellectual capital is as valuable or more valuable than financial capital. Improving intellectual capital will improve your bottom line; which equates to profits and cash flow.

QUOTE OF THE WEEK: “People who hunger for knowledge are the ones that get ahead” (Katherine Simmons Smith)