Stu's View

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Key Financial Health Indicators

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There are an abundance of operational measurements you may use to manage your company – profit and loss statements, % of sales, % of value added, gross profit, etc. To understand the real financial health of your company, however, you need to look at its life blood: the balance sheet and cash flow. Cash flow is especially important, and the overriding focus of banks, vendors and prospective buyers, particularly in a challenging economy.

Consider these keys indicators and their guidelines for success:

Key Indicators					
Ratio Type	**Indicates**	**Calculation Notes:**	**Minimum**	**Good**	**Industry Avg./Goal (*)**
Current Ratio	Working capital; or Current Assets (1) vs. Current Liabilities (2)	(1) Includes cash, receivables, inventory, pre-paid (2) Includes payables, current portion of term notes, accruals, etc.	Above 1:1	1.5.1	1.4:1 / 2.0:1
Debt to Equity	Leverage indicator; Total Liabilities (3) vs. Total Equity (4)	(3) Includes current liabilities and long term debt. (4) Investment contributions in the business plus retained earnings.	No higher than 4:1	2.5:1	2.7:1 / 2.0:1
Cash Flow Coverage *(also called Fixed Cost Coverage Ratio)*	Available cash generated to pay debt; EBITDA (5) divided by Debt Service (6)	(5) EBITDA = Earnings Before Interest, Income Taxes, Depreciation and Amortization (6) Principal + Interest due	Above 1:1	1.25	1.1 to 2.0
EBITDA (5) as a % of Sales	Cash Generating Performance	See (5) above divided by sales	10%	15%	8% / 20%

(*) per Printing Industry of America Ratio Studies, 2012

Now consider why it is vital to monitor these numbers:

1) **Current Ratio.** As the indicator of your working capital, this immediately tells banks and vendors if you can meet your operating obligations in a timely manner. Taken alone, current ratio is a snapshot of where you are; but when tracked over time, it also shows where you are trying to go. Achieving that "gold standard" of 2:1 gives you a lot of ability to withstand losses or even a down year. We recommend you monitor this monthly.
2) **Debt to Equity**. This leverage indicator reveals not only shows how much debt you have, but your ability to repay it and to withstand a down turn. In a highly capitalized industry like commercial printing and packaging, we like to see 4:1 here; but for most industries a good goal is 2:1.
3) **Cash Flow Coverage** *(Fixed Cost Coverage Ratio)*. This is perhaps the most important of your key indicators, and is the standard ratio used by banks to determine if you are generating enough cash to pay your notes. Most banks today may want this information on a continuous quarterly basis -- or even continuous monthly for troubled companies. Failing to meet this ratio because you have had a bad year results in a covenant violation – and opens up a real Pandora's Box of potential actions by the bank (increased rates, penalties, restructuring your entire arrangement). We like to see our clients maintain 1.25 here since the covenants in those bank agreements are typically 1.2 to 1.25.
4) **EBITDA as a % of Sales.** This indicator allows you to compare your company to others of your size in the industry. In the mergers and acquisitions arena for the printing and packaging industry, prospective buyers are looking for companies that are at least at the 10% minimum. This ratio is typically monitored annually, although it can also be done throughout the year.

Here's the bottom line: If other people are constantly evaluating your company based on these ratios, why aren't you? Monitoring these numbers and making timely adjustments should be an integral part of your company's continuous improvement to keep it mean, lean, and thriving.

Stu's View is contributed by Stuart Margolis, CPA and Partner of MargolisBecker LLC to provide information that helps firms operate profitably. More information can be found at www.margolisbecker.com.

About MargolisBecker

MargolisBecker has long been recognized as the financial expert for the printing, packaging and allied graphic communications industries, assisting thousands of companies with strategic and financial management, valuation, mergers/acquisitions, accounting, audit and tax services. The firm is noted for its expertise in enabling companies to optimize profits. Proudly, it is the purveyor of the industry's *Cash is King*, and *Value-Added Principles of Management*, and compiles the annual Printing Industries of America Ratios, the printing industry's premier financial benchmarking tool.

About New Direction Partners

The team at New Direction Partners LLC has guided over 200 printing company owners through the sales and merger process. The advisory services reflect a full set of skills to help you sell or expand your business: valuation, management consulting, financial advisory and investment banking. The deep experience and industry expertise at New Direction makes it uniquely suited to serve printing, packaging and allied graphic arts businesses.