



By Rob Wilbrink

## Renovating your store—expense or investment?

Don't make any decisions about remodeling your store before you do the math

**M**any storeowners approach store renovations with trepidation. Their biggest concern: what will this cost? But what is cost? If you buy a car, it's an expense because two years later it's worth half what you paid for it and it doesn't return any income while it depreciates. However, if you buy a boom truck, it's an investment that also depreciates but hopefully generates enough income to provide a good return at the same time. So if you renovate your store is that an expense or an investment?

If you think of it as just an expense, the next logical thought is, "This is a cost of doing business, so how can I reduce this cost?" So you spend less rather than invest more; the deck chairs get shuffled; compromises are made. Some renovations get watered down so much that customers don't even notice the changes. Stores are put into a state of turmoil for months on end, meaning customers need more help finding things but find staff unavailable, testy and stressed. Owners swear they'll never do it again.

When contemplating a store renovation, a better question to ask yourself than "what does this cost" is "what will be the return on my investment?", or "will our cash flow go up or down by doing this?" Well, first you have to do the math.

### Cost

To do a complete renovation with completely new fixturing, new counters and millwork, a complete signage package and professional merchandising with specialized accessories and displays costs \$20-40 per square foot. Larger stores normally are at the lower end and small stores at the higher end. An average 8000-sq.-ft. store will do about \$4-million in sales and cost \$280,000 to renovate.

### Payback Period

The average building centre does about \$500 per square foot in annual sales at a 26 per cent margin. Renovated stores consistently generate sales increases of 10-30 per cent. At the low end using the above example, that's \$400,000 in sales and \$104,000 in margin. Overall gross margin percentages also tend to increase 2-3 per cent. Using a conservative one per cent of the higher sales number creates an additional \$44,000 of gross margin, for a total of \$148,000. This renovation comfortably pays for itself within two years. This analysis does not factor in additional labour to service higher sales, however most building centres have the capacity to do 10 per cent more sales without adding staff. Beyond this, there likely will be more costs to service the extra volume.

### Cash Flow

With lease-to-own financing, a large part of the renovation can be paid over five years with no impact on existing credit lines. Lease-to-own financing is generally available to cover about 70 per cent of overall project cost (excluding construction and leasehold improvements). In the above example, lease payments on \$196,000 would be about \$3,881 for 60 months with a 10 per cent (\$19,600) payment at the end. It is wise to budget on an additional \$10 per square foot of inventory, as more efficient fixturing should deliver higher inventory intensity. The extra \$80,000 in inventory would create a carrying cost of \$533 per month at eight per cent interest. This brings the total monthly expense increase to \$4,414, or \$52,970 per year. Subtracting this off the \$148,000 conservatively leaves \$95,000 of positive cash flow per year.

### Return on Invested Capital

Leasing provides an effective way to reduce taxes paid on new income because payments are an expense that is fully deductible. This helps already profitable businesses pay back their investment faster. It also increases the return on invested capital. The lease covers \$196,000 of the renovation cost in the above example, leaving a net capital investment of \$84,000. This generates a pre-tax return of 113 per cent based on the \$95,000 of additional cash flow. The after-tax return on investment based on the small business tax rate ranges from 92-97 per cent depending on what province you are in.

Beyond the numbers there are other factors to consider:

- ▲ A professionally renovated business is much more marketable if you are planning to sell your business.
- ▲ Meaningful improvements to your business can be the factor that knocks a weak competitor out of your market, especially during a recession.
- ▲ Employees are proud to work in a well-presented store and customers are glad to shop there.

There's always a cheaper way to do anything; it all comes down to perspective. If you see renovating your store as an expense, it may become just that. If you see it as an opportunity to invest for great returns, you are much more likely to reap the rewards, and there is no better place to invest your money than in your own business. **HM**

*If you would like to do your own math, you can download a financial calculator at [www.bmfonline.com](http://www.bmfonline.com), or email [rwilbrink@bmfonline.com](mailto:rwilbrink@bmfonline.com). Rob Wilbrink is president of Burlington Merchandising & Fixtures.*