Everybody Is Talking About It!

RMR

Hear From 3 Integrators Making the Whole RMR Thing a Success
Integrators still trying to get rich selling products must understand the value of recurring revenue and help their customers understand it too.

There’s an “RMR” for Everything
December 11, 2018

NSCA Success Story: Boosting Cashflow with RMR
December 25, 2018

3 Steps to Build RMR without Drastically Changing Your Business
February 20, 2018

Project Backlog and Revenue Up ... But RMR Down?
September 25, 2018
What Is RMR?

Recurring Monthly Revenue (RMR) is income that a business expects to receive every single month - a predictable revenue! It’s normally based upon a financial agreement or contract.
Why RMR? - Pros

- Predictable revenue
- Helps with resource planning
- Evens out cash flow
- Growth may be funded by RMR cash flow depending on billing frequency
- May dramatically increase the value of your company
Why RMR? - Cons

- Sales commission plans may be challenging
- Cash flow is different from project based work
- Deferred revenue may affect your borrowing against AR
Typical RMR Services

- Inspections
- Preventative Maintenance
- Break/Fix
- Training
- Consulting
- S/H/X as a Service
- On-Site support
- Warranty / Upgrades
- Digital content (Music, video, news feeds etc.)
Cash vs. Accrual Accounting

**Cash**
- Revenue occurs when you get paid
- Expenses occur when you pay for something
- Cash is a leading indicator

**Accrual**
- Revenue occurs when expenses are incurred
- Invoicing is not required to earn revenue
- Cash is a lagging indicator
Billings Do Not Equal Revenues

Billing/Invoicing
- Billings are amounts invoiced to a customer
- Invoicing can be done ahead of the services
- Invoicing can be done upon delivery of services
- Invoicing can be done after services are delivered

Revenue
- Revenue is an accounting calculation
- There are formal rules for those calculations
How Is Revenue Calculated?

RMR Contracts Generally Are Time Based or Performance Based

**Time**

- A contract will have a coverage period
  - Jan 1\textsuperscript{st} – Dec 31\textsuperscript{st}
  - 12 financial periods
  - A portion of revenue is recognized each period
  - In this case 1/12\textsuperscript{th} of the contract each month

**Performance**

- A contract will have deliverables
  - An inspection
  - Hours of training
- Revenue is recognized when the service is performed
What is Deferred Revenue?

- Money you have invoiced that you have not earned
- You may not have the cash in your bank yet
- When you first invoice it, you have an asset (AR) and a liability (deferred revenue)
- When you receive the cash, you have an asset (cash) and a liability (deferred revenue)
Even A One Month Invoice May Be Deferred

- Create and post an invoice on Jan 1\textsuperscript{st}
- The invoice covers services for the period Feb 1\textsuperscript{st} to Feb 28\textsuperscript{th}
- The value of that invoice is deferred revenue, until we are posting into Feb
- You may not have received the cash by Feb 1\textsuperscript{st}
- It’s important to manage the payment terms
Deferred revenue is a liability on your balance sheet.

- You receive cash up front
- The contract is based upon services to be delivered in the future
- You have money in the bank (or AR)
- You have not delivered the services yet
- Cash (or AR) is your asset, undelivered services are your liability
Deferred Revenue – Projects vs. RMR

- Project deferred revenue – over / under billing
  - Billings can be predictable but often are affected by outside influences
  - May be under billings, negative cash flow

- RMR deferred revenue – advanced billing
  - Very predictable
  - Normally positive cash flow
Aligning Revenue and Expense

- Revenues are recognized by time or performance
- Expenses work the same way, but in reverse
- Prepaid expenses are an asset
- Direct labor is expensed at time of work
Aligning Revenue and Expense - Example

- Annual monitoring and support contract for $3,000
- Monitoring is sub-contracted and costs $150 per quarter
- Labor is variable – this is a risk
## Aligning Revenue and Expense - Example

<table>
<thead>
<tr>
<th>Item</th>
<th>Per Contract Duration</th>
<th>Per Period Budget</th>
<th>Per Period (January)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue</td>
<td>$3,000</td>
<td>$250</td>
<td>$250</td>
</tr>
<tr>
<td>Fixed expense – monitoring</td>
<td>$600</td>
<td>$50</td>
<td>$50</td>
</tr>
<tr>
<td>Variable expense – labor</td>
<td>$1,000</td>
<td>$83</td>
<td>$100</td>
</tr>
<tr>
<td>Gross Profit</td>
<td>$1,400</td>
<td>$117</td>
<td>$100</td>
</tr>
<tr>
<td>Gross Margin</td>
<td>46.7%</td>
<td>46.7%</td>
<td>40.00%</td>
</tr>
</tbody>
</table>
Moving Pieces

Successful RMR Requires Balancing

- Revenue
- Expense
- Cash flow
Financial Models For RMR Contracts

RMR Contracts Can Take Many Forms

- 100% financed
- Financed with on-going support revenue
- Services / equipment with capital investment
- 3rd party pass through
- 3rd party with added value
- Services only
In this model, a 3rd party finances the entire solution. This will not represent RMR to the vendor, but can be viewed “As A Service” from the customer’s point of view.

**PROS**
- Cash up front or installments
- More appealing for customer cash flow
- Can be a critical piece of a balanced portfolio

**CONS**
- Not really RMR
- Does not even out cash flow
Financed With Support Revenue

In this model, the installation, equipment and setup are a lump sum from a 3rd party, and the ongoing maintenance payments are made by the 3rd party of the customer directly.

**Pros**
- Good transition model, with recurring revenue
- Also provides an initial cash injection

**Cons**
- Smaller RMR component
Services and/or Equipment With Capital Investment

In this model, you fund the installation, equipment and setup directly.

**Pros**
- Full recurring revenue
- More options for customer solutions
- Option to finance capital investment

**Cons**
- Initial cash investment required
- Complexity of amortizing and matching expense
3rd Party Pass Through

In this model, you are reselling a product or service from someone else.

Pros

- Pre-built solutions
- Sometimes a simpler sales cycle
- Sometimes tied to equipment, software and maintenance

Cons

- May require up front cash investment
- Dates of 3rd party coverage may not line up with customer agreement
- Relationship between customer and 3rd party?
3rd Party With Added Value

In this model, you add services to a 3rd party service or product.

**Pros**

- Higher margin than straight 3rd party
- Creates a stickier solution for you customers

**Cons**

- May require up front cash investment
- Dates of 3rd party coverage may not line up with customer agreement
In this model, your primary product is labor.

**Pros**
- May provide highest possible margin
- Lower up front cash investment

**Cons**
- Self funded (training and support for direct labor)
- May have a higher risk for labor overruns
Creating A Balanced Portfolio

- Financing with recurring component is a great start.
- Pure service contracts have a low start up cost, but may represent risk depending on type of agreement.
- Finance capital investments if possible.
- Just like any financial portfolio, spread your risk out.
KPI’s and Reports

- Contract schedule
- Revenue projection
- GP projection
- Invoicing projection
- Contract profitability
- Customer profitability
Report Examples
Administration of RMR

Cost per invoice / support call etc.

- Automation for volume invoicing
- Analyze and understand your admin costs
  - What does it cost to create and send an invoice
  - What does it cost to collect on invoices
- Wherever possible, longer billing periods
  - $25 / invoice, $300 overhead for monthly, $25 for annual
# Administration of RMR

Cost per invoice / support call etc.

<table>
<thead>
<tr>
<th>Item</th>
<th>Annual Invoice</th>
<th>Quarterly Invoice</th>
<th>Monthly Invoice</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue</td>
<td>$3,000</td>
<td>$3,000</td>
<td>$3,000</td>
</tr>
<tr>
<td>Fixed expense – monitoring</td>
<td>$600</td>
<td>$600</td>
<td>$600</td>
</tr>
<tr>
<td>Variable expense – labor</td>
<td>$1,000</td>
<td>$1,000</td>
<td>$1,000</td>
</tr>
<tr>
<td>Admin costs</td>
<td>$25</td>
<td>$100</td>
<td>$300</td>
</tr>
<tr>
<td>Gross Profit</td>
<td>$1,375</td>
<td>$1,300</td>
<td>$1,100</td>
</tr>
<tr>
<td>Gross Margin</td>
<td>45.8%</td>
<td>43.3%</td>
<td>36.7%</td>
</tr>
</tbody>
</table>
Managing Invoice Dates

- Coverage period – Jan 1/20 – Mar 31/20
- Set your invoicing schedule to create the invoice Dec 1/19
- Set your terms so you are paid before the coverage date to maximize cash flow
Precision – Spending Dollars to Track Nickels

As much as we talk about tracking expenses to measure RMR performance, don’t over do it.

- Be wary of tracking small expenses to a contract
- Use cost based allocation to spread out cost
Managing Deferred Revenue

- #1 maintain the accuracy of your contracts!
- Review forecasts each and every month
- Review profitability each and every month
Where Do I Go From Here?

- Forecast first! - Model your revenue / GP / cash flow projections
- Build a strong portfolio to support your projections
- Review forecasts regularly
- Measure profitability
- Continually work to reduce overhead
THANK YOU!

For more information about this presentation:

Brad Dempsey | CEO
bdempsey@solutions360.com
(905) 868-9901 x222
www.solutions360.com

Mike Abernathy | Dir. Bus. Resources
mabernathy@nsca.org
(608) 643-9520
www.nsca.org