



The 2019 CLA Construction Benchmark Report



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CLA construction professionals have compiled financial data from our clients in the industry across the United States. Our goal is to provide insight and answers to the financial and operations questions that keep construction company owners and managers up at night, such as:

1. How do we attract qualified and reliable employees to choose to work with us over our competitors?
2. How do we prepare for the next economic downturn during a time of peak performance?
3. Which employee incentives will help improve profitability and decrease turnover?
4. How do we align our long-term goals with financial performance?
5. How do we effectively budget to control or minimize overhead costs?
6. In what areas are companies investing in their business to improve profitability?
7. Are we better off financing equipment or leasing it?

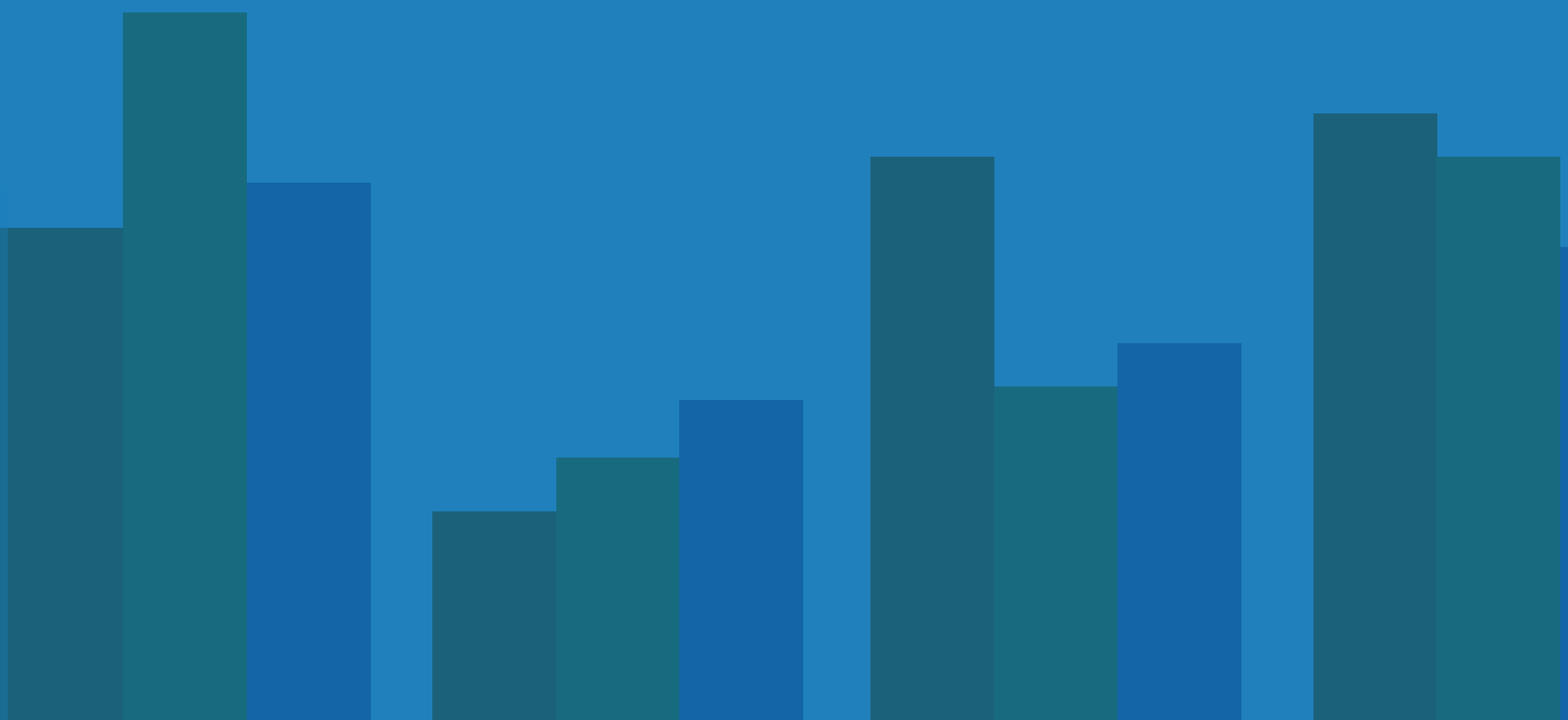
A strong benchmark analysis of financial data can provide you with answers to these and other questions, as well as provide insight into other areas you might not have considered.

The *2019 CLA Construction Benchmark Report* summarizes data from approximately 770 construction companies with operations throughout the United States. It draws on data from their financial information to provide a brief summary of some key industry trends. Contractors who recognize and understand the changes impacting the industry will be better positioned to take advantage of future opportunities.



Construction Contractors' To-Do List

1. Consider creating in-house training and providing educational opportunities for your employees to keep them engaged with and informed on the latest construction methodologies.
2. Consult your CPA to prepare for the new revenue recognition standard that will take effect this year.
3. Talk to your tax advisor to determine if the cash or completed contract method is better for your organization than the percentage of completion method.
4. Consult with your CPA or information technology advisor to understand current cybersecurity risks that might cause business losses and interruptions.
5. Develop goals and maintain a timeline to implement technology enhancements and business plans.
6. Connect with your accounting system advisor about how to save time on accounting for sub-to-self projects, rather than accounting for these projects outside the system.
7. Review your entity's tax structure and consider if a different entity type for tax purposes will benefit your company.



Overview and executive summary

Industry challenges and opportunities

Contractors face many complex and unique challenges that are driving change throughout the construction industry. Those who recognize the impact of these changes on their business and are prepared to make the necessary adjustments will be better positioned to create opportunities in the future. Several catalysts are currently at work in the industry:

1. The import and export market is still uncertain because of changing tariffs, so forecasting costs remains difficult with lumber and steel prices changing significantly after bids have gone out.
2. The labor shortage continues. Finding qualified workers and project managers is a challenge and is affecting profit, as competition for these people increases wages.
3. Contractors are facing two accounting changes that significantly impact their financial performance metrics: revenue recognition and lease accounting. Contractors should analyze the potential impact on their financial statements and discuss them with their bonding agent and bankers.
4. Tax reform offers both opportunities and challenges for contractors.
5. Cybersecurity has become an everyday problem and can impact a company's business for several days. Ongoing security and maintenance are imperative.
6. Many companies have made significant investments in technology but are not yet fully utilizing that technology. Additional training and a concrete plan for implementation are needed.

Key Ratios and Trends

Months in backlog — Based on the current market, we expected the same level of active jobs or slightly more jobs circulating compared to 2017, and all contractors (with an exception of the electrical and mechanical sub-industry) have a greater backlog in 2018 compared to the past two years. Contractors began expecting higher margins on their backlog with the median gross profit increasing to 12.30 percent in 2018, compared to 11.9 percent in 2017.

Pre-tax income as a percentage of revenue — The median pre-tax income as a percentage of revenue slightly recovered from 2017, but only electrical and mechanical contractors returned to the 2016 level, which was its highest in recent years. This appears to be the result of an increase in overall contract revenue volume in 2018 and a strong, profitable year.

Gross profit — The overall gross profit percentage for the industry has decreased from 16.8 percent in 2017 to 16.2 percent in 2018. The two sub-industries contributing to this decrease are civil and electrical and mechanical, which decreased 0.9 percent and 1.1 percent, respectively. The general building and other specialty sub-industries experienced slight increases in margins of 0.2 percent and 0.4 percent, respectively.

EBITDA — Earnings before interest, taxes, depreciation, and amortization as a percent of revenue is on the rise in all sub-industries. Other specialty contractors saw a 1.56 percent increase — the largest percent increase in this metric compared to 2017. The industry as a whole continues to grow while maintaining efficient overhead and cost structures to push more revenue to the bottom line.

Report methodology

Financial ratios and key performance indicators have been computed using information obtained primarily from audited and reviewed financial statements of our construction contractor clients. Participation in the study was voluntary, and data gathered have been analyzed by representatives from our construction industry practice. This report summarizes data from approximately 770 construction companies with operations throughout the United States. The companies are categorized into one of four sub-industries:

Civil contractors — This category includes contractors engaged in highway and street projects, bridges, oil and gas pipelines, railroads, underground utilities,

tunnels, water resources, site work, and other general excavation. Information from 173 civil contractors was included in the report.

General building — General contractors are involved in vertical construction, including commercial, industrial, residential, and multi-family buildings. A total of 237 companies in this category participated in the report.

Electrical and mechanical — Information from 154 companies engaged in electrical, plumbing, HVAC, low-voltage, and energy efficiency trades (including both new construction and service work) was included in the report.

Other specialty — This category is comprised of contractors that do not fit into the categories above. These companies are largely labor-intensive and include building subcontractors involved with work such as concrete, steel erection, roofing, and outdoor specialty trade contractors. A total of 206 companies are included in the report's other specialty.

Financial ratios and key performance indicators

Analysis of financial ratios and key performance indicators can help assess a contractor's financial health, operating efficiency, and profitability. Understanding how a company's performance compares to similar organizations can prompt it to investigate the variances and make operational changes to both improve profitability and efficiency.

Consistently monitoring key financial and operational indicators can help improve profitability, manage operations, provide key information for developing competitive bids, and maintain healthy financial statements for bonding. Some of the advantages and limitations of using comparative indicators are outlined below.

Advantages

- Benchmarks provide comparisons to contractors with similar operations.
- They identify unusual operating results and trends.
- Performance indicators highlight both areas of strength and areas for potential improvement.

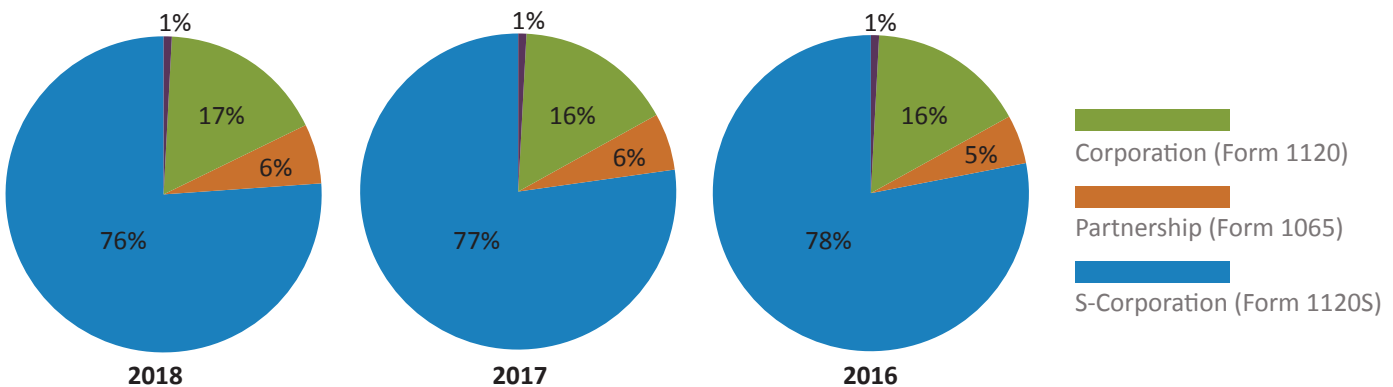
Limitations

- Variances alone do not necessarily reflect an opportunity or a challenge.
- Potential for inconsistency in data collection can reduce the usefulness of comparisons.
- Benchmarks should be used in conjunction with other analysis of a contractor's operations.

Ultimately, no single ratio or financial analysis should be evaluated on its own to assess a contractor's financial condition. Variances from benchmarks should be investigated and considered in the context of the company's specific operating structure, sub-industry, and the region in which it operates. In many cases, the most useful information is a combination of benchmark data and the company's own financial trend results.

Entity structure

Recent tax reform legislation has prompted contractors to analyze their organizational structures to determine the most advantageous tax plan for sustaining operations and fulfilling their owners' long-term goals. The following charts provide a summary and comparison of the entity structures of contractors who participated in the *CLA Construction Benchmark* surveys in 2018, 2017, and 2016.



Ratio analysis and key performance indicators

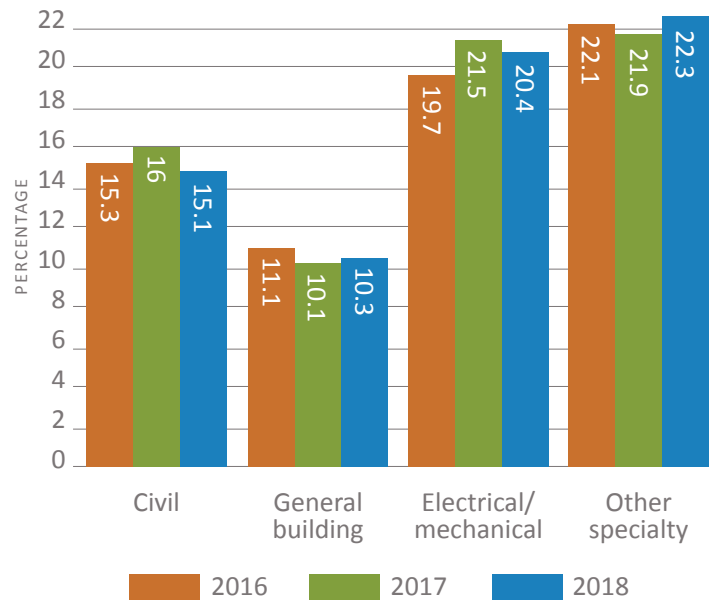
The following graphs present median data for years 2016 through 2018 for each sub-industry.

Gross Profit Percentage

$$\text{Gross Profit as a Percent of Revenue} = \frac{\text{Gross Profit}}{\text{Construction Revenue}}$$

The gross profit ratio represents the percent of total contract revenue that the company retains after incurring the direct costs associated with completing the contract.

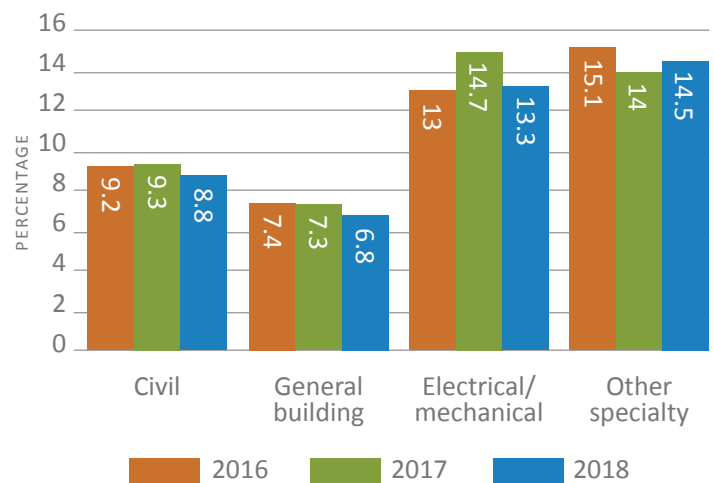
The higher the percentage, the more of each dollar the business retains, which means more money is left over for other operating expenses and net profit. Gross profit margin is impacted by the amount of work the contractor self-performs on the contract, as well as how the company allocates corporate overhead costs, such as payroll, between general and administrative expenses and contract costs.



General and Administrative (G and A) Expense as a Percentage of Revenue

$$\text{General and Administrative (G and A) Expense as a Percentage of Revenue} = \frac{\text{G and A Expense}}{\text{Construction Revenue}}$$

General and administrative expense includes costs associated with the day-to-day operations of the business and often include management and office salaries, rent, utilities, and insurance costs. Since general and administrative costs are independent of costs associated with construction contract activity, they are viewed as fixed. From a competitive standpoint, reducing G and A expenses as a percent of revenue can offer a company a competitive advantage over its peers and is achieved by maintaining efficiency in G and A spending relative to a company's revenue growth.



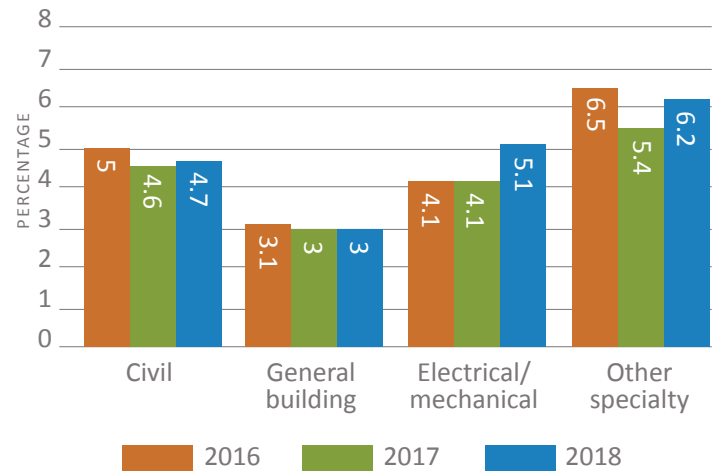
Certain expenditures are subject to discretion by management, including executive compensation, bonuses, benefit plan contributions, and charitable donations. In a rising construction market, an increase in G and A expenses is very common. These costs are often the distinguishing factor in G and A expense percentage differences among organizations.

Pre-Tax Income as a Percentage of Revenue

$$\text{Pre-Tax Income as a Percent of Revenue} = \frac{\text{Pre-Tax Income}}{\text{Construction Revenue}}$$

This ratio represents earnings before income tax as a percentage of total construction revenue.

Overall, the industry has been very strong, and all sub-industries either increased their pre-tax income as a percent of revenue or kept it comparable. This is a very positive sign for the industry since past years were also very strong, which suggests the industry's strength is improving.

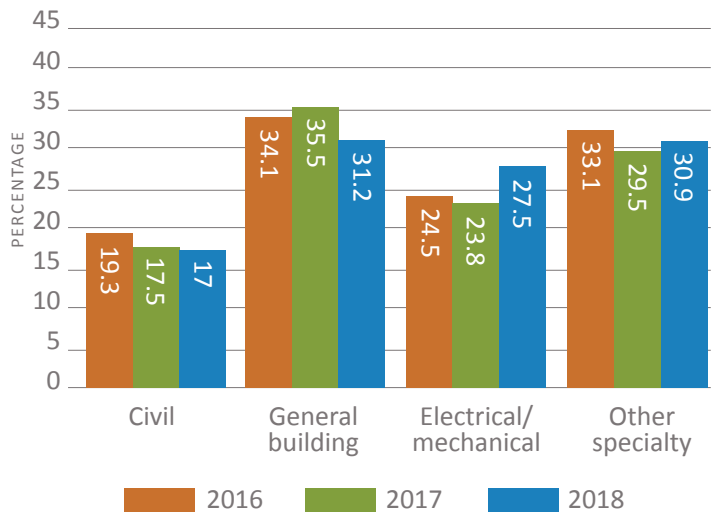


Pre-Tax Return on Equity

$$\text{Pre-Tax Return on Equity} = \frac{\text{Pre-Tax Income}}{\text{Equity}}$$

This ratio determines the rate of return on owners' capital invested or retained in the business. It measures how much profit a company generates with money the owners have invested. For an owner, this is one of the most important ratios because it shows if the business is earning a sufficient profit to compensate the owner for the risk of being in business.

A high return on equity ratio indicates that the company is effectively using its owners' funds. Higher ratios are almost always better than lower ratios, but consideration should also be given to the significance of actual dollars invested, which can vary significantly among sub-industries.



Overall, the general building category had the highest ratios, closely followed by other specialty contractors. This has been typical of the trend among the sub-industries. The electrical and mechanical and other specialty sub-industries improved on their rate of return compared to equity. General contractors experienced the largest decline, dropping from more than 35 percent in 2017 to 31 percent in 2018. Civil contractors' numbers have been the most consistent over the three-year period, with median return on equity variances of just more than 2 percent.

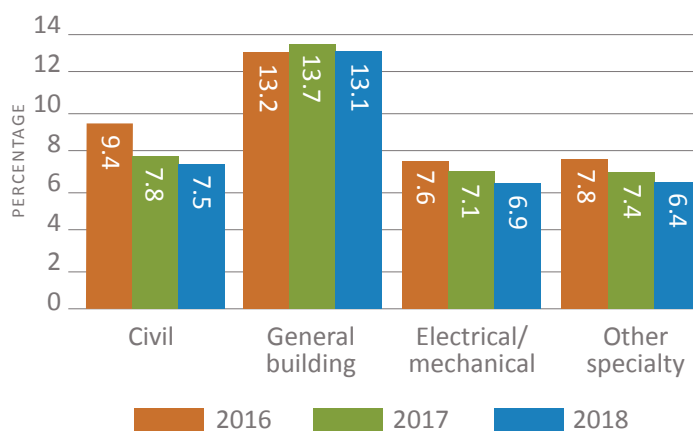
Working Capital Turnover

$$\text{Working Capital Turnover} = \frac{\text{Construction Revenue}}{\text{Current Assets} - \text{Current Liabilities}}$$

Working capital turnover indicates the amount of construction revenue generated by each dollar of working capital.

The higher the ratio, the more efficient a company is in using working capital to generate revenue. However, a very high working capital turnover (ratios approaching 20) may indicate a business does not have enough capital to support its revenue goals. Sureties and lending institutions often look at working capital as an important metric in their credit granting decisions.

Working capital turnover decreased slightly for most sub-industries between 2016 and 2018, and decreased for the general building sub-industry between 2017 and 2018. This indicates working capital has exceeded revenue growth over those time frames.



Debt to Equity Ratio

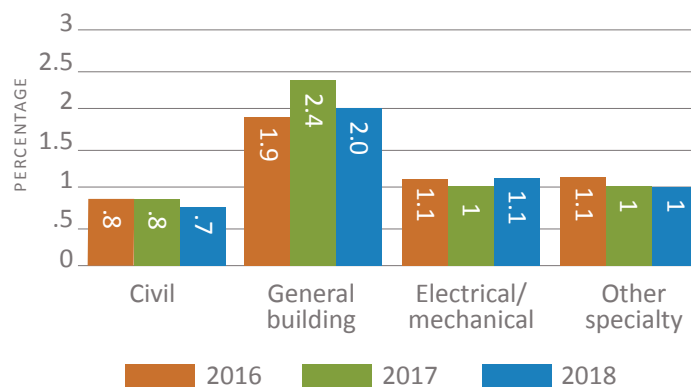
$$\text{Debt to Equity Ratio} = \frac{\text{Total Liabilities}}{\text{Equity}}$$

The debt-to-equity ratio measures a company's financial leverage. The ratio indicates how much debt (total liabilities) a company is using to finance its assets relative to the amount of investment by its owners.

The higher the ratio, the more debt a company is using to leverage its operations. To improve debt-to-equity ratio (decrease the number), a contractor generally must increase equity levels through net income retained or through additional capital investment by the owners. Debt-to-equity can be significantly impacted by the amount of pass-through costs, such as material and subcontract costs that are incurred throughout the contract, so the ratio varies significantly among the sub-industries represented.

Because the construction industry is a seasonal business, accounts payable and lines of credit balances can fluctuate significantly throughout the year, which can impact the debt-to-equity ratio.

Due to another year of strong profitability, many contractors have minimized debt financing and financed capital purchases with internal funds. Financing costs have been on the rise the past few years, and strong job performance has allowed contractors to use less outside financing. This has lowered the debt-to-equity ratio for many companies (largely general building contractors) and allowed them to maintain bonding capacity to support their revenue goals.



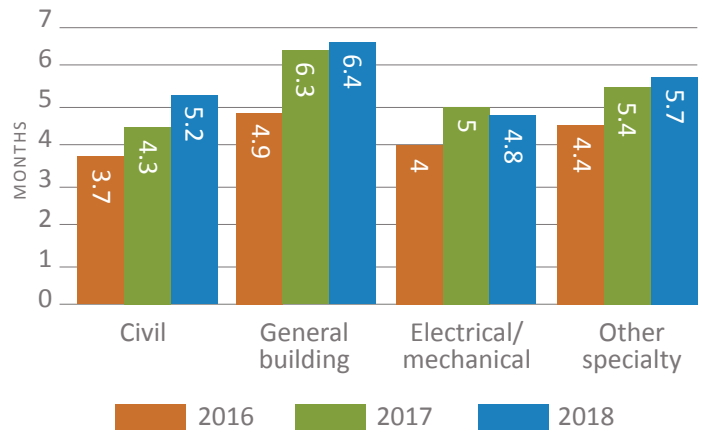
Months in Backlog

$$\text{Months in Backlog} = \frac{\text{Backlog Dollars}}{\text{Construction Revenue} / 12}$$

This ratio indicates the number of months it will take to complete all signed contracts or committed work based on the revenue volume of the previous year. A ratio of less than 12 indicates a need to secure new contracts in the next year to maintain a constant level of annual revenue.

General contractors, including those typically classified within the civil and general building sub-industries, typically have a larger number of months in backlog due to the nature and length of their contracts.

Backlog has consistently increased throughout the industry over the past three years, which is consistent with the overall increase in demand and future construction spending forecasts. In general, the large majority of companies in all sub-industries have enough backlog at year-end to operate through the first quarter without obtaining any new work. Most general builders have contracts for half of the next year.

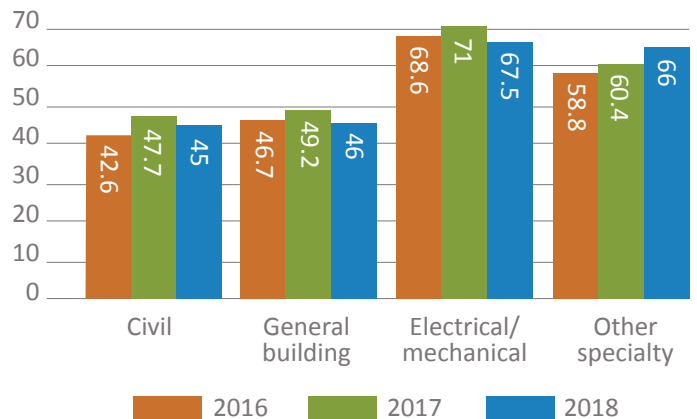


Days in Accounts Receivable

$$\text{Days in Accounts Receivable} = \text{AR} \times \frac{360}{\text{Revenue}}$$

Day in accounts receivable (AR) represents the average number of days it takes to collect receivables. AR in the figures below are net of any allowances for doubtful accounts and exclude retainage. Generally, the greater the number of days outstanding, the greater the likelihood of delinquencies and the potential for cash flow problems. A ratio of 60 days or less is generally considered acceptable.

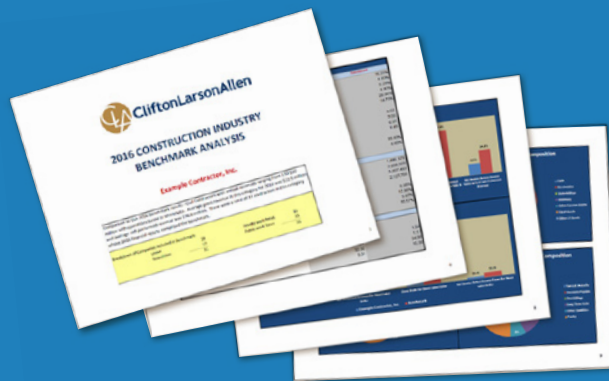
Electrical and mechanical and other specialty sub-industries take longer to collect because they are frequently used as subcontractors and are typically paid after the general contractors receive funds. The other specialty sub-industry's cash collection deteriorated by almost six days, but it was the only sub-industry that weakened in 2018. Electrical and mechanical contractors improved their numbers by 3.5 days. The civil and general building sub-industries also increased their cash collection time by approximately three days each. These improvements were impressive considering the continued pressure by customers to extend payment terms.



Benchmark Analysis

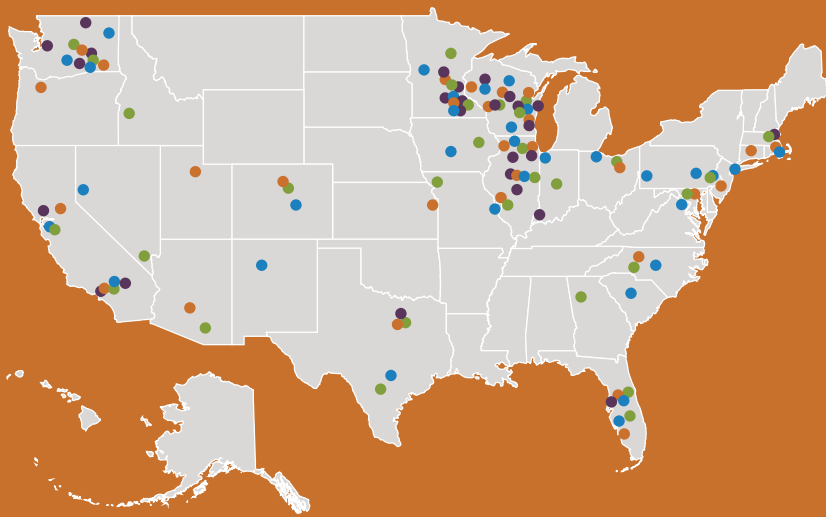
A more detailed comparison of your financial results is available with the CLA's benchmark analysis service. The benchmark analysis provides a comprehensive comparison of your financial results to a defined group of similar contractors that are selected using a number of factors, including geographic operating region, company size, union or non-union labor force, and public or private work focus, along with many other considerations. The analysis provides for easy comparison between different sized companies and combines balance sheet and income statement analysis and graphical comparisons of approximately 40 key performance indicators.

The information presented in the benchmark analysis has assisted many construction companies in identifying areas for improvement and highlighting aspects of their business that need further attention. Your company's decision-makers can use the analysis on an ongoing basis for strategic planning, risk mitigation, internal budgeting, and to help define and track financial and operating goals.



About CLA

CLA exists to create opportunities for our clients, our people, and our communities through industry-focused wealth advisory, outsourcing, audit, tax, and consulting services. We get to know you as a person so we can understand how to help you. Then we combine our knowledge with yours to make you stronger. With more than 6,100 people, 120 U.S. locations, and a global affiliation, we promise to know you and help you. We are dedicated to building an inclusive culture that thrives on different beliefs and perspectives.



Our construction professionals

Our teams include construction professionals, CPAs, engineers, and people who know the industry because they have worked in it. We participate in the construction industry at local and national levels through the Construction Financial Management Association (CFMA), Associated General Contractors of America (AGC), and Associated Builders and Contractors (ABC).

For a more detailed analysis and comparison of your company's results to the benchmark, contact Jon Weston, Principal, Construction and Real Estate, at jon.weston@CLAconnect.com or 218-825-2913.



CLA exists to create opportunities, and our professionals genuinely take this to heart when working with clients. We are grateful to be part of this list and are honored to be in the number one spot.

— *Jill Bosco, Managing Principal of Construction*