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THE 2016 CLA

# Civil Construction Benchmark Report

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# Civil Construction Benchmark Report

## Civil construction contractors face challenges unique to their subindustry. This report offers a concise analysis of national trends not available elsewhere.

Construction business owners and managers always have a lot of financial and operational questions on their minds. They want to know how their companies compare to the competition, or if their working capital is enough to maintain their revenue streams. They have concerns about their equipment and wonder if it's getting too old, or if they are investing too much in it, or how capital purchases affect their overall equipment costs.

To help them find the answers, CLA's industry professionals compile data from our clients across the United States and create an annual benchmark report.

The 2016 Civil Construction Benchmark Report summarizes data from 89 civil contractors that have operations throughout the United States. This report offers key financial and non-financial information to assist civil contractors in comparing themselves to their peers. Contractors included in the survey represent companies engaged in highway and street projects, bridges, oil and gas pipelines, railroads, underground utilities, tunnels, water resources, site work, and general excavation.

**Civil Contractors' To-Do List**

- Develop a process to assess and update equipment rates with the variable inputs for fuel costs.
- Become involved in industry and lobbying activities to promote the importance of infrastructure spending.
- Research real-time, on job-site, and labor and production tracking tools to improve timely financial reporting through the use of mobile technology.
- Develop relationships with local school districts to promote careers in the civil construction industry.
- Develop a management and ownership succession plan.
- Understand the impact that legal, tax, and accounting changes will have on your business. Pay particular attention to revenue recognition and lease accounting standards, as well as the phase-out of bonus depreciation.

## Industry challenges and opportunities

Civil contactors had a very successful year in 2015. Positive operating results were driven by lower fuel and material costs. Also, many projects performed in 2015 were bid with 2014 cost structures, which improved project performance.

Even with the positive results in 2015, there is significant uncertainly about civil contractor's performance moving forward. Several catalysts are currently at work in the industry that will impact civil contractors and their ability to maintain profitability levels similar to 2015:

1. Federal and state government budgets remain constrained, creating uncertainty about future infrastructure spending. At the same time, lower fuel prices are leading to a decline in construction opportunities in the oil and gas market.
2. Lower cost structures are creating more competition in the marketplace, which will put pressure on bidding and profitability.
3. Ownership succession is a significant issue for many civil contractors as owners near retirement without a defined plan to move the business to the next generation.
4. The consolidation of construction accounting and operations software providers continues to change the reporting landscape for civil contractors. As legacy systems are no longer supported, contractors are facing increased costs and demands on staff time to update or overhaul their financial reporting systems.
5. A civil contractor's ability to capitalize on construction opportunities may be diminished by the lack of skilled labor in the marketplace. Some civil contractors have had to turn away work because they did not have the labor capacity to complete the project. .

## Key ratios and trends

*Margins on self-performed revenue* — Margins on self-performed revenue increased throughout the civil industry in 2015. The largest increase was seen with non-union contractors. The biggest contributing factor to this change was lower fuel costs.

Even with the industry experiencing relatively strong margins, there are opportunities for improvement. Overall, companies are underutilizing the technology resources they have invested to budget, track, and forecast costs throughout the life of a project. As a result, many have been unable to convert data gathered into valuable information to help them manage results on their projects.

*General and administrative expenses* — A portion of the increase in margin on self-performed revenue was offset by higher general and administrative costs in 2015, especially for non-union contractors, whose costs increased 1.4 percent. A partial reason for this increase was due to increased IT spending as legacy accounting and operation systems were retired.

*Capital expenditures* — For the second year in a row, civil contractor spending on fixed assets significantly exceeded the annual expense for depreciation. Strong operating results and access to low cost financing were the primary contributing factors.

***Ownership succession is a significant issue for many civil contractors as owners near retirement without a defined plan to move the business to the next generation.***

## 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 is voluntary, and data gathered has been analyzed by representatives from our construction industry practice. This report summarizes data from 89 civil construction companies with operations conducted throughout the United States.

Analysis of financial ratios and key performance indicators can help assess a contractor's financial health, operating efficiency, and profitability. A critical element in the review of a contractor's financial well-being is understanding the magnitude of a variance compared to similar organizations, and then taking the initiative to investigate the reason for the variance. Ultimately, understanding the cause of variances may lead to a series of operational changes that may both improve profitability and create efficiencies.

Consistently monitoring key financial and operational indicators can help management improve profitability, manage operations, and 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.
- The data helps identify unusual operating results and trends.
- Performance indicators highlight areas of potential opportunities or challenges.

### 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 analyses 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 benchmarking data as well as the company's own numbers.

## Uses of publication

The purpose of this publication is to provide select financial ratio and key performance indicator results for CLA's civil construction clients. This report is intended to assist management by providing comparable data, industry trends, and other information to assist them in making financial decisions.

An organization's decision-makers can use the ratio analysis and key performance indicators published in this report on an ongoing basis for strategic planning, internal budgeting, and defining and tracking financial and operating goals.

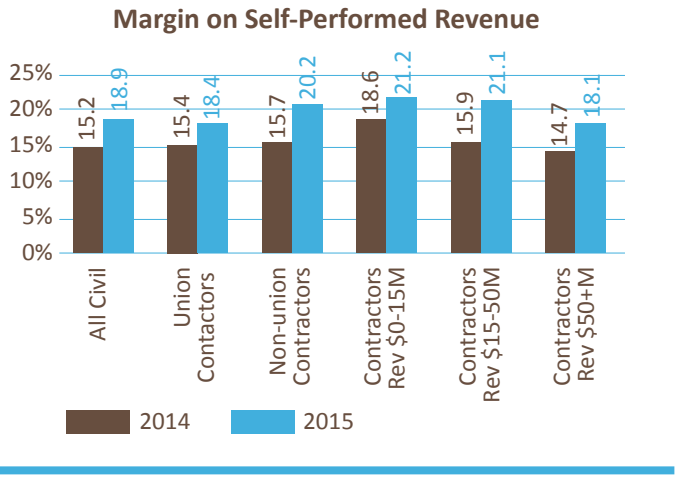
## Ratio analysis and key performance indicators

The following graphs present weighted average data and result from the summation of all participant financial data before calculating the particular ratio. For example, gross profit as a percent of revenue is arrived at by taking the sum of gross profit dollars for all companies divided by the sum of construction revenue for all companies.

$$\textbf{Margin on Self-Performed Revenue} = \frac{\textbf{(Construction Revenue - Total Contract Costs)}}{\textbf{(Construction Revenue - Subcontractor Expense)}}$$

This ratio represents the percentage of self-performed contract revenue the company retains after incurring direct costs associated with completing the contract.

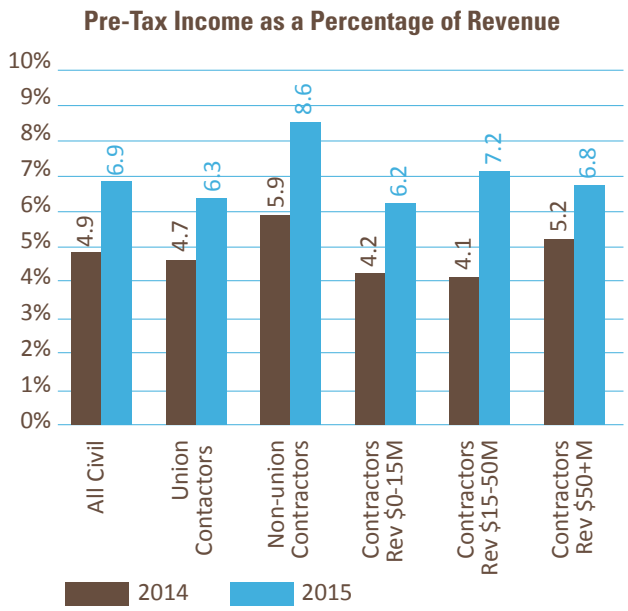
Subcontractor expense for civil contractors can be a significant portion of the overall cost associated with a project. Often subcontracted work yields little or no profit margin to the prime contractor and can result in total gross profit percentages becoming skewed based on the amount of work a particular company subcontracts to others. Analyzing a company's margin on self-performed revenue often provides a better indication of the company's ability to generate profit on the work it performs.



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

This is the ratio of earnings before income tax as percentage of total construction revenue.

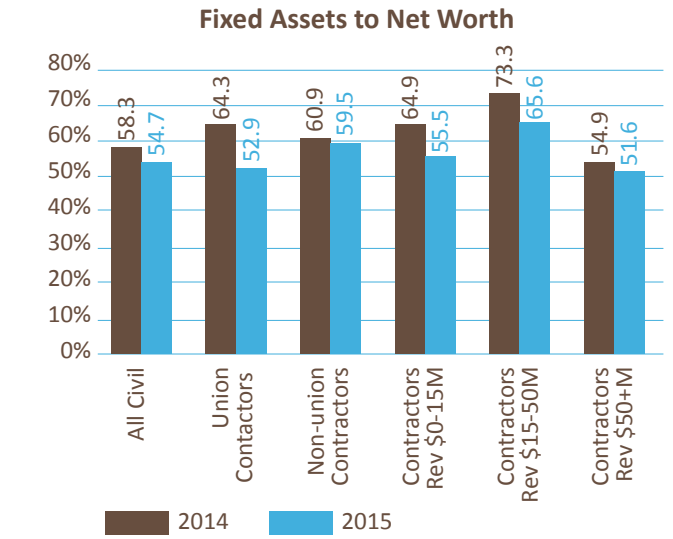
The higher the percentage, the greater the return available for owners to re-invest in the business. All segments of the civil construction industry saw healthy increases in 2015.




**Fixed Assets to Net Worth** = $\frac{\text{Total Net Fixed Assets}}{\text{Net Worth}}$

The fix assets to net worth ratio measures the amount of the owner's equity that is tied up in fixed assets. A lower ratio usually indicates better solvency because it translates into a greater percentage of assets available to meet current obligations.

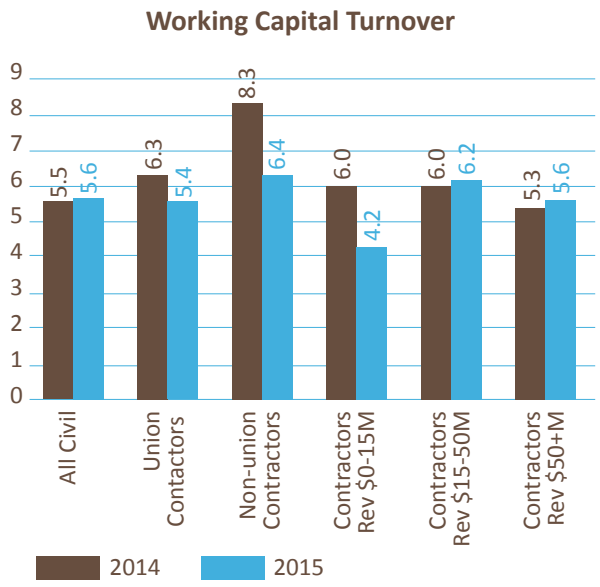
Despite the significant investment made by civil contractors in fixed assets during 2015 (see purchases as a percentage of depreciation expense on page 7,) the industry experienced a decrease or improvement in the fixed assets to net worth ratio. This can be attributed to strong operating results and higher growth in net worth.




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

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 growth.

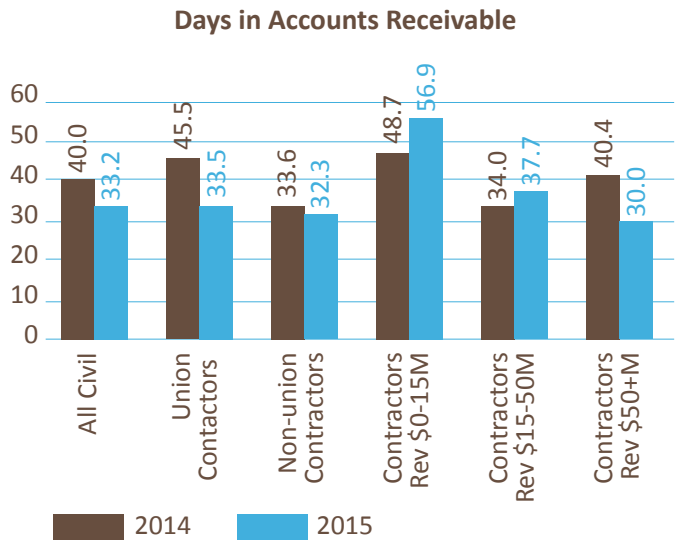
In 2015, there were mixed results in working capital turnover, depending on the size of the company. Increased business start-ups and continued competition in the small contractor market drove down working capital turnover as more stress was placed on these companies' balance sheets. In contrast, private and public infrastructure spending kept the larger contractors busy all year and increased working capital turnover mostly through increased revenue.




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

Days in accounts receivable calculates the average number of days that receivables are outstanding or how quickly a contractor converts its receivables to cash.

Fewer days in accounts receivable is desirable as this suggests a company takes less time to covert its receivables to cash. Civil contractors had mixed results in 2015 with most segments experiencing an improvement in the number of days. This ratio depends heavily on the contractor's customer base. Contractors with higher concentrations of public work generally have a lower days in accounts receivable figure compared to companies with larger concentrations of private work.




***Some civil contractors have had to turn away work because they did not have the labor capacity to complete the project.***

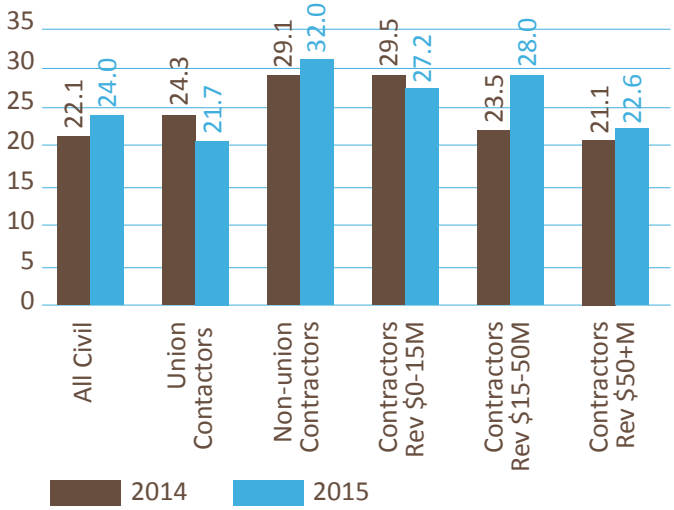
$$\text{Days in Accounts Payable} = \frac{\text{Accounts Payables}}{\text{Total Contract Costs}} \times 360$$

Days in accounts payable calculates the average number of days it takes a company to pay its creditors, such as subcontractors and suppliers.

More days in account payable are desirable because it suggests a company is intentionally stretching out its payments to improve cash flow. However, contractors must comply with prompt payment requirements and avoid damaging relationships with subcontractors and suppliers by delaying payment.

Companies with higher percentages of self-performed work generally have a larger spread in the number of days in receivables compared to payables because a greater percentage of their expense is payroll, which is often paid weekly.

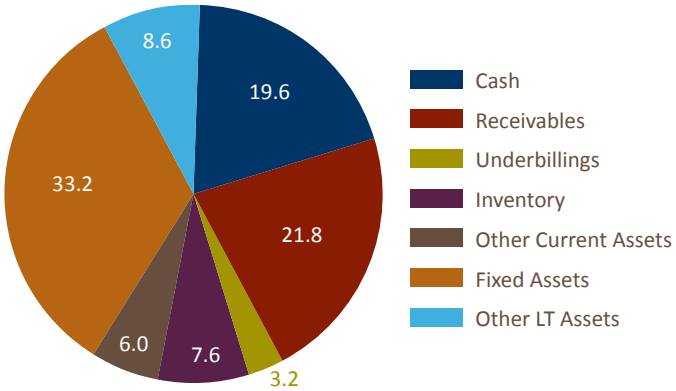
**Days in Accounts Payable**




## Balance sheet compositions

The following charts illustrate the weighted average composition of the balance sheets and income statements of all the survey participants. Contractors can use this information to assess their overall financial positions and results in relation to their peers.

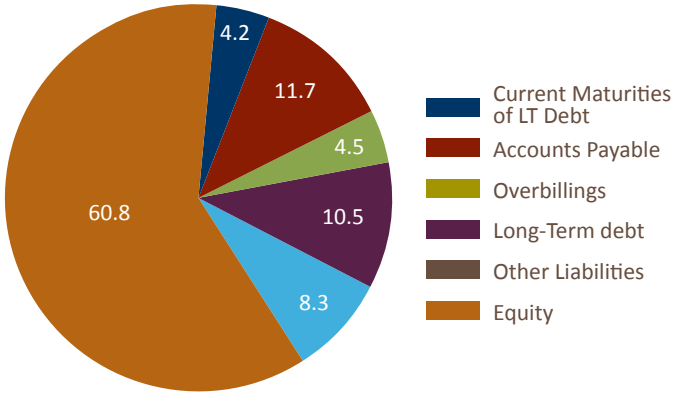
**Asset Composition**




Depending on a contractor's location, the asset composition of the company may not look exactly like this. For calendar year-end civil contractors in the northern United States, where the construction season can be as short as five months, generally there will be a higher percentage of cash and lower percentage of receivables in comparison to total assets. Conversely, for civil contractors who can work twelve months out of the year, receivables as a percent of total assets may be higher, and cash may be lower.

As illustrated above, the most significant component of total assets for civil contractors is fixed assets. This is because the civil industry is equipment-intensive. So unless the firm is a construction management firm or renting the majority of the equipment via operating leases, fixed assets are most likely the largest component of total assets.

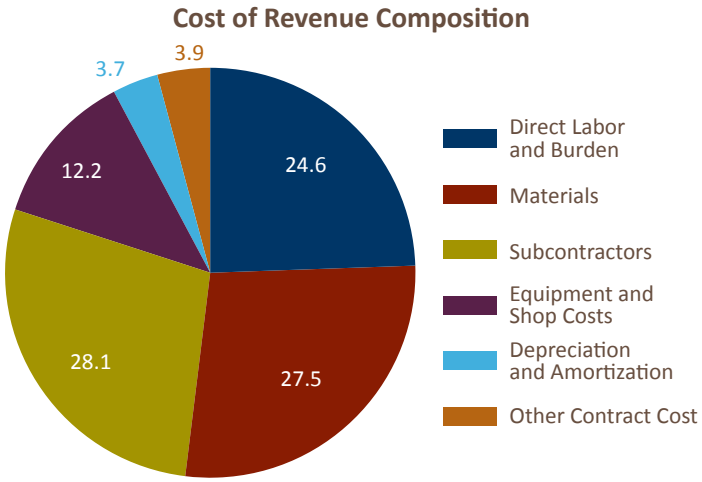
**Liability/Equity Composition**



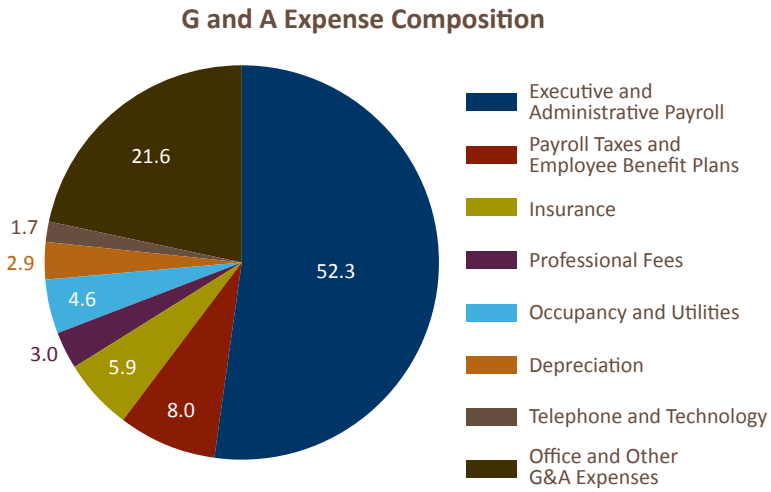

Similar to the asset composition chart, liability/equity composition may differ due to seasonality. If a contractor works seasonally and has a December year-end, accounts payable may be lower as a percentage of total liabilities, and long-term debt may be higher than for civil contractors with 12 months of construction operations.

Due to the nature of the civil construction industry, many companies retain significant equity levels to support their equipment fleet, minimize debt financing, and maintain adequate bonding capacity to support their revenue goals.

## Income Statement Compositions




This chart illustrates the composition of contract costs for contractors surveyed in 2015. These categories can vary significantly between contractors based on the type of work they perform, as well as operational strategies. For instance, some civil contractors self-perform a large portion of their contracts, while others rely more on subcontractors. Also, a contractor that performs more material intensive work may see a lower percentage for labor or equipment costs. Therefore, the composition for a particular contractor will depend on operating capabilities, strategies, and the nature of the projects under contract over the reporting period.




Depending on the size, complexity, and culture of your company, general and administrative expense percentages may also differ. The largest component of this graph is related to payroll. This includes amounts paid under management and performance bonus programs, which can be significant for many contractors. A related performance indicator (in the table on page 7) is a company's G and A as a percentage of revenue. This provides a good gauge of overall G and A spending relative to the revenue generated by the company, and this can offer valuable insights into the company's overhead structure compared to its peers.

***Consistently monitoring key financial and operational indicators can help management improve profitability, manage operations, and provide key information for developing competitive bids.***

# Additional Key Performance Indicators

Below are additional key performance indicators that may be helpful in assessing a company's overall financial health and performance.

| | | All Civil | Union Contractors | Non-Union Contractors | Contractors $0-15M | Contractors $15-50M | Contractors $50+M |
|---|---|---|---|---|---|---|---|
| Gross Profit Percentage | **2015** | **14.4** | **13.5** | **17.3** | **18.5** | **16.0** | **13.5** |
| | 2014 | 11.8 | 11.6 | 12.9 | 15.2 | 12.5 | 11.3 |
| General and Administrative Expense as a Percentage of Revenue | **2015** | **7.8** | **7.2** | **9.6** | **12.3** | **9.1** | **7.0** |
| | 2014 | 7.5 | 7.4 | 8.2 | 11.3 | 8.6 | 6.8 |
| Earnings Before Interest and Taxes as a Percentage of Revenue | **2015** | **7.1** | **6.6** | **8.9** | **6.6** | **7.6** | **7.0** |
| | 2014 | 5.2 | 4.9 | 6.2 | 4.5 | 4.7 | 5.4 |
| Pre-Tax Return on Equity | **2015** | **20.2** | **19.6** | **21.9** | **16.6** | **22.7** | **19.7** |
| | 2014 | 14.9 | 16.2 | 17.1 | 15.1 | 14.3 | 15.0 |
| Days in Cash | **2015** | **39.5** | **44.6** | **22.3** | **50.0** | **29.1** | **41.9** |
| | 2014 | 27.0 | 31.5 | 14.0 | 24.2 | 31.5 | 26.1 |
| Current Ratio | **2015** | **2.2** | **2.3** | **1.9** | **2.4** | **2.0** | **2.3** |
| | 2014 | 2.3 | 2.0 | 1.7 | 2.0 | 2.1 | 2.5 |
| Debt to Equity | **2015** | **0.6** | **0.8** | **0.7** | **0.7** | **0.8** | **0.6** |
| | 2014 | 0.7 | 0.6 | 0.8 | 0.9 | 1.0 | 0.6 |
| Equipment Purchases as a Percentage of Depreciation Expense | **2015** | **141** | **138** | **150** | **118** | **147** | **141** |
| | 2014 | 146 | 158 | 139 | 133 | 137 | 150 |
| Months in Backlog | **2015** | **5.9** | **6.4** | **4.6** | **3.0** | **5.7** | **6.2** |
| | 2014 | 4.2 | 6.5 | 2.6 | 3.4 | 4.3 | 4.2 |
| Distributions as a Percentage of Pre-Tax Income | **2015** | **46.4** | **51.7** | **33.6** | **65.1** | **52.5** | **43.2** |
| | 2014 | 39.7 | 55.0 | 26.6 | 58.9 | 56.2 | 32.6 |

CliftonLarsonAllen LLP (CLA) provides business resources. We deliver wealth advisory, outsourcing, and public accounting to help clients succeed professionally and personally. CLA exists to help people build a better world through whatever venture they envision.

CLA builds versatile teams to help organizations explore their opportunities. Our team members are immersed in the industries they serve and have specialized knowledge of their operating and regulatory environments. With more than 4,500 people across the country, as well as international relationships, we serve clients in all industries.

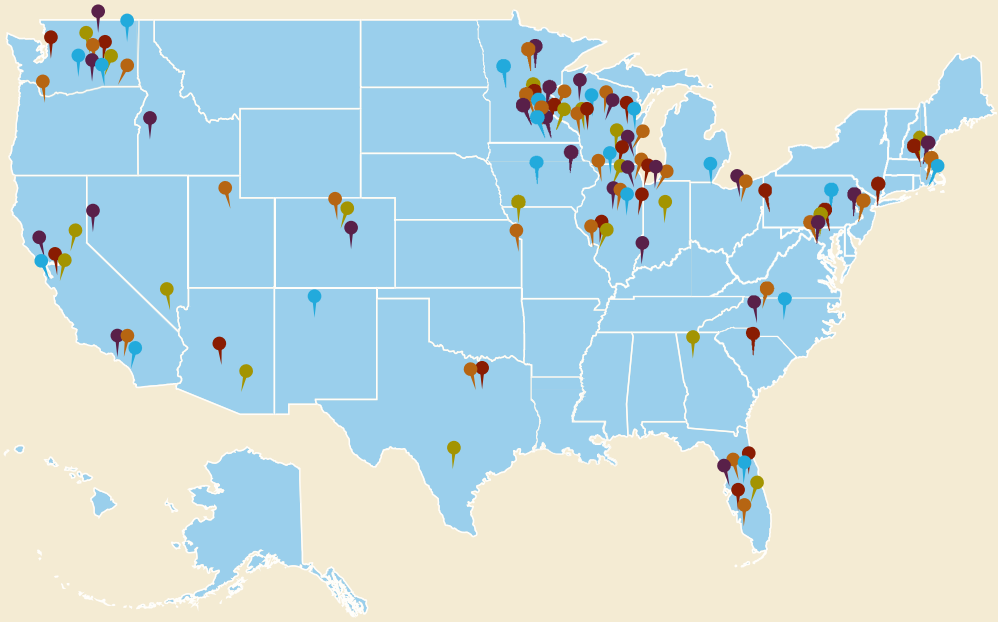
We believe that professional relationships can be personal and that those connections can last for generations, which means, we'll be beside you every step of the way and beyond.

## The CLA Promise

Our interactions with you are designed to support your goals and dreams and impact your success.

## Our people

CLA is made up of more than 4,500 professionals, including 600 principals and 1,800 CPAs.



## Our construction professionals

Our team includes 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), Associated Builders and Contractors (ABC), and other industry associations.

*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.*

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