THE 2016 CLA
Construction Benchmark Report
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For the past four years, the CliftonLarsonAllen construction and real estate professionals have been compiling financial data from our construction clients across the United States to provide some answers to the financial and operational questions construction owners and management always seem to have on their minds.

How does your company compare to the competition? How can a company that is smaller than yours be more profitable? How do your competitors continue to grow when your company has leveled off? What does your debt-to-equity ratio suggest about your business? These are just some of the questions the leaders of construction companies routinely ask — but how do they get solid, relevant answers?

The 2016 Construction Benchmark Report summarizes data from 327 construction companies that have operations throughout the United States. Drawing on data from their financial information, this report summarizes some of the catalysts currently at work in the industry. Contractors who recognize and understand industry trends will be better positioned to create opportunities in the future.

Construction Contractors’ To-Do List

• Develop employee retention plans focused on the next generation of workers.
• Identify and implement technology efficiencies to help offset labor shortages.
• Develop a management and ownership succession plan.
• Implement or enhance information technology security and controls.
• Develop and maintain a robust subcontractor qualification program.
• 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
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 businesses will be better positioned to create opportunities in the future. Several catalysts are currently at work in the industry:

1. A large number of key employees are near retirement age, and few younger employees are entering the industry to fill these positions. The most prominent challenge facing contractors is finding the leadership and workforce with the appropriate knowledge and skills.
2. Federal and state government budgets remain constrained, creating uncertainty about future infrastructure spending. However, it is worth noting that revenue volumes from private sector projects have risen through 2015.
3. Cybersecurity threats continue to endanger companies of all sizes. These threats challenge a contractor’s ability to secure sensitive data and prevent theft or fraud.
4. Access to low-cost financing for equipment and other capital improvement needs will allow contractors seeking growth to move forward.
5. Lower fuel costs have provided significant cost savings for companies with equipment-intensive operations. However, these same low prices are also responsible for a significant decline in construction opportunities in the oil and gas market. To price bids competitively, contractors must effectively navigate fuel cost fluctuations.

Key trends
Gross profit — Gross profit margins remained strong in 2015, with only the electrical and mechanical sub-industry decreasing from 16.9 percent in 2014 to 16.6 percent in 2015. Civil contractors experienced the largest increase in margins with average levels rising from 11.9 percent in 2014 to 14.4 percent in 2015. The biggest contributing factor to the growth was lower fuel costs.

Even with relatively strong margins throughout the industry, opportunities exist for improvement. Overall, companies are not fully utilizing the technology resources they have invested in to budget, track, and forecast costs throughout the life of a project. As a result, many have been unable to convert data gathered into useful information to help them manage results on their projects.

Working capital levels — Despite strong operating results for 2015, working capital levels as a percentage of both revenues and net worth decreased for each industry segment (civil contractors, general building, electrical and mechanical, and other specialty). This was largely due to higher equity distributions relative to net income and increased spending on capital improvements. Much of the relative increase in equity distributions can be attributed to higher taxable income levels resulting from the reversal of accelerated depreciation deductions taken in previous years.

Days in accounts receivable versus accounts payable — Overall, the cash collection cycle for contractors improved in 2015 compared to the previous two years. The cash disbursement cycle remained relatively constant between the years, and these factors led to better overall cash management in 2015.

Return on equity — With stronger gross profit margins and relatively flat general and administrative expense levels, each of the four sub-industries in the survey improved their weighted average pre-tax return on equity during 2015.

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 has been analyzed by representatives from our construction industry practice. This report summarizes data from 327 construction companies with operations throughout the United States. The companies are categorized into 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 85 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 89 companies in this category participated in the report.

Electrical and mechanical — Information from 61 companies engaged in electrical, plumbing, HVAC, low-voltage, and energy efficiency trades (including both new construction and service work) contributed their information to 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 92 companies are included in the report’s other specialty category.
Analysis of financial ratios and key performance indicators can help assess a contractor’s financial health, operating efficiency, and profitability. Understanding how an organization’s performance compares to similar organizations can provide the impetus to investigate the variances and make operational changes to both improve profitability and efficiency.

Consistently monitoring key financial and operational indicators can help management 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 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 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 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 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 to help define and track financial and operating goals.

### Ratio analysis and key performance indicators

The following graphs present weighted average data for each sub-industry. The weighted averages result from the summation of all participant financial data before calculating the particular ratio. For example, gross profit as a percent of construction 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.

As we compared our data from 2013 – 2015, we discovered some ratios that appeared to be outside of the norm, in particular, the 2013 data for the electrical and mechanical sub-industry. As we explored further, we found that the information from a small number of large clients may have affected the overall ratios of the sub-industry. In the future, our analysis will attempt to account for and reduce the influence of data that may not be representative of the sub-industry as a whole.

**Gross Profit as a Percent of Revenue**

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\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 the company retains after incurring the direct costs associated with completing the contract.

The higher the percentage, the more of each revenue dollar the business retains, which means more money is left over for other operating expenses and net profit. Gross profit margin is often impacted by the amount of work the company itself performs on the contract.
**Pre-Tax Income as a Percent of Revenue**

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\frac{\text{Pre-Tax Income}}{\text{Construction Revenue}}
\]

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

The higher the percentage, the more return can be provided to owners or re-invested into the business. This also provides insight into a company’s selling and general and administrative cost structure when compared to the gross profit ratio information.

**Pre-Tax Return on Equity**

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\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 a company’s profitability by revealing how much profit a company generates with money the owners have invested. This is one of the most important ratios because it shows if the business is earning a sufficient profit to compensate an owner for the risk of being in business.

A high return on equity ratio indicates that the company is using its owners’ funds effectively. 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.

**Debt to Equity Ratio**

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\frac{\text{Total Liabilities}}{\text{Equity}}
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The debt to equity ratio measures a company’s financial leverage. It 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 the debt to equity ratio (decrease the number), owners generally must increase their equity levels through net income retained or through additional capital investment. Debt to equity can be significantly impacted by the amount of pass-through costs, such as material and subcontract costs or the volume of a company’s business activity at a particular point in time.
Days in Accounts Receivable (AR) = \( \frac{\text{Accounts Receivable}}{\text{Construction Revenue}} \times 360 \)

This ratio 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.

Days in Accounts Payable (AP) = \( \frac{\text{Accounts Payable}}{\text{Construction Costs}} \times 360 \)

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

More days in accounts payable suggests a company is stretching out its payments to improve cash flow. However, care must be taken to avoid damaging relationships with subcontractors and suppliers by delaying payment.

Companies with a higher percentage of work performed in-house generally have a wider 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.

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. While not uncommon, 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.

CLA collected months-in-backlog data for 2015 because our clients requested this information. We intend to continue to gather and analyze this data for future surveys.
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 Mike Prigge, Principal, Construction and Real Estate at mike.prigge@CLAconnect.com or 612-376-4806.