

Insight on Industry Trends:

The 2017 CLA Civil Construction Benchmark Report



How does your organization compare to competitors? Understand your strengths, weaknesses, and opportunities for improvement. Explore the facts in this report.

Owners of privately held civil construction companies and their management teams face daily challenges, both operationally and financially. They need to know how their company stacks up against their competitors and if there is anything they can do better to improve their operating results.

This report provides succinct analysis of national trends for privately held owner-operated civil construction companies.

CLA's industry professionals have compiled data for the past five years from privately held, owner-operated businesses across the United States to create an annual benchmark report.

The 2017 Civil Construction Benchmark Report summarizes data from 96 civil contractors. This report offers key financial and non-financial information to assist civil contractors in comparing themselves to their peers. Contractors included in the survey are privately held, owner-operated businesses that are engaged in projects related to highways and streets, bridges, oil and gas pipelines, railroads, underground utilities, tunnels, water resources, aggregate producers, site work, and general excavation.

Construction Contractors' To-Do List

- Assess your company's information technology system's vulnerability to hacking threats. Invest in information security solutions and employee awareness programs to enhance controls.
- Become involved in industry and lobbying activities to promote the importance of increased infrastructure spending.
- Discuss the impacts of the new revenue recognition and lease standards with your financial institution and their effects on financial covenants.
- Become the employer of choice in the competitive labor market, and develop strategies to open the pipeline of future laborers for your company.
- Consult with your tax advisor regarding potential tax incentives for civil contractors, such as research and development credits, the work opportunity tax credit, fuel tax credits, and energy efficiency incentives.
- Start accumulating and summarizing lease agreements for the upcoming implementation of the new lease standard in 2020.
- Dedicate resources in the area of equipment and fleet management to better understand your equipment needs and maximize the utilization of your fleet.

Overview and executive summary

Industry challenges and opportunities

Across the subindustry, gross margins were consistent in 2016 compared to 2015, but overall profitability decreased by almost 3 percent to 5.2 percent of revenue. This reduction in profitability was largely due to increased general and administrative costs. However, civil contractors were able to maintain strong balance sheets with the reduction in profitability.

Even with the positive outlook in 2017, civil contractors face challenges to maintain or improve results. Several catalysts are currently at work in the industry that will impact civil contractors and their ability to improve profitability levels:

Infrastructure spending is on the docket in Congress, but political differences in Washington may inhibit its ability to pass infrastructure spending bills that create more opportunities for civil contractors.

The skilled labor pool is aging. Contractors continue to lack sufficient numbers of skilled replacements to meet demand. The same issue in management is occurring as numerous employees in civil contractor leadership positions are nearing retirement age without the next generation to take their places.

Cybercriminals continue to target small- and medium-size businesses through ransomware and online banking attacks.

Recent national and worldwide natural disasters will further impact the construction labor market and put upward pressures on material prices.

Without succession plans in place, many owners of civil contracting companies are choosing to increase cash distributions to fund their retirement, causing cash flow issues and pressure on working capital and net worth.

Key ratios and trends

Working capital turnover — Even with decreased profitability in 2016, civil contractors' working capital remained strong and effective; Working capital turnover increased almost a full point over 2015 across the industry. However, the composition of working capital changed. With increased distributions to owners and older receivables, cash as a percent of total assets decreased 5.3 percent over 2015, as the civil contractors' cash collection cycle deteriorated compared to 2015. Better project management will be key in 2017 to improve these metrics and overall cash flow.

Return on equity — Corresponding to decreased profitability, owners experienced a significant decrease in their return on investment in 2016. All industry segments, except contractors with less than \$15 million in revenue, saw this impact on their financial statements. The greatest decrease was from non-union contractors who sustained a 7.3 percent decrease in their return on equity investment.

General and administrative expenses — Executive and management compensation was a significant driver in the increase in general and administrative expenses for the civil industry in 2016. Compensation for these individuals as a percent of revenue increased 5.4 percent over 2015. The largest increase was with union civil contractors and contractors with over \$50 million in revenue. Both those segments saw an increase in this metric by over 9 percent. Another contributing factor was increased insurance rates in 2016. Insurance as a percent of revenue increased industry wide by 2.6 percent over 2015.

Overview and executive summary

2016 backlog — Civil contractors expect their backlog in 2017 to be less profitable than the work completed in 2016. Across the industry, gross profit on 2016 work was 14.1 percent, and estimated gross profit on 2016 backlog was only 8 percent industry wide. The largest decreases in expected gross profit was for contractors with revenue in excess of \$50 million. The main cause of the fading of gross profit is due to expected increases in equipment and labor costs. The current labor shortage is expected to drive up the costs of employment via higher base-wage rates, overtime pay, and benefits that the Millennial generation is demanding.

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 96 civil construction companies with operations conducted throughout the United States.

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. 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 leaders 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.
- The data help 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.
- Certain companies may be in a highly specialized market segment facing little or a lot of competition.

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 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 along with the company's own numbers.

Ratio analysis and key performance indicators

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

Margin on Self-Performed Revenue

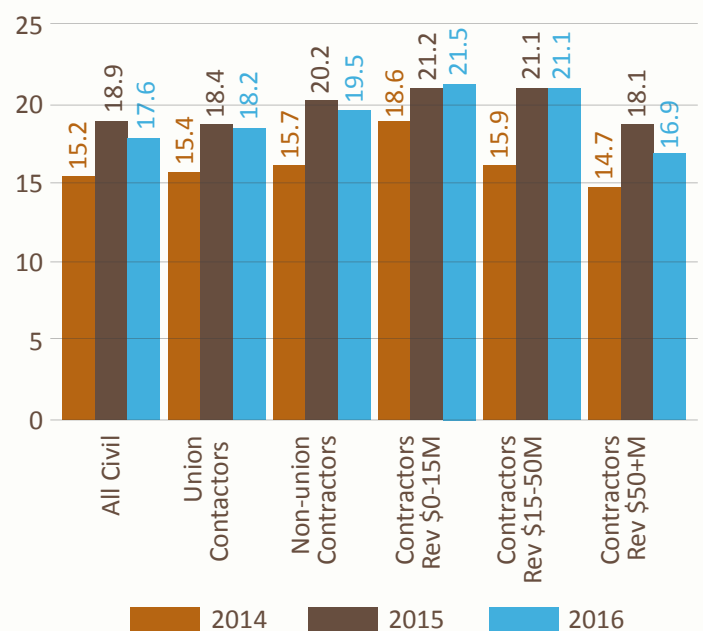
$$\text{Margin on Self-Performed Revenue} = \frac{(\text{Construction Revenue} - \text{Total Contract Costs})}{(\text{Construction Revenue} - \text{Subcontractor Expense})}$$

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.

Most industry segments experienced a consistent or slightly lower margin on self-performed work compared to 2015. The only segment which saw an increase in this ratio was contractors under \$15 million in revenue, with a modest 0.3 percent increase. Most civil contractors noted only a slight decline on gross margin for 2016, despite increased competition.



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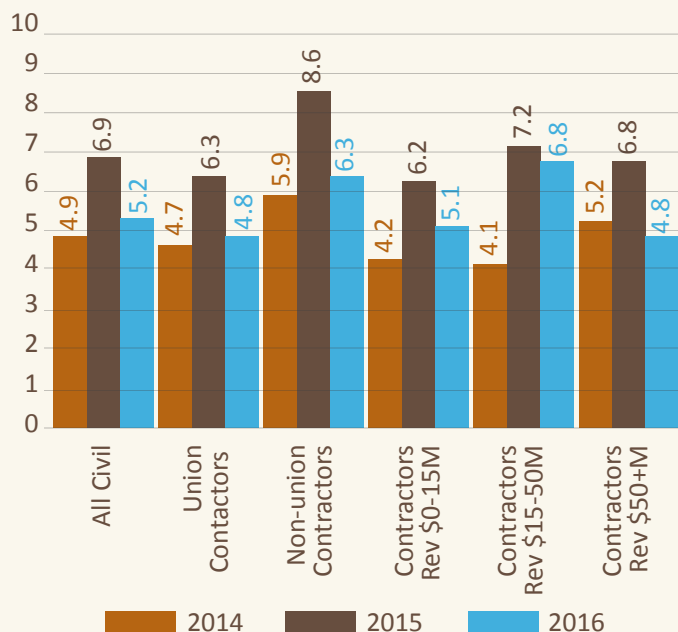
Ratio analysis and key performance indicators

Pre-Tax Income as a Percent of Revenue

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

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

The higher the percentage, the more potential return can be provided to owners or re-invested into the business. 2016 was a challenging year in providing return to owners or for further investment. Pre-tax income as a percent of revenue decreased in all segments in the civil construction industry and were much closer to 2014 levels.

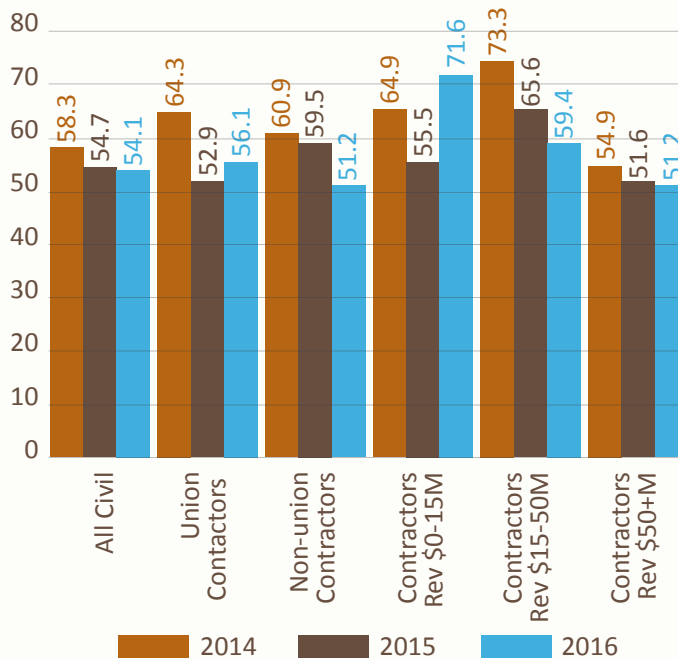


Fixed Assets to Net Worth

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

The fixed assets to net worth ratio measures the amount of an 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.

Civil contractors continued to invest in their equipment fleets in 2016 but at a slower pace. After a few years of favorable dealer financing, civil contractors slowed the pace of replenishing their fleets. Also, companies planned on lower volume in 2016 compared to 2015 due to increased competition and, therefore, budgeted for lower equipment acquisitions in 2016. This ratio reflected improvement in 2016 for the civil industry as a whole and in all segments, except for union contractors and companies under \$15 million in revenue.



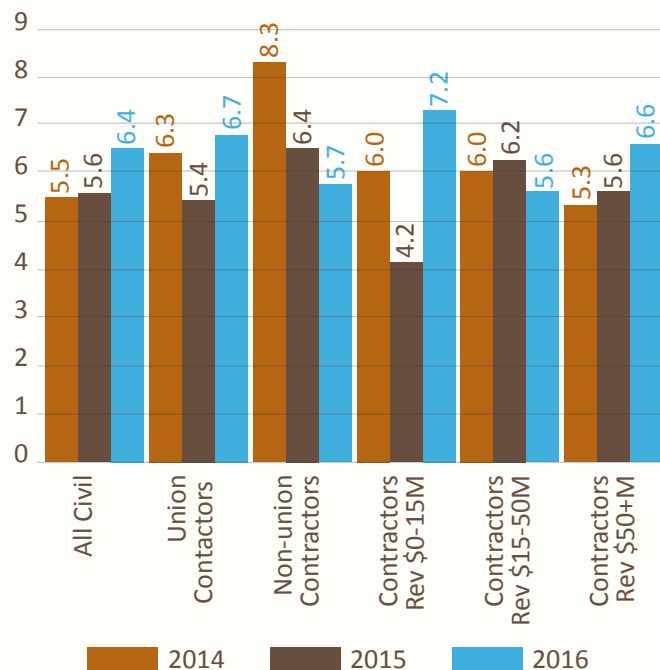
Ratio analysis and key performance indicators

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 8 percent) may indicate a business does not have enough capital to support its sales growth.

Working capital turnover varied throughout the industry segments. Larger, more established, union contractors' working capital produced greater levels of revenue in 2016 than they had in 2015. With the increased competition in the non-union marketplace, companies were not as efficient at putting their working capital to use as they have been in the past. Smaller civil contractors enjoyed a significant increase in working capital turnover, as many start-up companies launched after the Great Recession saw their efforts being rewarded.

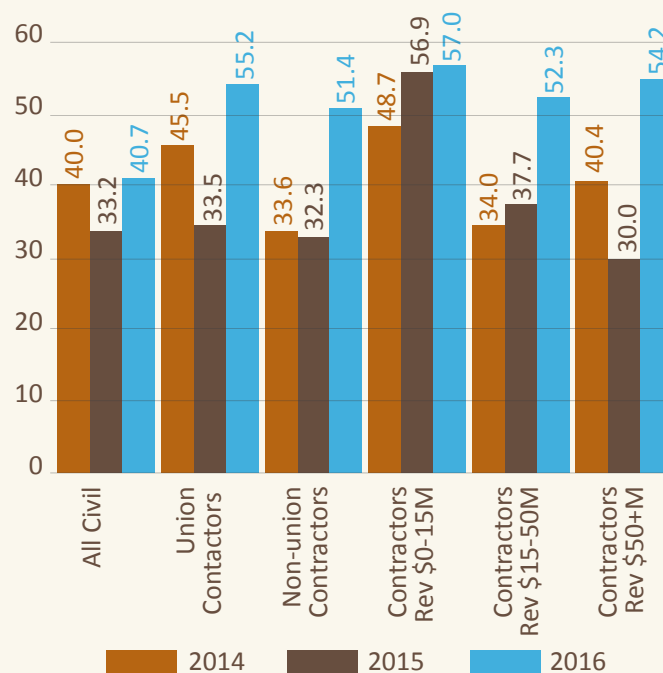


Days in Accounts Receivable

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

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 are desirable because it suggests a company takes less time to convert its receivables to cash.

Overall, it is taking civil contractors longer to collect on their receivables than it did in 2015. This was mainly caused by more private work in 2016 compared to 2015 and the longer timeframe for collection of receivables from private companies versus governmental entities. Even with the higher days in accounts receivable in 2016, civil contractors have more timely collection than other construction trades such as commercial builders, HVAC contractors, and plumbers.



Ratio analysis and key performance indicators continued

Days in Accounts Payable

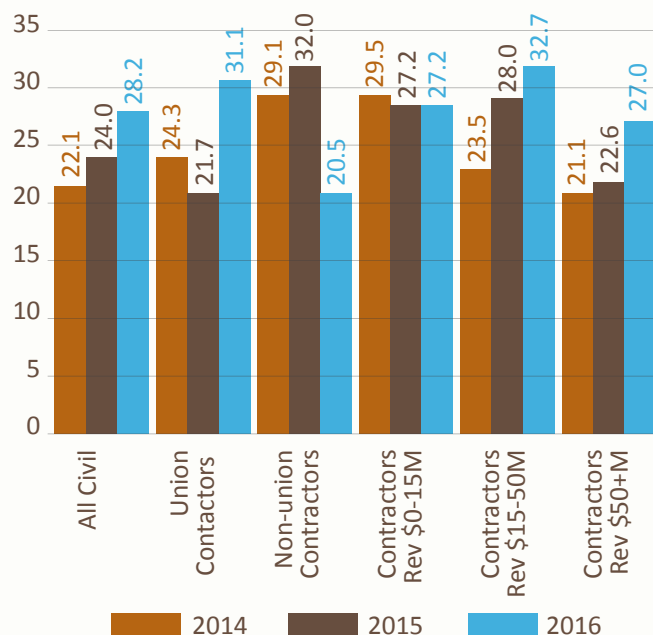
$$\text{Days in Accounts Payable} = \frac{\text{Accounts Payables}}{\text{Total Contract Costs}} \times 360$$

Days in accounts payable calculates the average number of days it takes a company to pay its outstanding debts to trade 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.

Results varied by industry segment in their payables cycles.

Larger union-based companies were able to improve this ratio to combat the increased aging of receivables. Non-union shops paid their payables faster in 2016 than they did in 2015, causing strain on their cash flow. In all industry segments, civil contractors are paying their payables faster than they are being paid by their customers, which puts strains on cash flow and creates the need for short-term financing during the peak construction season.

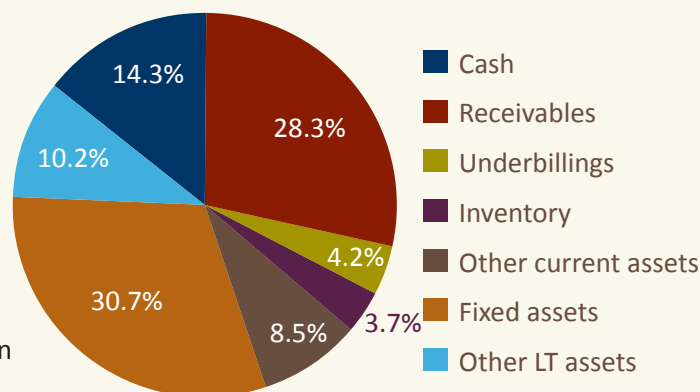


Balance Sheet Compositions

Below is 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.

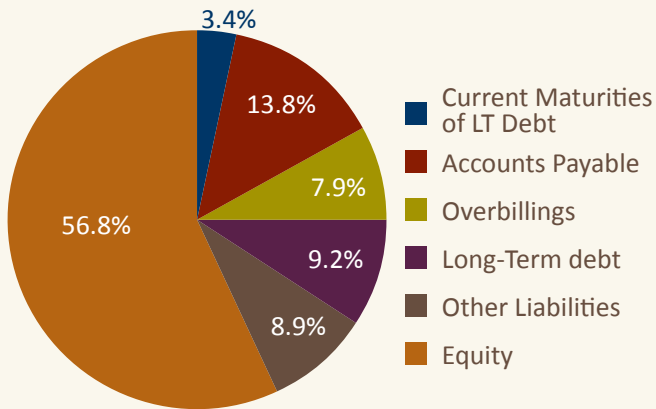
Asset Composition

The asset composition of civil contractors changed significantly in 2016. With the increased cash collection cycle and less investment in equipment, both cash and fixed assets were a smaller component of total assets in 2016. Part of the decrease in fixed assets can be traced to civil contractors' rent-versus-buy decisions on equipment and the use of operating leases. Underbillings, inventory, and other assets have similar composition year over year, and receivables in 2016 were a much greater percent of total assets (28.3 percent) than they were in 2015 (21.8 percent). This may lead to slight decreases in bonding capacity depending on how much receivables are being discounted by sureties. Similar to 2015 though, fixed assets remain the largest portion of total assets in the equipment-intensive civil industry.



It is important to note that a company's asset composition will vary due to location and seasonality of the construction season. Typically, seasonal contractors in the northern part of the United States would see a higher percentage of cash and lower percentage of receivables due to a few months of collections of receivables with minimal billings.

Liability and Equity Composition



Similar to asset composition, a civil contractor's location and seasonality would affect liability and equity composition. Seasonal civil contractors typically have lower accounts payable balances, and civil contractors operating 12 months of the year may have higher amounts of long-term debt.

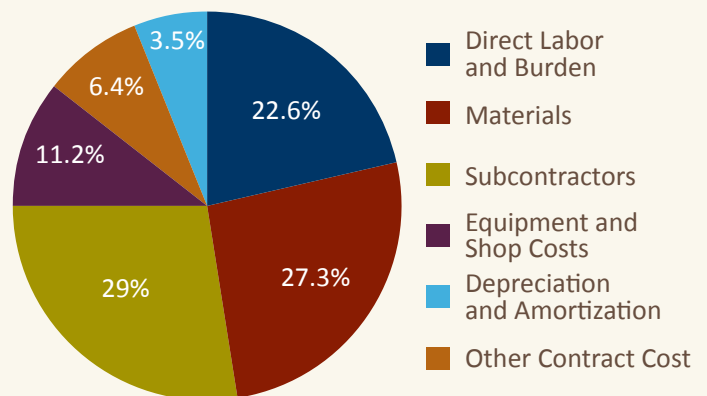
Due to the nature of the civil construction industry, many companies retain significant equity levels to support their equipment fleet, minimize debt financing, and maintain adequate bonding capacity to support their revenue goals.

With decreased investment in equipment in the civil construction industry as a whole and less favorable financing terms, long-term debt as a percent of total liabilities and equity decreased 2.1 percent over 2015. Also, worsening cash collections on receivables drove up accounts payable as a percentage of total liabilities and equity. Equity continues to be the largest component of total liabilities and equity by a significant margin; however, it slipped by 4 percent in 2016 compared to 2015 due to increased distributions to owners. Overall, civil contractors continue to report healthy net worth to finance operations and support bonding capacity.

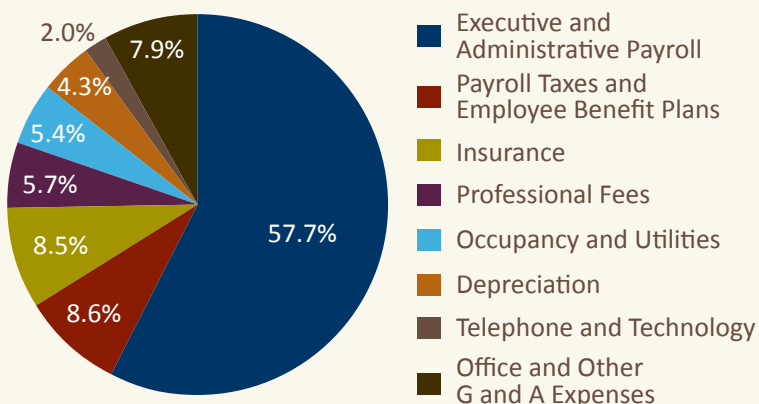
Income Statement Compositions

Cost of Revenue Composition

The chart to the right shows the weighted average composition of direct contract costs compared to total revenue for civil contractors surveyed in 2016. These comparisons vary depending on whether civil contractors self-perform most of their work or subcontracts, and if it self-produces its inventory or purchases it. Seasonality, location, and the company's overall business strategy also influence the composition. Therefore, the composition for a particular civil contractor will depend on operating capabilities, strategies, and the nature of the projects under contract over the reporting period.



General and Administrative Expense Composition



The chart to the left shows the weighted average composition of general and administrative expenses compared to total revenue for civil contractors surveyed in 2016. These comparisons may be different for a company depending upon many factors, including its size, complexity, corporate structure, and culture. A related performance indicator is a company's general and administrative expenses as a percent of its revenues. This provides a gauge of overall overhead expenses relative to how well those costs are generating revenues. This offers insight into a company's cost structure compared to peers.

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	2016	14.1	12.1	18.9	17.6	16.0	13.2
	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	2016	9.1	7.3	13.3	12.5	9.5	8.7
	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	2016	5.4	5.0	6.4	5.5	7.1	4.9
	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	2016	16.4	17.6	14.6	17.2	21.6	14.9
	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	2016	28.9	36.0	11.7	25.0	33.2	27.9
	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	2016	1.9	1.8	2.2	1.8	1.9	1.9
	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	2016	0.8	0.9	0.6	0.9	0.8	0.7
	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	2016	165	158	175	137	117	190
	2015	141	138	150	118	147	141
	2014	146	158	139	133	137	150
Months in Backlog	2016	7.0	7.6	5.1	5.0	5.3	7.8
	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	2016	53.9	56.5	49.2	45.0	71.8	47.1
	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

About CliftonLarsonAllen

CliftonLarsonAllen LLP (CLA) provides business resources. We deliver wealth advisory, outsourcing, audit, tax, and accounting capabilities 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 5000 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 promise is to know you and help you.

Our people

CLA is made up of more than 5,000 professionals, including 600 principals and 1,800 CPAs.

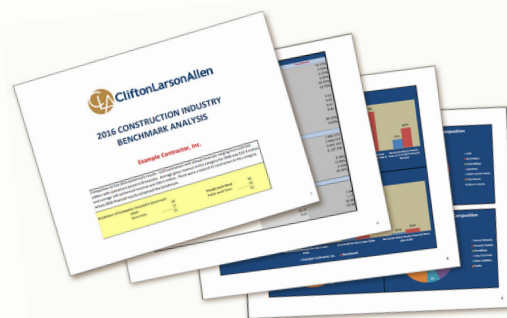
Our construction professionals

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 Mike Prigge, Principal, Construction and Real Estate at mike.prigge@CLAconnect.com or 612-376-4806.

Benchmark analysis

A more detailed comparison of your financial results is available through a CLA benchmark analysis. The 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, public work focus or private work focus, and many other considerations. The information offers understandable comparisons between different sized companies and combines balance sheet and income statement analysis along with a graphic comparison 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 businesses that need further attention. A company's decisions-makers can use the analysis as an ongoing basis for strategic planning, risk mitigation, internal budgeting, and to help define and track financial and operating goals.

For a comprehensive analysis of your financial data compared to the benchmark, contact your local CLA representative or Jon Weston at jon.weston@claconnect.com or by phone at 218-825-2913.

Merger and acquisition, wealth management, and investment planning services are offered through CliftonLarsonAllen Wealth Advisors, LLC, an SEC-registered investment advisor and member FINRA/SIPC.

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