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Insights and Trends:

The 2019 CLA Civil Construction Benchmark Report

EXPLORE THE DATA FROM 173 CIVIL CONTRACTORS, AND DISCOVER HOW YOUR RESULTS COMPARE TO THE PERFORMANCE OF YOUR PEERS.

CLA's construction professionals have compiled data from privately held civil contractors across the United States to create this annual benchmark report. Our goal is to identify trends in the industry, provide relevant and meaningful comparisons, and offer insights into opportunities and challenges in the civil construction industry.

The *2019 Civil Construction Benchmark Report* summarizes data from 173 civil contractors and categorizes them for comparison. 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 companies 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.

Civil Contractors' To-Do List

1. The threat of cyberattack is an everyday possibility in the current age. Is your company's IT system secure? Contact your IT professional for an assessment and defense strategies.
2. Ensure that your general ledger or enterprise resource planning (ERP) system provider is compliant with the new revenue recognition standard that takes effect for December 31, 2019, year-ends.
3. Discuss changing your entity structure or tax accounting method with your tax advisor. Explore the tax implications of the lower C corporation tax rates and increased annual gross receipts threshold of $25 million. However, do not forget the potential financial statement impacts of converting to a C corporation (deferred taxes would be put on your balance sheet).
4. Create opportunities for your people with cutting-edge training programs on the latest construction methods.
5. Put a succession plan in place. Get started now. Good plans can take years to develop and implement.
6. Get involved with your local middle and high schools to promote career opportunities in the civil construction industry to increase the pipeline of future laborers.
7. Contact your tax advisor to discuss how the Wayfair decision will affect your company.
8. Consider investing in an Opportunity Zone for tax deferrals and savings.
9. Analyze your company's balance sheet, and benchmark your overall cash position compared to your peers to see if you have enough cash in reserve for future downturns in the market.

Overview and executive summary

Industry challenges and opportunities

Civil contractors face many complex and unique challenges that are driving change throughout the industry. Those who recognize the impact these changes will have on their business and plan for them will be better positioned to create opportunities in the future.

1. Thankfully, the new revenue recognition standard will not disrupt the construction industry to the extent initially thought. But there will be changes to consider, such as:
    a. Accounting for change orders and claims
    b. Possibly combining activities into one performance obligation
    c. Accounting for upfront costs, waste and inefficiency, and uninstalled materials
2. Many companies are purchasing new equipment to modernize their fleets. Care should be taken to ensure those purchases make sense and the new equipment is being utilized efficiently and effectively.
3. The new lease standard will likely be delayed one more year to December 31, 2021. Combined with increased equipment financing costs, this makes renting equipment possibly more attractive in the next couple of years. Just the same, companies should be proactive in tracking their leases and organizing all the needed documentation to properly implement these changes. Lease accounting may affect a company more than revenue recognition, so early preparation is important.
4. With the political environment split so heavily, funding for needed infrastructure improvements to the United States' roads, bridges, flood management, and other areas is uncertain. The improvements appear to be supported by both sides in Congress, but political differences may cause funding shortages. Contractors should urge their Congressional representatives to fund these important projects, now and in the future.
5. Green and other environmentally friendly production and construction methods are the wave of the future and are not going away. Consider investing or developing these methods to be on the leading edge of this shift. Companies that do this will most likely find themselves better positioned than their peers to engage new contracts. Some of these costs could qualify for the research and development tax credit.
6. With the import and export market affected by changing tariffs, forecasting costs continues to be difficult, and prices may change significantly after bids have gone out.
7. Issues involving skilled labor and the next generation of management continue to be a challenge in the industry. Finding the next generation of workers is paramount to future success. Incentive-based compensation packages for certain labor employees and management may help build depth in organizations. This will create enterprise value for a company by having stable management in place. This should be reviewed as part of transition plans, which should be started much sooner than later.
8. Climate change is impacting jobs. Inclement weather is causing delays and affecting production. Contractors continue to look at more prefabricating in their shop versus job site to help combat delays.

Key ratios and trends

The civil construction industry has had three straight years of strong results. The median gross margin decreased slightly in 2018, but contractors controlled their general and administrative (G and A) costs, which kept pre-tax income as a percent of revenue right in line with 2016 and 2017.

Months in backlog – Industry-wide, months in backlog increased to more than five. This is almost a full month more than the change from 2018 to 2017, and one-and-a-half months greater than the change from 2016.

Working capital levels — Operating results in 2018 did not produce as much working capital as it has the past two years in the industry overall. Working capital turnover decreased for the second year in a row for the civil construction industry as a whole. All categories saw a decrease in working capital levels, except for non-union contractors, who had similar levels compared to 2017, and civil contractors with revenues between $15 million and $75 million, who saw a nice increase in working capital in 2018.

Overview and executive summary

Days in accounts receivable (AR) — Cash collection on receivables improved in 2018 industry-wide, with the average collection of receivables decreasing almost three days, year over year. The largest improvements in receivable collections were in non-union shops and contractors with revenues under $15 million. Large contractors (over $75 million in revenue) went the other direction and increased their days to collect receivables from 40 days in 2017 to almost 50 days in 2018.

Distributions as a percentage of pre-tax income — Distribution percentages industry-wide continued to increase in 2018 compared to 2017 and 2016. The excellent economy has caused owners to diversify their financial risk and get money out of their companies. Small contractors with revenues under $15 million increased their distributions the most, whereas union contractors decreased their returns to owners in 2018 compared to 2017.

Report methodology

Financial ratios and key performance indicators have been computed using information primarily obtained from audited and reviewed financial statements of our construction contractor clients. Participation in the study is voluntary, and data gathered have been analyzed by representatives from our construction industry practice. This report summarizes data from 173 civil construction companies with operations throughout the United States.

Financial ratios and key performance indicators

Analysis of financial ratios and key performance indicators can assist in the assessment of 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 and understand 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 and routinely monitoring key financial and operational indicators can assist management in improving profitability and managing operations, providing key information for developing competitive bids, and maintaining 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 either very little or significant 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 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 along with a company's historical financial results.

Ratio analysis and key performance indicators

The following graphs present median results for each key performance indicator (KPI). The median values for each KPI were computed independently and represent the mid-point of each data set. Since median calculations are being used, mathematical relationships do not always exist between the various KPIs included in this report.

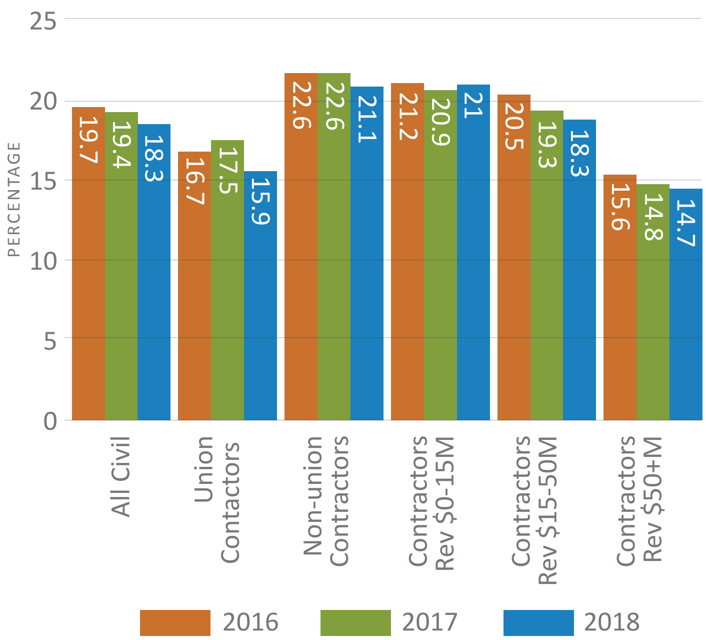
Margin on Self-Performed Revenue

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

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

Subcontractor expenses 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 relatively consistent or moderately lower margin on self-performed work when compared to 2017. The only segment that saw an increase (up 0.1%) in this ratio was companies with revenues ranging from $0 to $15 million. Many civil contractors have indicated an overall drop in self-performed gross margin for 2018.



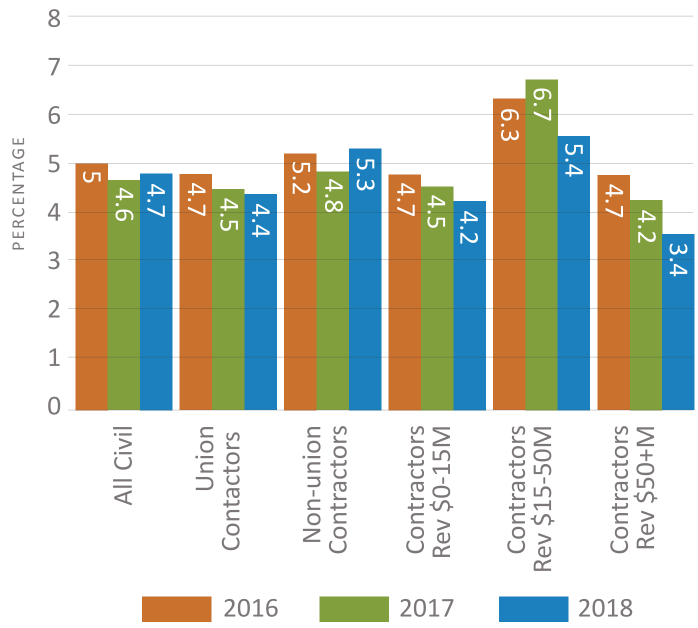
Ratio analysis and key performance indicators

Pre-Tax Income as a Percentage of Revenue

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

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. While changes in this ratio are mixed when comparing 2018 to 2017, the overall industry trend is that the ratio has continued to be less, relative to 2016. Large factors contributing to this trend are the increase in competition and increased labor costs due to higher demand in the industry.

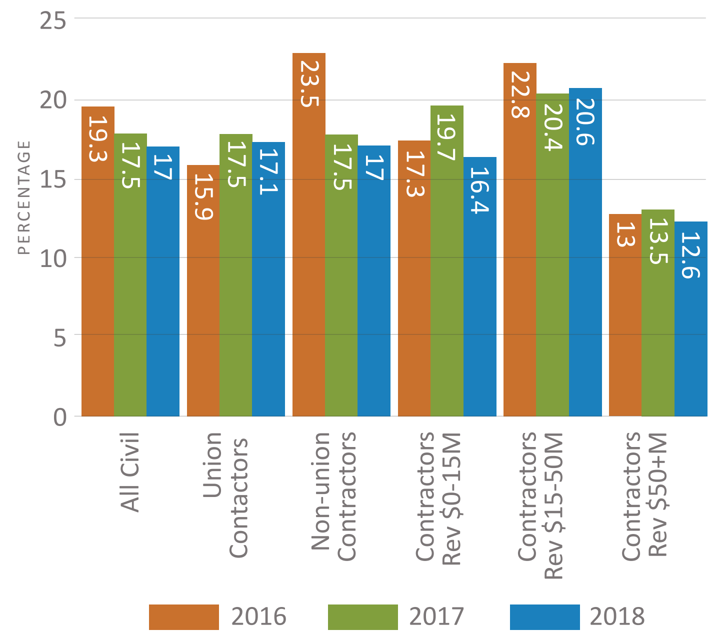


Pre-Tax Return on Equity

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

This ratio measures the rate of return on owners' capital invested or retained in the business. To 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 indicates that the company is using its owners' funds effectively.

Most industry segments experienced a slightly lower pre-tax return on equity when compared to 2017. The only companies experiencing an increase in this ratio were those with revenues ranging from $15 million to $75 million, up 0.2%. The decrease is largely due to companies retaining more equity to help elevate the need to take on debt while minimizing interest costs, along with slower operating results in 2018 when compared to 2017.



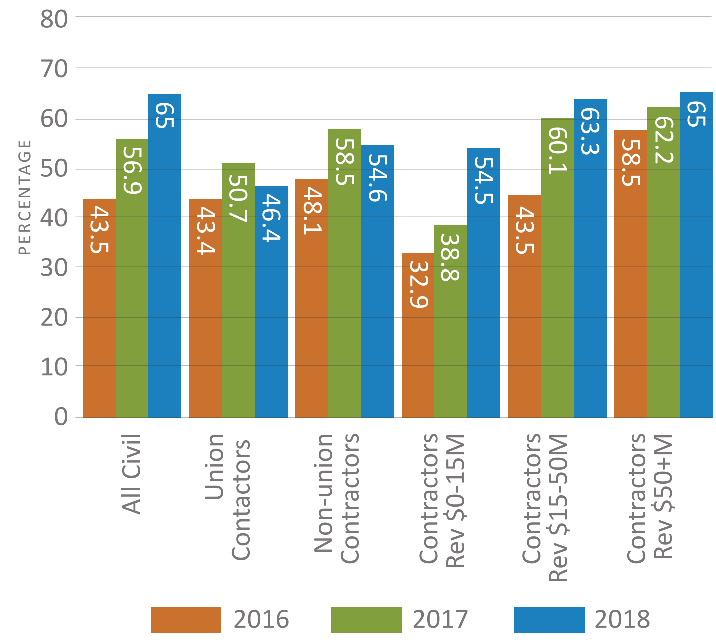
Distributions as a Percentage of Pre-Tax Income

$$\text{Distributions as a Percentage of Pre-Tax Income} = \frac{\text{Distributions}}{\text{Pre-Tax Income}}$$

(pass-through entities only)

This ratio has been calculated for pass-through entities (S corporations and partnerships) only and measures the portion of a company's earnings that are paid out to the owners as equity distributions. Distribution payments generally include amounts paid to owners as reimbursement for taxes paid at the individual level on company earnings, along with payments made to the owners as a return on their equity investment.

The median distribution percentages industry-wide continue to rise from 2017 to 2018, largely because of lower operating results but also because owners are diversifying risk by pulling resources out of their companies and investing in other mediums.

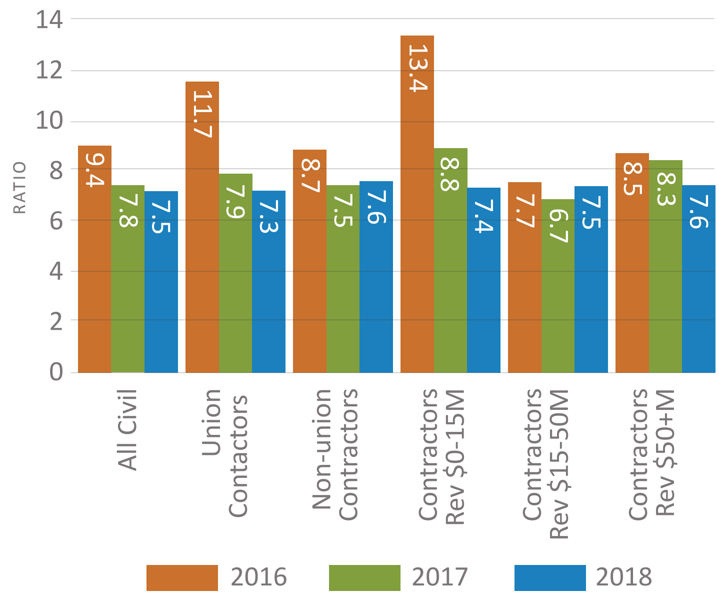


Working Capital Turnover

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

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 the business does not have enough capital to support its revenue goals. Sureties and lending institutions often look at working capital as one of the most important metrics in their credit-granting decisions.

Higher working capital levels can be a positive for companies looking to increase bonding capacity to support planned growth. For companies with an adequate working capital base, higher levels may not be needed, and investing those dollars into other aspects of the operation may provide a better return to the business.

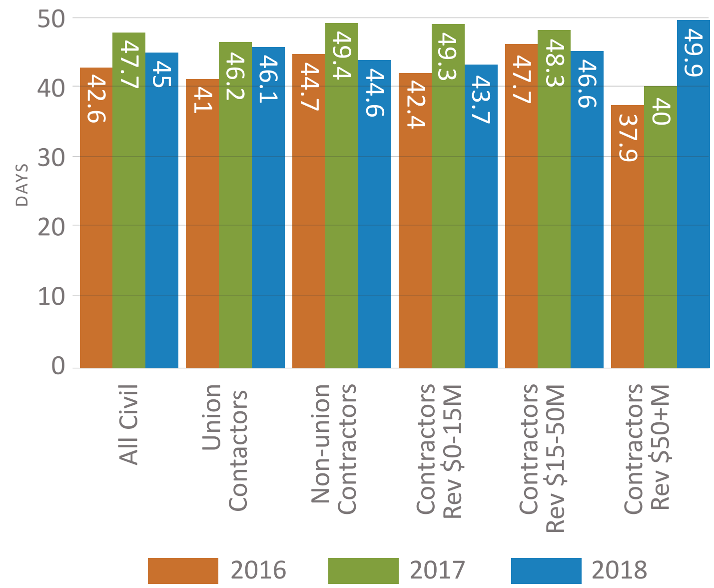


Days in Accounts Receivable

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

Days in accounts receivable (AR) calculates the average number of days that receivables are outstanding or how quickly a contractor converts its receivables (excluding retainage) to cash. Fewer days in AR are desirable because this suggests a company can quickly convert its receivables to cash.

Most industry segments experienced a decrease in their average collections. However, companies with revenues greater than $75 million saw a significant increase in their collection cycles. A contractor's primary customer base has a significant impact in this calculation, as those primarily working with public agencies reported an average number of days in AR of 43.8, compared to 49.7 for contractors working primarily with private enterprises. All contractors within the industry are collecting at an acceptable rate as, generally speaking, anything under 60 days is considered respectable.



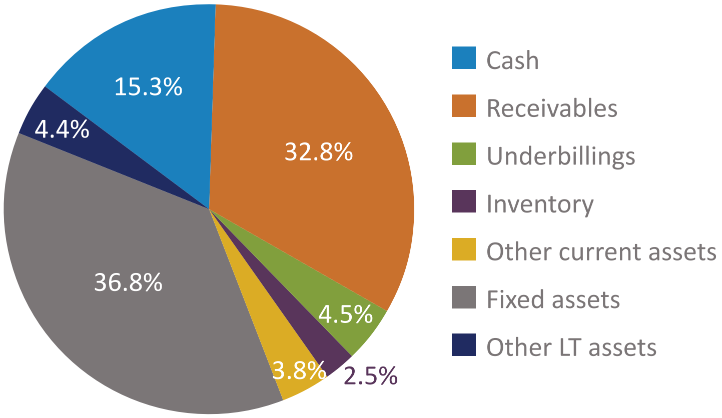
Balance Sheet Compositions

Below is the average composition of the balance sheets and income statements of all the survey participants. Companies can use this information to assess their overall financial position and the mix of costs impacting their operating results.

Asset Composition

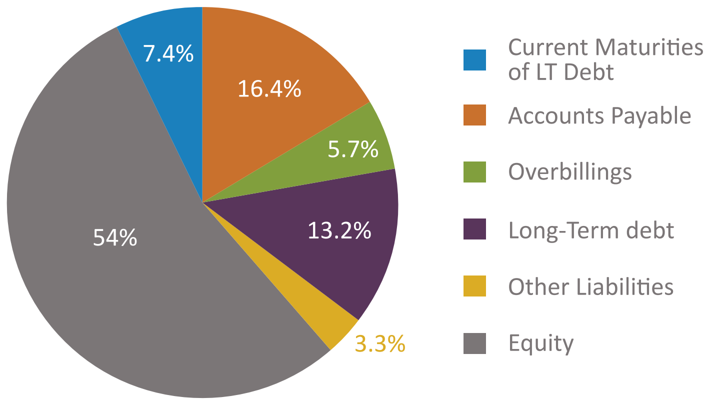
Companies continue to have very strong balance sheets from a liquidity standpoint, and there were no notable changes in percentages when compared to 2017.

It is also worth noting that a company's asset composition may vary due to location and length of the construction season. Seasonal civil contractors on a calendar year-end in northern regions of the United States may see a higher percentage of cash and lower percentage of receivables due to the winding down of their construction season and lower billing levels before the end of their year.



Liability and Equity Composition

Similar to asset composition, a civil contractor's location and seasonality could impact the breakdown of its liability and equity composition. Seasonal civil contractors on a calendar year-end typically see lower accounts payable balances compared to levels that would be present during the middle of their operating season.

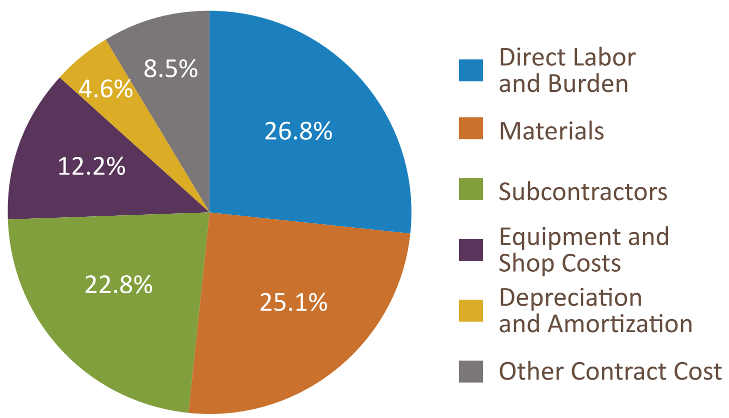


With lower operating results and increased equity distributions in 2018, equity as a total piece of the pie has decreased compared to 2017. Equity levels continue to be very strong in the industry, however, as companies continue to retain significant equity levels to invest in their equipment fleets, minimize their debt financing, and maintain adequate bonding capacity to support their revenue and growth goals.

Income Statement Compositions

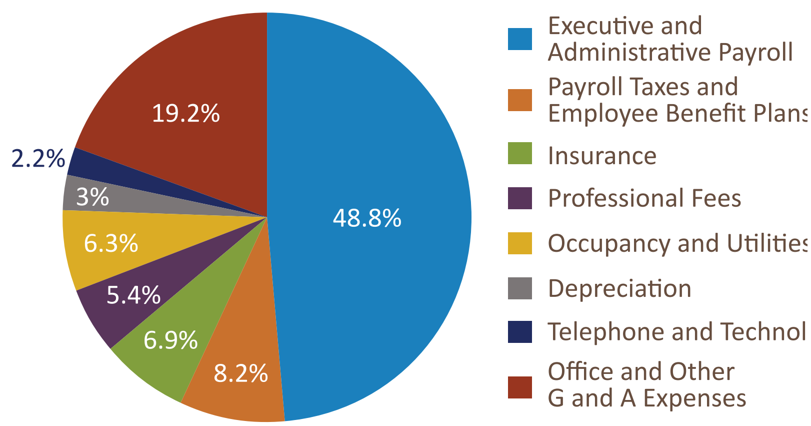
Cost of Revenue Composition

The chart above shows the average composition percentages for direct and indirect contract costs. The mix of these costs can vary based on the amount of work a company self-performs during the year. In addition, business strategy, expertise, and regional differences may impact these percentages. 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 above shows the average composition percentages for general and administrative expenses. These comparisons may be different for each company based on a number of different 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 a company's overall overhead expenses relative to how well those costs are contributing to generating revenues. This may offer additional insight into a company's cost structure compared to its peers.



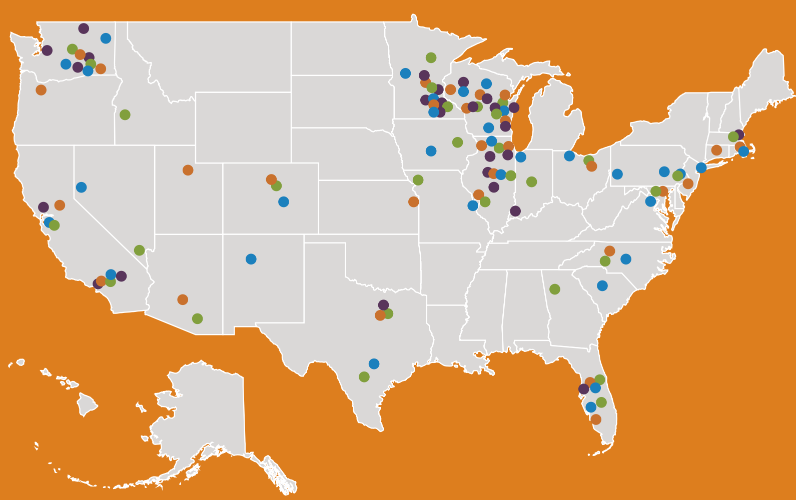
Additional Key Performance Indicators

Below are some additional key performance indicators that we believe will be helpful in assessing a company's overall financial health and performance. The ratios presented represent the median (mid-point) for each year and category.

		All Civil	Union Contractors	Non-Union Contractors	Contractors $0-15M	Contractors $15-50M	Contractors $50+M
Gross Profit Percentage	**2018**	**15.1%**	**12.4%**	**17.1%**	**17.8%**	**13.6%**	**10.3%**
	2017	16.0%	13.5%	19.1%	17.6%	16.0%	11.5%
	2016	15.3%	13.6%	17.9%	16.1%	16.1%	11.4%
General and Administrative Expense as a Percentage of Revenue	**2018**	**8.8%**	**7.8%**	**12.3%**	**12.8%**	**7.8%**	**7.5%**
	2017	9.3%	7.4%	12.2%	11.9%	8.4%	6.9%
	2016	9.2%	7.6%	11.5%	10.9%	9.3%	7.0%
Earnings Before Interest and Taxes as a Percentage of Revenue	**2018**	**4.9%**	**4.6%**	**6.0%**	**5.1%**	**5.7%**	**3.4%**
	2017	4.9%	4.7%	5.5%	4.6%	7.4%	4.1%
	2016	5.3%	4.9%	5.9%	4.6%	7.1%	4.7%
Days in Cash	**2018**	**23.2**	**29.8**	**18.9**	**22.6**	**23.1**	**29.2**
	2017	21.7	26.7	13.2	13.8	25.7	29.2
	2016	15.1	21.1	14.6	14.6	13.7	22.5
Current Ratio	**2018**	**2.0**	**1.9**	**2.3**	**2.3**	**2.0**	**1.7**
	2017	2.0	1.8	2.1	1.8	2.0	1.5
	2016	1.7	1.6	1.8	1.4	2.0	1.6
Days in Accounts Payable	**2018**	**20.4**	**25.1**	**16.1**	**16.2**	**23.7**	**34.0**
	2017	23.1	28.5	14.3	17.0	24.7	33.8
	2016	23.2	24.4	17.8	22.5	23.7	23.6
Debt to Equity	**2018**	**0.7**	**0.9**	**0.6**	**0.6**	**0.8**	**0.8**
	2017	0.8	0.9	0.6	0.8	0.8	1.1
	2016	0.8	0.8	0.7	1.1	0.7	0.8
Equipment Purchases as a Percentage of Depreciation Expense	**2018**	**114%**	**131%**	**109%**	**110%**	**103%**	**171%**
	2017	127%	143%	110%	133%	96%	181%
	2016	119%	126%	106%	162%	88%	172%
Months in Backlog	**2018**	**5.2**	**6.3**	**4.0**	**4.6**	**5.6**	**6.5**
	2017	4.3	4.8	3.4	3.1	3.9	6.3
	2016	3.7	4.2	2.4	2.4	3.4	6.9
Distributions as a Percentage of Pre-Tax Income	**2018**	**65%**	**46.4%**	**54.6%**	**54.5%**	**63.3%**	**65.0%**
	2017	56.9%	50.7%	58.5%	38.8%	60.1%	62.2%
	2016	43.5%	43.4%	48.1%	32.9%	43.5%	58.5%

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).

CLA has been recognized as the number one ranking construction accounting firm in the United States by *Construction Executive*. The list recognizes top independent construction accounting firms from across the nation.

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 customizable factors, including geographic operating region, entity structure, company size, union or non-union labor force, and public or private work focus. 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 and the insights generated through discussion of the results have assisted many civil contractors on a wide range of topics, including:

- Spending variances and cost savings in compensation, telecommunication costs, and insurance
- Tax credit opportunities
- Opportunities to improve return on investment and working capital through balance sheet restructuring
- Development of a financial framework for strategic or succession planning

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

Services for civil contractors

As a professional services firm, CLA provides a variety of services that can benefit the owners and management of privately-held civil contractors.

- Audit, assurance, and advisory services
- Benchmarking and market trend analysis
- Business valuations
- Development of equipment cost pools and overhead rates for public or private bidding
- Employee benefit plan audit, tax, and consulting
- Federal Acquisition Regulation (FAR) compliance
- Federal, state, local, and specialized tax planning and compliance
- IT and operational consulting including equipment profitability analysis and change order management
- Strategic ownership and management succession planning
- Telecom management services

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*