CliftonLarsonAllen

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The 2017 CLA Construction Benchmark Report

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CliftonLarsonAllen construction professionals have compiled financial data from our clients in the industry across the United States. The goal of this effort is to provide insight and answers to the financial and operational questions construction company owners and managers always seem to have on their minds, such as:

- What kind of return should I expect from my equity investment in the company?
- How can a company that is smaller than ours be more profitable?
- How do my competitors continue to win work at lower prices and stay profitable?
- How do we restructure our company's balance sheet to increase our bonding capacity?
- How does our general and administrative spending compare to other companies?

A strong benchmark analysis of financial data can help you get solid, relevant answers to these and other questions.

The 2017 CLA Construction Benchmark Report summarizes data from 377 construction companies with operations throughout the United States. Drawing on data from their financial information, this report provides 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

- Become the employer of choice and thus be more effective in recruiting and retaining the next generation of managers and employees.
- Be open to investments in technology and automation enhancements such as drones, GPS, robotics, autonomous equipment, and software technologies. Understand them as possible solutions to improve efficiency and offset labor shortages.
- Create a flexible long-range plan for management and key employee succession.
- Consult with your tax advisor on potential tax incentives including:
  - -Research and development credits
  - -Work opportunity tax credits
  - -Fuel tax credits and energy efficiency incentives
- Review your tax accounting methods for optimization.
- Budget for investment in information security solutions and employee awareness development to reduce vulnerabilities and enhance controls.
- Summarize your company's off-balance sheet leasing arrangements that will come onto the balance sheet in 2020 under the new lease accounting standard. Consult with your bank and financing partners to understand the impacts on your financing arrangements, underwriting formulas, and debt covenants.
- Consult with your CPA to understand the new definitions for revenue recognition under the updated accounting standard effective in 2019.

Overview and executive summary

Industry challenges and opportunities

Several issues are currently at work in the construction industry:

1. Demographics and a negative perception of the construction industry have led to labor shortages. According to AGC's 2017 Workforce Survey, 70 percent of the 1,608 respondents noted they were having a difficult time filling hourly craft positions. The demand for labor has resulted in higher labor costs in many parts of the industry as contractors have had to offer higher wages to attract talent. In addition, with many job openings unfilled, contractors may hire those will less skill, leading to an increased need for supervision and overtime to keep construction schedules on track and mitigate profit fade.
2. Technology advances, such as automation equipment, provide an opportunity for contractors to capitalize on efficiencies and offset labor shortages. The application of technology to improve communication between the field and office is a chance to identify risk of profit fade and apply countermeasures more effectively.
3. Many organizations are waiting too long to implement strategies for management and ownership succession. Knowledge and skill transfer threatens to become a critical issue due to the large number of employees at or near retirement age . In addition, few younger employees are entering the industry, and a lack of dedicated employee leadership development programs is compounding the problem.
4. Cybercriminals are threatening contractors of all sizes by targeting sensitive data through ransomware and online banking attacks. Many companies are not adequately investing in security.

Key trends

Gross profit — 2016 gross profit margins decreased slightly from 2015 for all sub-industries except electrical and mechanical, which reported a healthy increase from 16.6 percent in 2015 to 18.9 percent in 2016. Despite declines in three of the four sub-industry groups, margins remained relatively strong compared to long-term historical averages.

Return on equity — The weighted average pre-tax return on equity remained very strong for all sub-industries in 2016. The lowest percentage belonged to the civil group with average return of 16.4percent. The slight drop in gross profit experienced by the general building and other specialty categories was offset by lower general and administrative expenses as a percentage of revenue, resulting in a rise in return on equity compared to 2015.

Distributions as a percentage of pre-tax income — Distribution percentages remained high, with all sub-industries reporting percentages in excess of 50 percent of pre-tax income. Many business owners are choosing to increase distributions beyond their pass-through tax liability in order to diversify risk and establish personal liquidity outside of the business.

Report methodology

Financial ratios and key performance indicators have been computed using data obtained primarily from our construction contractor clients' audited and reviewed financial statements. Participation in the study was voluntary, and information gathered has been analyzed by representatives from our construction industry practice. This report summarizes data from 377 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 96 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 119 companies in this category participated in the report.

Electrical and mechanical — Information from 77 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 85 companies are included in the report's other specialty category.

Financial ratios and key performance indicators

Analysis of financial ratios and key performance indicators can help you assess your business's financial health, operating efficiency, and profitability. Understanding how your company's performance compares to similar organizations can lead to operational changes that may improve both profitability and efficiency.

Consistently monitoring key financial and operational indicators can help your company 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 analyses of a contractor's operations.

Ultimately, no single ratio or financial analysis should be evaluated on its own to assess your financial condition. Variances from benchmarks should be investigated and considered in the context of your 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 and your company's own financial trend information.

Ratio analysis and key performance indicators

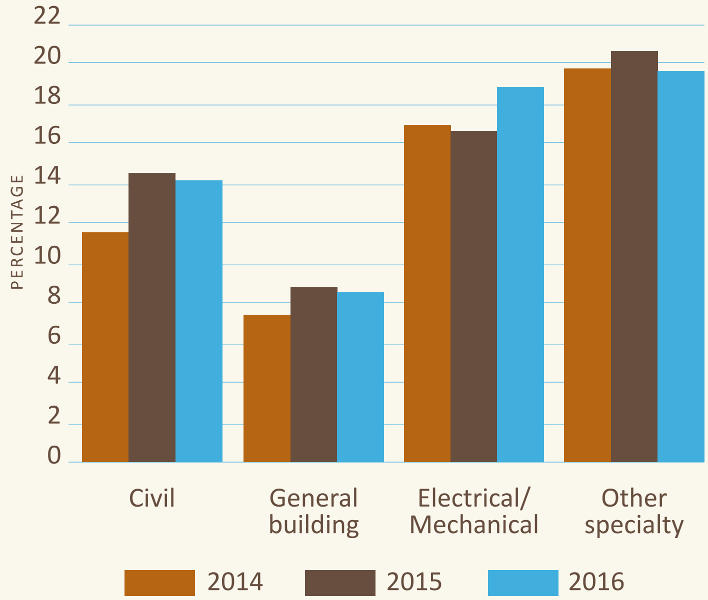
The following graphs present weighted average data for each sub-industry. The weighted averages result from the summation of all participants' financial data before calculating the particular ratio. For example, gross profit as a percent of revenue is arrived at by taking the sum of gross profit dollars for all companies and dividing by the sum of construction revenue for all companies.

Gross Profit Percentage

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

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.

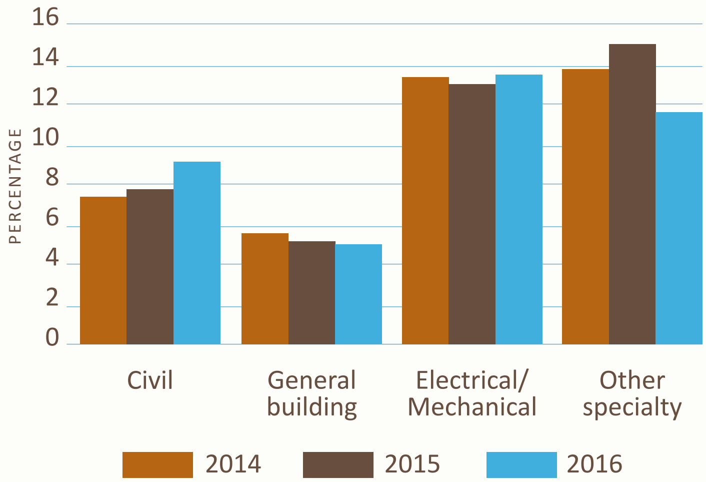


General and Administrative (G and A) Expense as a Percentage of Revenue

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

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 generally viewed as more fixed. Reducing G and A expenses as a percent of revenue can offer a company a competitive advantage over its peers.

Certain expenditures are more subject to discretion by management, including executive compensation, bonuses, benefit plan contributions, and charitable donations. These costs are often the distinguishing factor in G and A expense percentage differences among organizations.

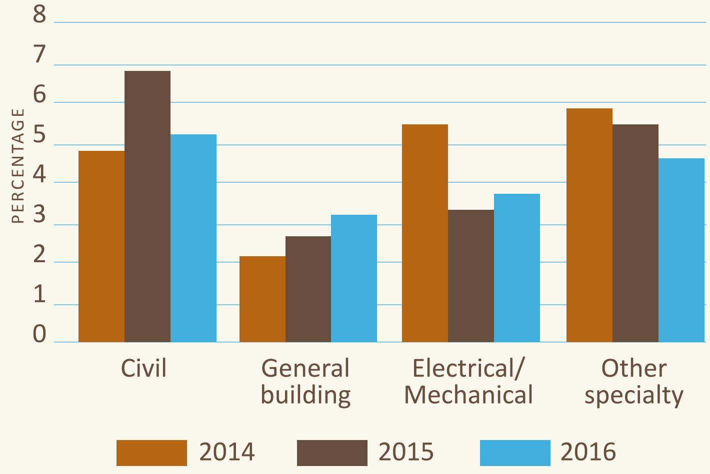


Pre-Tax Income as a Percentage of Revenue

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

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

The higher the percentage, the more return can be provided to owners or re-invested into the business.

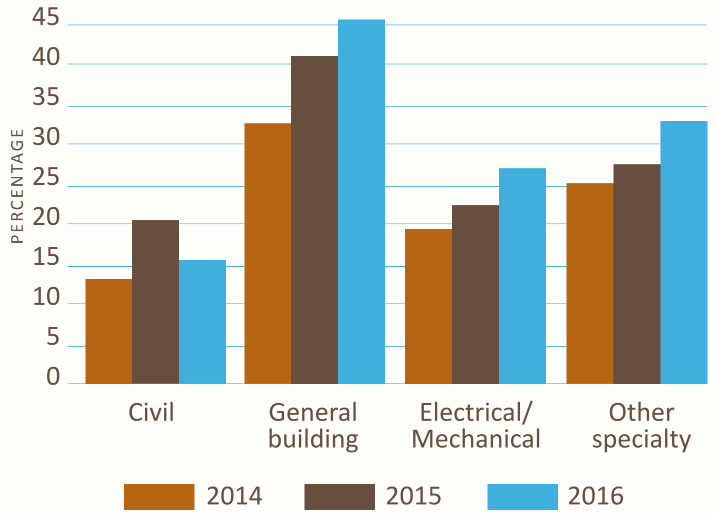


Pre-Tax Return on Equity

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

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 it 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.

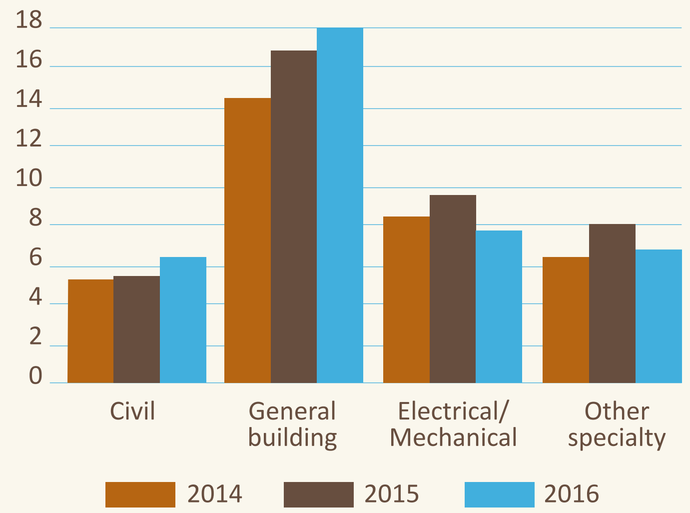


Working Capital Turnover

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

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

The higher the ratio, the more efficient a company is in using capital to generate revenue. However, a very high working capital turnover 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.

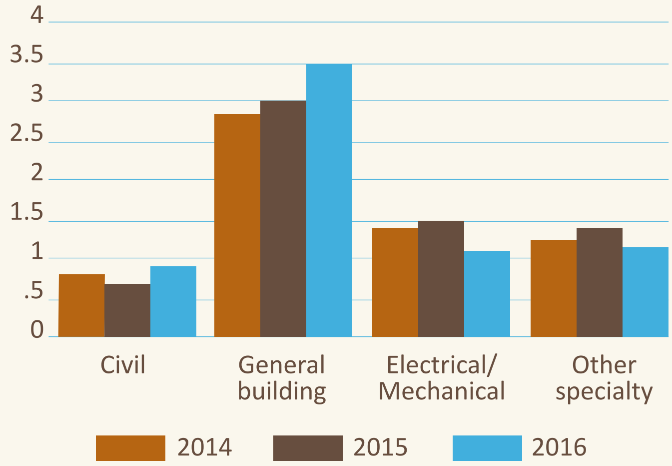


Debt to Equity Ratio

$$\textbf{Debt to Equity Ratio} = \frac{\textbf{Total Liabilites}}{\textbf{Equity}}$$

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, so there are significant differences among the sub-industries.

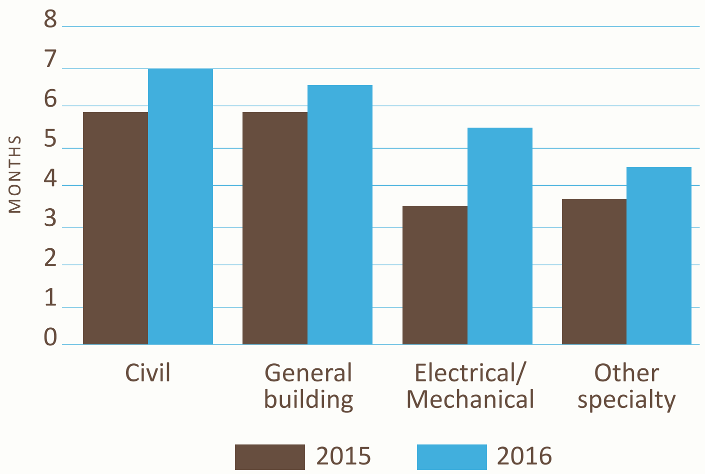


Months in Backlog

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

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.



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 decisions-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 CliftonLarsonAllen

CLA is a professional services firm delivering integrated wealth advisory, outsourcing, and public accounting capabilities to help enhance our clients' enterprise value and assist them in growing and managing their related personal assets — all the way from startup to succession and beyond. Our professionals are immersed in the industries they serve and have deep knowledge of their operating and regulatory environments. With more than 5,000 people, more than 100 U.S. locations, and a global affiliation, we bring a wide array of services to help clients in all markets, foreign and domestic. For more information visit CLAconnect.com. Investment advisory services are offered through CliftonLarsonAllen Wealth Advisors, LLC, an SEC-registered investment advisor.

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 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.

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