

Contractor Planning for Uncertain Times

TRAVELERS 

Tuesday, April 7, 2020
Webinar

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Disclaimer

This material is for general informational purposes only and is not legal advice. It is not designed to be comprehensive and it may not apply to your particular facts and circumstances. Consult as needed with your own attorney or adviser.

Unless otherwise specified, the figures and statistics contained herein are produced by FBI using data compiled from FBI's Performance Roundtable Program.

FBI Construction Recession Planning

What You'll Learn

1. Immediate preparations to position for a downturn
2. How to judge your current capital strength
3. How to assess your future work prospects
4. Best practices for leading through tough times
5. Options, plusses, and minuses for critical decisions
6. How to assess trends, plan ahead, and make adjustments

Critical Actions for All Contractors

1. Lead strong
2. Develop strategies to preserve and build cash
3. Stress test performance – cash flow AND profit
4. Evaluate your organization, talent, and structure
5. Stay close to your clients and customers; this is an opportunity to be a trusted advisor!

Critical Actions for All Contractors

6. Evaluate and manage your trade partner networks
7. Assess your financial and market positions
8. Develop short and long term strategies based on your positions
9. Make necessary decisions and take action!

Leadership Musts

1. Communicate more, not less – be calm and reassuring
2. Create a positive vision for the future
3. Get more personal. Be visible and accessible
 - Visit every job
 - Touch the “four corners” every day
 - Talk to every employee

Leadership Musts

4. You don't need to have all the answers – your heart and vision will paint the way
5. Staying in business is vital – you cannot help yourself, your employees, or contribute to the general recovery if you don't ensure your business viability

“Construction is a tough business for tough people who make tough decisions.”

Bundy Bundesman, The Family Business Institute

Leadership Musts: Instill Confidence as You Face and Make Difficult Decisions

THE STOCKDALE PARADOX

Retain faith that you will prevail in the end regardless of the difficulties.

Confront the most brutal facts of your current reality whatever they might be.

AND at the same time

Focus Your Leadership: Preserve Cash Position

1. Cash is King

- a. Ensure your lines of credit are secure. Consider drawing down on your credit lines while they are available
- b. Spread your money out among financial institutions for FDIC coverage
- c. Assess your investment strategies for liquidity and bonding capacity purposes
- d. Work your receivables, get your billings done in a timely manner, and follow the process

Focus Your Leadership: Preserve Cash Position

1. Cash is King

- continued -

- e. Stop early pay programs and slow payables (within acceptable range) to keep more A/P cash
- f. Overbill as you are able and monitor incoming overbillings closely to protect risk of sub failures
- g. Delay capital expenditures, major renovations, and repairs as prudent

Focus Your Leadership: Revisit Your Forecast

1. Forecast your next six, 12, and 24 months

- a. Evaluate contract backlog: What projects might slow or terminate? Consider owner's sources of funding
- b. Examine awarded work not yet contracted and apply same considerations
- c. Revisit your business development pipeline. Give consideration to:
 - Sector and how it has been impacted
 - Impacts on start dates
 - Re-evaluate margin potential. Downturns typically shift leverage to construction buyers

Focus Your Leadership: Revisit Your Forecast

2. **Develop a baseline of Operating Project Profit Contribution over the cycle. Stress test it with worst case scenario**
 - a. **Baseline:** your most likely scenario. Adjust your business model to this case with clear actions to take should the case worsen
 - b. **Worst Case:** assumes longer downturn, broader economic impacts across sectors, margin squeeze, and potential supply chain disruption
 - c. **Best Case:** adjust your business for the baseline and create actions to adjust for worst case. Hope for the best is NOT a viable strategy

Focus Leadership: Adjust Your Cost Structure

1. 70%+ of overhead is generally tied up in people (more on that later). Reducing minor office expenses generally won't have a big impact
2. Tune up your overhead budget quantifying your fixed vs. your variable costs
3. Eliminate low value added discretionary spending (e.g. club memberships, season tickets, etc.) or shift to personal account
4. After a long running expansion, overhead budgets are usually full of non-critical spending. Make the hard decisions to do without the things that aren't adding value

Focus Leadership: Adjust Your Cost Structure

5. **Maintain a long-term mindset and focus. Continue to invest in the things that are critical to continued success and differentiation:**
 - a. Talent development
 - b. Best in class processes
 - c. Strategic partnerships and time tested advisory relationships

Focus Leadership: Organization and People

1. **70%+ of most construction overhead is in people cost**
2. **Evaluate your org chart: current, baseline, and worst case**
 - a. This requires thought – it's not x% in each department
 - b. Think about how your approach to selling, pricing, and executing work may need to adapt and adjust your people resources accordingly

Focus Leadership: Organization and People

3. Take action: Cuts don't become easier!

- a. Take immediate steps to adjust to baseline scenario. DON'T DO it incrementally hoping "things will get better." Reductions can become "death by a thousand cuts" destroying morale and culture

4. Make reductions with care and respect. Preserve the opportunity to rehire good talent

Focus Leadership: Organization and People

5. Reducing headcount is generally better than reducing employee pay or benefits. Pay and benefit cuts tend to reduce morale and, therefore, productivity
 - a. If there are cuts, leaders should take the first and biggest hits – this is what leaders do!
 - b. Discretionary and profit sharing bonuses can be suspended
 - c. Raises are not expected and can be delayed except where a key person deserves something to recognize exceptional performance

Strategy Depends on your Individual Situation

- The direct and indirect effects of the pandemic and the economic uncertainty will be different in each region, market, and each individual business. The short term impact on companies runs from “business as usual” to “everything is shut down, and there is no end in sight.” Business impacts will vary widely and require different reactions and strategies

Strategy Depends on your Individual Situation

- Additionally, each company entered the current crisis in different condition. Some, probably most, were in good financial shape which gives more options in how to approach their short term action plans and long term strategies. Others enter this period with only moderate to weak balance sheets and work prospects

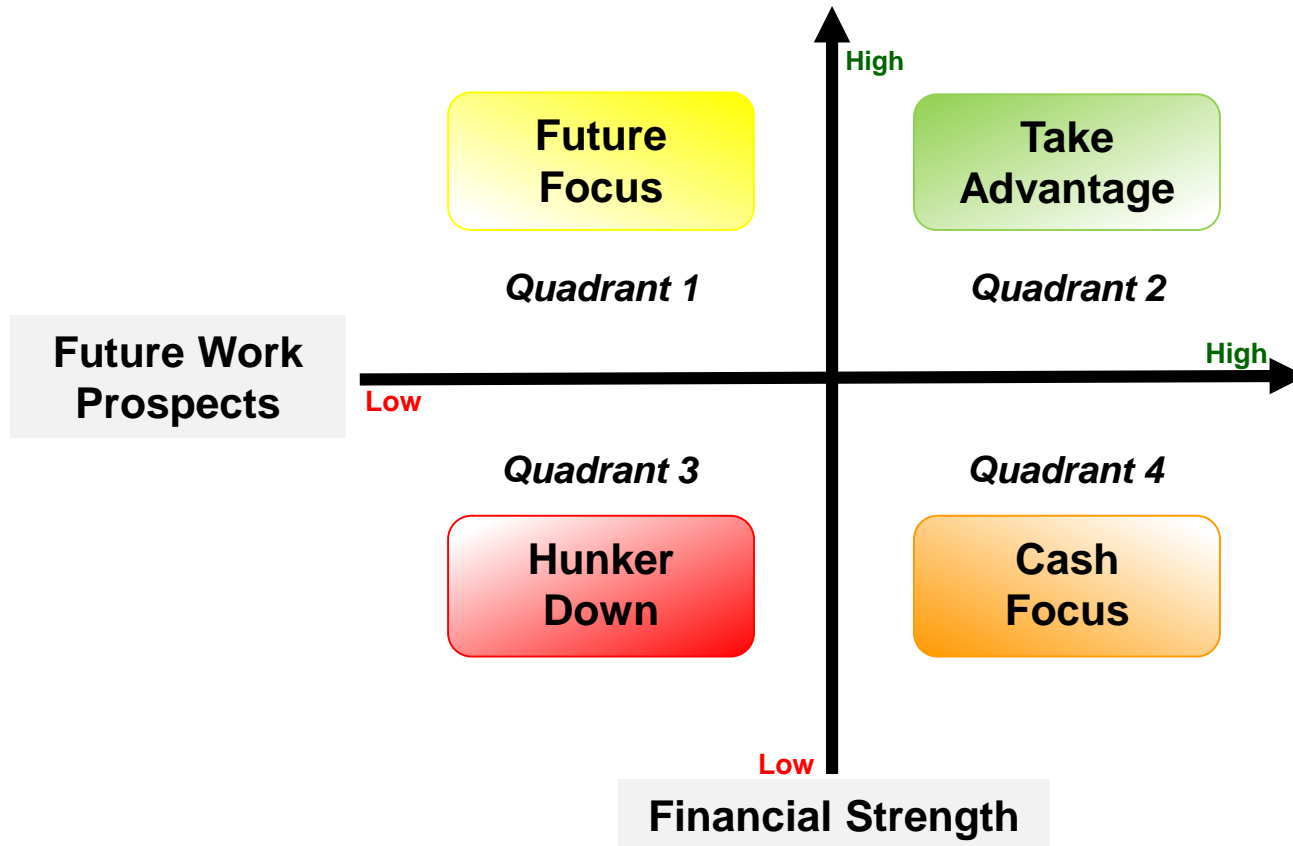
On the following pages, we will help you assess your situation and capabilities. You can use this assessment to help you develop the right strategies to fit your company's market

Assessing Your Situation

Two Scales:

1. **Financial Strength**
2. **Strength of Future Work Prospects**

Assessing Your Situation



Assessing Your Situation

Financial Strength Scale

- A. **Capitalization:** Lower multiples indicate a stronger balance sheet typified by sufficient equity. Range reflects Upper to Lower Quartile. The following figures are for Commercial & Institutional Contractors only, These standards vary for each trade.

Capitalization	Median	Range
1. Revenue to Equity:	12.5	(8 to 20)
2. Revenue to Working Capital:	15.1	(8 to 39)
3. Debt to Equity:	2.3	(1 to 5)
4. Sales to Assets:	3.0	(2 to 4)

Source: RMA Statement Studies, <https://www.rmahq.org/annual-statement-studies/>

Assessing Your Situation

Financial Strength Scale

- B. Financial Performance:** Higher percentages indicate ability to maintain strong balance sheet and cash flow through operations

Financial Performance	Median	Range
5. Operating Profit:	4.4%	(7% to 1%)
6. % Cash and Equivalents:	22.5%	(36% to 17%)

Grade each one: Strong on all six metrics scores high on the financial strength axis. Four is better than average. If strong on only one or two, that indicates the lower end of the scale

Source: RMA Statement Studies, <https://www.rmahq.org/annual-statement-studies/>

Assessing Your Situation

Strength of Future Work Prospects Scale

- A. Future Work Prospects. These are more subjective measures, but be realistic in your assessment**
1. Revenue (next three months) projected to run at or above last year's rate
 2. Total backlog at or above historical revenue coverage rate
 3. Sales pipeline of work at or near prior year level after considering impacts of economic slowdown
 4. Industry – the sectors and markets where you work remain solid and do not project any material reduction in capital spending

Assessing Your Situation

Strength of Future Work Prospects Scale

5. Local and regional viability – geographic (local and regional) economies remain reasonably strong versus experiencing significant negative impacts
6. Margin pressure – assess the extent you anticipate margins on new work to be impacted. More than a 1 - 2% point reduction would be deemed a negative impact

Like the Financial Strength test, use the scores to determine where you fall on the axis. The majority of factors positive puts you on the strong end of the axis and vice-versa

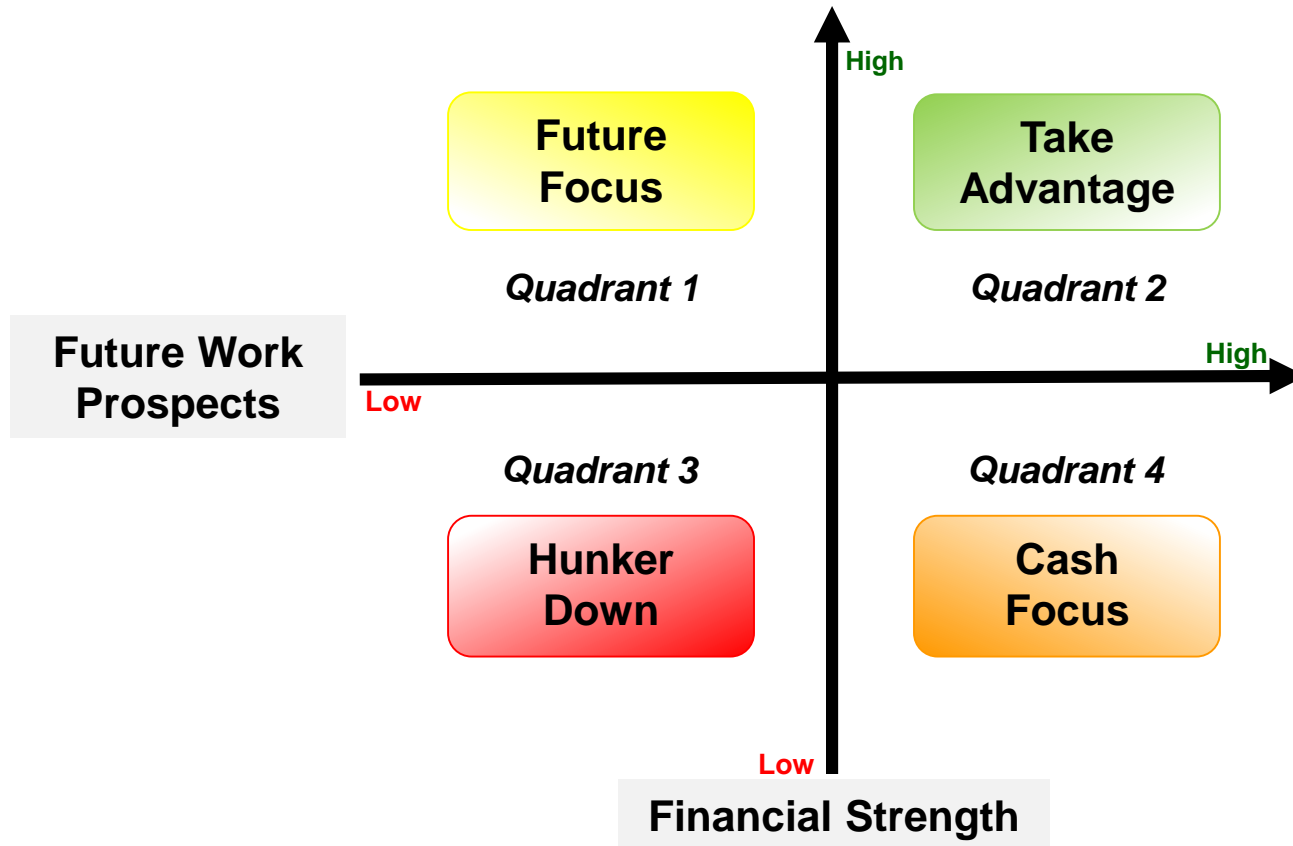
Example Companies

	Company A GC w/35% Self Perform	Company B GC w/minimal Self Perform
Capital Position:	Very strong capital position @ 17% of revenue. Cash position strong @ 13 months of overhead	Middling capital position @ 6% of revenue. Cash position also middling at 6 months of overhead. Good credit line facility @ additional 9 months
Backlog:	Good backlog, up 15% from recent norms. GM in backlog is at top of market pricing. Largely govt. and health care focus	Backlog great @ 140% of last year's revenue, but vulnerable with high mix of hospitality and industrial. Projected gross margins are OK, but lost some in performance last year
Projects:	Project losing about 10% of 2020 revenue due to project cancellation or delay. Minimal lost time/revenue due to pandemic	Expect as much as 50% fallout of projects not yet started
Break even:	Break even is @ 70% of last year's revenue	Break even is 80% of last year's revenue
People:	Company was close to right-sized in past year, possibly a key body or two short	Company was a bit short on experienced talent and the inexperience cost some profit
Primary Strategy:	Take Advantage (Quad 2)	Cash Focus (Quad 4)
Secondary Strategy:	Future Focus (Quad 1)	Hunker Down (Quad 3)

Example Companies

	Company C - Mason	Company D - Mechanical Contractor
Capital Position:	Middling capital position @ 16% of revenue. Cash position weak @ 1 month of overhead. Some LT debt and substantial credit facility	Weaker than desired capital position with limited credit facility
Backlog:	Great backlog, up 15% from recent norms. GM in backlog at top of market pricing. Diversified by industry and in multiple high growth markets	Backlog good compared to most years, but only 50% of annual revenue goals. Good industry mix, none in highly vulnerable sectors
Projects:	Project losing less than 10% of 2020 revenue due to project cancellation or delays. Minimal lost time/revenue due to pandemic, but potential impact or delays or cancellations is quite uncertain as is long term market strength	Lots of uncertainty about job delays or cancellation though nothing has fallen out as yet. Couple jobs shut down for two weeks as part of Covid-19 response
Break even:	Break even is @ 60% of last year's revenue	Break even is 80% of last year's revenue
People:	Company has great team, always in need of additional mangers, skilled and unskilled help	Just got team where wanted and needed. Would hate to restart this process again
Primary Strategy:	Take Advantage (Quad 2)	Hunker Down (Quad 3)
Secondary Strategy:	Cash Focus (Quad 4)	Cash Focus (Quad 4)

Assessing Your Situation



Quadrant 2 Strategy – Take Advantage

Reinvest profitability to solidify your team and your markets and position yourself as a market leader

1. Great people and teams are paramount to long term business success. A slowdown may offer opportunities to draw rainmakers, project managers, preconstruction leaders, and superintendents
 - Look for employees who can raise your experience level in important sectors or those with potential client relations
 - Set aside an “investment fund” to maintain and reward current staff – keep your best together
 - Addition by subtraction – economy may be a good reason to make those tough decisions you have been putting off

Quadrant 2 Strategy – Take Advantage

2. This will offer a great opportunity to win new customers as competitors may reduce their service levels as they tighten their belts
3. Look for less competition on larger work as others are unable to secure bonding
4. Focus on and sell your differentiation:
 - Take advantage of technology innovations others can't afford
 - Provide a higher level of service than others
 - Take advantage of your superior team and your ability to build better, faster, and safer
5. Continue with succession planning and plans. Adjust valuation and terms of payment as needed

Quadrant 1 Strategy – Future Focus

Don't panic – use your financial capabilities to keep your team in place and invest in efforts to rebuild backlog and develop “lifetime customers”

1. Borrow tactics from Quadrant 2 strategy
2. With a reduced workload upcoming, take advantage by culling your organization of lower performers - particularly those you feel might be a drawback to your culture
 - As work comes back, reload with people that represent an upgrade over past employees
 - Raise standards and expectations of performance. Make employment a *privilege*

Quadrant 1 Strategy – Future Focus

3. Invest in training and development utilizing any “extra” time by developing and implementing programs to raise your future level of performance
 - Increase or maintain recruitment of and investment in Project Engineers, Field Engineers, and interns
 - Start building your team of the future
4. All hands on deck business development – it’s everybody’s job!
 - Focus on building relationships
 - Focus on developing tomorrow’s lifetime customers

Quadrant 4 Strategy – Cash Focus

With weaker capital position but good work prospects, nothing is more important than preserving and creating cash

1. Borrow tactics from Quadrants 1 and 2 where appropriate
2. Focus on executing the work on hand successfully
 - Good work will create profits and profits create cash
 - Do everything you can to maintain successful teams and execution
 - Maintain or create incentives for great project performance

Quadrant 4 Strategy – Cash Focus

3. Use your performance and relationships on current work to help build your customer base, reputation, and business development for the future
4. Keep all capital in the company
 - Suspend or delay succession plans or payments as needed to build capital in the company
 - Right-size owners' personal needs/desires for distributions until capital position improves
 - Delay large capital investments

Quadrant 3 Strategy – Hunker Down

With relatively weak capital and a challenging flow of work, getting to break even is a must

1. Borrow tactics from Quadrants 1, 2 and 4 where appropriate
2. Manage cash flow to buy time to survive and build a profitable backlog
3. Focus on the basic Hedgehog Theory equation that defines success for construction businesses: $\text{Gross Profit} - \text{Overhead} = \text{Profit}$
 - Project your monthly gross profit runout carefully and conservatively – assume 10% less gross profit each month than forecast. This is a buffer as you have limited room for downside error!
 - Adjust your indirect and direct overhead accordingly to create a profitable result

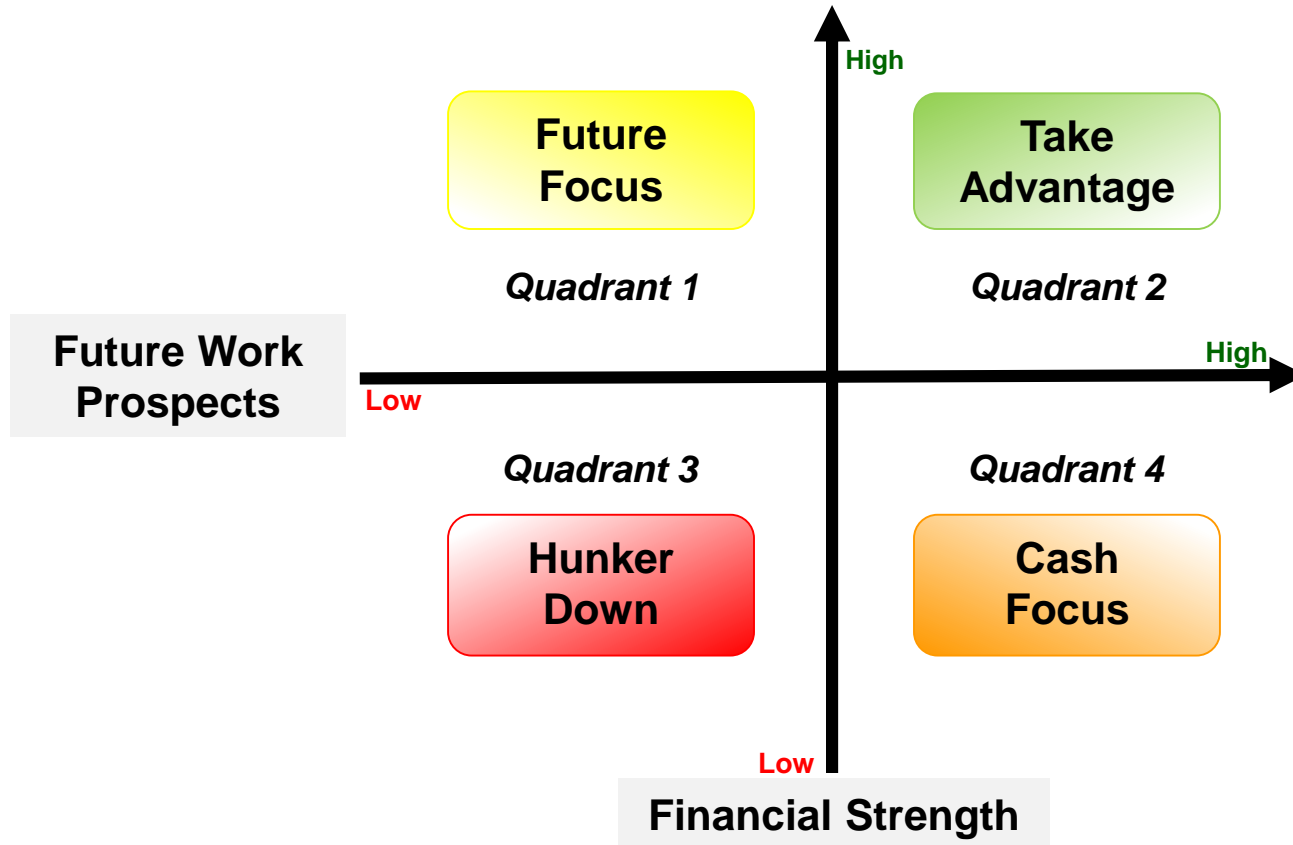
Quadrant 3 Strategy – Hunker Down

3. Focus on the basic Hedgehog Theory equation

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- Create an organizational plan to make up for reduction in operational forces
- Include a productivity plan – possibly with incentives to achieve projected profitability
- Prolong time you have to solve core profitability threats and rebuild balance sheet
- Retain all distributions, reduce tax deposits to expected profit levels for coming year
- Suspend any succession scenarios that require capital from the company to execute

Assessing Your Situation



**The Family Business Institute's mission is to
build better contractors!**

**We welcome your questions and feedback –
please call or email us at**

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