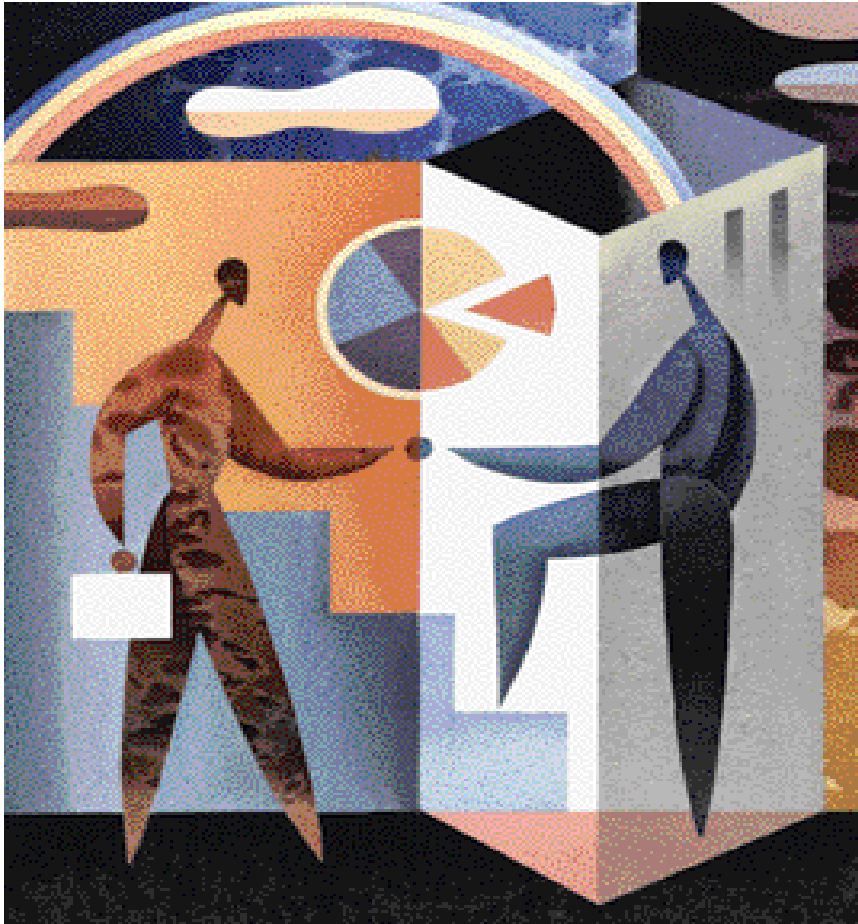

BY CATHERINE J. GIBSON & MICHAEL J. ELLIS

CFMA'S FINANCIAL SURVEY HOT TOPIC: *Surviving the Economic Crisis*



Everyone knows that the construction industry has been hit hard by this recession. However, some economists and politicians have proclaimed that “green shoots” are emerging in several markets.

If this is true, it can't come soon enough for the construction industry, which has been in survival mode for most of 2009.

Each year, a committee of construction industry financial professionals oversees the development of CFMA's Financial Survey and selects an emerging issue to explore as a Hot Topic.

The Hot Topic for *CFMA's 2008 Construction Industry Annual Financial Survey* covered contractors' attitudes toward the economy and its projected impact on construction.

At the time that survey was conducted, contractors predicted that the construction industry would not deteriorate much further, and that the looming downturn might not cause long-term damage to many companies. Ah, the insights from hindsight!

CFMA's 2009 Construction Industry Annual Financial Survey Hot Topic focused on the tools contractors used to deal with the economic crisis.

The complete financial survey report will analyze the data received from approximately 810 contractors. However, this article only covers the preliminary results for the optional Hot Topic section. (*Author's Note:* 450 contractors completed all Hot Topic questions and about 25 contractors answered some of these questions).

SURVIVING ON THE FRONT LINES

Contractors across the country demonstrated their resourcefulness for obtaining new work during this recession.



Merging with or acquiring another contractor were the most frequently cited “new business” strategies reported by Hot Topic respondents.

As shown in Exhibit 1, most of the mergers and acquisitions occurred in the Midwest. And according to Exhibit 2, respondents in the Industrial & Nonresidential and Specialty Trade sectors reported deploying these new business strategies most often.

Many contractors also pursued projects outside their current line of work (and/or in new industry sectors) and sought joint ventures with other contractors.

Reduced revenues due to decreased state government spending was one factor that led some contractors to seek work in new channels. Fifty-five percent of Hot Topic respondents anticipated reduced revenues resulting from a reduction in state spending. Specialty Trade contractors were most often impacted by this reduced construction spending.

Pressure on Profits

Contractors worked to preserve their profitability despite the adverse economic climate. However, 71% of respondents expected their profit margins to drop in 2009, and only 24% anticipated their profit margins to “stay about the same.” (Specialty Trade and Industrial & Nonresidential contractors were most likely to acknowledge diminished profit margins.)

With pressure on profits, contractors took steps to improve and/or maintain their profit margins. In addition to the most popular (though non-specific) response of “Other” (434 responses), survey respondents:

- Sought better discounts from suppliers (305);
- Were more careful when qualifying subcontractors (295); and
- Analyzed and tightened their internal controls (254).

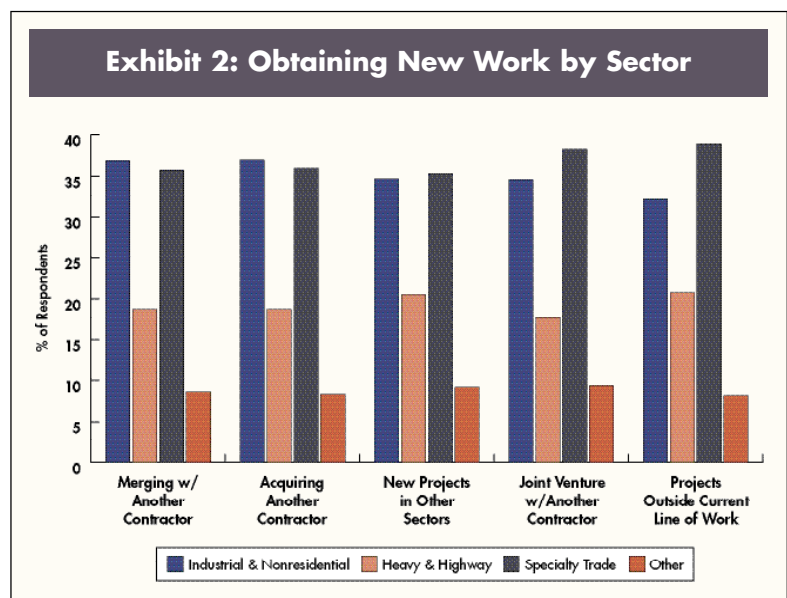
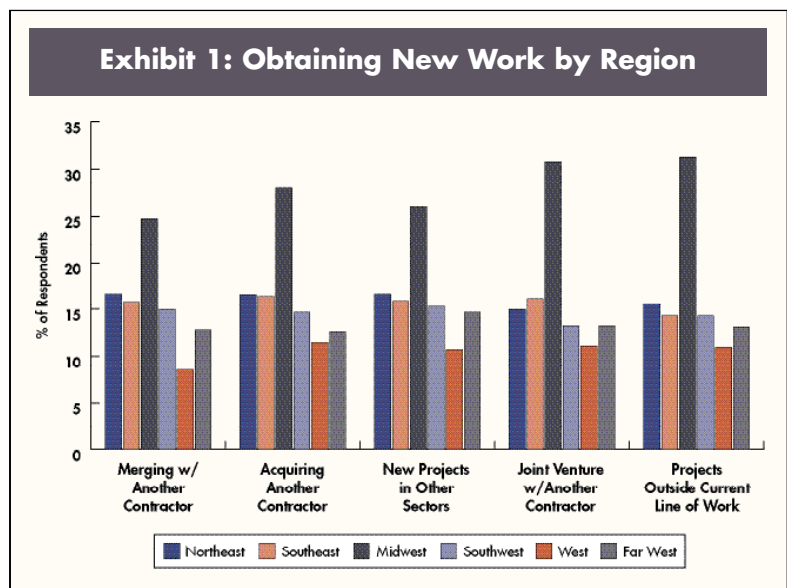
Unfortunately, not all contractors survived the downturn. Looking at the market over the past six months, more than half (52.2%) of the Hot Topic respondents reported more construction-related companies going out of business.

However, 45% indicated that the number of failing companies in the industry “stayed about the same” as in prior periods.

LENDERS IN CRISIS

Access to credit is vital to contractors. So, when the banking sector faltered and the credit crunch dried up available financing for builders and construction projects, the construction industry was hit twice as hard.

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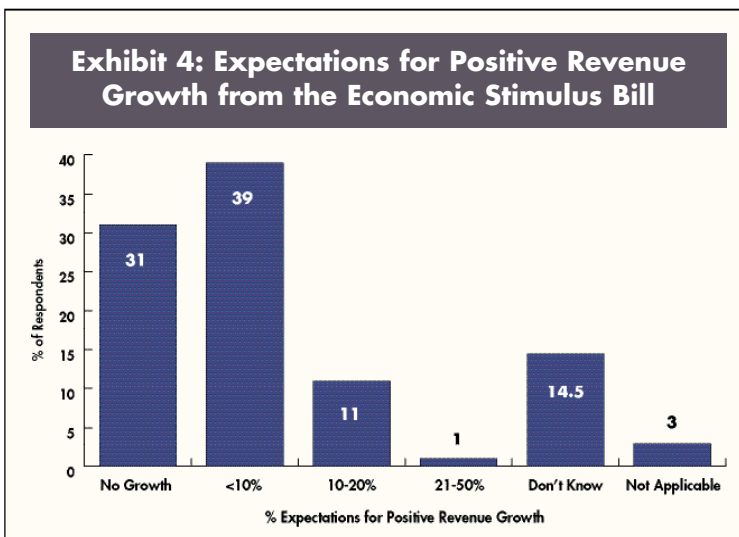
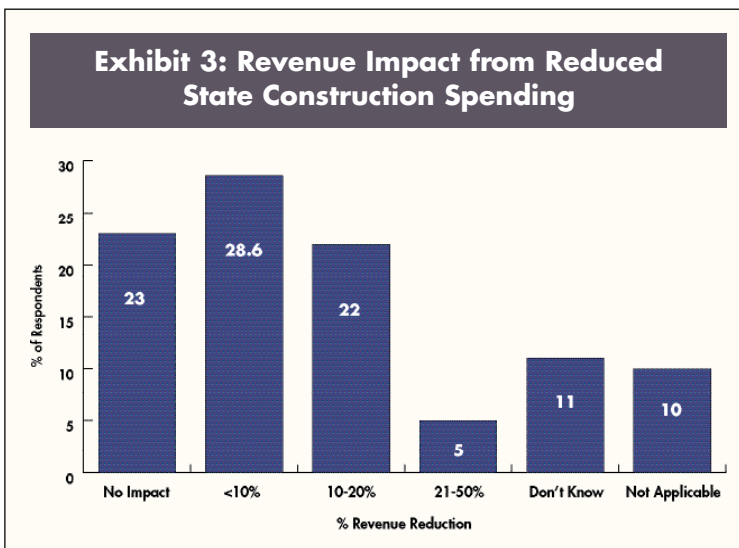


Hot Topic respondents shared how changes in the banking industry affected their companies and noted some of the top challenges: bank closures (458), lost lines of credit (452), the need for additional funding sources (435), and reduced or restricted lines of credit (418).

In response to these challenges, contractors sought retention bonds (432) and alternate funding sources (384); in addition, they billed clients in advance (375), and deferred supplier and subcontractor payments (374).

GOING CONCERN

This year's Hot Topic survey specifically queried respondents



about their “going concern” issues. Contractors who experienced a going concern issue with their audits or reviews identified the specific measures they took to maintain their relationships with banks, sureties, and other suppliers. The top five responses were:

- 1) Subordinated owner debt to outside debt (461);
- 2) Sought capital from new owners (460);
- 3) Subordinated stockholder debt to sureties and bank debt (459);
- 4) Increased working capital through long-term equipment financing (457); and
- 5) Injected more capital from existing owners (456).

INTENSIFIED COMPETITION

Most contractors felt the heat this year – much of it coming from increased competition. Looking back over the past six months, 88% of Hot Topic respondents said competition had increased in their market. However, not all survey respondents answered the question about their competitive strategies. The responses indicated the following as the preferred alternatives:

- Retain more capital/reduce stockholder distributions (332);
- Develop contingency plans (297);
- Update business plan assumptions (289);
- Develop best- and worst-case budget scenarios (248); and
- Develop a long-term strategic plan (238).

When asked which tactics have been most successful in helping their business excel in this down economy, 37% of respondents said they implemented cost-cutting measures and 26% said they were willing to accept lower margins.

LOOKING AHEAD

What does the phrase “green shoots” mean to the construction industry? For some, it boils down to the *economic stimulus bill*. To ensure they have access to economic stimulus-generated work, Hot Topic respondents said they are hiring:

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- Employees with government work experience (416);
- Employees with new skill sets (408); and
- Consultants knowledgeable in government work (396).

While efforts were made by many to participate in economic stimulus-generated work (especially Specialty Trade contractors), the expectations for a positive impact on revenue growth this year were not significant.

“Green” Initiatives

Given the current economic climate, Hot Topic respondents were asked to rate the importance of “green” initiatives. Two-thirds (66%) indicated that green initiatives were either very important or somewhat important. Not surprisingly, Industrial & Nonresidential contractors viewed green initiatives more favorably than Heavy & Highway contractors.

CONCLUSION

Even in a down economy, contractor survival was possible for those who were resourceful and “tightened their belts.” From practical solutions for getting new work to seeking alternatives for credit, the construction sector was forced to “tough it out” for another year. Many contractors got back to the basics of sound business management – justifying all costs, updating business and/or contingency plans, and staying competitive in priority markets.

Given that *CFMA’s 2009 Construction Industry Annual Financial Survey* in large part reflects 2008 financial results, the full impact of this recession on contractors is still to be determined. Since many construction projects can take 24 months or longer to complete, the real effects may just be starting to hit contractors now.

Keep in mind that much of the work completed in 2008 and many current projects are the results of backlogs created much earlier. Given the sober outlook of the Hot Topic respondents – notably, the 71% of respondents who expect their profit margins to decrease this year – it’s reasonable to conclude that new project planning has decreased.

Thus, contractors will likely feel the impact of reduced work for the next 12-24 months. Since the economic storm is not over for contractors, it’s vitally important that companies continue to employ all available techniques – including the survival strategies used by the 2009 Hot Topic respondents.

To order CFMA’s 2009 Financial Survey, which includes the Hot Topic section, visit www.cfma.org. For questions or inquiries

(including pricing for quantity discounts), please contact James Bartsch, CFMA’s Director of Research and Analysis, at 609-452-8000 or orjbartsch@cfma.org. **BP**

CATHERINE J. GIBSON is a Principal in the Business Consulting Group of Moss Adams LLP in Seattle, WA, where she leads the firm’s comprehensive planning service and the Management Succession Practice Group. She also is active in its Construction and Real Estate Practice Group.

Catherine earned an MBA in Finance from the Johnson Graduate School of Management at Cornell University, a graduate degree in Management from the University of Louvain in Belgium, and a BA from Mount Holyoke College.

Phone: 206-302-6515
E-Mail: cathy.gibson@mossadams.com
Website: www.mossadams.com

MICHAEL J. ELLIS, CPA, CCIFP, is the Chairman of Moss Adams LLP’s Construction and Real Estate Industry Group in Tacoma, WA. Mike performs and oversees audits and reviews of financial statements, tax planning and preparation services, and various consulting projects for contractors.

With over 25 years’ experience in public accounting, Mike is also a frequent instructor and guest speaker on construction accounting for various groups and associations. Mike holds a BA in Business Administration from Seattle University. He is a member of CFMA’s South Sound Chapter and of the AICPA.

Phone: 253-284-5235
E-Mail: mike.ellis@mossadams.com
Website: www.mossadams.com

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