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Moss Adams Construction Group Newsletter

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Benchmarking: A Best Practice in a Difficult Economy

by Kelli Franco, CPA, Partner

In the construction industry, it's definitely not business as usual these days. Contractors today seem to all be saying the same things: The sky is falling. We're hunkering down. There are 20 bidders on every job—half of which are unqualified.

What does this tell us? Strategically, we need to be better businesspeople than ever before. One way to do this is by benchmarking—determining your key performance indicators (KPIs) and understanding how they compare not just with those of other contractors but also with the requirements of banks and sureties.

What Are the Right KPIs?

They'll vary for each company, but sureties and banks typically use three types of ratios to measure performance: liquidity, operational, and leverage. Each feeds into the overall view of a construction company's balance sheet.

It's important to note that the individual ratios are not specific target points that result in a final pass-fail grade—rather, they're designed to give banks and sureties a snapshot of your business's financial health. Their approach hasn't changed much over the years; however, they're watching liquidity and leverage a little more closely now. Your ability to get bonding and secure loans and lines of credit will depend on more than just sending them your statements.

The table on this page gives you a closer look at some of these ratios to see how banks and sureties are benchmarking contractors. The thing to remember is, these ratios serve as indicators of financial health, but they aren't the only yardstick banks and sureties use to measure construction companies.

It's actually more important for you and the banks and sureties to understand what the ratio is indicating and whether the results are short-term or long-term. Benchmarking involves all of the

above and then tries to compare your company's indicators with those of an actual group of peers—same type, same size, and same geography.

Liquidity Ratios	How Is It Calculated?	What Does It Indicate?
Current ratio	Current assets ÷ current liabilities	The extent to which current assets are available to satisfy current liabilities. Minimum acceptable is usually 1.2.
Working capital turnover ratio	Revenue ÷ (current assets - current liabilities)	The amount of revenue being supported by each dollar of net working capital employed.
Operational Ratios	How Is It Calculated?	What Does It Indicate?
Return on equity ratio	Net earnings before income taxes ÷ total assets	The profit generated by the total assets employed. A higher ratio reflects a more effective employment of company assets. Contractors should strive to obtain a return of 15–25 percent.
Gross profit ratio	Gross profit ÷ revenue	The company's gross profit margin on its contracts.
Leverage Ratio	How Is It Calculated?	What Does It Indicate?
Debt to equity ratio	Total liabilities ÷ total net worth	The relationship between creditors and owners. Generally, a ratio of 2.5 or lower is considered acceptable.

Where to Begin?

The Construction Financial Management Association (CFMA) just published its 2009 Construction Industry Financial Analysis. You can obtain a copy of this comprehensive survey (containing detailed financial data from more than 1,100 respondents) at www.cfma.org. As a supplement to the CFMA annual survey, Moss Adams LLP has compiled our construction clients' financial information to provide a benchmarking tool, called the Moss Adams Construction Financial Analysis, specific to companies in our region. If you'd like a complementary copy, please contact your local Moss Adams office.

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