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DISCUSSION OUTLINE

• Accounting perspective
  ▪ Importance of cash management
  ▪ Improving cash flow
  ▪ Impact to financial statements
IMPORTANCE OF CASH MANAGEMENT

• The ultimate purpose of a business is to generate cash
• Cash is a key indicator of health
  ▪ Ratios
  ▪ Trends – Cash, AR, Under billings
• Cash fuels growth/protects organizations
KEY CASH RELATED RATIOS

• Most important ratios include:
  ▪ Adjusted working capital
  ▪ Debt to equity
  ▪ Return on equity
  ▪ Net Worth
IMPORTANT CASH RELATED TRENDS

• Trends are important
  o Signs of trouble
    ▪ Decreasing cash
    ▪ Increasing AR and under billings
    ▪ Use of cash for long term assets, loans to related parties
    ▪ Maximized short term borrowings
CASH FUELS GROWTH

• Cash is required to finance operating activities and provides security in difficult times
  o How much cash is needed for new work?
    ▪ Finance of job start up, current work
    ▪ New equipment
    ▪ How will growth impact debt covenants & surety relationships?
      – Unrealistic Growth #1 reason for surety claims
IMPROVING CASH FLOW

Where is cash typically trapped?

- Under billings – What is causing these?
- Idle equipment
- Pending change orders
- Accounts receivable
- Retentions
- Inventory, other assets
- Accelerated debt amortization
How do Presidents/Owners Influence CF?
- Set corporate culture
- Major asset acquisition
- Capital structure
- Personal needs
- Pricing/billing policy
- Non-productive family on payroll
How do CFOs influence CF?

- Management of cash that flows
- Short term investments
- Billings/Collections
- Manage payables (1% 10, net 30 = 18.25% annually)
- Use of line of credit
- Contract terms
- Credit checks
IMPROVING CASH FLOWS

How do estimators influence CF?

- Which jobs to bid
- Assumptions when developing bids
- Choice of vendors subcontractors
- Schedule of values
IMPROVING CASH FLOW

Project managers impact CF?

- Scheduling job activities
- Processing change orders
- Estimating costs
- Billing
- Negotiating with general and subcontractors
IMPROVING CASH FLOW

Superintendents Impact CF?

- Labor/equipment management
- Material requisitions
- Production only decision making
- Identification of changing conditions
- Safety/risk management
IMPROVING CASH FLOW

How can you make managing cash a priority?

- It must start at the top
- Change corporate structure
- Define where cash flow is a priority
- Training within the organization
- Compensation plans that reward cash flow
STATEMENT OF CASH FLOWS

• Composed of three sections
  o Cash flows from operating
    ▪ Cash provided from contract revenues
    ▪ Cash paid to vendors, subcontractors, employees
  o Cash flows from investing
    ▪ Cash used to purchase equipment or other investments
    ▪ Cash provided by the sell of these assets
  o Cash flows from financing
    ▪ Cash used to repay line of credit, debt, pay distributions to stockholders
    ▪ Cash provided by debt, issuing stock, contributions to the company from stockholders
# STATEMENT OF CASH FLOWS

## CASH FLOWS FROM OPERATING ACTIVITIES

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash received from contracts</td>
<td>$ 9,335,177</td>
</tr>
<tr>
<td>Cash paid to suppliers, employees, and subcontractors</td>
<td>(9,325,125)</td>
</tr>
<tr>
<td>Interest received</td>
<td>1,150</td>
</tr>
<tr>
<td>Interest paid</td>
<td>(16,446)</td>
</tr>
<tr>
<td><strong>Net cash from operating activities</strong></td>
<td>(5,244)</td>
</tr>
</tbody>
</table>

## CASH FLOWS FROM INVESTING ACTIVITIES

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Proceeds from sale of equipment</td>
<td>5,436</td>
</tr>
<tr>
<td>Purchase of property and equipment</td>
<td>(59,720)</td>
</tr>
<tr>
<td>Change in due from affiliates</td>
<td>178,724</td>
</tr>
<tr>
<td><strong>Net cash from investing activities</strong></td>
<td>124,440</td>
</tr>
</tbody>
</table>

## CASH FLOWS FROM FINANCING ACTIVITIES

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net repayment on lines of credit</td>
<td>(65,983)</td>
</tr>
<tr>
<td>Borrowing of long-term debt</td>
<td>-</td>
</tr>
<tr>
<td>Repayments of long-term debt</td>
<td>(15,435)</td>
</tr>
<tr>
<td>Repayments to affiliates</td>
<td>(83,000)</td>
</tr>
<tr>
<td><strong>Net cash from financing activities</strong></td>
<td>(164,418)</td>
</tr>
</tbody>
</table>

## NET CHANGE IN CASH

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Net change in cash</strong></td>
<td>(45,222)</td>
</tr>
</tbody>
</table>

## CASH AND CASH EQUIVALENTS, beginning of year

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>CASH AND CASH EQUIVALENTS, beginning of year</td>
<td>125,863</td>
</tr>
</tbody>
</table>

## CASH AND CASH EQUIVALENTS, end of year

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>CASH AND CASH EQUIVALENTS, end of year</td>
<td>$ 80,641</td>
</tr>
</tbody>
</table>
STATEMENT OF CASH FLOWS

• Show the relationship of net income to changes in the entity’s cash position
• Evaluate decisions of management
• Provides indicators of whether the entity has the ability to continue to meet its debt payments and other obligation
• Predict future cash flows of the entity
Cash is King
# Working Capital*

The excess of current assets over current liabilities.

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Current assets</strong></td>
<td>$ 748,000</td>
</tr>
<tr>
<td><strong>Current liabilities</strong></td>
<td>(525,000)</td>
</tr>
<tr>
<td><strong>Working capital</strong></td>
<td>$ 223,000</td>
</tr>
</tbody>
</table>

* An indication of a company’s liquidity.
Liquidity Ratios

Balancesheet Ratios

Liquidity Ratios

Current

Current Assets

Current Liabilities

For Contractors

December 31, 2012

\[
\frac{\text{Current Assets}}{\text{Current Liabilities}} = \frac{748}{525} = 1.42
\]

Shows a firm’s ability to cover its current liabilities with its current assets.
Liquidity or Short-Term Solvency ratios

Short-term funds management
- Working capital management is important as it signals the firm’s ability to meet short term debt obligations.

For example: Current ratio

- The ideal benchmark for the current ratio is $2:$1 where there are two dollars of current assets (CA) to cover $1 of current liabilities (CL). The acceptable benchmark is $1: $1 but a ratio below $1CA:$1CL represents liquidity riskiness as there is insufficient current assets to cover $1 of current liabilities.
Managing Cash Flow on Construction Projects

Presented by: Mark Richardson

Pinnacle Surety & Insurance Services
For All Your Bonding Needs…
The Dynamics

- How much money will it take to mobilize the job?
- Know your customer
- The contract
- The schedule
- Cash flow projection
- Change Orders (Under-billings) – Are you kidding yourself!
- People vs. Systems
- Financial Statements
- Interruptions to cash flow
How much money will it take to mobilize the job?

- Labor
- Equipment (own or rent)
- Materials (do you need to purchase before you can bill)
- When will the first progress payment be received?
- Subcontractors have to be prepared to finance the first 90 days of their work.
Know Your Customer

- Do they pay slowly?
- Do they have competent staff to process your paperwork?
- Are there sufficient inspectors to get to your job and sign-off work in a timely manner?
- Are there too many inspectors?
The Contract

- Do you understand the terms in order to be paid?
- If you are a Sub, do you know that the Prime’s contract with the Owner is incorporated into your contract with the Prime and how it will impact you?
- Have your attorney review your contract.
The Schedule

- The schedule drives the work
- The work drives the billing
- The billing generates the cash flow
- Know when you are scheduled to work, stop, and start again.
- Keep track of delays…it all adds up in the end!
Cash Flow Projection

- How much work will you do each month?
- How much of the work are you allowed to bill for?
- If you are a sub, how much of the retention is profit?
- When will you get your retention?
- If/when will it be necessary to use the line of credit?
- When will you be able to pay down the line of credit?
- Have you accounted for all of the above in your projection and incorporated the results in an overall business cash flow projection?
Change Orders – Are you kidding yourself?

- Are you doing work that should be a Change Order?
- Excess labor
- Excess material
- Excess equipment
- It’s like a four point swing
- Will you ever be able to bill for it?
People vs. Systems

- If you have the right system, does your staff (in the field and in the office) know how to document and input the information into the system? If not, you may miss a billing period, interrupting cash flow.
- If you have the right people, the right system will make them extremely efficient.
- The right people can work with any system.
Financial Statements

- CPA that specializes in construction accounting.
- Do you understand financial statements? Be a business person that is in construction.
- If you don’t want to understand your financial statements, you may not know the following:
  - Do you have enough working capital to take on more work?
  - Have you correctly paid your taxes (Payroll, Use, State, Federal, etc.) and Union dues?
Financial Statements - Continued

- If not, you may be spending money that isn’t yours to get or buy:
  - more work (which you won’t be able to cash flow)
  - more equipment (if financed you may not be able to pay for it)
  - buy property and improve it (more debt and use of cash)
  - buy a restaurant
Interruptions to Cash Flow

- A job that slows down or is temporarily stopped. One job can start the domino effect!
- Compliance issues; Prevailing Wage paperwork, proper releases from subs and suppliers
- Stop Notices
- Lack of workforce in the field to perform the work and provide information back to the office.
- Lack of office personnel to process paperwork.
- You may have enough bodies in the office to do the paperwork but are they qualified?
- Employees that do not have the skill set to perform the work and are not moved to another department or let go.
- Owner or business partner develops an alcohol, drug or gambling problem.
- Divorce – lack of concentration
- Death and lack of continuity plan.
- Material not available - drywall
- Equipment being manufactured offshore
- Earthquake
Conclusion

Cash flow is the life of the business. Make sure you keep alive!

Thank You!