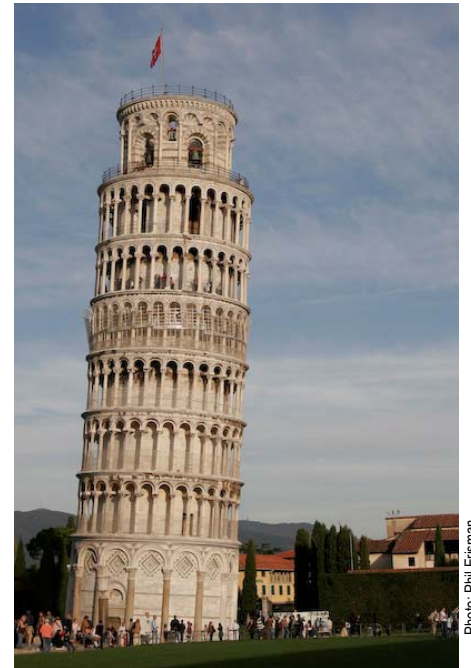


MEMORANDUM

FROM: David Schwartz

Dateline Pisa, August 22, 1173: Tower construction runs out of cash

The Tower of Pisa ran out of cash in 1173. Eventually it was finished 174 years later. Cash is always key and construction has cash issues like other businesses. I have never heard anyone ask if the Tower of Pisa turned a profit. No, it was not the bank. Jacquard Associates was not the consultant, although they did call Bonnano Pisano, the workout engineer. He compensated for the lean by making the new stories taller on the short side. The extra masonry caused it to sink further. Mussolini ordered the tower returned to a vertical position. Concrete was poured into its foundation. The result? The tower sank further. So much for workout consultants.



What's the point? Businesses have been running out of cash for thousands of years and construction joins all other businesses in cash needs. You and I deliver the Cash vs. Profit message, so in continued support I am providing you usable examples relating to construction. In the last 18 months, Jacquard has had a contractor; a construction services company, a material supplier and a subcontractor as clients.

They always start with “you don’t know my business.” All right, there are plenty of laws, practices, and jargon unique to construction. However, the business goal is still to generate cash. In construction, everything is *project* centric versus *product production* centric. This is a good distinction for all businesses; it brings different working capital elements to the forefront.

How does cash work in construction? In evaluating Return on Capital Employed or cash potential the conventional working capital elements come into play: margins, accounts payable (A/P) and accounts receivable(A/R). Inventory is typically less of an issue.

Accounts Receivable and Accounts Payable timing is totally out of balance. *Nine days for the money to go out and 90 days for the money to come in (less Retainage.)*



Accounts Payable – The lower down the food chain, the more cash responsibility you accept. Subcontractors pay 70% of expenses within seven days (payroll, tools and supplies.) The other 30%; insurances, leases and rent are a paid within 30 days. The average is nine days overall for A/P.

This is the money out.

Accounts Receivable – Contractor or Developer payment processes look like this.

1. Submit your bills on the third Thursday of every month.
2. We will review them within one week.
3. **If it is approved** (a discount often makes the approval process work) we will pay you 30 days after approval.
4. **If it is not approved**, we only have two days to resolve or you go to the next month's cycle.
5. If you're late for any reason, you go into the next month's cycle

Seventy five to 125 days of A/R is common: *This is the money in.* In this business, how do you make money? The conventional wisdom is to make a small fortune; you start with a large fortune. According to D&B 10,000 construction companies failed in 2004 and the surety industry lost \$3.4 billion between 1998 and 2003. (FMI www.fminet.com)

Where do Margins fit in? Contract bidding and negotiating is done in a highly competitive environment. The contractor generally understands the bidder's costs before the award. To truly insure a profit and cash you have to look at the rewards and risks. The ability to significantly cost reduce is crucial. Your client also has to understand their leverage, timing issues and their proven results for them. Developing a long term repeat relationship typically takes out bidding and some actual costs. Reducing safety costs is becoming critical to both parties decisions and the insurance rates. The ratio of reward versus risk is determined by your client's discipline. Are change orders signed, do they adjust personnel when they slowdown a job, and is overtime billed? We can save the discussion of Unions for another time.

Sometimes let the opportunity pass. Slow cash and poor actual margins leads directly to insolvency. One of our prominent clients sprayed fireproofing on new industrial structures. It is a very competitive business, with one material supplier and plenty of competitors. Who has the risks? To the right is the cash flow summary. There was no way to stay in this product/service line.

Project or product manufacturing, distribution, and service businesses look a lot alike. In construction this is true for all players, whether they are service companies such as the developer's attorneys or distributors such as equipment rental companies.

You're a Banker / Business Person, so how do you bid to the construction industry? These operating questions will help you evaluate whether the company is capable of performing in such a difficult industry. Check to see if each of the steps is done formally.

We have had a run of construction related clients over the last year. I suspect this is the beginning of a trend. We teach Cash Flow and ROCE concepts to the lender who referred the main client discussed. This is a "case in point" lesson for them. Since one of Quarles & Brady's referrals is included we thought you might find this interesting.

Use it as you will. We do have a coffee break session on Cash and ROCE if it would be of value to you. Thank you for all your support!

Industrial FIREPROOFING SERVICES

Typical Margin	12 -15% – very competitive
A/R Labor Material	7 Days 30s Days – 1 supplier
A/R	120 Days – Typical Gen Contractor



Your Business Questions

Review with them their view of cash in and cash out.

How do they achieve cost reductions?

What percentages of bills do get out on time?

Do they bill overtime? How?

What is their process for customer directed change orders?

How do they get their work?