

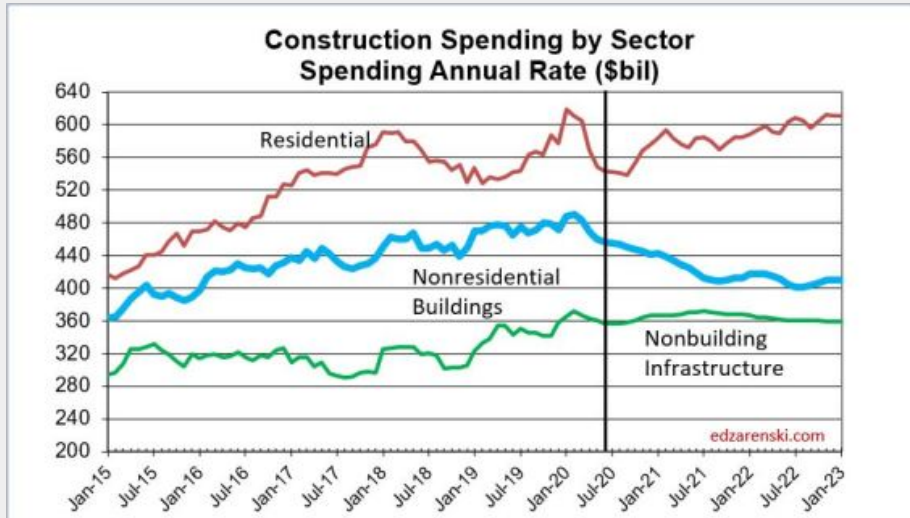


# GOOD UNDERWRITING RISK – SURETY

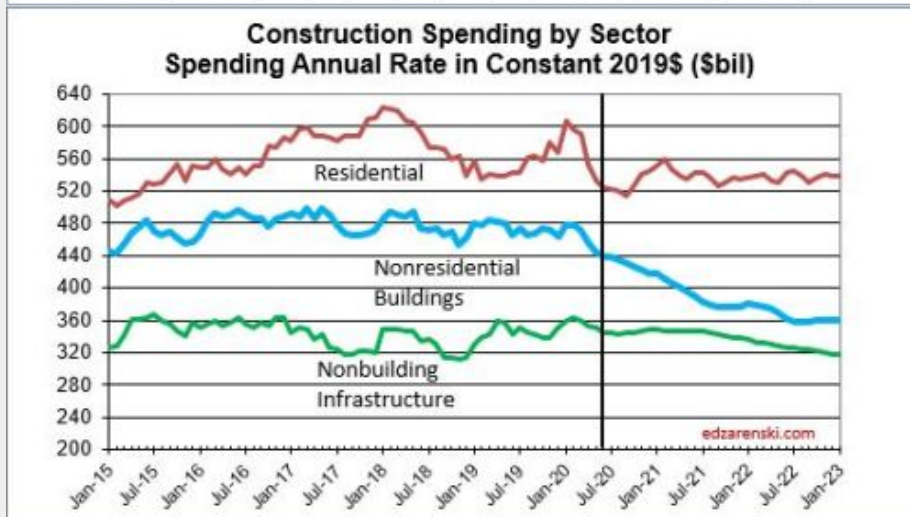
By: Andrew Waterbury

September 30, 2020

# Construction Spending



W/O INFLATION



WITH INFLATION

<https://edzarenski.com>

# Construction Spending



| <b>U.S. Total Construction Spending Summary</b>                           |              |             |               |             |               |                |
|---|--------------|-------------|---------------|-------------|---------------|----------------|
| \$ in billions  | Year-to-date |             | Forecast 2020 |             | Forecast 2021 |                |
| % growth vs prior yr  | June 2020 \$ |             |               |             |               |                |
| <b>Total Construction</b>   | <b>667</b>   | <b>5.0%</b> | <b>1385</b>   | <b>1.4%</b> | <b>1368</b>   | <b>-1.2%</b>   |
| Residential   | 276          | 7.8%        | 564           | 2.3%        | 579           | 2.8%           |
| Nonresidential Buildings  | 225          | 0.2%        | 460           | -2.6%       | 420           | -8.7%          |
| Nonbuilding Infrastructure  | 166          | 7.1%        | 362           | 5.4%        | 369           | 2.1%           |
| Educational   | 49.8         | 0.8%        | 104.0         | -1.3%       | 99.1          | -4.7%          |
| Healthcare  | 22.9         | 5.6%        | 46.0          | 1.0%        | 44.3          | -3.7%          |
| Amusement / Recreation  | 13.4         | -3.0%       | 26.5          | -8.2%       | 20.7          | -21.6%         |
| Commercial / Retail   | 40.7         | 6.5%        | 83.5          | 3.9%        | 74.2          | -11.2%         |
| Lodging   | 15.0         | -8.5%       | 29.7          | -10.2%      | 21.7          | -26.9%         |
| Office  | 39.8         | -1.2%       | 81.9          | -3.5%       | 79.1          | -3.3%          |
| Manufacturing   | 35.8         | -7.0%       | 72.0          | -10.1%      | 65.0          | -9.7%          |
| Other Nonres Bldgs  | 7.9          | 24.2%       | 16.4          | 16.5%       | 15.6          | -5.0%          |
| Power   | 60.2         | 16.7%       | 121.3         | 6.5%        | 107.4         | -11.4%         |
| Highway / Bridge / Street   | 42.9         | 0.8%        | 107.1         | 9.8%        | 117.4         | 9.6%           |
| Transportation / Air / Rail   | 26.9         | 0.6%        | 58.8          | 2.9%        | 70.7          | 20.2%          |
| Sewer / Water / Conservation  | 25.0         | 6.5%        | 51.9          | -0.2%       | 51.9          | -0.1%          |
| Communication   | 10.9         | 3.1%        | 22.5          | 0.6%        | 22.0          | -2.0%          |
| Forecast includes U.S.Census June 2020 year-to-date spending as of 8-3-20 |              |             |               |             |               |                |
| Forecast includes Dodge construction starts Midyear Update 8-6-20         |              |             |               |             |               | edzarenski.com |

<https://edzarenski.com/2020/08/14/pandemic-13-midyear-construction-outlook/>

# What we saw during the Great Recession



- **Subcontractors who typically did not bond their projects were being asked to bond back their work.**
- **Public agencies began combining scopes of work, driving up contract values.**
- **Companies that were working in the private/commercial sectors came to the public works market place making bid list more competitive and driving down profits.**
- **Lenders and private owners started requiring more projects to be bonded.**
- **Banks began to pull back on their lending, specifically in construction.**





# What to Expect from your GC's, Surety, and Bank



## GC's

- ❑ Bonding back subcontractors more frequently
- ❑ Stronger contract language passed down to subs
- ❑ Stringent review of subcontractors financial statements

## Surety

- ❑ Frequent financial reporting
- ❑ Continued review of work in progress
- ❑ Understanding of PPP loan forgiveness
- ❑ Status of Bank Line of Credit renewals

## Banks

- ❑ Frequent financial reporting
- ❑ Strict review of borrowing covenants
- ❑ Diversification of receivables



# What is Working Capital



Whether you are trying to qualify for a surety bond, borrow money from a bank, or just run your business, it is key to have quality Company Financial Statements. More important than being able to generate a financial statement, is being able to understand them.

**Working Capital** - is a measure of both a company's efficiency and its short-term financial health. Working capital is calculated as:

$$\text{Working Capital} = \text{Current Assets} - \text{Current Liabilities}$$

**Working Capital Ratio** - Indicates whether there is enough short turn assets to cover its short term debt.

$$\text{(Current Assets/Current Liabilities)}$$

Below 1 indicates negative Working Capital, anything over 2 means that the company is not investing excess assets. Most believe that a ratio between 1.2 and 2.0 is sufficient.



## Keys to Working Capital

### ● Current Assets

1. Cash
2. Accounts Receivable/Retention
3. Underbillings

### ● Current Liabilities

1. Line of Credit
2. Current Portion of Long-Term Debt
3. Accounts Payable
4. Overbillings



# Working Capital Focal Points



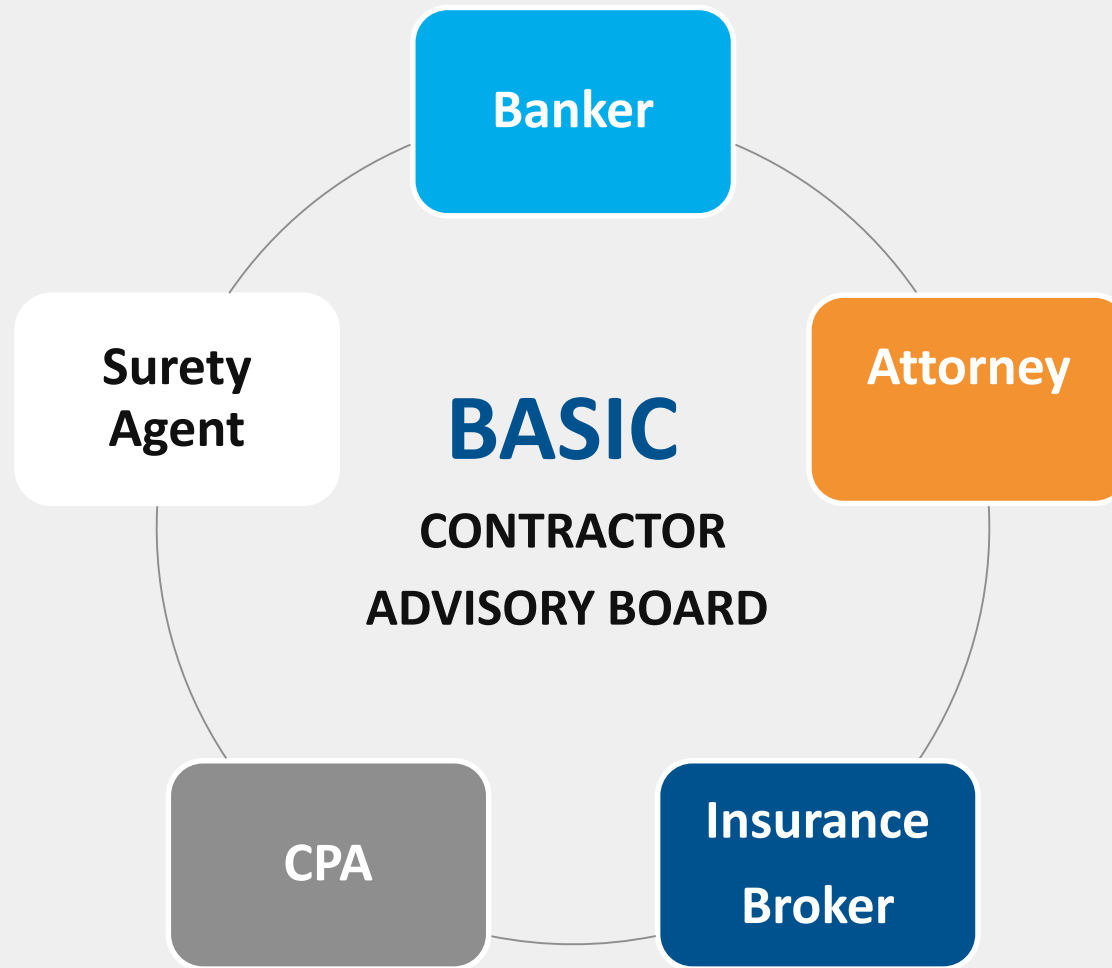
- **Cash Cash Cash !**
- **Receivables vs. Payables and Current Bank Debt**
  - Do you have quality receivables to pay all your payables and bank debt.
- **Retention vs. Profit of Project**
  - Ex. If you have 5% retention and your profit is only 10%, then you only have 5% to cashflow your company until the retention is collected.
- **Late Stage Underbillings**
  - Underbillings when a project is almost complete can raise questions on the ability to collect them.
- **Bank Line Of Credit Usage**
  - Subs tend to be in and out of their lines more often GC's typically should not utilize their line
  - Evaluate the cost of bank debt by looking at your Interest Expense



# Other Financial Focal Points



- **Profit vs. Overhead**
  - If profit margins are going down are adjustments being made to overhead.
- **Backlog Delays vs. Overhead**
  - As annual revenue goes down are overhead adjustments being made.
- **Work in Progress (Backlog) vs. Cashflow**
  - Understanding current and future backlog as it relates to cashflow.
- **Life after PPP or life without PPP**
  - What does cashflow and capital look like down the road.
  - Positioning to bring in future capital if needed.





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