Use Financial Budget Scenarios to Proactively Manage Your Business

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Construction Company budgeting is normally a yearly task where project revenue is forecasted for the next fiscal year, gross margin is assessed, and overhead expenses are reviewed. For the last 10 years most companies have forecasted increased revenue, margin and overhead. Risk in construction could be summarized into "winning enough work" and "job execution"

COVID has put us in a completely new business environment with new risks on top of the risk of an economic slow down. Here are some of the risks that can affect your construction business:

1. Jobs will be shut down sporadically for COVID on site during the rest of the year. Delayed work = delayed invoicing = delayed cash
2. There may be fewer projects to bid on for the rest of 2020 compared to 2019.
3. Margin on new projects will drop if your competitors “buy” work: Lower bid margin = more projects needed to cover overhead
4. Projects already won could be delayed or cancelled (especially oil & gas / retail / hotel / restaurant).
5. COVID cases could spike in your county or state resulting in a local shut down.
6. Government projects could be deferred due to massive decrease in tax revenue.

With so many unknowns you might feel overwhelmed and unable to come up with a plan for your company. Companies need to proactively plan rather than react to external risks. Lack of planning results in reactive decisions and is how businesses end up in real trouble.

There are 2 types of plans to prepare:

1. Risk Mitigation Strategies
2. Budget Scenarios

There is a difference between risk mitigation and financial scenario planning.

Risk Mitigation

Risk Mitigation is the process of identifying risks, assessing their likelihood, and developing strategies to avoid them, reduce their impact or manage through them.

Unfortunately, with COVID many of the risks are external and not controllable. Most mitigation strategies will require you to manage them when they occur.

Simple examples of risk mitigation for high probability risks would be:

1. Managing employee and subcontractor health and safety
2. Prepare a documented process if a job site is shut down including:
    1. An employee communication plan that includes local testing site locations if one of your employees becomes ill
    2. A plan for updating the project schedule for your workforce and subcontractors
    3. A contract review to see if the costs of closure is recoverable under a force majeure clause
3. Extended employee illness and death - ensure policies are in place to handle these tough situations. Review current insurance plans for coverage.
4. Project delays – understand the contract implications of extending the completion date
5. Labor shortages due to travel restrictions, illness, or family illness
6. Material delay due to domestic or foreign manufacturing plant shut down.
7. Project Profitability / Contingency Status– keep cost at completion forecasts up to date, review remaining contingency regularly as profits are at significant risk.

You will want to list your major risks, assign each one a probability that it will occur and then document your strategy for each one. Develop your strategies for the most likely risks first.

Financial Budgeting in a Multi-Variable World

You can keep your financial planning at a higher level. It is easy to get "wrapped around the axle" trying to assess the financial impact of risks that comingle. You simply need to assess the impact of an X% increase or decrease in revenue and cost of sales and plan out what you will do if that happens. It does not matter which combination of variables causes the change.

Companies that use scenarios typically prepare 3 plans:

BASE CASE – your best guess at what will happen

UPSIDE CASE – things go better than you expected than your Base Case

DOWNSIDE CASE – things go worse than your Base Case

Your job is to forecast revenue and gross margin under each scenario then assess what you would do to overhead expenses if your gross margin is insufficient to cover expenses. If you are forced to make tough decisions it is better to plan for them rather than react to a serious cash shortfall that puts your business at risk.

Prepare Your Base Case First

Preparing and planning for your most likely case will get you started with proactive planning. If you already have a 2020 budget, start with editing it by month for the remainder of the year. If you do not have a 2020 budget, use your 2019 actual results. Use a columnar report of your income statement by month as the budget template for your Base Case.

Load your 2020 COVID Base case into your accounting system as another budget in your system. Anterra connects to Sage 300 and Viewpoint Vista; each of these allows multiple budgets per year. Anterra also provides budget upload templates for clients if you find budget entry time consuming in your accounting system.

Financial Budget Scenario Management

Work through an analysis of Revenue and Gross Margin first. Some construction companies have only had minor financial impacts from COVID-19, others have been hard hit.

Create or run a report that combines actual results to date along with your Base Case to see a projection of your financial year. Measure the projection against your actual results plus your original budget to assess the “COVID Impact”. If you don’t have an Original Budget, you can compare this project to last year’s actuals to assess the year over year effect.

Anterra’s Financial BI Module has a budget scenario projection / comparison financial statement, here's a sample layout:

Anterra Construction - All Companies

COVID Base Case 2020 Projection

For the Period Ended March 31, 2020

Actual Results to last closed month end

Remaining Months Base Case Scenario

Projected results with variance to Original 2020 Budget = COVID Effect

	January 2020	February 2020	March 2020	April 2020	December 2020	Projected	Original 2020 Budget	Projected Budget Variance	Projected Budget Variance %
Revenue									
Contract Revenue	6,360,917	5,896,948	6,132,377	4,911,7	4,430,387	59,259,501	72,623,807	(13,364,307)	-18.4 %
Property Income	722,521	722,521	740,097			2,185,138		2,185,138	
Other Revenue	18,210	45,849	52,940	15,7	14,224	206,570	177,008	29,562	16.7 %
Total Revenue	**7,101,647**	**6,665,318**	**6,925,414**	**4,927,**	**4,444,612**	**61,651,208**	**72,800,815**	**(11,149,607)**	**-15.3 %**
Direct Costs									
Cost of Contracts	4,437,637	3,830,331	3,916,896	4,029,8	3,592,266	45,399,817	53,012,038	(7,612,221)	-14.4 %
Cost of Property	534,665	549,116	569,875			1,653,655		1,653,655	
Total Direct Cost	**4,972,303**	**4,379,447**	**4,486,771**	**4,029,8**	**3,592,266**	**47,053,473**	**53,012,038**	**(5,958,565)**	**-11.2 %**
Gross Profit	**2,129,344**	**2,285,872**	**2,438,643**	**897,**	**852,346**	**14,597,736**	**19,788,777**	**(5,191,042)**	**-26.2 %**
Gross Margin %	*30.0 %*	*34.3 %*	*35.2 %*	*18.*	*19.2 %*	*27.8 %*	*27.2 %*	*0.6 %*	
G & A Expenses									
Salaries	519,358	538,527	570,446	464,5	372,008	5,326,843	5,540,580	(213,736)	-3.9 %
Benefits and Taxes	124,985	131,235	141,733	151,	121,471	1,608,895	1,811,170	(202,275)	-11.2 %
Communications	83,324	87,490	94,489	99,	79,345	1,066,599	1,202,870	(136,271)	-11.3 %
Office Expenses	41,662	43,745	47,244	51,2	40,171	538,180	608,630	(70,450)	-11.6 %
Rent and Occupancy	166,647	174,980	188,978	205,5	165,041	2,150,409	2,427,398	(276,989)	-11.4 %
Travel and Entertainment	41,662	43,745	47,244	49,2	41,291	535,774	606,353	(70,579)	-11.6 %
Total G & A Expenses	**977,638**	**1,019,721**	**1,090,135**	**1,021,**	**819,327**	**11,226,700**	**12,197,000**	**(970,300)**	**-8.0 %**

Upside and Downside Scenario Preparation

You can extend your scenario comparisons to include “Upside” and “Downside” scenarios. Build the scenarios using your Base Case. An Upside Scenario simply means your base case is low; you would increase your revenue and margins. A downside scenario reflects lower revenue and gross margin than your base case by assuming that more risks occur. There should be at least 20% difference in revenue between your base case and upside/downside scenarios.

Compare these 2 scenarios to your Original Budget or last year’s actual results to measure their impact on your business.

Anterra helps clients compare scenarios side by side with a Scenario Comparison Report. It shows your YTD actual results plus each scenario for the remaining months to let you see projected fiscal year performance under each scenario:

Anterra Construction - All Companies

Income Statement - Fiscal Year Projection Comparisons

For the Period Ended April 30, 2020

	YTD Actual	Original 2020 Budget	YTD Actual + Remaining Original Budget	YTD Actual + Remaining COVID Forecast	YTD Actual + Remaining COVID Upside Forecast	YTD Actual + Remaining COVID Downside Forecast
Revenue						
Contract Revenue	24,198,248	72,623,807	72,622,540	60,155,768	65,116,705	58,067,959
Property Income	2,925,235		2,925,235	2,925,235	2,925,235	2,925,235
Other Revenue	116,999	177,008	215,408	190,845	198,820	187,824
Total Revenue	**27,240,482**	**72,800,815**	**75,763,183**	**63,271,847**	**68,240,760**	**61,181,018**
Direct Costs						
Cost of Contracts	16,286,875	53,012,038	51,761,896	45,471,949	47,140,966	44,552,952
Cost of Property	2,216,129		2,216,129	2,216,129	2,216,129	2,216,129
Total Direct Cost	**18,503,004**	**53,012,038**	**53,978,025**	**47,688,078**	**49,357,095**	**46,769,081**
Gross Profit	**8,737,478**	**19,788,777**	**21,785,158**	**15,583,769**	**18,883,665**	**14,411,937**
Gross Margin %	*32.1 %*	*27.2 %*	*31.5 %*	*28.6 %*	*32.1 %*	*27.3 %*
G & A Expenses						
Salaries	2,182,192	5,540,580	5,878,009	5,416,175	5,497,105	5,416,175
Benefits and Taxes	534,017	1,811,170	1,744,9[illegible]	1,593,524	1,620,15[illegible]	1,593,524

Assessing Fixed and Variable Overhead Expenses

If your scenario analysis shows you have insufficient margin to cover overhead, you need to plan to cut overhead.

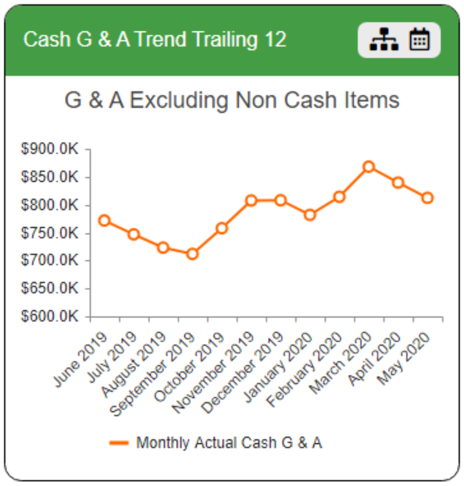
Fixed Overhead Expenses stay the same regardless of your level of activity. Typically, these expenses have contracts associated with them. Examples include:

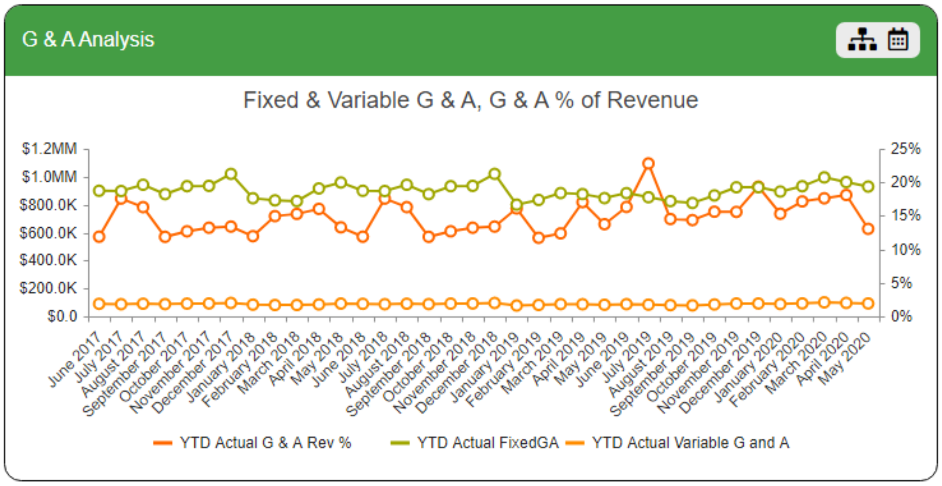
- Salaried staff
- Salaried staff medical benefits
- Rent
- Property taxes
- Mortgage interest
- Property and business liability insurance
- Basic phone service
- Equipment Leases
- Utilities

Variable expenses change with your level of activity

- Sales Commissions
- Bonuses
- Hourly Indirect Labor – site supervisors, foremen
- Office supplies
- Travel

Analyze the trend of your fixed and variable G & A and understand the relationship of total G & A to revenue. Anterra lets you build multiple dashboard trend graphs including dual axis graphs (dollars and percentage). You can build individual drill through trend components for fixed and variable G & A, total G & A or “Cash G & A” which would exclude depreciation and amortization.





Cutting overhead significantly is difficult as a large portion of total overhead is salaries. There are many strategies to keep good people employed including reduced hours, job sharing and temporary salary reductions. Prepare your plan with input from key staff and keep it confidential.

Summary

- Best practices for financial planning include reforecasting budgets when business conditions change.
- Using financial budget scenarios can help you project your results and plan proactively for downside risk. Optimal decision making is done with time to review and reassess strategies, not under immense economic pressure.

Visit Anterra's website at www.anterratech.com for more information on our financial scenario tools, financial consolidations or Construction BI.

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About the Author: Bruce Vanderzyde has over 25 years of experience in Construction and Real Estate Software. He is a frequent speaker at industry conferences and has worked with companies around the world to improve their reporting, business processes and systems strategies. **Anterra's mission is to help every user succeed in their role** by providing them the information they need and empowering them to build their own reports. Learn more by calling (832) 539 1400 ext 1.