Executive summary | Roundtable XVII | December 14, 2022

Wipfli construction CFO exchange

Host: Reed Sellers | Wipfli

Subject matter expert: Michael Vaccarella | Wipfli

Facilitator: Austin Evans | Profitable Ideas Exchange

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Introduction

Fifteen chief financial officers (CFOs) from the construction industry met virtually to share leading practices and discuss topics of mutual interest based on an agenda created through a series of pre-interviews.

Reed Sellers, partner at Wipfli, hosted the exchange, and Austin Evans of Profitable Ideas Exchange facilitated. Michael Vaccarella, a partner in private equity and transaction advisory services at Wipfli, joined to provide subject matter expertise. The focus of the discussion covered the following topics over the course of the hour: the impacts the economy is having on the construction industry and how mergers and acquisitions (M&A) approaches can promote growth as companies continue to face demanding workforces.

Value, vulnerability and volatility

Wipfli's Michael Vaccarella opened the conversation around the three V's that the Wipfli team see as a trend for the new year: value, vulnerability and volatility.

- Companies looking to add some resiliency in preparation for the upcoming year have interest in hearing how diversification and possible M&A could impact growth, especially in a time where all signs point to a possible recession on the horizon.

Value, vulnerability and volatility

CFOs share uncertainty as they look to the next year, with the general consensus that sooner or later the other shoe will drop.

- Rising interest rates and high inflation are certainly factors weighing on CFOs in construction as they head into the new year, but with unprecedented backlogs happening across the industry, many are curious which side of the business is bearing the brunt of the inflationary woes.

- Strong backlog, in the meantime, is keeping organizations optimistic but looking toward diversifying in order to protect against a potential downturn.

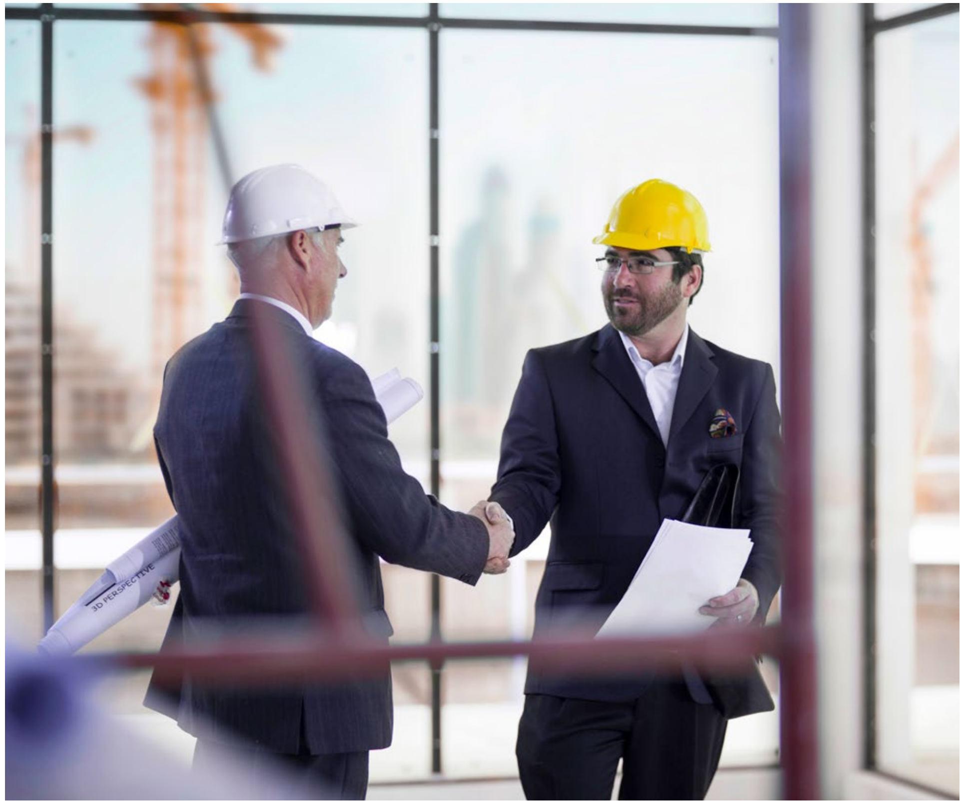
  Questions also arise about the quality of backlog, as some projects have been postponed or canceled altogether as interest rates increase. That being said, companies still report a 95%+ confidence in their backlog.

- To keep their company on top of changing headwinds, one executive held bimonthly barometer meetings on the quality of their backlog.

Value, vulnerability and volatility

The volatility of the last three years caused by the COVID-19 pandemic created certain booms in the construction industry, which provided some CFOs' companies a view into where to diversify.

- Even with robust backlogs, companies are beginning to notice the warning signs that certain areas are beginning to soften. As companies look to move into other aspects of the industry, they are starting to have talks around the challenges such moves may entail, such as difficulties in bringing in new talent during a volatile economic period.



Talent forecasts

Following the period of high resignations during the COVID-19 pandemic, the talent market has stabilized some, but it still looks very different from pre-pandemic times.

- Most notably, companies face empowered employees with new expectations and demands. With large corporations able to offer massive sums of money to available talent, companies are also having to find ways to retain the talent they have and find approaches to scale their business alongside their diversification blueprints.
- One company hired a third-party firm to go through and analyze their wage breakdowns and do a full review of their wage expectations. This structure gave 20% increases to some positions while identifying others that probably needed to be cut. The cost was expensive, but it identified key areas that could be cut during a leaner time period.

M&A concerns

For some CFOs, the discussion on expansion during economic downturn centers on M&A as a possible avenue to promote growth.

- Vaccarella shared a few viewpoints around mergers, noting that companies valued under the $10 million mark are positioned the best for making a market impact. Vaccarella also urged participants to carry out due diligence on any M&A target since a lot of unreasonable overvaluations exist in the market. Furthermore, start the net working capital (NWC) discussion early in the transaction negotiations. However, do not agree to a NWC target before diligence, and do not agree to the timeframe of the calculation (12-month average versus a six-or three-month average). Agree to this after financial diligence.
- One member's company just completed a double acquisition as a mass hiring approach in a market they were just moving into. This is a trend Wipfli's team is beginning to notice as more industries look to find readily available workforces.

M&A concerns

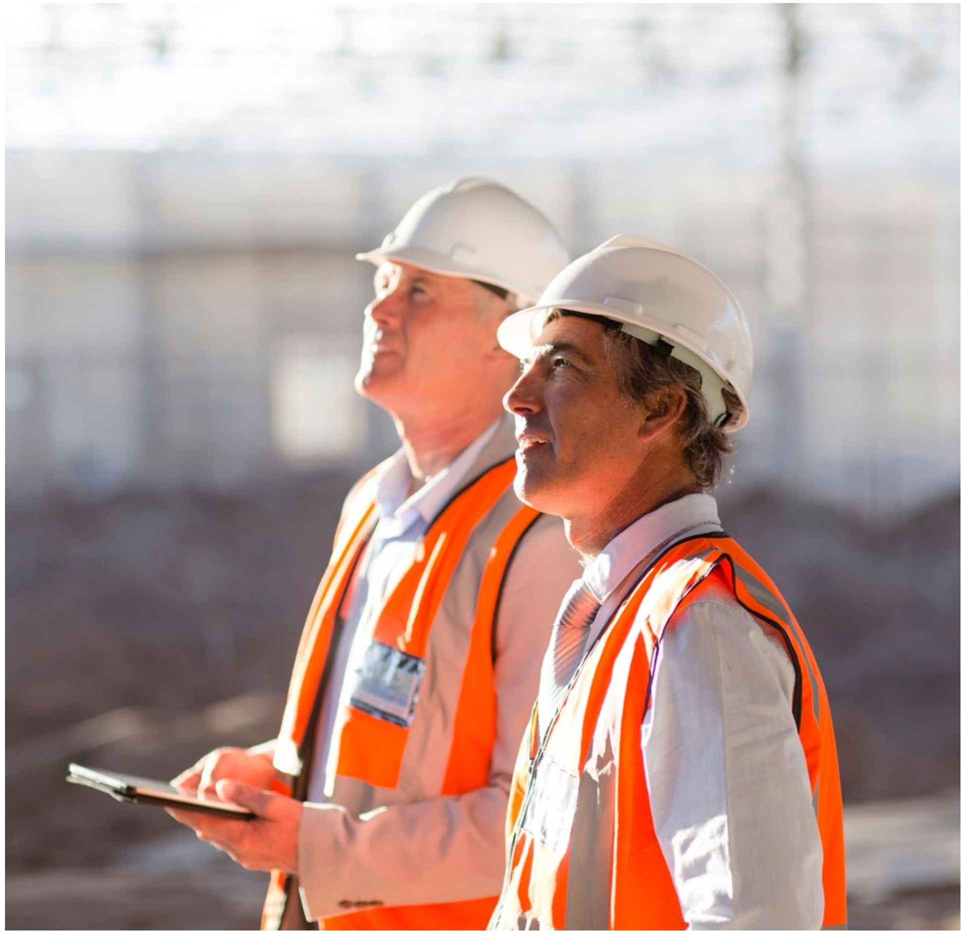
- Another organization found after their acquisition that they then had to spend funds on updating outdated equipment in order to get their new team up to speed. Vaccarella used this as an example of the need to also analyze capital expenditure (CapEx) when considering M&A opportunities. Value the business on free cash flow, not just EBIDITA.[1] Instead, use EBITDA, less new debt service, less CapEx.
- Members whose companies were able to acquire subcontractors fielded questions from peers on the types of discussions they had to encourage that strategy as a means of expansion. For the most part, business leaders chalked it up as a twist of fate and persistence but most importantly just asking the question is what started the conversation.

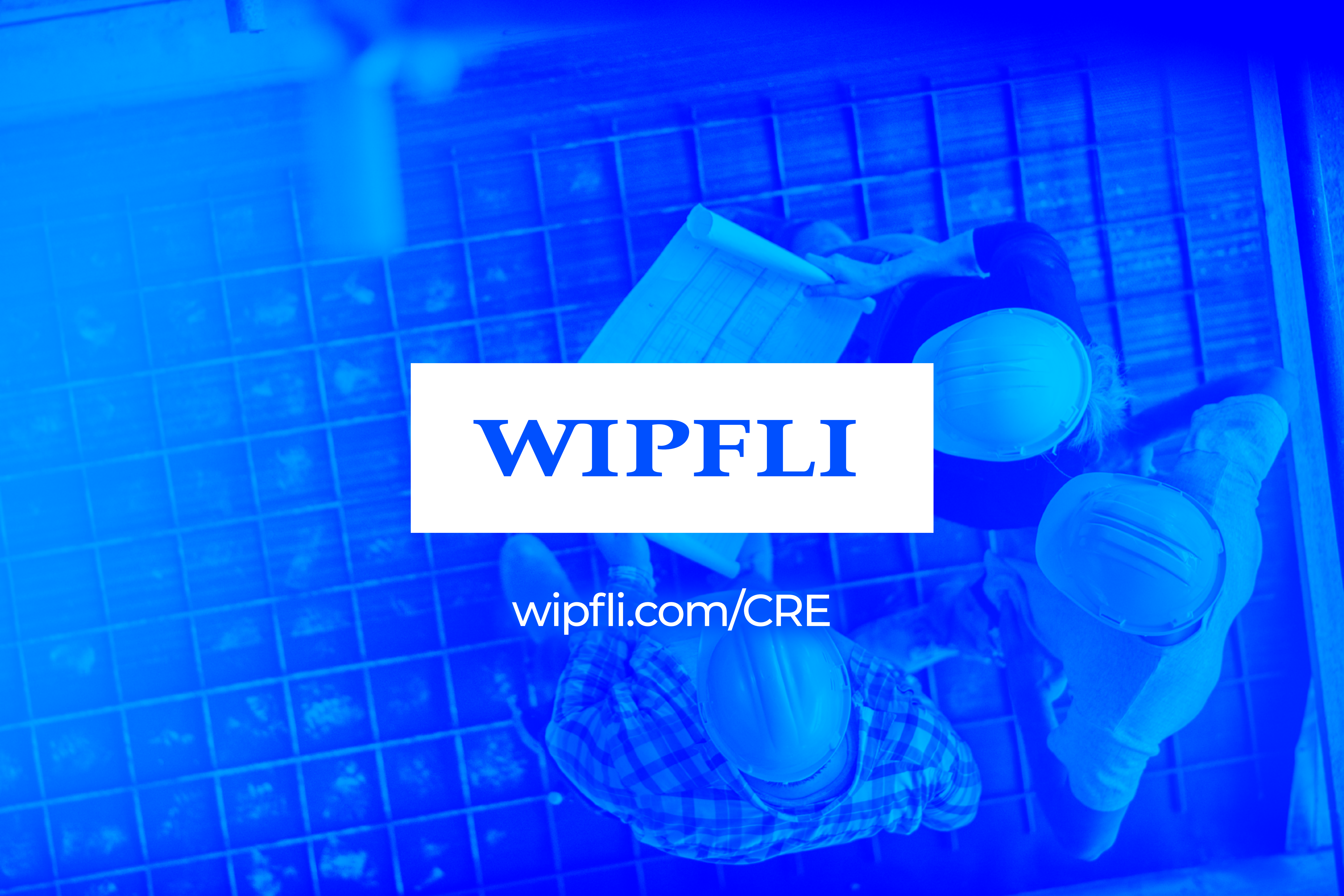
[1]Earnings before interest, taxes, depreciation and amortization (EBITDA) is an alternate measure of profitability to net income.

Resiliency for 2023

Having learned the importance of resilience during the upheaval of the COVID-19 pandemic, CFOs were curious to hear any and all resiliency strategies, as a recession seems imminent.

- Many organizations intend to be more conservative around hiring and budgetary risks. But with project backlogs extending into next year, business leaders will continue to monitor the impacts the economy has on the market before making drastic cuts.

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