

A construction site at sunset. A large crane is in the foreground, and several workers are visible on scaffolding. The sky is a mix of orange and blue.

# KEY ELEMENTS OF VALUING A CONSTRUCTION COMPANY, PROFESSIONAL SERVICE FIRMS, AND SUPPLIERS

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# Agenda

## TOPICS TO COVER

1. Why Valuations are Needed
2. Key Variables
3. Valuation Approaches
4. The Income Approach
5. The Market Approach
6. The Asset Approach
7. Valuation Discounts
8. Financial Performance
9. Market Conditions
10. The Impact of Risk
11. Adjustments for Accounting Methods
12. Nonoperating Assets
13. Rules of Thumb
14. Financial Ratio Analysis

# Valuations are Often Needed For:



Sale of a Business to  
an External Party



Transfer of Ownership  
to Trusts or Family



Merger of a  
Business



Sale of Business to ESOP



Purchase of  
A Business



Sales to  
Management or  
Key Leaders



Private Equity  
Investment



# Key Variables that Drive a Construction Business

- ➔ Backlog
- ➔ Fixed Assets
- ➔ Business Relationships
- ➔ Customer Base
- ➔ Economic Trends
- ➔ Succession Planning
- ➔ Risk





# Valuation Approaches



## Income Approach

Discounted Cash Flow Method  
Capitalization of Earnings Method



## Market Approach

Guideline Public Company Method  
Transaction Method



## Asset Approach

Net Asset Value Method  
Net Tangible Asset Value Method



## Income Approaches

### Discounted Cash Flow Method

*Present value of future expected net cash flows calculated using a discount rate*

- Includes projection of future net cash flows over several periods
- Includes terminal value at end of projected period (to infinity)
- Discount rate used to determine present value of future cash flows & terminal period
- Requires estimating future revenue growth, debt servicing, profit margins, discounted rates & capital requirements
- Best for strong financial histories & reliable forecasts



## Income Approaches, Cont'd

### Capitalization of Earnings Method

*Average amount of income for specific period & divided by capitalization rate that identifies anticipated returns & inherent risks*

### Common Adjustments

- Owners Salaries & Bonuses
- Related Party Transactions
- One-Time Non-Recurring Items
- Over or Under Market Rent
- Personal Expenses in Company



# The Market Approach

## Guideline Public Company Method

Very few publicly traded construction companies comparable to mid-small size companies

## Transaction Method

Little more common

- Bases a value on the revenue of similar company
- Accuracy relies on being close to comparative companies





# The Asset Approach

**Fair Value of Assets less Liabilities**

**Adjustment of Property & Other Items to Fair Value**

**Reductions for Shareholder Loans & Related Party Items**

**Valuation of Intangible Assets like Reputation, Client Contracts, etc.**





# Valuation Discounts



## **Lack of Control**

Value of control factors legal rights and economic potential



## **Lack of Marketability**

Value is directly impacted by ability to sell it and the market of potential purchasers



## **Key Person Discount**

Value is impacted by loss of key personnel that is significant to ongoing value of company

# Financial Performance



## Revenue and Profit Margins

Analyze historical revenue, net income and profitability



## Cash Flow

Focus on consistent cash flow as it reflects the business' ability to sustain operations



## Financial Statements

Assurance level, balance sheets, income statements, cash flow, WIP schedules

# Market Conditions



## Industry Trends

A valuator has to consider the current state of the industry, including demand, competition and economic factors



## Local Market Analysis

A valuator must understand the market in which the company operates including market demand

# Impact of Risk

 **Customer Concentration**

 **Barriers to Entry**

 **Competition**

 **Possible Unprofitable  
Backlog & Loss Projects**

 **Economic Cycles**

 **Location**

 **Supplies & Materials**

 **Management & Leadership**

 **Estimation Errors**

 **Litigation**

 **Regulatory Environment**

 **Mother Nature**



# Adjustments for Accounting Methods

**Cash Method**

**Accrual Method**

**Percentage of Completion Method**

**Completion Contract Method**



# Rules of Thumb

## Book Value

...if the company has not had a successful history

## Book Value Plus

...a Multiple of Backlog

## 10% – 30%

...of annual revenues

## 2 – 3.5 times

...cash flows for GCs

## 4 – 6 times

...cash flows for specialty trade



# Important Factors – Engineering Services Firms

## Large portion of intangible value

- Typically have low levels of fixed tangible assets
- Value focused on intangibles – customer lists, intellectual property, specialized knowledge, contractual agreements

## Significant private M&A activity

- Multitude of comparable transaction data to support a strong application of the Market Approach

**Median of 0.67x**

...net revenues

**Median of 5.5-6.5x**

...normalized EBITDA



# Important Factors – Construction Suppliers

## Largely dependent on the type of supplier

- Really a case-by-case basis; company value and transaction multiples can vary significantly based on the type of supplier, its customer base, and its geographic presence.

## Global Supply Chain Pressures

- Following the COVID-19 pandemic, global supply chain was disrupted in most every type of supply class
- This has largely returned to normal in the last 12-24 months for most suppliers; with value metrics returning to pre-COVID levels

# Financial Ratio Analysis

## Compared to Industry Benchmarks

- ➔ EBITDA – Earnings before Interest, Taxes, Depreciation, and Amortization
- ➔ Working Capital – Current Assets – Current Liabilities
- ➔ Debt to Equity – Total Debt to Total Shareholder Equity



# Financial Ratio Analysis, Cont'd

## Compared to Industry Benchmarks

- ➔ Months in Backlog – Backlog divided by (Annual Revenue divided by 12)
- ➔ Profit Margins – Gross and Net
- ➔ Seller's Discretionary Earnings – Starts with EBITDA and adds back or deducts potential expenses a new owner may or may not incur



# KEY TAKEAWAYS



Focus on Profitability  
of Work, Not Volume



Succession Planning  
is Imperative



Maintain a Healthy  
Balance Sheet



Understand How Changes  
in Volume Impact You



Try to Avoid  
Claims & Litigation



Focus on Your  
Workforce



Diversify Your Services  
& Customer Base

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A row of nine light-colored wooden blocks, each with a black letter, spelling out the words "CONTACT US" in all caps. The blocks are arranged on a light-colored, weathered wooden surface. The background is a blurred indoor setting with greenery.

**C O N T A C T U S**



Any Questions?