FORESIGHT CFO

THE Barbour Group

Surety Bond Requirements and Financial Performance

Inside Information

CLARITY. CONFIDENCE. IMPACT.

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Clarity

Confidence

Impact

Impacting CEOs Globally

DC - NYC - Chicago - Maryland - Virginia - Connecticut - Florida - Pune - New Zealand - Australia

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Bond Build & Grow Together

Award Winning &
Nationally Licensed Surety Agency

www.thebarbourgroup.com

Webinar Objectives

- Introduce the Surety Underwriting Process
  - Start-Ups to $1.5 million in Capacity
  - Established Firms

- Share Best Practices to Overcome Underwriting Challenges
  - Type of Work/Risk
  - Financial Analysis
  - Work In Progress Evaluation
  - Indemnity Concessions
  - Premium Determination

Let's Figure Out Who is In the Room

Poll Question

What was your topline revenue in the prior year?

This year with COVID, do you expect your revenue to?

Bonding – It's the Law for Government Contracts

Miller Act requires federal contracts of more than $150,000 to be bonded. (In some cases bonds are required for projects greater than $30,000). States adopted this law (Little Miller Act) and generally require bonds for projects in excess of $100,000. Flow down occurred to the private sector as a risk management tool.

What is a Surety Bond?

- A Surety bond is a three party agreement involving a Principal, Obligee and Surety.
  - <u>Principal/Contractor:</u> the party that owes a duty to a second party. Typically, the Principal enters into a contract whereby it agrees to perform according to its terms and conditions.
  - <u>Obligee/Owner:</u> the beneficiary of the bond guaranty. In exchange for paying for the Surety Bond, the Obligee is guaranteed that the Principal will honor the contract free of all liens.
  - <u>Surety:</u> the guarantor under the bond. In exchange for accepting the bond premium, it guarantees to the Obligee that the Principal will perform according to the terms and conditions of the contract and that all suppliers, vendors and lower tiered contractors and subcontractors will be paid if the bonded principal is declared to be in default. (Keep in mind that failure to pay a contract bond premium is not a defense for a surety to not honor its guaranty.)

Bonding is Not Insurance

- All sureties underwrite using a zero-loss ratio.
- Three party contract
- Company and each owner/spouse guarantee to pay back any funds paid out on their behalf by the surety – “indemnity”

Indemnity

- Bond programs are guaranteed by a General Indemnity Agreement (GIA)
- The indemnitors include the company & its owners AND spouses (exceptions are rare for small business).
- The indemnitors agree to repay the surety for any and all costs associated with settling a bond claim.
- The maximum exposure to loss is the limit on the bond. This is otherwise known as the bond penalty.
  - If the surety agrees to take over the project with its own forces, then it must complete the job at any cost.

Types of Surety Bonds

- Bid Bond – guarantees the principal will honor its bid and enter into a contract if awarded.
- Performance Bond – guarantees the principal will perform to the specifications of the contract
- Payment Bond – guarantees the principal will pay all parties involved in the satisfactory completion of the contract.
- Maintenance Bond – guarantees the principal will protect against defective workmanship as stated in the contract. Typically one year.
- Advance Payment Bond – guarantees the principal will repay monies advanced by the obligee on the project.
- Supply Bond – guarantees the principal will deliver specific material at the agreed upon price and schedule.

Contract Versus Commercial Surety

- CONTRACT SURETY – STICKS & BRICKS RISKS

- COMMERCIAL SURETY
  - SUPPLY, SUPPLY & INSTALL CONSTRUCTION CONTRACTS
  - IT - SOFTWARE
  - SERVICE CONTRACTS – MULTI-YEAR
  - SUBDIVISION
  - LICENSE & PERMIT, MISCELLANEOUS
  - PROBATE, COURT

WHAT DOES YOUR SURETY CONSIDER AS COMMERCIAL CONTRACTS?

Fast Track Bonds Up To 1.5 Million

- SEE ONLINE PORTAL ON WWW.THEBARBOURGROUP.COM FOR ON-LINE BOND APPROVAL ON PROJECTS $450,000 OR LESS
- Other programs can approve bonds up to $750,000 based on credit and up to $1.5 million with in-house accrual-based balance sheet and profit and loss statements
- Rate is 3% of contract value

Credit Based Fast Track Applications

- Liberty Mutual
- RLI Insurance Company
- Western Surety
- Capitol Indemnity
- Cincinnati Insurance
- Main Street America
- SBA-Quick & Easy
- HCC Surety
- NGM Insurance Company
- Penn National Ins. Company
- Philadelphia Insurance Company
- Old Republic Surety (Up to $750 on credit)
- Travelers Insurance Company

Hensel Phelps & The Barbour Group's Exclusive Bonding Program

- Projects up to $400,000 based on personal credit.
- If credit is poor, the program will step in and offer caveats to enable bond approval
- 99% success rate for approvals
- Over $85 million in contracts bonded
- Zero defaults
- Bond required for projects $50,000 and higher

Common Financial Screens

What are common reasons small businesses cannot obtain bonds?

Underwriter Top 10 List

NEW (1) – PERSONAL CREDIT

1) Strength of Balance Sheet
2) Financial Statement Presentation
3) Equity
4) History of Successful Projects
5) Debt
6) Experience in Type of Project
7) Consistent Profitability
8) Use of CPA With Industry Knowledge
9) Expertise of Company Management Team
10) Reputation of Firm and/or Principles

Source: GRANT THORNTON LLP'S 2007 SURETY CREDIT SURVEY FOR CONSTRUCTION CONTRACTORS (1-10), NOT NEW (1)

Alternative Markets

Do small businesses benefit from the SBA Bond Guarantee Program?

Is the SBA Bond Program an Option?

- Will guaranty surety bond up to 90%
- Projects up to $6.5 million ($10 million for federal projects)
- Eligibility follows NAICS size standards
- Cost is additional $6.00 per thousand of the contract price. Included into premium cost
- SBA program is 20 times working capital
- Will count unused portion of bank line of credit, if any, into working capital
- CPA Audit required for projects $6.5 milli and higher

The Submission

- Last 3 year-end financial statements for the company
- Current interim in-house statement
- With both the interim & most recent year-end:
  - Concurrent A/R Aging
  - Concurrent A/P Aging
  - Concurrent Bank Statements
  - Concurrent Work in Progress
- Last 3 years of Corporate Tax Returns
- Current Personal Financials on all owners.
- Last 3 years of Personal Tax Returns for all owners.
- Copy of Bank Line of Credit
- Resumes for all key personnel
- Business Plan
- Operating Agreement (LLCs)
- Articles of Incorporation
- Buy/Sell Agreement
- Contractor Questionnaire
- Life Insurance on owners
- Insurance Certificate
- Supplier References
- Owner References
- Bank Reference

Capacity

- Factors include:
  - How long has the business been in operation?
  - What is the form of Ownership?
  - Who are the current owners and for how long?
  - What is the experience of current owners?
  - Who are the other key employees and what are their responsibilities? Are they experienced?

Continuity

- A continuity plan should provide for the continuity of management AND ownership.
  - The buy/sell agreement or continuity management agreement should be funded by life insurance.
  - Since a person is substantially more likely to be disabled vs. killed, a disability product should be incorporated into the agreement in addition to a key-person life insurance policy.
  - Buy-sell agreement are uncontestable

Establishing the Surety Line

- Bonding credit is expressed on a per job/backlog aggregate basis.
  - For example: an underwriter might be willing to offer bonds on any one specific job up to $1 million with a total program not to exceed $3 million. Or, 1M/3M program
  - Based on cost to complete at any one point in time.
  - CNA Surety bases program on total contracts less billings

How Much Bonding Can I Get?

A multiplier between 10 and 20 times is applied to working capital to arrive at the aggregate bonding capacity.

What is Working Capital

= (current assets) – (current liabilities)

- Current Assets: "allowable" assets that turn into cash within 90 days
- Exceptions:
  - Retention and billed retention
  - Work In Progress inventory
  - Subordinated Debt – quasi capital
  - Underbillings – Unbilled receivables

Levels of Financial Reporting

In General:

- CPA **Compilation**: projects up to $500,000
- CPA **Review**: projects $500,000 and greater
- CPA **Audit**: projects $10,000,000 and greater
- **Exception** – "Fast Track" programs utilize corporate and personal credit scores to consider bonds up to $500,000

Importance of Construction Savvy CPA

- Is your CPA known by the surety industry?

- What is the quality of your financial statement presentation?

- Which revenue recognition method is utilized?

Methods of Financial Reporting

- **Percentage of Completion** – measures progress of job based on relationship between costs to date to total Costs. Only suitable for fixed price lump sum contracts.
- Accrual – accepted for inactive accounts, contractors with no open jobs at year end, contractors who do not engage in fixed price contracts
  - Ex. time and material and unit price contracts
- Cash – Not accepted

Surety Backlog

How does a surety keep track of how much work a contractor undertakes?

Backlog Spikes

I have a large job that exceeds my current bonding capacity. How do I approach my bonding company?

Bond Program Rate & Structure

- Standard vs. Preferred Rates

- Contract Price vs. Bond Penalty
  - Ex. Bond specs stipulate a 50% bond penalty

Indemnity Concessions

- Capital Retention Agreement (retained earnings)
- Limited Dollar Indemnity (personal)
- Homestead exclusion
- Personal Indemnity Release

Work In Progress Schedule

SCHEDULE OF WORK IN PROGRESS

CONTRACTOR NAME:

REPORT DATE:

FISCAL YEAR END:

JOB NAME	CONTRACT PRICE	Gross Profit %	ORIGINAL GROSS PROFIT	REVISED GROSS PROFIT	TOTAL COST	COST TO DATE	BILLED TO DATE	COST TO COMPLETE	EST DATE OF COMPLETION	BONDED PROJECT? YES/NO
		#DIV/0!		$0				$0		
		#DIV/0!		$0				$0		

WIP Example #1

- Contract Price: $100,000.00

  Est. Total Costs: $80,000

  Est. Gross Profit $20,000

  Billings to Date: $60,000

  Costs-to-Date: $40,000

  % Complete: 50%

  Earned Gross Profit: ??

  Over/Under billing ??

WIP Example #2

- Contract Price: $100,000.00

  Est. Total Costs: $80,000

  Est. Gross Profit $20,000

  Billings to Date: $30,000

  Costs-to-Date: $40,000

  % Complete: 50%

  Earned Gross Profit: ??

  Over/Under Billing ??

NON-STANDARD APPROACHES

What programs exist when the contractor cannot obtain a bond through traditional markets?

COLLATERAL
FUNDS CONTROL
SUBGUARD

Teaming and Joint Venturing

- **Teaming -** Some sureties will provide bonding capacity for a small business if they team with a larger and financially stronger contractor
- **Joint Venture** - Many sureties will only provide bonding support if they bond both partners. The joint venture agreement should spell out the work to be performed by each party

Teaming and Joint Venturing…

- Surety must review agreement
- Escrow/funds control could be imposed
- Indemnity disclosure for teaming agreement
- Confirm acceptance of JV by procurement agency
- Consider impact on backlog/bonding capacity
- Make certain that the teaming agreement references a subcontract agreement

Questions ??

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www.thebarbourgroup.com
www.ahcc-midatlantic.org – Education & Training for Hispanic Commercial Contractors
www.bgnetworkusa.com – Consulting
www.pfac-md-org - On-Line Charity Auction June 5th-12th, 2020
www.nsbpusa.org – National Small Business Party

Key Underwriting Ratios

- Solvency Ratios
- Efficiency Ratios
- Profitability Ratios

Solvency Ratios

Solvency ratios measure the ability of the company to satisfy its obligations as they become due

- Quick Ratio
  - **(Cash + Marketable Securities + Receivables) / Current Liabilities**
  - Measures the contractors ability to meet short-term needs
  - A liquid position is indicated by a ratio greater than 1.0
  - Receivables over 90 days old and retentions are not typically included in ratio computation.

Solvency Ratios…

- Current Ratio
  - **Current Assets / Current Liabilities**
  - Compares the amount of current assets available to satisfy the current liabilities requiring payment
  - The higher the ratio the better. Indicates that the company can meet its current obligations
  - Like the Quick Ratio, old accounts receivables and retentions are not typically included.

Solvency Ratios…

- Current Liabilities to Net Worth Ratio
  - **Current Liabilities / Net Worth x 100**
  - Recognizes that as net worth increases relative to "creditor's equity", the risk assumed by current creditors decreases.
  - The higher the ratio, the more risk being assumed by creditors
  - A low ratio may indicate that a company is ready to "leverage" net worth for growth.
- Current Liabilities to Inventory Ratio
  - **Current Liabilities / Inventory x 100**
  - Indicates the extent that the company relies on sales of unsold inventory to finance debt
  - The higher the number, the greater the risk to creditors
  - This ratio is suited more to evaluating manufacturers than contractors.

Solvency Ratios…

- Total Liabilities to Net Worth Ratio
  - **Total Liabilities / Net Worth x 100**
  - Measures the extent to which "creditor's equity" in the assets of the company exceed the net worth of the company
  - The higher the ratio, the greater the risk to the creditors
  - Preferred ratio is less than 3 to 1
- Fixed Assets to Net Worth Ratio
  - **(Fixed Assets – Accumulated Depreciation) / Net Worth x 100**
  - Measures the extent to which the company's net worth has been invested in fixed (capital) assets
  - The lower the ratio, the lower the investment in fixed assets

Efficiency Ratios

Efficiency ratios measure how effective an operation or business is performing.

- Collection Period Ratio
  - **Accounts Receivable / Annual Sales x 365 or Annual Sales / AR**
  - Indicates the number of days it takes to collect receivables
  - The lower the number, typically the higher the quality of receivables
  - The number should be compared to the industry average to get a feel for how your company is doing in collecting its receivables.

Efficiency Ratios…

- Net Sales to Inventory Ratio
  - **Net Sales / Inventory**
  - Indicates how quickly inventory is being turned over
  - This figure needs to be compared to the industry average
    - Too high a figure may indicate inefficient operations. Low supply to high demand.
    - Too low a figure may lead to obsolete or deteriorating inventory.
  - Skewing occurs when a contractor may be storing materials for a large, upcoming project resulting in a low ratio

It is critical that the operating cycle of the business is understood when using this particular efficiency ratio

Efficiency Ratios…

- Assets to Sales Ratio
  - **Assets / Sales x 100**
  - Measures the capital investment necessary to general sales
  - The resulting figure must be compared with the industry average
    - Generally, you are looking for a lower number
    - Too high a number indicates a potential under-trading of the assets

Efficiency Ratios…

- Sales to Net Working Capital Ratio
  - **Sales / Net Working Capital**
  - Indicates how the working capital is being used relative to revenue
  - Typically, a higher number is better than a lower number
    - Too high a figure leaves the company very sensitive to an interruption in cash flow
    - Too low a figure indicates an inefficient use of working capital

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Efficiency Ratios…

- Accounts Payable to Sales Ratio
  - **Accounts Payable / Sales x 100**
  - Measures how well the contractor is paying its suppliers relative to revenue
  - The higher the number generally indicates a less desirable position. It may mean the funds to pay off the suppliers are being used to otherwise finance the project

Profitability Ratios

Profitability ratios measure the ability to generate profit.

- Return on Sales Ratio
  - **Net Profit after Taxes / Sales x 100**
  - Expresses the company's profit as a percentage of sales
  - The higher the figure, the more profitable the company
  - Underwriters will check the earnings statement to see what, if anything, is affecting this ratio
    - Was there a capital gain on the sale of an asset?
    - Was there substantial interest income?

Profitability Ratios…

- Return on Assets Ratio
  - **Net Profit after Taxes / Total Assets x 100**
  - Measures how well the assets of the company are being used to generate profit
  - The higher the number the better the use of the assets

- Return on Net Worth Ratio (Profit to Net Worth or Earning Power)
  - **Earnings / Net Worth x 100**
  - Generally considered the overall indicator of a company's profitability as it measures the rate of return on the company's equity
  - Usually, the higher the figure, the better… but could also mean too little investment
  - A low figure may mean poor performance, conservative management or a mature company with a lot of built-up equity.

About The Barbour Group

- Established in 2002 – 100% woman-owned
- Specialize in contract & commercial surety
- Clients range from startups to Fortune 1000
- Small company agility + big company resources
- Devoted service to the community

Awards and Recognition

INNOVATOR OF THE YEAR

Inc. 500 | 5000

Class of 2009
Ernst & Young Entrepreneurial Winning Women™

smart CEO FUTURE 50

SmartCEO celebrates Brava
Women Business Achievement Awards

SBA.GOV
U.S. Small Business Administration

Certified WBENC
Women's Business Enterprise

Circle of Excellence
THE DAILY RECORD

TOP 100 MBEs℠
Honoring Minority and Women Entrepreneurs

INFLUENTIAL MARYLANDERS

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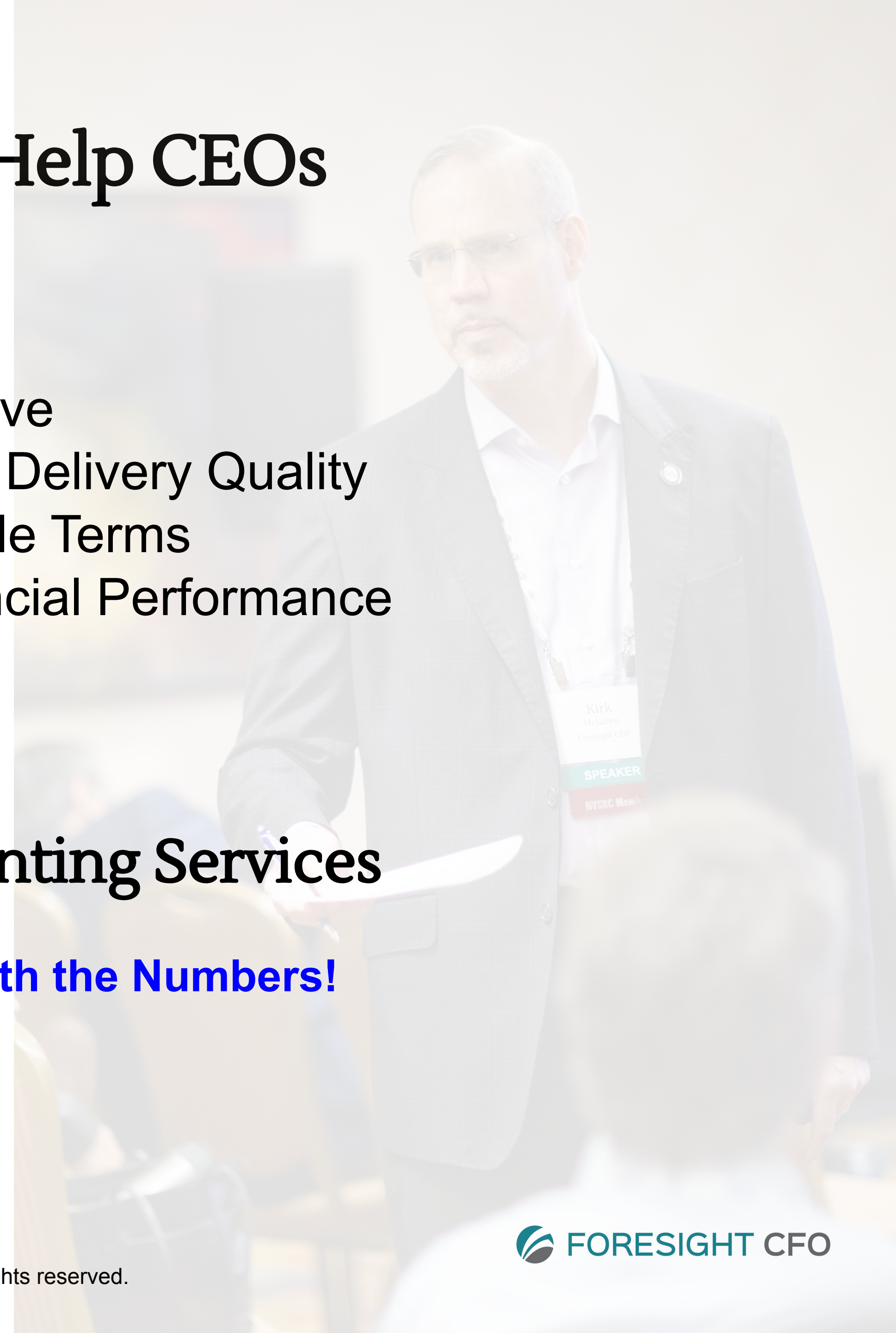
Foresight CFO - **We Help CEOs**

Win More Customers
Keep the Customers they Have
Have the People Capacity to Delivery Quality
Access to Capital at Favorable Terms
Achieve Top Percentile Financial Performance

We Do this Through
Growth CFO and **Accounting Services**

Plan, implement, and calibrate **With the Numbers!**



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We do this with **The 2% CEO Habits of Profitability™**

- ➢ **Habit 1** - Make Sure that You Have Good Numbers
- ➢ **Habit 2** - Manage Cash Well
- ➢ **Habit 3** - Identify the Right Growth Options
- ➢ **Habit 4** - Create Your Financial Roadmap
- ➢ **Habit 5** - Shake Up Possibilities

FORESIGHT CFO

Our Growth CFO Team Beats Full-Time CFOs Everytime

People

- ➢ 234 Years of Experience
- ➢ 2 Person Teams
- ➢ Capacity to Surge

Expertise

- ➢ Growth Guide
- ➢ IFM Certified
- ➢ Technology Enabled

Impact

- ➢ Focused on Priorities
- ➢ Deliver in 90-Day Sprints
- ➢ Measurable Impact

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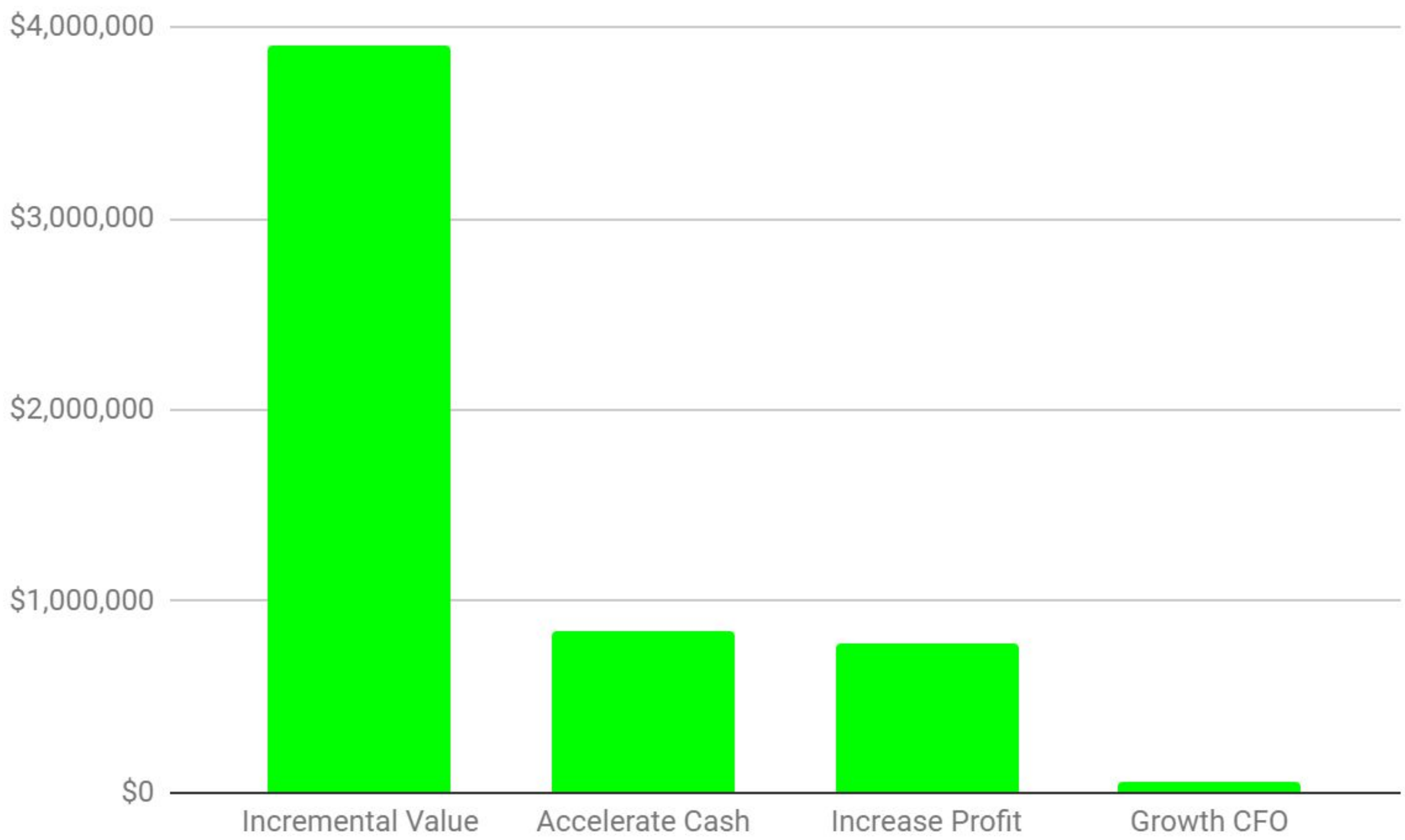
Growth CFOs Deliver Measurable Impact



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