Construction Industry Insights

Strong Backlog of Work Improves Company's Valuation

March 2023

In January, we shared an article: 10 Ways Construction Contractors Can Increase Their Company's Valuation Before Selling the Business.

Examples of ways to increase valuation included collecting outstanding retainage, maintaining a solid management team, and avoiding customer concentration. However, your best efforts to increase valuation won't matter if you don't have a healthy backlog of profitable jobs.

A good friend who has almost 40 years in heavy-civil construction and owns a small percentage of his company's shares, recently told me he evaluates the health of his company (and his investment) by considering, at any given moment, what would someone pay to buy the business. He then revealed that his company has almost no work on its backlog. He was discouraged and questioned why anyone would want to buy a construction business that has little booked upcoming work. My friend is right to be concerned.

The Importance of a Healthy Backlog

While a construction contractor's valuation is derived from many factors such as past financial performance, customer good will, and capital equipment assets, a contractor with little work is not attractive to potential buyers and becomes increasingly less attractive each passing day new jobs aren't being captured. Things can spiral down from here. Financial stability is undermined as the company burns through cash to maintain operations. Bonding capacity decreases. Skilled tradespeople, who are most critical to executing work in the field, may be laid-off and could be permanently lost from the company if they take up new employment elsewhere. Some members of the project management staff may get nervous about their jobs and seek new opportunities with competitors. Without steady work on the backlog, key elements of the business that once made it very attractive to buyers begin to fall like dominoes, taking valuations down with them.

Quantifying a Healthy Backlog

The criteria for quantifying a healthy backlog varies based on the contractor's industry segment, the size of the company, and the duration of the jobs it performs. Getting work on the backlog, especially when your company competes mostly on price, isn't easy.

Avoid Cutting Margins

If you are preparing to sell, it isn't wise nor necessary to cut your margins and win some low-price jobs just to create the appearance of having a backlog. Potential buyers, during their due diligence period, will quickly see these jobs as low profit and high risk and will be discouraged from making a strong offer, or could simply walk away. Rather, just as you would during the normal course of business, always be hunting new work, bid competitively but profitably, and keep your operations in stable condition. This could mean delaying when to sell the business until the backlog is filled, but this is time well invested to maintain valuation for the long haul.

Accelerate Efforts to Keep Profitable Work on the Backlog

Construction business owners can't take their foot off the gas when getting ready to sell the company. If anything, you may need to accelerate efforts to keep profitable work on the backlog. With this work in place, contractors can then focus on increasing valuations.

About the Author

Jeff Shannon is a Senior M&A Advisor with BMI Mergers & Acquisitions. He comes from a successful career in the construction industry that spans over 25 years with experience working on projects up to $200 million. He has held a variety of roles, from working on job sites to executive positions, and has expertise in infrastructure construction, particularly in the areas of highways, ports, utilities, mass transit, government, and commercial projects. Additionally, Jeff holds the Certified Merger & Acquisition Advisor designation (CM&AA) from the Association of Merger & Acquisition Advisors. In his most recent role, he was responsible for identifying new business opportunities and providing advice to shareholders and the executive team on growth opportunities, market trends, new technologies and general operations.

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