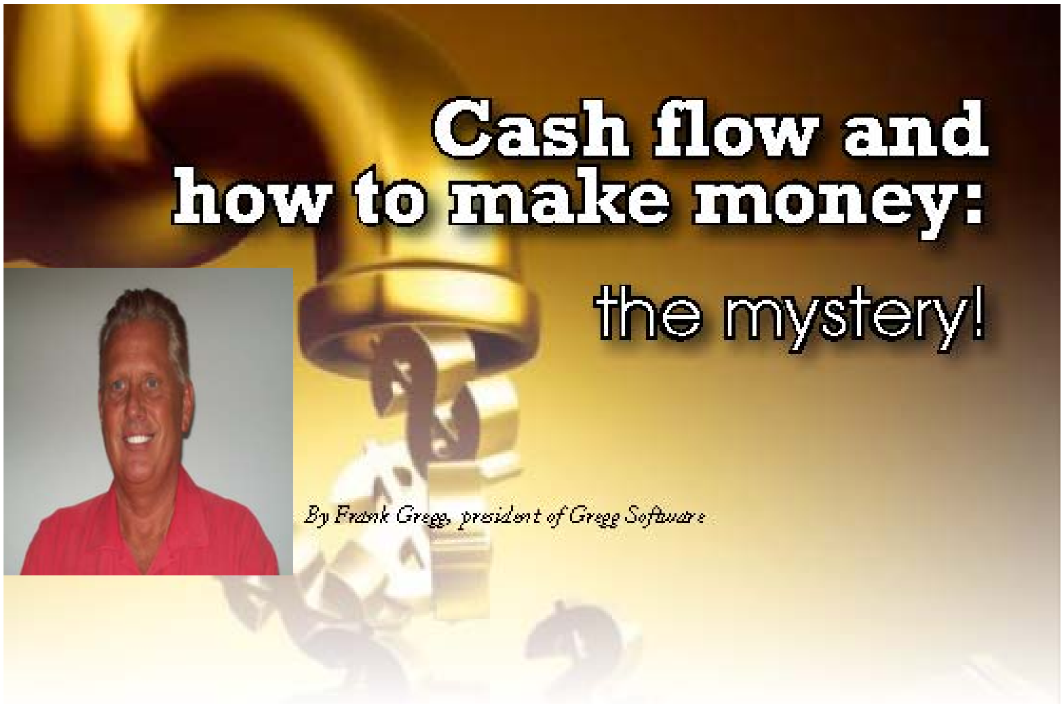

Cash flow and how to make money: the mystery!

By Frank Gregg, president of Gregg Software

Do your office workers know what makes up an estimate and what "cash flow" is?

Cash flow – a measure of a company's financial health – equals cash receipts minus cash payments over a given period of time, or net profit plus amounts charged off for depreciation, depletion, and amortization.

A positive cash flow means you have more cash coming in than cash going out. It doesn't have anything to do with actual profit and can be affected even if the company is profitable. The added cost during expansion or growth, new purchases and retention can result in negative cash flow.

Retention impact on cash flow

As commercial contractors, you can have retention held up to a year before getting paid. A 10 percent retention is a margin percentage. But even with a 10 percent markup, 10 percent retention will put you in the red.

Consider an $11,000 bid that includes a 10 percent markup on $10,000 ($1,000). Retention on $11,000.00 equals $1,100 – less than your markup, resulting in the need to fund project overhead from your pocket until the retention is paid! Making profit but having a negative cash flow puts you out of business.

If a commercial contractor doing $1 million worth of work per year wants to grow to $3 million per year, there must be enough cash to support the amount of retention to cover the growth – not to mention the monthly increases in expense cost.

Overhead impact on cash flow

Overhead is total cost that can't be directly attributed to the project such as building, rent, utilities, office labor, vehicles, and insurance – basically costs associated with conducting business.

Traditional overhead for a ceramic tile shop is 15 percent with 25 percent for a stone fabrication shop. Anything more is considered too heavy when compared to sales.

If you are using a complete accounting system with job cost, the overhead percentage can be calculated from what is usually printed in the financial statements. A good program can print a financial statement at any moment.

Invest in a good estimating program – it can equip one estimator to do the job of four workers, eliminating the human mistake factor and three payroll checks. You might be able to bid 10 times more bids making room for deeper jobs you didn't have time for before.

Profit and cash flow

Profit is the money left after job costs and your overhead has been paid. But the actual profit calculated is almost never completely realized. Back charges, repairs, punch list items and unforeseen problem costs always seem to happen. Even if a 10 percent profit is calculated, no more than 5-8 percent may be realized.

Many estimators are price negotiators and will cut their bid when asked – but be sure to break out overhead and profit before considering a cut to your bid. How else do you know how much you can afford to cut if you don't know what your profit is supposed to be?

Would you take this $12,500 job at $11,900? If so, you'd only make $400 profit with total cost of $11,500 including overhead.

Job cost	$10,000.00
Overhead 15 percent	$1,500.00
Profit 10 percent (on cost only)	$1,000.00
Total project	$12,500.00

Here's accounting food for thought for a company expecting to do $1.25 million a year:

Expected annual cost	$1,000,000.00
Actual overhead cost 15 percent	$150,000.00
Expected profit 10 percent	$100,000.00
Total expected Revenue	$1,250,000.00

You have a fixed base overhead. That means you must get to the total gross sales number to make this scenario work. If you don't get the total revenue to cover the total overhead you figured then the overhead cost "not covered" comes from profit.

If you are a bid-cutter, each time you cut profit from any bid, total revenue has to increase dramatically to cover your fixed overhead. Only then can profits match calculations, but you will have done much more work and taken more risk for the same money.

Unit pricing

Consider carefully before using unit pricing on a job. On ceramic tile jobs, when times get tough or the jobs get bigger to price, unit pricing can skew a job one way or the other. One price does not fit all and the good estimators know that.

On stone slab projects even the smallest project can go negative due to the need to purchase more slabs than the project unit pricing allows. For instance, you may need 41 square feet of material to complete a 40 square foot job, so you are forced to buy an extra slab. I found that many shops have a nice size bone yard because the client did not really want to pay what was needed. The result is the fabricator bought it and now it is "inventory in the bone yard".

Software programs: essential tools

Contractors with jobs that last many weeks should know where they stand against the cost on the estimate at any time. It's easy to calculate job cost in an accounting program and compare it to your estimate for that period of the project. The accounting program will give you the cost to date if it is kept current and the estimating program will tell you the cost of the work completed to date if kept current.

Have you ever heard the expression, "good competition is good for business"? One of my contractors in Indianapolis found his estimating program was so accurate and easy he promoted it to his competitors because bid tabs were so erratic. After two years of tracking the group, profits increased more than 15 percent across the board since everyone got on the same pricing level.

Frank Gregg is an estimating software developer who creates special takeoff and pricing programs for the ceramic tile, stone fabrication and stone installation industry. He teaches accounting and cash flow and consults accounting departments in job cost. He has taught over 1600 estimators and has over 400 companies using software since 1998. From 1970 thru 1994 he was president of Narciso Tile and Stone in Houston, Texas doing high rise buildings and large commercial projects for exterior stone and ceramic tile projects and had a fabrication shop. Contact him at Gregg Software Incorporated, www.greggsoftware.com; frank@greggsoftware.com or phone (713) 854-4489.