# Forecast Cash Flow to Avoid a Financial Disaster

**By Michael B. Ceschini**

A contractor would be foolish to start a large job without checking the weather forecast first, but all too many embark on a project without a forecast explaining whether financial conditions are right for the job. The following examples illustrate the power of a cash flow projection, and what's at stake for contractors that ignore the warning signs of an impending storm.

**Homebuilder Wiped Out By Large Project**

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Joe Brown was struggling to cover payroll on Brown & Brown Builders, the homebuilding company his family had run for more than 30 years. When he heard a developer was planning to convert a local shopping mall into a condo community, he hesitated to throw his hat into the ring. Not only was the multifamily development outside Brown & Brown's single-family comfort zone, it was larger than any project the company had attempted.

Not wanting to play it safe, Brown & Brown pulled together a bid—and the gamble paid off. The developer accepted the $15 million bid and the company started lining up the resources to complete the job. But three months after breaking ground, Brown & Brown filed for bankruptcy.

**Government Job Lifts Contractor to Next Level**

After four lean years, Jackson Marine Construction had an opportunity to bid on the expansion of a waterfront park run by the state economic development corporation (EDC). The EDC selected Jackson's bid of $25 million, but first the agency needed to evaluate whether the company had the financial ability to complete the job. This was a critical question for the EDC, as Jackson's failure to complete the job would significantly increase the cost of the project, cause extensive time delays and costly litigation.

Owner Tom Jackson turned to his CPA, who worked with the company's estimating department to review the project work, production and billing schedules. Then the CPA prepared a monthly cash flow projection that took into account receipts from billing requisitions, all labor costs (which would be paid when incurred), and subcontractor and material costs (which would be paid in subsequent months).

Once the CPA explained the project's cash flow from start to finish, Jackson saw that the cash outflows would outstrip his available cash plus cash receipts from billing requisitions by more than $3 million in the first few months of the project. Clearly, that was a recipe for disaster.

Jackson had two options: find the funds to cover the shortfalls until he could convert accounts receivable into cash, or withdraw the bid.

Jackson had a $2.5 million bank line of credit available. He also would have to infuse $500,000 of his own capital into the company to fill the cash flow gap. The cash flow projection demonstrated to the EDC that the company's liquidity, available bank credit and owner's capital infusion were more than sufficient to support the project.

Furthermore, at the end of the project, Jackson had repaid the $2.5 million line of credit and the $500,000 capital infusion, and the company reaped a profit of $3.5 million. Jackson then invested $500,000 of the profit into technology and equipment that allowed the company to continue to work on larger projects, launching it to the next level of growth.

**Beware of Patches of Dry Cash Flow**

What made the difference between failure and success in these two examples? A clear view of how cash would flow in and out of the business.

A cash flow projection allows owners to predict and plan for cash flow shortages. Regardless of whether a project owner, bank or surety requires a cash flow projection, smart contractors take the time to evaluate whether they will have enough liquidity to ride out the periods when monthly receipts from billing requisitions are either nonexistent or are outstripped by job costs. Inaccurate forecasting is at the root of many construction business failures.

On the surface, a cash flow projection is a simple math equation. Start with available cash, add monthly receipts from billing requisitions and subtract monthly expenses. However, a few challenges tend to keep contractors from reaping the most benefit from this exercise.

- **Inaccurate information.** The cash flow projection assumes that cash comes in and flows out predictably. If a contractor is counting on being paid within 45 days, but the owner actually pays on a 90-day cycle, the company will face gaps in cash flow that it didn't count on.
- **Bidding errors.** Profitability depends on knowing and accounting for all direct and indirect job costs. Because errors in the bidding process can eliminate any profit and cause long-term problems, every contractor should invest in job cost software that provides accurate costing data.
- **Over-reliance on gut decision-making.** To survive in the construction industry, contractors need to embrace strategic risk and develop strong instincts regarding opportunities and potential problems. However, too many business owners make decisions without understanding their financial position, or they disregard the numbers and go with their gut.

Savvy business executives leverage a solid understanding of the numbers to chart a profitable path. Taking the time to accurately prepare a cash flow projection for each project, as well as all combined projects, could make the difference between success and failure—just like checking the weather forecast can make the difference between a productive day and one spent watching expensive equipment sit in the rain.

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