Working Capital

Factoring supports contractor growth as U.S. construction spending set to rise

By Joseph F. Ingrassia

According to FMI Corporation's Q1-2013 Construction Outlook Report, construction spending in the U.S. is projected to reach $1 trillion in 2015. In fact, the industry is on track for an 8-percent increase in 2013 compared to 2012 with annual spending expected to reach $900 billion for the year.

These growth numbers are a resounding positive for the industry, positioning it to levels not seen since prefinancial crisis. However, increased sales growth can magnify the cash flow challenges unique to this industry due to extended payment term policies that are expected and the post Dodd-Frank regulatory environment.

Even as sales volumes increase, extended payment terms typically delay payment between 60 and 90 days, or as much as 120 days. With rising costs and pressure to remain competitive, companies without sufficient working capital face significant challenges to maintain on-time payments to suppliers and vendors, while keeping operational expenses current.

In addition, Dodd-Frank has impacted the ability of banks to provide credit facilities to many businesses, including those within the construction industry that fail to meet certain criteria.

For companies within the $2 to $20 million sales range, obtaining working capital to sustain operational expenses and execute on growth initiatives in this business environment can be an ongoing challenge.

GROWTH STRATEGY

The use of factoring as a cash management strategy can be an effective tool to bridge this significant working capital gap for construction firms. Through factoring, companies are able to self-sustain, take on higher volume contracts to grow, and strengthen the firm with increased cash flow.

Currently, most construction firms are essentially financing projects on their own, as most contracts specify "paid-when-paid." In order to maintain business and manage increased costs, firms need significant working capital lines of credit to sustain themselves.

Within the financial industry, factoring programs have been designed specifically for construction firms that eliminate annual fees and minimum factoring volumes to provide firms with needed working capital.

SINGLE INVOICE FACTORING

One option that has been successful at positioning companies for growth is Single Invoice Factoring. This allows firms to sell one or many invoices for

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cash flow and only when needed. The proceeds of the invoice purchase are applied by the factoring firm to insure that all subcontractors or materialmen are paid in exchange for their lien releases. Depending on any given month, the need to factor may increase, decrease, or become eliminated. As there are no volume requirements or fees, single invoice factoring can be a true on-demand cash management strategy.

In addition to providing contractors with the ability to fund ongoing operations, factoring firms, such as Capstone, give companies the ability to bid with confidence to know when certain underwriting criteria is met, the factoring firm will provide assistance should the contractor run short of working capital during the course of the performance of their trade.

For subcontractors, in particular, there are many challenges of managing operating expenses when extended payment terms are routinely negotiated into subcontracting arrangements.

CASE STUDY: PAINTING CONTRACTOR

In early 2013, a painting contractor with approximately $2 million in sales was experiencing cash flow challenges associated with extended payment terms. In March, the firm began to factor single invoices with Capstone to increase available working capital. Within 2 months, the firm factored 16 invoices averaging approximately $34,000 each and was able to increase revenue by an additional $1.35 million.

As a result, the contractor advised Capstone of increased bidding efforts on new contracts and wanted to confirm future support of these projects. After reviewing the creditworthiness of the potential clients, a level of credit exposure was provided to use as additional bids were submitted.

This contractor has been successful with a number of bids and now focuses on planning the execution and performance of contracts, while bidding on new work as opportunities are presented.

In addition to single invoice factoring, there are many options to use factoring and purchase order finance strategies to help manage through the current, traditional lending environment and contractual obligations, such as extended payment terms. For firms in Capstone's portfolio, the expected average growth rate is 15 percent per year.

Construction companies that are well capitalized now are positioned to benefit from the projected increase in U.S. construction spending during the next few years. For firms that are under-capitalized now, the need to develop a relationship with a factor that understands the construction industry will be a key cash management strategy in order to compete.

Access to working capital will determine which contractors are equipped to actively participate in new business opportunities to successfully grow their businesses. ■