

Good morning, everybody. Dennis Engelbrecht with The Family Business Institute, Digging Deeper.

Today, I want to talk about backlog. Backlog is probably the leading indicator of each construction company's near-term future, how much revenue you're going to be able to produce, how much work you're going to have going forward. And that's both revenue, gross profit, and even man hours for your people. So, very recently, I've been thinking more about this, but it's really been happening over time, and we've seen it in the numbers, but it takes more backlog today to produce a certain amount of future revenue in construction than it did just a few years ago and certainly five or ten years ago. So, what do I mean? Well, what I mean is very simply, backlog is not turning into work in place as quickly as it once did.

There are a number of reasons for that. One of which is the proliferation of alternative delivery methods. Those alternative delivery methods, CM at-risk, design build, design assist, et cetera, simply spend more time on the front end. So, people get these jobs, they have them in their backlog, but they're not starting for some period of time and coming to fruition then in some period of time. It's also, interestingly enough, taking longer to finish or execute the work. And even before, of course, the pandemic, you're probably aware that the construction industry has been beset by a shortage of resources, on manpower and skilled help, and even in construction leaders. That's been going on now for many, many years. So, as folks have retired and all of that, we're finding that's becoming more and more of a problem. And really, as a result of these resources, it is taking longer to finish and execute buildings.

And then finally, the current situation, we're having obstacles of getting jobs within budget. We certainly have supply chain issues. We also have external issues such as the ability to get a permit. You can hear people from all over the country talk about, well, it used to take four months to get a permit, now it takes 12 or 16 months to get a permit. Well, all of this pushes back the work. And that's really the point, is in the old hard bid world, you used to be able to count on backlog was going to occur. You had the job, you hit the ground running, you got it done. But nowadays, backlog takes a long time to come to fruition. So, the result of that is it takes more backlog and even more pipeline for backlog to be able to establish the revenue stream you're looking for in the future.

So, looking at the figures and looking back, you actually can see that. The amount of backlog it takes to produce a certain amount of revenue is probably up somewhere in the 20% range over the last five to seven years. It takes 20% more backlog to achieve the same amount of revenue. So, what that means is some of that backlog is obviously pushing into future years, but that's really the point. We've seen many examples over the last few years of folks thinking, well, we're full, we can't take on anymore work. Okay, so they stop looking for work or push off the opportunities they're looking for further into the future. And then, a job pushes or two jobs push or three jobs push, and they find themselves actually with a shortage of work either to keep their folks employed or to provide enough revenue to break even or make money.

So, I've seen that 2, 3, 4-month slump in many of our client companies over the last couple of years, simply because their backlog did not come to fruition as work put in place. All right? Excuse me. So, anyway, so think about that. If it takes more work or more backlog to produce work, you've got to set your goals differently. You've got to be looking at and thinking about some different standards for where your backlog needs to be. There's a second, I'll call it a problem that sort of plays into this. Many of you also have grown over the years. So, I'm talking to if you're a \$100 million company now, back six, seven years ago, you might have been a \$50 million company. If you're a \$200 million company, you might have been a \$100 million company looking back. Well, I've got some more bad news for you. The larger the company, generally speaking, the more backlog you need to produce 100% of the revenue.

Quick example. So, \$50 million companies that just looked at a quick cross section, and generally speaking, our \$50 million contractors need about 60 to 75% of their revenue in backlog to be able to produce that 50 million. Well, I looked at the \$100 million companies and on average, most of them needed 90 to 100% of that in backlog, 90 to 100 million in backlog to produce 100 million. When I looked at our \$500 million companies, most of them were running with about 120 to 130%

of revenue in their backlog. Now, think about why that is. Very simply, larger companies are doing larger jobs, larger jobs take longer. So, that job that's in place, more of that is actually going to take place in the next year or the following year than it did when you were a smaller company doing smaller jobs, which had a more confined timeframe.

So, as you've gone down this journey, it may still be stuck in your head that I need 60% of the year's revenue in backlog at any given time, where reality might be now that needs to be 80% or 100% or 120%. All right? So, you have to change your frame of reference for two things, one is you've grown and the other is the industry has changed. And now, one other factor that you may not have even thought about, so if it takes more backlog to produce revenue, you may also need more capital in your business in order to fund your bonding program, et cetera. So now, just say I'm a \$100 million contractor and I require \$110 million in my backlog or future work in process in order to produce that. Well, if that used to be 60 million to produce 100, and now it's 100 million to produce 100, well, I actually require more bonding, more bonding support, and I probably need more capital to be able to support that.

So, just here to make you think about your backlog perhaps a little differently than you were and remember that it takes more backlog to produce revenue. So, don't get caught short as you go forward, keep selling and build that backlog.

Again, Dennis Engelbrecht, Digging Deeper.