



PAY ATTENTION TO THE WORK-IN-PROGRESS REPORTS

Typically, a construction firm must provide a schedule of work-in-progress and completed projects quarterly to its surety. Why do they require this and what are they looking for?

For starters, understand that this has become one of the most important pieces of information that you provide to a surety (after considering the Corporate Financial Statements and maybe the details of your banking relationship).

The underwriter at the bonding company is looking for such things as the dollar amount of estimated costs to complete, gross profits on individual projects, overbillings and underbillings.

What will they do with this information? Such things include:

They will look at your current backlog in relation to the bonding program that they believe you qualify for. Remember, they look at bonded and unbonded work when calculating the aggregate program.

They will compare it to prior reports provided either by you or by your CPA firm as schedules in the financial statements. They are looking for such things as changes in gross profit and the progress of the projects.

They are looking at what projects may be underbilled as this may signify lower actual gross profit levels than are indicated on the schedules. This item is receiving the greatest scrutiny lately. Underbillings are the item on your Balance Sheet known as "Costs and Estimated Earnings in Excess of Billings".

They will look at the overbillings. Since this is often considered 'job borrow' and treated as a liability on your financial statements, the underwriters will look to see that the contractor's liquidity levels remain strong.

They may try to forecast what your next income statement may look like.

They are looking for increases in the contract price. Since their premiums are calculated based on contract price, they are looking for bonded projects that require additional premiums to be billed.

In the preparation of these reports, our recommendation is to remain conservative. An example will better illustrate our point. In this example, assume that a particular project closes out with a 20% Gross Profit Margin (GPM). In one scenario, the project was reported at a 10% GPM in the various schedules and ultimately closed out at 20%. The bonding companies reaction is very positive, congratulating you on a great job. If, however, you told them that you were going to make 35% on the project and it closes out at the same 20% GPM, their reaction would be quite different. They would not be congratulating you; they would be questioning you on what went wrong.

Our recommendations then are to prepare the schedule carefully. Review it. Compare it with the last one provided. See if there is anything that requires further investigation before it leaves your office, and then advise your surety with the report. Your thoroughness will make their job easier and, as such, will be appreciated. Seek input from your bond broker. If they do not know how to review this, find another broker (hopefully our firm!).

Famous Quotes

A lot of maturity takes place between

'It fell' and 'I dropped it.'

If you want a good formula for success, try aspiration, inspiration and perspiration.

Hard work is the yeast that raises the dough.

Hire the best people and then delegate.

-Carol A. Taber

I get quiet joy from anyone who does his work well.

-William Feather

"My door is always open — bring me your problems."

This is the surest way to turn on every whiner, lackey and neurotic on the property.

-Robert F. Six

Maximizing Your Surety Credit in 2006

Famous Quotes

Doesn't it seem some days as though people were put on this earth for no other reason but to aggravate you?

-Ed Howe

Treat people as if they were what they ought to be and you help them to become what they are capable of being.

-Johann Wolfgang von Goethe

Put your personnel work first because it's the most important.

-General Robert E. Wood

Forgive your enemies, but never forget their names.

-John F. Kennedy

The weak can never forgive. Forgiveness is the attribute of the strong.

-Mohandas K. Gandhi

In negotiation, he who cares less, wins.

-Anonymous

Luck? I don't know anything about luck. I've never banked on it, and I'm afraid of people who do. Luck to me is something else: hard work—and realizing what is opportunity and what isn't.

-Lucille Ball

As you may know, a contractor's aggregate bond limit is largely determined by a firm's working capital and net worth positions as reflected in financial statements, especially its fiscal year-end financial statement as analyzed by the surety underwriter. The year-end statement is the one primarily used to establish a bonding program with an interim statement, typically six months from the year-end, used to check on the financial status of a company.

You must plan in advance to be sure that the numbers and ratios are strong enough to support the credit that you need and in line with the industry standards. You need to focus on some of the main issues that are critical to maximizing your bonding company's support of your business plan in 2006 right now. You cannot wait until 2006 – it will be too late then!

For starters, it is, obviously, easier to make your firm look good when your firm is truly enjoying a good financial position. If the firm is on the brink of bankruptcy, very little window dressing will hide this. With this in mind, focus on the following:

- Cash should be maximized on the financial statement date (as well as at all other times), since the sureties frequently contact the bank for references at various points throughout the year (typically in conjunction with one of your requests for a bond). Cash is king, no doubt about it. Nothing is more important to a bonding company than liquidity. For this reason, many bonding companies prefer that their clients recognize revenue for tax purposes on some method other than cash.
- Receivables, especially those over 90 days, need to be collected. If a receivable is older than this and is not retainage, most sureties will not give you credit for it. Spend the effort to collect these receivables. Again, as stated above, cash is king.
- Projects should be billed as much as possible. Underbillings often raise concerns about a project's profitability.
- Loans to Shareholders and Employees should be zero or at least kept to an absolute minimum. The bonding company will not allow these amounts in their analysis, so this could have a serious impact on the credit granted.

- Inter-company transactions should be eliminated or, at least, brought down to bare minimum levels. Surety companies do not want the firm that they are bonding to act as a 'bank' for other entities. Even though the bonding company typically has the indemnity of the affiliated companies, it is very important to keep the balance sheet of the construction company as clean as possible.

- Distributions to the shareholders should be kept to a minimum and should only be at a level sufficient to pay tax obligations. At least be sure that distributions do not exceed the company's net income. If distributions exceed net income, this will result in a decline in stockholders' equity just as if your firm had lost money for the period. It is your money, but it is important to keep enough in the company to support the credit you need to operate and grow your business.

- The Line of Credit Debt should be reduced as low as possible, preferably to zero. This implies that you are not dependent on the bank. Bonding companies will periodically call the bank for a reference. On a related note, bonding companies often want to see a credit facility of 5% of the aggregate bonding. So, if you want a \$20,000,000 bonding program, work towards a \$1,000,000 line of credit.

- Defer equipment purchases that require significant down payments (or all-cash transactions). Equipment is a 'long term' asset, which does not contribute to your working capital calculation. You are replacing a current asset, cash, with a long-term asset, negatively affecting working capital. Also, whenever possible, consider using long-term financing.

- Reduce prepaid expense items. The bonding companies do not typically allow these items in their analysis of your working capital. From a bonding standpoint, it is better to have the cash.

- Minimize and control your overhead. Sureties look at this item, compare it with previous years in relation to revenue levels and make certain assumptions about a firm's management. Formalize or update your business succession / continuity plan, making sure that life insurance levels, if a part of the plan, are at the appropriate levels.

These ideas are just meant to keep you thinking about this very important topic. If you are interested in maximizing your bonding program, please give us a call to set up a meeting. Good luck!

WHY ALL THE QUESTIONS? IT'S ONLY A BID BOND

We have heard this so many times that we realized that we needed to do a better job in communicating what the bid bond obligation is. While many of us have handled, signed, and submitted bid bonds before, most of us have never actually read the bond form. We encourage you to do so.

For starters, if a bidder does not provide a bid bond, most specifications allow the bidder to post a certified check as bid security. For discussion purposes, let's assume that the specifications call for a 10% bid bond or certified check on a \$5,000,000 project. One could easily equate the value of the bid bond to the \$500,000 certified check that could be provided in its place. So, right there, it is more than just five pieces of paper.

The AIA Document A310 Bid Bond, a frequently used bond form, states that the Principal [the bidder] shall pay to the Obligees [firm to whom the bid is submitted] the difference (but not to exceed the penalty of the bond) between the amount specified in the Principal's bid and such larger amount for which the Obligees may in good faith, contract with another party, to perform the work if the Obligees accept the bid of the Principal and the Principal does not enter into a Contract with the Obligees and give the required bond or bonds as may be specified in the bidding or Contract document.

As such, the bonding company issuing the bid bond must be very comfortable that they will approve the performance and labor and material / payment bonds if their client is awarded the project. Most of the bonding companies' analysis is performed when a bid bond is requested. Barring any bid spreads, conditions not being met, or changes in financial position between the bid and award dates, the bonding company typically approves performance bonds rather routinely when they have issued the bid bond. This makes the bid bond a powerful pre-qualification tool for the Obligees.

We sometimes forget that the five-page document has significant monetary value. In the example above, the 10% bid bond for a \$5,000,000 project has a \$500,000 value. If the project is awarded to that bidder and they do not sign the contracts and post the requisite bonds, the bidder can be responsible for a sum of \$500,000. If the bonding company pays, they will seek reimbursement from the Principal and its Indemnitors (stockholders, spouses, affiliated companies, etc.) under the General Agreement of Indemnity. This makes the bid bond a very serious obligation.

Remember that the exposure is not just the difference to the second bidder's number. Even if the bid spread to the second bidder is 1%, the exposure could still be the full 10% if a 10% bid bond were submitted. The Bid bond does not obligate the Obligees to award the project to the second bidder. They only have to act in good faith. They may claim that the second bidder submitted a non-responsive bid or was otherwise determined to not be responsible.

Plus, in some bids, the owner requires that a 'Consent of Surety' be provided with the bid bond. This makes it even more serious since the terms of the typical consent require the surety to issue the Performance and Payment Bonds if the project is awarded to the contractor, no matter what.

Without this consent, bonding companies can, and sometimes do, refuse to issue Performance and Payment bonds in those cases where they issued the bid bond. There are many examples of this. The most common instances are those when the financial condition changed between the bid and award dates, a claim or potential claim arose on another bonded project, conditions set at the approval of the bid bond are not met or there was a substantial bid spread (more than 10%) between the contract and the next highest bidder.

The bottom line - It is not just a bid bond; it is a whole lot more.

Famous Quotes

Few great leaders encountered defeats so consistently before enjoying ultimate victory as did this individual. A frequently reported listing of these failures includes the following:

- Failed in business in 1831*
- Ran for the legislature and lost in 1832*
- Failed once again in business in 1834*
- Sweetheart died in 1835*
- Had a nervous breakdown in 1836*
- Lost a second political race in 1838*
- Defeated for Congress in 1843*
- Defeated for Congress in 1846*
- Defeated for Congress in 1848*
- Defeated for US Senate in 1855*
- Defeated for Vice President in 1856*
- Defeated for US Senate in 1858*

The man was Abraham Lincoln, elected sixteenth president of the United States of America in 1860.

Some days you're a bug. Some days you're a windshield,
-Price Cobb

Updating Your Underwriter's File

Now that we're in the fourth quarter of the year, the following information should be on file with your bond agent and underwriter:

1. Interim financial statements with all supporting documentation if your six-month interim is July or earlier. This should include concurrent aged schedule of accounts receivable with subsequent collection information.

2. Quarterly work in progress reports.

Did you renew your insurance or bank line in the past three months? If so, don't forget to forward a copy of your most current insurance certificate and/or updated letter from your bank outlining your line of credit to your bond agent for inclusion in your underwriting file.

Company News

The annual walk for Breast Cancer will be held on Sunday, October 16, 2005 at Jones Beach State Park, Field 4. Denese Thompson will be leading a team again this year. If you would like to make a donation or would like to join our team in this walk for an excellent cause, please contact Denese Thompson in at 516-745-7504. You can go to the American Cancer Society website at www.cancer.org/stridesonline to get further details or to make your donation to the Atlynx team on line.

The principals of The Amerisc Corp. And Atlantic Coverage Corp. are pleased to announce the formation of Atlynx Surety Broker, LLC.



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Disclosure

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