

BY MELANIE HODGDON

Rethinking Your Company's P&L

Whether due to a mandate by their state or a sense of respect for human over business health, an enormous number of contractors cut back activity somewhere along a zero to 100% continuum during the coronavirus outbreak. As of this writing, nearly every state has “opened up” to some extent, though the criteria and terms vary enormously.

Throughout this pandemic experience, many contractors have been torn between loyalty to their employees (keep everybody on for as long as possible) and a survival urge (eliminate every possible financial drain and hope for the best). Many of you took advantage of the Paycheck Protection Plan (PPP) or Economic Injury Disaster Loan (EIDL) loans; drew on lines of credit (for which you hopefully applied during times of plenty, when your company was a good candidate); dived into the savings that well-established, profitable companies have tucked away; or as a last resort, drew against credit card accounts.

Unexpected or expanded debt, even when a portion may be “forgiven,” can weigh heavily on business owners. And, because debt is handled on the balance sheet (as current or long-term liabilities), there is a strong “out of sight, out of mind” inclination that we all indulge in. But this inclination could lead your business to fail if you don't plan for debt reduction—especially if debt is something you're not used to.

WHAT ARE A CONTRACTOR'S “NECESSITIES”?

An article I read recently on personal finances in the age of COVID-19 recommended thinking in terms of absolute necessities. For individuals, this means food and medication. Everything else, the article suggested, may have to be put on the back burner.

For a business, things are a little different. Overhead is certainly one of the necessities. For example:

- If you don't pay your power bill, your office shuts down.
- If you have umbrella, liability, or contents insurance, failure to pay could make your business vulnerable.
- If you don't pay your office rent or mortgage ... well, there may be some allowance for that. Many states have a temporary moratorium on evictions. The original CARES Act allowed for mortgage forbearance or payment deferrals, and a temporary moratorium on evictions and late fees. That has since expired but may be extended (as of this writing, it is held up in Congress). Rules vary by state, and you are responsible for determining what rules and deadlines apply to you, but there is a clear risk to the business if you forego this obligation.

There are other necessities in terms of projects:

- You must be able to acquire materials. Rules governing acquisition and delivery may vary from supplier to supplier, so be sure to investigate. Best practices recommend that you pay with your customer's money by getting deposits at signing, front loading your payment schedule (contract jobs), and subscribing to BEBO (bill early; bill often). If you aren't getting up-front deposits (including on T&M work), then you're draining your precious cash when you don't need to and can least afford it.
- You must be able to incorporate trade contractors into the project workflow while still adhering to COVID-19 recommendations. Many prospective customers are deeply concerned about the prospect of allowing strangers onto their property, so stating and adhering to guidelines may differentiate you from other contractors while increasing the safety of your team. As with materials, you should always be paying subs using the customer's money, so projects should not cause any negative impact on cash flow.
- If you don't sub out all labor, then you must maintain a field crew. If you have successfully received a PPP Loan, good for you. However,

GAAP Compliant P&L

	Ordinary Income/Expense	Margins	
Income	\$1,000		
Cost of Goods Sold	\$710		"Above the line"
Gross Profit	\$290	29.0%	
Expense (overhead)	\$245		"Below the line"
Net Ordinary Income	\$45	4.5%	
Other Income/Expense			
Other Income	\$5		
Other Expenses			
Xxxxx	\$3		
Net Other Income	\$2	0.2%	
Net Income	\$47	4.7%	

Above is an example of a GAAP-compliant P&L. Notice that *Net Ordinary Income* is 4.5% and *Net Income* is 4.7%.

you will have to negotiate the complex rules of forgiveness (still in flux as of this writing) to be sure that you will be able to write off all that you think you can. You can't assume that 100% of that \$58,000 loan is forgivable—it may or may not be.

■ As with subs, your crew will need to adhere to health recommendations (and be prepared for “suggestions” to become “requirements” based on the status of the pandemic from week to week) and this will mean reduced efficiency. Remember when you had to adjust to RRP requirements (or stop taking work on any pre-1978 projects) in terms of estimating costs and completion time? Working through the pandemic will decrease efficiency and increase project time even more.

■ If you priced out a job and then were forced to delay the start date or suspend work, bear in mind that the job may now cost more than you originally planned for. There may not be any practical way to recoup this (certainly, keeping tight control of tasks performed within the written scope of work and rigorously tracking and charging for change orders will be particularly critical now), but be aware that you may need to revisit pricing on jobs for which contracts haven't yet been finalized.

And there are necessary obligations in terms of investment and prior debt reduction:

■ This is probably not the time to go out and buy a new truck! This is the time to be as conservative as possible. In all likelihood, you will need every bit of “spare” cash, particularly because nobody can predict how the pandemic will evolve or how many waves of the virus we may eventually endure.

■ If you can negotiate delayed or reduced payments while you ramp up, give it a shot. It never hurts to ask, and if your prior payment history is exemplary, you may be able to hang onto cash during the challenging transitional period between reduced or nonexistent work and a resumption of your income stream. Recognize that this income stream may well be reduced for some time to come, and bear in mind that many companies that looked profitable on paper belied up because they ran out of cash.

What should you do as a business owner to face these necessities?

BUDGET CONSIDERATIONS

If you based your budget only on accounts that are included within your profit and loss (P&L) or income statement (income, cost of goods sold, and expenses), you may be ignoring the need to start budgeting for paying down debt incurred because of the pandemic. Although it does not adhere to GAAP (Generally Accepted Accounting Principles), you may want to consider adding accounts for loan payments as if they were *Other Expenses* (a category of account within your chart of accounts that falls below *Net Ordinary Income* on your P&L) in order to include them on your budget (see “Management P&L (A),” above). Or you may even wish to include them as expense-type accounts in order to have their projected costs included in overhead (see “Management P&L (B),” opposite page). Such “non-GAAP-compliant” P&Ls are known as “management P&Ls” and are perfectly legitimate, useful tools for analysis. Be aware that for tax preparation purposes, accounts that belong on the balance sheet must undergo adjust-

Management P&L (A)

	Ordinary Income/Expense	Margins	
Income	\$1,000		
Cost of Goods Sold	\$710		"Above the line"
Gross Profit	\$290	29.0%	
Expense (overhead)	\$245		"Below the line"
Net Ordinary Income	\$45	4.5%	
Other Income/Expense			
Other Income	\$5		
Other Expenses			
Loan A payment	\$1		
Loan B payment	\$2		
Loan C payment	\$2		
Loan D payment	\$3		
Xxxxx	\$3		
Net Other Income	\$(6)	-0.6%	
Net Income	\$39	3.9%	

On version “A” of a sample management P&L, loan payment accounts (to populate your budget) have been added as *Other Expense* type accounts. Notice that *Net Ordinary Income* is still 4.5%, but *Net Income* has dropped to 3.9%. Remember to adjust these costs back to the balance sheet for tax preparation purposes.

ments, but throughout the year, you will be able to get useful numbers for the analysis of business health and for pricing.

PRICING CONSIDERATIONS

Since overhead is the basis of pricing your jobs, increasing overhead to account for debt reduction can help you price upcoming jobs more realistically. Notice that when debt payments are included, your bottom line is reduced. In terms of accounting, this is “wrong” since loan payments are not costs. However, this information becomes extremely important when you're considering cash requirements, especially since the only way to increase cash (other than by adding to debt) is to increase project profitability.

SCHEDULING CONSIDERATIONS

If productivity is expected to drop, then you will not be able to produce as many jobs in the same time period. During that same time period, your overhead will continue to march on. Therefore, you must find ways to reduce overhead or increase the efficiency of production, or consider raising your prices when you sell work. Is it realistic to assume that your crew will be able to produce faster while still adhering to safety guidelines? If not, and you can plan

Management P&L (B)

	Ordinary Income/Expense	Margins	
Income	\$1,000		
Cost of Goods Sold	\$710		"Above the line"
Gross Profit	\$290	29.0%	
Expense (overhead)	\$245		"Below the line"
Loan A payment	\$1		
Loan B payment	\$2		
Loan C payment	\$2		
Loan D payment	\$3		
Total Expense	\$253		
Net Ordinary Income	\$37	3.7%	
Other Income/Expense			
Other Income	\$5		
Other Expenses			
Xxxxx	\$3		
Net Other Income	\$2	0.2%	
Net Income	\$39	3.9%	

to complete only 80% of the projects you normally would, then project how much more profit you will need to squeeze out of each of them in order to cover overhead plus debt reduction.

FINAL THOUGHTS

The pandemic has thrown a devastating curve ball at the construction industry, and there is no way to predict when or the degree to which things will return to "normal." The best thing contractors can do is to stick to the basics: Understand your costs, monitor your job costs, don't over-extend, keep overhead to the absolute minimum, be prepared to downsize your labor force if sales don't support the status quo, and hang onto your cash like it's a lifeline, because it may well be.

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On version "B" of our management P&L, the loan payment accounts were added to overhead expenses. This increases total overhead from \$245 to \$253 and reduces *Net Ordinary Income*. Since you will base your pricing strategy on overhead, this change should force you to increase your markup to compensate. Remember to adjust these costs back to the balance sheet for tax preparation purposes.