

Subcontractor Review and Prequalification

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Subcontractor Review and Prequalification

- ▶ What is it?
- ▶ Why does Granger Construction Company use it?
- ▶ How do you perform the review?

What is Subcontractor Review and Prequalification?

- ▶ Extensive procedure to review subcontractors going beyond “calling for references”
- ▶ Valuable tool used to make informed decisions about hiring and/or bonding subcontractors.
- ▶ Allows mitigation of potential risk to the general contractor and owners.

BENEFITS OF USING THE QUALIFICATION PROCESS

- ▶ Demonstrates Granger's dedication to improving quality for our clients
- ▶ Builds a database of dependable subcontractors for future jobs
- ▶ Helps eliminate repeat contracting with subcontractors who perform poorly
- ▶ Encourages a measurable process of review consistent with our quality plan

BENEFITS OF USING THE QUALIFICATION PROCESS (continued)

- ▶ Provides subcontractors an opportunity to improve and rewards reliable subs
- ▶ Provides risk Management to safeguard Granger
- ▶ Reduces chances of claims and budget overruns
- ▶ Helps us evaluate subcontractors changing circumstances over time

When is the Prequalification Review used?

1. When an Owner/Granger contract requires subcontractor prequalification.
2. When a subcontractor requests prequalification before investing in their own bid preparation.
3. Before Granger subcontracts with a bidder who appears to be the lowest responsive bidder for contracts under the following conditions:

When is the Prequalification Review used? (continued)

- a. Granger has not worked with the subcontractor within the last two years.
- b. The contract amount is greater than \$500,000.
- c. When the contract amount is greater than \$500,000 and pre-qualification form and financial information on file is less than 1 year old, you do not need to do another pre-qualification form.

Financial Ratios

Working Capital	$\text{Current Assets} - \text{Current Liabilities}$	
Working Capital Turns	$\frac{\text{Revenue}}{\text{Working Capital}}$	Indicates the amount of revenue being supported by each \$1 of net working capital. A ratio exceeding 30 may indicate a need for increased working capital to support future growth.
Current Ratio	$\frac{\text{Current Assets}}{\text{Current Liabilities}}$	Indicates the extent to which current assets are available to satisfy current liabilities. Generally looking for a ratio greater than 1.0.
Debt to Equity	$\frac{\text{Total Liabilities}}{\text{Total Net Worth}}$	Indicates the relationship between creditors and owners. A ratio of 3 or lower is considered acceptable.
Accounts Receivable Turnover	$\frac{(\text{Accounts Receivable} - \text{Allowance for Doubtful Accounts}) * 360}{\text{Revenue}}$	Indicates the number of days to collect accounts receivable. A lower ratio means faster collection.
Accounts Payable Turnover	$\frac{(\text{Accounts Payable} - \text{Retainage}) * 360}{\text{Revenue}}$	Indicates the average number of days it takes to liquidate trade payables. The ratio should be compared to credit terms.

"Risk Factor Formula" or "R score"

- ▶ Attempts to answer three questions:
 - Is the subcontractor's performance adequate, considering its capital structure?
 - Is the subcontractor's earning power providing ample funds to maintain a proper balance between assets and liabilities?
 - Is there adequate equity in the company to deliver the capital necessary to support operations and fund unforeseen losses?

"R score" (continued)

1. A score below 5 indicates low financial risk
2. A score between 5 and 7 indicates moderate financial risk
3. A score above 7 indicates financial resources are stretched
4. A score above 9 indicates high financial risk

"Z score" Profitability Analysis

- ▶ The Z score provides an indication of the likelihood of financial failure in the coming year.
- ▶ A Z score below 2.675 indicates failure.

How to get started

- ▶ Bidder prequalification form (See Example Attached)
 - Proposed Contract Amount
 - Duration on Site (Beginning and ending date)
 - Cost of bonds
 - Second bidder information
- ▶ Industry Benchmark Data
 - CFMA Construction Industry Annual Financial Survey
 - Risk Management Association – Annual Statement Studies
- ▶ Insurance Company rating guide
 - Best's Key Rating Guide

Subcontract Review Examples

(See Handout Materials)

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Thank You!

