MBDI minority business development institute

Case Study
XYZ Management Corp.

XYZ Management Corp. is a W/M/DBE involved in steel fabrication and installation. As of year-end 2011, XYZ had 105 employees, self performed 95% of their work and grossed approximately $15 million in revenues. XYZ entered the MBDI bonding readiness training with an inferior bond line with a surety that most agencies would not accept. They were also declined for a bond line with a major surety shortly before the program launch. Five months into the training, having followed a rigorous timeline for organizational change presented by MBDI, they were awarded a $20 million bond line with a major surety company.

<u>The Issues</u>

Financial presentation. XYZ's CPA was not preparing their financials in accordance with Generally Accepted Accounting Principles (GAAP). The firm was a general accounting firm without experience with construction contractors. The financials were prepared on a compilation basis and the presentation was generally poor, with generic footnotes and inadequate explanation of details for a firm of their size. For example, no footnotes accounted for the various contracts undertaken over the year. The prior accountant showed 60% gross profits and 5% net profits, which was hard to understand and inaccurate.

Poor Credit Score. The owner's husband had a credit score of 675, which was not as high as it should have been due to a few late payments. This did not prevent the firm from obtaining bonding, however the recommendation from MBDI staff was that this issue needed to be addressed.

Presented to the Sureties Improperly. XYZ had been submitted to the sureties as a Commercial Surety risk because of the manufacturing component of their business. Because of this, they were declined for a bond line, which generally means that the surety will not re-open the file for at least a year.

Bond Line with a B rated Surety. For most projects with city and state agencies, a Treasury A rated surety is required. XYZ's small bond line was unusable.

Balance Sheet Concerns. XYZ's assets were being financed with debt. Their debt/equity ratio looked like it fluctuated greatly, all of which could have been explained by a good construction CPA. Not having the right financial presentation made the balance sheet look less than stellar due to the way the CPA accounted for certain line items. As an example, the retainage was not segregated in the financial statements, but was lumped in with the "over 90 days" category in Accounts Receivable. Thus, surety underwriters were prepared to un-necessarily write-off a large percentage of XYZ's Accounts Receivables. This would

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subsequently affect the firm's current Ratio and working capital ratios, and make them appear less strong than they are.

Bidding only as Sub-Contractors. Even though XYZ has the ability to self perform sizable contracts and has an excellent direct-relation with MTA, they have been unable to perform as a Prime Contractor because they have not been able to secure an appropriate bond line. As a prime, they will realize an even greater profit margin and have stronger control over the contracting process.

Progress

CPA. After one-on-one meetings with MBDI staff, XYZ interviewed a series of Construction CPA's and hired the most expensive and esteemed firm – J.H. Cohn, to manage their accounting. J.H. Cohn has prepared a reviewed 2011 year-end financial statement including all necessary footnotes, properly presenting the firm in its most accurate light.

Credit Score. The owner's husband has spent the last 6 months working to improve his credit score by focusing on timely payment. His credit score has improved to 700.

Bonding Strategy. A Broker Referral Network member approached the marketplace to properly present XYZ to surety bond underwriters. The broker visited their locations and met with the XYZ Management team in one-on-one meetings to gain a solid understanding of the firm's strengths and make a strong presentation to the marketplace. The broker worked with Travelers to explain the business model and had them move the risk from the commercial surety bond to the contract bond division for re-consideration. XYZ then met face-to-face with underwriters from Travelers Corp., ACE and International Fidelity both in their offices and at their manufacturing plant in upstate New York.

Bond Line. XYZ Management was able to secure a $20 million aggregate bond line with A+ rated Travelers Corp., the world's largest surety, in February 2012.

Prospects for the Future. As the XYZ Management Team continues to improve its infrastructure and grow sustainably, the Bond Program will focus on continuing to support them over the next 12 months as their infrastructure needs become more complex. They will need to move from "reviewed" to "audited" financial statements and implement other even more rigorous controls to increase their bond line further. With their present level of bonding, XYZ will be able to bid as a prime, improving their net profit margins further and allowing them greater control over projects. Moreover, we anticipate increasing their bond line to $25 to $30 million over the course of the next 12 months.

Mentoring Smaller Firms. XYZ Management has realized tremendous success through the New York State Bonding program. They have offered to work with smaller firms to help them progress. We look forward to developing the program to include mentorship opportunities for smaller MWBE firms.