Please circulating this widely. It will benefit your constituents. This research is continuous and includes new information as it becomes available weekly. Thank you, Tom

Tenth Weekly Crisis-era Message to Contractors from: Dr Tom Schleifer

The Construction Market: Recovery, Timing, Profit

If you did the exercise recommended last week in the ninth Crisis-era Message and determined to your own satisfaction that the US economy and the construction market will rebound in six months or less from its start, which would be on or about September 15, 2020, there is little need to read further. If you determined the US economy or the construction market will recover after that date, consider the following:

For the US economy to begin to recover it needs to stop getting worse. ("recovered" for our purposes means to be at least approaching 2019 levels. The construction market will follow the US economy recovery but historically lags it by 12 to 18 months. Because so many are convinced about this economic decline, that *"this one is different"*, you might want to predict a lag of say 6 to 12 months. In this *"best-case"* scenario the construction market would be healthy again as early as March 15, 2021. According to research into the eight major construction market downturns since WWII, that would be an extremely low probability, but let's work with that optimism for a while. What are the things that could improve or upset this projection?

First, you need to speculate, estimate, or make an educated guess about several important questions that will affect your business planning for this disruption:

- When will the US economy recover and will it rebound to where it was?
- When will the construction market recover and will it rebound to where it was?
- Will aggressive competition drive profits down as it has in all past construction market downturns since WWII?
- If so, will that cause construction business failures?
- Will some construction enterprises reorganize in order to profit with reduced sales?
- Is there going to be a new normal?

It will be helpful to evaluate or measure the likelihood of certain things happening that will affect our businesses: (Scoring: 1 = lowest likelihood, 5 = highest likelihood)

- The US economy bounces back almost immediately and the construction market recovery only lags 6 months. [Likelihood 1 to 5 ___]
- The US economy recovers but, because of changes in consumer and public spending it, does not approach the 2019 levels for the foreseeable future. [Likelihood 1 to 5 ___]
- Resistance to capital spending because of a caution to conserve cash holds the construction market back from approaching 2019 levels for the foreseeable future. [Likelihood 1 to 5 ___]
- Aggressive competition depresses profits during the construction market *decline* (as it always has in the past). [Likelihood 1 to 5 ___]
- Aggressive competition also depresses profits during construction market *recovery* (as it always has in the past). [Likelihood 1 to 5 ___]

Draw your own conclusions about the impact of your scores on your business. The future of the industry's recovery that you plan for your business can be as rosy as you believe it is likely to be. The problem is, when optimistic projection don't materialize, it can be disastrous. When projections you plan for turn out better than expected, it may still be problematic, but at least it's not a disaster. My approach for planning around a market decline is to take an average between the best-case and worst-case projected scenarios and then predict about 10% to 15% towards worst case. Why favor worst case? Because when the optimistic projection does not occur it is a disaster, so I want to error on the lessor penalty—on the less risk side.

Construction professionals have no choice but to make an educated guess about future economic developments because reacting to this disruption of the construction industry is critical to future success. *(Unless you agree with those that believe that business-as-usual will get us through this.)* Time is not on our side and for some construction firms it is almost too late to react because their balance sheet is already affected. Firms that were struggling financially (for whatever reason) going into this crisis will likely have difficulty getting through it. Another exposure that will compound this problem is that stopping and restarting a construction project is not without costs and new Covid-19 job-site protocols will have costs that were not anticipated in the original estimate. If you expect to be compensated for either or both costs you are not alone. Most of what I am hearing is the same. I wish I was as confident as some but my experience does not justify much support.

I will not go into a lengthy discussion of claims other than to advise caution on planning or accounting for the anticipated additional compensation. The expectation is a "claim" and my experience with the tens of thousands of claims I am familiar with is that some claimants will receive all, some nothing and some a portion that averages roughly 50%. And all of these are reduced by the amount of legal, consulting and other associated costs of claims. These prior claim results all added up to an average settlement of 50% on the high side to a negative number on the low side. I record pending claims at zero, conservative construction professionals book them at 25%, optimistic construction professionals book them at 50% and gamblers at 100%--ignoring the cost of claims. I am not saying you will not get lucky. I am saying don't contaminate your accounting records with luck. As to when claims convert to cash, you already know—if not, ask any experienced construction CFO. I did not mention the "merits" of a claim because I have not seen merit to have much effect on claim settlements, particularly long after the event in question. Some claims that I thought were a slam dunk lost and some I was sure had no merit at all won. My experience suggest that a flip of a coin is as good as any other method of predicting the resolution of a construction claim. Obviously, you can adjust this to your own experience. *For more on the cost of claims see ENR article "When to Avoid Costly Conflicts" by Tom Schleifer and Bob Rubin go to letstalkbusiness.net and click on "Articles."*

The industry profit margins and typical cash reserves are too thin to fund maintaining overhead during a market decline much longer than six months. If your margins are well above industry average, your cash reserves are strong, and you are willing to expend them, you can "wait and see" a little longer. I do not recommend it because business in not a game of chance. Protecting the value of the company is the primarily obligation of top management.

Next week: A discussion of the ongoing domino effect of this economic disruption, such as more than 50% of the US airline's fleets have been mothballed.

To assure you will continue to receive the free weekly Crisis Message to Contractors, you will need to send your email address to tom@schleifer.com.

Note: Information on overhead management can be found on letstalkbusiness.net click on "Manual" and go to Managing Overhead in the table of contents.