CFOS ARE HAPPY, BUT WILL THEY STAY THAT WAY?

This represents the largest 12 month increase among any of the indices and is a reflection of the fact that the average CFO remains comfortable with near-term prospects.

During the most recent Survey, 50 percent of the respondents indicated that profit margins have improved recently, while another 29 percent indicated that margins were roughly unchanged. What’s truly remarkable is the near-universal agreement that margins will continue to expand or at least remain stable. Ninety-four percent of respondents believe that profit margins will be slightly or significantly better (38%) or about the same (56%) over the year ahead. No Survey respondents expect margins to deteriorate substantially and only six percent anticipate mild deterioration in margins.

What makes this particularly impressive is that 81 percent of surveyed CFOs are either very or highly concerned by industry skills shortages. Expanding human capital shortages are consistent with rising labor compensation costs, which, all things being equal, should serve to suppress profit margins. Respondents appear to be indicating that market demand and pricing power will be strong enough to overcome the impact of rising wage and benefit costs on profit margins. It also helps that at least some firms have the luxury of being able to turn away a certain fraction of work, implying that they are able to focus their attentions on the most profitable projects. Falling input costs, including copper, diesel fuel, and natural gas, are also likely contributing to thicker margins.

There was one index that declined during the third quarter—the 2016 (Year-Ahead) Outlook Index. The Index stood at 125 during the most recent quarter, down nearly two percent from the prior quarter and four percent lower relative to a year ago. This is the only sub-index to decline on a year-over-year basis. Construction firm leaders are suggesting that while the near-term is likely to be associated with ongoing improvement, the longer term may not be.

There are many reasons for concern beyond those associated with human capital shortfalls. Some contractors are unnerved by prospects of tightening monetary policy and rising interest rates. Others are worried about shifting public policies regarding construction, including those that relate to funding the federal Highway Trust Fund. During the implementation of the third quarter Survey, CFOs would have also been aware of the potential for another federal government shutdown. Others expressed concern regarding healthcare costs and regulations. Accordingly, 26 percent of construction firm leaders expressed significant concern regarding the state of public policy and its likely impact on construction, up from 21 percent during the previous quarter.

In Summary

For now, the recovery of the U.S. construction industry remains in place. Many construction firms have become more profitable, which is consistent with improved cash flow and an expanding capacity to invest in people and technology. That could help support productivity enhancements in the U.S. construction industry, which in turn would inure to the benefit of future profitability.

To the extent that there are lingering concerns, many are related to the public policy environment. The 2016 presidential election stands to be a bitterly contested one. Comments by Survey respondents indicate a belief that Washington will not accomplish much in 2016, notably with respect to infrastructure finance. Undoubtedly, the growing malaise of the global economy is also of concern to construction industry stakeholders, as is the broad perception of a future accompanied by rising interest rates. Nonetheless, for the first time in years, many construction industry leaders appear satisfied with the prevailing status quo.

The Status Quo Is Satisfactory

For many years, construction firm leaders wondered when things would return to normal. At long last, seven years into the current economic recovery, there appears to be some fondness for the status quo. Nonresidential construction spending has risen 12 percent over the past year, enough to help firms rebuild backlog, bolster profit margins, improve cash flow, and sustain hiring.

The Construction Financial Management Association (CFMA) conducts its CONFINDEX Survey each quarter. The Survey’s most recent iteration (Q3:2015) indicates that CFOs have become reasonably content and that the most recent quarter has not dampened industry spirits. The Overall Index stands at 131. While that reading was unchanged from the second quarter, it is up by more than three percent from a year ago and up by 66 percent since the initial 2008 reading in December.

The Business Conditions Index, which is largely a reflection of current sales and profit margin dynamics, stood at 145 during the third quarter of 2015. This sub-index is up both quarterly and annually and is also up an astonishing 130 percent from the December 2008 reading of 63. Recall that late-2008 was associated with a period of declining construction spending and nervousness regarding the ultimate depth of the recession then in progress. The stimulus package known as the American Recovery and Reinvestment Act would not be approved by Congress for another two months. Money available to finance projects was quickly drying up, as were business lines of credit.

Only nine percent of surveyed CFOs expressed significant concern regarding demand for construction services. Anecdotal evidence suggests that some construction firms are beginning to turn down work, the first time these stories have been told in years. Only 10 percent of CFOs are very or highly concerned about the availability of financing for projects, which is consistent with the view that the volume of work will remain brisk. The Financial Conditions Index was unchanged during the third quarter relative to the second. However, this sub-index is up by a bit more than six percent, relative to a year ago, and is up 26 percent since the December 2008 reading.

The Current Confidence Index also remains at lofty levels. During the third quarter of 2015, the subindex stood at 136, up by nearly one percent from a quarter ago and by roughly nine percent year-over-year.
A SIMPLE EXPLANATION OF CONFINDEX™

• **The Overall CONFINDEX™ Number**
  • Composite Index Comprised of 4 Sub Indices
    1) Business Conditions
    2) Financial Conditions
    3) Current Conditions
    4) 2016 Outlook – look ahead to September 2016

• **Measurements Taken Using 8 Questions**
  • Current Business Conditions
  • Future (1 year) Business Conditions
  • Current Bank Credit Availability
  • Future (1 year) Bank Credit Availability
  • Future (1 year) Bonding Credit Availability
  • Line of Credit Status
  • Current Backlog
  • Future (1 year) Backlog

• We calculate indices by taking the “net” of positive responses minus negative responses and adding 100. (Neutral and No Answers are excluded)

• Any index greater than 100 reflects more positives than negatives. Any index less than 100 reflects more negatives than positives.