INDUSTRY SPOTLIGHT

Understanding Life Cycle Cost Analysis from an Owner's Perspective

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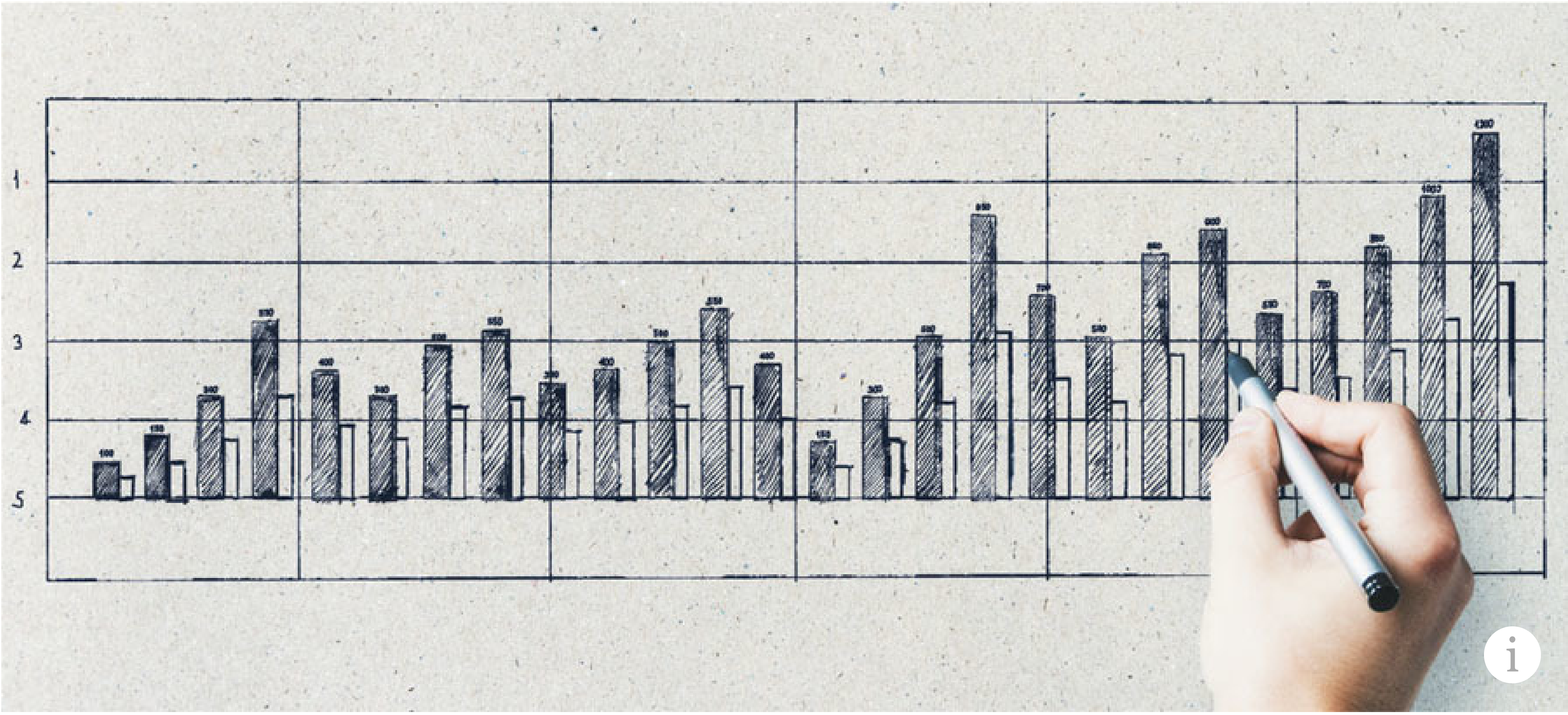

Life Cycle Cost Analysis is a difficult subject to define based on the audience and its collective expectations. Given that concrete pavements are generally accepted as a superior product within our industry and publicly, it is essential to keep in mind the potential variables that deserve to be considered. Many institutional owners are equity investors, meaning their facilities are owned and generally have more predictable business models. They are able to forecast and schedule facility maintenance expense and capital investment with a high degree of accuracy and expect long-term service from their facilities and infrastructure investments. On the other end of the spectrum many corporate clients, and for this comparison I speak specifically to my retail fleet experience, are dominated by leased building assets and a very dynamic business model in which to forecast facility capital expenses.

POWER UP PLACING

- Economic
- Convenient
- Reliable
- **PROFITABLE**

All owners want the greatest possible value from their investment dollars and it is our responsibility to research and understand how to best market and fulfill those expectations. As an example, I have an institutional client that is well educated, highly effective in his discipline and possesses an above average level of construction knowledge. He has been involved in multiple capital building projects, manages the maintenance of multiple facilities and is a steadfast advocate for concrete parking lot pavement. Following are the top five things I have learned from this business relationship:

1. Leadership position for several years and takes the consequences of his decisions very seriously

2. Leadership has a clear understanding regarding the market value rate of his investment dollars

3. Leadership operates a business that has a low level of economic volatility

4. Leadership plans and executes a business plan that is founded on a stable revenue stream

5. Leadership has a long-term expense and a capital investment plan

The opposing example comes from my 32 years of personal experience managing expense and capital investment dollars in a 400 building fleet of retail locations in 26 states. Corporate leadership changed frequently and had minimal experience in the construction industry. It did not possess hands on experience in managing facility maintenance nor the consequences of investment deferral and may have had an overall interest in minimizing investment in physical assets to enhance short-term gains. Here are the top five lessons taken away from this experience:

1. Leadership and business philosophies change often
2. Leadership has an internal financial hurdle rate for its investment dollars based on investor expectations
3. Leadership operates a business that is highly susceptible to market and investor forces that may require radical departure from planned forecasts
4. Leadership executes a business plan based on weekly, monthly and quarterly revenue and gross margin
5. Leadership investment in facility maintenance is significantly influenced by direct revenue, margin and market capitalization

Understanding these two examples, here is a recapitulation of these diverging business positions as they relate to our marketing:

1. Stability in leadership has a significant impact on the decision-making process; institutional tenures may average 15-20 years while corporate tenures typically average 3-5 years.

2. Value of investment dollars is generally tied to long-term institutional rates indexed from prime or long-term bond rates stabilized by solid revenue streams. While internal corporate hurdle rates of return of 15%-20% are influenced by inventory levels, first in/last out inventory, last in/first out inventory, market opportunities, politics, world events and/or EBITDA (earnings before interest, tax, depreciation and amortization).

3. Institutional business economics are generally based on stable revenues and cost of money, while retail is dominated by fluctuating costs of goods, revenue and margin based on credit worthiness, shifting market trends, inventory availability subject to global events, acquisition costs and customer fulfillment.

4. Institutional business planning being more predictable allows for long-term forecasting, scheduled preventative maintenance and opportunity to take advantage of economic downturns to capitalize on vendor market pressure that lower costs. Corporate planning is typically very fluid based on real time leading to deferred maintenance, partially appropriated capital requests and emergency or unplanned repairs.

5. Institutional goal orientation is directly relative to the decision-making process, long-term leadership, reliable funding, low volatility, stable revenue

and predictable forecasting, providing for personal accountability. Fiscal responsibility and solid initial and long-term preservation of building, infrastructure and furniture, fixture and equipment (FF&E) assets that provide legacy returns to the owner. Many corporate executives today are hired on three-year employment contracts, which pins their career, compensation and future marketability to a very short time period with minimal consideration for legacy accomplishments.

My marketing experience suggests you know your customer and anticipate what circumstances govern his or her business decisions before you get too far in the weeds discussing LCCA and never engage in a conversation around return on investment (ROI). This discussion is so complex and subjective that most people may not understand how it relative to their own business and, additionally, there are an infinite number of ROI equations, expectations and opinions to manipulate the result. I suggest staying with a simple comparison that is generally supported within the industry. There are several software packages available that have basic inputs that allow you to produce an illustration that may be beneficial when speaking with a client. And remember this: In the concrete industry we can design for 20, 30, 40 or more years which may outlive the useful life of many buildings and most certainly many decision makers' careers.

In summary, we need to focus on how to best design and deliver a superior product at a competitive initial investment that provides a comfort level to our clients. As we move forward, we can look to the success of the auto industry for guidance, where scheduled maintenance and extended warranties provide a platform for positive marketing and provide additional revenue streams.

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