Profit Is Not A Four Letter Word!

Three Steps To Profitable Sales

Tom Stephani

MIRM, GMB, MCSP, CAPS

Custom Construction Concepts, Inc.

Crystal Lake, Illinois
2007 International Builders Show

Before We Begin…

- Cell Phones Off
- Ask Questions Anytime
- Please Give Us Your Feedback
Small Volume Builder Statistics

- NAHB Defines a SVB as one who builds 25 or fewer homes per year.
- Almost all “Custom” Builders are SVB’s
- 80% (48,000) of NAHB Builder members are SVB’s!
- 66% (39,600) of NAHB Builder members build less than 10 homes per year!
Profile of Small Volume / Custom Builders & Remodelers

- Entrepreneurial
- Self Taught
- Stubborn
- Independent
- Poorly Capitalized
- Disorganized
Traits of Marginal & Unprofitable Builders

- **No Plan** - They have no clue where they’ve been or where they’re going
- **Seat of the Pants Management**
- **Compete on Price Only**
- **Use “Checkbook” Financial Management**
- **Despise Warranty Work**
- **Do it all Themselves**
Traits of Successful & Profitable Builders

- Have a Plan - Strategic, Business, & Marketing
- Organized - Systems oriented (E-Myth)
- Sell Relationships and Service
- Good Financial Management
- Use Warranty Work as a Marketing Tool
- Delegate - Surround themselves with strong, talented people
Three Steps to Profitability

1. Define
2. Plan
3. Measure
Three Steps to Profitability

1. Define
2. Plan
3. Measure
Define It
What is profit?

Simply stated, it is payment for -

- Risks taken
- Capital invested
- Liability exposure

It is your right and responsibility to generate a net profit for your business.
Define It

- Mark-Up - Factor applied to costs
- Margin - % of sales price
- Gross Profit - Sales price less job cost
- Net Profit - Gross profit less overhead costs
- ROI - Return on Investment
Define It

Markup & Margin, what’s the difference?

- A 15% **mark-up** on a job costing $200,000 will yield a selling price of $230,000.
- A 15% **margin** on a job costing $200,000 will yield a selling price of $235,294.

If you build 10 houses per year, the difference between a 15% **Mark-up** and a 15% **Margin** is $52,940!
Defining “Profit”

Income Statement

Sales $2,000,000
Sticks / Bricks 1,700,000
Gross Profit $300,000
Gen. / Admin. 200,000
Net Profit $100,000

Mark-up - 17.6%
Margin - 15%
Net Profit – 5%
ROI - Depends on Investment
Define It

Margin is a Function of...

- Contract Type
- Cost
- Size & Complexity
- Site Conditions
- Location
- Other People Involved
- Hand holding Required
Define It

Components of Margin...

- Profit
- Office Overhead / Salaries
- Marketing / Commissions?
- Project Management / Supervision?
- Insurance
- Vehicles / Cell Phones / Pagers
- Warranty
Define It

When discussing your fees with Clients, Realtors, and Lenders...
Don’t call it, “Profit & Overhead”
always call it “Builder’s Margin”
Define It

What Should SV & Custom Builders Make?

- Depends on size
- Don’t confuse profit with owner’s salary & benefits
- Typical Gross Margins for SV & Custom Builders range from 8% - 20%.
- Successful / Profitable builders are usually in the 16% to 20% range.
Three Steps to Profitability

1. Define
2. Plan
3. Measure
How Do You Price Your Work?

- Detailed Estimating System
- Unit Pricing
- Historical Data
- $ per Square Foot
- Wing It!
- To the Client’s Budget
“What Ever It Takes” Builders

Buyer’s Budget $350,000.00
Home Cost .... $315,000.00
Balance (margin) $35,000.00 (10%)

A “What Ever It Takes” Builder will design & spec home to fit the owner’s requirements and will sacrifice his margin to make the deal work.
“Bottom Line” Builders

Buyer’s Budget ........ $350,000.00
Subtract Margin ........ $ 52,500.00  (15%)
Sticks & Bricks ........ $297,500.00

A “Bottom Line” Builder will control the design and spec of the home to fit the $ available without sacrificing his margin.
### Profitability Chart

**Know Your Numbers!**

<table>
<thead>
<tr>
<th>Homes</th>
<th>1 to 3</th>
<th>4 to 6</th>
<th>7 to 9</th>
<th>10 to 12</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Salaries</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Owner</td>
<td>50,000</td>
<td>60,000</td>
<td>70,000</td>
<td>80,000</td>
</tr>
<tr>
<td>Super</td>
<td></td>
<td>40,000</td>
<td>50,000</td>
<td></td>
</tr>
<tr>
<td>Secretary</td>
<td>50,000</td>
<td>12,000</td>
<td>18,000</td>
<td>24,000</td>
</tr>
<tr>
<td>Sub Total</td>
<td>10,000</td>
<td>14,400</td>
<td>25,600</td>
<td></td>
</tr>
<tr>
<td>Burden</td>
<td>24,000</td>
<td>36,000</td>
<td>48,000</td>
<td>60,000</td>
</tr>
<tr>
<td>Overhead</td>
<td>84,000</td>
<td>122,400</td>
<td>201,600</td>
<td>244,800</td>
</tr>
<tr>
<td>G &amp; A</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Commission</td>
<td>2,500</td>
<td>12,500</td>
<td>30,000</td>
<td>41,250</td>
</tr>
<tr>
<td>Warranty</td>
<td>2,500</td>
<td>6,250</td>
<td>10,000</td>
<td>13,750</td>
</tr>
<tr>
<td>Total CODB</td>
<td>89,000</td>
<td>141,150</td>
<td>241,600</td>
<td>299,800</td>
</tr>
</tbody>
</table>

### Effect of Volume and G&A on Net Profit

<table>
<thead>
<tr>
<th>Homes</th>
<th>1</th>
<th>4</th>
<th>7</th>
<th>10</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales</td>
<td>250,000</td>
<td>1,000,000</td>
<td>1,750,000</td>
<td>2,500,000</td>
</tr>
<tr>
<td>10%</td>
<td>(64,000)</td>
<td>(41,150)</td>
<td>(66,600)</td>
<td>(49,800)</td>
</tr>
<tr>
<td>12%</td>
<td>(59,000)</td>
<td>(21,150)</td>
<td>(31,600)</td>
<td>200</td>
</tr>
<tr>
<td>14%</td>
<td>(54,000)</td>
<td>(1,150)</td>
<td>3,400</td>
<td>50,200</td>
</tr>
<tr>
<td>16%</td>
<td>(49,000)</td>
<td>18,850</td>
<td>38,400</td>
<td>100,200</td>
</tr>
<tr>
<td>18%</td>
<td>(44,000)</td>
<td>38,850</td>
<td>73,400</td>
<td>150,200</td>
</tr>
<tr>
<td>20%</td>
<td>(39,000)</td>
<td>58,850</td>
<td>108,400</td>
<td>200,200</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Homes</th>
<th>3</th>
<th>6</th>
<th>9</th>
<th>12</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales</td>
<td>750,000</td>
<td>1,500,000</td>
<td>2,250,000</td>
<td>3,000,000</td>
</tr>
<tr>
<td>10%</td>
<td>(14,000)</td>
<td>8,850</td>
<td>(16,600)</td>
<td>200</td>
</tr>
<tr>
<td>12%</td>
<td>1,000</td>
<td>38,850</td>
<td>28,400</td>
<td>60,200</td>
</tr>
<tr>
<td>14%</td>
<td>16,000</td>
<td>68,850</td>
<td>73,400</td>
<td>120,200</td>
</tr>
<tr>
<td>16%</td>
<td>31,000</td>
<td>98,850</td>
<td>118,400</td>
<td>180,200</td>
</tr>
<tr>
<td>18%</td>
<td>46,000</td>
<td>128,850</td>
<td>163,400</td>
<td>240,200</td>
</tr>
<tr>
<td>20%</td>
<td>61,000</td>
<td>158,850</td>
<td>208,400</td>
<td>300,200</td>
</tr>
</tbody>
</table>
Zeroing in on the Right Contract For You

- Who Owns the Lot During Construction?
- Who Provides the Construction Financing?
- Who Guarantees the Price?
- Who Pulls the Permit & Insures the Project?
Responsibilities - New Home Construction

Primary -
- Purchase of Lot
- Construction Loan
- Cost Over-Runs
- Insurance Liability
- Warranty
- Options / Changes

Secondary -
- Design / Errors
- Govt. / Utilities
- Estimate Accuracy
- Clerical Work
- Sub Selection
- Dispute Resolution
- Inspections
3 Basic Types of Contracts

- **General**
  - Your Lot, Your Loan

- **Limited General**
  - Their Lot, Their Loan

- **Construction Mgmt.**
  - Their Lot, Their Loan, They’re the GC
General Contract

- Pricing Based on Market
- Highest Margins
- Highest Risk
- Most Responsibility
Limited General Contract

- Pricing Based on Cost & Market
- Lower Margins
- Lower Risk
- Reduced Responsibility
Construction Management

- Pricing Based on Cost / Time
- Lowest Margins
- Lowest Risk
- Least Responsibility
## Price / Contract Type / Margin

<table>
<thead>
<tr>
<th>Home Price</th>
<th>General Contract</th>
<th>Ltd. Gen. Contract</th>
<th>Construction Mgmt</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>%</td>
<td>$</td>
<td>%</td>
</tr>
<tr>
<td>200K</td>
<td>18.0%</td>
<td>36.0K</td>
<td>15.0%</td>
</tr>
<tr>
<td>300K</td>
<td>17.5%</td>
<td>52.5K</td>
<td>14.5%</td>
</tr>
<tr>
<td>400K</td>
<td>17.0%</td>
<td>68.0K</td>
<td>14.0%</td>
</tr>
<tr>
<td>500K</td>
<td>16.5%</td>
<td>82.5K</td>
<td>13.5%</td>
</tr>
<tr>
<td>600K</td>
<td>16.0%</td>
<td>96.0K</td>
<td>13.0%</td>
</tr>
<tr>
<td>700K</td>
<td>15.5%</td>
<td>108.5K</td>
<td>12.5%</td>
</tr>
<tr>
<td>800K</td>
<td>15.0%</td>
<td>120.0K</td>
<td>12.0%</td>
</tr>
</tbody>
</table>
## Sample Mix of Contracts & Volume

<table>
<thead>
<tr>
<th>10 Homes (all w/o land)</th>
<th>8 Homes (all w/o land)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Sale Price</strong></td>
<td><strong>Margin</strong></td>
</tr>
<tr>
<td><strong>3 GC's</strong></td>
<td>#1</td>
</tr>
<tr>
<td>#2</td>
<td>$300,000</td>
</tr>
<tr>
<td>#3</td>
<td>$400,000</td>
</tr>
<tr>
<td><strong>4 LTD GC's</strong></td>
<td>#1</td>
</tr>
<tr>
<td>#2</td>
<td>$450,000</td>
</tr>
<tr>
<td>#3</td>
<td>$350,000</td>
</tr>
<tr>
<td>#4</td>
<td>$500,000</td>
</tr>
<tr>
<td><strong>3 CM's</strong></td>
<td>#1</td>
</tr>
<tr>
<td>#2</td>
<td>$250,000</td>
</tr>
<tr>
<td>#3</td>
<td>$300,000</td>
</tr>
<tr>
<td><strong>Totals</strong></td>
<td>$3,650,000</td>
</tr>
<tr>
<td><strong>CODB</strong></td>
<td>$299,800</td>
</tr>
<tr>
<td><strong>Net Profit</strong></td>
<td>$222,325</td>
</tr>
<tr>
<td><strong>% of Sales</strong></td>
<td>6.09%</td>
</tr>
</tbody>
</table>
Plan For It

Three ways to increase Profit

- Increase volume
- Decrease costs
- Increase margins
Plan For It
Increase Volume

**Pro**
- Economies of Scale
- Better buying power
- Increased exposure
- More income

**Con**
- Management headaches
- Increased Overhead
- Increased exposure & liability.
- Less Control
Plan For It
Decrease Costs

Pro
- Savings flow to bottom line
- Can cut price without compromising margins

Con
- More effort required on “front end”
- Quality can suffer
- Can “cheapen” the product
Plan For It
Increase Margins

Pro
- Fewer houses / same gross margin
- Same # of houses / higher gross margin
- More houses / much higher gross margin

Con
- Can price you out of the market
- Harder to sell to clients
- Appraisal problems
### Salaries & Overhead by Number of Houses

<table>
<thead>
<tr>
<th></th>
<th>1 to 3</th>
<th>4 to 6</th>
<th>7 to 9</th>
<th>10 to 12</th>
</tr>
</thead>
<tbody>
<tr>
<td>Owner</td>
<td>50,000</td>
<td>60,000</td>
<td>70,000</td>
<td>80,000</td>
</tr>
<tr>
<td>Super</td>
<td>40,000</td>
<td>50,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Secretary</td>
<td></td>
<td>12,000</td>
<td>18,000</td>
<td>24,000</td>
</tr>
<tr>
<td>Sub Total</td>
<td>50,000</td>
<td>72,000</td>
<td>128,000</td>
<td>154,000</td>
</tr>
<tr>
<td>Burden</td>
<td>10,000</td>
<td>14,400</td>
<td>25,600</td>
<td>30,800</td>
</tr>
<tr>
<td>Overhead</td>
<td>24,000</td>
<td>36,000</td>
<td>48,000</td>
<td>60,000</td>
</tr>
<tr>
<td>G &amp; A</td>
<td>84,000</td>
<td>122,400</td>
<td>201,600</td>
<td>244,800</td>
</tr>
</tbody>
</table>

Sales needed to cover G & A and create a 5% Net Profit at various margins:

<table>
<thead>
<tr>
<th></th>
<th>1 to 3</th>
<th>4 to 6</th>
<th>7 to 9</th>
<th>10 to 12</th>
</tr>
</thead>
<tbody>
<tr>
<td>10%</td>
<td>1,680,000</td>
<td>2,448,000</td>
<td>4,032,000</td>
<td>4,896,000</td>
</tr>
<tr>
<td>12%</td>
<td>1,200,000</td>
<td>1,748,571</td>
<td>2,880,000</td>
<td>3,497,143</td>
</tr>
<tr>
<td>14%</td>
<td>933,333</td>
<td>1,360,000</td>
<td>2,240,000</td>
<td>2,720,000</td>
</tr>
<tr>
<td>16%</td>
<td>763,636</td>
<td>1,112,727</td>
<td>1,832,727</td>
<td>2,225,455</td>
</tr>
<tr>
<td>18%</td>
<td>646,154</td>
<td>941,538</td>
<td>1,550,769</td>
<td>1,883,077</td>
</tr>
<tr>
<td>20%</td>
<td>560,000</td>
<td>816,000</td>
<td>1,344,000</td>
<td>1,632,000</td>
</tr>
</tbody>
</table>
Three Steps to Profitability

1. Define
2. Plan
3. Measure
Measure It

In Order to Effectively Measure Profitability, you must...

- Keep your books in-house
- Have a good “system” for tracking job costs
- Understand basic financial management
- NAHB Chart of Accounts
- Spend the time
Creating a financial system

- Pay on dates that match inflow
- Use a dedicated VISA card
- Set-up trade accounts to take advantage of discounts
- Do not commingle funds from bank payouts
- Don’t “front load” your jobs
- Create a Warranty Reserve & tracking system
- Withholding Reserve
Measure It

Computer Software to help

- Quickbooks & MS Office
- Integrated packages
Measure It

Monthly Reports

- Job Cost for each home
- Balance Sheet
- Income Statement
- Cash Flow
- Warranty Report

These reports should be available to you no later than 30 days after month end.
Things That Cause Profits to “Slip”

- Lack of Marketing
- Weak Plans & Specs
- Haphazard Purchasing
- Bad Estimating
- Dragging Schedules
- Poor Change Order System
- Quality Control / Warranty
- No Financial Control
Now That You Have It, What Do You Do With It?

- Make sure that you pay your taxes before using the $.
- Create a bonus system based on ownership, effort, and efficiency
- Get it out of the Company
- Plan for a “Rainy Day”
- Plan for retirement with 401k’s, SEP’s, IRA’s etc.
Sample Bonus Plan

- Must be written & understood
- Determine % of Net to be in Pool
- Adjust for Owner Compensation and burden
- Split the Pool based on salary
## Bonus Pool Example

<table>
<thead>
<tr>
<th>Sales</th>
<th>Margin</th>
<th>Net</th>
<th>$</th>
</tr>
</thead>
<tbody>
<tr>
<td>Profit Goal was...</td>
<td>$ 3,000,000</td>
<td>16%</td>
<td>5%</td>
</tr>
<tr>
<td>Actual was...</td>
<td>$ 2,500,000</td>
<td>14%</td>
<td>4.2%</td>
</tr>
</tbody>
</table>

40% of Net to Pool $ 42,000
Burden @1.2 $ 35,000
Employee Payout

- Owner @ $80,000 = 51.9% X 35000= $ 18,165
- Super @ $50,000 = 32.5% X 35000= $ 11,375
- Secretary @ $24,000 = 15.6% X 35000= $ 5,460

Total Bonus Payout $ 35,000
Summary

- Your must understand what profit is.
- You must plan to make a profit,
- You must constantly monitor and manage for profitability.
- **And...** Profit is **NOT** a 4 letter word!
2007 International Builders Show

Thanks For Coming!!
Evaluations Please!

For more info…
tom@custombuilding.com

or

(800) 421-3665