Numbers, Numbers, Numbers

How Do Yours Stack Up?

The International Builder’s Show
Orlando, FL
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Presented by:
Steve Maltzman, CPA
Outline of Presentation

What Numbers to Benchmark
- Financial Benchmarks
- Operational Benchmarks

GAAP, Tax or Management?

How do Your Numbers Stack Up
- NAHB CODB Study
- Other Benchmarking Data
Benchmarking

How do my numbers compare to other builders? This is a question that I hear over and over again when I speak to builders throughout the country. Since the late 1970's the National Association of Home Builders has been doing a cost of doing business study in which they have surveyed members on their financial results. This study gives home builders a glimpse at other builders’ books by providing data about profitability, cost of sales, and expenses from hundreds of home builders across the country. The most recent study was based upon a financial survey conducted by NAHB in 2003.

I had the opportunity to be involved in reviewing and analyzing the data from the cost of doing business studies from 1986 through 2001. One of the things that I learned from being involved in those studies is that it was difficult to get consistency in reporting of financial results.

Over the past eight years I have had the opportunity to be the accountant for NAHB’s Builder 20 clubs. These clubs, sponsored by the National Association of Home Builders provide builders with an opportunity to get together twice a year with non-competing builders throughout the county. In addition, members of the club regularly correspond with each other via group e-mail to discuss issues relating to their businesses. The clubs provide an excellent opportunity for builders to network as well as benchmark their financial and other information with similar builders.

During the spring, all Builder 20 club members submit their financial results in a standard format. The group reviews spreadsheets, which compare each of the club member’s results. In addition, every summer we provide an overall analysis of the financial results of the club members sorted in a variety of different categories. The data is confidential and is not disseminated outside of the 20 clubs. If you are interested in finding out more about the 20 clubs contact them at (800) 368-5242 X8609 or via e-mail at 20clubs@nahb.com.

GAAP, Tax or Management?

When dealing with financial results, builders have three masters that they have to report to.

1. At a minimum of annually builders need to provide financial result to their banker or investors. These results should be reported in a format which adheres to generally accepted accounting principles (commonly referred to as GAAP).
2. Builders all have to pay taxes either at the corporate level or if your building company is a flow-through type entity such as an S Corp, LLC or sole proprietorship.
3. The most important use of financial results is for management purposes which may be different than tax or GAAP reporting.

The key area in which management accounting differs from GAAP and tax reporting is in how the company reports cost of construction. Even within each of the methods there is a wide range of inconsistency in reporting construction costs.

For management purposes, gross margin should be defined as sales less “sticks and bricks” plus
land at market value. All other costs, such as construction period interest, interest on finished inventory, supervision and other indirect cost should be included as operating expenses for management purposes. For GAAP and tax purchases indirect costs and interest is allocated to homes.

In looking at builder benchmarks it is important to make sure that the data you are looking at is an accumulation of costs and expenses on an “apples to apples” comparison.

**What Numbers to Benchmark**

**Financial Benchmarks**

Financial Benchmarks are best viewed as a percentage of revenue sales in the following major categories. The numbers identified in parenthesis represent the ranges that should be targeted for each of the categories for production-oriented builders.

- Cost of Sales (70-75%)
  - Land @ Market (20-25%)
  - Direct Costs (50-55%)
- Gross Profit (25-30%)
- Indirect Construction expense (3-4%)
- Finance expense (1-2%)
- Sales & marketing expense (5-6%)
- G&A (Overhead) expense (4-5%)
- Net Profit (10-15%)

There are 3 categories of other financial ratios which measure liquidity, leverage and return on investment that are derived from the balance sheet and a combination of the balance sheet and income statement that should also be analyzed,

**Liquidity**

- Current ratio (2/1)
  - Current assets/current liabilities
- Acid test ratio (1/1)
  - Quick (cash) assets/current liabilities

**Leverage**

- Debt to equity ratio (3/1)
  - Total liabilities/total owners equity
- Interest coverage ratio
  - EBIT (earnings before interest & taxes)/total interest charges
Return on Investment

- Return on investment (ROI) (20-30%)
  - Net profit/average owners equity
- Equity turnover (8-12)
  - Total annual sales revenue/average equity
- Inventory turnover ratio (including land)
  - Cost of sales/average inventory
  - Depends upon product type & cycle time

Following is a chart of the results of all builders from the latest NAHB Cost of Doing Business Study.

2003 Cost of Doing Business

Operational Benchmarks

It is more difficult to obtain outside benchmarks to compare to when it comes to the area of operations. It is best to accumulate these benchmarks internally and measure against internal targets. There are 6 areas of operational benchmarks that you should be looking at:

- Efficiency & Productivity
- Sales & Marketing
- Quality
- Schedule
- Construction
- Customer Satisfaction
Efficiency and Productivity
• Productivity ratio ($1-1.2 million)
  – Total sales $ revenue/number of full time equivalent employees
• WIP turnover (3-4)
  – Total Direct COS (less land)/ Avg. WIP
• Average number of days each warranty service request is open
• Direct cost variance from budget as a percentage of total budgeted direct cost
• Total number of variance purchase orders (VPO)

Sales and Marketing
• Referral rates (Total sales or traffic/# customer referrals)
• Advertising cost $/number of traffic units
• Advertising cost $/ number of sales contracts
• Fallout ratio (Cancellations/Sales)
• Product sales matrix %s (presale vs. spec, by plan type
• Conversion ratio (Traffic/Sales)

Quality
• Open service requests/number of homes under warranty – (quality of service)
• Total service request items/number of homes under warranty – (quality of product)

Schedule and Construction
• Time of construction – measured consistently from point A to point Z
• Weekly/monthly measurement of annualized production gain – specialized manufacturing industry measurement to gauge the production within any period, location, crew, etc.

Customer Service
• Would you recommend ratio
• Scoring on satisfaction (1 to 5) on
  o Salesperson and process
  o Construction manager and process
  o Selections process and personnel
  o Plan flexibility and availability of plan styles
  o Financing process and people (if in-house)
  o Home owners manual
  o Warranty
  o Performance
## How do Your Numbers Stack Up?

### Profitability Ratios

**Period Ending: December 31, 2005**

<table>
<thead>
<tr>
<th></th>
<th>Target %</th>
<th>Your Co. %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Sales Revenues</td>
<td>100.0%</td>
<td>100.0%</td>
</tr>
<tr>
<td><strong>Less: Cost of Sales</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Land (at Market)</td>
<td>20.0%</td>
<td></td>
</tr>
<tr>
<td>Direct Construction Costs</td>
<td>50.0%</td>
<td></td>
</tr>
<tr>
<td><strong>Total Cost of Sales</strong></td>
<td>70.0%</td>
<td>0.0%</td>
</tr>
<tr>
<td><strong>Gross Profit Margin</strong></td>
<td>30.0%</td>
<td></td>
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<tr>
<td><strong>Less: Operating Expenses</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><em>Construction Expenses</em></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Construction</td>
<td>2.5%</td>
<td></td>
</tr>
<tr>
<td>Warranty</td>
<td>1.0%</td>
<td></td>
</tr>
<tr>
<td><strong>Total Indirect Construction Expense</strong></td>
<td>3.5%</td>
<td></td>
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<tr>
<td><strong>Total Financing Expense</strong></td>
<td>1.5%</td>
<td></td>
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<tr>
<td><strong>Sales &amp; Marketing Expenses</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Advertising</td>
<td>1.0%</td>
<td></td>
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<tr>
<td>Model Operations</td>
<td>1.0%</td>
<td></td>
</tr>
<tr>
<td>Commissions &amp; Sales Exp</td>
<td>3.0%</td>
<td></td>
</tr>
<tr>
<td>Other Sales &amp; Marketing</td>
<td>0.5%</td>
<td></td>
</tr>
<tr>
<td><strong>Total Sales &amp; Marketing Expense</strong></td>
<td>5.5%</td>
<td></td>
</tr>
<tr>
<td><strong>Total General &amp; Admin Overhead</strong></td>
<td>4.5%</td>
<td></td>
</tr>
<tr>
<td><strong>Total Operating Expenses</strong></td>
<td>15.0%</td>
<td></td>
</tr>
<tr>
<td><strong>Net Income from Operations</strong></td>
<td>15.0%</td>
<td></td>
</tr>
<tr>
<td>Plus: Total Miscellaneous Inc</td>
<td>0.1%</td>
<td></td>
</tr>
<tr>
<td><strong>Total Income before Taxes</strong></td>
<td>15.1%</td>
<td></td>
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</tbody>
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For an excel version of this spreadsheet please check out our website at: [www.SMAconsulting.net](http://www.SMAconsulting.net)
Speaker Biography

Steve Maltzman
President / SMA Consulting

Steve Maltzman, president and founder of SMA is a CPA with more than nineteen years experience working within the construction industry both as a controller and chief financial officer for various building and remodeling firms. In addition, Steve spent over three years as product manager for a leading developer of software for the construction industry, and five years as an auditor and consultant for a major CPA firm. Steve currently serves on NAHB’s Education and Information Systems Committees and is a member of the American Institute of CPA’s (AICPA). Steve Maltzman holds an MBA degree in accounting from Rutgers University and a BA from Dickinson College.

Contact Information

California Office:
1003 East Cooley Drive
Suite 207
Colton, CA  92324

PH: 909-420-0200
Fax: 909-363-7672

Email: smaltzman@SMAconsulting.net

www.SMAconsulting.net
www.builderstraininggroup.com