Newsletter 49 – Builder Finances

Education, Certifications, Special Skills
Masters of Business Administration
Stanford Graduate School of Business
Bachelor of Science in Mechanical Engineering
Rice University
Texas Engineering 38724

Experience
Management of construction organizations for 42 years.
Member of 51 project teams

Professional and Community Affiliations
AGC Project Delivery Systems National Subcommittee – 1998-99
Lorman Seminars 2003-2014
USGBC and CEFPI speaker
Adjunct Faculty Texas A&M 2012-2013

Founder and First President, West University Recycling

It was early last year that we last checked on the economics of being a construction company. The best information is still from the Construction Financial Management Association, which does an excellent yearly survey and explanation.

The average builder in the Southwest region has yearly sales in the $100 million range. For tax purposes they are an S Corporation, which means that it's stock is held by a small number of involved employees who pay individual rather than corporate taxes. They have been through a down time with the financial crisis in the 2011-2014 period, but have come back well in recent years. The average yearly billing is about $108 million, but there is a wide range from $10 million to $500 million.

The financial profile changes a lot from small to large companies. The large companies can charge a smaller percentage fee because they can use a lot more debt financing in a low interest rate economy, to produce a similar return on their equity:

	$10 Million Billing Firm	$300 Million Billings Firm
Fee (Gross Profit) to Sales	15.90%	5.50%
Sales to Total Assets	2.1	3
Total Assets to Equity	3	5.5
Return on Equity	22.50%	27.20%

That looks like a very good return on equity, but remember that returns on equity were below 8% a few years ago, and 66% of the companies entering the construction industry fail the first four years. It's high stakes bet.

Look at www.spms.us/writing.html. There's some good stuff there!

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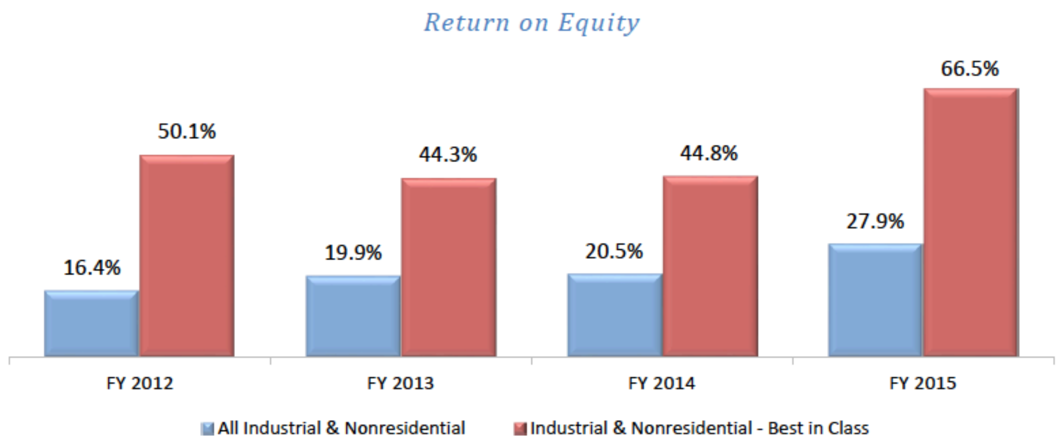
It's a good bet for most established firms right now though, with interest rates low, financing available, and volume going up. The "best in class" firms – that is the best 25% financially – have an amazing 66.5% return on equity.



Getting paid and paying bills continue to be slow this year. In the Southwest the average time to be paid is 41 days, and the average time to pay a bill is 46 days. It's a "pay when paid" world.

Despite the news, and some of our projects, only one in 200 firms in the Southwest has foreign ownership.

It is interesting to compare all this with heavy and highway contractors. That industry has far less debt to equity, and so they wind up charging a far higher profit percentage, to make the same return on equity. The $10 million per year highway contractor has an average 25% markup, and the large one still has a 15% markup. The same ratios are true of specialty subcontractors – they don't have as much financing as building general contractors, so they mark up 15 to 25 percent. And it takes an average of 61 days to be paid.

As interest rates slowly rise, and the business cycle begins a slow correction, it looks like these will probably go back down in the next few years. But for now, things are generally fine.

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