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Sold! Now What?

Builders gain valuable skills while waiting out their non-compete clause.

By Pat Curry

WHAT DOES A BUILDER DO AFTER he's sold his company to a big builder? Three guesses, and the first two don't count. Answer: He builds houses.

Well, not at first. A seller typically spends some time working for the new owner, signs a non-compete agreement for a certain number of years, and then goes back to building homes in the same market.

Non-compete clauses are specific in prohibiting sellers from building in the same market and niche for a period of time, usually between two to five years. But that doesn't mean the time is spent playing golf or catching up on reading. Judging from the experience of several builders who sold their companies to larger builders, if they couldn't put sticks in the ground, they were stockpiling dirt, watching the calendar pages flip, and counting the days until they could pull the first building permit.

What builders choose to do after their non-compete agreement ends is very much a function of age, says Michael P. Kahn, a Florida-based building consultant who specializes in mergers and acquisitions. Builders in their 50s and 60s who are ready to retire and have no one in the family who wants to take over the business will use the sale as an exit strategy from the company. They may develop lots, but they're essentially done building. Builders in their 30s or 40s typically use the cash from the sale and their earn-out portion of the profits to get back into home building in some way.

“Once you're a home builder, you're a home builder unless you're at an age where you don't want the risk anymore,” Kahn says. “Most of these transactions have made multi-millionaires out of the sellers, from people who had most of their net worth tied up in the company.”

A builder typically sells for one of three reasons, says Al Trellis, president of the Home Builders Network, a consultancy that brokers deals. He wants to reduce his risk, spend more time with his family, or “finally get to the cash he could never get to.”

Here are the stories of four builders who decided to sell:

Patriot Homes, Columbia, Md. Harry “Chip” Lundy hardly felt a hiccup in his operations when he sold his interest in Patriot Homes to Lennar in 2002. His partner, Rick Kunkle, stayed with the company to run the division for Lennar. Lundy left to focus on another home building company that they had started, Williamsburg Group.

“They didn't want me anyway,” Lundy says. “They wanted Rick. He had worked for Ryland [Homes]. I was an entrepreneur.”

They had decided to sell Patriot Homes, he says, because they were building 400 houses a year, needed additional capital to get to the next level, and weren't willing to personally take on the extra risk.

Plus they realized a need to find a way to extract themselves from the business.

“How else do you get out of the company? Do you die?” Lundy says. “We wanted to do some estate planning.”

The deal was simple and quite fair, Lundy says. During his non-compete period, which runs through 2007, he can't compete directly against Patriot Homes, which builds in the $200,000 to $300,000 price range, but he can continue to build under the Williamsburg Group name. The average price of his homes is in the $600,000 range. The number of units he can build in the Virginia/Maryland area, where Patriot Homes builds, also is limited.

“The non-compete is really very lax; it wasn't restrictive at all,” Lundy says. “They said, ‘How many do you want to build a year?' I said, ‘About 50.' They said, ‘How about 100?' I said, ‘Fine.' We'll never build 100 houses. ... I can't say enough nice things about Lennar. We dealt with some good people. We're happy. I think they're happy.”

While Lundy says he had no qualms about selling the business he had started and seen grow rapidly to the $100 million revenue range (“It's not a child; it's an asset. It had value. Someone was willing to pay for that value”), he had a great deal of concern about his staff. He and Kunkle wanted to make sure that none of the employees would lose their jobs as a result of the sale.

“We looked at this as a family,” he says. “It was a very close-knit organization. ... Lennar was very, very good about that. To this day, no employee has been let go. They've only been promoted.”

Anchor Homes, San Antonio Unlike many other builders, LuAnn Butler and Doug Carpenter want to stay with Fieldstone Communities, the California-based company that bought their business, Anchor Homes of San Antonio. They had just started the company in 2000; in 2002, they closed 39 homes in their target market of starter homes. Fieldstone acquired Anchor in April 2003 to launch a San Antonio division. Butler and Carpenter are co-division managers; they have every intention of building a career at Fieldstone.

“We found we shared very similar values about the kind of business and division we wanted to be,” Butler says, “with regard to caring about employees and having strong corporate values, integrity, and so forth. The people part of it was [as important as] the financial part.”

Carpenter and Butler have quickly seen the benefits of being part of a larger organization. They have a design center to offer customers more choices in a more professional manner, and they've been able to hire some great management talent. Plus they have access to Fieldstone's purchase order and accounting systems and “our purchasing power for land and interim financing has grown much, much more than when it was a very small company.”

There's been a learning curve, to be sure, as they are responsible for a much larger organization. They grew from seven to more than 30 employees, moved to a new office space, implemented a new computer system, and created processes for most of their functions. They delivered twice as many homes as they did the year before they were acquired, with plans to triple that number within a year. There are three times as many employees to manage and a corporate hierarchy to report to.

“It's been a fast pace,” Butler says. “We've had to keep up.”

Overall, though, they're quite happy right where they are.

“Fieldstone is very flexible and easy to work with and shares our values,” Butler says. “It's actually been very friendly and a good match.”

Pinehurst Builders, Myrtle Beach, S.C. Ralph Teal Jr. had been approached several times over the years about selling his South Carolina–based company, Pinehurst Builders. He started the company in 1992, building 20 to 25 houses a year. The company grew at a meteoric rate, nearing 500 houses annually in just six years. The offer from Crossmann Communities in 1998 “made a lot of sense to do,” Teal says.

Teal worked for Crossmann for two years, followed by a three-year, non-compete agreement with a carve-out clause that allowed him to develop lots with a residential value above $35,000 during that time. At first his new company, Nations Homes in Myrtle Beach, S.C., focused on land development. In 2004, its first full year without restraints, the company will close about 120 houses. More significantly, it has approximately 1,100 sites in the pipeline.

“All the engineering and zoning work is done,” Teal says. “We're waiting to pull the trigger to start building.”

The time he spent at Crossmann (which has since been sold to Beazer Homes USA) taught him how a publicly owned builder operates, from the budgeting process and inventory requirements to improving margins through better purchasing and management.

“A lot of people think home building is just sticking a house up,” Teal says. “It's a pretty sophisticated business. If it's managed properly, you can increase your margins. ... Because of our experience running the former business, Nations Homes is in far better shape than the company we sold. ... It turned out to be very good for us. We were happy we did that.”

So happy, in fact, that he wouldn't mind selling again.

“We're building the best organization we can,” he says. “There's no doubt we can get back in this marketplace with the land positions we have and get 400 to 500 houses pretty easily. We didn't set out with the idea we'd sell it again, but we'll be open-minded. We'll see what happens.”

Trimark Communities, Denver At 300 closings a year, brothers Dale and Rob Francescon felt they'd taken Trimark Communities as far as possible without an infusion of cash, and they

weren't willing to put their personal assets on the line—again. They sold to D.R. Horton in 1996 and agreed to run the division for four years.

They made a successful transition from owners to employees because they knew what to expect.

“You have to understand what you're getting yourself into because it's different,” Dale says. “You're no longer in control.”

At the end of their four-year hitch, their new bosses asked them to stay, but the Francescons had an entrepreneurial itch to scratch. Carefully reviewing the restrictions in their two-year, non-compete agreement, they carved out a business that would let them honor the terms and prepare for the next phase of their careers. The primary restriction was a ban on actual construction. They were free to buy and entitle land and develop lots.

They combined their own experience with what they had learned at D.R. Horton to build a land pipeline and to put a capital base together to compete with the host of national builders in the Denver market. Within 18 months, the land conduit was in place. When they started scouting capital, they returned to consultant Michael Kahn, who had handled the sale of Trimark to D.R. Horton. He connected them with Utah-based Woodside Homes. They eventually formed a joint venture with Woodside to create a new company, Century Communities.

Their joint venture gives them access to Woodside's insurance, software, training, and mortgage services. It's saved them time and money as they establish their new niche in the Denver market. While Trimark exclusively built for-sale multifamily, Century Communities has a 75 percent to 25 percent split between for-sale attached and detached.

In their first full year of business, Century Communities closed just under 100 homes. They anticipate 250 closings in 2004 and have a five-year plan to reach 500 to 600 closings per year.

“We have a measure of control and all the attributes of being part of a much bigger home builder,” Francescon says. “We saw the advantages of that when we were at Horton.”

Words Of Wisdom Obviously, selling a business is something that doesn't happen every day, and it's a major event in the life of a company.

Trellis' advice for potential sellers is to look beyond the money to the broader issues of why they want to sell and the culture fit between the two companies.

The toughest part of the deal for most sellers is the transition from owner to employee and having to give up what they have created.

“It's like watching your child grow up,” he says. “That's the lament of anybody who owns a business. ... Money is wonderful, but most builders willing to sell are making money anyway. You have to feel the time is right and it's what you really want to do. Today, I had a guy who didn't want his employees to have to work for [a company] he didn't think [had] good people.”

You also need to be clear about what you're trying to accomplish and that the transaction achieves those goals.

“As I've talked to other people who sold to Horton, some of them didn't think it through, what the ramifications would be and whether they could live in a different environment,” Dale says. “Make sure you know what your goals are and understand the restrictions.”

The best advice Lundy says he could offer another builder thinking about selling his company is to be patient and to consider all his options. If one company makes an offer, shop around and look for other buyers. He also found tremendous benefit in having an advisory team that included both an attorney and an accountant.

“Most builders know how to build houses but don't know how to sell a company,” he says. “We didn't. How many companies do you sell? We had no clue.”

Making The Break *Preparing an exit strategy takes careful planning.*

When's the best time to start planning your exit from your company? The day you open the doors.

“No one does that, but it sounds good,” says Leslie Shiner, a construction management consultant with California-based Intuit. “Those who do it well will reap the rewards.”

Exit strategies typically are the most ignored portion of a business, Shiner says, and builders are no different.

Basically, builders have two major strategies available—liquidation and continuation. In liquidation, you make as much money as you can from the business and shut it down when you're ready to get out. In continuation, you either sell the business to another builder, a partner, or your employees.

If you'd like to see the company outlive you in some form, you need to create a structure that can run without you. That's tough for many small home builders, who form the essence of their companies. “They're typically charismatic guys who can sell you anything,” Shiner says. “Home buyers love them, but it is not the kind of company you can easily sell.”

New York–based CPA and succession planning specialist Paul Rich says that most of the builders he knows are entrepreneurial risk takers with a passion for the business, a tremendous amount of energy, and a strong sense of ownership. They have the ability—and the stomach—to personally guarantee loans at the bank. They're frequently tax sensitive “and maybe even cunning,” he says. Where they often drop the ball is in hiring future managers and/or owners for their companies.

To prepare for sale, Rich says, you need to be able to run the business lean and mean to demonstrate good management and high profitability. Examine your core business to see where it's strong and continue those strengths and shore up any weaknesses. Put procedures in place for various functions of the business and hire a capable management team to execute the corporate strategy. Have job descriptions for positions and make sure employees are clear about their responsibilities.

Branding is critical. Many builders name the company after themselves. That can work to your detriment. What can work well is identifying and marketing a specialization such as green building or infill.

You also need a history of earnings and growth and a reputation for fiscal responsibility and corporate integrity. If there are issues such as lawsuits, outstanding debts, and lingering tax obligations, they need to be addressed.

“When someone looks at you, you have to have your best suit on,” he says. “Don't be sloppy about it. It's part of the image. ... Pay your bills on time. I don't need to buy an undercapitalized builder.”

You also need to understand the difference between cash flow and net profit, Shiner says.

“You can look good on the books in terms of net profit, but if you don't have cash flow, no one will want to buy you,” she says. “If you're a small company and can't add value, all you've done is bought yourself a job. People [add value] by creating processes so someone else can step in and make money.”

If you're thinking of selling in the next three to five years, talk to your tax professional about your accounting methods, says Al Caicedo, a Michigan financial advisor who specializes in retirement planning. Just about every small business runs in a way to minimize tax liability. The problem is that it also minimizes the value of the business because it looks like you're not making any profit.

You'll take a tax hit during those years, but you should make it up in the sale price. You want to have a good track record of maximum profits to get a true valuation of the business.

Speaking of valuation, it's a tricky process for a home building business because it's essentially a service company without significant assets and should be done by a professional.

“You don't value your business more than once, typically,” Shiner says. “Find someone who does it regularly.”