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COMPANY DEEP-DIVE

Transitional General Manager at Southern Home Services Sees HVAC Industry as Pandemic-Proof and Expanding Into Plumbing and Electrical Services

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Summary

The client speaks with a Transitional General Manager Integrator at Southern Home Services about the residential HVAC market. They discuss the company's operations in several states and the importance of compliance. The expert explains that the HVAC industry is pandemic-proof and recession-proof, with increased focus on indoor air quality. They mention the trend of HVAC companies expanding into plumbing and electrical services. The conversation also covers the shift between HVAC repair and replacement, affordability of replacements, and financing options. The expert discusses the efficiency of units, financing availability, and the breakdown of costs. They explain the cost of a heat pump and the use of technology to educate customers. The conversation touches on growth rates, acquisitions, and challenges faced by businesses. The expert quantifies price increases and discusses different HVAC brands. They emphasize the importance of improving processes and offering comprehensive home services to stay competitive.

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Client 00:00:00

Thank you for taking the time to speak with me today about the overall residential HVAC market. To start off, could you please give us a quick overview of your background and experience in this space?

Expert 00:00:09

I've been around this most of my lives as far as the growth in HVAC company but got back into it in the mid- to late 2000s with ARS, which at the time was the largest by far, American Residential Services and worked up through the ranks. I came as a confident Transitional General Manager Integrator at Southern Home Services salesperson and was a General Manager and then a multisite operations manager, HVAC.

Left there and became the COO of a foundation repair, waterproofing company, which is still home services instead of being HVAC plumbing, electrical, the foundation and waterproofing, and crawl space. But residential market, same lead sources, same closing similar sales process, different sales cycle and then got back into the HVAC, electrical plumbing just less than a year ago.

With Southern Home Services now, I do work with several of the big players in doing consulting roles in whether it's Winch Group or Apex done some stuff with Redwood Services and different companies in regard to consultant roles in different roll-ups or business analysis of what their potential is in particular branches.

Client 00:01:13

What states do you guys' address?

Expert 00:01:15
We're big in Florida. That's actually where I'm working now. We're in Massachusetts, Virginia, Kentucky, and Missouri.

Client 00:01:22
Actually, very select states not continuous, i.e., Florida, Texas, Massachusetts, but not New York or Pennsylvania like it's very select states.

Expert 00:01:31
Yes, a big part of doing acquisitions that I think some of the people missed it in this regard is compliance is a big part of it. For instance, when I was doing the COO of the foundation repair, waterproofing, which is really another big up-and-coming space in the private equity market. For example, we did work in five states.

I could do work in Illinois, and there'll be very little compliance in regard to permitting or regulation. We will go into somewhere around Illinois, same state. And for us just to do a small 10-foot extension on a gutter, we'd have to get permit and have an inspector come out to see us put that extension.

That's a big part of thinking about acquisitions. I've seen a lot of companies miss that because they think that something looks good and they don't really do their homework in regard to the due diligence of what headwinds are they going to run into when they're trying to do business?

Even, for example, in Kentucky, every technician has to have a license, every service station, and every HVAC has to have a license whereas you cross the border, in Indiana or Ohio, they don't. That's a big difference.

Client 00:02:34
Which regions do you oversee?

Expert 00:02:35
I don't oversee a region specifically. I go through and I integrate businesses. I´ve been in Virginia and in Florida. It comes in which business, which acquisition they need me at to integrate and then I'll hire a general manager and I'm training them then go to another location.

Client 00:02:51
Love to actually use this conversation to talk about some of the actual underlying HVAC trends. Do you feel comfortable talking through what happened through COVID? What might be happening on the ground today as different cross currents in the economy from interest rates being more expensive? Do you feel comfortable talking about that?

Expert 00:03:06

Yes, it's actually why this has become so popular with private equity and investors. For a lack of a better analogy, it's pandemic proof and recession-proof compared to other industries. I think that COVID really identified that.

It really comes down to how well the business is operated and which, by the way, this marriage of the influx of private equity into the sector from the smaller $5 million companies up to $350 million or more. There's a big range of professionalism for lack of a better word.

Then being able to convert that into being an operation that can take advantage of this ideology that it's pandemic and/or recession-proof. So that being said, what happened with COVID is a couple of things. Prior to that, money was very cheap, and finance was very cheap. People didn't have to be as process oriented to be successful.

Client 00:03:56

Agreed. I actually didn't mean to ask about PE ownership of various contractors and integrators. I actually meant to ask about underlying behaviors of the consumer.

Expert 00:04:04

The people then are stuck in their homes and they didn't have their home offices. And so what started happening was they started identifying issues. This is where the pandemic proof analogy comes in is if I'm going to have to be here, I'm at the work here, all a sudden, it was like indoor air quality became very important.

The fact that my office, I didn't realize it was drafty, it was cold and so really what it did is it put a microcosm or a spotlight on the fact of the issues that maybe they lived with, go with, or didn't even realize they had.

But when they're home 24 hours a day, and now their office, it brought it to the forefront. And so that really is what we saw with that. Once people got comfortable enough that they were able to let people come into their house and offer them solutions because we had to get very creative in regard to maybe doing some of those sales processes virtually.

It was a very crazy time that I was going through that. Our technicians couldn't even come to the building. But they had to let us into the house. They just had to. It was very interesting in regard to, they would quarantine themselves in a bedroom and give us access. Then we would do an evaluation, send them pictures or whatever. But other than maybe California and that goes back to the compliance side of it.

There were some more headwinds in some areas that a lot of parts in America, that window was three to six months where it was really crazy. Then that's where they really kicked in for the next couple of years where people really started identifying I need to get this taken care of. And so that's where we really got that change in that mentality.

Now we come back into the recession side of it or the bad economy or what you spoke about with the high interest rates. It still is a recession-proof business because now people aren't buying homes.

Instead of having a 2.5% or 3% mortgage interest rate, then I fix like their house to go to a 7% or 8% interest rate. They're going to maintain their house. Now they have to maintain their home because what maybe they thought, "Oh, we're going to move in a year from now, we're going to move two years from now.”

Now that problem what they knew they had; they're not moving. And so the other thing is that HVAC companies have really done a good job. You know that you have to get your filter change, and you have to get your equipment maintained. We have to make sure that somebody comes into the house and maintains that equipment at least once, probably twice a year.

And so really, what's going on is now you have on one side, the mentality of I'm going to be here for quite a while. I don't really see myself moving any time soon. I'm uncertain about what's going to happen with the economy. Now I have to make sure that things are up to par and then maintained.

So what the HVAC companies are rolling up plumbing, which I've been doing for a while. And now the big one is electrical. And so what it does is when they're in that house and they get that free pass to come in once or twice a year to do the HVAC maintenance, they're saying, "Hey, by the way, your electrical panel is only 100 amp. Well, we'll go in the future.”

Client 00:06:55

This was not safe, for example.

Expert 00:06:57

It maybe not even safe, it might be like, "hey, we're adding to our power grid.” We're managing our power grid, but not even that, everyone's going to electric car chargers. Essentially what your house was set up for 30 years ago, you're not going to have ample power to meet the expectations.

Client 00:07:13

To be able to have a high?

Expert 00:07:15

The expectations of the future. Then the same thing on the plumbing side. So it could be safety issues, it could be issues in regard to just, "hey, we got to flush the water heater, maintain water softener, water quality, and it could even be we're going to get involved with smart home network and technology to be able to manage that and be able to continue to get in the houses as we're doing these once or twice a year inspections.”

So the difference really is for the companies that are going to really do well in this are not only to be able to have a mentality, but we’re also going to maintain the entire home. And if you already have the infrastructure, it's pretty simple to add, I shouldn't say a pretty simple.

It's to add the infrastructure of a company that's already built around home services of, say, HVAC and plumbing to add electricians or to add another service and say, "Hey, we're a trusted partner because it happens all the time.”

It happens to me sometimes where if I'm outside of an area, and I've been in this industry for a long time, and I have to hire electrician I don't know anybody I'm nervous like are they going to take advantage of me? I don't really know.

If's that's same company you have a trusted partnership with, if they can expand and now they turn one call into two calls or three services, and they have that business. So instead of having the return on investments of having to do marketing to get into a call, which normally that cost us about $350 on average.

And that doesn't mean you're going to convert or sell them. That's just the cost of customer acquisition. So now you can invest those dollars into your customer and develop relationships in regard to maintaining their house. And so that's really where the secret sauce is.

Then it's going to be tied together with smart home technology, they have devices out there that every thermostat can be basically put on your phone for couple of dollars to no money. The logo of your company will come up, time to change your filter, your motor over here and your sump pump is over amping. You compressor windings are outside of the specifications of the manufacturer.

If you start seeing good indicators of the quality of your air and your crawl space is something is going on because it's a high humidity, the sensors they can put in the house, leak detection, but everything can be managed through your phone and you can keep adding to this platform.

And that's really what it's going to look like. This is the difference is say, "Hey, is comfortable on this aspect of it is people who stay in their homes, the maintenance of the homes is going to become critical.” Now the difference was before COVID, it was like I said, there was an analogy of money was cheap.

And it was like, I know I need to replace it. People didn't have to work really hard. There was enough business out there that they could have people that weren't great at processes. They weren't really great communicators. They could just sell you a system, my uncle had one put in whatever.

While the future is going to be phenomenal in regard to opportunity, the difference is going to be they're going to have to be better at the process. So for interest, if now money is not cheap and it's at a higher interest rate, and now we have to make sure that I teach them and understand this customer why this makes sense.

Okay, Mr. and Mrs. J your interest rate is 9.5%. And so we can make a payment that is whatever it is for that system. But this is why it's going to make sense because we're going to save you and have an analysis with their electric bill, their gas bill and actually do an energy cost analysis and throw in some warranties.

Client 00:10:27

That's actually an interesting point, love to talk about some of the specifics there. Like do you guys offer financing to your end customers? And before we even get into that, we'd love to talk about like replace versus like replacement, is that something you track for some of the HVAC consumers you guys go into?

Like is there a shift between people wanting to replace more versus repair? Has that shifted at all last year? Is it shifting this year? And then I love to talk about how people afford some of these? Like replacing HVAC isn't cheap.

I assume it's a $10,000- or $15,000-line item. Do you guys provide financing? How do you make that sale? Did the OEMs make financing for that? And then also, like how do you think about like pricing? It seems like pricing has gone bonkers surely through COVID for a lot of these materials. I mean, yes.

Expert 00:11:14

Yes. But basically, that's where I'm going to and I'm saying that the training around those are going to be much better in this time because how the process is going to look is you're going to go into the house. And yes, to say it's a $1,500 to repair. So first question, repair versus replace.

If we go in there, and this is what the analogy looks like, if you buy a car and it's the first oil change and you get the book out of the glove department, it basically says, you have one or two things you got to take care of. If you get to 75,000 miles, it's about twice as many things.

You get 150,000. Now you've got to change the timing belt, you got to do all these things. So there's a certain analogy you can put together in part of that training. It's like telling a story as part of the sales process. Now you have a $1,500 repair.

And to get back to factory fresh similar to the car analogy on an eight-year-old system, you have to do all these different things that are in the owner's manual to get on top of the $1,500. So you could do the $1,500, but that's just get to work at Mrs. Jones.

But to really to change the timing belt and the rotors on the brakes and whatever it's going back to that analogy, well, now all of a sudden, you had a $4,500 ticket, okay. And that's just to get this eight-year-old piece of equipment to just stay within the maintenance required because now you have a $1,500 repair on top of those other maintenance items.

Then, what you do is the energy cost analysis that I was talking about. So if we go and change the SEER rating and we got the efficiency and by the way, then we also start talking about how you're working from home to this bedroom's cold, you got a draft in your office, and you wanted to take care of this for a long time.

There's a lot of companies that will go in, and they will just do a $1,500 repair and walk away. Then there's other companies, if they're very much training around sales process, they set the customer down and give them options in regard to what would you prefer.

For instance, if the repair is probably on a piece of equipment that's less than five years old, most of the time, that's going to stay a repair. I mean the life expectancy depending on what region you are in a country. If I'm working at Florida. Eight-years-old is right at the end of it. Pretty much. I mean, yes, because it runs hard.

Client 00:13:32

All the time, right.

Expert 00:13:33

For example, if I lived in Indianapolis then my air conditioner runs three to four months. That runs eight months a year but the blower motor runs 12 months a year. And it just really having those conversations around what makes sense. Then like if I have a house in Florida. That's completely different.

There, yes, not only does it run year-round. The humidity did have to take out of the air and the other factors in regard to the expectation of that system is it's very hard on the life expectancies of these systems. People know that. They understand that and part of our job is to educate them.

Client 00:14:08

So this motor would be like 15 years. It sounds like okay. But like Florida is running all the time. What does this look like?

Expert 00:14:16

The standard industry is 10 to 12 is where people look at replacement. I mean, yes, a lot of times, it will last 15, but realistically, it's around 10 to 12 and most people replace it. There's a couple of other factors. And going back to that analogy, it's like driving a car to 300,000. It might still be driving it.

But what's the efficiency, what's the safety, what's the gas mileage, and what's the next thing that happens to I don't want to put more money into it. And that's where it is. When it gets past like 10, 12 years, just like driving the cars 350,000 or 300,000 miles.

Client 00:14:52

I mean, at least a decade. Like this is not something that's going to last.

Expert 00:14:57

Yes, for sure.

Client 00:14:58
But it does sound like Florida, you shave a few years off, right, sounds like eight to 10-ish.

Expert 00:15:03
For sure.

Client 00:15:04
So Florida, Texas.

Expert 00:15:05
So you got Florida. Yes, Arizona. Then the same thing, if you get to North Dakota, you get some of these extreme cold upper Wisconsin or Minnesota. It's the same thing. I mean it almost comes down to hours used versus less expectancy. It comes down to how hard something is used.

Client 00:15:23
So Florida maybe shave two years off-ish, what about like Texas, same thing, I assume?

Expert 00:15:28
Yes, for sure. Yes, especially in Southern Texas or around the coast.

Client 00:15:33
How much more efficient is the unit today versus it was eight years ago, for example, or 10 years ago? Does this shave half of your energy caught off?

Expert 00:15:41
No, it doesn't. There's something that you have to be careful around with this because there's a lot of misrepresentation. Basically, SEER rating is similar to like miles per gallon. So for instance, if I was doing 16 miles a gallon, I'm getting 20, that's not a 50%.

Now there is certain amount of a decrease in regard to as it ages, it losses some of its efficiency. And by the way, they're right around the most popular 17 or 18 SEERs. So they only usually going up, maybe depending at the time they bought it from a 12, 14 to 18.

So there's probably a lot of increase in the SEER rating by maybe four points. Where a lot of what the real savings comes and there's some savings on that. Then depending on if it's a gas furnace, the efficiency around that depending on what type of for if they depend on what they had, there could be some real savings there.

The exponential side of the savings really comes to cost of repairs and the increase in energy. So like with when you talk about inflation, the thing that's increased above the inflation rate is energy cost. And so that's really the thing that people get really concerned about.

So the conversation could be more around, yes, your gas and electric bill has gone up in 10 years, 35% or 50%. Yes, you might only be saving 15% or 20% on a SEER rating. And by the way, there's a lot of, like I said, misconception around the people who'd really budget. But you're saving 20% of something that costs you 50% more. That's where you have to be very good.

The average person has to really understand it. We have to have the numbers. Like Mrs. Jones, you tell me like where your bill is. You tell me and let them give you the numbers and go through their bills and if that one almost sells itself. So if I can sell this you for $150 a month, and now it's under warranty.

Because where do you think that, in their mind, inflation, regulations around energy, going back to compliance and regulations. It's probably not going to keep getting cheaper in the next 10 years. So the more that I put myself in a position to save more. And green and use less energy, less footprint on the environment, those things is also very much important to people.

Client 00:17:49

When you said like on a per month cost, who provides the financing for you guys?

Expert 00:17:53

There's a lot of companies out there. So Service Finance, GreenSky, Cantor Bank, or Wells Fargo.

Client 00:17:59

You guys can actually get financing for your customers through these financing partners?

Expert 00:18:03

For sure.

Client 00:18:04

So financing is not an issue.

Expert 00:18:05

No, it's a huge part of this businesses, and they have a lot of different types of financing. They even have come from Microf like a lease to own for people that have a really horrible credit.

Client 00:18:15

But you guys can offer?

Expert 00:18:16

Yes, we offer it. We get money. And it's just like any financing, whether it's on their bill similarly priced high-end items. We've built relationships with.

Client 00:18:26

Do you feel like you're unique in that versus some of the competitors? Or do you feel like a lot of these contractors are equal?

Expert 00:18:32

No, not unique at all. As a matter of fact, even a lot of the mom-and-pop like smaller, like independently owned $10 million companies they have it. They're not going to be able to negotiate.

Client 00:18:44

Like offerings, yes.

Expert 00:18:45

Right. They're apparently the same offerings, but they come at a price of dealer fees. We can negotiate better dealer fees. But even the smaller mom-and-pop businesses will have. And then the other thing is that there's a lot of second-tier financing.

For instance, I want 18 months 0% interest. It's a $10,000 item, and they'll come back and say, "Hey, you can't qualify your FICO score, your debt-to-income ratio, but we'll give you an eight-year 15.5%”. They went from 18 months 0% interest to seven or eight year at 15.5%.

And it's like, holy smokes, like I swear I wasn't expecting. But I don't have any air conditioning and I don't have any heat, I don't have plumbing in my house. I can't flush my toilet, it's critical. I don't really have a choice. They signed a contract and then it's like if you own a great credit, you need a car. Then the difference is that you can refinance it or you could pay it up early.

All the ones that we deal with, they don't have prepayment penalties, or you can refinance and get your stuff figured out. And that's another reason why it's recession-proof. So you have the aspect that we just talked about in regard to coming at it from a service side talking about going through the process.

Client 00:19:58

$10,000 system today, how much does it typically cost per month for the end customer at this point?

Expert 00:20:04
We have different finance programs because we would go up to 12 years on the financing, yes. And which used to be a little bit tough, but it's very common that we can get something for $10,000 down depending on how far we stretch it out to the low $100s, $110 or $115. And then how we can package that is and that usually are low to mid-grade model.

Client 00:20:26
Low to mid-grade model.

Expert 00:20:27
One of our maybe base just above base models is coming down to $8,000 to $10,000. But again, for somebody, it will work great, it will last for the next 10 to 15 years, we can get you to $115 or something like that.

Client 00:20:42
Is this for 12 years? How long will that be for $10,000?

Expert 00:20:46
For $110 a months, but we haven't even do that have. But we can do for $120 months or like $115 a month that $10,000-ish. By the way, those come back and maybe say, we just had one, we'll do 18% for the same amount of time, but now your payment's $158 instead of $118.

And if you get your stuff squared away, two years from now, refinance and whatever. So the big selling point with that is all of these systems, every one of these systems has 10 years parts that come with them. It doesn't matter of the manufacturers that almost everybody deals with.

So all the parts are covered 10 years under warranty. Then the only thing that they are really on the hook for is if there's labor. Just like going back to a car analogy, people understand to buy brakes, doesn't cost that much for the part is the labor to get it in to have it worked on. What we can do is we can wrap and put like 10 years of labor on there.

We can buy from an outside warranty company, a policy, like an insurance policy for labor. Usually, depending on the type of equipment, it's usually under $1,000. So a lot of times what we'll do on a customer like that is we'll say, hey, we have to build in our margins. For that $10,000 system, we're going to give 10-year parts, 10-year labor, $118 a month.

For that $118 a month. I know you really didn't want to payment for 10 years. That sounds unheard of. You don't even finance your car for that long. But just think of it adding $118 to your house payment, we're going to save some efficiencies on the energy, those type of things, but it's under warranty the entire time.

Anything goes wrong, it's like a bumper-to-bumper warranty on your car for 10 years. They're like, oh, that's unusual. Everything that's covered is 100% under warranty for 10 years, I'll sign a contract for $118 a month.

Client 00:22:41

So just so I get the components right, the unit itself could cost $8,000 to $10,000?

Expert 00:22:46

No. You mean our cost.

Client 00:22:48

How much would the actual HVAC cost? Like out of the $10,000 system the low to mid-grade model, how much of it is, say, materials from like how much you guys have to take Carrier or Daikin or whatever, and how much is parts and how much is margin and how much is labor on its own?

Expert 00:23:03

Yes, our goal is to really stay at that 50% gross profit margin. So basically the material is normally around 30% of that.

Client 00:23:11

So like $3,000, call it?

Expert 00:23:13

Yes, on that equipment made, so for instance like such as $10,000 system, the heat pump might be like $1,700 or $1,800, the air handler might be $900, then you have other materials in regard to a thermostat, different pad whips/disconnected and things like that.

Client 00:23:32

How much would the heat pump would be?

Expert 00:23:34

In Florida as an example, it's really similar anywhere in regard to the gas furnace and air conditioner. But for instance, this is a five-ton air handler with the top of the line modulating variable speed. It's $1,414 and that's like the top of the line, not bad.

Basically, outside heat pump, you can get in a range for what we're talking about 17 SEER single-stage heat pump, say, $1,500 to $1,600 the air handler for the inside of the house, maybe $900, maybe you have $2,400 or $2,500 equipment.

Then you have another $500 or $600 of materials, putting around 30% margin. And then most of the time, your labor is going to be around 10%-ish, maybe a little less than that, maybe 8%. A lot of people pay like a piece rate.

So now your install costs went up and it stays still around that between 8% to 10% margin depending on the type of system or the type of install because maybe there is ductwork or different things that have to go with that.

But still, at that point, you're at the high 30s percentage margin. Then you have sales commissions that go into that depending on what it is. You might have a turnover; you have to pay a technician. But let's just say for 10%. That still gives you like a 52% or 53% gross margin and then you're going to take your other expenses in marketing and business expenses out of that.

Client 00:25:00

Are repair margins higher? It sounds like net-net, very much would rather prefer to just replace, right, because it's a much bigger system. And the margin itself doesn't matter, like even in repair is very high margin, for example.

Expert 00:25:13

So yes, it's just like the multiple and factor is off of the number. So if I grow at 100% from $1 million or I go to $2 million. But if I go from $30 million to $40 million, I grew at 30%. So it's the same thinking in regard to that, yes, you might have a 65% margin on change the blower motor but it's a $1,500.

And the liability and the time efforts that you have to put into it's similar because it's also then you can press yourself out. If you're trying to get 65% margin on $10,000, now that just became $12,000. And now you're pricing yourself out of your competitive market.

Client 00:25:53

At this stage, as we move into 2024, do you feel like the consumer is getting harder to convince to buy the system? Or do they just say, obviously I'm going to repair for $1,000 instead of paying like $100 a month for like 10 years, for example? What does it feel like today as we move into 2024?

Expert 00:26:10

No. I feel like this is a time of technology. We're going through an age where people can look up Google information like they have in the past. So that's why we have to use those tools to our advantage. The companies that are not on the forefront of doing that are struggling with it for sure.

There's even people that are trying to keep that system and pride themselves on I'm going to try and get that thing to last 20 years. Well you're doing a disservice to your customer by doing that. And because there's a lot of things we mentioned before.

The cost of those repairs that you're continuing doing and the energy cost and just different changes in the industry and for the comfort that you get from the system. We are such a now. But right now, I can taking a look at Florida or Indianapolis, and with some of this technology, I can look and I can turn up and down my system, I can turn the motor off or on.

There's a lot of things that you give up. We have to use technology in our advantage where customers are trying to use technology in our advantage to why not to replace. The companies that are going to be the most in front of technology of educating a customer of why to replace are the ones that are going to win. But I'm not concerned about.

As a matter of fact, I think it's a real good opportunity going back to the things we talked about earlier in regards to business and stay in their homes because this industry has been a lot of how we've always done it, and they're really fighting the trades in America are really behind the curve in regards to that evolution to what technology is going to do for you.

And because there's also an investment in training, I mean we need to start to actually shut down trade schools in America for a long time. And if you don't go to college, you're not going to be successful. Now we're really trying to build that back that pipeline.

Client 00:27:50
Yes, like Germany.

Expert 00:27:51
Yes. So now in regard to that, now we also have to teach them, not only do you have to go to school to be a technician, but now you have to be able to communicate.

Client 00:28:00
What you're doing. Correct?

Expert 00:28:02
Yes. Like Germany is a good example. It's so funny because how like meticulous they are in regard to the inner workings of these machines. And that's how they look at, that's how their mind works. But our technician is going to be able to communicate that to the end user.

And not only do we have to get the pipeline rebuilt in regard to just their knowledge to be able to work on these systems, now we have to teach and be able to get them to communicate that, and that's whole another level of training that pipeline. By the way, most companies are a long way from doing that. And so the people that are in forefront of that are going to win for sure.

Client 00:28:37

What are you guys budgeting in terms of growth rates for like HVAC services? And maybe just like high level, what was it in 2023 versus 2022? I'd love to just talk about high-level ranges perhaps as we look into this new year.

Expert 00:28:49

What was the metric?

Client 00:28:50

The overall growth rate for the business. Like it sounds like you guys are taking market share. Yes, growth rate. Like not including, just like-for-like growth rates. Not including acquisitions you guys are doing, but what the same stores are doing. What do we do in 2023? What was that versus '22? And what does that look like as we move into '24?

Expert 00:29:11

Yes. I've done a lot of business plan with a lot of different companies, and we just did ours here. Usually, the target is 10% to 12% top line growth. There's a lot of strategic ways of doing that, and part of that's market-driven in regard to either geography and/or specific business units. But really, that number of 10% to 12% is very consistent.

There are some that will try to throw out a number of 20% or whatever. By the way, there are some businesses that can do that. But it really is not the standard and even can be something if you're not careful when you're leading strategic planning like this can deflate or be detrimental.

Client 00:29:48

Did you guys grow faster than that during COVID?

Expert 00:29:51

I wasn't here. I don't know. I was with ARS at that time. We were pretty consistent with that number at right around the 10%. Then when I left and went to the foundation repair waterproofing, which is a similar industry in regard to things I was talking about even to include technology. I got there in the end of 2020.

At the end of COVID, we grew from 12% to 21% to, in the next year 32%, so adding up way beyond those numbers. However, there's a lot of different ways to grow. And whether it's growing up electrical division into your business is small, whether it is cross-selling, whether it's getting better. I've seen a lot of different business models how to do it.

The one thing I would tell you is they don't care if they put a projection out there that they were going to do in HVAC replacement, repair plumbing and if they get 12% or 15%, and it looks different than what they projected, as long as the gross profit margin and EBITDA is there, they don't really care how you got there and then they take that information and adjust it as they go.

Client 00:30:52

Was '23 around 10% as well or higher than that?

Expert 00:30:55

No it was because of acquisitions. And another big part of it was price increases, to be honest with you. But that's specific to certain businesses. There were others that did well. The '23 wasn't a great year in general in this industry.

Client 00:31:09

Was or was not?

Expert 00:31:10

Was not. A lot of it was due to supply chain and then price increases and people were slow to respond to it. A lot of times, people got similar margins and increase, but it was because they weren't prepared for a lot of the things I laid out earlier in regard to market changes. I think that people are better positioned for that now.

They could go to a private equity or they could go to outside people and talk about their portfolio. But to be honest it's what I was talking about earlier in this SEER rating. There's some very misleading information. A big part of this was we increased prices 20% and that's not growth.

But a lot of times, people don't see that. They just say to you that the revenue went from $100 million to $120 million. And when you pull back the curtain, it's not as bullish as that looks. Now that for me is it doesn't take away from the things I talked about earlier because it's like mom-and-pop and Wall Street got married.

That's what we're going through is we're going through this old, like, well, this is how we've always done it, and this is how my dad did it, and grandpa did it and then you got private equity over here. I want my 15% growth in bottom line. There it got this real struggle because you got a three- to four-year contract to get me my 15% year-over-year return.

They're dragging, grab those values in, waiting dollars done it, that's what's going on. That's what's happening. So the people that are going to do it the best are going to win and they're getting better at it. People like me are really trying to put perspective around that, just like this conversation here.

Client 00:32:39

When you say price increases, are you talking about material price increases? Like the $10,000 system, I don't even know. Can you quantify how much was the price increase? Where was it coming from?

Expert 00:32:51

Yes. For instance, like just even right now, Lennox just gave a huge price increase. They went 20% across the board, but a lot of companies do it. Most of time that's extreme. Most of the time, every year, Carrier, Rheem or whatever of these top line companies, it's very common to have 4% to 6% every year.

Lennox just got a new CEO; they raised prices 20% . It's just unbelievable, but the reality is that really most of the materials. So let's take that same analogy. If it's $10,000 on a $3,000 material cost, $2,500 of that being equipment.

Fixed costs really haven't changed that much going into 2024. There might be a slight increase, but that's something that we can look at other than the 20%. If you take out of that $3,000, there's $2,500 going back to the analogy we used earlier on the seven feature heat pump with the air handler. Well, that $2,500 now has gone up to $3,000. So now I have to cover $500 is my same gross profit margin. So that's something that's a misconception.

Now what happens though a lot of times is that, that $10,000 will turn into like $11,500, $12,000 system. There are some other costs like, for instance, the commissions go up because it's the number and there's a few other things. Essentially, the larger companies will make you believe our price's not by 20%. The price across the board is 20%.

What they are doing is they are building in net profit, EBITDA margins by having sent a message across their team and saying, you guys need to figure out how to sell it because I got to return to this. There's a lot of this top-down push down type of management and not collaborative management. I'm trying to change that in the few business that I do with people.

Client 00:34:40

What's your thought on this 20% increase? Will it be, in fact, 20%?

Expert 00:34:45

That's just again on material. Yes, I do think it will be. A lot of people will change and start using it. So some people are going to absorb it. And those service experts negotiated it to 15% because they're so big.

Then there's going to be other people that are going to move to different suppliers to stay. So some people are going to stay because they have relationships with Lennox. Some people are going to move to like a Carrier or to a Rheem and negotiate a little bit better deals and it's going to be a mix.

Client 00:35:15

It's going to be a mix. Is Lennox the cheapest out there? Who's the cheapest one?

Expert 00:35:19

They have like the Ducane or these Tempstar or these off brand ones, but typically the cheapest would be like a Goodman, they're owned by Daikin, yes. They would definitely be the cheapest.

Their value brand is called Goodman and be able to have Amana and then Daikin. So Daikin has a pretty nice high-end stuff. But as far as the industry goes, they're going to be the most value brand that's not like an off brand that you never heard of. Then there's the Carrier and Bryant have same equipment, like they say it’s the same.

Then Lennox probably the most expensive at this point or Trane as well is expensive. And then Rheem and Ruud is the same equipment as well, depending on the region, is there as well. But it's probably Lennox is the most expensive, Trane, Lennox then Carrier, Bryant and then Rheem.

I would say that Carrier, Bryant, Rheem, and Ruud, they're really close. Lennox and Trane are most expensive and they're probably at 10% to 15% more than Carrier, Rheem and Ruud. And a lot of that has to do with the size of your business and the negotiation you can make the supply chain that they have and the region you're in.

There's some different factors there, but normally, what I've seen, and I've done business in all of America, it's really Trane and Lennox the most expensive and Carrier and Rheem are really right below them.

Client 00:36:35

Why use the most expensive? Does the company don't even care?

Expert 00:36:39

Because they don't. Most Trane customer doesn't care because some of the 10-year parts warranty. Even a Goodman has a 10-year parts warranty.

Client 00:36:47

So why not all use Goodman?

Expert 00:36:49

Because a couple of factors. There are more issues in regard to having the senior tech out on maintenance or problems or issues like that. There are more breakdown issues and even though the warranty might be on the part, customer satisfaction is not as great.

Secondly, they have better name recognition in regard to marketing. So they will actually have SEER certified like Carrier dealer, certified Lennox dealer, or Trane dealer, they will actually make you a pro dealer. And when leads come in, they'll actually flip leads to your location.

Also like they give you marketing dollars and is recognizable. The offset of the marketing name recognition and the leads that you get from them because then if you're not a Lennox, Trane or a Carrier training, you went through their training to work on their equipment, then you're not going to get those favorable conditions.

Client 00:37:35

And you guys use all of them, right, Lennox, Carrier?

Expert 00:37:38

Yes, we do. Lennox is our number one throughout the company, but we do some other stuff too.

Client 00:37:44

It's surprising that pricing never goes down in this industry. Are you concerned at all like when the refrigerant changes is another 15% price increase on these units? Does it matter? I don't know just another couple of hundred dollars.

Expert 00:37:56

Yes, it's just like anything, I can't control it. And no one else can and is government regulated. And so as long as we're all on the same playing field, I can win if I'm better at my processes and that's the direction it's going to.

Amazon figured out the best way. I mean, he's like, okay, how can I get in every house? The two most popular things were books and albums. He did books. Then he brought albums and now you've got everything in the house.

So whoever figures out the best way going forward to maintain the entire home, and that's where it's going. They're not going to worry about refrigerant. They're not going to worry about technologies because they're eventually going to maintain their attics, their crawl spaces, even Southern comes through the home services, getting in the house on the HVAC.

Eventually, they're going to windows, doors even they're going to be paying the entire home. And that's like what the Amazon of the home services industry is whoever figures the best to get the hook in the customer to where I trust you. Paint it, put the gutters on whatever, everything. You're the company that I trust.

Client 00:38:58

Okay. Well, thank you again for taking the time to speak with us today. This was very helpful. Enjoy the rest of your day.