Sound Financial Bites 060 - Kevin Short

Episode Transcription

> *"Control the behavior, work the price up, control the terms. Those are the 3 key things."*

Hello, Paul Adams here. Welcome to Sound Financial Bites, where we help you with bite-sized pieces of financial and life knowledge to help you design and build a good life.

Hello, and welcome to Sound Financial Bites. We are so glad to have you today. Today, we're going to be continuing with part two of Outrageous Price by Design: Selling Your Business for an Outrageous Price with author and M&A expert, Kevin Short. Now, in the first part of the podcast - if you haven't heard it, you may want to go back and listen to it - Kevin really walked us through this unique process they used to cultivate an audience for selling a business, how to think differently about selling the business, how they take it to an auction process, that I promise you is much more like Sotheby's than eBay. It really is a unique way for somebody to look after business and how to look at the marketplace, so I hope you enjoy this part two of Outrageous Price by Design with Kevin Short.

Now, Kevin when we've talked before, you shared with me that when you get the outrageous price, so we talked earlier about this great big funnel and it work its way down from lots of people go in the top and there's a little bit of a briefing on what the company's like without disclosing the company, and then you get open to more and more potentially confidential information as they get down towards the bottom of the funnel.

But, when they get to the bottom, that five, the last five people are the ones getting the greatest amount of detail, etcetera, as one kind of pause here in talking to other business owners I know, one of the ways you work to get the bigger price is you're not actually talking with them about going from, what you shared the four multiple versus the eight multiple, but rather what is your EBITDA worth to the buyer. Because, it's the same multiple, four. It's just what's it worth to somebody else, because they're going to do something with the business that's going to drive up the EBITDA. You need to summarize that as an outsider?

Yep, absolutely. They know they can take that business and they can double the EBITDA because of certain synergies that they have and they've quantified.

In a few minutes, I'm going to ask you to tell the story that really, really puts a point on that, and what I think happens to most business owners is they're always trying to get a higher multiple, but that buyer doesn't want to buy your business for a higher multiple. What they want to do is increase the EBITDA in their platform, and once they increase the EBITDA in their platform, your buyer that you thought was going to punch you in the throat when they saw you instead said, "I want more businesses like that," and it's because of what they did. So, the profit from that company that made it a better deal for them that you could have not anticipated.

Correct, and they knew that the day of closing. They knew that before closing. They knew what was going to happen and the value that they were going to get out of this business.

So, the funnel's worked its way down, you've cultivated the audience from 400 at the first round, then 150 get, which I think it's interesting that you call it a book, but literally a degree of due diligence on that person that you said, "Oh my gosh. This is the person we want to use. We like what this company has to say and do." They write, what did you call it? An expression of interest?

"You're not going to be happy. You might even say something derogatory about my mother when I tell you the price."

Correct.

Now, I don't know about you, but to me, I kind of think maybe what I'll do next time if somebody floats an idea at me that I'm not sure I want to say yes or no to, I'm going to say, "Let's consider as an expression of interest."

That's right. Non-binding.

Non-binding expression of interest. So, they do that, and then if they're way off in their potential price and the expression of interest, then you kick them out, then you work your way down to the LoI and then the final five. Here's something I think that's unique. I think, many times, a buyer, if they're working directly with the owner, thinks maybe they don't have to perform very well, because they're like, "Well, I'm buying something. There's nobody else." It would seem like this entire process gets these very professional buyers - people that buy businesses all the time, they're the experts - they now have to behave well because there's now ethics they have to follow that they don't have to follow if they were dealing directly with an owner, Am I off-base in saying that?

No, it's a great point. We had a deal one time in geotextile. That's the guy, they're selling all the netting and the drain tile that go along the sides of highways when they're building them. Again, another plain business, and the four finalists for Home Depot blows Ferguson out of UK and a competitor out of Iowa, and when we -- they all submitted their EOIs. They were expressions of interest. They were all very similar in price. So, we had to figure out a way, how do we tell the difference? Because, we don't want to go forward of one of them and fail. That's never a good idea.

So, we designed a test for all four of them. We gave them the document, the copy of the legal documents we were willing to sign. Our attorneys prepared it ahead of time, and there's a test. Mark this up, tell us what you can live with and what you can't. Well, Home Depot threw it in the trash. They said, "Look, we're Home Depot, we'll use our documents," and my response was, "Okay, you're out." "What do you mean we're out?" "You're out of the process." This was a test. I told you upfront, and we were looking for how reasonable you are, normally, and we just found out you're not. "Wait, wait, we're Home Depot. You have to know who we are." I said, "I understand. Orange signs, orange letters, but your cash isn't any greener than the other parties who are all at the same price point." He said, "Tonight, give it back to us and we'll try it again." Well, it looked like somebody had been stabbed. There was so much red ink all over the document. So, again, they're out.

The other two big players were similar. Better, but similar. Then, the guy from Iowa said, "Look. I know Harold is a seller. I'm basically okay with your document because I know he's straight," and he said, "I can close in 30 days." Well, all I'm saying is meant that the risks of the deal, not closing, dropped dramatically, and that's who we picked. Again, the money was the same whoever he picked, and he closed that deal quickly. So, that's what, like my example of Home Depot, they weren't behaving. Can you imagine what they would have done to him? If he had to sell a business, they would have jerked him all over the place, and he wouldn't know what hit him. At the end of the day, he would have gotten a lot of his money because they would have re-traded the deal and dropped the price. So, you're right. By having somebody in there representing you, these big buyers who are going to take advantage of you, if they can, can't do that.

You know, it reminds of the story of an acquaintance of mine whose brother would literally, through college, buy an old junk car and then sort of fix it up a little bit, change the oil and wash it, whatever you could do aesthetically for not much money. Then, he would do that during the week and then the next Saturday, he would put up a classified and put it for sale and he just scheduled everybody for about the same time. Four or five people showing up to buy this car and it wasn't a very expensive car. It was a relatively inexpensive car, but what he found was he did not have to negotiate his terms or price much because they handled it. Sometimes, he'd get a few hundred dollars more than what he was initially asking, but nobody offered him less when there is another willing buyer in line who said, "Well, if he doesn't take it, I will," and it caused everybody to behave better with him, whereas otherwise, somebody comes up.

In fact, the story goes something to the effect of the first person would come up and sort of, "Well, I don't know. The tires look a little ball and the interior's a little --" and they would be critiquing the vehicle, and then the next person comes up and then they understand that person's another buyer, and suddenly they stop. They will start accentuating positives of the vehicle. It is very interesting. This is like that on a large scale, except with buyers who are professionals that really have to be managed through a process, because otherwise, to your point with the Home Depot. They'll just run roughshod over you.

"When you get into these high-dollar amount [companies], you're not selling to somebody who's new to the game."

They will.

That's great. So, you've got it down to the five, and you mentioned that you've got this whole process where you're like, "Okay, that's not enough money." They've all come out and visited the owner, maybe their leadership team has made presentations of the business, and what it does, and why they think it's a good idea for somebody else to own it. Now what?

So, now it's time to begin the move towards clothing. You've got the five bidders there. What you hope is that one of the bidders comes out of the pack and their price begins to go up, like we talked about earlier, the steel processing center. They make it easy for us to pick the right buyer because they were almost double the price. If they don't then you've got to figure out, well how do I?

Because, you only get to choose one. You're only going to go into the final phase, the final phases, due diligence and legal documents. For the most part, you're only going to do that with one party because the parties will not move forward. The buyers will not move forward unless they have what's called a stop shop or the exclusivity with you, meaning, "I've told you my price, you've agreed to it, you're now going to take the business off the market and you, the seller, are committing that you will not talk to any other buyers during this period of time, which sounds crazy. Why would you ever do that?

The reason is the buyers won't move forward without it because they are about to spend 100 to 300 thousand dollars doing due diligence and legal docs, and they don't want to find near the end of that that you've just taken an offer from somebody else for 10% more. They want commitment from you that they are the buyer. That's the problem. When you pick that party, you're now committing to be exclusive with them for 68 to 90 days. You better be sure you picked the right party that will close without attempting to re-trade the deal. That's what you worry about. You also want to make sure that if there's anything negative about the business, that they've learned it by now, because you do not want them bailing on the deal later.

It's so much easier to sign that exclusivity, the stop shop agreement after you know that they have been -- now, there's going to be no mysteries. We've already disclosed pretty much everything. Those five people, we're not leaving anything on the sidelines, the ethics are high, everybody knows that we've got dead bodies buried, we’ve shared where they are, you're not going to find new ones during due diligence, and now when we say, "Do the stop shop," we realize they're already a long way down a system where they've committed themselves. They've committed time, energy, effort to getting this far in the process with your organization, so now it's not so scary for me to only have this one buyer offering $20 million for the business at the end of the pipe.

Correct. It's your point earlier about buyer behavior. The buyers will walk in the door they want and try to get you to sign the stop shop, and if they're dealing with us, they know that's not going to fly, that's ridiculous, but they try it all the time if the seller's not represented. At that point, you're looking for ways to test someone. One of the ways to develop a test is the legal docs to see how reasonable they are.

But, there's other ways. Let's say now you've selected a party to move forward with. One of the things in that stop shop that we're going to put in there because stop shop is our leverage. "We're going to move forward with you, Mr. or Mrs. Buyer, and we're going to give you a period of exclusivity for 60 days. At the end of the 60 days, we will have closed or not." If anytime during this period of exclusivity, you attempt to re-trade the deal, meaning change the price of the terms, either in writing or verbally, the stop shop evaporates. So if you tried to lower the price next week there is no stop shop anymore. That, again, is done to try to control their behavior so they're not in there trying to re-negotiate the deal, because now they have the leverage. You told the other buyers to go away.

And when you tell other buyers, they all know, "Hey, this is under a 60-day stop shop," so they know that if they never heard anything by day 61, they might come back.

That's right. They will attempt to check in along the way. But, imagine this though. So, these are legitimate buyers, smart folks. Let's say the one we chose to move forward for whatever reason chooses not to complete the deal. Now, we're going to go back to the other four and say, "We were just kidding about not wanting to sell to you. Now, we're interested selling to you again." That doesn't go over very well at all. So, your first question is what happened? What's wrong with the business? What did they find? I better have a good story or they're not going to come back to the table.

Very good, and then that gets the transaction complete. You built the audience, you've moved them through, slowly disclosing more information. Five people get to the final dance. One buyer and moves them through the process. Such a different way than kind of what -- which I know, and it’s also a different game between that $10 million and $250 million value business versus the person selling the $2 million business that looks a lot more like great guys. It's such a different market where it's kind of that broker put together a willing buyer and a willing seller, but they're just kind of trying to work it out as one-off. It's not so much.

You don't have the competition. They're missing the competition.

The auction at the smaller levels.

Correct, that's exactly right. And a lot of sellers get approached by buyers every day of the week and they think it'd be easier to just take one of those offers and do it. But, again, you don't have competition. You can't control the behavior, you can't work the price up, you can't improve the terms unless you have competition.

Control the behavior, work the price up, and control the terms. Those are three key things. That's great, that's great. Okay, now though always, we can't produce a big auction because of the specific type of business, and yet I think this specific type of business, as you tell the story, gives us a bit of the blow-by-blow of what that auction process might feel like overall on the blow-by-blow basis, but right down to one buyer, one seller, how do you create this buying environment? Can you tell us about the company on Chicago?

That's my favorite story. Not only was it fun - we had a fun client - but it's the only situation where we can prove the value of the process. What had happened was the client had decided to sell the business and there's really only one buyer in his industry, a billion-dollar player. The industry was medical waste. So, imagine the doctor's office that you go to, there's usually a red container, plastic container on the wall. It's called the sharps container. That's where they're putting needles and all things that are dangerous and not exactly clean, and needs to be disposed of properly. So, his company would come by, pick those up, sterilize all the waste, and then shred it, and put it in a landfill. In his market, he controlled 100% of that business. Every doctor's office, every dental office, every hospital were using his services.

He agrees to sell the business for four multiple, which was a reasonable price for their business. He was making a billion and a half dollars a year EBITDA, and that resulted in a $6 million purchase price. He agreed to it. Moved down the path the day of closing, the buyer backs away, doesn't close the deal. So now, we've established that he's willing to sell it for $6 million, the buyer backs away. He meets me a year later and he said, "Any way that you think can get this buyer back to the table? I need that $6 million."

So, I spent a couple of days with him brainstorming because it never made sense to me why this billion-dollar player was even talking to him. He has a fairly small business in that industry. As we talked about it, I said, "Well, why do you think they were trying to buy you in the first place?" He said, "Well they had never have gotten into my city. They couldn't get into my city because I had it wrapped up." I said, "That makes some sense. What else do you think they were looking at buying you for?" He goes, "That's it. They just want to get this city." I said, "Well you had 100% share. That's really unusual against the billion-dollar player who has been trying to get into that market for five years." I said, "What do you think they would think, what would they say, if you began to expand it to other markets? Do you think that would get their attention?" He said, "I don't know. We never talked about that. That's never been an option." I said, "Well, I think we ought to experiment with that, because therein lies the outrageous price." I don't want to try to get $6 million from them because they'll never pay it. You've already said you'd sell for that, they walked away. If they're going to start negotiating with you, it's going to be at a lower number. So, let's figure out a way to establish a higher value on business."

As a pause there, one thing that I think is so interesting, you talk about testing, and we have clients and owners that listen to this podcast who are in technology and they do a lot A/B testing when it comes to certain types of advertising, website, emails. What you're effectively doing is AB testing these little relationships.

Correct.

We're going to try this. So, this guy in this heavily-regulated industry, very, very public with the registration that we're just going to run this test.

So, the test is we're going to pull a permit in a major metro, in this case, Chicago, which happened to be the backyard of the buyer. So, we go up there and we pull a $200 permit that we're going to open up a new location to handle medical waste. It's public. They advertised that right away, the regulatory agency. The buyer becomes aware of this and calls the next day and said, "What are you doing man? You're going to hurt yourself. Just go sit down."

Here? They called the next day?

Correct, because he pulled a permit. They said, "You know what? Why are you doing this?" He said, "Well, I've hired an investment banker. We're going to raise some capital and we're going to expand to Chicago, Philly, Miami, New York, and a couple more." It happened to be their top six cities for revenues, and he said, "We believe we're really good at this and we're going to expand." They said, "No, all you're going to do is get yourself in trouble. Why don't we come down and reopen the conversation with you about buying it?" And to the client's credit because he'd been heavily scripted, his answer was, "No, thank you. This is the path I'm going on. I'm going to expand the company," and hangs up.

You coached them on how to interact.

Every call, every call, and he took to coaching very well. They called back a week later, they called back two weeks later, and he said, "No, thank you." Eventually, he says to them, "Look, no reason to call me. If you want to talk to my investment banker about buying me, go ahead and try it." They call me and, again, scripted, and my answer was, "We're not interested. Thank you very much," because they walked away at 6 and I knew to get more than 6 or to even get the 6, I had to impress upon them. We did not want to sell. In fact, we were going to expand. We're still in the motive. We don't know if this experiment is trying to get their attention but it did get a phone call, it did get them back to the table. We told them no. Go ahead, Paul.

I was going to say the thing that I'm hearing here that I don't want our -- this is not a negotiating tactic as much as it is you're doing things in the relationship with the buyer to have them tilt their cards a little bit or at least give you better indication what they might be willing to buy back to that metaphor of shooting arrows into a cloud and seeing which direction they bounce out. We can start to see the shape of what's in there but we'll never know what's actually in there until after the sale.

Correct, correct. I am setting the table. Hopefully, I'm setting the table for some productive negotiation. But, I don't want to start the negotiation yet until the table is set. We did this for a while. Eventually, they'd say, "Come on, you've got to have --" because every time there would be a lull in these conversations, we'd pull a permit in a different city, and then we get them right back to the table at a fever pitch. They say, "You've got to have a price at some point."

So, eventually I said to him, "You're not going to be really happy about this. You might say something derogatory about my mother when I tell you the price, but here's the price. We're okay with the four multiple that was established up front, but what we're multiplying is the amount of money we believe we're going to be making soon from the expansion. We think our EBITDA is trying to go up from one and a half to $5 million," and they said, "You want $20 million?" I said, “Your math was, A, very fast and very accurate. So, you're taking $5 million times a multiple of four and that's the purchase price we're willing to sell it for." They said something about my mother and they hang up the phone.

We've predicted the future very well. A week later, and I call my client and told him what has happened. All this was part of the plan because I did not expect him to roll over on the first call and say, "Sure, we'll give it to you." A week later they called back and say, "We still think you're an idiot, we still don't like your mother, but we're willing to raise our price from $6 million to $12 million." Now, in that moment, I realized we had them, because we knew they were nibbling on the end of our line. We didn't know if we had a rubber boot or if we had a great white shark. So, wow we know that we got something valuable. But, it came too easy, so my immediate response was, "No, thank you. I told you it was $20 million. We're going to keep doing our plan," and hang up.

Now I've got to call my client who was really set on getting $6 million and tell him I just turned down 12. That was happened at that moment. So, he said, "I hope you know what you're doing,” and I agreed with him. I said, "I hope I know what I'm doing too." At that point, we went silent. They kept calling back. A week later, they called back and said, "Alright. We can raise it to 14," and then 16 and then finally they got to 18 and said, "There isn't any more left in the tilt, so that's all we're going to give you." So, we talked and agreed to take the price.

Now, even with all that preparation, negotiation, the day of the closing they called me and said, "We can't pay you $18 million." This is after they've just spent two months doing due diligence, "We can't pay you that kind of money." So I said, "Okay. We're not surprised if that's the kind of behavior or that's the kind of people you are. You did this last time, so we're out of here." I knew that if I had blinked that the price would have gone from 18 to 16 to 14 to 12. We would have kept going down like a rock. I called my client. I said, "This is what happened. I told them to get lost. He was my safety valve. I knew that they would call him before they'd walk away. I was pretty aggressive.

Pause there. I think this here, we've talked about it several times, but they are professional buyers. You run your business for a living. When you get in these high dollar amounts, when you're selling a 10 to 250 million dollar company, you're not selling to somebody who's new to the game. It's not their first rodeo. They have done this before, hence wise so key that there was the no flinch moment with you and it's so important that the client didn't flinch. So now, you're telling the client, they're probably going to call you pretty soon.

Yeah, he said, "What's going to happen next?" I said, "Oh, they're going to call you in 60 minutes and they're going to talk to you because they're not going to call me." So, at 60 minutes, he calls me and says, "Hey, they didn't call." I said, "Well, hang in there." So, they called a few minutes later and they said, "Your guy's really upset." he said, "Well, he should be. You tried to kill the deal again." They said, "Alright, are you willing to still sell?" he said, "Yeah, if you're talking about the $18 million cash," he said, "I will show up to closing in two hours." That's what they did and they paid the cash. But even up to the day of closing, they tried to re-trade the deal. So, those are the things you've got to pay attention to, and if you do it well, then you may end up with an outrageous price.

That's so good. So, what had started at not getting $6 million, and had he gone back to them, he may have gotten less than six. But, as you said, you know, I think about that idea of are you creating the right environment for the conversation? There's conversations that are appropriate to have in the lobby or church because the environment's right, and there's conversations that the environment's not right to have certain conversations when you're with your spouse, when you're chasing around kids or grandkids. There's the stress of the situation versus that might be the right environment over a cup of coffee to have that deeper intimate conversation that what you're having to do that's so unique is creating a brand new environment.

And as our listeners get a chance to pick up your book, read it. We appreciate, again, that you're willing to give away some of these white papers. We're going to be able to email people, but it's all creating the environment for the conversation, so it has the highest likelihood of success, really for both parties because even this buyer that paid "triple", they avoided by paying triple a very real threat, because had he done what you guys propose, he would have made more money over the next five years and in every one of those markets, he would have taken it right out of their pockets because they're multipliers.

Right.

That's really good. Really good Kevin. Well, I'm so glad you could share that story and I think that's a gift to more business owners, and actually it's an entertaining story. So, when you get a chance to talk to your client that sold that business, please tell them on behalf of me and our audience, just thank you for being okay with disclosing all that. We'll certainly have fun with that, and I hope a lot of our listeners get a chance to re-tell it.

I would just say that I want to share with our audience something that you've shared with me before that was so interesting. If I mess this up at all, you just correct me, is I said, "Kevin, how would you advise somebody who's a key executive thing about buying the business they work for, or a business owner that's been in the business for some time who was running the business, what is the key advice you'd give them?" I thought it was so interesting what you said is, "Basically, the advice was the same for both people." Both of them were figure out your exit, like that if you are somebody who's going to buy a business, do you already have a strategy that you're going to use to sell this business at some point after you get into it? You're going to do acts with growth and it's going to be 10 years, 15 years or three years, but you're going to sell it.

Yeah?

Correct. You have to be thinking that way, like a buyer, who's going to buy your business five or 10 years from now? What can you do to make it more valuable? What kind of research you need to do to figure out who the best buyers are in your industry? How do you get to know them? How do you get to meet them? How do you get to be on their radar screen during that period of time before you actually sell? In this case, before you actually buy.

Cultivating your audience for sale while you're still running the business.

Correct.

This might just be a relationship. This doesn't need to be you're disclosing anything.

Correct.

And then the same advice was for the existing business owners. You've been around the business for a while is to begin thinking about your exit now. That might be working with an exit planner, that might be just make putting together a due diligence box. We have a list that we can give people. It's like here's everything a buyer is going to ask when they buy your business, and if anybody needs that just email us at info@sfgwa.com - Sound Financial Group WA, whiskey alpha dot com - and we'll get that to you. But, if you think about, if you assembled that box, just how much differently you think about your business. So, I thought it was a great advice to think that you have the same advice for the buyer as you would for the person owning it, which is you got to know when, one day, your chips are going to get off the table.

Yep.

Very good. Kevin, thank you again. This was just a great conversation. For those of you getting a chance to listen, love to hear what you think. Don't hesitate to shoot us an email, note on Facebook, or LinkedIn and you know, I hope you guys have a great rest of your day, and my sincere hope is that the time that we've spent with Kevin today gives you chance to further reflect whether as a person thinking about buying a business, somebody that owns a business, or somebody that cares about the business owner, and this has been interesting to you, forward them the episode. If you're on an iPhone you can just go right to the podcast app, share it, and it will allow you to send them a text message with this podcast, and allow them to hopefully get some additional material in learning that's going to help them design and build a good life right alongside you. Have a great day.

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