systemHUB
Kerry Boulton | Grooming a Business to Sell
Transcript

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Dave: Hey,

It's Dave from systemHUB here. We've got another great interview for you with Kerry Bolton.

Now, we've found quite recently that we're moving in some similar circles and have done for a long time. But we have never really connected until we ended up getting a shared mutual client.

Now Kerry runs a group called the Exit Strategy Group. She helps businesses get top dollar when it comes to selling their business. She's worked with.

Huge names over the past few decades, everything from. Domino's to Telstra to Toyota, even down to small Mum-and-Dad companies looking towards retirement. What are they going to do with their business?

She's been featured in numerous different publications. She's an author, a speaker and she is still very much a hands-on consultant which I love. Then you have a really deep knowledge of your subject matter. So with great pleasure, I get to interview her today so first. Kerry, welcome and thanks for making the time.

Kerry: Thank you very much David. It's a real pleasure to be here.

David: Being a systems guy, what I'm super keen to do is work through your system for the way that you groom businesses for sale. I think the vast majority of businesses don't think about selling right up front when they're setting things up. Oftentimes, they just close the door when they're ready for retirement.

So I think it's more the exception rather than the rule for companies to think about selling before they do.

I know you've got a four-step process that you like to take your clients through and that's really what I'm keen to uncover. Maybe I'll ask my first question and then that will kick into a discussion of what makes a business saleable.
When should you really start thinking about getting your business ready for sale?

Kerry: Dave I think probably the crucial part of all of that is that the best time to start thinking about it is when you're actually starting your business. Don't put it off until you suddenly think, I've had enough and I want to get out. The best time to start thinking about it is now. That applies even if your business is a really good, strong viable business.
So much of what happens in a business often resides in somebody's head or in some key people's heads Very little of it is really set down and systemized.

I have had the great good fortune really of having my own businesses and been able to build them and then sold them. Not often do you get the opportunity to do it more than once. But I have, so I have first-hand experience of what it's really like. I know that there's a big wave of businesses selling as the 'baby boomers' are reaching retirement.

There's not a lot of information out there about how to prepare your business and yourself for a sale. So I created a four step process as you said which is around the acronym of EXIT.

Step number one is to evaluate, number two is to explore, number three is then to innovate and number four, of course is to transition. The time frame around that of course will vary depending on the individual and the businesses involved.

David: Perfect. Let's dive into step number one, which is to evaluate. What's involved there?

Kerry: First and foremost it's about taking the temperature of where you're at now with your business and with yourself. Most people have little idea about what their business is worth and often it's an inflated idea. Even if they do have some sort of notion of the value of the business, it is around what they need for the future. In fact, that may not necessarily relate to the business directly.

The first thing we do is run through a couple of marking tools to get an idea of where the business actually sits against best practice in their histories. They're not difficult tools to run through. They're quite easy and they're very descriptive. These tools show you the key drivers in the business and give you some feedback about where you sit and where the gaps are.

You arrive at a number which would be a type of a financial valuation. This is not a formal evaluation system, it is an estimate. You can then test the water around what you think your business is worth and what the world at large is saying this business is worth. We are talking about profit, that is going to be part of it.

If we're talking about valuing a business, we'd be talking about what are the assets the business has, what are some of the other things that someone might consider when calculating the value. It's about looking at the key underlying drivers that are in a business.

These are things somebody who is looking at the business might look for. If any of these are out of whack, this is what devalues a business. The first thing to consider is financial performance.

Naturally, you're going to have to have a good track record in terms of your financial performance for at least the last three years. Let's have a look and see where that's heading. It’s not only your profit and loss but also your balance sheets. That's where your assets come in to play.

The second thing to look at would be growth potential. Is there room in the business to grow? A lot of owners, business owners run the business and don't actually think about this. They think more about the short-term gains rather than the potential long-term. In fact selling your business could be the biggest payday you ever have. Look at the potential in terms of the market.

The next key thing would be about looking at the customer concentration. Are you a distributor for a major technology, for instance? Are some products that represent more than 50% of your business? If so, that's an issue that has to be addressed. Maybe there are key people in your business. See what we can do to minimize the risks associated with that.
Another key driver, of course is cash flow. Does your business generate cash or does it use cash? No matter what happens in the future, there are always two important numbers. First there is the value of what you’re selling going to sell and what the buyer is going to pay for the business. The second is the working capital.

There are always those two numbers. The more cash the buyer might have to put in, then obviously the less they're going to pay you for the business. There's more than one number. Do you generate cash or do you use cash?

One of the other key drivers is business differentiation, so value proposition.
Can you position yourself so that you've got something that's really different, that's unique that sets you apart from your competitors? The famous one that Warren Buffett often talks about is he really only ever looks at businesses that have that differentiation. They must stand out from the crowd and are not subject to constant competition.

Another key driver is recurring revenue. Do you have a business that generates income? Let’s use as an example, real estate. When you've got a real estate sales business, you've got your people having to go out there and get their listings. They're going to have to sell those properties. That's ongoing but at the same time the value lies in the property management side of the business. That is, they're managing rentals. There's a constant income that's coming from rental properties. That is generated by the rental commissions that the agents earn to manage the property.

Recurring revenue creates enormous value in a business. So you're not having to generate a sale every single time.

Another great example is in the health system. Come up with some sort of gauge where you could say, this might now be worth, X number of multiples of profit.
Your pre calculation is to figure out how much risk there is. Obviously the more risk, the lower that multiple should be and the less risk that the higher the multiple. That’s what might be called industry rules of thumb. Businesses can be valued along those lines where it's a multiple of profits.

I like to work with my clients to be able to get better than that. We don't want to be the norm and it will vary because it depends on the market conditions at the time.

There are some big public companies out there or International groups doing what's known as industry roll. There's a really good opportunity for you there to get a much better multiple. Timing is really important. Assess the market and see what's happening out there. Have your ear to the ground and know what's going on in your industry.

David: I remember reading an article that you had published around looking for the strategic buyer. They're going to be happier to pay higher multiples. If we think about a range though, like you said, let's say the average is on the lower range of what someone might look at. But then, let's say someone worked with someone like yourself and was able to tick a lot of these boxes. They might make it very much a strategic buy at the higher end of that range. It might be an increase on multiples of what they could have got otherwise.

Say one to two, it might be as low as that. I think right now the average in across the board in the marketplace you're lucky to get 10 times at the moment generally speaking.

I was just reading a report yesterday that came out where the average is around about two, that's it. That's particularly for smaller businesses. That's quite often a common thing for the business owner when they're trying to sell. They will calculate the amount including the take-home money as though their wage was part of that.

However, obviously that's not really part of the business because you're going to have to hire someone to run it.

Kerry: That's a different calculation. Often there are what's called add backs when you're looking at the numbers. To be able to come up with a number that is the operating profit of the business depends on your targeting. In this stage we've done the deep dive to have a look and evaluate where the business is.

Then we can do some further exploration and start thinking about who might buy the business. Let's move to that second stage. Let's see if we can come up with a target of ten potential strategic buyers.

Who would my business be attractive to, who might want to buy the business or who might want to buy a component of the business? It’s not always going to be the whole business that's sold, It might only be a component of the business and that might be a better way to go for some people. It's really about sitting down, doing a brainstorm and thinking, let's see if I can come up with 10 businesses. Generally speaking you would be looking at the whole range. Maybe it's a competitor. Maybe it's it is a large public group It could be an international buyer.

Let's see if we can sit down and brainstorm at least ten potential acquirers and then do a little bit of homework. Last week. I was just speaking to another client who's in the medical equipment servicing business. He was ‘baby boomer’. There are two International groups now in Australia looking at creating national networks and buying up smaller businesses Not only had the thought processes already started about exit and succession but now there are opportunities for a bigger play with an international group coming into Australia to acquire those businesses. it really means thinking about who's out there. How can I make my business attractive?

Also explore your own personal goals. One of the things that's really important for business owners is to think about life after business, for men in particular.
Unfortunately, they have an identity that's really tied to their business and that really needs thinking about. What am I going to do? It might be quite a few years down the track but let's get the thought processes going now. You will need to create a new purpose for yourself in terms of life after business.

That's part of the whole exploration process. Define your personal goals. What are they, aside from this? What are your financial goals? What are you have?
What sort of money will you need to live on, what will be a nest egg for you for the future, not only yourself but also for some of the other stakeholders and family? They will be affected no matter what

You've been running a business and everything goes along really well. You get a great sale, you are out of your business. All of a sudden you're home, you're trying to run the household the same way as you ran the business. You might find a little bit of conflict.
This whole exploration process means looking at all of those areas and giving some thought to them. Start discussions with those who will be affected by your decisions.

With the exploration phase at what point would you start seeding with potential acquirers? For a larger business, this is something that might have a long lead time. The earlier that could be done, just stops you having a forced fire sale. You start cultivating potential buyers because one could be the biggest customer of your life.

We start doing what every good sales person would do and that is to build relationships with those potential acquirers. If you do that over a period of time, then you certainly reduce the strain and stress that comes with thinking, oh, I've got to sell the business.

Put the energy in and you'd be surprised at what happens. You start cultivating the relationship, start going along to conferences or network meetings or whatever.

David: Perfect. Then we move into the third step, the innovate step.

Kerry: Yes. That whole Innovation process is around when we discover where the gaps are. At the evaluation stage, that will give you feedback initially on where to concentrate your efforts. The same thing happens with the Explorer stage. We combine the two, so we've got the clinical analysis and benchmarking analysis of your business from a few different sources.
Then we can say, here are the gaps. It's giving us feedback on where the gaps are. It’s where we see grey business. We can identify where the concentration is and having explored potential acquirers, what are they looking for?

Once you know where what type, then maybe we need to tweak the business. That way we can actually make us far more attractive to a potential acquirer. That's what we do through that whole Innovation process. The result of that is that the value of the business increases enormously.

That's why I say to people give yourself enough time. Don’t say well, I've got six months until I need to be out of the business. You might find yourself in that situation, we do need to make sure that we look at all contingencies.

There could be some business partners who are at different ages and stages. Do you have another client where there were five shareholders and they range in age from 32 to 58? Obviously their aspirations are different because of the age difference.
We need to look at those sorts of things.

We should make sure options and contingency plans are in place. Hopefully no one becomes ill because then they might have to leave the business. Addressing all of those potential issues Is about getting risking in the whole Innovation process. That's what we do and we'll concentrate on the value drivers, where the gaps are and what we can do to close those gaps. The result of it is incredible. There will be improvement in the business valuation.
What are some of those value drivers? Some of them are in the evaluate stage and cover some of those opportunities. There certain things which you commonly see and working on these areas add significant value.

Where's the biggest bang for your buck? There's always an order of priority as to where you can get the best results. Let's l say on the financial side. Most private business owners have, and rightly so, drawn the profits from their business. We're assuming we've got a nice, successful business here and they've drawn the profits from the business. But in the in that process perhaps they’ve artificially changed the bottom line.

Let’s look at what we need to do. What do we need to do to restore the bottom line? To get proper results, you don't do it in one go. You work over a period of time and you make sure that those adjustments are right.

The other thing is around business growth. It may be because you've concentrated on.
Just drawing profits from the business that you haven't put money back into the business to grow it. We would look at that and say, do we need to do something here? What else do we need to do to be able to grow the business?

One of the issues I see is that people do not have their businesses systemized. They do not have their intellectual property sitting in a system. I'm not talking about inventions or technical expertise in that regard.. I'm talking about the basic everyday systems that make life easy for somebody in their business. I am yet to go into a business where I see it done perfectly.

David: That's obviously one of the things that has connected us and why we've got a couple of shared clients. Both of these topics go hand-in-hand. There’s always a shortfall that is risking the viability of the business. If you can walk out of the business and it can run without you because it's fully systemized, people know where to go. They know where to find information and know their ABC. This is the way things are meant to happen. That is the most valuable business that you can possibly have.

Kerry: It's a hard one to answer because I try and calculate and think about how much value systemizing a business can add. It's so difficult to calculate because it'll increase efficiency. It'll reduce waste. It will add the value just by having it there because of that succession.

David: I am curious to know, have you got any idea, when you’ve systemized your business, could sell for a multiple of 2 times more or three times or more?

Kerry: It's very hard to say. I don't think I could probably be as definitive as that but there is absolutely no doubt that it will definitely increase the value of the business It will increase thirty or forty percent without a doubt. I'm sure being able to do that even in businesses that have gone through some certifications like the ISO type certificate and are good in the technical aspect are going through to get certified. But there’s everything else like ringing the phones and following up leads.

Have a marketing system. That would be the most valuable part of any business. If you've got that well systemized, there is no doubt in my mind that could quadruple the value of a business because so few businesses do that. They really stand out if they’re able to do that.

Then we move into that final stage which is the transition stage. What sort of things do we address? I'm assuming at this point that you've thought about your business and where it's at. Potentially you have moved into that step to explore and see what else is out there.

Then the Innovation really sounds like it's a lot to do with the implementation about what you uncover, where you are, what the person wants to see when they're buying to add the most value in your business. Building that bridge you'll fill in those gaps

One of the last things we do in stage 3 though is to do what I call a mock due diligence.
We go through the business to do another sweep to see, if I was a buyer, what would I want from the business and do my due diligence? It's especially so for a business owner. We want to have everything ready.

We just do one, that's a practice. Yes, because we've gone through and systemized and done everything, then we make sure we have all the information. We put it in an electronic data vault. When the time comes, it just makes life so much easier.

David: What sort of things then would go into that due diligence pack?

Kerry: Some financials, evidence of all your paperwork, the evidence of all your legal status with you company details and all of that sort of thing. You would want copies of all your contacts. You'd want contracts between you and your clients or staff. You'd want all your policies and procedures in that data vault. You'd want evidence of justification of your marketing positioning. You may have external references or testimonials and so on for due diligence purposes, but also for your marketing purposes. You want to see any IP registrations, domain names, password lists, you name it.

In fact a business recently that has just been given a list. One of my clients I'm working with now has just been given a list for due diligence. Fortunately we have already been through this, so it's been relatively painless for her to be able to do the due diligence.
Usually it comes from the client. It's not like you're offering up the Dropbox folder. You've got it all there. They ask you and then you just go here.

It is basically, there are 300 questions. There were 300 items on that list to provide a ballpark figure. The depth of questions would depend on the value of the business

It's 300 questions long. Are we talking about an eight-figure business? It may be a million-dollar business. This is just doing your due diligence and that goes two ways. You want to do your due diligence.

Admittedly you can't necessarily put up a 300 question list, it's just as important for you to do your due diligence on an acquirer as it is do it on you. You might have certain criteria that you want to make sure happen.

I'll use one of my own examples. This was an international freight forwarding company. One of the key criteria I had was that everybody had a job. The only person out of a job was me. The business who eventually acquired us was an International group which had no representation in Australia. You need to do your due diligence on that potential acquirer and make sure that you're happy with who they are. Is it a company like the *Pretty Woman* Company as in the movie *Pretty Woman?* The modus operandi of the Richard Gere character was to go out and buy all these businesses. Then he'd strip the assets. I would be out of work and you know end of story.

If that's what you'd be satisfied with happening, or if it's not of any concern to you, that's fine. I have no judgment whatsoever against any of that but just so know that's what you're potentially facing. So it's really a two way street in terms of due diligence.

They'll want all your figures. They'll need to see all your financials. I've heard it referred to as being like a product oral examination I have heard people say the price that you might have initially started at, every question they're asking that doesn't quite reflect something that you said is a chance for them to negotiate down. Don't go into a due diligence exercise with your eyes shut because that really is the first place to start for a negotiation. It's going to be the place where they going to start negotiate it down.

One of the most important parts before that is that you sign a confidentiality agreement or a nondisclosure agreement that is tight. Once an acquirer gets the information that you are going to provide as part of your due diligence at this stage, you're opening up everything. So you've got to be confident that you're going to be able to progress beyond this stage. We move into that next stage, which is the transition stage. What does this refer to: is this the negotiation component or is this the hand over or all of the above?

It is all of the above. We've done our practice due diligence. At this point, you may or may not want to invest in a formal valuation. That might just depend on your business because you'll know already by this point whether there's an offer on the table from the potential buyer. Are you going to accept it? Here terms are as important, if not more important than price.

Price is what you pay, value is what you get. That's another Warren Buffett quote. The terms of a deal are really important. A great story someone I met in the US last year told me. Stephanie Breedlove, a beautiful lady, created a fantastic business with her husband. They were providing accounting services for families for nannies. What a niche.

She grew the business to a nine million dollar revenue business all recurring revenue. So there were huge growth opportunities because there are only in a couple of locations and yet their margin on the bottom line with staggering when they eventually got past all the hurdles.

It was great and I think they had employed about 20 people. She was approached by a company called care.com to sell the business. They initially offered her 36 million dollars,
The way they would have arrived at that was because it's accounting business. The main thing there is the potential turnover The strategic play is obviously going to be another thing but going back to what we said before if they're turning over nine, we're took probably talking 36 there. That's probably four times earnings or thereabouts.
She turned it down. The interesting part about this, of course was that she and her husband looked at it and said well 36 million dollars. We are actually making four and a half million dollars a year. We're living a very comfortable lifestyle. The business is going along really well, it's working like clockwork. They're relatively young, in their 40s. We can chug along for 10 years. That'll be fine.

That's probably nine times profit there, which is quite high on that scale we were talking about. The interesting part of it all is that they're business was the opposite of that of Stephanie's business.

They worked with big groups. The fit for them strategically was a huge expansion in a market that they could access. So they turned it down. They came back six months later and said, how much do you want and I think Stephanie said that they said 60 million and they eventually settled on 54 and 50% was cash and 50% was in shares in care.com.

These are the sorts of deals that happen. They had a two-year run out. They had certain profit hurdles that they had to reach in that period. They knocked it out of the park and they knew they would. Within 18 months Stephanie finished up in the business after that. She's a beautiful lady and she now spends her time mentoring and she's a Business Angel, mentoring other business women,.

The key elements there, are how the value was there and loads of strategic play was the biggest driver. The recurring revenue was there and she had a bit of guts to say no. There was of course an especially high valuation there. So you can't put a number around this. You can't put a multiple number and that's the genius of it. If you can, find a strategic buyer who can take your business. They’re going to pay you a multiple, but there are obvious synergies. There are obvious savings. They're going to turn that profit that was being generated in that business into a multiple many times over. Where they are a listed company the price earnings multiples are much higher than they are for private businesses. The arbitrage is there between what you might get will be five or six times which you think is great.

Take that story with Stephanie at care.com. They're the one that added a big type store. That’s the exception, not the rule. You might say, I'm getting a 10 times valuation which actually occurred with another one of my clients in an industry roll-up. They were paid the revenue of the business which actually turned out to be a tech times multiple.
But It was a public company and their PE was 16 to 16. They might have been paid ten times multiple, but the public company already gained more than a 50% uplift. Really it boils down to what's the number that you're happy with?

What do you need to have to live on for the rest of your life? Are you happy with the outcome? Have you figured out what you're going to do which is a second purpose? What will be your next reinvention?

For me, I'm in my fifth reinvention. You can be happy with what's transpired and you've got a sense of purpose for the rest of your life.

In the tail end of it. I think if there are no final questions, I might have for that transition because I know we're just coming to the close now things. Are you wanting to get the right financial advice in this regard to and making sure that you've got all your estate planning set up correctly?

I'm not a financial advisor, just speaking from a place of experience that's all. You might say, I want this to go to somebody. You can't will trust, you can't will assets' interest. You've got to get all these things sorted out but right at the top level, of course, it's about making sure you've got the right financial advice to have all of the legal requirements and taxation requirements in place.

David: We might wrap it up for now. I know if people want to keep an eye on what you're up to and find out more because it's really a deep topic and we've just scratched the surface.

I know you've got your book which people can get from the website and the best place for people to go. I think the best place to go to get a complimentary copy of my book, which is at exit strategy book.com au.

Perfect, and I'll just pop a link near this interview as well.

So thank you so much Kerry for your time, and no doubt we'll keep chatting together and working together.

Kerry: Thanks, Dave. That was great.

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