Sound Financial Bites 059 - Kevin Short

Episode Transcription

"[Business owners] go to sell [their business] and there's just not enough money for them to support their lifestyle."

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. I am so glad to have all of you with us today. Some of you are washing dishes right now, some of you are driving, some of you are in the middle of a hard workout, and bless you for both sweating while listening to Sound Financial Bites. We have a great episode and guest for you all today, who I think you're going to love. If we've not yet had a chance to meet, my name is Paul Adams. I am the host of Sound Financial Bites, and president and CEO of Sound Financial Group.

Today, we're going to talk about outrageous price by design, with our guest Kevin Short. Now, where I met Kevin, to give everybody a little bit of background, is at an event that's specifically designed to help advisers be effective at helping business owners exit their companies. There are very few educational platforms from which advisers can engage to help make sure that business owners are in a position that they're most likely going to be able to have their business go to who they want, the way they want it to go to them at the price that they want it to go to them at.

One of the guest speakers, I nearly flew out early, but one of the guest speakers was a gentleman named Kevin Short and I decided, "I'm going to go ahead, fly out as scheduled, I committed the entire conference," and it was a great conference but you're always wanting to get home to your family. Kevin came in, and he's a tall guy, just like a seasoned business guy. You can tell he's got the perfectly gray hair, he just wears a suit like it was made for him. Kevin is a managing partner of Clayton Capital Partners, and they're in St. Louis, and what they do is they help businesses between the values of 10 to 250 million dollars in value sell for twice the EBITDA of their industry average. We're going to share with many of you what that means, and what that means to you.

I think what we're going to find is going to be equally applicable if you're one of those high-income earning executives, and this podcast is going to give you a little broader base of understanding the buy and sell transactions out in the marketplace, or if you're a key employee working for one of those business owners, if you're a partner in a firm, or if you're the owner, you're going to take away some great things from this podcast.

Now, Kevin is the author of Sell Your Business for an Outrageous Price, and you can find that on Amazon, it comes right to the top when you're typing it in. He's also written another book that was in accordance with the Business Enterprise Institute called Cash Out Move On: Get Top Dollar and More, Selling Your Business.

Kevin brings us extraordinary amount of value and over 150 of these kinds of transactions with 25 years doing this. It's so exciting to have you on the podcast today Kevin, and getting a chance to extract some of this knowledge to get to our audience. It's so glad to have you.

Thank you. It's really nice to be here.

Here's what I thought we ought to do just to start off. Why don't we start by defining -- I mean, some of our listeners, I know, are critical thinkers, type A, sometimes even question authority a little bit, or maybe all the time, share with us first what you mean. Because, you don't say it loosely, I know, having gotten to know you, outrageous price. What do you mean when you say outrageous price?

If you know that, in your industry, let's say you're in an electrical parts distribution business, so not a sexy business, just do a lot of blocking and tackling, and the average multiple of EBITDA, that the companies so far are four times EBITDA. That's the average. You hear it day in, day in your industry. If you can figure out a way to sell for eight or more times EBITDA, then you've gotten an outrageous price. That's the definition: two times the average price for your industry.

Got it, and you do that in a unique way, but before we get to that, as a lot of our listeners have heard me talked about how important it is that business owners need to retire, build their financial independence from their personal balance sheet. They can never be financially independent on their business balance sheet. Now, you have some direct experience with that where you have seen the owners go through, grow their businesses, and they go to sell, and there's just not money enough for them to actually support their lifestyle, even if they get an outrageous price.

"Most of our entrepreneurs don't spend any time worrying about retirement."

I want to make sure. I'm going to ask you to share one of those stories in a moment, but as everybody's listening like this is not the silver bullet, what we're going to talk about today. We still have to be responsible, as individuals, to build our personal balance sheets enough that the business sale is additional wood on our personal balance sheet if you will, or additional -- I was going to say additional wood on the fire, but it's strange to say your personal finances being on fire. But, it's still money that you need to transfer from the business to your personal balance sheet, but you're going to be in trouble in some way if you haven't made that a consistent ongoing practice.

We've even started teaching our clients that what we have to do is even leave the business value off of their balance sheet and our program allows us to say that is not going to be even showing on your balance sheet for 10 more years, when you might be likely to sell, and that kind of takes away, what I would say, is a tranquilizing effect on business owners when they see that large value of their business on their balance sheet.

But, would you mind sharing just a little bit of where you've seen, or how you've seen people trying to cope with they got there, it's too late, they can't save money now, they're in their whatever age that they're selling the business, and how they deal with that?

Absolutely, Paul. We've seen it happen where people have spent their whole life plowing money back into the business versus taking money off of the table and putting it on their personal balance sheet. We had an owner in the office the other day that, at the end of the day if you were anybody else in the community, you'd swear this guy was wealthy. He had a big brand, big business, big meaning $70 million retail business, and you had this impression he's just made of money.

Well, after looking at his financials, I said, "Well, help me understand because the sale is going to net you $5 million, which is nothing compared to the image he has in the market. I'm hoping you have enough money saved up personally to fund your retirement. He's 65, and he's looking at selling for retirement reasons. He said, "Well, I've gotten my house paid off and I've got $400,000 in my 401(k)."

I was blown away. After all these years of running this high-profile business, he didn't have any more money than that put away. I said, "Well, what are you going to do?" His concern was that's why he cannot raise his price. I said, "Even with an average price, you're going to have a hard time replacing the income that you're making today, out of the business with all the tax benefits."

To me, as I look at somebody saying, "Well, I've got 5 million, I just automatically translate things to cash flow at 4% distribution. Somebody's got all this income, this huge identity and he's got a paid-off house and $400,000. He's got about $100,000 a year income now, and he's making -- I guess if he's going to get that kind of -- he's probably been making like $800,000, $600,000?

He's earned a million and now he's going to be struggling, absolutely, or run out of money.

"Why do some businesses sell for so much more? There's no pattern to it."

Yeah, and that's the other thing that I've seen is you watch somebody, and everybody goes, "Wow, that person sold their business for $5 million," everybody is backed fellow business owners, and entrepreneurs will even say, "Yeah, good job getting your exit." What they don't see, though, is the lifestyle that person is leading is actually going to eat into that capital over the next 20 years, which the thing that's deceiving about that, if we're running a marathon and somebody wasn't in good enough shape, we'd know in a mile or two. What this is, 20 years later or 10 years later is when that person is going to run out of money spending that way, and nobody sees it. It's like it's off of our purview so it -- one of the reasons why we have the podcast is just making sure we can make people aware of that future potential breakdown before we get there.

Most of our entrepreneurs do not spend any time worrying about their retirement. They don't do any planning, they don't take advantage of the pension, and post-retirement savings programs. They're so focused on their business, they're not prepared when they get there.

Yeah, and I do love what you said that that guy mentioned to you was, "This is why I need to get an outrageous price because I don't --" but it doesn't work. You talked when we were chatting before about how business owners -- and this is normal. So, if you're a business owner and you're hearing this, this is no admonishment. I found myself subject to it. I had a friend the other day who just took one particular feature of his business and he said, "I just keep it on my balance sheet," even though he has the type of business that won't even sell, he keeps it on his balance sheet, and I asked him why. Like we all do that because it's pride. We want to see it reflected, but too often what people value it as what they need to sell it for versus what the market will bear.

How do you talk to a business owner when they're in that mindset? I would imagine that's pretty hard to exit somebody out of. We've got a business owner, they're just by themselves in the car, no witnesses, they can reflect on this themselves, how would you advise them to think differently?

Well, in his particular case, I'd say, "Well, what's going to go on?" He said, "I want to be out in five years," I said, "What are you going to be doing in the next five years?" He said, "I'm going to build three more locations across the country." "So what's that going to cost, and what's it going to get you, etcetera, etcetera," and while it was the right answer for the next 10 or 20 years, it was the wrong answer for the next five. I asked him, "Well, what if you did not reinvest in the business and the business was the same size roughly in five years, but you've put away $6, $7, $8 million for your retirement?" I said, "That, to me, would be a lot smarter for your purposes." Even though it was common sense and maybe saving his retirement, he's addicted to the growth, and that's what a lot of these entrepreneurs do. He's addicted to growth. That's who he is, that's who he wants to talk about with me.

At the cocktail party that I did, "Yep, we're up 18% this year, we're this, we're that." You know, it's hard to get a lot of ego out of it, "Well, we're flat but I put away a million and a half dollars this year." It doesn't have quite the same ring to it.

Yeah, yeah. What's funny is that it's socially acceptable to talk about how your business is growing and it's not socially acceptable -- my wife and I have had to build a specific network of friends we can talk about the fact that we put away a lot of money of the money that we make like that is. What's weird is the person saying at the cocktail party, "Oh, we're flat, But I took a million five off the table and that's now building my business." That, for whatever reason, whether it translates to the business owner's income, it lands as ego or you brag.

We need to talk about we're up to 120 employees or 30 million in revenue and people accept that, and that's something I hope that, over time, as business owners start to see more and more of the baby boomers get in trouble because they don't have enough on their personal balance sheet to build financial independence despite the sell of the business that that will begin to shift for them. So, thank you for sharing some of your experience around that.

Now, let's talk about this unique process that what you talk about in your book How To Sell Your Business for an Outrageous Price. You use a specific process and an oft misunderstood term for business owners about how to sell that business. Could you just kind of -- we'll start with a little bit broad overview of the process then I want to dig in on it on a little bit more.

Yeah, the process is really, really important. You just can't willy-nilly get twice what the normal price is for your industry. So, this is lot of homework. Homework is critical to this process and you better follow every step of the process. Like making a cake, if you leave the eggs out, you're going to have a problem. So, we find the best -- so, there's two different ways to do this. One is we call "outrageous price by accident" and the other is "outrageous price by design". So, we always plan for both, and we execute on both. The core way that investment bankers sell companies is through an auction process where you go out and build a database of the best buyers, and you tease them, you send them a teaser, get them into the deal, you send them a book about the deal, and when you have enough velocity of that buying group, then you ask them for their vested interest. That's how you begin the auction. You do that on every deal. On an outrageous -- go ahead.

So, it's like this, I remember when you spoke you had a graphic. It was sort of this funnel. Like, you start with this large audience, and that's how I explained to a few people when I shared with them about what you shared at Business Enterprise Institute is it's in what you would say for the younger generation term that thinks about Twitter and Facebook. It's like they build an audience for the business, what the business is.

Correct, and so if we don't do our homework to build that audience, then at the end of the process, it doesn't work. So, what goes in at the beginning of the process, think of a large funnel with the wide mouth on top, we might dump in 400 prospects into our process that we've researched that we believe from reason or another, they may have interest in our client, the seller. We market to the 400. Of that 400, maybe 100 will say, "Yeah, I'll look at your business." They'll sign a non-disclosure, we'll get them some preliminary information.

Of that 100, that'll meltdown to about 50 who really are interested and we begin answering their questions, learning what they're going to do with the business as much as they can etcetera, etcetera. At the end of a couple of months of exchanging information with those 50 in my example, we then will say, "Alright, it's now time to figure out who's interested, what kind of price range are you thinking about." So, we're going to ask them for an expression of interest, and that will happen, we'll give them a two-week notice to prepare their expression of interest, which is a written document that basically says, "I'm thinking about paying between this and this and it will be all cash," or whatever special terms they want.

Of those 50, we make it 15 who actually gives us an expression of interest. These numbers hold up pretty well on every deal. So, going back to the top, we got to put the right 400 in there to make sure we've got the right 15 that now have submitted an expression of interest. This is when the actual thought around the auction work begins, because we're going to go back to the 15 and say, "That wasn’t enough. We need you to increase your offer," or whatever the case may be. But, we're now beginning to work them against each other. They do not know who else is in the profits.

At least not at that stage.

They never will. They never will. They never did. So, the difference then, you think you see the guy, the stuff that he's auctioned, you know who's going to get you in the room. We don't do it that way. This are called "competitive auctions". We're in control auctions. So, we've worked them up. At that point in the process, we're going to ask five of them -- we've selected the best five of the offers. We're going to have them come to town, wherever the seller lives, his business is, and we're going to have dinner with each one individually, and we're going to make a presentation to each one of them individually for half a day. We'll do that over a two-week period meeting with the individual buyers.

The point is we want to learn more about them because my clients would like to know who they're selling to. That could affect their choice, and they need to know more about us, because we've been careful about what we've been giving them so far because we're worried about confidentiality. What we need proprietary, we've held back at this point. We don't want 100 buyers. Now, it's 100 and -- I'm sorry, it's five and we can manage that.

I'm going to ask. I know this is going to sound a little bit funny, but I realized that for our audience, I may have skipped an important point that I want you to maybe go all the way back at the beginning. So, here we are in the funnel, worked its way down, there's two other really important components I want to talk about in part one of this before we kind of land the plane at the end of the auction process here. So, let's go back.

The outrageous price came from the one specific situation you had where you had thought somebody had way overpaid for a business that you were selling years ago. Would you mind telling us that story?

Well that's where the concept was born. Up that point, I was your traditional investment banker. I thought that buyers were logical, efficient, rational, and that the price that was paid for companies all fell within a certain small range. We took a steel processor to market, and when the bids came in, all of them except one bid somewhere around a four to a five multiple, which is what we expected.

One of the bidders, a publicly-held company bid an eight multiple, and I literally thought that they had made a mistake, that the batteries in their calculator were running down. So, I did not mention it to them. I had the presence of mind, did not mention that I thought they had made a mistake. They closed the deal in an eight multiple, and we're excited, the client's excited, and we go on our merry way, thinking we've really gotten away with something here. Run into the buyer six months later, and I'm a little anxious of what he's going to say because, by now, he's figured out he paid twice what he had to. And his first question to me was, "Any more businesses like that one? We need to buy another one." Not what I was expecting.

Yeah, you were thinking like dodging him, trying not to make eye contact in the room.

Right, exactly. I said, well what I thought was to myself was, "If you're willing to pay twice what something's worth it, I can probably find you something by noon today." Luckily, I didn't say that. I said, "Well, help me understand what did you, what's going on with the business?" He said, "Well, we've gotten rid of the union of that one location. We've merged two warehouses together. We put their products down to our channel. We put our products down to their channel, and as of today, six months later, we have made back our entire purchase price." You could have knocked me over with a feather.

So, I'm thinking, "We got away with something by selling for eight multiple," which implies eight years of earnings. Now, I'm realizing we sold for a .5 multiple, six months of earnings. What I learned at that moment was I didn't have a clue what he was going to do with the business. So, as a result, I had no idea what the business was going to make under their ownership. If I had, I might have positioned the business differently from a pricing standpoint.

Because they paid more and they were happy with the transaction and that's the key I was thinking as our audience, "Here's the auction in and of itself." It's like, "Are these people being manipulative?" It's like no, every one of these large business buyers that you've taught me is a pro. These people, they just, like you run your business for a living, all these people do is buy businesses for a living, and they're a black box, or as I heard somebody once say about the certain types of transactions you don't know what's going on the inside, it's like shooting arrows into a cloud and the only thing that gives you any indication is to what's inside the cloud is which direction the arrows come out the other end, but you still never know what's in the cloud.

Correct. So, you never know what they're thinking, and so that began the journey towards the book as to what in the world, why do some businesses sell for so much more? We've all heard the stories. We've heard competitors sell for a whole lot more than everybody else, but there's no pattern to it. You go ahead and do the research to find any literature books, articles, etcetera, there's nothing out there about how this works. Why do some people get more money for their business than others? Why do buyers pay a lot more for some companies than others?

So, that begins the journey of 15 years that resulted in the book. Because, what we learned was, why does this happen? We learned that. Then, that lead us to the thought of, "Is it possible that you could cause this to happen, or the steps that I can take today to make sure that when I do sell, I've got an opportunity to get the outrageous price."

That's where all that led and that's what impacted our practice of representing these vendors and helping them get these outrageous prices. Sometimes we help them get ready for it, sometimes we help them execute and get the price. But, we don't know what a buyer is thinking. We closed the deal one time with KKR, Kohlberg, Kravis, and Roberts, one of the largest private equity firms in the world, and the day after closing, we had no idea what they were going to do with this business. The day after closing, they fired everybody and merged their operations into one of their plants that wasn't too far away. We had no clue that was going to happen. That's the extreme example. It seems like that would have come out during some part of the conversation; it did not. The buyer was very careful about that.

Then, you also have, and what we're going to do, we're going to, I think, in a moment here, we're going to close part one of this, and I need to tell our audience -- I forgot to mention this at the beginning. I'll remind you again at the beginning of part two, but Kevin's been very generous. He's actually okay with sending out a piece from his company that was actually the conversation piece, the booklet that became the beginning of his new book, How To Sell Your Business for an Outrageous Price, and a couple of other white papers on transitioning your business to a key executive, and how to handle key executive compensation, which if you're a key executive, that would be a good thing to understand is that maybe next time you go in for a raise, you may want to ask for a compensation package, not more money per year, and those documents, I think, are really going to help all of you with that. So, thank you Kevin for being willing to share that.

My pleasure.

And you all are going to be able to get that at soundfinancialbites.com/kevinshort. So, we're going to get that available and out on a link so people can just go in, put in your email address. We'll drop it right in your email box. But, before we go on the part two -- so we've got kind of this impetus event where you saw somebody pay what you thought was way too much for the business and they got huge value. Then, you've got, within the process, which is the auction I want to come back to in a moment. But, you've also got a process that's in between the two, you don't work with anybody. You're very specific, and I remember one of the things you mentioned is you actually decline a lot of businesses.

Correct. It's because they're not ready.

Yeah. Would you tell us just kind of a little bit about what that process is like, how many people you at least have an initial conversation with before a business is solid enough to get screened all the way through and come out the other end to get into one of these unique, cultured audience, cultivated audience through which they go through the buying funnel for the business?

So, as a result of our marketing, we will talk to a new prospect every day of the week. I don't know why that's happening that way, but that's the pattern. We will take -- so, over a six-week period, we'll talk to 30 different prospects. We'll take on one client during that six-week period that is ready, that we agree on at least the beginning of the evaluation period. We never know what the company's going to sell for, but we generally have a sense of what the low end of the range is. I do not know what the high-end of the range is.

But, if we can't agree on the low end, then we generally see one or two this week. Or, if we think that there's a value to waiting because there would be a significant improvement, like the fellow the other day with the $70 million business, he needs to pull some money off the table first before he sells. So, our recommendation was to sit tight and wait. That's the reason. Most of these folks are not ready, which is one of the reasons we talked to the folks at Business Enterprises Institute. They're in the business of helping these folks to get ready to sell. It's very important.

Very good. Now, in a moment, we're going give you a little bit of a snapshot of what's coming next. What we're going to do in part two with Kevin is we're going to tell you both a real specific story of a specific client that Kevin has permission, has written about in the book that's like a blow-by-blow of what this process looks like, as well as getting out of the bottom of that audience build and being down to those final five buyers, what does that actually look like and how do people go back and forth with actual stories from the field of selling, selling for an outrageous price by design.

I hope all of you have a great rest to your day. So glad to have you here on the podcast, and we hope it's been a contribution to you to help you design and build a good life.

Hi, Paul Adams here. I want to acknowledge you for taking the time to invest in yourself by listening to our podcast. Not everybody does that, and out of my commitment to you, I will take just a few of our podcast listeners between each of our episodes and spend time with them one-on-one. And if you think you'd like some of that one-on-one time to learn more about our process, our philosophy, or whether or not we'd be a fit to work together, just email info@sfgwa.com - that's info@sfgwa.com - and I'll be more than honored to take that time with you. You can also go to our website, www.sfgwa.com, download the first three chapters of my book, see upcoming in-person events that we have, or listen to past episodes. You can also go to our Facebook page and engage us there, our LinkedIn, and send us questions for upcoming podcasts. You might hear one of your comments or questions on a future podcast. For our full disclosure, you can check the description on this podcast, or on the podcast series, or go to our website. Have a great day.

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Episode Transcription

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