MAXIMIZE BUSINESS VALUE PODCAST - EPISODE 35 Transcript

Tom Bronson (0s):
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Announcer (5s):
The maximize the business value podcast. This podcast is brought to you by mastery partners, where our mission is to equip business owners, to maximize business value so they can transition their business on their terms. Our mission was born from the lessons we've learned from over 100 business transactions, which fuels our desire to share our experiences and wisdom. So you can succeed. Now, here's your host CEO of mastery partners.

Tom Bronson (36s):
Hi, this is Tom Bronson and welcome to maximize business value of podcast for business owners who are passionate about building long-term sustainable value in their businesses. In this episode, I'd like to welcome our guest Bharat Kanodia. He is principal at Veristrat a valuation firm based in San Francisco. I met Bharat through Provisors of professional networking organization with local groups throughout the U S but after talking with Bharat, I visited his YouTube channel. What's it worth - worth a stop for you? For sure. And I fell in love with his process and his down to earth delivery style.

Tom Bronson (1m 19s):
I'm sure you're going to love his YouTube channel. So as we've discussed many, many times on this podcast, one of the biggest obstacles to a successful business exit is unrealistic on our expectations regarding the value of their business. So today, we're

going to talk about how to value a business with a leading valuation expert. Welcome to maximize business value. Bharat how are you today?

Bharat Kanodia (1m 49s):
How are you doing Tom? Thanks for having me

Tom Bronson (1m 52s):
So glad to have you with us. Tell us a little bit about VeriStrat and maybe your YouTube channel.

Bharat Kanodia (1m 59s):
You love indulging people, don't you? I do so, thanks again. So yeah, we're a valuation and advisory firm and we help venture eco venture capital, private equity, private businesses, founders, and entrepreneurs who are looking to raise capital. We help them understand valuations. Valuations over the last 10 to 15 years have gotten a lot of PR because everyday you hear that, Oh, this company raised a hundred million dollars at $4.7 billion in valuation, and this company is worth so-and-so. And what I am doing with very strong in my YouTube channel is I am lifting the veil.

Bharat Kanodia (2m 44s):
I am explaining in very, very simple terms to people how valuations work and how you can take advantage of some of the things on which valuations depend on.

Tom Bronson (2m 58s):
I love that. I love because it's just one of those things that is a mystery to most business owners. They can't really articulate it, but they have a value in mind. So, so what is your background and why did you start the business in 2010?

Bharat Kanodia (3m 14s):
You know, a, a, a young kid growing up in new Delhi, India, I would look at the stars and I would dream about coming to America one day and becoming an appraiser. No, that's okay.

Tom Bronson (3m 31s):
Yeah. That's every kid. Yeah. I wanted to be a fireman and then be a appraiser. I get it.

Bharat Kanodia (3m 40s):
No,

Tom Bronson (3m 44s):
No. I can already tell this is going to be more fun than I'd bargain. Yeah.

Bharat Kanodia (3m 50s):
So, no, I, I went to college in Madison, Wisconsin, UWA, Madison for engineering, and I hated it. I hated it to my core. I, but I, you know, when are you going to do, are you going to get out of Madison, you know, drop out? No, that's not an option. So you just power through when you graduate. But once I graduated, I was off my father's payroll. So now finally I could do whatever I wanted to do. So I wanted a job in finance, but who's going to give a 21 year old kid with an engineering background, a job in finance. Well, I found one guy who I could talk into giving me a job in finance, my, my ex boss.

Bharat Kanodia (4m 33s):
So they were looking for one engineer on staff. And after he interviewed me, he said, all right, you're it. So I was one of the few engineers on staff at a company called American appraisal, which at that time was the largest and the oldest evaluation forum in the world. In fact, American appraisal had invented the valuation business. There was no other evaluation firm before that for him. So I got to work at that farm. You know, now that form is acquired by Duff and Phelps, but I got to work with some of the original appraisers. You know, these guys, they invented the business as we speak at that time, which was great.

Bharat Kanodia (5m 18s):
And my boss loved me. So I got good opportunities to advance my career. You know, I started out doing simple, tangible assets, like machinery and equipment. And, you know, they liked my work there. They said, okay, now you can do real estate. So I started doing real estate evaluations. Then they liked my work there. Then they moved me on to doing

infrastructure evaluations where I'm appraising like airports and stadiums and pipelines that like my work there. And then they graduated me to doing companies. So it sort of spiraled up if you will, from my first job in 2000.

Tom Bronson (5m 55s):
Wow. So you, this, when we talked last week that you actually have appraised airports and pipelines, that just sounds fascinating to me. And, and I think you also mentioned that you appraise bridges, right? So, so I guess if it's, you can appraise almost anything, right.

Bharat Kanodia (6m 18s):
It, and you know, it is kind of funny when somebody says, why would you need to appraise a bridge? Or why would you need to appraise an airport? Well, there are valuations or appraisals, if you will, right? Let's, let's use those terms interchangeably for this conversation, right? Technically they're separate. But for, for, for conversation, let's say same evaluations are useful for purposes, right? The traditional purposes that we know of is some kind of a deal or transaction. Somebody is trying to buy a business or sell a business, or buy a share, or sell a share, or it could be done for insurance.

Bharat Kanodia (7m 1s):
You need evaluation of your household insurance. Similarly, they need evaluation of a bridge or an airport or a hotel for insurance. They need valuations for accounting. So say if somebody invests a hundred dollars in a company, they need to show on their books, what that hundred dollars is worth in six months in a year or five years. And the fourth type of valuation that most people need is for tax purposes could be gift or estate or some kind of way where uncle Sam can say that, Hey, this is my cut. Perfect.

Tom Bronson (7m 37s):
Perfect. So it's, it's safe to say that you've got a broad experience in valuing all kinds of, of interesting things, including businesses. Of course. So, so let's jump in. Why is it so important for business owners to really understand the value of their business?

Bharat Kanodia (7m 60s):

You know, great question. And I've been harping on this for years and most business owners, and I'm a business owner and I, and I, and outside of the valuation business, I have other ventures. So I speak as a valuation expert and as a business owner, most business owners, including myself, we do not think of getting a valuation until there is a need, unless somebody says that you need to get a valuation. Whereas as a business owner, I now think that all business owners should get evaluation at least once a year, similar to why do you go to a doctor for a yearly checkup, similar to why'd.

Bharat Kanodia (8m 49s):
You have an exam at the end of the semester, or end of the year, just to sort of it's scorecard. It helps you understand where are you in terms of growth in terms of benchmarking to others or benchmarking to your competition and valuation as an exercise, I mean, can be very expensive, but if you want to do just a scorecard type evaluation, just to understand that, Hey, this year, yeah, we're putting, you know, everybody's putting in 80 hours a week, but did we add value to the company? And that is something is simple. Valuation can tell you,

Tom Bronson (9m 31s):
I liked that having a, a simple evaluation sort of thinking about it like a scorecard. I think that's brilliant. I'm a big fan of, of keeping score, right? Thinking about KPIs and things like that, your evaluation could be one of your key performance indicators that you get on an, on an annual basis. You know, I, I'm gonna, I'm gonna run the risk here of, of bursting your bubble and making you hang up on me. But I have, you know, it's hard to value businesses. I get that. And I appreciate what you do, but I have the simple formula for valuing any business on the planet.

Tom Bronson (10m 11s):
I can establish exactly what it's worth, and you want to know what my formula is, finding a willing buyer and a willing seller who agree on the price. There you go. I just eliminated all this stuff. The hard stuff that you do, but it's so important for a business owner to have a realistic expectation. Most business owners don't give a lot of thought to what their business is worth. And then therefore they create in their mind some valuation that is perhaps unrealistic and, and really not based on anything other than what they might

think it's worth. Or some anecdote of a friend who recently sold a business, or, you know, you had heard a valuation on another business, completely unrelated to theirs, but if you've really got a clear understanding of what a business of what your business is worth, then you can focus on building that value to get to the point that you can exit that business in a way that you want.

Tom Bronson (11m 17s):
So I'm a huge fan. I love the, the whole scorecard and, and getting that on a regular basis and doing it more as a, as a, as a thumbnail exercise, as opposed to a, to anything else. So, so I think it's important that we explore a little bit here of what buyers are looking for in a target and how that relates to value. So, so Bharat, I know you work with a lot of buyers that are, you work with private equity and investment bankers. What do buyers look for in a target? Oh, it's very easy.

Bharat Kanodia (11m 56s):
Business's really easy, Tom. It's just, we make it very complicated businesses. Very straightforward buyers are looking for two things, two and only two things. And rest in my humble opinion and people pay me for my opinion, is BS buyers look for consistent cashflow. Number one, buyers want consistent cashflow. Number two buyers don't want to do anything to enjoy that cashflow. That's it two things. So if you have a business that gives consistent cashflow and a buyer or the owner can sit on his butt and enjoy that cashflow, that business is worth a lot of money.

Tom Bronson (12m 40s):
I love that. I bet, you know, of course you'd boil it down to two simple things and it is a complicated underneath that. And you know that as well as I do, but I like those two points. That's why one of the things that we discuss with our clients all the time is got to have clear duplicatable processes, right? So that if something happens to the owner or a key employee, that you've already got a step-by-step paint-by-numbers process for how that works. And so being able to, to get that consistent cash flow is so, so very important. And, you know, the way I have always kind of looked at the, a what a buyer is looking for it is that long-term predictable cashflow.

Tom Bronson (13m 30s):
And if you have kind of a hockey stick or a rollercoaster or approach to your cashflow, then, then a buyer is going to have a hard time believing that. And so, so I agree. I think I've decided now, instead of having the 500 points that we look at in a business, I'm only going to look at these two things. And I think it's a, it's a brilliant strategy. So if it is those two things, how can sellers prepare for a, for an exit?

Bharat Kanodia (13m 59s):
Great. So, so consistent cashflow and autopilot. So how can one get consistent cashflow? So recently I was appraising a CPA firm and you know, the CPA is, you know, that firm, they also do some strategic advisory type of work right now. Nowadays, if you had the war strategy in front of anything, it's sexier, it's cooler, right? So they do advisory work as well. But the advisory work is fairly ad hoc. If it comes in, it comes in, you know, they're making $80,000 for, you know, a months of work. And if it doesn't come in, doesn't come in it's ad hoc.

Bharat Kanodia (14m 38s):
But the tax and the audit piece and the assurance piece, you know, that is recurring revenue. So, you know, there, they were like, okay, so we have this much work, that's recurring revenue. And this much work, which was about 30%, the chunks, they said, this is ad hoc. I said, okay, well, your ad hoc take that off the shelf. That's worth nothing. And they were angry at me. They're like, what do you mean? It's worth nothing. I'm like, okay, can you guarantee that we will get this work next year? No. Can you guarantee is going to be higher than this? No. Can you guarantee is going to be 20% lower than this? No, I'm like, well, then it's worth nothing. I'm glad you bought your Mercedes, but the buyer's not going to care.

Bharat Kanodia (15m 18s):
So I'm good, consistent cashflow. You can develop consistent cashflow by a few things. The most important thing with consistent cashflow is customer loyalty. Now you could call it loyalty, or you could call it, you know, customer membership or, you know, whatever you want to call it. There's a reason why Costco sells you. The $75 membership, $75 doesn't matter, but it gets people to buy in. That's the customer

loyalty. The airlines are giving you miles. They're not stupid. The miles are sitting as a liability on United or Delta or all these airlines. They don't want it there, but that is the cost of gaining customer loyalty.

Bharat Kanodia (15m 59s):
If you buy zoom subscription today, right? If you buy zoom, I think it's like $15 a month. I think if you pay on a monthly basis, but if you pay for the year upfront in sort of one 80, it's 150, why are they giving you a 20% discount customer loyalty wall street rewards the hundred and $50 for zoom far more than 180, because now you got the customer for the year.

Tom Bronson (16m 28s):
Right? Right. So, so having that kind of long-term relationship. And of course the beauty of doing that by signing an annual subscription, the theory of course on the, on the company side is that you're going to use that and become dependent on it. When it comes time to renew next year, there is a very high likelihood that you're going to renew and buyers know that. Am I, am I kind of going down the right path?

Bharat Kanodia (16m 56s):
Oh, absolutely. If somebody told me that, look, I've got two customers, one is going to pay me a million dollars upfront. And one is going to pay me a hundred thousand dollars per month. Guess which one I'll tell them to take. I'll tell them to take a monthly paying customer because you're going to have to service the million dollar customer to which you don't have the capacity to do. So rather take the a hundred thousand dollars a month customer and build your process in a way that you can service that customer.

Tom Bronson (17m 23s):
Yeah. And not that I want to get into a, an accounting conversation, but, but I was recently with a prospective client that they, they got a three year agreement, basically a prepaid three-year agreement. And I was asking questions. I said, what is this big lumpy thing that, that happened in, let's call it April this year? Why did suddenly your revenue triple that one month? And then it's back down to where it was. He goes, Oh, well, we, we signed a three-year agreement with a client and got paid upfront. And I said, and all

of that hit your financials now. And, and he said, yes. And I said, well, that's not the appropriate way to do that.

Tom Bronson (18m 6s):
That should have gone to your balance sheet. And you relieve it over time because then you relieve it when the service is delivered, you know, a year from now a, a a by the way, that's a liability, right? And a year from now, if you sell this business, you're going to have to pay that chunk. That's still remaining on that to the buyers so that they can fulfill that. So a lot of times people don't really get the advice of their financial advisors and, and when you're evaluating a business, that's the kind of thing that you would catch in there. Cause you'd ask the same question. Gee, why did suddenly we have this balloon month and nothing beyond there.

Tom Bronson (18m 50s):
So I love that consistent recurring revenue is a big theme for us. And so, so I, by the way, before we take the break, I didn't even give you a chance to respond. What did you think of my evaluation formula?

Bharat Kanodia (19m 6s):
I love it. I really do. And I'll tell you why, because it resonates with me one time I was working on a litigation job and both sides had hired us jointly the buyer and the seller. And they were both, you know, angry, pissed off at each other. So let's just say for argument purposes, one said the value is 20 million. And one says the value is 30 million and I'm the schmuck in the middle. Who's trying to decide, okay. What's what, and I was just a kid, right? So, and you know, I feel like, Oh, my first litigation case, what am I going to do? And you know, a lot of depends on this is not funny money, right? This is like real money. These are affecting people's pockets and bank accounts and legacy and you know, retirement and, you know, inheritance and all that.

Bharat Kanodia (19m 50s):
Right. So I, I was a little stressed if you will, maybe I was taking it a little too seriously. So I went to my boss. I'm like, Hey, you know, you know, what am I supposed to do here is like, you know, I frankly can justify 20 million and I can justify 30 million. What am I to

do? I mean, I'm an appraiser, right? I know what w what assumptions I need to tweak to get here or to get here. And, and I can talk myself into both. And my boss says, Bharat, you're not understanding your job. I'm like what? He's like, you're not understanding why you're hired. Like, okay, you tell me then he's like, your job is to piss them off equally, like, Oh, okay.

Bharat Kanodia (20m 30s):
So it was just an eye opener for a young kid. So yeah. I agree. It's a willing buyer, willing seller somewhere in the middle. Yeah,

Tom Bronson (20m 37s):
That's exactly right. So we've got to take a break. We are talking with Bharat Kanodia, let's take a quick break. We'll be back in 30 seconds.

Announcer (20m 45s):
Every business will eventually transition. Some internally to employees and managers, and some externally to third party buyers, mastery partners, equips business owners to maximize business value so they can transition their businesses on their terms. Using our four step process. We start with a snapshot of where your business is today. Then we help you understand where you want to be and design a custom strategy to get you there. Next, we help you execute that strategy with the assistance of our amazing resource network. And ultimately there'll be able to transition your business on your terms. What are you waiting for more time, more revenue, if you want to maximize your business value, it takes time.

Announcer (21m 26s):
Now is that time get started today by checking us out at www.masterypartners.com or email us at info@masterypartners.com to learn more.

Tom Bronson (21m 37s):
We're back with Bharat Kanodia, principal at veristrat, a valuation firm based in San Francisco. We're talking about business value. So Bharat, before the break, we talked a

little about preparing a business to exit. What are some of your go-to levers to maximize business value?

Bharat Kanodia (21m 56s):
Again, going back to basics. So I would be looking for consistent cashflow and the cashflow consistent cashflow that runs on autopilot. Okay. So consistent cashflow. What would get me a consistent cashflow, some kind of a customer loyalty referral appreciation program, right? If they have that in the mix, if not, that is something they need to start working on. Secondly, making things run on autopilot, this is where the processes and the people and the procedures they come in. And what I'm talking about, processes and policies. I'm not talking about, you know, 50 page documents, a hundred page documents, which you put together, and then nobody reads it sits in the back somewhere.

Bharat Kanodia (22m 38s):
I'm talking about investing in technology technology. Nowadays, Tom, as you know, is cheap now, right? $10 a box, $10 a month, $50 a month, a hundred dollars a month. You can get technology that can, you know, you can run a five person firm that does work equivalent of a 200 person firm. If you have the right technology backing it. And when I say technology, I don't mean custom technology. I just mean the technology platforms that are just out there for us to use vinyl subscription basis. That is really always my advice to entrepreneurs. When they say that, Hey, where do I invest?

Bharat Kanodia (23m 20s):
I said, invest in technology.

Tom Bronson (23m 21s):
So, so are those kinds of things? Do you actually peel back the onion when you're doing a valuation and actually consider things like that in the valuation?

Bharat Kanodia (23m 33s):
I will look at how close this business is to being run on autopilot. If the owner is saying though, no, no, no, no. I got to write the, or I gotta call this guy or I need to be doing this.

That is not telling me a very good story, because when you're then trying to sell the business, you're not selling a business, you're selling a job, no investor wants to buy a job. They're looking to buy a business. Right?

Tom Bronson (24m 1s):
In fact, I always say that, that now I know in your business, there are reasons or, or kind of deductions that you would take for owner dependency, but in very small businesses, you know, my opinion is that a business that is a hundred percent dependent on the owner is almost worth zero. It might not be worth exactly zero, but it's almost worth zero. Because, because if something happens to the owner, the business is going to fall apart, if it is dependent on there. So I'm glad that you take a look at those things. So, so what sets your business apart from other business appraisers?

Bharat Kanodia (24m 45s):
I am a different kind of appraiser, Tom, most people in my world, they silo themselves into doing one type of evaluation or one type of an asset. So somebody might say, Hey, I only appraise wineries, or I only appraise Aesop's or I only do insurance work. As I had told you about my experience working for American appraisal, and I had good bosses and they sort of let me sort of run with things. So I'm one of the few appraisers who can value tangible assets, like a power plant or a copper mine, or a stadium to the other side of the spectrum, intangible assets, like a copyright or a domain name or a patent or things in the middle, like entire businesses or different classes of stock within the business, like the options or the RSUs, or what have you, and in different industries.

Bharat Kanodia (25m 39s):
I mean, I have appraised bridges to airports, to technology companies, to your local repair shops. So think of me as internal medicine or a physician.

Tom Bronson (25m 52s):
I love it. I love it. So one last business question broad, this podcast is about maximizing business value. What is the one most important thing that you would recommend to any business owner in order to build long-term sustainable value in their business?

Bharat Kanodia (26m 12s):
Always think of your business from a buyer's perspective. So if you were to vanish from this planet tomorrow, can the buyer run your business without you? And if you think he or she can't, that's not a good sign. If they need you to run the business, they're not going to pay you high enough for the business. If you can establish that they do not need you for the business and they can enjoy that's consistent cash flow and let the business still run on autopilot, that business has value. So the closer you closer to get this, now you may not be able to get to it a hundred percent, right?

Bharat Kanodia (26m 55s):
Nothing runs a hundred percent on autopilot, right. Or no, cashflow is a hundred percent consistent, right? But the closer you closer to get to it, 70%, 80%, 90%, the higher the value.

Tom Bronson (27m 7s):
Awesome. I love that. I think that that is so important. And of course, as we work with our clients, that's exactly one of the things that, that we tear apart and try to figure out where our, where in the business is it dependent on the owner and how can we help solve that equation? Because if it is a business that is not transferable, it really takes a hit on, on a valuation. For sure. So, so of course, everybody who listens to our podcast on a regular basis knows that I always ask a bonus question. So here we go. And they always stay tuned for this question, because this is sort of the, the fun side.

Tom Bronson (27m 49s):
Although we've already seen for an, for an engineer appraiser, you've got a, you've got a sense of humor and I love that. So, so here's your bonus question? What personality trait has gotten you into the most trouble through the years?

Bharat Kanodia (28m 2s):
Oh, I'm I'm I think outside the box or some people might call me a kook I'm I believe into conspiracies and all that. So I am not afraid of thinking outside the box. And you know, an evidence of that is like my YouTube channel. Nobody in my business would ever think about creating a YouTube channel with a 10 foot pole. But I did it because I think

people needed education. Most people in my business want to go for the big fish for the, for the private equity, for the venture capital. I have worked for those people. I have worked with people who make $10 million a year. Now I'm going for the little guys. Now I'm only going for the businessmen whose revenue is less than $5 million because there are so many of them, right?

Tom Bronson (28m 48s):
Yeah. That's, you know, look of, of what I call small business, a hundred million in revenue and below that's 99.7% of all businesses that employ people. And so, so that's like almost 6 million of them are a little over 6 million of them United States. And so you're right. That is where most of the folks are. So, and by the way, I do love your YouTube channel. And so tell us where that is and how our viewers and listeners can get in touch with you, Bharat.

Bharat Kanodia (29m 21s):
So there'll be a link to my YouTube channel in the description below, or you could go to YouTube and type in what's it worth. And my channel will pop up. And in each episode, we're trying to educate owners on different types of businesses. So a medical practice, a CPA practice, an auto repair shop, a winery. What have you?

Tom Bronson (29m 42s):
I am a huge fan of the one on wineries. So, so I did enjoy that a lot because our listeners know that that I was in the wine space for some time. So thank you for being our guests today. I really appreciate you taking the time to kind of lift the veil, so to speak on, on how to value a business. Thanks for being with us.

Bharat Kanodia (30m 3s):
Thanks for having me, Tom, great chatting.

Tom Bronson (30m 6s):
You can find Bharat Kanodia at veristrat.com or on his YouTube channel, which is what's it worth, or you can find him on LinkedIn. And of course you can always reach out to me and I will be happy to make a warm introduction. I can already tell, even though

Bharat, I have only known one another for a short time that we're going to become fast friends very quickly. This is the maximize business value podcast, where we give practical advice to business owners on how to build long-term sustainable value in your business. Be sure to tune in each week and subscribe or follow us wherever you found this, and be sure to comment. We love comments and we respond to all of them.

Tom Bronson (30m 49s):
So until next time, I'm Tom Bronson reminding you to make sure you really understand the value of your business while you work to maximize business value

Announcer (31m 4s):
Thank you for tuning into the maximize business value podcast with Tom Bronson, this podcast is brought to you by mastery partners, where our mission is to equip business owners to maximize business value so they can transition on their terms. Learn more on how to build long-term sustainable business value and get free value building tools by visiting our website, www.masterypartners.com that's master with a Y masterypartners.com. Check it out.

Tom Bronson (31m 33s):
<inaudible> that was perfect. I wouldn't make any changes on that.