MAXIMIZE BUSINESS VALUE PODCAST - EPISODE 83 Transcript

Announcer (5s):
Welcome to the maximize 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, the CEO of mastery partners, Tom Bronson.

Tom Bronson (35s):
Hi, this is Tom Bronson and welcome to maximize business value. A podcast for business owners who are passionate about building long-term sustainable value in their businesses. Today, we welcome my close friend, Craig Beck. He's the owner of beyond CFO Craig and I have been acquaintances for several years, but have really gotten to know one another over the past two years through our accountability group, the rogue forum, which probably athlete made for the group of folks that we have in it. It's part of business navigators, the servant leadership group here in Dallas that you hear me talk about frequently.

Tom Bronson (1m 15s):
Greg has an interesting background that is so helpful to his clients, but we'll talk about that at a moment today, we're going to focus on two really important topics that business owners should really understand and use to their advantage EBITDA, which is earnings before interest taxes, depreciation, and amortization, and working capital. Both of these topics are extremely important to any business owner who is planning to exit whether now or in the future. So welcome to maximize business value. Craig,

Craig Beck (1m 53s):
Thanks, Tom, appreciate the opportunity to be,

Tom Bronson (1m 57s):
I'm so excited for this conversation. You and I've been talking about doing this for a long time. So before we get into the details of what we want to cover today, tell us a little about beyond CFO.

Craig Beck (2m 9s):
So beyond CFO is my company and we, we show owners of middle-market companies, how to improve the value of their, of their company by focusing on the gap between the company's current state status and the owner's vision of the company. And we identify and resolve issues at the intersection of engineering, operations, legal and financial areas,

Tom Bronson (2m 32s):
Engineering, operations, legal, and financial areas. That is a wide spectrum there. I know we're going to talk about your experience in a second, but, but I have to say you're, you're singing my song. Any business like yours, that'll help business owners really realize their vision and maximize the value of their business. That is great in my book. So what is your background and why did you beyond CFO?

Craig Beck (3m 1s):
So that my, the breadth of my background is actually one of the things that I suggest to potential clients that I bring to the table that a normal CFO doesn't, doesn't, I'm not a normalcy, I'm a normal CFO, but they don't, you know, they don't typically bring the breadth of experience that I do. I started as an engineer. I, I did that for a couple of years, focusing on the economic impact of whatever engineering change I was about to make. So kind of half business, half engineering, which is what really industrial engineers do. Then I went back to school and became a securities attorney and help people raise money and improve their capital structure.

Craig Beck (3m 42s):
And during the latter part of practicing as an attorney, I got my MBA in finance at Carnegie Mellon. So I've always focused on the economics and, and I started beyond CFO. When I left Heller financial in 1998, to help a client improve his capital structure by going public through a $1.8 billion, mastered 11, a partnership that was a big number, then small number today, but I've been helping owners of companies from, with revenues between 5 million and 150 million realized the vision for their company ever since some of the recent examples of what I do are, you know, we've reduced an owner's tax liability by over $600,000 through getting some R and D credits for him changing the company retirement plan and getting him involved in private insurance, we've uncovered a fraud that costs the company a little over $2 million.

Craig Beck (4m 45s):
We raised 1.8 million for two partners to buy out six other partners. We raised $10 million to build a new processing plant, which will more than double the EBITDA that company we'll talk about. Even Don a minute, those are kind of the notable ones. There are a lot of other minor, relatively minor ones that actually over time improve the company value as well. So those are the kinds of things that we do.

Tom Bronson (5m 10s):
Wow. That, but by the way, you know, 1.8 billion, did you say at 1.8 billion? Yeah. That's funny right there. Small money. Sure. Yeah. 1.8 here, 1.8 billion there, next thing you know, where we added up to some real money. So, so sounds like you might get bored pretty easily, you know, engineering and then law degree and then finance, you know, that's the abor easily Gregg.

Craig Beck (5m 41s):
I love to learn now. I really do love to learn.

Tom Bronson (5m 45s):
Yeah. It's kind of fun. Isn't it? You know, I'm, I'm a lifelong learner. I love to read books as, as one of my friends, Jim Roddy always says, you know, buying books are a $15 way to get an MBA. And so, so I love that. I, I I'm a voracious reader, but you are way over

degreed in to compare it to me. I got nothing. So, so congratulations on all of that hard work. So let's get into the topic at hand I'd venture to guess that most business owners know what EBITDA is, but would you give us a quick explanation of what EBITDA means?

Craig Beck (6m 25s):
Sure. As you mentioned before, it's earnings before interest taxes, depreciation, depletion, and amortization. And so to break that down earnings, just so you know, is net profit. So the bottom of your PNL is where, where we start on EBITDA, then there's, you're gonna it's before interest. So you're going to essentially add back interest, which is the non-principal portion of payments on debt then taxes. But we're really only talking about income taxes. So if you got some state and local taxes that really aren't involving income, that's not the kind of taxes that you're going to add back to EBITDA.

Craig Beck (7m 6s):
And if the entity is a pass through entity, there won't be any taxes. Cause that'll show up at the, at the, on the owner's tax returns, the appreciation depletion. We're talking about gap, not tax depreciation here. And that's significant these days, since you can write off very rapidly things that you buy, like a perfect example is equipment. And so you can, you, you can accelerate that depreciation, but we're talking about gap and appreciation here, which is generally accepted accounting principles to police and falls in the same category, but really only applies to things like oil and gas or mining, where you have minerals that are depleting, but we are in Texas.

Craig Beck (7m 49s):
So I thought I'd mentioned that since we do a lot of oil and gas here and then finally amortization, which is similar to depreciation, but it applies to things like Goodwill non-compete agreements, government permits, and those sorts of things that are associated that that accompany would have whenever it has purchased another company. And so those were the elements that get you to EBITDA again, earnings before interest taxes, depreciation, depletion, and amortization.

Tom Bronson (8m 21s):

So an interesting point that you just raised and the whole depreciation issue. So when you get that kind of bonus depreciation, you know, it seems like every year Congress is allowing, you know, what is it, section 1 79 bonus depreciation for things. So when you're looking at EBITDA, you should normalize it for the normal gap depreciation versus the bonus depreciation. Correct? Correct. Okay. All right. I want to be sure that that's, that's a nuance that people don't really think about because, you know, you can, you can buy new equipment and put it in use and take bonus depreciation for tax purposes, but that doesn't satisfy a gap accounting.

Tom Bronson (9m 5s):
It's, it's worth explaining that a little bit further. So, so, you know, why don't we just use even, or why do, why would we use EBITDA versus just net profit? I mean, net profit really be the indicator of the earnings of a business.

Craig Beck (9m 26s):
Well, in this case, when we're talking about a business transition, the objective is to estimate what funds are available to pay the capital providers, either the investors that are buying the company or the banks that are supplying debt. So what you're trying to do is see what free cash flow would be available. And so we're typically talking about looking at the gap based accrual financials was, has a smoothing effect versus the lumpy cash in cash, out of cash financials. And we're trying to adjust it to exclude non-cash items that are costs of the business that are born over time.

Craig Beck (10m 6s):
The best example of that is one we just mentioned, which is depreciation. So, and that's essentially what depreciation is doing. It's trying to account for the decline in value of the equipment as it wears out, but realizing that that's really not taking cash out of the business on a weekly, monthly, quarterly basis. And so we're going to adjust for that since it's not really a cash on.

Tom Bronson (10m 34s):
Okay. All right. Well, that makes a lot of sense. Now I typically recommend to my clients just for simplicity sake to actually move those items, you know, the income taxes,

depreciation, amortization, move those items below the line so that you can see really what the net operating profit is for the business. And you actually get a picture roughly of what your even die is right on your financial statements. Would you say that that's a reasonable practice

Craig Beck (11m 7s):
Actually from my clients? I usually, I I'm. So when, when QuickBooks, for example, produces your PNL, I usually take that and add the calculations to the bottom of the P and L that essentially get you to EBITDA. So, because I use that in other ratio analysis that I do whenever I provide, you know, like a monthly report, monthly financial report and ratio analysis to my clients so that they can understand what's happening in their, in their business, through their financial statements. So, absolutely. I agree with you

Tom Bronson (11m 44s):
The now, you know, one of the biggest reasons why businesses don't transact, and as I've said on this show and throughout our website, and pretty much everywhere that people listen to me, 83% of attempted business transactions fail to reach the finish line, meaning only 17% get there. And one of the reasons, the biggest reasons that 83% fail is because business owners are really don't understand how their business is valued, or they've heard something on the street, or they're trying to apply something that they read about some major acquisition, Google bought some company.

Tom Bronson (12m 26s):
And so they're trying to apply those multiples to their, to their own business. And it just doesn't apply. But I also hear frequently folks saying, well, I'm going to get a multiple of my revenue. I want two times revenue or three times revenue, which is an applicable methodology for a very small fraction of businesses, but 97% of small business transactions. And when I say small business, I'm talking about anything less than a hundred million in revenue, kind of that lower middle market and down 97% of those transactions are based on a multiple of earnings. So when we think about that is EBITDA.

Tom Bronson (13m 8s):

What we're talking about when we say based on a multiple of earnings.

Craig Beck (13m 12s):
Yes. Typically that's true. There are some variations, but as you pointed out, the vast majority are based on EBITDA multiples. It is the best, quick estimate of free cash flow that will be available to provide the return to investors and pay the banks. It is independent of a current debt structure. It's less dependent on accounting methods and less likely to be manipulated compared to other metrics. The one drawback it has is that it doesn't account for growth. So nothing's perfect, but it is the best thing out there and is every deal that I've ever looked at the first cut was always based on a multiple of EBITDA after that, you know, different buyers will look at things a little bit differently, but you start having the conversation at the very least based on an, even on multiple compare to industry, you know, similar industry that, that you're, that the company's in and because of the multiple effect, each dollar of EBITDA is more value than some owners realize.

Craig Beck (14m 29s):
And for example, if you have an EBITDA change of a hundred thousand dollars and you're, and you're in an industry that commands a 10 multiple, then you're talking about a million dollar price difference. And so you've got to keep, keep that in mind. It's not just the dollar of EBITDA that, that you may be changing. It's the price by whatever the multiple is.

Tom Bronson (14m 56s):
Yes. You know, that's absolutely right. You know, I always tell folks that, you know, pay your taxes now and, and a dollar to the bottom line is worth several more dollars to you at transaction time. And so, so be sure to, to focus on driving those earnings. Now, another thing that another adjustment that we typically see in a lot of small business transactions are what we call discretionary expenses. So what are discretionary expenses and how should they be treated in the valuation of a business?

Craig Beck (15m 36s):

So discretionary expenses really is a very broad spectrum of expenses. And quite frankly, some of them are legal and some of them are not at least. And I'm really referring to from a tax perspective. Some examples of, of discretionary expenses are higher salaries from the owner compared to the market. So for instance, if the company is paying the owner $300,000 and the market for having somebody run a company like that is a hundred thousand, just to keep the numbers simple, then you could add back $200,000 because the buyer is going to say, I can hire somebody to replace the owner for a hundred thousand dollars.

Craig Beck (16m 23s):
So there, there will be $200,000 that right now doesn't drop to the bottom line that will be available to pay me my return and banks, what we owe them. So that's kind of the way a, a potential buyer would look at that. And, and owner would suggest to the, to the, to the potential buyer that they should look at that other areas, the one that falls into the, probably not legal is salaries of relatives that don't actually work in the business. If you can document that the company was in fact, charged those wages and, and the, and the, and the relatives don't actually work in the business.

Craig Beck (17m 8s):
Then again, that would be money that would be available. Other things are higher than market rent. A lot of CA a lot of owners will have their company and the real estate that their company operates at in different entities. They will own them separately, and they will charge the operating entity rent for using that space. It can either be above market or below market. And so you would adjust EBITDA accordingly, you know, which w whichever way it was private automobiles, a lot of companies have company automobiles that are necessary for operation of the business.

Craig Beck (17m 49s):
A lot of owners run their private automobiles that are really not used in the business, through the company. And so that too would be something that wouldn't be an expenditure of the company after the new owner buys it children's educational expenses, sponsorships improvements to non-business related properties. Sponsorships is kind of an interesting one. Let me go back to that for just a second. If a

company sponsors, let's say a company, the son of the owner is one of the top five NASCAR drivers might make sense for that company to sponsor them because they get really good marketing out of that.

Craig Beck (18m 29s):
On the other hand, if, if that son or daughter is, you know, in a, in a sport that doesn't provide as much exposure to the sponsorship, then you know, it may not be worthwhile. And therefore wouldn't be something that a new owner would, would pay for. And therefore wouldn't, wouldn't be an expense of the company and therefore adjusting EBITDA up because that wouldn't be an expense would be, would increase the EBITDA and therefore make the value of the company higher. So discretionary expenses should be added back to the increase to increase EBITDA when they won't be expenditure by the business after the new new owner takes over.

Tom Bronson (19m 23s):
So I want to expand on, on a couple of those things that you've just said. So owner's comp I frequently hear from business owners if they just want to add back their entire compensation, but you made an excellent point that a buyer is going to not add back the portion of the owner compensation that he'll have to pay somebody else to do that work, or he'll have to pay himself right. To do that work. And so typically owner compensation is not fully added back. Is that it? And I think based on what you said, you'd agree with that. Am I correct?

Craig Beck (20m 2s):
Absolutely.

Tom Bronson (20m 4s):
Yeah. So, I mean, you know, you might have an owner that's paying themselves a million dollars, but for a business that size, perhaps they could get away with a $200,000 a person running that business. Well, that's an $800,000 add back, not a million dollar add back. And so I wanted to highlight that point. The other thing that you mentioned here that, that it just occurred to me is when, when a business owner owns real estate kind of in separate entities and they're paying that, and if they're paying below market rates,

then that actually is going to, when you restate the earnings and, and handle the discretionary expenses, that means you're going to be adding back cost.

Tom Bronson (20m 44s):
Right. So reducing the, the earnings. So am I right in that?

Craig Beck (20m 49s):
Absolutely. And that, and that, and that happens as frequently as the other way, quite frankly.

Tom Bronson (20m 55s):
Yeah, absolutely. I've seen it very frequently. So because if they own the building and let's say the buyer is not going to buy the real estate, they're only buying the business, but they're going to rent the real estate. Well, the owner's not going to give them an advantaged rate. They're going to charge them market rates for that. So you've got to add that cost back in and thus reducing the earnings. And so, so it's a kind of a nuance there that business owners should be thinking about. Well, most small business owners have discretionary expenses, right? And, and other than the folks that are not working kind of in the business, which scares me, by the way, I, I, I do a little bit of buyer representation for some of our clients.

Tom Bronson (21m 37s):
I'm, I'm, you know, doing some due diligence and some work for some clients that are acquiring businesses. And in one case recently, I had a business that, that my client was attempting to buy. And when I asked for a schedule of the discretionary expenses, I got things ranging from of course, automobiles for himself and for his family who were not working in the business cell phones for everybody. But then I had the pool guy, the housekeeper, the, the lawn guy, you know, and those things that they were running through the business and, and expecting to be able to add those things kind of back in one of the things that I tell a business owners frequently is buyers get adjustment fatigue.

Tom Bronson (22m 27s):

If you're doing all of those things and running that stuff through your business. Now it's unlikely that a buyer is going to give you full credit for all of that stuff, because it's hard to document and, and add back. And frankly, it just, it frustrates them when they see adjustments that looked like that. My advice typically is get most of that stuff off of the books and pay the taxes on it now. Right. Because you can increase those earnings and get paid back. So in your professional opinion, is it okay for a business to have discretionary expenses or should they minimize those expenses?

Craig Beck (23m 9s):
Well, I think it's okay for them to have discretionary expenses, but as you pointed out at some point, potential buyers may experience add back fatigue, or I think he used a slightly different term for that, but it's fatigue in, in this area. Whenever you're trying to add back to me, discretionary expenses, especially when you're right there, they're not going to get credit for them if they're not clearly documented and they can't easily be traced through the general ledger. So that it's clear that in fact, those expenses did reduce the net income of the company. So there's, so there's kind of a balance that needs to be maintained between giving up value by not claiming legitimate discretionary expenses as add backs that EBITDA while not causing potential buyers to become frustrated by having to track down too many add backs,

Tom Bronson (24m 7s):
Right. It's so important for business owners to really understand those and dive in and, and, and attempt to minimize that kind of thing long before, that's time for a transaction so that those are gone out of the books. And by the way, most business, most buyers are gonna look at three years of financials. So don't think you can make those adjustments in one year and it'd be okay, cause then you're going to also be reconciling all those other adjustments. So I say, try and do those things at least three years before a transit transaction so that they're not on the books that people are asking for. Right. So awesome.

Tom Bronson (24m 47s):

Hey, that is a lot of great information on EBITDA. We're going to change gears after the break. We're talking with Craig back, we'll take a quick break. We'll be back in 30 seconds.

Announcer (24m 58s):
Every business will eventually transition some internet 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 the way 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 (25m 39s):
Now is that time get started today by checking us out at www.masterypartners.com or email us at info@masterypartners.com.

Tom Bronson (25m 52s):
We're back with Greg bag, founder of beyond CFO before the break, we talked about EBITDA earnings before taxes, interest, depreciation, and amortization. So let's change gears and talk about working capital. How do you calculate working capital? Is it a, is it a formula that can be used in virtually any business?

Craig Beck (26m 18s):
There, there is a typical gap accounting formula for a working capital and simply current assets minus current liabilities, which are those that are expected to occur within the next year, but while working capital with regard to a business transactions related to that formula, it can be, and most often is in my experience a much more complex assessment and calculation.

Tom Bronson (26m 46s):

So, so is it the same for almost any business then, or is it really dependent on what type of business that you're in if you're making those calculations for internal?

Craig Beck (26m 57s):
Well, so, so the definition for, in my view for a transaction is similar, but when you start to get into the details, it becomes, there are a lot of nuances, not only with regard to the type of business, but with regard to an individual business, but the, but the, the trend, the business trans transition equal working capital equation is operating, operating current assets minus operating current liabilities, or maybe in layman terms would be the cash that the buyer will need to operate the company in the normal course of business after he takes over the company.

Craig Beck (27m 38s):
So, like I mentioned there, as you ask that there are nuances by type of business, but the individual business creates probably as many as the type of business. And it's usually related to the way a company accounts for certain transactions in, in the normal course of business. So some examples of, of that are, I've seen a company recently that was a target of one of my clients that had recognized revenue last year, they'd signed a contract to provide services for one year, and they had recognized that revenue last year.

Craig Beck (28m 19s):
So there, the, when we looked at the financials, that EBITDA was up because of that revenue, but then they didn't reflect the corresponding liability on their current year balance sheet because, and they needed to, because they had the cost of supplying those services in this year. And so it was kind of a double kind of a double whammy. And so you've gotta be careful about something like that. Other more typical examples are our accounts receivable overstated. And if they are, that means that they're not going to bring in as much cash after closing is as what you might expect.

Craig Beck (28m 59s):
In other words, is there a history of bad debt in the past? That's, you know, the customers are the same. And so you should expect roughly the same bad debt, but it's not accounted for anywhere in the financials. Likewise are the accounts payable,

understated, which would require more cash than expected after the closing, you know, that's usually looked at through the quality of earnings due diligence phase. Another area is, is inventory overstated, or is it obsolete? This, if it's obsolete, you're not going to use it to create your finished goods.

Craig Beck (29m 40s):
And therefore you're not going to get future value that you would expect because you're not, you're not generating the expected cash. So those are kind of typical, maybe one, not so typical, but the other ones are fairly typical things that you need to make sure you look at.

Tom Bronson (29m 57s):
I'll tell ya. One of the, one of the common things that I see businesses that have inventory, unless they're really on top of it and doing their cycle counts, random accounts, and making sure that that everything on the shelf is sellable. A lot of times businesses just let inventory get out of control. Now, I find that sometimes that's because of their banking relationship. They want that inventory on their balance sheet because it supports a like a line of credit or something like that. But, but I can give you an example after example of doing inventory on an acquisition and making significant adjustments for what I call dead inventory that, you know, hadn't moved in over a year and, and I've actually derailed some acquisitions just on the, on the inventory issue alone.

Tom Bronson (30m 58s):
And so, so pay really close attention to the inventory. The, one of the things that that I think is fairly common too, and this is there's a correlation between the size of the business and this issue, the smaller, the business, the more surprised buyers are that there might be a working capital component to an acquisition. A lot of business owners when we've done acquisitions, you know, there's always a working capital component. I've done a hundred transactions when, when companies are buying my, or, you know, when I'm selling my businesses or when I'm buying businesses, there's always a working capital requirement there because you're buying an ongoing concern and you need to

have the capital in order to continue to operate the business for some reasonable amount of time.

Tom Bronson (31m 53s):
Right. And so, and so if you've got good, AR that's gonna pay, that'll bring cash into the business. If you've got a reasonable handle on the AP, but most business owners, when, when I have that first conversation with them about working capital components, they're like, what do you mean? I'm just going to sell the business and they have to bring their own cat. I had to do this when I started up now, you've know a lot of transactions as well. I know that you've that you, in your business, that you've supported a lot, even prior to starting beyond CFO. I just want to get your perspective on, do you see a working capital component frequently in M and a transactions?

Tom Bronson (32m 39s):
Always. Okay. I was going to say most of the time, but I agree. I think it's almost always there. Sometimes if you're buying a tiny little business and it's just buying the assets, I, I have done some acquisitions without it, but, but you were starting to say something there.

Craig Beck (32m 58s):
I was going to say, it's either, it's either there explosively or it's there implicitly, but it's always like,

Tom Bronson (33m 6s):
Oh yeah. Okay. All right.

Craig Beck (33m 9s):
Because if it's not there, there's some adjustment to price. So it's, it's there implicitly when that price is adjusted because there's no working capital.

Tom Bronson (33m 20s):
Yeah. Yup. It's, it's interesting. And, and I got into a really lengthy and almost heated debate in my last sale of a business. The working capital requirement requests that they

put on the LOI was significantly higher than what we knew the business needed to operate. So, so they were using that as an opportunity to basically lower the price, right, by requiring a high working capital component. And, but we were ultimately able to negotiate that to be something that we felt like was reasonable.

Tom Bronson (34m 2s):
You know, our business was a recurring revenue business. 80% of our revenue was recurring revenue. And, and twice a month we'd push a button and money would just flow into our bank accounts. So we had very predictable income and it, it, a working capital component might be more complex for a business that doesn't have that recurring revenue. And so, so, so we were able to successfully reduce that didn't get as far as I wanted it to go. And I'm a skilled negotiator when it comes to doing a transaction. So, so I love the fact that my good friend Craig says it's always there.

Tom Bronson (34m 44s):
So business owners, when you're planning for a transition, please do not be surprised if there is a line item on an LOI that talks about a working capital requirement. And so think about those things and get advisors who can help you understand that. Because when you see that many times, it becomes a very emotional thing for a business owner, and sometimes it derails derails deals, but you just heard it from somebody who is in the know, it's always there, whether it's written on the document or whether they're reducing the price as a result of it, then, then they're going to get the working capital.

Tom Bronson (35m 25s):
They need to operate the business. I think I, I can't overstate that. Are you, would you agree with that, Craig?

Craig Beck (35m 32s):
I would agree with that. And there's there's if you don't mind, there's one of the things I'd like to point on inventory that is not directly, at least initially related to a tramp, you know, a transition, ultimately it would be. But one of the things I discovered is that a lot of companies that have their financials prepared only for the purpose of getting their taxes done, won't have, and this specifically applied to a mining mining company that was a

client of mine. They, so they won't have any inventory on their balance sheet because all of that will have been expensed.

Craig Beck (36m 14s):
The problem with that is, is that when it's, if you, if you use that balance sheet to go to a bank to get, to get alone, particularly a line of credit that is often dependent upon equipment value, accounts, receivable, and inventory, you've knocked out a big portion of your potential borrowing base for a line of credit specifically. And that client has a small line of credit with the bank based on equipment and an accounts receivable, but they had no inventory. And when we redid their, their accounting, we changed that and created, you know, we, we basically got about a million, three of inventory on the books and the men, because it was finished inventory at that point, the bank was willing to loan 70% against that.

Craig Beck (37m 15s):
So we, we, we were able to expand their borrowing base significantly for a relatively simple reason. Now that'll ultimately affect the, the, the Trent the transition transaction, because that's an asset that's on the books that wasn't on the books before. So just, just thought I'd point out kind of a, another, another issue with not dealing with inventory properly.

Tom Bronson (37m 48s):
I agree completely, you know, one of the things I sometime ago joined a, an advisory board for a business that was basically expensing all of their inventory, which is fine if you're buying the inventory and using it and then charging for it, you know, in the same month. But I looked at the, the first time I looked at their financial statements, I was seeing these outrageous swings and their in their gross profitability. Right. You know, the right, you know, so revenue, less cost of goods sold and, and a few other things, but gross profit.

Tom Bronson (38m 28s):
And I was seeing things from, you know, 50% to minus 20%. And, and, and it was all tied to that to cost of goods sold. So they were expensing everything. I said, no, we need the

expense to line up with the revenue. When I see these wild swings in gross profitability, it tells me that something is not right now in this particular business. I nailed it down right away to the inventory. But have you seen that before? And is that something that, that business owners frequently do

Craig Beck (39m 6s):
Once that haven't converted to a accrual accounting? I see it all the time.

Tom Bronson (39m 11s):
Yeah. Yeah. Cash accounting, right. For tax purposes. And that kind of thing. I always say, and I run the risk here because you're a much keener financial mind than I am, but I tell business owners, if I'm looking at their books and their cash accounting, I go, look, you can't manage the business on cash accounting. You need to manage the business using a cruel accounting. And we pay our taxes based on cash accounting. And, and you should be operating that way. Now I made that statement at great risk. Are you going to say that I'm all wet here?

Craig Beck (39m 46s):
No, no. I think you're absolutely right. In fact, I tell my clients that there are actually three, most people tell, tell people that there are two sets of books, textbooks, and kind of gap books. But I tell my clients, there are really three sets of books, tax gap, and management, because you need a little bit different information as close to gap, but you need a little bit different information to run your business. Then even a gap set of financials will give you, but a tax set of financials, as you pointed out is really inadequate to, to, to run the bills.

Tom Bronson (40m 19s):
You just can't operate the business. You can't, you can't make decisions based on what you're seeing on, on cash, financial statements. At least I don't think that you can. And so it's so much easier to look at it the other way. So before we, before we wrap up here, is there any other wisdom you want to impart to us about why working capital is important? Okay.

Craig Beck (40m 40s):
I think it's important. We touched on one of them. I think it's important because the buyer, if it's not calculated, right, he may have insufficient funds to operate the business after closing. And if that's the case, he's probably overpaid for the business. So it's kind of a double whammy there.

Tom Bronson (40m 58s):
Yeah. Yeah. I, I totally agree. So, so pay attention to that working capital. So, one last question, before we wrap up here, Craig, this podcast is all about maximizing business value. I know that that is near and dear to your heart. As much as it is to mine. You had to give business owner just one thing. What is the one most important thing that you think business owners should do to maximize value in their business?

Craig Beck (41m 25s):
I think they need to understand where they bring the highest value to the company. I see a lot of owners getting distracted and when they were smaller, they could afford to do that. But as they grow the camp and then don't let anything distract you from focused on that area. There, I, I think about people in the business that are counting in three categories, finders, minders, and grinders. And that's the owner of B2B CFO kind of came up with those terms, but you know, the owners are the finders of new customers and you know, our new ideas, they've got minders of the business that are absolutely necessary to keep things rolling. And then they got the people on the shop floor that are the grinders.

Craig Beck (42m 6s):
They don't need to be minders or grinders. They need to be finders. And, and, and to produce that highest value. So focus on that and don't let, don't wait, don't let yourself get distracted. Like you may have let yourself do when the company was smaller.

Tom Bronson (42m 20s):
I've heard you use that term before. And that, that comes from your old, a business, a B2B CFO. I didn't realize that it came from there. So, so finders, minders and grinders, it's three folks. It also lines up really well with our mutual friend, Mike Rose, his book, R O E,

which talks about kind of those three roles. He calls them way, one way, two and way three, which, which in essence are the finders minders and grinders. And so, so there's lots of evidence about which one of those. I love that, you know, whatever you're great at, go do that and find somebody else to do the other stuff, such great advice to business owner.

Tom Bronson (43m 4s):
So I'm not going to let you off the hook though. I always ask this question. I have to ask you a bonus question. Craig, what personality trait has gotten you into the most trouble through the years?

Craig Beck (43m 18s):
Well, I'm not sure it's a personality trait has got me in more trouble, but it's one which has probably cost me more money over the years than anything else. And that's the failure to remember that perfect is the enemy of good, which is Voltaire. And that done is better than perfect, which is Sheryl Sandberg. So those are things that I remind myself almost daily of today and it's changing the way that I look at things I wish I would have began to do that 20 years ago or more.

Tom Bronson (43m 49s):
Yeah, it's, it's almost a, an obsession for folks that are, are hesitate to use the label, but perfectionist, right. They want it to be perfect and, and get it right. But to me, that just gets in the way of getting it done. I am so fortunate that that's never been a part of my personality. I would rather be done than perfect. And, and, and it's gotten me in trouble probably fewer times than, than trying to make it. Perfect. Right. So, so that is great advice for business owners. I love that. So how our listeners and viewers might want to get in touch with you, how can they do that?

Craig Beck (44m 31s):
Well, they can always call me. My cell phone number is (630) 240-1383. Or they can reach me at Craig back at CFO dash, I'm sorry, beyond-cfo.com. You can take a look at my website at beyond-cfo.com or you can look me up on LinkedIn.

Tom Bronson (44m 58s):
Awesome. Those are four great ways that I'm going to give them one more way. Thank you Craig, for being our guest today, this has been a great pleasure and a great education for business owners. Thanks for being with us.

Craig Beck (45m 10s):
Thanks for having us.

Tom Bronson (45m 11s):
You can find Craig beck at beyond-cfo.com or on LinkedIn, but of course you can always feel free to reach out directly to me. And I will give you a warm introduction to my close friend, Craig Beck. This is the maximize business value podcast, where we give practical advice to business owners on how to build long-term sustainable value in their businesses. So be sure to tune in each week and follow us wherever you found this podcast and give us a comment or a suggestion, something that you'd like to hear on a future podcast. We respond to all of those until next time. I'm Tom Bronson, reminding you to spend time, to really understand EBITDA and working capital while you maximize business value.

Announcer (46m 5s):
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 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 (46m 51s):
That was perfect. I wouldn't make any changes.