MAXIMIZE BUSINESS VALUE PODCAST - EPISODE 64 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 CEO of mastery partners, Tom Bronson.

Tom Bronson (35s):
Hi, this is Tom Bronson and welcome to the maximize business value podcast. A podcast for business owners who are passionate about building long-term sustainable value in their businesses. So today I want to talk about business valuations. I'm hearing a lot about that recently. And so I wanted to talk a little bit about that because identifying value is a central part of exit planning. One of the reasons that 83% of attempted exits fail is that business owners have unrealistic expectations of the true value of their business. Over the years, I've come to realize that this error is caused by a number of factors.

Tom Bronson (1m 17s):
So let's talk about some of them, by the way, this podcast is taken a right out of my book, maximize business value begin with the exit in mind, there's a link to get a copy right on our website. So let's start with unicorn evaluations. First and foremost, there is precious little data regarding transaction statistics, particularly as it relates to non-publicly traded privately held businesses. The real news is that people can find, or the only news that people can find on a regular basis is from large publicly traded

acquisitions or some disruptive technology company sale or investments made in unicorns.

Tom Bronson (2m 0s):
So a unicorn of course, is what the investment world calls a privately held company. Typically a startup that has a valuation north of a billion dollars. Now I don't want to get into my opinions regarding unicorns purely based on my definition above these unicorns are able to attract investors at their valuations. So it would appear that the valuation is valid. At least to the people writing those big checks. Those valuations are wildly inflated compared to other reasonable valuation methods. So therefore due to the public, the publicity surrounding them, people are left to draw their own conclusions about this valuation being the norm.

Tom Bronson (2m 49s):
Of course, if a company has some wildly disruptive technology or business model, think of companies like Airbnb or Uber or Tesla, no rules regarding valuations really apply again because of the massive press around these types of companies. The average person is driven to think that these valuations are the norm for all businesses, rather than the exception that they are. Secondly, let's explore The retirement requirement. One of my favorite Valuation methods is the, what I need to retire method. Now don't laugh. I did the first time I heard this requirement years ago, but it's really more common than you think several years ago, I was leading a massive roll-up in the retail technology space.

Tom Bronson (3m 40s):
My team was buying companies at a pretty healthy clip. We used a clearly defined proprietary valuation method that made it very easy for us to make an offer and cut right to the chase regarding whether the seller was serious or not. We typically wound up purchasing about one in 10 of these companies with which we talk or most companies we never got to an initial offer, but for those we did, it certainly led to some interesting conversations. One in particular stands out. It's one of my favorites. We were looking at a software company that that would have been a great tuck-in for us.

Tom Bronson (4m 24s):
These transactions are also called a bolt-on, which is an acquisition that adds value and can be rolled into an existing business. So tuck-ins, and bolt-ons are the same. It had about nine, $900,000 in revenue, and it had been losing money for several years now, based on our valuation model, we could get somewhere between 750,000 and a million dollars for an initial offer, not bad for a company that had been bleeding red ink for a long time. Now, when I tossed that offer to the owner, his response was that the company was worth about $4 million.

Tom Bronson (5m 5s):
So at this point I started probing about how he came up with that valuation, hoping he could S we could find some common ground and his response was classic. Well, that's what I need to retire on. On the inside. I was screaming Really that's your valuation method. But what I said was, well, most of them Buyers are not particularly altruistic in their evaluation methods, but if that's what you need, then if you'll give me another 30 minutes, I'll tell you how to get there. And if you follow my advice, you'll be worth much more in a year or two or three, and I'd be happy to pay that price, or even more.

Tom Bronson (5m 50s):
If you achieve the results, I've been proceeded To outline the changes that needed to be made in his business. And we hung up. We agreed that he would reach out in a year with a progress report. So what happened when he called, sorry, that's a trick question. Of course he didn't call. He was too busy living his lifestyle business to make the necessary improvements, to get the valuation that he wanted. Last, I heard his revenue had dwindled even further, and the company may have actually ultimately folded. It's a shame. Really. I was hoping that, that he would turn it around and sell it to me. So that's the retirement valuation method.

Tom Bronson (6m 32s):
Not many buyers are interested in that. So how about the X factor? I like to call it another fun and common valuation I hear on a regular basis is we've invested X dollars. So we need to at least get that to sell the business. Now, if you're a genuinely a unicorn with some disruptive technology, that requirement might be a valid, a valid evaluation

method. Then again, if you're, if you genuinely have a disruptive technology, you're probably not looking to sell the business for merely what you have invested. Several years ago, I had a conversation with a company looking to sell because their shareholders had had investment fatigue, a frequent outcome.

Tom Bronson (7m 19s):
When companies fail to achieve projected results and early investors wanted out in reviewing the financial performance. I learned that they had invested capital of nearly $10 million, but only had delivered a few hundred thousand dollars in annual revenue. The company had existed for a number of years, and the owners poured their investment into product development. Granted, the product was pretty slick, slick, but it was by no means disruptive. It was an also ran in a particularly crowded space. They had delivered the product, but soon after they started, but had a chance, but never had a chance really to be the leader.

Tom Bronson (8m 5s):
It took so long to develop the product that they, there were already too many entrenched products on the market and their relevant relevance was waning. Even before they'd launched the product and talking with the company, I told them the painfully obvious, it's just not worth what your investors have put into the business. So either they need to be willing to take a huge loss or make investments, or they can make investments to get the sales engine off the ground. They launched into what I lovingly called the shark tank conversation. You know, the one from the popular television show, a person comes in to pitch a startup and has a wildly inflated and unsubstantiated valuation.

Tom Bronson (8m 50s):
And Mr. Wonderful, Kevin O'Leary pounces. I love that part many times find myself laughing at his methods, but his message is actually spot on many times. So, so that is the X factor. One of my favorites is country club valuations. Finally, there's a phenomenon that I call country club valuations. This is the one that's really hard to overcome. It starts when your buddy at the clubs sells his business and buzz starts about how much he got for his business. I heard you got $10 million. I know my business is worth more than that.

Tom Bronson (9m 30s):
So I'm asking, so the price I'm asking is going to be at least $10 million. There's So much wrong with this valuation. I don't even know where To begin. What is your budget In the same business? What were his revenue and EBITDA compared to yours? Was his business in a hot market? How did his company's operation compared to yours? What about the preparedness of his business to sell versus your business? I could go on and on typically. And interestingly, there's probably no basis for the rumored $10 million sales price. Your buddy probably never actually told anyone what he got for his business, but when someone tossed out that $10 million figure, he just sheepishly grin, and the rest is history.

Tom Bronson (10m 19s):
I can tell you, I've got examples of that actually happening for businesses that I've acquired. The news spreads Like wildfire at the club and the fish tail gets bigger. Every time it's sort of like the telephone game we all played when we were kids. When you sit in a circle and the first person whispers something to the person on his right, who was present to the next person and so on, until it gets back to the original person, by that time, the message has changed so dramatically that it's usually unrecognizable. Don't be fooled by country club, valuations. They rarely are based. Right. Finally Talk about professional estimates.

Tom Bronson (11m 1s):
The best solution is to prepare your business or to prepare your business for sale is planning ahead, get a regular estimate of the value from a business professional, a valuation professional, who does that for a living really good investment bankers and business brokers will usually provide this estimate at a minimum cost or in some cases free of charge. They're going to take All of the right factors into consideration and compare it to the data that is not readily available on the open market. Now we here at mastery partners provide this analysis. As a matter of course of our business, we offer three different flavors.

Tom Bronson (11m 43s):

First, we offer an express valuation right on our website. You can go click it, give us a little bit of information. And we can tell you, you know, give you a sort of a thumbnail of, of what your business is worth. That's for free. Second, we have a more detailed estimate of enterprise value for a nominal cost. And finally, we offer a very detailed opinion of enterprise value as a part of our four step process to help business owners build long-term value and achieve a satisfying exit. Of course, if you need evaluation for a dispute, engaging a professional value or engaging a professional to get a valuation is the best way to get one that will hold up in court.

Tom Bronson (12m 26s):
But that typically comes at a hefty price for the typical purposes of planning, an estimate or an opinion of enterprise value is a great place to start with this estimate in hand, you can develop a long-term strategy for the future, and that's what we're all All about. 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 follow us wherever you found this podcast and be sure to comment. We love your comments and we respond to all of them. So until next time, I'm Tom Bronson reminding you to get a grip on the value of your business now, so you can maximize business value.

Announcer (13m 18s):
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 (13m 48s):
<inaudible> that was perfect. I wouldn't make any changes.