LIQUIDITY EVENT LESSONS
WITH LATTICE WEALTH MANAGEMENT

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[00:00:31.26] - Speaker 3

Welcome to Liquidity Event Lessons. I'm Mike Ross.

[00:00:37.02] - Speaker 2

I'm Ryan Ross.

[00:00:39.00] - Speaker 3

Liquidity Event Lessons is all about what you should be thinking about and doing both pre and post-sale of a business, certainly for the business, but really for yourself.

[00:00:53.08] - Speaker 2

This episode is all about selling your business and a little bit about buying a business. We're going to how and why private equity firms are going down market. We talk about what is considered a small business. We talk about things that affect the price of a business. We talk about the terms of a sale and also why very few businesses trade for all cash. We talk about the people the smart business sellers have in the room when selling their businesses. Maybe that's a financial advisor, CPA, business broker, etc. Enjoy this episode with Matt Cohen. Hi, Matt Cohen. Welcome to Liquidity Event Lessons. Just in case people listening don't know you or who you are, what you do, can you give us a quick 30 seconds about your background?

[00:01:39.18] - Speaker 1

Sure. Good morning. I'm a commercial business broker. I specialize in the sale of privately All the companies, all B2B, and most of our projects, our clients have between 2 and 15 million in sales.

[00:01:51.27] - Speaker 2

Okay. Is there a specific firm you're doing that at?

[00:01:56.06] - Speaker 1

Our firm is called Synesis Advisors.

[00:01:59.03] - Speaker 2

Okay. You're based in the East Bay, I think, right? Or do you have- We have an office in San Francisco and an office in Santa Monica. Okay. Well, really quickly, right out of the bat, I'm very curious about, is there a size of business that you guys usually work with?

[00:02:12.28] - Speaker 1

Yeah. Most of our clients have revenue between 2 and 15 million. The sweet spot these days is maybe 6 to 8. We do have some projects that are larger. I have a client now with 25 million in sales.

[00:02:27.01] - Speaker 2

I'm curious about just the general private equity market. Are there any specific trends that you've experienced over the last years, months that have been pronounced that you've witnessed just in terms of where the market's going?

[00:02:41.09] - Speaker 1

That's a great question. Our project sell to a mix of financial buyers who would be people like you or I who say, Oh, I don't like my job. I want to go buy a business. Competitors or corporate purchasers who might already be in the business and are looking to grow. And then private equity groups or search fund-backed private equity groups. And we're seeing a huge influx of private equity buyers coming downstream to our lower, lower middle market area. And they're not just looking at the kinds of businesses you would associate traditionally with private equity, like scalable tech businesses. They're buying brick and mortar stuff, blue collar stuff, plumbing, landscape contractors, janitorial. I I've never in 24 years of doing this, I've never seen anything like it.

[00:03:34.14] - Speaker 2

I see. You're saying that these PR firms are-PE. Yeah, see, the PE firms, they're not just looking to absorb the high tech stuff, the chip fabs. It's hard to do. But they're going for the service businesses that are operating on a local level, maybe. Is that right?

[00:03:55.18] - Speaker 1

Yeah, they're rolling up more traditional businesses, and a A lot of them are licensed businesses, which is what we're seeing. So contractor licensed type businesses. And the problem is, first of all, it's great. They're smart, they have money. The problem is that even a client who has a large business, say a $25 million business, they're making $3 million in EBITDA, business runs well. They don't necessarily have the financial controls and processes in place to satisfy these professional, well-trained buyers. Remember, a lot of these buyers have been to business school. They work in private equity, so they're looking at buying things, and they're used to information being presented to them in a certain way. And the clients that we represent, great businesses, smart people running their business. It's all working, but it's not up to snuff necessarily for that. So it makes sometimes the due diligence component real I see.

[00:05:01.22] - Speaker 2

Well, I just want to make a a clarification for myself. When we talk about small businesses, you mentioned 2 to 15 million. Is small considered by revenue, or is it by head count? Or how do they qualify as small?

[00:05:16.29] - Speaker 1

It depends who you're asking. For us, as a business broker, my projects are large relative to most business brokers. In fact, a lot of the projects that we deal with have the same nuances as mid-market projects, like working capital requirements, quality of earnings, due diligence, very thorough analysis needed to get them closed. But most business brokers are working on sub $1 million deals. Ours tend to be more complex and a little bit larger, but still not nearly approaching middle market. They're lower, lower middle market.

[00:05:54.01] - Speaker 3

Matt, I would imagine that most prices are a multiple of EBITDA But I'm wondering beyond that very black and white, well, maybe not always black and white number, what other factors caused prices to be well below the going rate or well above the growing rate? What's the variance around EBITDA in terms of different factors of a particular business?

[00:06:22.05] - Speaker 1

Yeah, another really great question, and one that we could spend two days on or two years on. First of all, in our world, It's not EBITDA that's used. It's seller's discretionary earnings. So we're making an adjustment and adding back all the compensation the owners take. And we're not making a market rate negative adjustment for a professional CEO, because we're assuming a single owner operator is going to replace that owner. Now, that's most of our projects. A $25 million project that's going to PE will be an

EBITDA deal. To answer your question, though, there's a lot of factors. There's quality of earnings. Who are the customers? Is it a recurring revenue model, or is it project driven? That drives a lot of the discrepancies between multiples. Customer concentration. Do they have more than 10 % in one or more customers? Because that creates inherent risk to the buyer that a customer could go away in the early stages after they purchase it, and then they're unable to make their debt service obligations. Those are probably the biggest factors. And I think the third biggest factor is second layer management. A lot of our projects, our clients are old school entrepreneurs, husband for one in wife or one guy, and they work a lot, and they don't trust themselves to manage people, and they don't trust people to take over sensitive components of the operation.

[00:07:58.04] - Speaker 1

It goes back to the PE comment earlier, they're running things in more of an old-school way. Without second-layer management and having someone retire three months after the deal closes, that affects risk and affects value.

[00:08:13.09] - Speaker 2

In terms of what they trade for, I know that I've heard of companies, you can just buy it with all cash, or maybe you have a loan or things like that. What are the terms that usually come up? Is one asset that you're trading for better than another asset?

[00:08:30.11] - Speaker 1

Everybody wants all cash, and hardly anybody gets it. All right. Okay? That's not the way it works. That's not to say it's not possible. So some subset of our deals are done with SPA 70 financing, which loans up to $5 million. And there's the ability to put financing on top of that through the same lender and rare in certain instances. But a lot of our deals have some seller note with a right of offset, right? The buyers are trying to mitigate their risk. So they're like, yeah, I'll pay you four and a half times your earnings, whether it's SD or EBITDA, it doesn't matter. But there are all these things, there are all these works on this deal that I don't know what's going to happen. I can only know it once I get in. So to mitigate my risk, I need some earnout, or a seller note with a rate of offset if certain things happen. So we see a fair amount of that. Sometimes we see some equity exchange, like if the buyer lets the seller have some stock in their entity. We see that from time to time as well.

[00:09:36.25] - Speaker 3

So drafting off of that answer, you've been doing this a long, long time beyond the cut and dried normal terms. My guess is you've seen some rather creative tangents in terms of term issues related to what you just mentioned in terms of keeping the buyer stock and like. Give us some interesting adventures you've been through in terms of creative terms.

[00:10:08.08] - Speaker 1

Well, the two I just mentioned, like an earnout or a seller note with offset, can have an infinite number of variations. Right.

[00:10:17.27] - Speaker 2

Is anybody offering a car? They're just like, Hey, I'll give you my Ferrari.

[00:10:24.23] - Speaker 1

I don't think I've seen that, but I've seen some... It's hard to even go down the different permutations of what we've seen. But the buyer is looking to mitigate their risk. And the best seller is the one that can put themselves in the buyer's shoes. They can say, okay. And I tell them all the time. I said, look, imagine if you were the buyer, and you were buying this business, and you know what you know, and you don't know what you don't know, and what you see is 20 % of your business is in this one customer, and that customer is your brother-in-law, and He's only been a customer for a year. How are they going to mitigate their risk there? And so when people listen to that and they really think about it, we can get deals done.

[00:11:10.14] - Speaker 3

So let's keep going along that narrative. At the end of the day, one is selling a business, but at the end of the day, especially with mom and pops or a guy selling a business, this needs to translate to a personal outcome. What best practices do you encourage sellers? Now, this is after the transaction, clearly, but what best practices do you encourage sellers to go through to make sure they get the best outcome on a personal level?

[00:11:42.27] - Speaker 1

I mean, it has to occur long before the transaction. They need to understand the likely deal scenario. So what's the deal going to look like, both from price perspective and terms perspective? If they're carrying 90 % of the deal on a long note, when they pay taxes, it's radically different than if they get all cash at close. Right. So I really like it when I have an opportunity to evaluate the seller's financial situation and operations, and help them understand what a deal is likely to look like. And I do this a lot. I do 10 of these, probably before I get a project that I think I can handle, or that I think I can be successful for the client. For many reasons. So I encourage them to take that information and meet with their tax advisor, so they can look at what the tax consequences are, and to meet with their financial adviser so they can understand from a personal perspective, what does it mean if I get all this money now for my retirement, for my other business opportunities I'm trying to get into? What does it mean if I delay some of these payments and I take them over time?

[00:12:53.05] - Speaker 1

How much will I save? So the sooner they do that, the earlier they do that, it can't be done after the deal. I always insist on meeting with their tax advisor. It's not really my place to meet with them and their financial advisor, but I need to make sure that the tax perspective has been relayed.

[00:13:14.17] - Speaker 2

I got a question about deals falling apart. I wrote a note down. People who... They work a lot, right? You got these people that that's their thing. This is all they do. They don't play golf, they don't have a boat. They work, right? They've been building the business for 20 years, and then they're like, All right, I'm ready to sell. And we're going to sell and it's going to be great. And then we're going to have some money. But then maybe they get cold feet because they're like, What do I do after I sell? How often does that happen? And how do you Try to minimize that from happening.

[00:13:47.23] - Speaker 1

Yeah. I mean, it doesn't happen very often because, first of all, I stress test the clients, right? I want to make sure they understand when they get into this project with us, it's a lot of work for them. It's a huge amount of work for them. And just getting the business packaged, gathering the information, learning enough about the business so that I can properly represent it is a huge amount of work for the seller. So that mitigates that risk somewhat. We do run into situations from time to time where they'll lock up with a buyer, especially if it's a non-industry buyer. And over time, they'll be like, this guy doesn't know anything about name an industry, right? And even if the person is really smart and engineering degree, master's degree from Stanford, and a million things can be right, he doesn't know anything about hammer and nails. So I have seen that. It's awful when it happens. We try to flush that out before they dance too long so that we don't waste everybody's time.

[00:14:52.04] - Speaker 3

Going back to the advisors, you meet with the tax advisor. Perhaps the person is smart enough to have you meet with their financial advisor. Are there circumstances when you walk away from those meetings and saying, This person isn't up to it. They got the wrong dude here, or something like that? And how do you manage that issue?

[00:15:15.13] - Speaker 1

Well, with the accountant, it's a little easier because a lot of accountants just do taxes, but they don't do tax planning. They don't really understand the ramifications of the different transaction scenarios. So that's a little easier. Financial advisors is really not my place. I don't know necessarily what's going on, and I can't look at their trust and their other investments. And so I generally don't get too deeply involved in that. But The one that really is a pet peeve is attorneys, because I need them in my deals, and the ones that are great are great. But the ones where people bring in, and they say, Oh, I'm going to bring in my attorney, and he's my golf buddy, and I find out he's a BK attorney or personal injury attorney. And not that they can't do a good job on the project, but typically, they're not thinking the way we need to think, which is, We're here to get the deal done. We're not here to nitpick on things that maybe don't matter. And so that's been a problem over the years from time to time. And I'm pretty straightforward about telling the client when they have the wrong attorney.

[00:16:28.01] - Speaker 2

Is there a case where an Is there any fees get out of control? Maybe they have the wrong one, or maybe the person they're using isn't well-versed, and maybe that might be the same person. But how do you make sure that those attorneys' fees are not excessive?

[00:16:44.04] - Speaker 1

Well, let's talk about accounting fees first. So in some deals, like the ones I was describing earlier, where a PE firm is trying to buy a mom and pop, and even if it's large, and they don't have a finance department, so they don't have a CFO, they don't have an accounting department. They're doing their accounting correct, but they don't have a finance department. So it all gets dumped off on their outsourced accounting firm. Those fees can get large fast. So that's one. With respect to legal fees, you got to start with the buyer. So I don't represent buyers in isolation. But if a buyer wants to make an offer on a business, and they want to come straight at it with a purchase agreement, custom purchase agreement, that could cost them a lot of money. And then the seller has to have it read. So there's a case for making LOIs, where you don't necessarily need to spend a lot of money or any money. There's also form agreements for smaller, more straightforward deals through the California Association of Business

Brokers, which are drafted by a committee of attorneys who do small business deals, and they work very well on many kinds of deals.

[00:17:59.05] - Speaker 1

Not to say they don't need addendums or different pieces of the language needs to be stricken, but that can save a ton of money. Can I make one more comment about attorneys?

[00:18:08.29] - Speaker 2

Sure.

[00:18:09.17] - Speaker 1

I have a lot of jokes, but I won't make any. Attorneys sometimes will come in and try to deal with things that the intermediaries deal with, which is the terms and price of the deal. And that can be really frustrating, and that can rack up fees. So when an attorney comes in and says, Why do you have a seller note? It's too long. And the guys agree to it. The parties have agreed to it. And those kinds of things are really problematic, and they can rack up fees unnecessarily. So that can be one way to mitigate the fees. Is to look, if you're in a deal, your attorney is there to protect you legally to make sure that the outcomes are done correctly. And if there's problems, there's mechanisms to handle them, but not necessarily to restructure the deal.

[00:19:04.07] - Speaker 3

I've heard that from other sources, too. So would it be fair to say that you primarily represent sellers, Matt? Correct. Or they're buyers, too. Sellers, right?

[00:19:14.20] - Speaker 1

Correct. Yeah. I mean, sometimes we end up double-ending deals, or we have situations where the buyer is very sophisticated, like the PEs or competitors, industry groups, and they don't have a specific representation. But we're a seller's firm.

[00:19:31.20] - Speaker 3

Are there scenarios where you get closer to a deal and you go to your seller and say, walk away from this one? It sounds good, walk away. It just doesn't look right to me.

[00:19:45.03] - Speaker 1

Well, I commented on stress testing sellers before we take on a project, and you can magnify that tenfold for how we stress test buyers. So let's say we have a deal that is a $5 million dollar gross and it throws off 800,000. That's a category that a lot of people, particularly in the Bay Area, could get into. For 20 % down, they could get an SBA loan and they could buy that business for three or four million dollars. So we get a lot of tire kickers. And when we market companies, we market them blindly. So people don't know the name of the company, or we withhold other information depending on the comfort level of the seller. They certainly don't know the name or the location. So how do we only share information with people that are qualified to get it? So just the NDA, that's important, but that's not the real issue. The real issue is to interview them, look at their financial situation, look at their work situation, make sure they understand what does it mean to take on an SBA loan? Your house is going to get leaned. Have you told your spouse?

[00:20:56.29] - Speaker 1

You have to get life insurance and pledge it to the bank because if you croke, the bank doesn't care. They're going to get paid. Have you told your spouse? So there's a lot of components of this that just go into interviewing and stress testing people before we even bring them into the mix.

[00:21:12.26] - Speaker 3

Along the same lines, in so many cases, it may be spouses, but it may be two business partners. And we all know that business partners don't necessarily see things the same way. How often you say two business partners when one is raring to go on a deal, and the other one not so much. And how do you mitigate that issue?

[00:21:36.11] - Speaker 1

Well, I'm assuming you're talking about sellers because that's what I know better. Really trying to get a sense of their motivation. I mean, I'm in the motivated seller business, right? That's my business. And if I make a market and I bring forth ready, willing, enabled buyers, my expectation is that That's going to tell the seller what the deal is worth over time. So we meet with both parties. Obviously, there's a lot of paperwork, including shareholders authorisation, documents that have to be executed. So Nothing gets done without everyone knowing. A lot of times, there'll be a proxy if there's passive shareholders, where one guy will be responsible for doing the deal, and they give them that power. But that's always a challenge. I mean, The more heads in the game, the more challenging it can become.

[00:22:35.10] - Speaker 3

What things do you typically see that when you're bringing it up, it didn't even dawn on the seller that that needed to be dealt with? What are those things that you know need to be dealt with, and half the time with the seller, it's a complete surprise?

[00:22:55.08] - Speaker 1

You mean what could they have done to get through It have their business structure so that due diligence will go smooth. Yeah.

[00:23:02.28] - Speaker 3

Let's take that approach. Yes.

[00:23:04.22] - Speaker 1

I mean, first of all, there's some excellent consultants that do that. And we both know some. And if I get a lead on a project and they say, Oh, I'm three years out, And I interview them and find that they're missing second management. They don't have Quickbooks. They have some antiquated proprietary system sitting on a hard drive in the back room. Those kinds of things can be remedied. They can bring If there's other financial controls or things that are not being properly documented, that's huge. We don't do it, but I can certainly uncover a lot of it and then point them in the right direction. And that can make a massive difference, not only on price in terms, but whether the business can even sell. I mean, I look at a lot of projects. Everybody thinks their baby is the prettiest, right? Their business can sell. But I look at a lot of projects, and and think, man, there might be one person on Earth that could buy this or would want to buy this, and I probably can't find them. So there has to be a reasonable chance that enough people would want to buy this before we can sell it.

[00:24:13.16] - Speaker 1

So we see that.

[00:24:14.29] - Speaker 3

What about Matt? I bump into this all the time, too, the do it yourself first. I don't need you. I'm just going to go find a buyer myself. What are they missing? It's just such a conversation and financially-intensive conversation. When you bump into those, what part of the picture are they missing when they say they can do it themselves?

[00:24:42.26] - Speaker 1

Sometimes they do, right? I mean, I don't know what goes on unless I see the project, but I do get a fair amount of folks that had tried or are still trying to sell it to a friendly competitor or a group of employees, or maybe they're put it on the market. And after a year or two, they come to us and say it's not working. It really depends. A lot of entrepreneurs, not so much in the space that we play in, but restaurants and retail, they're serial entrepreneurs. They know how these deals work, and they can do it after they've done a couple, three or four or five. They're good at it. They have a good attorney that does the liquor license and a good real estate person. They can do it. Our projects are almost all first-time, one-time sellers. Someone has a plumbing company, or they have a staffing agency, or an import company. They've had it for a long time. They don't know all the different nuances of it. So it can be really frustrating.

[00:25:44.21] - Speaker 2

We got two more questions, and then we'll let you go. So first question is, the general market, again, is it now a seller's market or a buyer's market? And what are the indications that lead to those That conclusion.

[00:26:02.05] - Speaker 1

I mean, I'll say it's always a seller's market because inventory is extremely scarce in the projects that we take on. It's always a seller's market. Now, Do interest rates and cost of capital affect the price? Yes. Do perceptions of the economy and what might happen in the future affect the price? Yes. But there's very, very few good businesses properly packaged, properly marketed, available for people to buy.

[00:26:36.29] - Speaker 2

Actually, a follow-up to that. How do you guys market the business for sale?

[00:26:41.19] - Speaker 1

It really depends on the project. It's a combination of networking with other intermediaries and accountants and financial planners like Mike, using online advertising, direct outreach. There's other online marketplaces which just go to private equity firms. There are some that go to specific industries. So we've got a multifaceted approach to accomplishing that.

[00:27:12.02] - Speaker 2

So just finding out who are those qualified buyers to- Just plan in traffic. Yeah.

[00:27:17.17] - Speaker 1

I mean, we put together a detailed marketing plan for each project, and we implement it and execute on it, and update the seller weekly, and let them know, Here's what we did this week. Here's what's going on. Here's the feedback. We're receiving this feedback, and this is maybe something we want to modify in the positioning or the price of the business in order to achieve the best outcome.

[00:27:40.23] - Speaker 2

Cool. Well, final question, how do people get a hold of you?

[00:27:44.03] - Speaker 1

I'm not that hard to find. Sintesis advisors, they can call me. You want me to give my phone number?

[00:27:51.08] - Speaker 2

We can put it in the links as well. You don't need to put that if you don't want to.

[00:27:56.00] - Speaker 1

I think the thing to plug is I'm always If it's interested in talking to people for any business of any kind, if it's not a project for me, I'll refer them to an appropriate person. If the project is too small or the project is too big, I've got people. And if it's the project that I know I can be successful, my offer is to help them understand what they've got, evaluate the financials, evaluate the operations, and give them an idea of what a deal is going to look like. Very different than evaluation, which is often just a number. We're going to talk about risk mitigation terms like we discussed earlier. And I do those. I don't charge anybody for it. It's an opportunity for the client, potential client, to get to know each other and really start to understand, can we work together for a year and get this done?

[00:28:44.16] - Speaker 2

This is Not even a question, really. But I imagine, do you ever go into the mall or a store and you're like, I wonder what the overhead is here? Costs like that. I feel like I'm in a credential commercial sometimes. I imagine you might be the same way. I don't know.

[00:28:57.10] - Speaker 1

Well, I don't do retail. And so I I don't necessarily do it like that. But if the plumber shows up at my house and they have this Mercedes Sprinter van for 100 grand, and then another guy shows up because this guy can't figure out, I'm like, I wonder how big they are. That's a deal that I could probably work on.

[00:29:18.05] - Speaker 2

He shows up to fit your aches back. Hey, are you looking to sell, by the way?

[00:29:22.17] - Speaker 1

I mean, sometimes I've asked.

[00:29:27.12] - Speaker 2

Cool. Well, Matt, we appreciate you coming and this has been a pleasure of a conversation, so hopefully we can do this again soon.

[00:29:34.29] - Speaker 1

I appreciate you guys. Thank you very much.

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