Rob Follows On…
Selling Your Business to a Strategic Buyer and Getting Up to 300% More Money For It

Steve Sanduski: I’m here today with Rob follows. Rob is the founder of STS Capital Partners, which is an international midrange mergers and acquisitions firm. Rob is also a very successful entrepreneur and earlier in his career, he started a company and sold that to a much larger company and then ended up becoming a leading executive with that firm. He also is actively involved in YPO and WPO and near and dear to my heart Rob is also an adventurer. He is one of a very small number of people who have climbed the Seven Summits and for those of you that may not be familiar with what that is, that means he has summited the highest mountain on each of the seven continents. Rob it's a real pleasure to have you here on the show today.

Rob Follows: Thank you very much Steve. It’s my pleasure to be here and I look very much forward to talking about M&A with you.

Steve Sanduski: In most of our episodes here on On Your Mark, Get Set, Grow, we’re talking about how entrepreneurs and CEOs can grow their companies, but what we want to talk about today is how can you sell your company and you’re certainly one of the foremost people out there in the world who can help entrepreneurs sell their companies.

I’ve got a number of things that I want to talk to you about today related to that, and the first place that I'd like to start is just how does an entrepreneur know when they're ready to sell their company, in that I would imagine, I know, that entrepreneurs view their companies like their children, and they're so attached to it. They put so much blood, sweat, and tears in the building the business that to let go of that company to sell it is a hugely emotional decision. From your standpoint, from your vantage point, how do you know when an entrepreneur is ready or how can an entrepreneur know when they're ready to actually sell their company?

Rob Follows: Thank you Steve. That's a great question. I think first of all I'd like to frame it in, we see two things in the marketplace. One a reactionary sales and the other proactive sales. Of course we'd like to suggest that every entrepreneur be proactive in thinking about when they might be ready to sell and when might be the best time to sell. Usually, the best time to sell is when the business is growing and has a long curve of growth ahead of it.

Being proactive around getting ready to sell usually I think comes from having great mentors or coaches in your life that you can be really objective and have deep on-the-business conversations so that about when the business will have a great management team, have good strong information system slowing, and therefore, be able to transfer to new share holders without much trouble, and that I think is a conversation for entrepreneurs and their coaches or their mentors.

On the other hand often we see sellers reacting to things happening in their lives which can be unfortunate and really are what financial investors look for, and those are often referred in the business as to the six or seven Ds and those include unfortunately death, disease, disability, disenchantment, divorce, too much debt on a company, etc. and that's not where you want to be when you come to the point of wanting to sell your business. You want to do it proactively, not reactively. You don't want to give buyers one of those Ds that they'll be focusing on so they understand that you're not in the strongest position to sell.

My highest recommendation for other entrepreneurs would be to sell proactively when they and their coaches feel they're at the top of their game.

Steve Sanduski: Okay. Rob if you're in a position where you can proactively sell the business is there some kind of checklist that you would say to an entrepreneur that, "Hey okay you are in a position of strength right now. The business is on a strong growth curve. You're open to selling the business. These are the two or three or five or 10 things that you need to get in order in your business before we can even think about approaching a potential strategic buyer with your company?"

Rob Follows: Sure. Another great question. Thank you Steve. First of all, all strategic buyers want to see a very strong management team. You want to be sure that you and your coach feel that you’ve got a great financial leader, a great sales, great IT, whatever all … may be it’s IT as well, all of the areas that are critical to your business need to have a very strong leader that could transfer in the sale of business to work for a new share holder. That’s absolutely critical as a baseline.

As information systems that are very strong and reliable are really important because when buyers come in they’ll be looking at your financial reporting systems and your other management information systems and they’ll be drilling down in different areas to make sure that they're solid as part of their due diligence and so you want to proactively plan to be very strong in those areas. That’s the baseline.

If you want to go a level up then once those are prepared you can start a process that we call preparing to sell to a strategic, and that will include once your management team is completely strongly and you can demonstrate to a buyer that you're not required in the business, that you can take time doing other things and focusing other things you actually take some time to approach two or three years may be even a year or two or three ahead of the time when you think you’ll be ready to sell.

You can actually talk to strategic investors not on the basis that you’re for sale but on the basis with an advisor that some day you might be, and if you were what kinds of things would be strategic to them and what will come out of that is a list of three or four more things that specific strategic investors several of them in your market might interested in and you can grow towards those.

Steve Sanduski: Okay. Rob. Let's talk about some definitions here. I’ve heard you talk about financial buyers, strategic buyers. Can you just give us a quick definition to make sure we're all on the same page on what a financial buyer is versus what a strategic buyer is?

Rob Follows: Absolutely. Financial buyers are basically middle men that buy companies with the clear objective of reselling them, so that they make a financial gain, and that’s why generally they are referred to as financial buyers, and if you ever are sitting at lunch in New York or Wall Street, or in Toronto on Bay Street or in the City of London or in Singapore Down Town what you’ll hear is these financial buyers talking about a 10 bagger. What a 10 bagger is a 1000% gain on the purchase price that they’ve made. That’s a very clear example of what a financial investor is looking to do. To buy low from a business owner, lower than the market value at the time and to find a strategic buyer and sell high to the strategic buyer.

Our message to the entrepreneur is you too can sell to strategics. Every financial buyer that makes an offer on a business has normally already identified not just roughly but very specifically who they're going to resell to. Strategic buyers are generally large corporates that are either in your industry internationally, in your industry in your own home country, or in an adjacency that's the businesses beside yours, another vertical beside yours where they can move as an expansion strategy either into your vertical, that or vertically integrate. May be one of the customers or suppliers in those verticals would be interested in integrating either up or down the value chain.

Those are different examples. I can give you many more later of why somebody be strategic but basically, a strategic buyer is somebody that will see and have a lot more value in owning in your business than you do as a share holder.

Steve Sanduski: Okay. We've got different types of potential buyers out there. Financial buyers, strategic buyers. You could do an IPO. There's business brokers. Are there any rules of thumb or can you give us some idea for when an entrepreneur would be looking at each of these different ones, may be based either, I don't know, on the size of their business or the industry that they are in. Are there any generalities or specifics that you can give us with the different types of potential buyers and what entrepreneurs should be looking for when each of those might make sense for them?

Rob Follows: I believe very strongly as I was somebody that went through selling my business Steve without a Mergers and Acquisitions boutique advisor or an I-banker, or broker, whatever you'd like to call them, without an advisor that was looking out for my interest, and there are several roles that are played in the process of selling. One of them is negotiating. Another one is being the really sexy guy that the buyer is interested in the business of. The process of selling your business effectively is having strategic buyers fall in love with your business. Who can help you achieve that? It's somebody that really is not conflicted so you want to be working with and investor bank or an M&A advisor who is telling you and you can check references on have actually and always do support the entrepreneur.

They're not working behind the scenes with a private equity or a venture capital or other financial buyers. They're actually really looking out for your interest, and the way you'll be able to measure that is if it's possible with the size of your business, they'll tell you that you can sell directly to strategic investors. You don't have to sell out to financial investors. That's the first thing that somebody you can see and you believe strongly that you can trust to represent your interest and not be conflicted with any other buyers' interest in their mind.

The reason that's such a big deal is as an entrepreneur you sell your business once, as an I-banker and private equity groups and other financial investors, they're doing many, many deals a year, and therefore, they're very, very keenly interested in long-term relationships with each other and that's where conflicts can come up that compromise entrepreneurs.

Steve Sanduski: When you're selling to a strategic, are there any guidelines on the size of your business before it becomes attractive to a strategic or is each situation different?

Rob Follows: Each situation is different. Generally, though at 50 million and up, you'll catch the interest of strategic buyers if you have a solid management team and by then you usually do. 50 million in revenue that is, and you've solid information systems, and you've got a high growth curve in front that you can show the strategic how you're planning to grow. The exception to that is technology. If you have very strong technology, you can in fact sell for $50 million to $100 million potentially without that much in revenue.

If you have a recurring revenue business that's leveraged by technology, that could be popped on to a strategic distribution platform and go global immediately, we can negotiate a high percentage of that revenue and that value for the sellers. If technology is involved and if there is a solid repeatable that is to say scaleable technology and business model, then it can be an organization with less revenue than $50 million could actually produce more than 50 million in the sale price.

Steve Sanduski: Okay. It sounds like selling to a strategic will most times give you the highest price. Correct?

Rob Follows: Yes. Up to 200% or 300% sometimes of what a financial buyer will pay.

Steve Sanduski: Okay. Then how do you as an I-banker, as mergers and acquisitions company how do you get the highest value for an entrepreneur when you're trying to sell to a strategic?

Rob Follows: Yes. Thank you for asking. That's a great question. The process is one of first of all coming to deep understanding and clear understanding what the stake holder's outputs are. What is it you as an entrepreneur, you want to be clear on this, one is required outcomes versus preferred outcomes. The line between those is where the negotiations will stop. If somebody doesn't have all your required outcomes as strategic and that's not going to produce a huge amount of income for them as the strategic then we won't be moving down a process with them.

First of all, understanding the outcomes that you want, and then secondly understanding the critical enablers of the business. What is it that makes this business strategic to a buyer potentially? Then, thirdly going out to see several dozen strategic buyers in all different countries of the world in different verticals and interfacing with them on what makes it strategic for them. What comes out of that is an indicative value. These are corporate managers. If you can convince them that this is a great way for them to spend their capital and their time, they will give you an indicative value and from that emerges a soft auction and you run a soft auction between several strategics where you'll end up with the highest possible price coming out of that process.

Steve Sanduski: I would imagine this is probably on a case-by-case basis as well, but when the entrepreneur sells the company to a strategic, does the entrepreneur typically stay on for an extended period of time or do they sign a contract for may be a year for transition and then they are out or how does that typically work?

Rob Follows: That totally depends, but what I would say is the number one driver of that is what the entrepreneur wants. If the entrepreneur wants to stay for a year with the company, if they're comfortable with it, it shares their values and honors their vision, then great. If they want us to we can negotiate that because that will reduce the risk from the buyer's perspective and increase the price. If the seller wants to stay on the entrepreneur for may be another three to five years potentially as I did in my case when I sold my firm and ends up becoming an executive leading a global company as an example because that's something they really want to do where they end up enjoying then we can negotiate for that as well.

I think the starting point is what does the entrepreneur really want. If the entrepreneur has never had a boss and wants out soon after the transaction closes, you just have to give that buyer assurance you're not running from a skeleton in the closet as it were, but that they are actually very entrepreneurial and not corporate and want to get on with the next chapter of their life. As long as the management team is solid and the balance of the team is solid, then we will have the opportunity to negotiate that.

Steve Sanduski: You've done hundreds of deals in your career. What are some of the biggest mistakes that you've seen as entrepreneurs have sold their businesses?

Rob Follows: Biggest mistakes. Entrepreneurs go to the market with, sometimes entrepreneurs go to the market without doing some background question and research on what the value of their business could be. They have really inflated views of the value. They might see their business as a software business and say Rob "I think this business is worth a $160 million may be 230 million." I'm thinking of a dinner I had last week. We do the initial research and realize that it's not really seen by the market as a software business, and so that's a real concern.

I think that over valuing the business is a mistake some entrepreneurs make, and others make the mistake of undervaluing the business and believing financial investors and they say "its only worth three to four times EBITDA" really you don't know what your business is worth until you get out in the marketplace. Either setting the expectation too low or too high I think is a mistake. I think you want to strengthen your business, make it as attractive as possible so that several strategics will fall in love with it and then as the offers come in from the marketplace, you get a sense of the range of the value and hopefully that meets the … I think your I-banker will have done a great job if that meets your goals that you've set.

Steve Sanduski: Okay. I think earlier you were talking about and here you're just talking about making your business as attractive as possible to a potential strategic buyer. I think, earlier you mentioned the importance of having a strong management team and having good technology that's scaleable. Anything else that entrepreneurs could do to make their business attractive to a strategic buyer?

Rob Follows: They want to understand and you always want to understand what is it objectively? If you come out of the in-the-business role that you're in perhaps acting as CEO in the business and move on the business looking at your business from a strategics point of view, what is it in your business that really is, really leverageable for a different share holder? When you start to think that way, and then start to understand what it is that can be of value and every business is different and you focus on building and strengthening those critical enablers, you will strengthen the value of your business.

It's different in each case Steve, and that's really why having a skilled I-banker to take you to the strategics even if it's year or two ahead and real committed ones will do that for you, and understanding back from the strategics what it is they're looking for not saying it's a sale but saying you're interested in understanding what is strategic to them, will be instructive. You'll learn a lot.

Steve Sanduski: When you do have a strategic buyer interested and you actually consummate the sale, again I imagine every case is different, but are there any generalities that you can make in terms of how the entrepreneur is paid for their business? Is it some mix of upfront cash, stock, performance post sale, incentives, any thoughts on what an entrepreneur might expect in terms of the cash that they get when they sell their company?

Rob Follows: I have an old chart that I teach fellow YPOs on this one when we have a seminar on M&A and that slide is on the risk or profile of the money paid upfront versus money paid out over time. You can get everything upfront, but it'll be a lower number. Just put yourself in the buyer's position. You're taking all the risk if you pay everything upfront. If you get what you want, what your required outcome was upfront. Let's say you said, "I think my business is worth $30 million. If got $60 million, I'd be thrilled."

Well then may be the objective we set is to get 60 million upfront and if we get another 40 million over time, and we've got the buyer viewing this as a $100 million transaction, then you're winning on both fronts. You're getting upfront what you really felt you needed just in case things don't work out afterwards but the upside is at a reduced risk for the buyer such that they'll be willing to offer more. Again, if you take all your money upfront, the buyer is being put at risk for everything so the number will be lower than if you take some upfront and some over time but if you are going to take it over time, you need to very, very strongly negotiate at the table because it can be bottom-line oriented if you're not controlling it, has to be top line and it has to be within what your stand of control will be worded on.

Steve Sanduski: Rob, let's say that I have a business that has 100 million in revenue and I think I'm ready to sell my company and I come to you and I say, "Rob, I've got this company and it's a 100 million in revenue and I'm ready to sell." What would be step one, two, three, four, five, however many, just again at high level generality? What's the process that would then happen between you and this entrepreneur?

Rob Follows: Oh sure! Well thank you. First of all I'd be honored to talk with anyone that's interested in preparing to sell or just sell their firm now and we would start off with a meeting or a conference call whatever the preference is on understanding what it is that you've looked at in the past, have you been to market before, what are the outcomes you're looking for, how's the strength in your management team, what a due diligence process looked like, do you have … is there any conflicts between the share holders. I want to understand completely from you as a potential client what your business is made of, what it looks like, how it will present. That's critically important for us to have a sense as to whether the process will bear the fruit that you're looking for.

We'll spend time with you on that. We'll talk about who you view as strategic investors. We create a list of potential strategics that we would see from all the work that we have, all our databases and all the work that we would have from our advisors to contribute to the process in your industry and verticals beside it. We'd ask you to do the same and then we put together a draft work plan and before anything was signed, we'd spend some time together, brainstorming, getting a feel for each other and making sure you're comfortable with us and we're comfortable with the business.

Then if all of that blends along the lines that the entrepreneur was looking for, that you were looking for, we would then enter into an agreement. We'd assign a team. We put a team together, assign a team, a deal team to the deal and start to work with you the entrepreneur on putting together all of the information that's required and thinking about who would be strategic. Out of that comes a teaser which is a no name one pager that gets sent to strategics either with you engaged with us on the phone with them or in meetings with them or not. We decide how confidential it's going to be. Usually we keep it completely confidential, both from your employees and from your competitors, so there's no damage possibly done in the process.

We want to avoid that at all cost. Keep it completely confidential and then when the book which is the confidential information memorandum is ready, in whatever form that takes and the teaser is ready, list is ready, and we feel like we've got the primary due diligence material signed up then we have to go to market meeting and we launch depending what time of the year it is usually September, January are good times to launch the process reaching out to the market.

Steve Sanduski: Again I know this is going to vary from deal to deal but from the time that I reach out to you as an entrepreneur and say "Hey I want out sell my company" to the day that I get the wire transfer and my bank account gets hugely inflated on average roughly how long a process are we looking at for that to happen?

Rob Follows: It does vary because some processes get stalled by regulatory or other issues, but four months to eighteen months, I would say so six to eighteen months, and the real critical variance there is how prepared clients are to spend the time on getting the information together that's required to present the company well and to get through successfully through due diligence.

Steve Sanduski: I know you mentioned earlier about having your, if I’m the entrepreneur, having any advisors that the entrepreneur already has, involved in the deal. I know you’ve been working with Mark Moses, CEO of CEO Coaching International. How has Mark and his team fit in some of the deals that you’ve done?

Rob Follows: Oh! Fantastically. I think it’s a symbiotic relationship. I think that entrepreneurs all need to have coaches because it helps them be objective. It helps them stay at least for a disciplined percentage of time in the year on the business thinking strategically about what the business is, how it supports their lives and where it fits. Naturally in that process at some point in time over the course of one’s lifetime, our recommendation would be that you decide to at some point in time sell and the reason for that is only 3% of businesses make it to the third generation.

Without getting into all of that, Tom Deans writes a great book on every family’s business where he says that he approached his father to say “Hey! Dad I didn’t really want the business. I’m sorry, but I really want to be an entrepreneur with you and invest the capital. Could we sell it?” and Dad said back “Oh! I never thought you could run it that well anyway so yes why don’t we sell it and go into business together in new businesses,” and so our view is that coaches could help entrepreneurs choose the time that meets their own personal objectives to decide to sell, to plan for that, to build the management team for that, to build their plans up for that, to understand what their critical enablers are. All of that coaching really prepares an entrepreneur fabulously well to do really well in a sale to a strategic.

Steve Sanduski: Well that’s great Rob, and as we wrap up the call here, is there anything that you’d like to add that I haven’t asked you?

Rob Follows: No. I just want to say thank you and we look forward to working with entrepreneurs.

Steve Sanduski: Great. Thanks Rob. I appreciate it, and what would be the best way for people to reach out to you if they'd like to contact you?

Rob Follows: I'm easy to reach rob@stscapital.com. It's R-O-B for Rob at STS capital.com. STS stands for Success to Significance or Selling to Strategics. Hopefully, that's memorable.

Steve Sanduski: I think it is. Rob, this has been great. I really appreciate your time and thank you.

Rob Follows: Thank you very much Steve.

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