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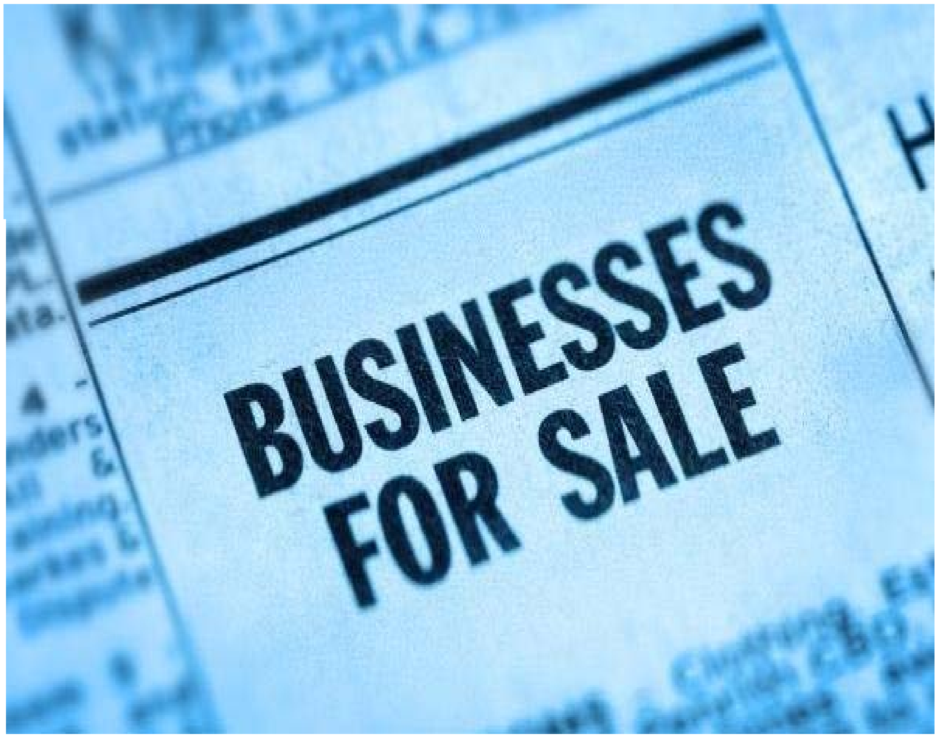
STRATEGY

Lesson #246: Buying a Business is Hard Work!!

POSTED BY: GEORGE DEEB - 9/30/2016



you may know, Red Rocket has been on the hunt for a business to y. We are specifically looking for digital technology companies with at least $500,000 of profit, where we can apply our sales and marketing expertise to help grow those businesses. We have looked at over 50 businesses in the last few months, but have yet to get to the finish line. I wanted to share some learnings with all of you, in case you are ever on the hunt to buy a company. As you will read: buying a business is really hard!!

LOTS OF HUNTING REQUIRED

You need to explore multiple channels in terms of knowing where to look. Leveraging your network, reaching out to investment bankers or business brokers in your space and even searching online, on sites like BizBuySell, BizQuest and BusinessesForSale.com, are all fair game. And, it is a fluid market, so new stuff comes up all the time, so you need to constantly be working these channels in high frequency, to make sure you don't miss anything important and be able to move quickly.

CUTTING THROUGH THE CLUTTER

Firstly, there is the process of narrowing down the targets that are most interesting to you. Even if you are narrowly focused, on something like e-commerce businesses, as an example. There are so many different types of products being sold across a wide range of revenue size, and needing to narrow them down to the ones which are most interesting for your needs. And, secondly, how a company markets itself for sale, does not always match up to the reality of the situations once you start due diligence. For example, they said they have $1MM of profit with the way they had been running the business (on a shoestring budget), but fully loading expenses on a going forward basis, maybe it only has $500K of profit, which materially changes the ory.

JE DILIGENCE SHORTFALLINGS

addition to the financial due diligence shortfalling described above, ere is often times operating issues that get uncovered during due igence, as well. As an example, you think you may be buying a rong e-commerce business with a lot of direct traffic to their own ebsite, but often times they are simply Amazon dependent sellers at look to Amazon for marketing to customers and fulfilling orders. nat creates problems like, Amazon owning the customer list, not the isiness, and risks Amazon disintermediating this product seller with nilar product or squeezing them on margins long term, putting the ture financial health of the business at risk, entirely dependent on nazon.

TS OF COMPETITION

There is a lot of money on the "sidelines", looking to be invested into interesting businesses. And, the more attractive the business, or more profitable the company, the exponentially more investors looking at the same business. Which means you need to be prepared to move quickly (with capital lined up) and potentially pay premium prices to outshine the other offers, or risk losing the deal.

INSANE VALUATIONS

Many companies just don't have a reasonable expectation to what their business is really worth, with them proposing very high asking prices. For example, if they are in the venture world, they drink the Kool Aid of "unicorn-level" valuations multiples (e.g., 10x revenues). When the reality is, without them venture funded and growing a lot slower, they are typically valued at more reasonable 3-4x cash flow multiples. So, finding a seller with reasonable valuation expectations is not always easy.

MULTIPLE PARTIES TO PLEASE

There are typically three parties involved in any transaction: the seller, the buyer and the financing source. If you can finance the transaction yourself with your own cash or equity, that is preferred, given one less party to make happy. But, if outside private equity investors are required, it materially complicates things. Because not only do you need to like the business, but the investors need to like the business too. If any one of the "three legs to the stool" is wobbly, the whole deal can fall apart.

LOTS OF HOURS INVESTED GOING NOWHERE

ısed on all the issues above, you often need to invest many hours of ɔrk into any single project before realizing it will never get to the ıish line. This is not a really efficient use of time, but the process is ıat it is, and you really don't have a choice, unless you outsource the ːal searching, due diligence process and fund raising process to hers. So, be prepared to be frustrated and spin your wheels.

ɔpefully, this gives you a good expectation of what to expect when ırting to hunt for businesses to buy. But, if you are persistent and ıtient, all it takes is one deal to get to the finish line!!

ː sure to read these companion articles on Things to Consider for &A, Setting M&A Goals and Potential Pitfalls with M&A.

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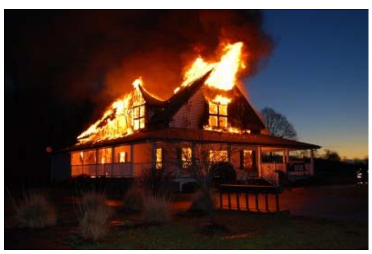

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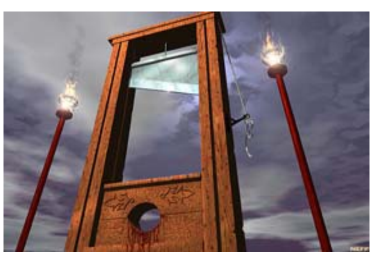

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comments:

Greg Chapman said...

After having been involved in the world of business acquisitions for more than a decade, I couldn't agree more. The section regarding due diligence was particularly helpful. I found myself failing to attend to this variable when I was a novice. This list is great because it summarises all the important purchasing points to take into account.

October 17, 2016 at 9:53 PM

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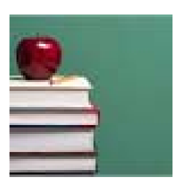

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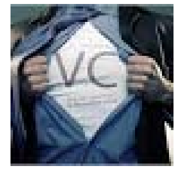

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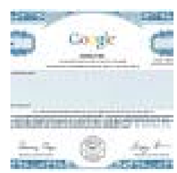

Lesson #139: How to Calculate Equity Split Between Founders in Startups

The other day, I got asked a question about how best to divide

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ABOUT

Red Rocket is your "one-stop shop" for growth: we help B2C and B2B companies with their growth strategy, execution team and financing needs. We are particularly deep in the digital technology space, but have done work across industries. We have consulted or mentored over 750 companies, to date.This blog serves as a small business executive's strategic "playbook", with actionable "how-to" lessons on a wide range of topics, including business, strategy, sales, marketing, technology, operations, human resources, finance, fund raising and more. Click the "Lessons 1-202" tab for the full list, or search by topic using the "Categories" tab.

Learn more in our explainer video.

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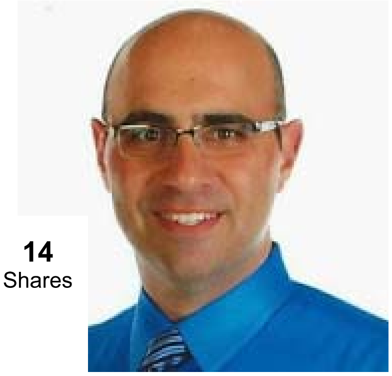

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