Episode 21 - Brandon Jacob - Your Exit Strategy [00:24:41]

Intro: Welcome to Profiles In Prosperity with your host David Heimer.

David Heimer: Hi, this is David Heimer, welcome to Profiles In Prosperity. I am delighted to have Brandon Jacob join us today. Brandon is a CPA, but more importantly, Brandon is the owner-operator of Contractor's Financial Opportunity, which is a financial consulting firm, which guides owners of contracting businesses with business valuations and exit strategies. Brandon has an amazing amount of experience, 20 years helping people sell and buy their heating and air conditioning and plumbing businesses. He's done valuations, exit strategies, divestitures of branches, due diligence, acquisition, candidate prospecting, transaction negotiations. Brandon's done it all. I know no one else in our industry with Brandon's width and depth of experience in acquisitions and exit strategies. Brandon has written many articles for our industry and he is the author of two books. The first book is "For What it's Worth", which is a practical guide for understanding how to determine the value of your HVAC or plumbing business. His second book is "Operation Exit Strategy", which explains how to develop and implement an exit strategy. These books are both great. I recommend them all the time. If you get a chance, you should read them. So Brandon, Jacob, welcome to Profiles In Prosperity.

Brandon Jacob: David, thank you for having me. It's good to be here.

David Heimer: So I'd like to start off with a brief story that was told to me by one of our Service Roundtable members. This happened at a meeting we were having in Detroit. He's an HVAC contractor there, and one day he got a call from another contractor in the same city. And the contractor that was calling said that he was shutting down his business. He'd been in business for 30 years and what he wanted was our member to come over and look at the equipment and see if he wanted to buy anything from the business. So the guy I know, went over to look over all the equipment stuff. The contractor had some tools. He wanted to keep this truck and he wanted to sell his customer lists. Our member bought it all for $1,200, not including the truck. And here's what he said to me, "that guy had been in business for 30 years at the end of it all, all he had to show for all that work, all those years of hard work, where some tools, an old truck and a customer list. His business was only worth 1200 bucks, plus his truck. It terrified me because I was afraid I was on the same path and I didn't want that to happen to me." So tragically, Brandon, that's not an uncommon story. I'm sure you have seen it a lot. And that's why I think it's so important that contractors read your books and plan an exit strategy before it's too late.

Brandon Jacob: The word tragic is a great word for that, right? Because I definitely have seen that. You know, David, part of what I do is help contractors do these types of acquisitions and what I find the Detroit example's, an extreme example, but I find a lot of time, these guys are selling their business and they put absolutely no planning into it, nothing at all. A lifetime of work and today I'm going to sell my business, no thought, no professional help, no nothing. But on the flip side of it, as you know, I've been part of some transactions where the seller has put in a little planning or in some cases, a lot of planning and they sold their businesses for multi-millions of dollars. We're in an industry where {cross talking 03:36}.

David Heimer: Where you are able to retire comfortably.

Brandon Jacob: Very, very comfortably. So I think sometimes we talk about the tragic side of it, but it's also important to point out that there's a very favorable side of it as well, if there's planning.

David Heimer: Exactly, in your first book, you discuss business valuations and how an HVAC or plumbing company might be valued. Why are business valuations important?

Brandon Jacob: From the standpoint of an exit strategy, and in this case, let's define an exit strategy. That's the plan to sell your business. And then I'll also talk about the valuation when you're going through the actual process of selling. Evaluation is important in the planning phase because it gives that business owner an unbiased and accurate valuation based on facts. And a lot of times a business owner, who's going to receive a valuation from someone like myself and say, oh, maybe I thought my business was worth more. And you know, it gives them the ability to say here's my site and here's how far I am from that site. Number two, evaluation from somebody like myself, not all valuations are done to do this, but from a consultant standpoint, evaluation can provide the business owner with the reasons why, you know, why is my business that I thought was worth a million dollars? Why is it only worth $750,000? Okay, Mr. Business owner here are the three reasons why here's the four reasons, whatever.There could be many reasons.

From a selling - now we're talking about the actual selling. I'm selling my business now, you know, if I'm going to sell my house, I'm going to sell a car, a vehicle, or a boat. Typically we are going to do an appraisal, right? We have some kind of knowledge of what's the value of this thing we're selling and to kind of venture off into the sale of a business without having again, an unbiased and valuation based on the facts. There's no way you could effectively sell that business. And I have seen it David, where the seller had a great proposed transaction on the table from a buyer. I mean, it was a do it, and do it today kind of situation. But fantasy land was, I want more money; business didn't dictate more money. They had a great deal. And you know what, I'm talking about a tragedy, what a tragedy to miss out on a great deal because you're uninformed.

David Heimer: So I know this could be a really long list, but when you're talking about the value of an HVAC or plumbing business, what ends up driving that value? And maybe you could just give us the top three or so.

Brandon Jacob: Okay. I mean, as you pointed out, there are certainly many facets that go into a business valuation, but let's start on number one, because number one outpaces everything else, right? It's just that important, and that's earnings, right? The ability for the business to demonstrate consistent positive earnings and it's important to clarify. We're not talking now about contracting businesses and this is how it works in our industry. This is how it works, it's how publicly traded businesses are valued is how a private equity company would value any type of business, regardless of the industry. Earnings, number one thing that drives evaluation. Number two is going to cover off on several sub facets if you will. It's that ability for the business to demonstrate and prove that those earnings are going to continue. Okay, you know, hey, we're demonstrating these earnings and these earnings are going to continue subsequent to the sale of the business and under that is the work mix. Is my work mix going to be recurring? customer concentration.

Customer concentration, let's say that I'm a contractor and I do some commercial work, 35% of my business is associated with one customer, okay. Service agreements fall under that, right. Buyers look at service agreements as a business's ability to continue to service customer's management. That's more for larger businesses because let's face it, you know, Service Roundtable, you do have some business owners that aren't big enough to have management. So when I say management and continuation of management, we're speaking more to larger businesses and the momentum of the business, right? Hey, I got great earnings this year, but they're half of what they were a year ago. That's going to be a concern as well. And then number three is, and this is just a function of map, is revenue, right? Earnings are number one, well naturally, or we hope the higher my revenues, the bigger my businesses in terms of volume, the bigger; the number of earnings I'm going to produce on a yearly basis. So that pretty much covers off on the top three evaluation areas of importance.

David Heimer: So earnings, the ability to show that those earnings are going to continue into the future and then revenue, I get it.

Brandon Jacob: Absolutely. Yep.

David Heimer: And on the earnings typically, what period of time do people look at your earnings for? I mean, as you said, it's not, you know, the fact that you got great earnings this year, that's probably not enough information, right?

Brandon Jacob: No, and that's a great question actually, and it's asked a lot because there's maybe some confusion that ancient history is 10 years, that's not relevant either.

When I do evaluation, I like to look at the last three years. But I like to put a greater emphasis in my calculations on the most recent year, because at the end of the day, and we may come back to this in the latter part of the conversation at the end of the day, that most recent year is the most important, but we can't often sell our business based on the results of just the most recent 12 months.

David Heimer: Sure, makes sense. In your second book Operations Exit Strategy, you explain how you create and execute an exit strategy. Is it true that most people don't start their businesses with an exit in mind, that is they don't start the business with a goal of say, selling the business in 10 years or something like that?

Brandon Jacob: Oh, definitely. I would say 90% or maybe, even more, start their business without a plan to one day sell, or I guess it falls underneath a build to sell kind of plan, maybe even 95%. But that is irrelevant because you may be 15 years into your business and listen to this podcast and say, hey, I am going to sell one day. It's not too late to start an exit strategy. And I use the analogy, right? Foresters will say the best time to plant a tree is 25 years ago and the second-best time is today. Right? So if you haven't done anything now's the time to say, okay, let me dedicate a little bit of time into starting to plan the exit of my business.

David Heimer: So assuming that a company hasn't been designed to sell, are there any rules of thumb for how long it would take them to get ready to sell?

Brandon Jacob: There's no one general rule, if you will because the challenge is, many of these businesses, each one of them is its own unique situation. If I'm a business owner and I'm producing $5 million dollars a year in annual sales, and my goal is to build it to a $20 million dollar business and then sell well, naturally it's probably going to take me a few more years than somebody who says, you know what, in 2018, I want to sell, or let's take another extreme example. If I'm ready to sell and I look back in the last couple of years, my earnings have been going down, my business is going down. That's a different situation. As I pointed out earlier, though, the most recent 12 months is the most critical period for a buyer to analyze. So if we were going to call anything a general rule, I would say at least 12 months to prepare your business so you can produce 12 months of good earnings. I think that would be the least amount of time. And then David is important you didn't ask this question, but I'll bring this up. Selling a business is not something that happens overnight, right? It could be 6 to 12 months, even if I'm prepared to go into a transaction.

David Heimer: Would you say that that's the average in our industry? Is that a six to 12-month exercise?

Brandon Jacob: I would say so. Yes, absolutely.

David Heimer: Okay, that is great information. Let's say I'm your average plumbing or HVAC contractor. I've listened to this podcast and I decide, I need a plan to exit. I'm doing, let's say about $2.5 million in sales. I'm 10% profitable and I'd like to retire in five years. What would you do for me?

Brandon Jacob: David? The very first thing, and it's always the first piece to any engagement would be a valuation. Because nothing really starts until we know where the contractor sits in terms of here's my business today. And as I pointed out earlier in that process, in one of my evaluations, we're going to highlight those areas that could be improved in order to improve, not only the value of the business but also the salability of that business as well. Right? Because it's really two different things. Hey, here's the value on paper, but there's a lot of things contractors could do. From there, if somebody wanted to take a plan seriously and didn't want to invest a ton of time into it because let's face it, a business owner at two and a half million dollar a year contract in business, he's busy, right? It could be as simple as an updated valuation once a year, where I come into their facility and sit and get this plan on the top of their mind. Right. And some of it is mental as well. Some of it is discussing all those questions that a first-time business seller might have, but it starts with evaluation.

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David Heimer: So you do the valuation and I'm guessing then at that point, you're going to be looking for opportunities for him. You're going to tell him what the holes are. On the books, you're carrying a whole lot of inventory, but you know, I went and I looked around in the back and your inventory looks really old. I saw some stuff, it looks like it was stored there about 20 years ago. Have you done a physical inventory? Is that the kind of thing that you'll be talking to them about?

Brandon Jacob: Absolutely. We're going to talk about the condition, the accuracy of the financial statements. And that's a great example, right? How many contractors, you know, a lot of them, we might not do an inventory every year and we might carry the same inventory balance on our balance sheet for 20 years. And it was $50,000 and out in the warehouse, you're right, just $5,000 worth of inventory. That is not something you want to put in front of a buyer because now you've just given them a nice juicy nugget to negotiate when they come into your building and say, you only have $5,000 worth of inventory and your balance sheet says 50. Another example would be vehicles, right? I mean, how many times do we step into a contractor's business and you know, yeah. I have a fleet of 15 vehicles and three of them are on - I love to use this example. Three of them are on cinder blocks as spares. Well, there was a point where those things start to become negative. Negative in the eyes of a buyer and the list goes on and on.

David Heimer: Sure, so what about that scenario? I mean, to me that sounds like a pretty attractive scenario. I would think if I were you and I was contacted by somebody with 2.5 million in sales, 10% profitable, like to retire in five years. I'm thinking that you would be looking at that and thinking to yourself, yeah, that's a pretty good scenario. I mean, sure there's bound to be some things he should do to improve the salability of his business. But five years from now that gives us time to work on this stuff. Is that true?

Brandon Jacob: Absolutely. I mean, ultimately it would be five to three years. But let me be clear because I don't want any listener to think, "oh, I'm going in nine months because I'm retiring."

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David Heimer: Yeah. Well, he should call a meeting.

Brandon Jacob: There is still enough time to call me and say, hey, I want to arm myself. It's not optimal, but there's still enough time to at least go in understanding the value and understanding how to present the business. And it's not calling your competitor in Detroit and saying, come on down and let me - you mentioned earlier in this podcast, he received $1,200 and you did say that was the value of his business. I could assure you that was not the value of his business. It might have not been probably wasn't a hundred thousand dollars either, but you get my point. He could have made more money.

David Heimer: Yeah, sure. He wasn't prepared and he really hadn't done much thinking about it. And if he had done much thinking he did the wrong kind of thinking. Yeah.

Brandon Jacob: And that's just it because so many people are not, I live it, I see it. So many people are not going to prepare and they get slaughtered. It's a bad slaughtering too, it's shameful. But there's nothing to be shameful about. If someone's listening right now to this podcast and says, hey, I'd like to give it a little bit of thought. I began doing valuations and the M and A side, Mergers Acquisition side. And my plan was to have as many people as possible with these grandiose five-year, dot every I and cross every T plan. And I've seen people do that, but that's a minority. And if you can't do that, if you're not dedicated to that again, it's not optimal, but you still could sell your business and you can still sell your business for a lot of money, as long as you put some planning into it. And just, if you don't mind, I'm going to throw a little plug. This is something that most people will do one time, right. Planning and selling their business, and it's not something to go alone on.

David Heimer: It can be the most financially significant event in their lives. Right.

Brandon Jacob: That is correct. And just a little bit of time and a little bit of, hey, I've been through this so many times I could shed some light on some things, pays huge dividends.

David Heimer: Yep, hey I had one other question along this line. So there are some companies that do an evaluation every year. I mean, presumably the first time they do it, it's quite a bit of effort, but the second time it shouldn't be that much of an effort. One, is that something that you recommend? And two, if people do that, what is the advantage to them in doing that?

Brandon Jacob: Well, those are great questions and absolutely point being 100% accurate. The update every year is not nearly as significant, as long as the business hasn't changed significantly. And typically in a year's time, a business doesn't change that much. So it's really refreshing, the most recent financial results. I have people who do it and I certainly do recommend it. And there's two reasons why someone would want to do it. One I'll use the word force. I don't know if that's the best word, but that's the only thing I'm going to do as a business owner. It forces me to sit down and say, oh, I have to get my evaluation updated. I'm going to think about my exit strategy just for that much time this year. And that could be just enough to start addressing some of those challenges to improve the value, improve the salability of the business.

Number two David, a little amazing one is here I go. I update valuation every couple of years with Brandon Jacob and along comes a buyer. And as a business owner, now I may not be looking to sell my business, but that phone call comes in. Hey, we're interested in buying your business and your market. Are you interested? I'm armed. I'm ready. I know the valuation of my business and I've had some involvement in planning my exit. I'm not standing there going 'now what', because that buyer could be the greatest opportunity in the world and it could be the biggest waste of time. And what we want to do as a business owner is quickly take advantage of somebody who is the right buyer and quickly, how do you want to say it? Somebody who's wasting time. We just want them to go away.

David Heimer: Yeah. And the other thing I was thinking about is that let's say I get the valuation done. Year one, year two, it's updated. So I've been working for a year in this business. Have I improved things? Is the valuation better? Am I working? All that effort I did this year and the valuation of my business went down. That would be an eye-opening thing and hopefully, it would put me back on the right track, you know, stop doing some of that stupid stuff I'm doing.

Brandon Jacob: Yeah.

David Heimer: Hopefully what I would see instead is, look that work you did paid off and your business is worth more now.

Brandon Jacob: Somewhat of a reality check, right?

David Heimer: Yeah. All right. Well, I don't want to pick your brain too much here. This has been fabulous stuff. You've given us great information. I really appreciate your time. I know you're a busy guy. I recommend your books all the time.

Brandon Jacob: Thank you.

David Heimer: I'm not kidding when I say, I think every contractor in our industry should read them and small promotional plugs for our listeners. Brandon's books are available at shop.serviceroundtable.com, so, shop.serviceroundtable.com. And Brandon if a contractor wanted to contact you, what's the best way for them to do that?

Brandon Jacob: They can contact me via email at brandon@contractorscfo.com. And that's plural contractors, C F O as in chief financial officer.com. My direct number is 713-443-8311.

David Heimer: Would you give that one more time for our dialing pleasure?

Brandon Jacob: Absolutely, 713-443-8311, and contractors are more than welcome to call me. I could set up a time if I'm busy, but David talking about these businesses, I love hearing their stories. It's a passion of mine when somebody calls and says, I've built this thing for 25 years and now I'm ready to retire and I want to sell it. I mean, that is exciting, because it's a process that everybody, that caller is smart enough to say, I have to do this because everybody sells their business at some point in time.

David Heimer: One way or another, just like life we are all going to exit our businesses. Right? I think it’s better to plan it out than let it happen by surprise or accident.

Brandon Jacob: It’s tragic when we don't plan, that's for sure.

David Heimer: Well, Brandon Jacob, thank you so much for being with us here today. I look forward to seeing you in the near future.

Brandon Jacob: Thank you, David. Thank you for having me on.

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