VILLWOCK ADVISORY SERVICES, LLC.

HOW WE TRANSFORMED A COMPANY WITH $12.5 MILLION IN REVENUE INTO A $17 MILLION COMPANY IN JUST 16 MONTHS

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This is a true, factual story of an entrepreneur we will call John. Everything in the story actually happened, although the company name, the industry in which it operates, and John's name have been changed for the privacy of our client.

I had known John for about seven years. We met when I was approached by an investment group that wanted to roll-up John's industry. This group needed financing, along with assistance in the acquisition of eight additional companies. The first company to become part of this larger entity was to be Atlanta Service Corp, which was wholly owned by John.

John had acquired Atlanta Service Corp ("ASC") from the original founder in 2000 at which time the business did $3 million in annual revenue. By 2005 when we met, his company was doing $10 million in revenue with margins that we believed were above average for his industry.

The buying group had a credible plan, and some of the managerial talent needed to be successful. But the more we worked on this project and learned about the service industry niche, the more we realized that a roll-up strategy was doomed to failure.

The reason a roll-up didn't make sense is because John's company was one of the very few in his industry that was professionally run. Virtually all other competitors were lifestyle businesses … significantly smaller than ASC and if ASC were to acquire these lifestyle businesses, there was no assurance that the revenues would continue to stay with the business once the founder sold.

There was a large probability that ASC could pay for an acquisition that would lose a majority of its sales in the first year … not an attractive model.

After a couple of months working with the acquisition group, we delivered our findings and recommended that they not pursue a roll-up of this sector. After hearing us out, they reluctantly agreed that we were probably right.

During the next five or six years, John and I talked every six months or so, just to get caught up and talk about what was going on in his service business.

One day in 2011, John called me. A private equity group was knocking on his door and they wanted to talk about buying a majority interest in John's business. He asked if I would help him through the process, and I readily agreed.

To make a long story short, we went through a six month process together. As part of the process my firm put together a package of information, created a data room for legal and financial due diligence and went through the normal M&A sales process.

At the end of the day, the terms offered by the private equity firm, we believed, were inadequate. I suggested to John that the private equity firm was not going to get to a valuation and terms that I thought was market, and I suggested that we put our pencils down and let him go back to running his business. He agreed.

That experience left a bad taste in John's mouth. He had spent months trying to get to a satisfactory deal with a potential buyer, but couldn't. He felt that the buyer really didn't understand his service business, and that as a result the buyer was discounting the price and adding above market escrows and other terms that protected the buyer at the expense of the seller. Frankly, I agreed.

Shortly after the deal fell through, John asked me to dinner. We spoke for a couple of hours about how his business was doing and I could tell that John was getting to the point that he wanted to start thinking about pro-actively selling his business. We talked about alternatives, potential buyers, valuation and what a process and transaction would likely look like.

The bottom line was that John was approaching 60. He could see himself working another three years, but wanted to have a path and plan in place to make sure that he could sell the business and retire.

Having listened for two hours to him talk, it was my turn to give him my thoughts & advice.

I told John that his industry was highly fragmented, with a level of service that was substandard compared to the service his firm provided. The business had plateaued with annual revenues of $10-11 million annually for each of the past five years.

We talked that I believed he could double or triple his business in 3-5 years, and then exit. Since he was already a “one armed paper hanger”, he would need to hire a few key people, but the business was there for the taking.

I suggested that he consider partnering with me. I would put together the strategic & financial plan, and advise as to how to implement the plan. If we needed equity or debt capital, my firm would be responsible for raising that capital. If we decided to add locations, he and I would work together to insure that the implementation of the plan went well. I’d also put in place the financial reporting and structure that never existed at the company.

We continued our dialog and I began to advise John on the capital needs of his business and how he could raise the needed capital. We talked more about a formal joint venture and in October 2012 we formally started working together.

What was amazing is that for 2011, the business did $10.1 million in revenue. With the disappointment of not selling to the private equity firm, John was ready to do something in the business again. By September 30, 2012, the LTM revenues had already grown to $12.5 million.

We began formally working together in October.

The first thing we did was to revisit all the information we had assembled in prior years on the business, and I began to craft a business plan. John and I met often as I needed to learn a lot about the business from him, and the more detail I went into, the more questions I had.

It took just a couple of months, but a full business plan was put together. John had never financially modeled his business. We tore the business apart so we knew the revenues and costs of each service line, and understood the triggers to expand or contract revenues and margin in the business.

We began to meet and talk through the true economics of his business. Most entrepreneurs, even some public company CEO’s, don’t have the true understanding of the economics of their business. For each service or product, how much is the business truly making? How should SG&A be allocated back to the products to most accurately reflect the true economics of the marginal sale? What’s the fixed cost of a product or service compared to the variable cost?

What are the drivers of incremental sales? Is it price? Units? Combination? How can the various variables be "tweaked" to gain incremental profitability?

What are the true capital needs of the business? How should those needs be best met?

In John's case, before we were formally retained, I expected that the business would need to take on a minority partner with about $3 million in equity in order to achieve the type of growth we discussed.

How surprised I was when looking over our new cash flow projections one night. The business was already creating over $1 million per year in free cash flow that could be used for growth. This cash flow could be reinvested in new capital equipment, which in John's business was vital in order to grow revenue and profitability. More cash into capital equipment should yield higher sales and also higher margins on those increased sales.

John's business didn't need more equity, but rather a carefully scaled growth plan. Instead of selling 30% of his business and 3 years later taking 70% of the proceeds, we figured out how to get to the same end point and John would own 100% of the business.

It goes without saying that John was more than delighted to hear that conclusion. No dilution and no minority partner to deal with. Best of all worlds.

The business still required outside capital, but it could be in the form of senior debt to help fund the capital equipment. We talked with about a dozen financial institutions and finally decided to go with a long-term SBA term loan.

The loan took longer than we would have liked, and the closing costs were much higher than non-government guaranteed loans because of the terms set by the SBA. But when the alternative is either high cost mezzanine debt or equity, the SBA terms still were relatively attractive.

As we were working to find a good lender, we also redesigned all of the company's financial reporting. For managers to make good decision, they need good information. The old adage, "garbage in, garbage out" continues to be true.

We designed a package of financial reports that could be used with financial institutions, potential partner or buyers of the business and most importantly, by John and his team to plan and run the day to day business.

We also worked with John on a weekly basis to check on performance, volume and to continue to work with him to cast the vision for where the business was going. As new opportunities appeared, we talked through why the business should or should not take on the opportunity. If we thought the opportunity was good for the business, then how much would it cost? What were the risks? Do we have the right people to implement?

In the past 16 months there have been several times when I thought John wasn't seeing something in his business accurately.

The saying, "can't see the forest for the trees" is true for almost every entrepreneur. When we run our own business, we often can't see the obvious. Sometimes the reason is pure pride. We can call that the "I'm the CEO and therefore I know what to do" syndrome.

Sometimes it is simply lack of experience. I can't tell you how many times I've had a CEO that thought a bank should do something, or that a buyer or seller of a business should view a contract term in a certain way.

The reason that the CEO wants a bank to do something the bank won't do, or the CEO believes a stock purchase agreement should or shouldn't have a particular clause is simply because the CEO has never done a transaction like this before. There are certain normal and customary terms in a bank agreement, and the bank isn't going to omit or renegotiate a portion of a boiler plate contract. The CEO can scream all he/she wants, but it's not going to change. Want the financing? This is the contract. Sometimes the CEO believes that the world is going to change because the CEO says so. Doesn't happen … and they are shocked and angry.

Lack of experience in M&A, for instance, is the #1 reason entrepreneurs should hire an investment banking firm that does M&A all the time, and an M&A lawyer. So many CEO's go with their corporate lawyer into an M&A transaction, and it almost ALWAYS ends badly. Deals get blown up because a good meaning corporate lawyer tries to play M&A lawyer.

And a CEO playing investment banker? Don't even get me started!!!

When working with CEO's, I expect that there will be times to educate the CEO. This could be about something we discovered while analyzing the business, or it might be as we are talking with a bank or potential joint venture partner. CEO's have a great ability to get into their own heads to understand motivation for a transaction, but often they have a tough time getting into the head of the person they are negotiating with. It is critical to understand the motivation of the person on the other side of the table, to know where they can bend and where they absolutely can't bend. We can always walk away. But if we walk, let it be for the right reason and not because we don't understand the other side.

A CEO who has never been in this situation has no way of knowing what can be given up and what is a waste of time, energy & relationship to argue.

In some areas, John has listened very intently … while in other areas it has been more of a challenge. This gets repeated with every client.

The key difference between successfully and unsuccessfully working with a client is whether the client will listen on the issues critical to the growth of the business, or not.

Over the past 16 months, John has added capacity through capital equipment acquisitions. We have funded the acquisitions with a combination of free cash flow and long-term loans. We have looked at opportunities and passed. We have also looked at opportunities and gone after them. In John's business, additional capital equipment translates into additional sales & earnings, so long as the demand for his service continues to grow.

I hope that by now you see a key element as to why and how John was able to grow his business so quickly when it had been virtually unchanged for 5 years.

We built a partnership where two heads are much better than one.

I brought an expertise in the financial arena that he lacked.

While he knows his business better than I will ever know the business, my vision for the business has transformed his vision for what is possible.

His belief and confidence in his ability to grow his business has expanded exponentially.

We have developed a strong mentoring relationship. When something goes wrong, I get a call. When something goes right and he's about to set a new record for the business, I get a call.

On three occasions during the past year, groups have knocked on the door asking about potentially acquiring a majority interest in, or 100% of John's business. In each case we have listened to the buyer's vision and plan. John and I have talked about how his business and his employees would fit in with a potential buyer.

Like most CEO's, John wants to make sure that his people are well taken care of after a transaction. He has spent years building the business and wants to leave it in strong, capable hands. Furthermore, in most cases, the buyer will want John to stay around for a one or two year transition, and he wants to make sure that he can work with the buyer.

Given my M&A experience, we have had these discussions without any disruption to John's business. I handle all the information requests, most of which I handle out of my files. I interact directly with the buyer, minimizing the amount of time that John needs to spend with the buyer.

John and I talk often about what a sale of the business should look like. We talk about the value of the enterprise, impact of deferred capital spending, higher levels of working capital and cash and how to minimize taxes, escrow amounts and legal liability. We have an M&A lawyer in the wings, waiting for the call to get started. The company's CPA has prepared an analysis of the tax implications of an assets sale vs. a stock sale. Even before we start talking with a buyer, we are armed with the information we need to steer a conversation towards an optimal outcome.

Our goal is to leave nothing to chance. A buyer isn't going to agree to everything we want, but we should know up front the economic, legal and social implications of the important issues.

When we started talking in 2012, the goal was to potentially double an $11 million business in three years and exit in the fourth quarter of 2015.

All of our financial models go through the end of 2015.

Every financial decision, and in fact, every business decision has been made in light of the expectation that the business will be sold in the fourth quarter of 2015.

We have a laser focus on the outcome … which is the sale of the business. John would be delighted to sell the business in 2014 if the right buyer comes along to pay for $17 million in LTM revenue.

One thing I've drilled into John is that the best time to sell a business is when someone wants to buy a business. For instance, it didn't matter how desperate someone was to sell a business in the fourth quarter of 2008, it wasn't happening. In fact, it probably didn't happen until 2010.

We had three clients late in the selling process in the third quarter of 2008 that ultimately had to stop the process because buyers couldn't get debt capital. Two of the three businesses completed sale transactions in 2010.

The moral of this story is that we don't know what the economic conditions or banking conditions will be in the fourth quarter of 2015. It's a good goal to have, and it makes sense to drive the business to that goal, while at the same time operating the business as if John will own it forever.

And since we don't know what the conditions will be in late 2015, if a suitable buyer comes along in 2014 and we can agree on value, terms, conditions and social issues, then John would be well advised to sell with a lower purchase price in 2014 then we think we can get in 2015.

Certainty beats uncertainty most of the time.

From my vantage point as I write this, the most important take away from the above is that I work to make a true partnership between the CEO and myself. I don't run the business, the CEO does. I don't own the business, the CEO does (with or without others). We can call it consulting, or mentoring. But I prefer to call it a joint venture. I become an integral part of the management team. This might be for a short term assignment to complete some task, or it might be for a 3-5 year assignment to grow and then exit a business.

So what's my background, and why am I spending time designing the web site, doing the videos and writing this EBOOK?

My story begins with my father, who was a senior executive for Exxon Chemical. His job was to execute M&A transactions for Exxon, and provide an economic framework for other senior executives to make decisions. While a chemical engineer and not an economist by training, he found that certain economic indicators were leading indicators for what was coming in the chemical business. He taught me early in life that when everyone is getting killed in a sector, it is often the best time to buy. Conversely, when profits are at record levels in a cyclical business, it is often time to sell.

Thus my interest in economic cycles and buying and selling businesses was born.

Early in high school I figured out that I wanted to become an investment research analyst. I often researched companies for my school papers, writing why BF Goodrich or Occidental Petroleum should do well. I studied Economics in college, and early in my junior year wrote a paper for an Investment Analysis class that the Professor liked so much he hired me to be his assistance for both undergrad and graduate MBA courses in investment analysis during the rest of my junior and senior years in college.

I felt sorry for the 40+ year old executive MBA's who had to see a 20 year old assistant about why I had graded their paper the way I did, or to argue that the Professor was wrong on one of his test questions. Awkward!!

Graduating in 1976, the brokerage firms weren't hiring. So I called the Director of Research at a high quality regional firm in Dallas for six months. He finally gave me a job so I'd quit bothering him.

Long story short that began a 23 year run. I became Director of Research for two firms and in 1991 started to focus my attention on healthcare. The Wall Street Journal voted me the #1 research analyst in America for healthcare service companies in 1996 and one of the top 5 in 1997, the last year I was eligible for the award.

I moved to Atlanta in 1997 to take over as director of healthcare research for The Robinson-Humphrey Company.

The Balanced Budget Act was passed in October 1997, and by the middle of 1998 it became obvious that all hell was breaking loose. The result was that about one-third of the home health agencies in America went broke, and at one time there were 15% of all the nursing home beds in America in a single Delaware bankruptcy courtroom.

I saw a huge opportunity. My research activities gave me access to the best healthcare executives, and to all the private equity funds that financed healthcare transactions. My understanding of the operations of a healthcare company was excellent, and putting those three elements together creates a company.

I founded an investment bank focused on healthcare in 1999 and in the three years that followed assisted in starting two hospital companies and one outpatient surgical care company. I added a couple of partners and we built the firm up to about 10 people.

While I had previously headed the healthcare research group for Robinson-Humphrey, the person who was head of healthcare investment banking went off to Robertson Stephens & Co.   You may know that story that Robertson Stephens was the #1 stock underwriter during the dot com boom. It was sold to a commercial bank … and that sale didn't go very well. Instead of selling the firm back to the investment banking partners, the commercial bank CEO decided to take a $700 million write-down and shut the firm.

My investment banking counterpart started a new firm the next day, and we began to talk. After a couple years of discussions, and his decision that this new firm was going to be his long-term "gig", I decided to sell my interest in the firm I founded to my other partners to rejoin this executive in his new firm.

We've now been together eight years, and we've had quite a run. And as I get closer to my 40th year in this business, I've decided to make a transition. I get more excited about helping the John's of this world take their company from $10 million to $20 million then I do working to execute the next M&A transaction.

Advising an entrepreneurial CEO who will listen is a great deal of fun, and I can get out of bed in the morning energized knowing that I'm making a big difference in his company.

John was my first client, and I've taken on a second client – an $18 million company that has the potential to be 10x that size with a strong financial partner and development strategy.

John started with me in October 2012, and the second CEO started June 2013. In 2014 I want to add 2-3 more clients. As I indicated above, we are in discussions to potentially sell John's business in 2014. If I can find more quality companies where I think there is an excellent fit between what the company and its CEO needs and what I can provide, then perhaps I'll start hiring staff to leverage my time. But in the meantime, I'm very confident that myself and outside accounting contractors can handle up to 5 companies.

After all, I used to research up to 22 companies at the same time. That meant keeping up with 22 CEO's, 22 CFO's and probably 15 COO's, all at the same time. Of course that doesn't include the couple hundred institutional investors that I constantly talked with.

The next question you may have is, "How do I work with companies? What does the deal look like?"

With every client there are some essential criteria before I will accept to work with the client.

First, I must be convinced that my experience, expertise & Rolodex must be able to make a meaningful difference, so whatever I'm paid, the client has received 5-10x in value.

A local attorney introduced me to a niche cosmetics company that was growing rapidly. The CEO needed assistance to get the company to the next level and was eager to talk. After an hour on the phone, I told the CEO that she had a great business, good niche and I believe with the right advisor could grow the company to 5x or 10x its current size. Unfortunately, I wasn't that advisor. She needed someone who could open doors in retail locations, get shelf space, and leverage her brand in advertising and on the web. All great things – and all things that I don't have a competitive advantage to produce. If I took her on as a client, I'd be learning along with her, and I'm not about to do that.

If we have a fit, then great. And if not, I'd be glad to suggest other people who might be able to help.

It is essential that I can make a very significant difference.

Second, I need to be convinced that you and I can work together, and that you will listen. That's not to say that you and I will agree on everything, or that you will implement everything I suggest. But, it is to say that you will listen and consider the input. I've worked with CEOs who have never been wrong in their entire lives – all you need to do is ask them. Life's too short to work with that personality type, because at the end of the day my incremental value will be lower than I want – and frankly I don't want to have a client where we can't build a strong personal & professional relationship.

Third, I'm looking for clients that want to have a significant liquidity event in no more than five years, three years would be better. With John, everything we do, every conversation, every meeting revolves around what we need to do today to maximize a value in the fourth quarter of 2015. That's not to say that we would make short-term decisions that would hurt the business if he owned it forever, but we have a laser beam focus on the goal. I find this type of focus significantly increases performance, drive and outcome.

Fourth, if we work together, I fully expect to significantly increase equity value, and want to share in a portion of the increase. At the front end of an engagement, we jointly agree on the equity value of the company. We then execute a long-term stock purchase warrant for a predetermined percentage of the upside from the value today. In John's case, we agreed that the market value of his company was $8 million when we started. Today it is probably $14 million. If we were to sell the business today, then I would receive a percentage of the upside. In John's case it's 10%. So he puts an additional $5.4 million in his pocket, and my firm gets $0.6 million. Plus, if it takes 2 years, my firm also earns $240,000 in monthly retainers, and he has an increase in cash flow in those two years of about $1,400,000. Seem fair?

The first step is to download the initial due diligence request and request a telephone conference call. Once you let me know that you want to move forward (just email me at jvillwock@gmail.com) then I'll set up a Dropbox folder and invite you to the folder. This way you can simply download the information and it's available to me 24/7. If we ultimately decide not to work together, I'll just delete the folder.

Once the information is downloaded, we will arrange for a 90 minute conference call. There is no cost or obligation for having this call. If we finish the call and both of us want to work together, then we can circulate a draft engagement letter and get the process started.

For each client there is a two-step engagement.

The first step is the Initial Consultation which includes the evaluation of all the information your company provided, a 2 day trip to your business for me to learn more and to get a sense of how we might work together, and a final written evaluation of everything we learned, to be delivered within two weeks of the company visit. The fee for the Initial Consultation, including all travel costs, is a flat $24,500.

Assuming we agree to move forward, then the monthly retainer is normally $9,500 unless there are special circumstances which might require more than a normal amount of my time. Any travel or other out of pocket expenses are added to the retainer and invoiced monthly. The retainer agreement has a 30 day cancellation clause, so there is no long term commitment.

That's about it. I need to be convinced that I can make a big difference, that you and I can work together, that there is an end game in mind (even a major recapitalization qualifies), and we negotiate a percentage of the upside to a predetermined current value.

This is very straight forward. No "gotcha's".

So what do you say?

If you think you and your company are a fit, then I invite you to download and fill out the information package. Send me an email and let's get the conference call on the calendar.   Again, there is no cost or obligation for the initial phone consultation.

I look forward to learning more about your business.

Regards,

Jeff Villwock
Villwock Advisory Services, LLC

