The Deal Room Podcast

Episode 245 – Entrepreneurship and positioning yourself for M&A success with Chris Rolls Part 2

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Transcript

Joanna:
Hi, it's Joanna Oakey here. And welcome back to The Deal Room Podcast, a podcast proudly brought to you by our commercial legal practice, Aspect Legal. Now today we have on the show Chris Rolls, to bring us the second part of our two-part series.

Now, if you didn't catch our first part of this two-part series, please head back to part one as we talk to Chris about his experience as a serial investor having built and sold four businesses, three of which were amongst the largest of their kind in Australia. But now here we are with part two of our two-part series, where we turn the tables and talk to Chris about his position as a buyer. He founded PieLab Venture Partners in 2016 (now PieLab Capital), which is a venture capital fund that invests in early-stage technology businesses focused on the real estate sector. And in this episode, we talk all about his experience as a buyer, what he's looking for in businesses on the market, and how it is that sellers can position their businesses to be attractive to buyers.

So if you're looking to sell your business at any point in the future, or indeed, you're involved in business, sales, or acquisitions in any way, shape, or form, this episode is for you. So without further ado, here we go with our discussion with Chris.

Joanna:
Chris, a huge thank you for coming back to us on The Deal Room Podcast.

Chris:
No problems, Jo. Glad to be back.

Joanna:
Oh, it's fabulous to have you back. Now, part one is for anyone who missed it. Very interesting background to where we're going in part two talking about your background in buying and selling well, not buying businesses selling businesses at that point. Now we're flipping the viewpoint here, and looking at what you know, as a buyer, and those useful bits of information for any of our listeners out there who are looking at a sail into the future. So Chris, if anyone who heard the story before will know a bit about your background, but very quickly, in a nutshell, maybe we just start, if you can give us a quick overview of PieLab. And then we'll get into what's your perspective as a buyer.

Chris:
Yeah, sure. So what PieLab is, is we're a firm that invests in private businesses, so we take varying stakes, all the way through to 100% of them. So we're a bit like a private equity firm, although not like a more traditional private equity firm that buys businesses grows them rapidly over a period of sort of three or four years, and then sells them again, we have sort of a much longer time horizon for that. And in an ideal scenario, we buy good businesses and hold on to them forever. And, and help those businesses grow. So that's what we do, we typically buy businesses that are generating sort of between one and $3 million of EBITDA. So they're not huge businesses, but they're also not sort of micro businesses as well.

And we typically invest in sort of cheque sizes of sort 5 to $15 million is sort of our sweet spot. And, you know, like all private equity groups, they all have different nuances. And sort of some of the nuances that we're after, particularly is a buying asset like businesses, so businesses that don't have lots and lots of you know, heavy machinery and plant and equipment. And we'd like businesses with the subscription or recurring revenue. And that's sort of they're the sorts of businesses that we like to acquire.

Joanna:
Brilliant, Okay, wonderful. And so, we talked a lot in part one about the ideas or the learnings that you had as a seller. Of course, now you've had a lot more experience in the market since you sold your previous businesses, looking at businesses through the eyes of a buyer. And one of the things you said in our last episode, which I absolutely resonated with is the importance for sellers to understand what a buyer is looking for in their business. What creates value and risk in the eyes of a buyer, and essentially looking at their business with the goggles on as though they were a buyer? Of course, it's one thing to say that it's another thing to actually give them that lens. And so that's what I'm hoping to do today in our discussion. So why don't start with what it is so so you've talked about this Lots of businesses that you look to acquire, but what do you other standouts that make a business valuable for you as acquire versus those businesses where you can see perhaps the sellers haven't understood the value in a buyer's eyes?

Chris:
Sure. So there are a number of different things that we look for when we're buying a business. And as we mentioned very briefly, in the previous sort of episode, we're really trying to identify risk. And, you know, as I said, when you go to buy a business, you don't know all of the risks, and there are a whole bunch because you just don't have the knowledge that the seller has. So the sorts of things that we typically look for are histories of, you know, stable revenue, you know, so we've got a business that over the last five years, that revenue has fluctuated from, you know, $3 million, 1 year to 5 million, the next to 4 million the year after to 7 million the year after that to 2 million the year after that, where you've got that very big volatility of revenue, those sorts of businesses are very difficult to sell, and generally don't attract, you know, good multiples. And that's simply because the volatility, volatility is a risk. Any business has a set of fixed overheads. And if this year, the revenue is $7 million, but the risk is that next year is going to be four, then that represents a big risk for the buyer of the business.

So that's one of the first things stability of revenue. And then, of course, revenue is one thing, but profits are another. So just because you've got stable revenue doesn't mean you have stable profits. So looking at sort of the bottom line and sort of say, well, you know, a history of stable profits is also an important thing. They don't yeah, one of the really interesting things about businesses is that a lot of people have this perception that in order to get a good price for your business, it has to show, you know, rapid growth. And that's not the case that there are different buyers for different types of businesses. So when we look at a business, rapid growth is not something that is the be-all and end-all. For us. It's always nice to the business is growing, and we don't like businesses that are shrinking. But sometimes you see people when they're getting their business ready for sale, they're investing lots in sales and marketing to try and show large amounts of growth. Now the problem with that is while that might make revenue growth, it often adds a layer of cost that results in revenue growth, and profits not growing or potentially profits shrinking, which strangely can actually detract from the value.

So seeing good linear growth in both revenue and profit is much more important than seeing off-charts, revenue growth and you know, declining profits. So that's sort of another thing that that that we look at. The third thing, I think that it's really important is understanding that when you are the owner of the business, who's operating the business, and you're selling it, one of the big questions in the eyes of the buyer is who is who's going to operate it when they own it. And so ensuring that you've got a solution for that now, that may be an internal employee that you are grooming to take over the business, it could be a really disciplined set of processes and procedures in place that allow for someone to come in and run that much more easily than if they weren't there. So there are a few ways of mitigating that just because you have been running it doesn't mean you can't demonstrate that this is a business that can run well, without you. Of course, the best way of demonstrating that is actually having a business that runs without you. And interestingly, the business that the last business that I sold, I did exactly that I stepped out as the CEO two years before we sold it, it was under management, it continued to grow. And it had you know, a good history of sort of, you know, stable revenue and stable profits, which made it an attractive asset for someone to buy.

And they're the sorts of things that I think are important. So when you sort of look at those stable revenue, stable profits, ideally growing our solution for who's going to run the business, and then you sort of get into a whole myriad of other, you know, risk items, things like you know, all of the contractual issues internally, their business contracts with suppliers, contracts with employees. potential legal issues in the business, you've got the elements of financial due diligence, how much are we spending on sales and marketing? Are we getting returns for that all of that sort of operational and financial due diligence that an astute buyer will do when buying your business? But those first three I think, are probably the big deal breakers in most cases when people look at a business.

Joanna:
Yeah, brilliant. And one of the things that we had talked about in the past was the opportunity that you see for sellers in staying around with the business, of course, this is one of it can be one of the tricky things, I find that when sellers get a mind, get an idea of a sale in their mind. That's it, they want to get sold, they want to get out straight away. And of course, that absolutely can impact number one, the pool of buyers. And number two, the value that they may have. And I guess part of the issue is getting sellers to think about sale well in advance so that they are happy so that they're happy to sell at a point where they are happy to still be engaged with the business for a while, perhaps, you know, give us some insight into the business owners that you've worked with, and the reasons that they've been happy to stay around the positives for you as a buyer, and how it is that sellers recognise when that might be the optimal point for them to start thinking about the sale, realising it might very well be a lot earlier than they'd otherwise realized.

Chris:
Yeah, sure. I think one of the things that I see a lot, particularly with older business owners, so people that are potentially contemplating retirement, people who have been running their business for a long time. They, often have this perspective that, for example, if they're going to retire, then their only option is to sell 100% of the business. And, very often people get poor advice from accountants along those lines, which is, you know, they go to say, Look, I'm ready to retire. What do I do? An accountant says, Well, you need to sell your business. Now, now there are pros and cons of selling 100% of the business versus not selling 100% of the business. And most people don't really understand the nuances between the two.

And one of the things that we actually do, when we're talking to business owners is really understanding what it is that they want. And one of the interesting things you find is that you know, most people, you know, particularly when they're at retirement age when they've spent a lifetime building a business, haven't really thought about what happens the day that they sell it, what are they going to do each day, you know, and often they feel lost, there's this element of kind of, well, I've been going to work, you know, for the last 20 years, and I sold my business, it's settled yesterday, I have nothing to do today. And sometimes it takes a little while to get to the point where they actually feel almost like a sense of loss.

And sometimes it happens straight away. And one of the things that is a way of avoiding that is to stay involved in the business. Now there are a few benefits of doing that. The first is that if you're a seller of a business, and you're willing to retain, say 30% of it, that says a lot to the incoming buyer in terms of your trust in this business's ability to continue to generate profits, it's a big risk mitigator in the eyes of a buyer.

Chris:
Now, having said that it also adds some complexities as well, one of the things you need to do is you need to have a shareholders agreement in place, you need to have an understanding as to if you are retaining 30% of the business, what happens if you decide you don't get on with a new buyer, and you want to be able to sell your 30%. So there are lots of aspects of that. But they can all be dealt with in real sort of reasonable ways that protect the interests of both parties. So one of the things that we do when we look at a business is we have a really frank conversation with the owner about what they really want because sometimes we see a business and I'll give you an example of one.

We bought a business couple of years ago, it was a business where in the IT sector, a husband and wife were running the business. And they were they originally had the business on the market to sell the whole thing. And a actually had it actually under contract and it subsequently fell over. And when we got talking to them became clear that you know the husband quite liked running the business and probably wanted to continue it. His wife was more conservative, wanting to potentially take some of the risks off the table. And we said to them, Well, how would you feel in a scenario where we bought 70% of the business, you retain 30% of the business, you stay on as the CEO? And we move forward, you know in what was an unexpected way for them. And they agreed on that and we still work with them.

There are partners, they still own 30% of the business, and the business is doing well. It's been a great partnership, and you look at that and sort of say it's a very different outcome. It was actually what they wanted, but they didn't think to mention that. Now a big part of that is being able to trust the buyer that goes in because obviously if you're selling down 70% You need to be able to trust the party on the other side.

And that's one of the things that we spend a lot of time doing is explaining how we operate being very clear about the way that we like to operate a business. So in our business, we like to operate businesses for maximum profit generation. So they can pay dividends when not necessarily after, you know, a scenario where we grow a business by 50 or 100% a year. And the reason behind that is that reduces risk if we're not sort of really pushing the boundaries on growth, it also generates free cash flow for the seller, which is a really appealing scenario.

So in a scenario where you keep 30% of the business, one of the interesting things is that you end up with a much better cash flow, and position post-exit, and a lot of people don't sort of think about.

Chris:
If you're going to sell a business, and you're gonna say you sold a business for whatever, $5 million, by the time of time you go and pay off some debt, maybe, you know, buy a holiday house, maybe pay off the mortgage, you obviously have to pay tax on the proceeds, what you're left with is a much smaller

proportion to then go and invest to fund potentially a retirement or if you know, if that's what you're wanting to do. And most people, when they then go to their financial planner, they're encouraged to invest in a portfolio of some shares, or some residential property, and their cash yield is sort of three to 5%, you know, so all of a sudden, they sold the business for five, their proceeds were maybe only three, by the time they paid all those expenses, they're going to invest that they get 5% a year, you know, that's $150,000 year when they could have been used to living off three or $400,000 a year.

Whereas if they keep that 30% in there, first of all, they're not paying tax on that 30%. And in almost all cases, when we partner with someone in that scenario, we're able to increase the number of dividends that are flowing out of that business. So while they may only keep 30%, they end up sort of getting cash flow that might be as close to sort of 50% of what they were getting previously. And the other thing, of course, is they get to stay involved. They don't always stay on as the CEO, sometimes they just join the board. But we like having them around because they've got an element of knowledge, it de-risks things for us. You know, and it also enables the people that are working in their business to feel more comfortable that the person that you know, was there, their CEO was the owner of the business isn't sort of abandoning them as well. So there are lots of advantages to that. You've just got to pick the right partner. And that's an important thing.

Joanna:
I love it. I think you're absolutely right. It is, though, absolutely about choosing the right partner, the right buyer there. But I have some fabulous memories of clients I've worked with over the years one comes to mind readily. I worked with him in his sale, it was a great business, he built it up over 40 years. And he sold the business to a large listed buyer. And, I'd call him you know, once a month, or every couple of months after the sale, just to check in and see how he was he was still living office! The office that they had been in, you know, because the business moved out and into... the business itself moved out of the premises. He's still there, he went back every day. I was like, What are you doing? He's still there? Why are you still there? Go on holiday with your poor wife, who's been waiting for you to get out of this business. But he was so connected to the business, it literally took him about eight months to get out of that mindset. And he just would have loved an approach, like the approach that you're talking about here. Because, you know, it's his business baby.

Chris:
And that's a sort of thing. And unless you are an entrepreneur and have built a business, you probably don't realize the level of attachment that entrepreneurs have to their businesses. It's their legacy. And you know, and I think that's, that's one of the reasons why private equity sometimes gets a bad name. Now, now, we are a private equity investor, meaning that we invest, we acquire equity in private businesses, but we don't have a fund structure that requires us to buy a business, grow it rapidly and sell it, we actually buy businesses and hold on to them for the long term, ideally, forever and never sell them. That's our preferred, you know, scenario. And so one of the things we find is that we are quite a preferred buyer of a business because we don't go to try and strip costs out in order to rapidly grow profits.

We don't dress the business up for a quick sale three or four years later, we don't merge it into another business, which means that people lose them, you know, lose their jobs. The most important thing for us is really focusing on finding a good business with good long-term partners and continuing to run it largely as it has been run before, by introducing little tweaks in order to improve the performance over the long term. So because we don't have to sell it in three years, we don't have to do things really quickly. We can, you know, work on the improvement over multiple, multiple years. And that's one of the things that was one of the reasons people like selling businesses to us.

Joanna:
Brilliant. Look, Chris, a huge thank you for coming on to the podcast today. Look, I think you've given a lot of information that will be really useful for our sellers, and for our buyers out there, how about you let us know how it is, if any of our listeners would like to get in contact with you find out a little bit more about PieLab, or think they might have an opportunity for you perhaps to partner with? How do they find it?

Chris:
Sure, I mean, the easiest way is to go to our website, PieLab, P-i-e-l-a-b.com.au. And we're pretty easy to get in contact with from there, you know, and if there are listeners out there that have a business, feel free to get in touch, even if you don't think it's going to fit or it might not be big enough, we often stay in touch with people for multiple years before, you know they're ready to sell the business. And that's actually a good thing because it allows them to generate, you know, build a relationship with us and learn how we operate. We bought a business last year that we're in touch with the owner for sort of four years, you know before we actually acquired it, and that's not an uncommon thing we're in, we're not necessarily any hurry. What we want is the right outcome for everyone so that everyone works together and gets a good outcome moving forward.

Joanna:
I've got so many ideas for other podcasts in the future where I want to drill into that a bit more. But Chris, I just want to say thank you so much for coming on to the deal room. It's been a real pleasure having you.

Chris:
No worries, Jo it has been fun having a conversation. Thank you.

Joanna:
Well, that's it for this episode of The Deal Room Podcast. We hope you're now primed for your next deal with these pointers and have enjoyed these fascinating insights. Now if you'd like more information about this topic, then head over to our website at thedealroompodcast.com where you'll be able to download a transcript of this episode as well as access contact details and any other additional information we referred to today's podcast.

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