## How to Buy A Business At A Bargain

**February 26, 2008**

**Steve Rucinski**: Hello, everybody. This is Steve Rucinski, today's host. Anita is out of town on business and won't be able to join us today but she'll be back with us again next week.

Our show today is "How to buy a business at a bargain price." But first, we have our "Tip for the Week" from JumpUp.com, our sponsor.

**Steve Rucinski**: Thank you so much, JumpUp.com by Intuit for being such a wonderful supporter of small business. Are you looking to start your own business? Maybe you're even considering purchasing one. It's a wonderful feeling to be your own boss. Almost everyone relishes the potential opportunity to do so but it's risky, not to mention even scary.

When it comes to buying an existing business, there are so many questions. Ultimately, wouldn't it be nice to pay a fraction of the cost of a start-up and start your business off on the right foot? I think it would, but can it be done?

Well, today's guest says you can. Our featured guest today is John L. Herman, Jr. of Hermanisms.com. John Herman shared with me before we started that he prefers to go by Herman, so I'm going to use Herman from here on out.

Herman is recognized as an expert in the sale of financially troubled companies. He's appeared before more than 40 different bankruptcy courts throughout the country, and completed more than 300 transactions in a wide variety of industries. He has previously owned an investment service business, and was recognized as the national leader in the sale of financially troubled companies.

Herman is also an author and has written two books. One of which will be offered in a Virtual Scavenger Hunt Contest that we'll be announcing at the end of the show, so stay tuned.

Welcome to the show, Herman. We're pleased to have you with us today!

**John L. Herman, Jr.:** Steve, what a pleasure to be with you.

**Steve Rucinski**: OK, let's move on to our topic on "How to buy a business on a bargain." First of all, where can we find financially troubled deals to acquire?

**John L. Herman, Jr.**: Steve, they're everywhere, all around you. Since 60% of companies never reach a profit level, half of every business you see or visit today is underwater yet they don't simply scream to the world, "Look at us, we're going under." You need to actually ask some of these owners if it's something you want to buy.

You can also check with the bankers in their workout department. Every major lending source has a workout department to deal with troubled loans. Sometimes, that's a great place to buy a company where the loans are underwater.

Asking is the key. I once pulled in to a gas station and asked the owner if he was tired of running that kind of business. He sold it to me for the inventory in the ground and on the shelf. I paid him $30,000. Less than a year later, I sold that gas station for over $100,000. So sometimes I tell people who are looking to buy, "You just have to ask."

**Steve Rucinski**: Yes, just ask. How about that? That's amazing. Well, once a business is located, you've asked or however you arrived at it, how do you assess its value? Tell us a little bit about that process.

**John L. Herman, Jr.**: Well, when you're acquiring a business, you would want to ask to see any appraisals that were done. Most of the time, the owner had to do appraisals to get his bank loans to buy it or start up the company. Always ask the appraiser. Get the appraiser, so you know what the same stuff would liquidate for today.

Just because he has an appraisal from last year saying it was worth "x" amount of dollars, it doesn't mean that that's the liquidation value or going-out-of-business value. That usually is the value that he put down as a going concern.

Also check around for auctions in that industry. Get to know machinery dealers who can give you a desktop number of what the equipment or assets might be worth. If you take restaurants as an example, many people think they can buy a restaurant. I once bought $100,000 worth of new equipment. When the installer was leaving, he smiled and said, "Call us in six months when you fail and we'll give you 30 on the dollar for the stuff."

Now, he was joking, but that's actually what really happens in the industry. So if you want to buy a restaurant, you might look for the guy going out of business, rather than start your own from scratch.

**Steve Rucinski**: Interesting. When it comes to putting together an offer, what's the secret on knowing what the lowest offer you can make is?

**John L. Herman, Jr.**: Well, it has nothing to do with what the seller wants. It also has nothing to do with how much he owes the bank, or what something across town that might be making money is selling for. The secret is knowing what the absolute highest price the assets would bring if he had to shut the door and sell them, either through a liquidation sale or an auction.

Knowing you are willing to pay at least a dollar higher than that and anyone else who wants to buy it, then you're going to always be able to pay the rock bottom price. When you start negotiating value, you have to understand, he has a bottom price that he's going to get if he shut the doors. You want to start there and go up so you get it for the price you want.

**Steve Rucinski**: Where can I get help finding the value of those assets? How do I go about that process?

**John L. Herman, Jr.**: Well, there are professionals in every field who are machinery dealers whether it's restaurant equipment or manufacturing equipment. I bought both building companies and plastics companies. In every field, there's a machine tool dealer who can tell you what he would give you for those assets, if you give him an asset list. It might cost you a few bucks to get that done, but it's well worth it if you know what the floor is.

Inventory, now that's a little trickier. You really have to look at what the seller has left as inventory, because he may be stock full of updated stuff and is carrying a price that you can never get for it. There are plenty of professionals around.

You also have to understand that the banker who is holding the note, he also has in his pocket those liquidation appraisals by people. So that he knows when he made the loan, what the bottom figure he's going to get if he has to quickly get out of that deal.

**Steve Rucinski**: What is the owner's investment that means to me, the buyer?

**John L. Herman, Jr.**: It almost never matters what the owner put into a business, it matters more what his staying power is. How much longer can this owner keep paying to hold on to the business before he goes flat broke? How far will the bank who holds the debt allow the owner's to waste the going concern value of the business by wrecking the customer base and taking the value out of the inventory by using it to stay afloat?

In brief, what I'm talking about here is it really doesn't matter what he paid or what he has in it. It only matters how much longer he can hold on to it.

**Steve Rucinski**: Interesting. Why do bankers love buyers with cash and how does that work against the seller who has debt with that same bank?

**John L. Herman, Jr.**: The banker is in the deal for himself only. He stops loving an owner when the payments are late, short, or not paid at all. Every bank has a workout department who will simply look at your business for what they can do to maximize their return. If you knock on that banker's door with cash in your hand that could maximize their return, they're going to help you push the current owner off the cliff to get to your cash.

So simply put, they're not going to be able to force the owner to sell to you but they can certainly put a lot more pressure on that owner to sell to you than you could. So if you're in a position to have cash to buy something, it's always good to let the banker know who made that loan. You're standing on the sidelines ready to bail him out. He is going to become your friend.

**Steve Rucinski**: I think the other thing it does for the banker is that there was a cost to go to that workout process. They've got a ready-made cash person but they don't incur that cost in addition to the risk they have with the loans.

**John L. Herman, Jr.**: It's always good to let the guy know who's going to get the gold at the end of the game. You're standing there with the bag of gold and, believe me; he's going to move mountains to get to you.

**Steve Rucinski**: Right. I got you. I'm going to pause for a minute, Herman, we've got a -- is it a guest caller or we just have a listener, let me see if we've got somebody on the line here with a question. We've got a caller from area code 360; do you have a question for our guest? Well, I guess not. We'll go back to our dialogue here. Pardon my interruption.

OK. I think I know a business and I'm trying to put together an offer. What are the things I need to consider when doing that?

**John L. Herman, Jr.**: My offer versus the liquidation value sets the floor of what we could lose. I want to look at what if we had to shut the doors and sell, what's the bottom number we're going to get in terms of our money back.

Then I want to look at at least six months for the lease to see if there's a favorable time period so we can flip the business. I want to know what my six months of operating costs are going to be. I want to know what my exit strategy is before I even buy the thing in the first place. So those are things that I consider before I ever make an offer.

**Steve Rucinski**: How do you make the owner take your low offer seriously?

**John L. Herman, Jr.**: By being honest with him from your very first conversation. On the first day, all I do is listen to the owner and seller, and let him have his say. Then I go gather some information on my side. I want to know his debt, his sales and his losses. I want to see some sense of his survival rate going forward using his own figures.
Let's say he owes two million dollars, and he projects to make $200,000 a year. That means it's going to take him 10 years of working for nothing, just to pay back the debt. You're going to be shocked, Steve, how many times owners never calculate how little they're going to put in their pocket in the next three to five years. When you start to shake them and give them the reality of their situation, they're going to start to take even your low offer seriously.

**Steve Rucinski**: It seems so strange that the second guy through the door of the business has a better shot of making the money. Why is that? What's behind that story?

**John L. Herman, Jr.**: It's really simple actually. Sixty percent of all business start-ups never make a profit. You've got an opportunity to buy one of those losers for a fraction of the amount of money that the first guy spent. You're going to be in the same business he's in with a lot less debt structure. If he needed to pay 10% on a $2 million debt and you bought it for $1 million, you're $100,000 ahead of him from day one.

So many times people come to me and say, "Well, you know, why are you taking advantage of that guy's situation?" I always answer, "I didn't put him in that situation. He's going to be there whether I buy it or not, so why shouldn't I benefit from his situation?" That's the very essence of buying low and selling high. He paid full value; I want it for a discount. That's the essence of buying at a discount.

**Steve Rucinski**: Interesting. I don't know if you know the answer to this question, but if you took all of the businesses that start or what I'm trying to get at is, of all the people that enter into operating a business, what percentage are buying the existing business versus starting from scratch with all that greater risk and cost?

**John L. Herman, Jr.**: Most people don't buy an existing business. Seven hundred thousand new small businesses are started every year pretty much from scratch. The interesting statistic is almost 700,000 also go out of business because in less than five years, 60% of them never ever make a profit.

It's kind of like the guy who one time called me a used-car dealer. He said, "Herman, all you're doing is buying these used things and fixing them up and selling them. I don't understand. Why don't you get some new cars? Why do you always buy used cars?" When I said to him how much money we were making buying and selling used cars, he never bothered to ask me again why I didn't mind being a used car salesman.

**Steve Rucinski**: Yes, it seems so obvious, but sometimes the things that are so obvious, we don't apply any intelligence to our efforts.

**John L. Herman, Jr.**: It's difficult for people to face the reality that you've got to go in and negotiate with the man who's about to lose most of what he's put up with, put out over the last two, three, four, five years. When you see the pain in a man or woman's face, who owns that company and they are losing, it's pretty difficult for some people to walk through that door and still try to buy that at the lowest price.

As I said, I suffered through losses in my first business ventures, so I know exactly what the guy is going through. I'm actually doing the owner a favor, because he can start getting on to the new part of his life quicker, if I can get a deal done with him.

**Steve Rucinski**: Yeah, that is a great way of looking at it. I've acquired a troubled company, what is my plan of action then?

**John L. Herman, Jr.**: Well, the first thing I do when I take over any troubled business is manage cash like it was the most prized possession on Earth. Spend only what you know works and is needed to spend. This week we had a big news story about the people at Countrywide going to go off to the Ritz-Carlton and ski and have a discussion about the mortgage industry. What a ridiculous waste of money.

Even though they are near financial death, they are still willing to go waste eight hundred dollars a night for hotel rooms. When you take over a company that has been in trouble, you want to reestablish with your customers that they are gold. They are going to be rewarded for staying with us by getting the best service and the best price they can ever get from anyone else in the marketplace. So, managing cash and managing my customers is my first objective when I take over a troubled business.

**Steve Rucinski**: Great advice, for any business, not just the one that's taken off for trouble. Your customers are a great asset; you can never pay enough attention. John, you've written a couple of books. Why don't you tell us something about them? Why you wrote them and how you work with them today.

**John L. Herman, Jr.**: The first book I wrote was called "The Innkeeper Tales". We own a bed and breakfast and restaurant in Baltimore, Maryland. My son is a world class chef, and I spent some time down there getting to know the business. It was my investment so I wanted to watch my dollars.

I actually spent some time as the innkeeper serving people breakfast in the morning, travelers from around the world. We would share business stories, and it got to the point where the guests were saying, "Herman, you really should write this stuff down." So "The Innkeeper Tales" is the first book, and it's true stories told over the breakfast table about some very interesting business characters who came through my inn in Baltimore.

The second book, "Hermanisms - Axioms for Business and Life" is my philosophy in a very short read. Seventy-seven axioms, it shouldn't take you long to read each one. It will teach business owners, entrepreneurs and start up people things that I've learned in 30 years and 300+ deals that it would take them a long time to learn, but not much if you sit down and read the book.

**Steve Rucinski**: So, you're an author. Are you offering other services these days to help people?

**John L. Herman, Jr.**: Oh, absolutely. I do have the ability to be hired as a business consultant in deals. I tell people all the time, the smartest thing that they can do is hire somebody who's going to, maybe spend a few dollars of their money, but save them many more times that, because you're going to be able to get some expertise.

I'm at the point now, where I went from making a hundred thousand dollars a deal, to charging very few dollars for my consulting time. People get the benefit of somebody like me who has done hundreds of deals, for a price that they can afford. Now I'm at a point in life where I enjoy giving back.

I do business talks to companies around the country. I do speeches at colleges, and I love to be hired on a one-on-one basis to be a consultant, so more than just with books, I am able to help other people in many ways.

**Steve Rucinski**: Think back before you started buying businesses. One question we always ask every entrepreneur and business person we get on the show is, if you had to think back across all that, what would you have done differently? What lessons did you learn? If you could list one, two or three things, what were they?

**John L. Herman, Jr.**: Well, I think that anybody who suffered big catastrophic losses... I had one company that I started with fifteen thousand dollars, and I grew it to a ten million dollar company in less than three years. We were publicly trading. The stock was trading at 20 times. The problems that I had back then were: not asking other people for advice soon enough, and not realizing that many successful entrepreneurs love to help people on the way up after they've achieved some level of success.

Once I started to catch on to that notion, the last twenty years of my life, I was very successful. Getting the benefit of knowledge not just from what I could learn by doing, but what I could learn by asking other people about who had succeeded before me. So I would say: get involved sooner with reading books from people who have done it, and also pick up the phone or email them. You'd be surprised at how many people will write back to you and give you advice.

**Steve Rucinski**: Get help and support, yes. It's funny how hesitant we are to ask for help sometimes. Where can people find out more about you and your books and what you do?

**John L. Herman, Jr.**: Well, www.hermanisms.com is my primary website, and on there you're going to see things like my daily blog, "The Herman School of Business". You're going to see information about my two books: "The Innkeeper Tales" and "Hermanisms - Axioms for Business and Life".

There is also contact information if you want to write to me. I love to hear from people, and I'd be happy to share with them. I give away the first hour of consultation free, so if somebody has got a business plan or an idea they want to throw around, they're going to get expert advice for nothing in terms of the first hour from me and that's going to be a big help to get them on their way.

**Steve Rucinski**: Right, perfect. Well, let me share with our listeners the Virtual Scavenger Hunt that we're going to have. Herman has been kind enough to provide us with multiple copies of his book that he mentioned earlier, "Hermanisms - Axioms for Business and Life" and, like I said we're going to have a Virtual Scavenger Hunt. The giveaway contest begins on Monday, March 3rd, next Monday, and you can learn more about this at smallbiztrends.com.

We'll be asking you to answer three simple questions, the answers of which can be found on a Virtual Scavenger Hunt via Herman's website at hermanisms.com. So, be sure to come over at smallbiztrends.com on Monday March 3rd, learn what the questions are, and then you can send those questions in to us. Get them in as early as possible. We'll be rewarding the books that we have been provided on a first come, first served basis.

So, John Herman of hermanisms.com, thank you so much for joining me today.

**John L. Herman, Jr.**: Hey Steve, what a wonderful interview. Thanks, and I hope your guests learned something.

**Steve Rucinski**: Well, you've just heard another in-depth entrepreneurial interview on Small Business Trends Radio. Thank you for listening. You can find archives of this show and over 100 others on the web at smbtrendwire.com. Join us next week, same time, same place. Tuesdays at 1:30 PM East Coast US time. I'm Steve Rucinski, and that's a wrap.

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